

## **Ardian Fullani: Key policy issues for remittances in transition economies - a view point from a recipient country**

Speech by Mr Ardian Fullani, Governor of the Bank of Albania, at the high level conference organised by the EBRD and sponsored by Switzerland, London, 28 September 2005.

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Remittances these days can easily classify as one of the most important sources of finance assisting the convergence of developing nations, to the point of overshadowing conventional funding like bank credit. The flow of remittances worldwide goes beyond 100 billion USD per year, with developing countries being recipients of more than 60 percent of this considerable amount.

Remittances' estimations in these countries often exceed trade inflows, or foreign financing and investment. Therefore, they have become an important device for channelling funds and resources from developed countries toward countries in need. Moreover, remittances, like foreign direct investments (FDI), are regarded as very stable and safe capital flow, helping developing countries to achieve sustainable high growth rates.

In recent years, we have seen a growing awareness about emigrants' remittances as an important financial source for development. This issue was included in the G8 meeting agenda of 2004 and in the spring meeting of IMF and World Bank earlier this year, emphasizing the growing significance of migration, and with it, of migrants' remittances, calling for intensification of efforts to improve and identify their causes, as well as to establish an environment that could enhance the impact of remittances on development process.

Let me briefly give you our (Albanian) experience with remittances and some suggestions to improve their ingress and effectiveness in the economy. During 90s, Albania experienced a massive migration movement abroad, which soon became a crucial financial source for the new market economy. According to some studies (Barjaba, 2004; INSTAT, 2002; Kule et al, 2002, 2002), since 1990, nearly 800,000 Albanians may have left the country either permanently or temporarily. Some more recent estimations show that the number of Albanians living abroad may have reached 1 million. This is a considerable figure for a small country like Albania with just 3 million of inhabitants. As a result, exodus phenomenon has attracted a great deal of attention in political and economic circles.

Remittances role in the economy has grown considerably over time. We can appreciate their weight easier if we put them against some main economic indicators. However, before doing that I want to say a few words on data reliability of remittances. It is very difficult to carry out an accurate estimation of remittances in Albania bearing in mind that a large share does not go through formal (official) transferring channels, therefore escaping the official registration of capital flows. The Bank of Albania traces only that part of remittances that goes through the official network, which includes banks and money transfer agencies. Remittances sent unofficially such as, cash brought by emigrants or their friends during their visits to Albania, need to be estimated.

Transition experience so far has shown that high trade deficits were not just financed through official capital flows, which undoubtedly have played a key role, but also through remittances that have increased financing opportunities within current account. During the period 1994 – 2004, out of 6.3 billion USD current transfers that entered the country, 5.8 billion is estimated to be contribution of Albanian emigrants.

economic developments. Although during the first stage of transition, inflationary and depreciation expectations were high, monetary policy reaction by the Bank of Albania of

keeping high (Lek) interest rates, ensured a normal inflow of remittances in Albania. Between 1994 and 1996 the attraction of foreign exchange inflow was further boosted by extraordinarily interest rates offered by pyramid schemes, reaching a historical peak level in 1996. A considerable drop in the volume of remittances was recorded during 1997 and 1999, a period characterized by a political and social unrest.<sup>1</sup> With the return of serenity remittances inflow picked up again.

The Bank of Albania estimations indicate that total workers' remittances has reached around 1,028 million (one billion) of USD or 13.5 percent of GDP. This is main country export. Furthermore, remittances are estimated to be three times higher than foreign direct investments (FDI) inflow and its value exceeds by far official aid from abroad.

I want to concentrate a bit more on the mechanism of transfers and on the ways remittances are used.

In the case of Albania, as in many other developing countries, remittances enter the country by either formal or informal means. The most recent surveys show that only 22.6 percent of emigrants prefer to use official means, whereas 77.4 percent turn to unofficial channels – in most cases by themselves.

The official network includes the commercial banks and money transfer companies, the activity of which is regulated and supervised by BoA. Money transfer companies (Western Union and Money Gram) have played a significant role in transferring remittances from the beginning of their activity in the 90s.

Their wide geographical extension throughout the country covering also many rural areas has complemented adequately the rather slow expansion of the banking sector in facilitating money transfers.

Lately, the official network has gained considerable grounds over the informal ways in terms of total transfers carried out. The volume of remittances channelled via official means in 2004 is estimated to have been around 46 percent of the total, as opposed to just 12 percent - the average for the period 1994-1996. It seems the official network has earned Albanian emigrants' trust for transferring their money. The development of the financial system in Albania it's a key factor in explaining the movement of transfers toward official means. Thus, only during 2004, there have been 30 new branches and banking agencies opened throughout the country. Nevertheless, the unofficial flows remain still high, accounting for more than half of the total volume.

Banks and licensed agencies, despite being safer, are more expensive than the alternative unofficial means to the point of inducing many emigrants to stick to the latter means. In a comparative study of Manuel Orozco, 2003 looking at transfer costs across different countries, show that banks appear to charge less than money transfer companies. These latter tend to be costlier because of higher transfer charges and disadvantageous exchange rates they face.

Moreover, some research shows that transaction costs of transferring remittances via money transfer companies in the South-Eastern Europe are higher than the region risk. Banks becoming aware of this comparative advantage, have introduced lower transfer charges while offering at the same time new financial products and services to encourage and attract savings of this segment of clients. However, I retain that although banks have the opportunity to be cheaper than money transfer companies, remain quite bureaucratic and less flexible compared to money transfer agencies, not to mention their inadequate geographical

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<sup>1</sup> Year 1997 represents a year of chaos for the Albanian economy and society, as a result of the collapse of pyramid schemes and 1999 the year of Kosovar crisis.

coverage of rural areas where more than 60 percent of population lives. Therefore, despite recent promising developments, banks have not gained much market share of remittances in Albania.

The results obtained by a survey<sup>2</sup> on remittances carried out recently also show that, the banking system still remains less preferable by Albanian emigrants who send money to their family members or relatives - only 15.2 percent of emigrants show interest for using banking system. Some of the reasons influencing migrants' decision for (not) choosing banks to transfer their money were:

- *Geographical proximity of Albania and Greece* (Albanians residing in Greece and Italy travel to Albania frequently, on average 2 to 3 times a year, transferring money themselves).
- *Insufficiency of emigrants' families to the banking system.* Empirical measures have shown that while a considerable number of emigrants have become familiar with banking in the resident country (74.4 percent of them hold their savings in the banks of their country of residence), the corresponding families in Albania appear to be less familiar with the banking system in Albania. Only 45.3% of Albanian families hold a banking account.

At this point, some policy implications are evident: improving population awareness of banking services, encouraging expansion of banking throughout the country and facilitating possibilities of money transfers. BoA, is in process of designing a *public communication strategy* that aims at bringing the public closer to banking products and services, including transfers. The flow of remittances may also raise if the fiscal burden of financial transfers is reduced. Enhancing competition by increasing the number of participants in the market would also push transfer commissions down. Here, the government has to incite the establishment of other companies as well as apply the reduced taxes. Another way of amplifying competition in the sector is by pressing on price transparency.

Remittances, as mentioned earlier, are also affected by economic and financial situation in beneficiary country. International experience brings many examples to illustrate this point. After a constant growth of remittances in Philippines, as a result of improvements in the investments environment in the early 90s, they became very shaky as the financial crisis affected the Asian countries at the end of the 90s. Likewise, Turkey after experiencing a stable growth of remittances during the 90s, saw a drastic fall as the financial crisis broke out in 1999-2000.

However, an interesting observation in these cases is that, the fall of remittances and their volatility were lower than those of private capital flows. Remittances seem to react less to economic ups and downs compared to other capital flows displaying considerable stability over time (Ratha, 2003). In this context, countries with high remittance percentage relative to other capital flows could be more immune to capital drain during crises.

Remittances are not simply expression of emigrants' fondness to assist their families in adverse situations. They also represent an important financial source that augments capital inflows and investments in economy. Remittances may have a positive impact not only on the volume but also on the quality of investments. Migrants and/or their relatives being more familiar with the local economic and social environment could make a better use of the capital brought into the country than foreign investors. Nowadays this is not just a theoretical inference. A growing number of emigrants that fled during 90s, are returning and funds but also a lot of know-how.

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<sup>2</sup> A survey carried out with the assistance of the International Organization of Migration (IOM) in Albania and CARDS project. The questionnaire period comprises April-June 2005.

However, there is always another side of the coin. Remittances inflow might have negative effects as well. If the recipient country remains dependant on money transfers, it will encourage further migration of labour by reducing the effectiveness of investments of domestic and foreign investors because of the unstable workforce. What's more important, if remittances go mainly for financing imports, their impact in the development of the domestic economy drops significantly. I fear Albania is one of these cases.

Remittances are being mainly used to secure daily family needs and to improve life style, as well as to construct or reconstruct houses, and to finance traditional family ceremonies. Only a small portion goes into banks as saving deposits. In fewer cases, remittances have been invested in real estates, manufacturing or services and agricultural sectors. This distribution of remittances alleviates poverty but does not lead to new job creation via investments, which would prevent new emigration by generating local opportunities. Being utilised little as resources for the economic and social development of the country, remittances may have led to individual, family or local dependency.

During the first stage of transition in Albania policies for optimising the administration and utilisation of workers' remittances for developing purposes have been completely lacking. A few sporadic measures have aimed at driving workers' remittances into official channels and improving savings and investments incentives of emigrants in the country but have been by and large inadequate.

More recently, the Albanian government has taken a more attentive approach toward remittances and their potential contributions in financing the growth and development of the country. With the assistance of the European Union by means of CARDS program, and the support of the International Organization of Migration (IOM), this year the Albanian government has compiled two important documents regarding migration and remittances issues, called: National Strategy of Migration and Action Plan. The main objectives are: (i) the review of remittances flows and (ii) the identification of political constraints and institutional and regulative framework that influence these inflows, in order to:

- increase the volume of remittances;
- help shifting them into formal channels; and
- enhance their use in support of country's economic growth.

Bank of Albania role in achieving these objectives consists primarily in maintaining the macroeconomic and financial stability, which constitute important preconditions for the success of any policy related to workers' remittances.

Migrants will be more willing to send and invest remittances if inflation is kept under control and exchange rate and financial conditions are reasonably stable.

Furthermore, the Bank of Albania in cooperation with other governmental and non-governmental institutions has been considering some more concrete measures in order to enhance the role of remittances in economy. I would like to mention a few of them:

**First: improvement of statistics on remittances.** Reliable data regarding remittances is a key ingredient in designing and assessing policies about enhancing their developing role. The Bank of Albania has continuously stressed the importance of accurate estimation of capital inflows in the form of migrants' remittances. Assisted by IMF missions, it has been working to bring the methodology closer to the international standards in defining remittances.

Also, there is a close cooperation with our main partner countries Greece and Italy, as the main destinations of the Albanian emigrants, to harmonise our methodologies in order to improve the accuracy of remittances' estimation.

**Second: Bringing workers' remittances into formal channels.** The high portion of remittances that goes through unofficial channels asks for actions to make official channels

more appealing in terms of efficiency, safety, cost and anonymity. Although, I mentioned earlier that emigrants seems to have more access to banking than their families back home, their relation with the banks is still difficult due to language problems (most often the forms are in the native language of the resident country) and in many cases excessive document requirements to open a bank account. Regulatory authorities in respective countries could be of help in this respect. Also, Albanian banks may receive Albanian workers' remittances via "banking correspondent institutions" in the resident country and microcredit and microfinance Albanian organizations which could serve as local agencies to handle this process.

**Third: Directing workers' remittances toward country's development needs.** Usually, emigrants are out of the main focus of banking services, since this category of clients is considered to have unstable jobs.

Nonetheless, there exists opportunities to offer financial services to emigrants too. Among others I could mention here: linking of workers' remittances with investments for example by channelling remittances flows toward micro-credit loans or projects; also supporting of migrants' contribution and migrants societies in the development of the country. Remittances could also help approaching rural areas population to the banks. If the recipient families also decide to keep remittances in their bank accounts this could assist economic development as more funds are available to be lent to private sector. Microcredit programs and qualitative improvements of banking infrastructure, in concert with introduction of new financial instruments that would attract more remittances, are also important.

Finally, I would like to express my sincere appreciation to those involved in this conference which provides us a valuable support in our efforts to improve effectiveness of remittances utilization in our economies. I am confident that the distinguished speakers from various institutions, who are present at this conference, would share further helpful ideas and suggestions (we already heard some very interesting ones in the previous discussions), thus ensuring the formulation of sound measures to be incorporated in our policies on remittances.

And I strongly hope this exchange of experiences and expertise will continue in the future and contribute producing adequate human, infrastructure, and institutional capacities to transform remittances from potential into real driving forces for the development of our countries.

Again, my highest consideration for this activity and

Thank you for your attention!