Ranee Jayamaha: Moving from informal to formal in the provision of remittances

Speech by Dr Ranee Jayamaha, Deputy Governor of the Central Bank of Sri Lanka, at the Global Payments Week, Sydney, 3-6 October 2006.

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Let me begin by thanking the World Bank, IMF and BIS officials for giving me this opportunity to speak on the Worker Remittances in Cross Border Payment Flows.

Most of what has to be said on this topic has already been articulated by the previous speakers. Let me therefore be very brief. I intend to make this presentation in three parts. Part I deals with an overview of remittances. Part II elaborates the importance of remittances in the Sri Lankan economy and Part III discusses possible solutions to issues relating to remittances at macro and micro levels.

Part I – Global overview

In terms of magnitudes, worker remittance has become a significant component in foreign inflows and balance of payments in developing countries. The statistics presented here are largely estimates. According to the latest reporting, worldwide remittances during 2005 had been approximately US$ 250 bn and it is likely to increase further. In 2005, developing countries appear to have received US$ 167 bn from about 175 migrants. It is also estimated that around 500 mn of the world population is dependent on remittances.

Formal institutional channels

It is important to highlight some key points on the formal institutional mechanism/channels of remittance flows. Traditionally, the banks collected and disbursed remittances. Now there are many agencies involved in the remittance industry, but banks continue to play a lead role. Having realized the increasing volume of cross-border remittance flows and the importance of remittances in the world economy, the institutional channels have increased and they have begun to use technological innovations to speed up the delivery of remittances. Remittance transfer services such as Western Union, Eurogiro and Moneygram are well-known for cross-border transfers. More recently, SMART Card companies and telephone companies have also begun remittance transfers with or without links with banks. These new agencies have helped to speed up remittance transfers and provide alternative delivery mechanisms, but remittance transfer prices remain at high levels. It is also noteworthy that governments as well as the formal financial institutions are keen to ensure that remittances are used effectively and prudently by the recipient countries as well as the individual recipients. The word 'effectively' refers to the use of foreign exchange inflows by the countries for its development activities, while 'prudently' refers to the use of remittances by the recipient in a meaningful manner. From the institutional point of view, ‘prudently’ also means risk-mitigating mechanisms placed by the formal financial sector in remittance transfers.

All remittance flows are cross-border transfers and they take the form of large value transfers or individual low value transfers. In the past, the formal institutional mechanisms concentrated heavily on disbursing funds to the recipients. Given the heightened importance of remittances in national economies and the promotion of smooth remittance flows between countries by the international organizations, the formal financial sector has now begun to pay greater attention to the initial point of remittance collection (capturing). This means that the institutional mechanisms are focusing on both capturing as well as disbursing of remittances. The international cooperation and coordination is very important at the point of capturing because the banks and formal financial institutions in the country of origin should facilitate cross-border transfers of remittances without placing prohibitive rules and regulations and pricing on the remitter.

Payment system and technological advances

As you are aware, technological advances, partnerships and improvements in the payments infrastructure have significantly contributed to enhance remittances on a worldwide basis. In that sense, the payment system improvement is a key to the enhancement of remittance transfers. The technology advances are intended to facilitate automation, reduce costs, provide additional delivery channels and mitigate risks involved in cross border transfers. However, the reduction of costs and the introduction of additional delivery channels are yet to be developed to a satisfactory level by the formal institutional network, not only by introducing enhancements to the payment infrastructure, but also by making a concerted effort to reduce cost on remittance transfers.

Several international banks and money transfer systems such as Eurogiro, Western Union have taken the initiative to target both blue and white collar workers at reduced transfer prices. Despite the facilities offered by these money transfer systems, there still remains a significant portion of remittances of un-skilled workers that are not captured by the formal money transfer systems.

Enabling regulatory environment

An enabling regulatory environment is necessary to enhance cross-border remittance transfers. While recognizing the need to deter money laundering and terrorist financing through cross-border transfers, laws relating to this type of activities should not discourage genuine remittance flows through the banking system. Nor should they be discriminatory or prohibitive to remitters or receivers. Most countries with fully open current and capital accounts have facilitated cross-border transfers than the countries with capital controls. The situation is expected to be improved with the relaxation of exchange controls in both the remittance originating country and the recipient country. There is also a need to monitor and regulate the agencies and other service providers which recruit migrant workers. It is reported that, in some instances, the agencies tend to persuade migrant workers to go for lower wages and salaries or employ them under harsh working conditions. There have also been instances where the agencies or agents take money upfront from workers and have left them in the lurch.

Remittances through informal channels

According to estimates, still 30–40 percent of remittances are transferred through the informal institutional networks and private channels. In some instances, informal systems do not transfer foreign currency from the origin/host country to the recipient/home country. Arrangements are made to provide funds in local currency at the recipient's end. For example, if a migrant worker in the US wishes to transfer USD 500 to his family in Sri Lanka, he prefers to go to informal systems like Hawala and Undial because of the high charges and commissions in the formal banking sector. Under the informal money transfer systems, the dollars may stay in the US or get to Sri Lanka at a later time. The Hawala agent's representatives in Sri Lanka provide Sri Lankan rupees to the migrant's family speedily and at a relatively low cost. If dollars are retained with the Hawala agent in the US, Sri Lanka's banking sector lose the opportunity of using foreign currency and, therefore, the country does not gain any benefit from the worker remittance. If the Hawala agent sends dollars at a very later date to replenish the equivalent of Sri Lankan rupees, again there is an opportunity cost to the country as foreign currency is not available when needed. There is also a possibility of the Hawala agent sending dollars to Sri Lanka through an un-known courier service, but such dollars may not get to the banking sector at all.

It is difficult to institutionalize remittances of illegal immigrants as such immigrants do not wish to identify themselves to the formal banking and financial institutions in the host country. Hawala and Undial systems are popular among illegal immigrants. It is, therefore, important for the remittance receiving countries, where possible, to compete with informal systems and divert remittances to the formal banking channels. Banks and financial institutions should be more innovative and make arrangements to collect/capture remittances from legal/illegal migrants at the field level and coordinate with the host country's banking/financial institutions to transfer monies to remitter's home country speedily and at a reduced cost. Informal transfers largely take the form of cash. The absence of an efficient financial infrastructure at the remitter's end as well as receiver's end is also found to be a discouraging factor that contribute to the use of informal channels. In some destinations, there is no access to sophisticated infrastructure in the host countries for cross-border transfers. Migrant workers, therefore, depend heavily on informal systems.

In this context, a global attempt should be made to facilitate cross-border remittance transfers as such transfers have a significant impact on the development of many nations.

Part II - Importance of remittances in Sri Lanka's economy

I now proceed to illustrate how dependent Sri Lanka is on worker remittances. Over the last couple of years, worker remittance has been the single largest inflow of foreign exchange after exports in Sri Lanka. Remittances have played a significant role in financing the widening trade deficit and maintaining balance of payment surpluses. During 2005, over 75% of the trade deficit was financed by worker remittances.

	1980	**1985**	**1990**	**1995**	**2000**	**2005(a)**
Export Earnings (Goods)	1,065	1,315	1,984	3,807	5,522	6,347
Textile and Garments	110	293	628	1,853	2,982	2,895
Tea	373	442	495	481	701	810
All Other Exports	582	581	862	1,474	1,839	2,642
Export Earnings (Services)	279	329	531	821	953	1,540
Worker Remittances	152	292	401	790	1,160	1968
Foreign Direct Investment	43	24	34	28	175	272
Foreign Loans and Grants	307	517	526	847	422	972
Worker Remittances, as a % of Total current account						
Inflows	9	14	13	21	15	19
Trade balance	15	40	57	53	65	76
Loans and grants	50	56	76	93	275	197
Total imports	7	14	15	15	16	22
GDP	4	5	5	6	7	8
(a) Provisional						

As shown in the table above, in 2005, remittances increased to US$ 1,968 mn, indicating a 22.6% growth compared to 2004. The remittance flows have further increased to US$ 1,726.7 mn by end September 2006 and a 20% increase is expected by the year end.

Remittances provide income support to families and opportunities for un-skilled workers to travel, improve skills, earn foreign exchange and engage in self-employment afterwards. It is estimated that about 1.3 mn Sri Lankan migrant workers are employed in different countries in various capacities. The banking sector, the government as well as the country as a whole benefit from worker remittances. The country uses remittances for payment of imports, goods and services while the banks invest remittances in foreign currency bonds issued by the government. That helps the government's foreign borrowing programme. More recently, the government resorted to issuing of foreign currency denominated bonds and attracted a significant part of worker remittances through banks. In addition, the banks also use worker remittances for their foreign currency trades and investments. If not for remittance inflows, Sri Lanka would have been severely affected by the increase in oil prices that raised the oil bill by three times in 2006. The enhanced remittance inflows also reduced pressure in the foreign exchange market and hence on the exchange rate.

The geographical distribution of remittance inflows to Sri Lanka during 2005 has been as follows:

- 57% from Middle Eastern region
- 18.5% from European Union
- 6.5% from other European countries
- 6.5% from North America

- 4.5% from Far East-Asian countries

Government policy

Successive governments in Sri Lanka have encouraged and promoted Sri Lankans to work abroad, both in skilled and un-skilled categories. The workers are permitted to open tax-free Non-Resident Foreign Currency (NRFC) Accounts which facilitate the receipt and retention of remittances in foreign currencies. Expatriates and workers are also allowed to have Resident Foreign Currency (RFC) accounts after their return to Sri Lanka. Taking the deposits in these accounts as collateral, low interest housing loans have been provided to the remitters and their families. The government has introduced “Sri Lanka Nation Building Bonds” to enable Sri Lankan migrant workers and other expatriates to participate in the Nation Building programme.

In addition to government, the Sri Lanka Foreign Employment Bureau, Association of Licensed Foreign Employment Agencies, the Commercial Banks, Specialised Banks, money changers and money transfer systems are key players in the remittance industry in Sri Lanka. The Sri Lanka Foreign Employment Bureau continues to hold awareness programmes to educate remitters to channel funds through formal institutions and also look into the welfare aspects of migrant workers. The banks have now taken the initiative to establish links with migrant workers prior to their departure. The Central Bank of Sri Lanka has permitted banks and financial institutions to establish exchange houses in several countries to enhance accessibility by remitters. More recently, the Central Bank has taken a keen interest to enhance remittance flows into the country.

From a payment system improvement point of view, it is essential for Sri Lanka to consider using wireless ATMs and E-Banking systems in rural areas to facilitate speedy disbursement of funds. As has been the case in the Philippines, Mobile Commerce (MCom) through SMART *Padala* (Philippines) and global G-Cash services should be introduced in Sri Lanka. In the meantime, internet-based transfer services such as wire transfers, automated clearing house transfers and cheque transfers should be further facilitated. Sri Lanka should take steps to reduce high remittance fees from remitting countries, such as Japan, Italy and the US by building up partnerships with banks in these countries as well as money transfer companies. In Sri Lanka too, Telecom services and Dialogue GSM are planning to introduce SMART Cards to connect remittance receivers and their bankers. As the SMART card system may require the use of agents in outstations, the banks involved should register these agents and provide on-line banking facilities to them. While the telephone company ensures the security of money transfers, the agents and banks should attempt to reduce cost of money transfers as well as mitigating risks involved in this activity.

In addition to the banking sector, Sri Lanka should speed up the linking of Sri Lanka's postal system with the global postal network.

Eurogiro, based in Europe offers several products for payment transfers through the Eurogiro system to accounts of postal members or to the accounts of third party banks. In addition, Eurogiro provides cash and money order services, Western Union urgent cash, cash on delivery, cheque payments and also bulk and pension payments. The Eurogiro postal network uses Tele Money Order (TMO), which is linked to a two-day cash project using Eurogiro bulking principles. Among their products, cash transfers, card payments and direct debits are also popular. In addition to the postal service, Eurogiro connects with banks, other alliances and financial institutions. Sri Lanka's postal service should explore the possibility of partnering with post office members in the remittance originating countries.

Issues relating to remittance transfers

Despite the promotional activities, institutional arrangements, favourable legal and regulatory framework, improved payment infrastructure, there still remains several un-resolved issues relating to remittance transfers. The lack of awareness of facilities available through formal channels is a prime factor. The absence of, or ineffective links between banks/financial institutions and migrant workers prior to their departure is another factor, which persuade migrant workers to use informal channels. The lack of transparency of full knowledge of the pricing at the point of sale or at the time of delivery of remittances is another important factor that needs to be addressed early by the formal channels. High charges and commissions and the use of cheque float by banks, despite the introduction of the Cheque Imaging System, which aimed at preventing paper cheques from being transported to different destinations, are clear deterrents in disbursing funds at the recipient’s level. Similarly, the delays and paperwork involved transactions through the formal sector has been a deterrent. The distant work sites in some of the Middle Eastern countries with no access to banking facilities has been reported as another factor which provides opportunity for informal channels to capture remittances.

On the recipient's sides too, the unnecessary expenditure incurred on their savings through purchases of non-priority consumer items has been cited as an imprudent way of spending valuable foreign currency. In addition, migrant workers are faced with numerous social issues due to family breakaways and health hazards through consumption of liquor and drugs etc. by remitter's family members. This is not the forum to discuss these issues, although they are also important factors affecting the remittance industry.

Part III - possible solutions

Macro level

In discussing possible solutions to improve remittance flows across countries, it is important to refer to the General Principles for International Remittance Services prepared by the WB and the BIS. These guidelines are prepared at a global level and require both host/home country support to implement the recommendations underlying these principles. In summary, at macro level, the principles are as follows:

Principle I : The market for remittances should be transparent and have adequate consumer production

This requires transparency by individual remitting countries about their services as far as possible. The global price including fees at both ends, the exchange rate and other transfer fees should be made known to the remitter. Equally, the time it takes for transfers and accessing locations should be reduced. The receiver should be encouraged to provide bank account details to the formal channels to avoid delays.

Principle II: Improvements to payment system infrastructure that has the potential to increase the efficiency of remittance services should be encouraged.

This principle involves both domestic payment infrastructure in the remittance receiving countries, cross-border payment infrastructure in both home and host countries, including the infrastructure of corresponding banks. There is a role to be played by the central banks of both remitter as well as receiver's country in improving the cross-border payment infrastructure. Many central banks have taken the lead in facilitating the payment infrastructure, but there still seems to be gaps in the use of electronic networks in semi-urban and rural areas. The central banks and other relevant agencies should encourage the operators to increase interoperability of electronic networks. Similarly, the postal service should be encouraged to play a bigger role in transmitting remittances on a cross-border basis. The postal network is well known in semi-urban and rural areas and they are in a position to provide remittance services at competitive prices.

Principle III: Remittance services should be supported by a sound, predictable, non-discriminatory and proportionate legal and regulatory framework

The implementation of this principle requires special laws and regulations for remittances, while the existing or new laws should be sound, predictable, non-discriminatory and proportionate. Specially, for remittance corridors, (e.g. US-Mexico, US-Brazil, the Middle East-Philippines) both sending and receiving countries should cooperate with each other to sort out legal obstacles in transferring remittances. It is also noteworthy to consider avoiding dangers of over-regulation in remittance transfers. The Money Laundering and Terrorist Financing Acts can also deter some of the cross-border money transfers. The authorities responsible for implementation of these legislation should be mindful of the need to use judgment in dealing with genuine remittances.

Principle IV: Competitive market conditions, including appropriate access to domestic payment infrastructures, should be fostered in the remittance industry.

This requires the avoidance of exclusivity conditions as imposed on an agent choosing to offer only one remittance service and to promote several direct /indirect access to domestic payment systems in the country. Here too, the central banks have a role to play. The central banks and supervisors should work with competitive authorities to ensure consistent approaches and discourage exclusivity conditions. It is also important for supervisors to ensure that money transfer systems are not unnecessarily anti-competitive.

Principle V: Remittance services should be supported by appropriate governance and risk management practices

Good governance and risk management practices by all stakeholders make remittance service safer and help protect consumers. This requires the remittance industry developing guidelines for good governance and risk management. Similarly, authorities should give guidance on how to meet anti-money laundering and combating terrorist financing activity requirements in a manner that such laws do not deter genuine remittance transfers.

Global and regional payment groups' support

In implementing the general principles for the international remittance services, the multilateral organizations, such as Asian Development Bank (ADB), World Bank, International Monetary Fund (IMF), European Bank for Reconstruction and Development (EBRD) and Inter-American Development Bank (IADB) jointly have developed guidelines, of which the final report is expected to be released by end 2006. The host/home country authorities should then evaluate their remittance systems against each general principle and foster dialogue within and among countries, where possible, through regional initiatives in payment systems, such as Financial Sector Assessment Programs (FSAPs), Arab Payments Initiatives (API), Commonwealth of Independent States Payment Initiatives (CISPI) and Western Hemisphere Fund (WHF). Behind the general principles, the critical elements are greater competition, high service level risk mitigation, appropriate regulations and enhancement of payment infrastructure on domestic as well as cross-border.

In implementing the general principles, it is also important for governments in both host/home countries to recognize remittance service as part of public policy. Similarly, under the provisions of the General Agreement on Trade for Services (GATS), opportunities should be sought for movements of natural persons for delivery of services. Many countries, including Sri Lanka, attempt to re-orient their policies to encourage skill migration under GATS.

Regional and international bodies should play an active part to resolve some of the cross-border money transfer issues. International money transfer services should offer enhanced services at reduced costs. International message services, such as SWIFT, should facilitate the remittance flows through innovative products and technology link-ups between central banks and other stakeholders involved in remittance transfers.

Micro level initiatives

In addition to the macro level global principles, at micro level, the formal financial institutions should make all efforts to enhance accessibility to remitters and receivers. It is also necessary to recognize the remittance collectors, such as Hawala and Undial and for formal financial institutions to establish agency links with them. The moneychanger system should be streamlined, monitored and geared to attract remittances. In speeding-up delivery at low cost, the postal network should be strengthened. Both the postal network and the formal banking institutions should deliver remittances at doorstep. The banks and financial institutions in the home country should provide a package of facilities to migrant workers, prior to their departure. Opening of bank accounts, granting of housing loans are key to attract remittances to the formal channels. Banks and other formal financial institutions should display their charges and commissions on remittance services and be more transparent in their dealings with remittances. These are some of the steps that should be taken by remittance recipient countries, including Sri Lanka, in enhancing remittance inflows while making the remittance industry a sound and safer one.

Thank you.