

The Role of Remittances in Leveraging Sustainable Development in Latin America and the Caribbean

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1. Background: ACCION International and Its Experience in Remittances

ACCION is a U.S. non-profit institution founded in 1961 and working in microfinance for the past three decades. ACCION's mission is to give people the tools they need – financial services and training – to work their way out of poverty. ACCION works through 30 partner banks and microfinance institutions, primarily in Latin America and the Caribbean, to provide financial services to low-income people in 23 countries, including the United States. As of the end of 2006, ACCION's affiliates and partners were reaching more than 2 million clients with microloans, with a total portfolio of \$2.4 billion. Most of ACCION's partners are fully regulated commercial banks and finance companies that pursue a double bottom line of financial performance and social mission.

ACCION has been working in the area of remittances since 2002. Our perspective on the remittances industry is primarily that of our partners in Latin America who provide financial services to the recipients of remittance flows, though we also work to a smaller extent with remittance-sending communities in the United States. We have carried out extensive market research to understand the financial needs of senders and recipients. We are working now with banks and microfinance institutions to develop financial products that complement remittances and can help leverage the economic impact of these funds. ACCION has also helped banks and microfinance institutions set-up remittances service through partnerships with money transfer companies and the piloting of a bank-to-bank remittances service through Citibank and our affiliate in Ecuador, Banco Solidario. ACCION is currently developing financial literacy tools to help recipients make informed financial decisions.

2. The Volume and Importance of Remittances Between the U.S. and Latin America/Caribbean

According to IDB studies, remittances to Latin America in 2005 accounted for more than \$53.6 billion. Approximately 75 percent of this volume (US \$ 40.2 billion) came from

senders in the US. The volume of remittances to Latin America is the fastest growing in the world.

The overall importance of remittances as an economic phenomenon can be seen not only from their size, but also from facts such as the following:

- Over 60 percent of adult, foreign-born Latino immigrants in the U.S. send remittances home on a regular basis, averaging US\$100-US\$300 per month.
- For at least these 6 countries in the region remittances flows are equivalent to 10% of GDP: Haiti, Nicaragua, El Salvador, Jamaica, the Dominican Republic and Guyana.¹

Because remittances are made up of large numbers of small, private transactions, based in the lower income segments of the population, they have certain unique economic characteristics.

- Remittances put large sums of money into circulation in countries in Latin America for the purchase of goods and services that boost the economy. In this way, remittance flows have a positive impact on economic development.
- Remittances tend to be countercyclical, as senders increase flows during bad times in their home countries. Thus they provide some measure of economic stability when economies in the region go through crisis or slower growth.²

The private character of remittances means that it is easiest to trace the impact of remittances by examining how recipients use them. Research has shown that remittances improve the well-being of recipient households.

- The majority of these funds are sent to help improve the economic well-being of households back home. Studies place the proportion used for everyday needs at between 60 and 78 percent.
- A significant portion goes to health and education: 5 percent for the education of children left behind in the home country and between 5 and 9 percent on family health.
- Remittances to Latin America have been shown to have a positive impact on the education and health of children, especially among low-income households.
- A smaller, but growing percentage – 7 percent – is used for savings. Remittances have also been found to have a positive correlation with increased savings rate among poorer recipients.³
- Funds are also being used to carry out the dreams or investment goals of immigrants and recipient families. Approximately 6 percent are sent for investments back home, including real estate.⁴

¹ Inter-American Development Bank. Remittances as a Development Tool. <http://www.iadb.org/mif/remittances/index.cfm>.

² The World Bank. 2006. Global Economic Prospects: Overview and Global Outlook.

³ Fajnzylber, Pablo and J. Humberto López. 2007. Close to Home: The Development Impact of Remittances to LAC. Conference Edition. The World Bank

3. ACCION's Market Research on the Potential for Remittances to Support Family and Business Investments in Latin America

ACCION has carried out extensive market research among senders in the United States and especially among recipients in Latin America. One of the most important findings from this research is a challenge to the traditional perception of migration as a one-way process that involves the complete integration of the immigrant into the United States and the breaking of bonds back home. Our research found that immigrants continue to be deeply involved in the lives of their families in their home countries.

Today's immigrant has not abandoned his or her home country but is living a life that integrates both the U.S. and the country of origin. This can be seen from the persistence of remittance flows, which continue for as much as a decade or more after the immigrant leaves his or her country. Spouses work together to carry out home improvement projects, build new houses or start businesses back home. Recipients speak of their relatives who send remittances as the person who has helped them in the past and who will help them in any future emergency. The continued involvement of immigrants across borders relies on communications, technology, transportation, and the ability to move money from one country to another.⁵

Most of ACCION's work in this area has focused on developing financial products and services that assist recipients to use remittance flows for improving the quality of their lives through investments for the future – focusing on the 22-40 percent of remittances that are used for purposes other than everyday consumption needs. Facilitating the use of remittance flows for investments is one way to enhance the economic development impact of those flows.

ACCION has identified a Remittances Life Cycle -- a set of patterns in the evolution of the immigrant's experience over time – that influence the size, frequency and potential uses of remittance flows. The Arrival Phase, lasts one to two years from the point of arrival of the immigrant to the United States. In this phase the recent immigrant is finding his (or her) way in the U.S., spending most of his earnings on establishing his life in this country. Remittances flows, while frequent, are not large, and may be used to pay off the debt incurred in getting to the U.S. During the Intermediate Phase, between the second and fifth years of presence in the U.S. the recipient has generally achieved some stability in the U.S., with a higher income, and is still very close to his family. This is the time when the sender is most likely to direct his remittance payments into investment projects. In the Established Phase, which begins gradually and at different times for different immigrants, the immigrant relaxes ties with the country of origin and focuses more on building assets in the U.S. Remittance flows continue and because of the

⁴ Inter-American Development Bank. Remittances as a Development Tool. Op. cit.

⁵ Jaramillo, María 2005. Leveraging the Impact of Remittances through Microfinance Products: Perspectives from Market Research, ACCION InSight #10, Boston, MA. (www.accion.org/insight).

immigrant's higher income, they may remain high, but there is less interest on the sender's part on investment projects at home.

This life cycle reflects the experience of the sender. However, ACCION's research has shown that in developing financial products to respond to the needs of immigrants and their recipient families, senders and receivers need to be considered as separate markets. Recipients tend to be housewives in charge of the household left behind, parents taking care of children of the immigrant or the children themselves. Immigrants and recipients have distinct financial needs and goals as well as different perceptions towards financial products. Successful financial products that leverage remittances need to respond to the specific needs of senders and the needs of recipients.

A fundamental problem is that many recipient families do not have access to the kind of financial products and services that facilitate investments. Most of them are "unbanked" – lacking a bank account or any established relationship with a financial institution. IDB research puts the percentage of recipients lacking a bank account at 90 percent.⁶

ACCION's work focuses on enabling our partners and affiliates to serve these recipient families with the kinds of financial products that they and the senders of remittances both wish to develop. We seek to leverage the remittance flows in order to improve the ability of the recipient to qualify for life-enhancing financial services.

Our market research suggests that the following financial products are most relevant for remittance receiving families and provide the greatest opportunity for senders and receivers to cooperate in supporting investment:

- *Savings Accounts.* Recipients in Latin America expressed a preference for savings accounts where they could directly receive their remittances. They valued the convenience and increased security that this would give them. At present the vast majority of payments are received in cash because recipients lack bank accounts, in some countries there is a low participation of banks in the offer of remittances services, or because banks are not interested in serving low-income clients. Interest is also strong, particularly among senders, for programmed savings accounts that can help households save for specific purposes such as education, emergency funds, or the down-payment of mortgages.
- *Home Improvement loans.* For recipients and senders alike, improved housing becomes physical evidence of the improved welfare achieved through migration. Recipient households we interviewed in Nicaragua and Ecuador were already using remittances to buy construction materials to build a second floor or renovate a room in their house. Remittances could help households qualify for a home improvement loan to be able to start or complete their construction projects in shorter times.
- *Insurance.* Immigrants in the US: expressed a great interest in health and life insurance. The protection of families back home is a key concern for immigrants, and

⁶ Inter-American Development Bank. Remittances as a Development Tool. Op. cit.

as mentioned before families rely on their immigrant relatives to help them in case of emergencies.⁷

Some potential also exists for linking remittances to mortgages and working capital loans for microenterprises. However, the greater complexity of these products makes it more difficult to leverage remittance flows for these purposes. In studies carried out it was identified that sometimes new home purchase and business start-ups represented wishes or hopes of immigrants more than real investment plans. In the past couple of years more banks from Latin America have reached out to immigrants in the US to offer them mortgages to buy houses back home. However, it is still too early to determine the success of these programs in part because of lack of data to quantify how much real demand exist for these services, because the goals, attitudes and levels of integration change for immigrants over time, and because of the lack of a legal and regulatory framework that can facilitate these kind of off-shore mortgage financing.

4. The Structure of the Remittance Industry

Most remittances between the U.S. and Latin America are sent through money transfer companies like Western Union or Money Gram. While money transfer companies handle 70 percent of total flows, banks handle only 11 percent and credit unions 2 percent. A significant 17 percent is sent through informal means such as the mail or through individuals traveling back home.

Most remittances flows are cash-to-cash. Senders bring cash to the money transfer company, and recipients receive cash at a remittance distributor's office. Initiatives in the past couple of years have begun to move these flows toward account-to-cash or cash-to-account, including the use of pre-paid cards in Latin America to disburse remittances funds. ACCION is currently working with its affiliated institutions to promote the channeling of remittances to accounts or to cards that can facilitate the banking of recipients.

In addition to the benefits of reducing transactions costs, it is also beneficial for senders and recipients to move remittances flows into financial systems and away from cash. When flows are associated with bank accounts, senders can maintain greater options for how to manage the money they receive and recipients gain access to a broader range of financial services. Increased access to financial services can expand the range of ways in which remittances funds end up being used.

5. Issues from ACCION's Experience

Remittances are private funds sent between individuals living in different countries. The goal of ACCION's remittances project is to support the decision making process of senders and recipients regarding how funds are used. ACCION believes that this can

⁷ Jaramillo, María. 2005. Beyond Small Change: Making Migrant Remittances Count. In: Terry, D. F. y S.R. Wilson (Eds.). Beyond Small Change: Making Migrant Remittances Count. Inter-American Development Bank.

increase the economic impact of remittances and support the development of local economies.

Currently, the remittances service infrastructure makes it hard for immigrants and recipient families to implement their decisions on how these funds should be used. Because the majority of funds are being sent through cash-to-cash mechanisms it becomes difficult for the immigrant to designate what percentage of the amount sent should be used for a specific goal. Receiving remittances in a savings account can help immigrants and their families manage better these funds by saving a portion of it or splitting its use into different projects. Depositing remittances into savings accounts also makes it easier to link these funds with other financial products that can give families greater options for channeling remittances to investment goals.

ACCION has provided technical assistance to Citibank and Banco Solidario in Ecuador to implement a bank-to-bank remittances service. This service is currently being used by Ecuadorian immigrants and their recipient families. Some of the challenges encountered on the sending side in developing this service have been: (a) lack of understanding of this “unbanked” segment; (b) fears and barriers to using banks; (c) the cost of compliance to serving low income customers – especially those with limited levels of (financial & general) literacy and (d) the difficulty this segment has in completing the requirements or having the proper identifications most banks demand.

In adapting financial products to respond to the needs of immigrants and recipient families ACCION has also encountered challenges in the legal framework that limit the development of transnational products. For example, legal regulations prevent the development of an insurance product that an immigrant can purchase in the US protect their family back home. In a similar way there are limitations in the offering of insurance products that a family in Latin America can purchase to protect their relative in the US.

When working with our affiliates in Latin America who are interested in offering mortgages in the US for immigrants we also encountered a complex legal structure that makes it very difficult for a foreign bank to open a point of presence in the US. The complexity, paperwork, time and funds required to obtain a representative office license make it hard for smaller banks in Latin America to offer their services to immigrants in the U.S. Because of the legal complexities involved in mortgages and insurance, ACCION has focused on developing products for remittance recipients in areas where no policy barriers have been encountered: home improvement and savings accounts.

To the extent that ACCION and its bank partners are successful in incorporating remittances into formal financial systems, money transfers have the potential to affect not only the day-to-day well being of the recipients but also their asset base. By channeling remittances into savings, home improvements and business growth, remittances can build the foundation for growing out of poverty.

6. Recommendations

ACCION's experience with remittances to date leads us to make the following broad policy recommendations.

1. Promote mechanisms that allow for rapid, reliable and convenient movement of funds, including the entry of banks into the remittances industry.

Encourage the integration of the Automated Clearing House (ACH) systems between the United States and Latin American countries in order to make it easier for banks to offer bank-to-bank remittances services. In 2003, the ACH systems of the United States and Mexico were linked in order to reduce the cost and time of cross-border financial transactions. This systems integration can be extended to other countries in the region.

2. Promote a competitive setting in which consumers benefit from price and service quality competition among suppliers. Balance the need to prevent misuse of these channels for money laundering and the need to maintain an environment that supports competition among money transfer companies. An increase in regulation has led to banks closing the accounts of small and medium sized money transfer companies because of the increase scrutiny from regulators.

3. Remove barriers to the access of senders to banking services.

- Increased acceptance of alternative ID forms to open a bank account in the US (Matrícula Consular or Passport).
- Reduce fears that the unbanked segment might have of using financial services.
- Develop an environment that can encourage banks to continue working to bank immigrant communities by offering remittances services as an entry point to establishing a banking relationship with them.

4. Support the expansion of financial services to recipient families.

- Promote the development of cooperative international legal frameworks that can support the offer of trans-national financial products to support immigrants in achieving investment goals back home. Important products in this category are mortgages, and insurance.
- Continued positive enabling environments are needed to ensure that microfinance institutions interested in reaching the lower income populations can continue to do so.

5. Increase the financial literacy of senders and recipients regarding financial planning and the informed use of financial services.

- Encourage the dissemination of information and financial literacy tools to increase awareness among immigrants of the remittances and banking services available to them, and how to be a smart consumer of such services, including the trade-offs between money transfer companies and banks as remittance channels.
- Support also financial literacy programs that can help recipient households in Latin America increase their understanding of how financial products work, the benefits of receiving remittances through a bank account, and the potential that remittance funds have to help them generate assets and achieve investment goals.