

Understanding Remittances: Demography, Transaction Channels, and Regulatory Aspects

2.1. Cross-border remittances are a challenge to measure because they are heterogeneous, with numerous small transactions conducted by individuals through a large variety of channels. Prerequisites to improving data on remittances are an understanding of the transaction channels that are available and an ability to compile or estimate data that cover all channels that are heavily used. The transaction channels used may depend on the financial system, the overall institutional environment of the sending and receiving countries, the convenience and costs associated with use of these channels, and the demographic characteristic of the senders and receivers.

2.2. Remittances are often linked to migration. Migration is the movement of persons from one economy to another. As used in the *RCG* and in the balance of payments more generally, “migrant” refers to a person who emigrates from an economy of origin and becomes a resident in another economy. It should be noted, however, that migration status is not relevant to the definitions of standard components in *BPM6*.

2.3. A person may move from one economy to another for the purpose of short-term employment. In the *RCG*, a “short-term worker” refers to a person who moves to another economy for the purpose of employment on a short-term (less than one year) basis.² Short-term workers and migrants supporting relatives in their country of origin are a major source of cross-border remittance flows. This chapter discusses the link between different types of workers and their associated remittance flows.

2.4. The identification of transaction channels for remittances can help compilers assess the extent to which their existing data sources cover remittance transactions. Remittances can take various forms, ranging from funds transferred through “formal” or

regulated institutions or channels (e.g., banks, nonbank financial institutions, and money transfer operators) to “semi-formal” and “informal” channels (e.g., hawala, cash carried in person, in-kind transfers).

2.5. The *RCG* does not strictly identify which transaction channels qualify as formal or informal, recognizing that such judgments are subject to country-specific legal, regulatory, and institutional factors and therefore may vary from country to country. The *RCG* also emphasizes that all international transactions, no matter whether they are informal or formal, legal or illegal, should be covered by balance of payments statistics. However, at various points the *RCG* refers to the difficulties in obtaining data on informal remittance transactions. It has been argued that, because of such difficulties, the remittance transactions undertaken through informal channels are sometimes not well covered in current balance of payments data.

2.6. Section A of this chapter provides a demographic perspective on remittances, looking at the relationship between movement of persons for short-term or long-term employment purposes and remittances. Section B develops an inventory of transaction channels and their institutional environment, which is vital for understanding remittance flows and potential data sources. Section C draws attention to the divergent legal and regulatory environments of remittance transactions by individual countries and the widespread use of informal channels.

A. Demographic Perspective on Remittances

2.7. International labor migration has attracted attention in the discussions of reasons for increasing international trade in services and demographic shifts observable in many parts of the world. The roots of

²Also includes border workers.

cross-border labor migration are related to, among other factors, divergences in economic performance between countries and regions, uneven technological change, and the integration of markets and societies.³

2.8. Following the skill content of labor, migrants and short-term workers can be categorized as unskilled, low-skilled, and skilled. Because the migration of low-skilled workers is generally associated with stiff immigration restrictions, there is a tendency for illegal or unregulated migration of unskilled or low-skilled workers. The extent of the informal economy in the host country affects the demand for illegal labor. In a comparative sense, a deficit of skilled workers in the host countries results in a less restrictive regime for skilled workers and as a result skilled migrants and short-term workers tend to flow through the legal channel. Because skilled migrants and short-term workers are more likely to migrate through legal channels, they reduce the administrative burden of the destination countries in enforcing migration regulations. There has been a steady increase in the migration of skilled workers from developing to developed countries since the 1970s. It is argued that although skilled migrants and short-term workers tend to have opportunities under unilateral visa programs, unskilled migrants and short-term workers usually depend on bilateral or regional agreements such as seasonal and other work programs.

2.9. Numerous demographic characteristics are thought to be associated with remittances, and there is general agreement on the effect of many of these variables on the amounts remitted. These characteristics include size of the stock of migrants and short-term workers, country of origin and work, ethnic background, duration of stay, average income level, gender, legal status, and the presence of children in the household.⁴ Income is recognized as the primary determinant of the capacity to remit.

³Migration is, of course, not a recent phenomenon. However, the past 50 years saw rapid improvements in transportation and financial infrastructure that allowed short-term workers to travel even longer distances in search of work and migrants to remain in touch with their country of origin, such as through visits and lower-cost communication, and to more easily transfer funds such as remittances.

⁴More specifically, gender affects the level of income of the migrants and short-term workers because females often have lower average incomes than males. The presence of children in the household increases household expenditures and changes the nature of economic interest, and therefore reduces the propensity to remit. Research conducted by Statistics Canada showed that the proportion of migrants and short-term workers remitting and the amounts remitted were different depending on place of birth.

2.10. Although the motivation of migrants to remit declines with the duration of stay, their capacity to remit often increases because their income tends to rise over time. Such statistics are useful for understanding the dynamics underlying remittance flows, but they are scarcely available in most countries. The migration statistics are generally collected through a population register or population census.⁵ The immigration data of countries with population registers are generally more accurate than those of countries without a register or census, because registration with the authorities is often necessary for migrants and short-term workers to obtain, for instance, a job, a dwelling, or health insurance. However, the issue of whether the emigration data of register countries are more accurate than those of census countries is not settled.

2.11. The problems in obtaining data arise in contiguous countries where the percentage of seasonal or illegal workers tends to be high. Because the illegal workers stay away from either the population census or the network of the formal modes of transfer out of fear of apprehension by the authorities (associated with the fact they are in the country illegally), it becomes challenging to correctly gauge the size of the stock of migrants and short-term workers. Depending on circumstances in individual countries, it may be important to develop an integrated approach to estimation that involves coordinated efforts of migration authorities, immigration offices, enumerators for the population census, and compilers of remittances statistics (migration data are further discussed in Box 2.1).

2.12. A worker may travel for either short-term or long-term employment, partly depending on the socio-economic and political conditions in the host and the source countries. In most instances, short-term workers consume less of their income than do migrants, and therefore more of their income or compensation is available to support family members in their home country. Short-term workers maintain strong ties with their country of origin because of their permanent interest in their home countries. Among migrants, remittance senders tend to be more concentrated among more recently arrived immigrants, and at least half the

⁵Countries with population registers require residents to register their primary residence, and to provide administrative data on demographic variables. Some countries maintain a registration requirement but also carry out a population census; such countries often rely primarily on registration for understanding demographic change. Other countries rely solely on population censuses.

Box 2.1. Data on Migration

Data sources for compiling migration statistics include population censuses, surveys, border surveys, and other administrative records. However, reliable statistics on migration are difficult to collect and are often incomplete. Annual data on bilateral migrant stocks (migrants and short-term workers), for instance, are available for only a few Organization for Economic Cooperation and Development (OECD) countries. Many countries collect data on migrant stocks using population censuses, which are usually infrequent, and estimates of growth rates are needed to produce time-series data. A further problem is that individual countries may apply different definitions to classify the data, leading to data that are incomparable. For example, differences occur in the way countries classify migrants and short-term workers according to their duration of stay and the purpose of their visit. Also, many countries use the place of birth of a migrant or short-term worker as a key variable in migration statistics, but some countries use the concept of nationality, and a small number of countries use a combination of the two. These definitions are not compatible with the concept of residence as it is used in balance of payments and national accounts statistics.

Sources: World Bank (2008a and 2008b).

migrants who have stayed for up to 10 years may be regular remitters.⁶

2.13. Compared with migrants, short-term workers are associated with lower fiscal burden on the host country, less social conflict, and greater flexibility of host countries to adjust labor inflows in accordance with the domestic labor market conditions.

2.14. Migration programs for labor may promote more legal flows of labor. Bilateral labor agreements have proved to be important in facilitating the migration of low-skilled and seasonal workers (these agreements often encourage migration by reducing the regulatory burden; high-skilled labor often is mobile independently of bilateral agreements).

2.15. Whereas employment of short-term workers may not involve movement of families, migration is often associated with movement of families along with workers, perhaps with some time lag. Migration may also entail some degree of reduction in labor participation rates because the families (spouse and children) of migrants may not fully participate in the labor force in the host country, depending on their skill and age characteristics.

⁶Although remittances are related to migrations, an important distinction must be made between the immigrants and the remitters. Remitters are, in part, a subset of immigrants; also, some nonmigrants remit.

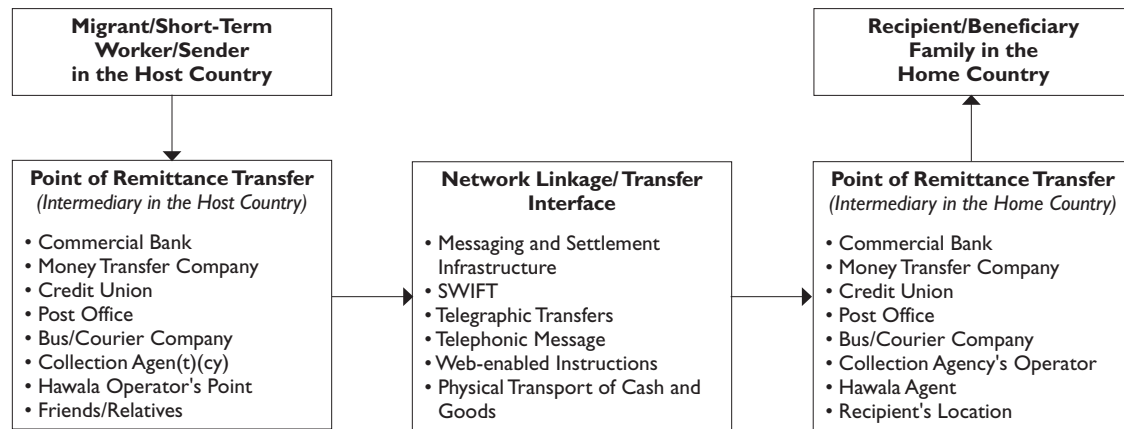
B. Inventory of Transaction Channels and Institutional Environment

2.16. This section provides an inventory of transaction channels used for remittances and briefly discusses the impact the institutional environment has on the availability of transaction channels and their selection. It considers both formal and informal channels and attempts to identify new channels, such as Internet and cell phone-based transactions.

2.17. The channels are not strictly identified as formal or informal. The reason is that a particular channel may be viewed differently based on the regulatory regime, institutional structure, and legal system in different countries. A specific channel may be formal in one country but informal in another, given its regulatory treatment. Also, the inventory presented here should not be considered complete because remittance service providers innovate quickly and new transaction channels may be developed.

2.18. As noted, money remittance transaction may involve a sender, a recipient, intermediaries in both countries, and the payment interface used by the intermediaries; together, these comprise the remittance channel (see Figure 2.1). Most remittances are of relatively low value, are regular or frequent, and mainly involve persons at both ends because they are generally targeted at family maintenance. Remittances assume the form of cash or credit transfers and transfers in kind (involving transfers of goods). Cash transfers are

Figure 2.1. Remittance Channels



Note: Not all funds transferred through these channels are remittances.

sent in either the foreign currency or the local currency by means of physical transfer of cash. Credit transfers are based on payment instructions from providers in the sending country to providers in the receiving country. The payment instructions using messaging services enable contact between the entities operating at the sending and the receiving ends, and the settlement process enables actual transfer of funds between these entities. Noncash or in-kind transfers, which comprise mainly consumer goods, involve physical delivery predominantly through informal routes. However, before a look at the microstructure of the channels used for cross-border transfer of funds by migrants and short-term workers, it would be appropriate to understand broadly how the remittance transactions take place. A remittance transaction typically requires some type of network to connect senders and receivers for the purpose of messaging and settlement of funds.

2.19. Cross-border remittance flows can take place through various channels, depending on the availability of services, preference of the remitter, and the institutional environment. Formal remittance channels are those officially authorized to operate in the money transfer business, such as banks, money transfer operators, or other officially registered institutions. Semi-formal remittance channels include formal institutions providing money transfer services outside the regulatory mechanisms of the country authorities. These institutions are well organized in transferring money but not controlled by any financial services regulatory authority. Informal remittance channels are outside of

financial regulation and supervision but often legal; the least official and formal channels for transfer of funds may involve intermediaries who do not operate as formal businesses. The remitter's choice between the various channels of fund transfers may be influenced by a host of factors, such as the kind of institutional infrastructure available in the host and the home countries, ease of access to formal financial institutions, speed of funds transfer through alternate channels, differential cost of funds transfer, government regulations, incentives offered by the home country in the form of tax concessions and interest rates, identification requirements, and procedural burdens embedded in the formal channels. These issues are discussed in later sections.

2.20. The relative attractiveness of the various channels of transfers is determined by a multitude of factors. A high level of penetration of the formal banking sector in the sending and receiving countries may encourage migrants and short-term workers to use account-to-account transfers. However, despite the availability of bank services, fixed transaction costs and burdensome documentation requirements to meet regulatory obligations may render small-value transactions unattractive for the banks and clients. Thus, the cost of sending money abroad may significantly influence the choice between formal and informal channels.

2.21. In addition to costs, speed of delivery may strongly influence the decision of the sender to choose a particular channel. Although online methods offered by formal channels are relatively more efficient in terms

of delivery speed, their usage is constrained by the lack of information technology infrastructure at the sender's or the receiver's location. Informal channels also can be efficient in delivery speed; it is often reported that transfer through hawala takes less than 12 hours to reach the recipient.

2.22. Apart from explicit costs, hidden costs in foreign exchange transactions may significantly influence decisions regarding a particular channel. For instance, exchange rates offered may significantly change the final payout to the recipient and hence the attractiveness of a particular mode of transfer. In particular, under exchange control regimes, unofficial operators may offer a currency exchange rate that is more favorable than the official exchange rate, attracting senders to informal channels. Risk of losing money in transit may also influence the choice of a particular channel. Where migrants and short-term workers are able to frequently visit their home country, they may prefer to carry cash or deliver goods themselves or have their friends make delivery. Migration status may also significantly affect the attractiveness of a particular channel. Illegal migrants and short-term workers may prefer to remit money through informal channels because they may not meet identification requirements to open bank accounts and remit money. Furthermore, formal channels are also more likely to be used when the geographical distance between the sending and receiving countries is high, causing difficulty in physically transferring remittances in cash or kind. However, some informal channels are effective and popular in making long-distance payments.

2.23. The various formats of fund transfer that may be used by the migrants and short-term workers are set out below.

Banking channel

2.24. Commercial banks are traditionally important vehicles for effecting cross-border remittance transactions, in light of their extensive networks in both the sending and the receiving countries, and participation in the international payments and settlement systems. Some banks with a global presence may use their own network for money transfers, whereas others with limited networks may use a franchise transfer service provided by a global operator, join a cooperative network, or utilize a correspondent banking relationship. The international banking network—interlinking national payment systems—enables remittances from a bank

providing fund transfer facilities to be transferred to any other bank across the globe.⁷

2.25. The payment formats used by banks include electronic fund transfers and transfers by telegram, fax, and telephone. Types of fund transfers through banks may be cash transfers, account-to-account transfers, prepaid funds (prepaid cards, money orders, bankers' drafts), and credit (credit cards). The type of transfer most often used is telegraphic or other wire transfers that operate on the basis of the branch network or the correspondent relationship. The remittance is sent by a bank via wire transfer to its branch or correspondent bank in the beneficiary country, which forwards the remittance electronically or by draft to the beneficiary bank. Checks can be deposited for credit to a beneficiary's account. Drafts can be purchased from exchange companies or the correspondent bank and mailed to the branch where the beneficiary has an account.

2.26. Online money transfer services offered by banks are an efficient means of fund transfers and enable cross-border transfers from the sender's bank account to the beneficiary's account in the receiving country. These are more often used in remittance corridors where a banking network is well developed and correspondent relationships are widely used.⁸ Innovations in information technology and the introduction of increasingly sophisticated methods of fund transfers, such as dual debit cards, stored value cards, and other variants of card-based online transfers, also are now being used with increasing frequency in many countries.

2.27. The automated teller machine (ATM) card is widely used as a remittance channel. A credit or debit card product uses credit and debit card payment systems for transferring money from one card account to another. Such transfers often involve the deposit of the funds into a card account with a given bank branch and subsequent transfer of the funds to another card issued by the same branch held by persons in the receiving country. This two-ATM model is used in Latin America, with a remitter based in the United States sending a second card with full rights to withdraw funds to a

⁷In some countries there exist bilateral agreements for the settlement of transactions channeled through the banking system with the involvement of central banks. For example, the program Directo Mexico transfers funds between the United States and Mexico with the involvement of the Bank of Mexico and the United States Federal Reserve.

⁸A remittance corridor is the path connecting a specific pair of countries or a specific pair of cities between which international remittances flow (CEMLA).

family member who can use the card at ATMs abroad. These products are also available in South Africa but have not been widely promoted. They require a relatively strong level of cooperation and trust between both parties. Also, limited ATM infrastructure in many countries restricts the availability of this method.

2.28. Technology support providers offer their Internet interface to banks, which may then be integrated to the bank's website. A customer subsequently wishing to transfer funds would log on to the bank website and interactively direct a transfer of funds. The system debits the customer's overseas bank account and credits the account of the receiving bank/service provider for credits to the beneficiary's account, as per instructions given by the customer.

2.29. Banks may also undertake money transfer through a variety of innovative arrangements with the financial entities in the host country. For instance, Indian banks have entered into special arrangements with private exchange houses in the Middle East, Singapore, and Hong Kong SAR for channeling inward remittances. Under this arrangement, an exchange house issues drafts (in Indian currency) to the beneficiary and at the end of each day calculates total drawings. On the next working day, daily collections are deposited in a designated account opened in the name of the drawee bank by the exchange house with a bank acceptable to the drawee bank.

Money transfer operators

2.30. Money transfer operators (MTOs) are financial companies (but usually not banks) engaged in cross-border transfer of funds using either their internal system or access to another cross-border banking network.⁹ MTOs may use their own outlets or numerous transfer agents, such as banks, exchange bureaus, post offices, and other intermediaries like retail outlets, cell phone centers, travel agencies, drug stores, and gas stations, to deliver remittances in the destination country, because MTOs and associated activities usually address the same target clients. Funds are delivered through cash, checks, or drafts. MTOs have wide networks in the sending and receiving countries, have less stringent identification requirements, and often focus on low-value,

high-frequency transactions. To send or receive money at an agent's location does not require credit cards, bank accounts, memberships, or citizenship papers. The payments, in the large majority of cases, are carried out by collecting cash from a sending party and delivering cash to a receiving party (cash-to-cash).

2.31. The remittance process through an MTO often begins with a sender delivering cash to a subagent of the MTO in the host country. Second, the subagent transfers funds to the MTO agent through the domestic payments system. In the third step, the MTO agent orders its bank to transfer funds from its domestic account to the overseas account of a partner, nonresident MTO agent. Once the funds are credited to its account, the partner MTO agent requests that funds be credited to its subagent. The subagent in the receiving country then, in a final step, delivers cash to the final beneficiary. This chain involves somewhat fewer steps when banks operate as MTO subagents.

2.32. MTOs are quite varied in their size, organizational structure, and procedures. Global MTOs work mainly on the principle of franchised services.¹⁰ Such MTOs rely on a proprietary network, representing the infrastructure of their payment systems, which allows a cost-effective interconnection of a large number of offices spread worldwide. A global MTO network includes agents, subagents, and clearing centers.

2.33. Subagents represent the operational front office or the access point or "physical counter" that migrants, short-term workers, and other clients approach to send or receive funds internationally. A large number of subagents all over the world provide MTOs with a strong presence in almost all countries. The subagents settle with their parent agent the net balance of amounts they received from sender clients and amounts they paid to recipient clients. This first level of clearing occurs frequently, such as on a daily basis, and is normally carried out through a (domestic) bank transfer.

2.34. The agents, under varied legal arrangements, work on behalf of the MTO's parent company. They can be considered the operational back-office units,

⁹In some countries, MTOs are required to be registered with monetary authorities as nonbank financial institutions, whereas in others they operate as companies outside the financial sector. Very few countries allow only banks to operate as MTOs (in these cases, domestic banks acquire franchises of international MTO chains).

¹⁰CPSS and World Bank (2006) defines a franchised service where a central provider, without necessarily having any access points of its own, provides a proprietary service: the central provider creates infrastructure to support the service (e.g., messaging and settlement, advertising) and obtains the necessary access points by inviting institutions in both sending and receiving countries to offer the service or act as franchisees on essentially standardized terms.

because they carry out a relevant part of the administrative work—in particular, collecting details on outgoing payments from subagents and transmitting the details on incoming payments to subagents. Therefore, agent information systems must store and maintain detailed administrative records on payments, such as the subagent involved, amount transferred, fees, date of transaction, and country and address of the sender and the beneficiary. As a consequence, agents may be a potentially valuable statistical data source.

2.35. The agent is engaged in a second level of clearing, perhaps once a week or bimonthly, to settle the aggregate net balance of remittance activities—that is, the sum of balances of the agent vis-à-vis its subagents—with the international clearing center. In addition to sending or receiving funds, agents also exchange with the clearing center all information needed to identify outbound and inward payments. The clearing center may be located in a country that is not the sending or receiving country, nor the country of the MTO's parent company.

2.36. The exchange of funds between subagents, agents, and the clearing center requires the intermediation of banks. Whenever the settlement involves two different countries—this happens often for transfers between agents and the clearing center—a cross-border bank transfer occurs, typically through correspondent banking relationships. The clearing center takes care of the multilateral clearing of flows in various directions, ensuring appropriate funding of agents in receiving countries. Settlements, even if on a net basis, are always channeled through the banking system.¹¹

2.37. The money transfer industry is characterized by the presence of small- to medium-sized MTO firms, which do not rely on a proprietary network. Usually such MTOs transact in cash with clients and transfer or receive the corresponding amounts abroad through the intermediation of the banking system. Although the global MTO subagent that anticipates receiving money may grant a sort of short-term credit to beneficiaries before receiving the actual credit, for nonglobal MTOs cash is delivered to beneficiaries mainly only after the bank transfers related to the payment are completed. A special contractual arrangement is usually in place to regulate the relationship

¹¹It may therefore be incorrect to argue that traditional data collection systems based on bank reports completely miss covering remittances through MTOs. However, settlements may obscure flows because they are routed through international settlement centers and typically are made on a net basis. Chapter 4 provides further detail.

between small MTOs and the settlement bank used to transfer funds abroad.

2.38. In the case of large MTOs, transfers are made virtually everywhere, even the most remote locations, almost through a “door-to-door” delivery of money. The persons operating MTO subagencies are often of the same nationality as potential customers and speak the same language. This situation involves some “ethnic proximity,” which potential customers would find attractive.¹² Newly arrived immigrants are characterized by a relatively low rate of financial participation in the host country and, for this reason, by a relatively high propensity to use MTO services. This explains the higher success of this channel in countries that represent relatively new migration destinations. The share of MTOs is also high when the banks and the informal channels, for any reason, are less popular. The usefulness of the MTO data as a statistical source varies across countries depending on volume of transactions, quality of data, and other factors.

Postal network

2.39. Post offices, traditionally the agents of domestic money transfers, have also emerged as important carriers of cross-border funds and are generally regulated by communications laws in most countries and not by the central banks. Post offices either provide their own services for international money transfer or act as agents for other money transfer companies.¹³ International postal money order service is available to transfer funds to individuals or firms in countries that have entered into agreements. Among the remittance service providers, post offices have the largest outreach network including remote locations, particularly in receiving developing countries where the financial infrastructure is inadequate to deliver remittances.

2.40. Remittance can easily be made to a number of countries from post offices handling international remittance services. International postal money orders may be sent by letter mail or expedited mail service.

¹²For example, in sender countries, MTO subagents are often located in ethnic stores selling goods originating from immigrants' home countries.

¹³The United States Post Office has its own transfer system, Dinero Seguro (safe money), which began in 1997 and offers electronic money transfer. In Europe, the Euro-Giro system operates in direct cooperation with European postal systems in international money transfers to more than 30 countries, including China, Israel, and Brazil. In Africa, PostSpeed is operated by post offices in Uganda, Tanzania, and Kenya for fund delivery within East Africa.

However, money orders to some countries can be mailed directly by the remitter. Usually there are limits on the maximum amount for a single postal money order. Ordinary money orders, in which the remittance amount and handling charges are paid at the post office in cash or via a transfer from the remitter's account, are available for delivery to the payee's address.

2.41. Even though the postal network covers all areas of the world, it has not been fully utilized in cross-border transfer of remittances in many countries because of limits on transactions, liquidity problems in the disbursing outlets in the receiving countries, and delays. In some developing countries, money transfer agencies use a postal network to enhance their outreach in remittance transfer markets.

Credit unions

2.42. Many credit unions facilitate international payments by providing bank drafts and, in some cases, immediate electronic money transfers through agency arrangements with large international MTOs.¹⁴ Credit unions usually arrange money transfers through either an existing network or the International Remittance Network (IRnet), a remittance settlement platform established by the World Council of Credit Unions.¹⁵ Through it, credit unions offer an electronic funds transfer service providing credit union members with a way to send money overseas or domestically.

2.43. Under IRnet, transactions are processed through an automated clearing house facility, whereby funds are transferred to an intermediary bank with whom the credit union has an arrangement. The bank in turn transfers funds to its branch in the recipient country and credits the account of the credit union.

Telecommunications companies

2.44. Telephone companies have recently started to offer remittance services in many countries, often using their mobile phone networks for making transactions. These services are designed so that the recipient can receive credit for prepaid telecommunication services ("air time credit") for their relatives or obtain cash. Prepaid credit is intended for payment for telephone services and often cannot be sold

(or refunded). Therefore, these transfers are practical only up to the amounts that the recipient would be required to pay for telephone usage. Stored value cards issued by mobile phone companies are one means of transferring money by individuals using mobile phones. Under this arrangement, a telecommunications service provider requires the subscriber to register with the system.

2.45. An example of the use of telecommunications companies for remittances is the case of the Philippines, where two mobile telephone companies have recently introduced mobile phone-based money transfer services. The recipient receives a text message confirming the transfer and withdraws cash through any authorized agent. This is a means to make a cash-to-cash transfer when neither party holds a bank account. Similar transfer mechanisms are being planned in West Africa and elsewhere.

2.46. Another variant is the mobile phone payment system based on Subscriber Identity Module (SIM) technology, available in Zambia and the Democratic Republic of the Congo. The sender can deposit funds into an account by using a cell phone to transfer funds from a bank account or deposit cash at a partner bank. Purchases can be made through text messaging by entering into the phone the amount to be paid and authenticating the transaction using a personal identification number. The service provider instantly transfers the amount to the merchant's account.

2.47. The rate of innovation in this field is high, and new remittance services based on mobile phones are announced regularly. An example of a mobile phone-based system is outlined in Box 2.2.

2.48. Money transfer services based on mobile phones are gaining popularity because they transmit money "at the speed of text" and are cheap and relatively secure. It is also worth noting that mobile remittances draw a large portion of the informal remittances into the banking system as financial services become available to the unbanked community.

Internet

2.49. The Internet is also being used as a means to transfer funds between households. Some "traditional" MTOs offer Internet-based transactions in addition to transactions through their branches and agents. Other companies are based on Internet-only business models.

¹⁴Credit unions have been active in funds transfer particularly in the United States-Latin American corridor.

¹⁵IRnet provides service to more than 40 countries in Latin America, Asia, Africa, and Europe.

Box 2.2. An Example of the Flow of Information and Funds in a Telephone-Based Remittance System

Information Flow

A sender visits a remittance company and fills out an information sheet. The remittance company in the sender's country submits to its partner bank in the recipient's country all relevant information provided by the sender. At the same time, the remittance company assigns an account number to the beneficiary's mobile phone and credits the number of the beneficiary. The service sends a text message to both the sender and the recipient, notifying them that the money has been transferred. The beneficiary can now get cash from the partnering institutions or through an ATM at a participating bank.

Funds Flow

The remittance company in the sender's country maintains a prefunded account at a local bank in the receiving country. When a sender remits, the funds are transferred to the beneficiary's money card. Meanwhile, the beneficiary receives a notification through a text message that the funds are credited to his or her money card. The beneficiary then claims his or her cash at accredited encashment centers by showing the text message in his or her mobile phone.

2.50. Personal money transfers from one virtual account to another have recently entered the market and are quite innovative. Although these payments are not widespread, they have become more popular. In order to make a transfer, a person opens a virtual account on the Internet. Money is put on the account usually using express payment cards, cash dispensers, cash offices of credit organizations, or credit cards. Money on virtual account is electronic money (stored value or prepaid product in which a record of the funds or value available to the consumer for multipurpose use is stored on an electronic device in the consumer's possession).¹⁶ Cross-border money transfers can flow between virtual personal accounts. If a person intends to make a payment via the Internet, it will be sufficient to put money on virtual account and transfer money to another account through the electronic payment system. Recipients of transferred funds exchange electronic money for national currency, or could put it on their account at a local bank. Electronic money systems are managed by firms that are considered credit organizations but that operate under simplified rules compared with banks.

Courier companies

2.51. The entry of courier services in the remittance transfer market has been attributed to the weaknesses of other formal institutions. Courier companies may deliver remittances through regular mail, electronic

communications, and their own physical delivery of packages. At the remitting end, the transaction involves the sender visiting the location of the courier company and tendering the money. The courier company receives information about both the sender and the receiver. At the receiving end, an employee or agent of the courier company visits the recipient and delivers the money after proper identification of the recipient.

Transport operators

2.52. Cross-border transport operators (primarily bus courier operators) are involved in carrying goods and money. Bus courier operators are not official money transfer agents, but they may transport declared or undeclared money as part of their legitimate courier business. The transaction involves the sender visiting the bus company office and tendering the cash over the counter. The sender, in turn, is given a receipt and a password, which he or she shares with the beneficiary in the receiving country. To collect the money from the bus company office, the beneficiary provides the password and personal identification, as required.

2.53. The use of cross-border transport operators as a channel of sending both cash remittances and non-cash remittances (in-kind transfers, mainly durable consumer goods) is substantial in African countries, such as Kenya, Tanzania, and Uganda.¹⁷ They have

¹⁶For a more detailed description of electronic money, see CPSS (2004).

¹⁷Between South Africa and Zimbabwe, cross-border transport
(continued)

Table 2.1. Informal Value Transfer Systems

Type of Transfer	Transfer Mechanism	Where It Is Popular	Cash Flow Between Countries at Time of Transfer
Hawala	“Transfer”: payment instruction transmitted	Middle East, South Asia	No
Fei Ch'ien	“Flying money”: payment instruction transmitted	Asia	No
Hundi	“Collect”: payment instruction transmitted	Asia, Middle East	No
Chits and chops	“Notes, seals”: payment instruction transmitted	Asia	No
Black market peso exchange	Asset exchange	Latin America	No
Cross-border transport operators/drivers	Physical transfers	Africa	Yes
Relatives, friends, migrants, and short-term workers traveling home	Physical transfers	Middle East, Asia, Europe, Africa, Latin America	Yes

Sources: El Qorchi, Maimbo, and Wilson (2003); and U.K. Remittance Working Group (2005).

Note: Informal fund transfers are also known as hui kuan (Hong Kong SAR), padala (Philippines), and phei kwan (Thailand).

gained importance because of the inherent advantage of this mode in terms of speed and cost vis-à-vis formal methods, and convenience in delivery.

Other, often unregulated, channels

2.54. A large number of small money transfer businesses all over the world are often not subject to registration, licensing, or regulation, depending on local circumstances. Many of these businesses are part of channels that are culturally embedded and have been described as “alternative remittance systems,” “informal value transfer systems,” and “informal funds transfer systems” (see Table 2.1).

2.55. Initially developed to facilitate trade between countries (and sometimes regions within countries), these channels later emerged as inexpensive and effective methods to transfer money to remote locations. They are popular for small-value transactions by migrants and short-term workers, although they are not always as secure as more formal alternatives. Tighter regulatory requirements (such as anti-money laundering and combating the financing of terrorism legislation) have tended to increase the requirements for opening accounts and thus discourage the use of banks by low-value remittance customers.

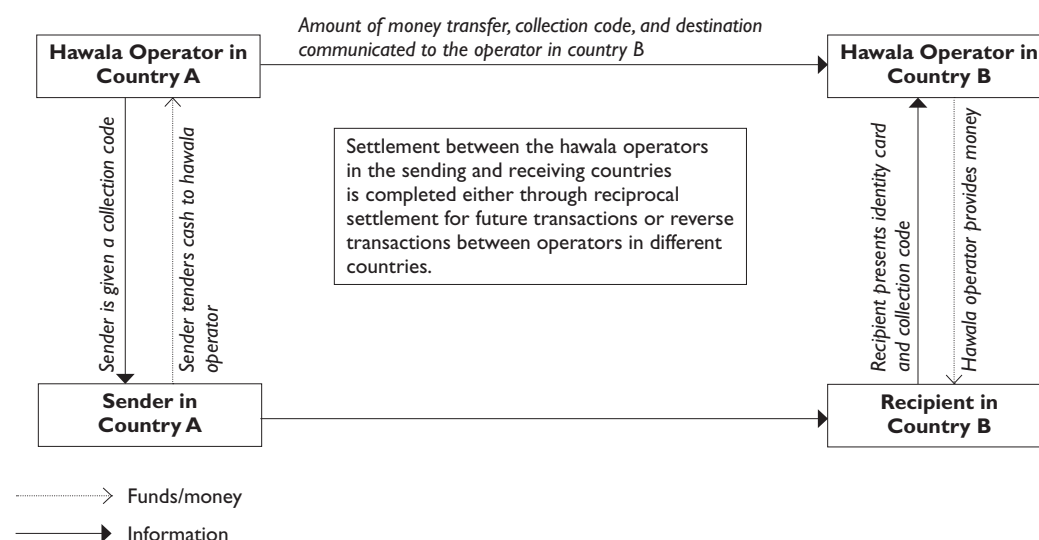
operators are the mode of channeling both cash and goods most preferred by migrants (Maphosa, 2005).

2.56. Exchange control restrictions create a wedge between the official exchange rate and the black market rate. These restrictions thereby essentially impose a penalty on migrants and short-term workers who remit funds through the official channel and contribute to the relative attractiveness of using informal channels. However, timely delivery of funds vis-à-vis the formal channels and in some cases delivery by agents to the doorstep of the recipient make these channels attractive.

2.57. Illegal migrants and short-term workers (who in some countries do not have access to the regulated money transfer system because of identification requirements) often prefer informal channels because these are unregulated. Nonetheless, the use of unregulated channels appears to have diminished in recent years as a result of the liberalization of foreign exchange controls, reforms in the payments infrastructure, and competition in the remittance market.¹⁸ Reliable data and information on unregulated remittances channels are lacking.

2.58. Among the informal value transfer channels to developing countries, hawala is apparently the most organized system in the Middle East and South Asia (Figure 2.2). Hawala transactions go through a special-

¹⁸However, in some countries, such as Haiti, Cuba, and Nicaragua, unregulated remittance channels account for more than 50 percent of the total funds transferred (Orozco, 2004).

Figure 2.2. Structure of Hawala Value Chain

ist broker. Money itself does not regularly move across borders, either electronically or physically, except to settle net positions. That is, the system is based on trust and the brokers balance the transfers over time.

2.59. A typical transaction involves the sender visiting the hawala operator in the sending country (A). Hawala operators may operate from locations such as grocery stores or travel companies. Basically, the hawala operator in country A receives money from the sender and advises (through telephone call, fax, e-mail, and so forth) the counterpart hawala operator in the receiving country (B) to disburse the cash to the beneficiary in local currency after proper identification and verifying the remittance code (password) from the beneficiary. Subsequently the transactions need to be settled between the hawala operators of countries A and B, bilaterally or multilaterally (involving a hawala operator in a third country).

2.60. Networking among hawala operators is required for the smooth operation of the system. The settlement may assume many variants of the reverse transactions between hawala operators in different countries. Operators in the hawala networks often rely on modern telecommunication technologies and may use complex arrangements to settle transactions.

2.61. Another informal value transfer channel is hundi. Even though hawala and hundi are used as inter-

changeable terms in parts of South Asia, they differ. Hundi was one of the earliest and most important credit instruments in India. Thus, unlike hawala, a hundi is a physical document or financial instrument. It could be used for transferring remittances (the confusion with hawala arises from this point) or as a bill of exchange. In simple terms, it was a popular bearer instrument. According to a study, hundis also could be used as finance bills or trade bills. The hundi was payable either on sight or at a later date. In some countries, such as Pakistan and Bangladesh, the term used to describe the practice of hawala is actually *hundi*.

2.62. Technically, a hundi is an unconditional order in writing made by a person directing another to pay a certain sum of money to another person. In a typical hundi transaction, the migrant or short-term worker transfers a sum of foreign currency to a local agent under the agreement that the overseas moneychanger of that agent transfer the local currency equivalent at an agreed exchange rate to the sender's family or nominee. Hundi dealers offer door-to-door and same-day service, which is particularly welcome in remote areas.

2.63. In the chit¹⁹ system, which was introduced by the British colonialists in China during the nineteenth

¹⁹Chit is a diminutive of the Hindi word *chitti* and means a note, pass, or certificate given to a servant.

century, the salaries of workers employed by the British were deposited to an escrow account managed by a Chinese comprador (an intermediary between a European firm and a local buyer). These foreign workers would write chits to pay for food and other essentials that they purchased from local merchants. In turn, the merchants would present these chits for collection (payment) to the comprador, who would then deduct the corresponding amounts from the accounts of the foreign workers.

2.64. A system similar to the chit system is called chop; it works in the same way as the hawala system and is still in use today. A client in country A wishing to remit money to a recipient in country B goes to a broker at a store or outlet who will take the cash, make an entry into a ledger book for the amount received, and communicate the relevant information about the transaction (amount to be remitted, name and location of recipient, and so forth) to his or her counterpart broker in country B. The broker also creates a chop (in this situation, possibly a train ticket or playing card), tears it into two pieces, gives one piece to the client, and sends the other piece to the overseas counterpart. The client sends his or her half of the chop to the recipient. A match of the two halves must be made before the broker releases the money to the recipient.

2.65. In some remittance transaction models, aggregated financial claims are offset (and settled) by transactions in goods. This model does not require cross-border financial settlements and is therefore popular in countries with foreign exchange restrictions. One example is the black market peso exchange, a form of asset swap used in South American countries. A migrant or short-term worker wishing to transfer money to his or her home country submits funds to a broker, who agrees to pay out an equivalent amount to the intended recipients in the remitter's home country (the broker has offices or representatives in both the remitter's host country and home country). In countries where foreign exchange restrictions make access to foreign currency (and imported goods) scarce, this equivalent amount may be based on a discount to the official rate. More specifically, the broker uses funds from the remitter to purchase goods in the remitter's host country, and ships these goods to importers in the remitter's home country. The importers pay the broker representative for the imported goods using local currency. The broker representative, in turn, pays the intended recipient of the remittances.

2.66. The "cash-in-hand" mode of transfer is popular particularly in remittance corridors where there are

constraints in accessing formal financial institutions, as well as in congruous regions where migrants and short-term workers frequently travel back and forth to their home country and thereby can reduce the risk of nondelivery of remittances to beneficiaries.²⁰ Many migrants and short-term workers use a courier system, which involves a regularly driven van from the host or home countries (and back) to move goods and funds. Carrying cash (whether by friends, relatives, or migrants/short-term workers themselves) while traveling between the host country and the home country is a popular mode of fund transfers in many African and Latin American countries.²¹

2.67. Cash-intensive businesses, particularly outlets with good international communication facilities, often offer remittance transfer services as a sideline. Such businesses include foreign exchange outlets, unregulated financial houses, shipping companies, grocery businesses, brokers, jewelers, gold dealers, clothing shops, guest houses, restaurants, travel agents, phone cards, international telephone shops, bus companies, and taxi firms. Country case studies show that churches and other religious organizations also often play a role in fund-raising or funds transfer to the place of origin. Usually this is linked to community projects, but a modest role in transferring individual remittances is sometimes also reported. Nongovernmental organizations could also raise money and transport humanitarian aid to the home areas.

Trade-based systems

2.68. In trade-based remittance systems, the remittance senders finance the purchases of imported goods by traders who reside in the same country as the remittance recipient. The traders use earnings from the sales of these goods to pay remittances to the designated beneficiaries.

2.69. One of the most common trade-based remittance methods is based on a credit system. The remittance sender contacts an importer in the recipient country (typically the sender's country of origin) with the request to pay out funds to the beneficiary based on credit. After the arrangement has been made, the

²⁰In-kind transfers are popular in many African countries, particularly among migrants and short-term workers from rural areas.

²¹In Cuba, the informal system of mulas is widely used to carry cash and goods by informal entrepreneurs from the United States, who visit regularly as tourists. A survey of African migrants in the United Kingdom conducted by Africarecruit in 2003 estimated that 36 percent made use of the cash-in-hand transfer method.

importer pays the agreed amount of money to the recipient. The arrangements could be made in person (if the importer visits the sending country) or by telephone, fax, or Internet. The remittance sender will repay the loan when the importer next visits the country where the sender lives.

2.70. In another version of this system, remittance senders make advance deposits with the importers, who will pay out funds to the recipients at a later point in time. In this version, the importer will accept deposits from senders during a business trip to another country. During this trip, the importer may then use the funds received to purchase goods. Subsequently, the goods are imported to the country of the remittance recipients and sold there; the revenue is used to pay cash remittances.

2.71. Both versions of the trade-based remittance system are often used by migrants and short-term workers from small countries that have a strong link with another country (e.g., Swaziland imports many goods from South Africa, and many Swazi nationals work in South Africa on a temporary basis).

C. Legal and Regulatory Issues

2.72. An understanding of the legal and regulatory aspects of remittances is important for analyzing the use of formal and informal channels. Different channels pose different challenges to compilers, and obtaining data on transactions depends on the menu of channels used in a country and the institutional and legal environment governing remittance transactions and data compilation. In many, though not all, countries, banks and other financial institutions are required to report their international transactions (including remittances) to central banks or other national financial authorities. However, the regulatory environment and practices substantially vary across countries in treatment of entities engaged in funds transfer and the various modes of transfer used, which has significant implications on reporting and coverage of statistics on remittances. A poor legal and communication technology infrastructure may hinder the regulation of some kinds of entities in some countries, thus posing challenges for reporting, whereas in others, the entities may be regulated and supervised by a number of different agencies, creating data overlaps and challenges to compilers who need to integrate these different data sets.

2.73. Recent emphasis on regulatory issues in remittances has come from the Financial Action Task Force

(FATF) on money laundering and financing of terrorism. The FATF has issued recommendations that urge countries to implement a regulatory framework by registering or licensing money or value transfer providers. An important element of the framework in some countries is encouraging entities providing remittance transfer services to identify themselves. Registration schemes have been adopted in countries with a large number of informal remittance providers, where a primary goal is to identify the institutions involved. In contrast, in licensing regimes, providers are filtered, *ex ante*, and must demonstrate their ability to comply with regulatory directives. In both regimes, providers must comply with certain information gathering and reporting requirements, in particular:

- Customer identification: Providers of financial services must ensure that their clients are identified (e.g., by passport or national identification card); this could be particularly problematic in the remittance sector, where customers are often undocumented or illegal migrants and short-term workers.
- Record keeping: Providers have to maintain an appropriate record of transactions and of customer identification data; the records should be made available to the authorities when needed.
- Suspicious transactions reporting: Providers must report information to the authorities on transactions that may be connected with illegal purposes.

2.74. Also common to both registration and licensing regimes is the ongoing monitoring of activities through reporting to the authorities. This aspect is obviously important from a statistical compilation perspective. Reporting may consist of periodically (e.g., annually or quarterly) submitting to authorities information on all transactions. The amount of detail provided varies from country to country, from only occasional reporting of very aggregate information (e.g., annual turnover) to full details for individual transactions, such as customer name, place of work, nationality, passport or other identification number, transferred amount, beneficiary/sender name, partner country, and purpose of transfer.

2.75. Although the FATF recommendations have increased the extent and uniformity of regulation of the remittance industry, including of the MTO sector, this industry is not homogeneously regulated across countries. This is partly due to the general nature of the recommendations themselves, which provide wide latitude to countries. Moreover, in cash-based and low-income countries, implementation and administration

of an adequate regulatory framework is particularly problematic. A variety of public agencies (e.g., central banks, financial or money laundering supervisors, local authorities, and customs and tax authorities) share the responsibility to supervise MTOs and other remittance providers in some countries, whereas in other countries MTOs are largely unregulated. Depending on the regulatory framework, regulatory data may be available for statistical purposes (and data being collected for regulatory purposes can often also be adapted for statistical purposes). In some countries, regulatory information is used for statistical purposes, and in other countries independent statistical data collection activities are undertaken.

2.76. Countries often also adopt a regulatory framework, with a set of statistical regulations, directly addressing statistical activities. They define the institutions responsible for the various broad statistical areas, the type of information to be collected, the population of respondents, and their statistical obligations. Sanctions are sometimes imposed for missing or incorrect reporting. Central banks typically have the power to require banks and other financial intermediaries to report sta-

tistical information on their operations, including cross-border transactions, carried out on their own behalf or on behalf of clients. Consequently, in most countries central banks are able to conduct indirect data collections on payments (i.e., reporting the information on behalf of customers) through the information on cross-border settlement that banks undertake on behalf of MTO agents and other entities. In countries that have foreign exchange controls, recording, verification, and reporting requirements are likely to apply. However, in countries with less rigorous financial regulation and supervision, many types of entities undertaking money transfer activities may not be reporting data that are adequate or useful for statistical compilation, thus posing a challenge to remittance compilation.

2.77. Countries where central banks are at the same time balance of payments compilers and supervisors are in a better position to impose the statistical obligation to report transactions directly (i.e., not via banks used for settlements). If it does not contrast with any legal provision, another possibility would be to use the information reported for supervisory needs for statistical purposes as well.