
6

Reducing Remittance Fees

Following the discussion in chapters 4 and 5, on the macro- and microeconomic importance of remittances, chapter 6 focuses on a specific policy issue: reducing remittance costs and strengthening the financial infrastructure that supports remittances. Reducing the cost of personal remittances is the most promising area of policy intervention for several reasons. First, it will stanch a drain on the resources of poor migrants and their families back home. Second, it will increase flows through formal channels, especially banks. Third, it will improve financial access for the poor in developing countries.

Cost is usually not an issue in large remittances (made for the purpose of trade, investment, or aid), because, as a percentage of the principal amount, it tends to be small. But for small, personal transfers, remittance costs are high—unnecessarily so. Providers of remittance services in the formal sector typically charge a fee of 10–15 percent of the principal amount to handle the small remittances typically made by poor migrants.¹ High fees place a financial burden on the migrant remitters and on the recipients of the remittances, who receive a smaller amount of the much-needed funds sent by their family members.

Major international banks tend to focus on large-value remittance services rather than on services for migrants. Poor migrants may feel uneasy about using a major bank for remittance services; they tend to prefer smaller financial institutions, money transfer operators

(MTOs), or informal channels, such as a friends, family members, export-import firms, and transport companies.

The main messages of this chapter are as follows:

There is significant scope to reduce the fees on remittance services, especially for the small transfers typically made by poor migrants. Remittance transaction costs are often significantly lower than the fees that most customers pay. Reducing transaction fees will increase the disposable income of poor migrants and increase the incentives to remit (as the net receipts of beneficiaries increase). It may also significantly increase annual remittance flows to developing countries. Cross-border payments for retail trade, investment, and pension benefits (typically defined in foreign currency) would also increase in response to a reduction in remittance fees.

A weak competitive environment in the remittance market, lack of access to technology-supporting payment and settlement systems, and burdensome regulatory and compliance requirements all tend to keep fees high. Competition in the remittance market could be increased by lowering capital requirements on remittance services and opening up postal, banking, and retail networks to nonexclusive partnerships with remittance agencies. Disseminating data on remittance fees and establishing a voluntary code of conduct for fair transfers would improve transparency in

remittance transactions. In countries with exchange controls, efforts to align the official and the market exchange rates would reduce the foreign-exchange spread in remittance transactions.

Reducing remittance costs and improving access to the financial system for migrants and their families will do more to encourage the use of formal channels than will regulation of so-called informal services. While regulation is necessary for curbing money laundering and terrorist financing, overregulation of informal services may conflict with the objective of reducing remittance costs.

Expanding migrants' access to banking services may enable remitters to bundle remittances and thereby take advantage of the lower fees available for larger remittances. This would require expanding the banking network, allowing domestic banks from origin countries to operate overseas, providing identification cards to migrants, and facilitating the participation of savings banks, credit unions, and microfinance institutions in providing low-cost remittance services. Remittances, in turn, can be used to support financial products—such as deposits, loans, and insurance—for poor people, and to contribute to the financial development of the recipient economy.

The plan of this chapter is as follows. The first section describes remittance fees and costs in various remittance channels. It shows (a) that remittance fees paid by customers are high for smaller transactions, especially in low-volume corridors; (b) that the cost of providing remittance services need not be so high; and (c) that remittance flows to developing countries would increase if remittance costs were reduced. The next section examines the factors underpinning remittance fees—market competition, regulations, payment infrastructure, and technology—and suggests policies for reducing costs and fees. This section also briefly discusses the recommendations of the international Financial Action Task Force (FATF) to prevent misuse

of remittance systems for criminal purposes. The last section discusses complementarities between remittances and other financial products such as loans, deposits, and insurance. Finally, an annex to the chapter briefly describes the historical evolution of three major remittance service providers (Western Union, MoneyGram, and Bank of America) to provide a perspective on the remittance market.

Remittance fees and costs

The remittance industry consists of formal and informal fund transfer agents. Major competitors include a few large global players, such as the major money transfer operators (MTOs) and banks, as well as hundreds of smaller participants that serve niche markets in specific geographic remittance corridors. The informal fund transfer agents include friends, family, and unregistered MTOs such as *hawala* dealers and trading companies.

The price of a remittance transaction includes a fee charged by the sending agent (typically paid by the sender when initiating the remittance transaction) and a currency-conversion fee for delivery of local currency to the beneficiary in another country. (A stylized remittance transaction is presented in annex 6A.1.) Some smaller MTOs require the beneficiary to pay a fee to collect remittances, presumably to account for unexpected exchange-rate movements. In addition, remittance agents (especially banks) may earn an indirect fee in the form of interest (or “float”) by investing funds before delivering them to the beneficiary. The float can be significant in countries where overnight interest rates are high.² Many recipients spend considerable time and travel considerable distances to collect remittances. These costs typically are not included in the price.

Remittance fees are high, regressive, and nontransparent

Remittance fee pricing is complex, and rarely are senders informed about the full and

precise price of a remittance transaction. Fees may be as high as 20 percent of the principal, depending on the remittance amount, channel, corridor, and transaction type. The average price is reported to have been around 12 percent of the principal in 2004 (Taylor 2004; Kalan and Aykut 2005). Prices are believed to have declined recently but are still very high in low-volume corridors. Currency-conversion charges are even less transparent than remittance fees; they, too, vary depending on the competitor, corridor, and channel, ranging from no charge in dollarized economies to 6 percent or more in some countries (Orozco 2004; Hernández-Coss 2004; Kalan and Aykut 2005).

Major MTOs such as Western Union and MoneyGram apparently charge higher remittance fees than banks and other financial institutions that offer remittance services to attract migrant customers (table 6.1). Informal channels such as *hawala* are reported to be cheaper than formal services. Some heavily traveled remittance corridors, such as United States–Mexico and South Africa–Mozambique, are much cheaper than others. Urgent transactions delivered in minutes cost much more than next-day transfers, and electronic transfers cost more than bank checks or

drafts, because they also clear much faster than the latter.

The fee amount also depends on the remittance amount. Average remittance fees, as a percentage of money sent, decline rapidly as the transaction size increases, indicating scale economies and the potential advantage of bundling remittances—that is, the advantage of sending more funds, but less frequently. According to one firm’s fee schedule, the cost of sending money from Belgium to Africa drops from 21 percent to below 4 percent as the transaction amount increases from 40 euros to 900 euros (figure 6.1). Similarly, the cost of remittances from the United States to Mexico (through the major MTOs) is more than 10 percent for \$100, but less than 3 percent for \$500 (figure 6.2).

In recent years, remittance fees have declined in high-volume corridors in response to several factors. First, global and regional MTOs have intensified their competition in mature corridors (United States–Latin America, for example), as new competitors have been attracted by high and growing remittance volumes. In the United States–Mexico corridor, for example, remittance fees have dropped nearly 60 percent since 1999 (box 6.1).³ Second, Bank of America and

Table 6.1 Approximate cost of remitting \$200

Percent of principal amount

	Major MTOs	Banks	Other MTOs	<i>Hawala</i>
Belgium to Nigeria*	12	6	9.8	—
Belgium to Senegal*	10	—	6.4	—
Hong Kong, China, to the Philippines	4.5	—	—	—
New Zealand to Tonga (\$300)	12	3	8.8	—
Russia to Ukraine	4	3	2.5	1–2
South Africa to Mozambique	—	1	—	—
Saudi Arabia to Pakistan	3.6	0.4	—	—
United Arab Emirates to India	5.5	5.2	2.3	1–2
United Kingdom to India	11	6	—	—
United Kingdom to the Philippines	—	0.4–5.0	—	—
United States to Colombia	—	17	10	—
United States to Mexico	5	3	4.7	—
United States to Philippines	1.2–2.0	0.4–1.8	—	—

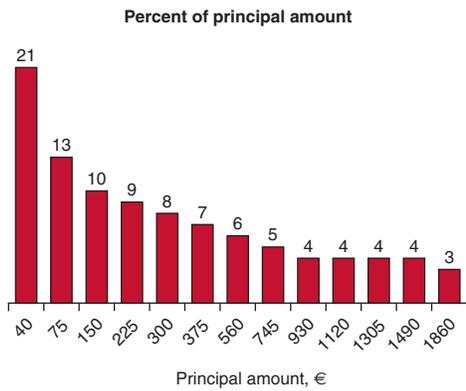
Source: Brocklehurst 2004; Orozco 2004; Gibson, McKenzie, Rohorua 2005; Hernandez-Coss 2004; Ratha and Riedberg 2005; Kalan and Aykut 2005; Andreassen and others 2005.

*World Bank survey of African diasporas in Belgium.

Note: Figures do not include currency-conversion charge.

— Data not available.

Figure 6.1 Remittance costs are high and regressive



Source: Western Union branches in Brussels and Paris.

other banks in source countries are using minimal transfer fees to attract migrant accounts, while a growing number of banks in recipient countries (including ICICI and Bancomer) are competing for remittance customers. Third, the use of Internet-based technology for messaging and advanced clearing and settlement has reduced the cost of remittance transactions. In some countries, new remittance tools have emerged, based on cell phones (see box 6.6) and smart cards. Finally, government

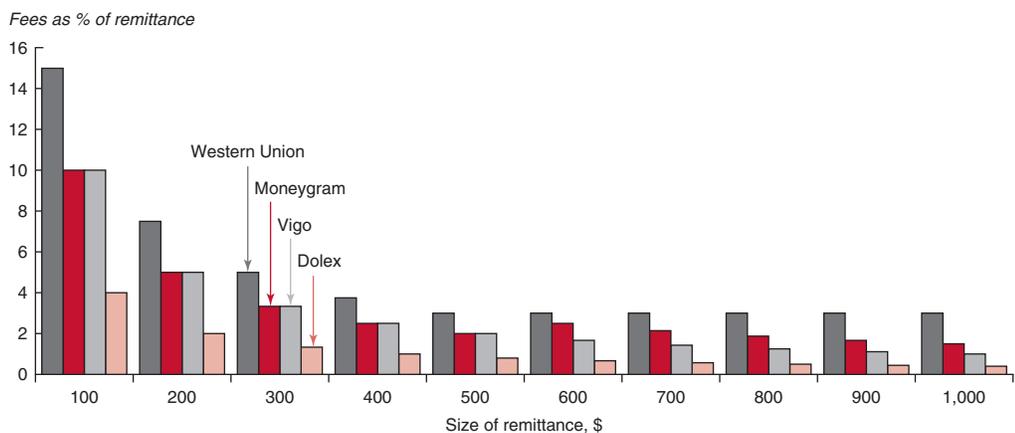
policies to improve transparency in remittance transactions (as in the United Kingdom), provide financial training to migrants (as in the Philippines), and establish bilateral initiatives (such as the Partnership for Progress between the United States and Mexico) have helped reduce remittance costs.

These positive developments remain the exception. In most corridors, particularly the low-volume corridors, remittance fees continue to be very high. In the New Zealand–Tonga corridor, for example, fees are about three times as high as those in the United States–Mexico corridor. The wide gap between remittance fees and costs shows that both should be reduced.

The cost of a remittance transaction appears to be far lower than the price

Service providers’ remittance costs appear to be much less than the fees charged to customers. Domestic transfer fees are only a fraction of the cross-border remittance fees (net of the currency-conversion charge). The cost of a domestic automated clearinghouse (ACH) payment in the United States is one-third of a cent. Domestic transfers using Visanet cost 2 cents per transaction, as opposed to 51 cents

Figure 6.2 Remittance fees in the United States–Mexico corridor



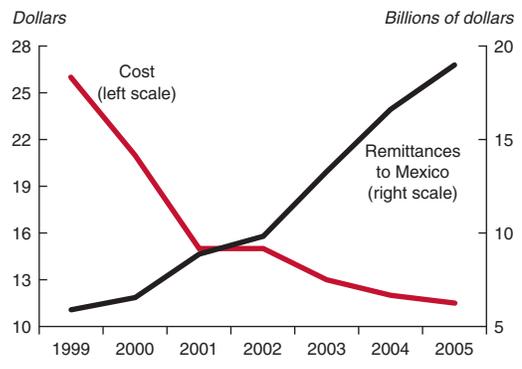
Source: Kalan and Aykut 2005.

Box 6.1 Decline in remittance costs in the United States–Mexico corridor

The cost of sending \$300 from the United States to Mexico declined nearly 60 percent between 1999 and 2005—from \$26 to \$11 (according to PROFEC data, see figure). The decline can be traced to greater competition. Prices generally remained stagnant when one MTO dominated the transmission service through exclusive contracts with distributors. Practitioners inside the industry cite the breakup of these exclusivity contracts and the entry of new competitors—especially banks—into the corridor as key events leading to a steady decline in prices.

Starting with Citibank's acquisition of Banamex in 2001—a \$12.5 billion deal reportedly motivated by the attractiveness of Banamex's remittance business, U.S. banks have increased their stake in the United States–Mexico remittance market in the past two years. Being able to use the *matricula consular* identification card to establish identity when opening an account has helped this process. The card is

United States–Mexico, remittance fee per \$300



accepted as a valid identity document in 32 U.S. states, more than 1,000 police stations, 409 cities, 125 counties, and 280 banking institutions.

per transaction for international transfers (Brocklehurst 2004). In some corridors, fees for international remittances are as low as \$1.80 per transaction (London-Manila), which hints at a falling lower bound for the cost of remittances. The fact that some banks have been offering free remittance services as loss-leaders to attract new business suggests that the actual cost of remittances is modest. Courier services that offer remittances also charge small fees for this additional service. Finally, industry cost estimates as well as other calculations presented below suggest that remittance costs are not very high.

The cost of providing remittance services varies with the business model used by the service provider. Western Union, MoneyGram, and Vigo use agents who pay all operating costs in exchange for their franchise and a commission on sales. In the “branch” model used by Dolex and many of the smaller

regional MTOs, the fixed and operating costs associated with each branch are paid by the MTO. By leveraging existing businesses on a commission basis, the agency model is much less capital-intensive than the branch model and can be expanded rapidly through partnerships, but it has higher variable costs.⁴ In both models, relatively high fixed costs are associated with transaction-processing operations, compliance with regulatory requirements, marketing, and administration.⁵

Data on MTOs' costs of providing remittance services are hard to obtain. However, an analysis of profitability of the market leaders⁶ using publicly available financial statements suggests that remittance costs are significantly lower than the fees charged to customers. Western Union has sustained operating margins that are at least 50 percent higher than other MTOs and industry peers in the payments and electronic processing market

(table 6.2).⁷ Its operating profit *per remittance transaction* may have averaged \$8 to \$9 in 2004. This is consistent with an earlier annual report (Western Union 2000) that put the company's operating profit at \$684 million (or 30 percent of its \$2.3 billion revenue). The operating profitability of the other major market players (MoneyGram and Dolex) has been in the range of 15–20 percent (table 6.2). A very simple model for Western Union (which assumes that agency commission costs are 35 percent of revenues after deduction of fixed costs and that all other costs are fixed costs) suggests that average transaction fees could be reduced by as much as one-third while maintaining operating margins within the same range as those of other major MTOs and peers. Reducing these operating profits to zero would provide a rough estimate of the break-even cost for these firms. Such an exercise reveals that the break-even fee for Western Union is probably around \$9 per transaction and would fall below \$5 if the volume of transactions were to double (box 6.2). Although it would be unreasonable to suggest that any company reduce its prices to cost, this simple model does appear to indicate that there is considerable latitude for reductions in transaction fees within the higher-priced corridors.

A more direct way of estimating the cost of a remittance transaction in a hypothetical MTO is to add up plausible cost components,

Table 6.2 Operating profits of major MTOs

Percentage of revenue		2004
First Data Corporation, Western Union money transfer operations ^a		32
MoneyGram money transfer operations		15
Global Payments money transfer operations, including Dolex ^b		20
Peer group average ^b		18

Source: Yahoo Finance Database financial summaries; Kalan and Aykut 2005; Piper Jaffray Equity Research; MoneyGram International.

a. 90 percent Western Union; 50–55 percent non-United States/Canada consumer-to-consumer money transfers.

b. Includes American Express, Total System Services, DST Systems, Sunguard Data Systems, and Fiserv. These companies are not directly comparable to the MTOs as they are not necessarily in the money transfer business.

such as staff to process the transaction and provide security, rental of the premises, fixed costs (including franchise licensing), the cost of network and technology, and administrative costs for regulatory compliance.⁸ This methodology yields a cost estimate of \$5.50 for the first remittance transaction (table 6.3). Because most remittance transactions tend to be repetitive—the same amount is remitted from the same location to the same beneficiary—the cost for subsequent transactions drops to \$3.60 (less staff time is required). It drops to under \$3 per transaction if electronic processing is used.

Admittedly, the calculations in table 6.3 are based on a theoretical model of a basic

Table 6.3 Estimating the cost of a remittance transaction

Cost in dollars

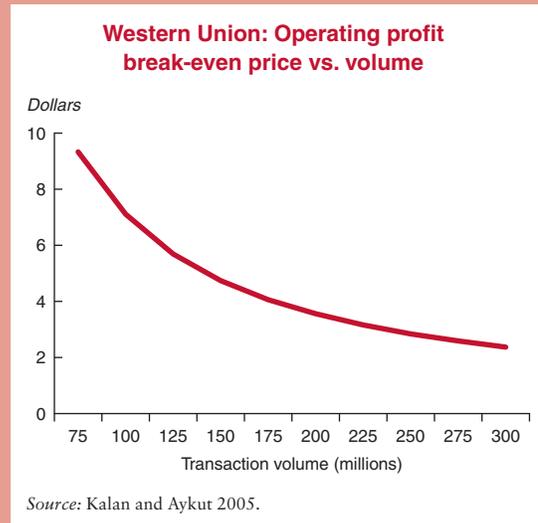
	First transaction	Subsequent transaction	Electronic processing	Explanation
Sending staff	2.50	0.83	0.50	10 minutes of staff time at \$15 per hour
Receiving staff	0.17	0.17	0.17	10 minutes of staff time at \$1 per hour
Fixed costs	0.27	0.27	0.27	\$40 million system cost recovered over 10 years; 2,000 branches with 20 transactions per day
IT, telecommunications	0.60	0.60	0.60	1 minute international phone call
Rent	1.50	1.50	1.50	\$30 rent per day; 20 transactions per day
Administrative costs	0.50	0.50	0.50	Compliance, general overhead
Total costs	5.54	3.60	2.94	

Source: Ratha and Riedberg 2005.

Box 6.2 Estimating remittance industry costs

Remittance industry costs are difficult to obtain. Isolating the cost of remittance services is difficult in the case of financial institutions that provide other services as well. Estimating costs is not easy even in the case of dedicated remittance service providers because of the differences in the quality and reliability of remittance services (only some providers give customers legal redress). In Remittance industry costs, therefore, we have used publicly available information on Western Union, the largest MTO that is also a publicly listed company.

We used a simple model to estimate a break-even fee for Western Union’s international money transfer operations. The model suggests that for Western Union’s operating margins on its international money transfers to drop to the peer group average of 17.8 percent (table 6.2), the average transaction fee would have to be lowered from \$22.90 to \$15.30 (column 2 of the table below)—very close to the company’s current fee in several U.S. corridors. The model also indicates that the break-even fee at which the operating profit becomes zero is \$9.30 (column 3). This price is in the same range as MoneyGram’s standard flat price in the U.S. corridors. A sensitivity analysis using this model suggests that the break-even fee would be \$6.50–\$7.00 if agency commissions were 25 percent, and around \$11 if commissions were 45 percent.



The figure illustrates how the break-even fee shown in the table decreases as the number of transactions increases. If transaction volume doubled from the current 76 million to 150 million, the lowest fee at which the international operation would remain profitable would be \$4.74.

	2004 data	Calculation assuming peer group margin of 18%	Calculation assuming break-even margin
Operating margin (operating profit over revenue) (%)	30	18	0
Operating profit per transaction (revenue minus costs) (\$)	8.8	3.9	0.0
Costs (\$)	20.4	17.7	15.7
Agency commission, 35% of fee	8.0	5.3	3.3
Fixed costs	12.4	12.4	12.4
Revenue (\$)	29.3	21.6	15.7
Foreign-exchange commission	6.4	6.4	6.4
Fee	22.9	15.3	9.3

Source: Western Union financial statement for 2004.

Note: Reflects 76 million transactions in 2004. Fixed costs include marketing, administration, depreciation, and amortization, agency start-up, and other unidentified costs. Figures may not add up due to rounding errors.

remittance transaction that does not capture the global network and diversified services provided by major MTOs. Moreover, the model's assumptions are subject to considerable uncertainties, the greatest of which is that average costs would be higher if the number of transactions were smaller. It is worth noting, however, that many independent agents provide remittances as a side business: for them, fixed and variable costs could be significantly lower than for dedicated remittance service providers. Indeed, there may be a case for providing free remittance services in order to draw customers for other products and services, as practiced by certain banks.

Remittance costs should continue to fall under the influence of increased competition and better technology. Large MTOs may have considerable latitude to reduce fees while maintaining reasonable profit margins. In corridors where costs have already fallen significantly, further decline may be modest; but elsewhere there is scope for significant decline, especially with the volume of transactions rising rapidly.

Reducing remittance fees will increase remittance flows to developing countries

Reducing remittance fees would increase the disposable income of remitters, encouraging them to remit more. It also might encourage

smaller and more frequent remittances. And lower prices in a particular channel might encourage remitters to shift from other channels—notably informal ones.

The degree to which a fee reduction would result in an increase in flows depends on the purpose of the remittance. At one extreme, where the purpose is to meet a specific need—payment for tuition, a medical emergency, a social ceremony, or the purchase of a gift item—the amount of remittance may not be sensitive to the remittance fee. At the other extreme, remittances by a poor, cash-strapped remitter may be highly cost elastic. Similarly, remittances meant for investment are likely to be cost elastic. In reality, most remittance transactions fall between these two extremes. Even when remittances are driven by altruism, they will tend to be cost elastic, as evidenced by the literature on charity, which shows that people tend to donate more as the cost of donating declines (box 6.3).

In a recent survey of Senegalese migrants in Belgium, two-thirds of the migrants said they would send more if the cost of sending went down. In a survey of Tongan migrants in New Zealand, 30 percent of remitters said they would increase the amount of remittances by 0.74 percent (on average) if costs fell by 1 percent (Gibson, McKenzie, and Rohorua 2005). That survey found the overall cost-elasticity of

Box 6.3 Even charitable donations are sensitive to cost

Charitable donations and bequests, like altruistic remittances, increase when the costs of such actions decline. In one of the best-known early studies of the responsiveness of gift-giving to tax deductions, Feldstein and Taylor (1976) estimated a price elasticity of the amount given of -1.3 .^a Although this finding has been challenged on the ground that gift-giving responds more to temporary changes in the cost of giving (Glenday, Gupta, and Pawlak 1986), the general agreement is that people give more when

it costs less to do so (Cordes 2001). The literature on charitable bequests reaches a similar conclusion. Bakija, Gale, and Slemrod (2003) estimate a price elasticity of -2.14 for charitable bequests.

^aIn the United States, taxpayers can deduct the amount of charitable contributions from their income for tax purposes. Thus, Feldstein and Taylor (1976) view an increase in the income tax rate as a decline in the price of charitable donations.

remittances with respect to the fee (averaging the elasticity over those who would increase remittances and those who would not) to be -0.22 . Based on this estimate, Gibson and others (2005) calculate that lowering the fixed cost of sending money through banks and MTOs from New Zealand and Tonga to competitive levels in the world market would result in a 28 percent increase in remittances from existing remitters. It might also induce some nonremitters to start remitting.⁹

If the cost elasticity (-0.22) of the New Zealand–Tonga study were applicable to all developing countries, a reduction in remittance cost from 12 percent to (say) 6 percent could result in an 11 percent increase in annual remittance flows to developing countries. One caveat to this calculation is that the cost elasticity applies only to high-cost corridors, which also tend to have low volumes. In corridors where the remittance cost is already low, further decreases may not increase flows. For example, a fee reduction by a major MTO may not produce much effect if a major part of the flows is already moving through low-cost informal channels. This is confirmed by the World Bank survey of Senegalese migrants in Belgium; half of the respondents who paid remittance fees of 20 percent or more said they would send more if costs were halved; not even one-fourth of those who paid less than 10 percent said they would send more (table 6.4). Almost 75 percent of the Senegalese migrants who send money through the large MTOs said that

they would send more if the costs were lowered, a result confirmed by findings from a World Bank survey of the Nigerian diaspora in Belgium.

An indirect implication for cost elasticity may be drawn from Yang's (2004) finding of an elasticity of 0.6 for remittance receipts denominated in Filipino pesos with respect to the peso–dollar exchange rate. Applying this elasticity to a remittance transaction of \$150, if the remittance fee were halved from (say) 12 percent to 6 percent, remittance receipts would rise by 3.6 percent, or \$5.4, while the remittance fee would decline from \$18 to \$9.31.¹⁰ If the same elasticity were to apply to the entire flow of remittances to developing countries, remittance receipts, in response to a halving of costs would increase significantly, by more than \$5 billion using only recorded flows, and more than \$8 billion using both recorded and unrecorded flows.

Reductions in remittance fees would also be likely to increase other cross-border retail flows such as transfers from public and private institutions to individual beneficiaries (pensions, child-care payments), small-value payments in exchange for goods and services, acquisitions of assets, and debt servicing.¹¹ In more developed countries, migrant remittances are only a small share of retail payments, which, in turn, are a fraction of wholesale payments. But in developing countries, especially in smaller and poorer countries, remittances are a significant source of funding in relation to the size of the economy and, therefore, of the retail payment system. A reform of the retail payment system to facilitate remittances would probably benefit other (not easily quantifiable) components of retail payments.

Based on the evidence presented above, notably the finding that the cost elasticity of remittances is negative, policies that aim to lower remittance costs by increasing access to banking services, promoting competition, and disseminating information have the potential to provoke sizeable increases in remittance flows to developing countries.

Table 6.4 Remittances are more cost-elastic when costs are higher

Cost (% of principal)	% of respondents who would remit more	
	Senegal	Nigeria
1–9	23	64
10–19	50	67
20 and above	50	83

Source: World Bank Survey of Senegalese and Nigerian diasporas in Belgium.

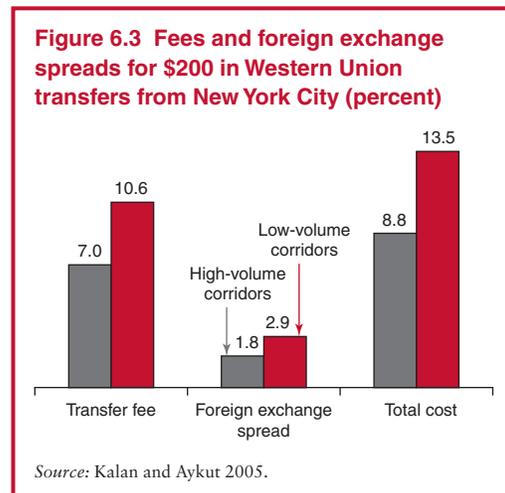
Factors underpinning high remittance fees

What accounts for high transaction costs in the remittance business? Are they related to large sunk costs, regulatory measures that restrict competition, or the lack of access to low-cost public infrastructure (such as payments systems)? Do exchange controls, country risks, or other specific factors keep the cost of cross-border transfers higher than those of domestic transfers?

Before answering these questions, it is worth noting some general findings from a cross-country regression analysis of remittance fees (Freund and Spatafora 2005). Remittance fees tend to be higher in corridors in which bank concentration is high and competition low (as reported in chapter 4, table 4A.2.2). They tend to be lower in more developed financial sectors (proxied by the ratio of deposits to GDP) in the recipient country and in dollarized economies and other economies that present low exchange-rate risk. Greater credit risk¹² reduces the willingness of agents to provide remittance services. Finally, high wages at the recipient end (as proxied by domestic output) are associated with more costly remittance services. These results, which should be treated as indicative rather than conclusive, suggest that measures to increase competition among remittance-service providers and to reduce financial risk and exchange-rate volatility are likely to reduce the transaction costs associated with remittances.¹³

Several factors related to conditions in the corridor and in the sending and receiving countries have significant impacts on remittance pricing. Two corridor-related factors that have a significant impact on price are the (potential) level of competition in the corridor and special arrangements with postal systems to handle distribution.

A high level of competition may considerably reduce remittance prices in a corridor. The level of competition in a corridor can be proxied by remittance volume, since high-volume corridors attract more competi-



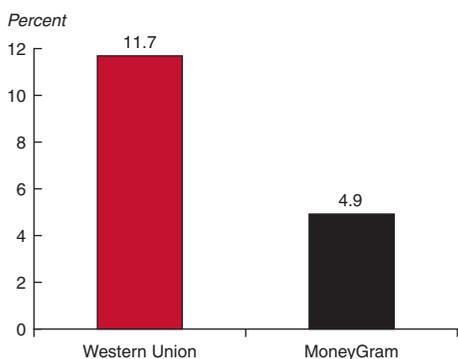
tors, particularly small niche players that compete primarily on price. The relatively lower prices in high-volume corridors, such as United States–Mexico and Saudi Arabia–India, can be ascribed in part to the presence of regional and smaller players, in addition to the major MTOs (and in part to scale economies). The remittance prices of the global market leader, Western Union, are significantly lower in the high-volume U.S. corridors than elsewhere (figure 6.3).¹⁴

High volume in a corridor does not always guarantee high competition, however. *Exclusive* access to an extensive distributional network (such as a post office network) may distort competition in the corridor. Using post offices as money transfer agencies can give an MTO a significant advantage, because the postal system almost always offers the most extensive distribution networks in both sending and receiving countries, particularly in rural areas. Exclusive arrangements with postal systems have been employed by the two largest MTOs, Western Union and MoneyGram.

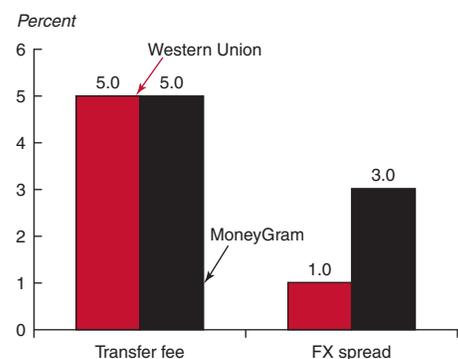
Exclusive arrangements can block or bar entry by small competitors and may thus allow the company that enjoys the arrangement to maintain a high price premium. Moreover, exclusive arrangements with the post office, typically a trusted and ubiquitous presence, may facilitate price leadership and

Figure 6.4 Exclusive arrangements with post offices skew competition

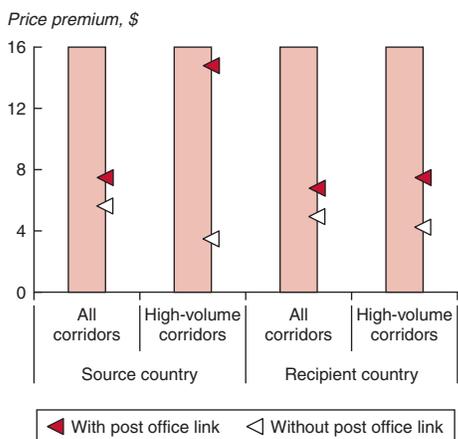
a. Fees for \$200 remittance, France–Morocco corridor



b. Fees and foreign exchange spread for \$200 remittance, United States–Vietnam corridor



c. Western Union price premium over MoneyGram for \$200 remittance when Western Union has post office link



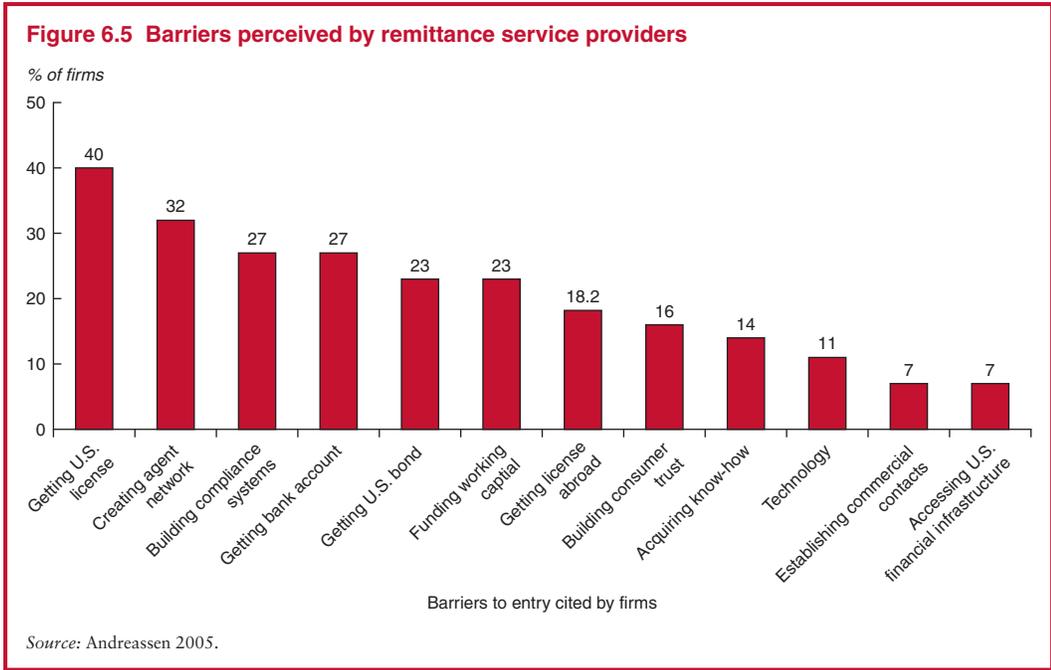
Source: Kalan and Aykut 2005.

price signaling—thereby raising the fee structure across the board. For example, arrangements with the postal systems in France and Morocco may help explain Western Union’s ability to charge significantly higher fees in that corridor than its major competitor, MoneyGram (figure 6.4a). However, in the United States–Vietnam corridor, where MoneyGram has such an arrangement, Western Union lowers its price to the same level as MoneyGram’s, whereas MoneyGram charges higher foreign-exchange commissions (figure 6.4b).

At the global level, Western Union’s price premium over MoneyGram’s fees, even in high-volume corridors, appears to be significantly higher when the company has a link with the postal system in either the sending or receiving country (figure 6.4c).¹⁵ On the other hand, when MoneyGram, which almost always offers lower prices than Western Union, has the agency relationship with the post office, its strong distribution advantage forces Western Union to lower its prices to compete in the corridor.

Other factors that appear to have an impact on corridor pricing include active participation of banks, credit unions, or other nonbank financial institutions in the remittance market; cultural and geographic commonality with a group of countries that includes one highly competitive, high-volume corridor with lower prices; the size of informal transfer network in the corridor; and government policy initiatives within the corridor.

Regulatory and policy decisions have a significant effect on remittance costs. In a recent survey of providers of remittance services in the United States, 40 percent of those surveyed cited the process of getting a license as the chief barrier to their operation, followed by building a compliance system (figure 6.5). In the United States, remittance service providers are supervised by state departments of consumer affairs and banking. Not all states have specific regulations on remittances. And registration requirements vary widely from state to state (annex 6A.2). To set up a money transfer



business with offices in all 50 states would require net worth and bonds of more than \$5 million (Ratha and Riedberg 2005). Although bond and capital requirements protect consumers and deter fraudulent practices, the wide variation in requirements from state to state, mirrored in wide variances among countries, can be confusing and costly, thereby discouraging competition from new, smaller players. Many countries, including France, Italy, and the Russian Federation, require a provider of remittance services to be a fully licensed bank or financial institution. Only recently did Germany allow remittances to be conducted under a financial institution license instead of under banking regulations. Costly and stringent licensing requirements, like bond and capital requirements, discourage the entry of smaller players that could provide effective competition in many remittance corridors.

Regulating informal remittances may raise costs

Since the terrorist attacks of September 11, 2001, authorities in many countries have

adopted more stringent regulations and stepped up enforcement of existing rules governing the transfer of foreign exchange.¹⁶ An increasing number of countries are requiring MTOs to register with the authorities and to report transactions on a regular basis. These regulatory requirements have raised the cost of fund transfers to the remittance service providers, which tend to pass them on to customers.

National requirements center on the registration of transfer businesses, application of know-your-customer procedures, detailed record-keeping, and frequent reporting. “Money service businesses” in the United States must maintain a list of their agents and make the list available to the Financial Crimes Enforcement Network (FinCEN) upon request. Operating such a business without registering it is a crime. The introduction of the USA Patriot Act in late 2001 tightened the know-your-client requirements for fund transfers. In addition, U.S. financial institutions are required to comply with the recommendations of the international Financial Action Task Force to Prevent Money Laundering (FATF

2005), which are incorporated into U.S. regulations, and to comply with the sanctions list maintained by the Treasury Department's Office of Foreign Assets Control.

Since early 2005, correspondent bank accounts of hundreds of money service businesses in the United States have been closed by banks for fear that they may be targeted by authorities for servicing customers regarded as "high-risk." The wave of closures can be traced to a June 2004 notice from the Office of the Comptroller of Currency that "[s]ome national banks also provide banking services to foreign [money service businesses], a line of business that can carry significant money laundering risks."¹⁷ Clear guidance on how to assess risks and spot suspicious activity is lacking.

Some argue that the users of informal remittance channels face a great risk of fraud and default. Requirements for bonds, capitalization, auditing, reporting, and disclosure can shield consumers from excessive fees, fraud, or other losses. At the same time, trust and self-regulation, characteristics of informal remittance networks such as *hawala*, *hundi*, *padala*, *fei chien*, and others, have proven effective in protecting customers against losses, although they are by no means immune to fraud. Moreover, their low cost, speed, reach, and convenience of informal door-to-door remittance services remain extremely competitive compared with the inefficiencies of formal operators (Ballard 2005; El Qorchi, Maimbo, and Wilson 2003; Maimbo and Passas 2005). Law enforcement cases from all continents show that formal and informal remittance channels are both susceptible to criminal abuse.¹⁸

The regulatory regime governing remittances must strike a balance between curbing money laundering, terrorist financing, and general financial abuse, and facilitating the flow of funds through efficient formal channels. Policies that encourage formal operators to imitate the best practices of informal transfer systems will benefit poor migrants. Strengthening the formal remittance infrastructure by offering the advantages of low

cost, flexible hours, expanded reach and language, and increasing efforts to identify and regulate the unregulated sector, would effectively facilitate remittance flows while preserving their integrity.

Policies to reduce remittance costs

Measures to reduce remittance costs should aim to improve the efficiency of remittance transactions by (a) enhancing market competition to reduce high profit margins; (b) helping remittance service providers' access to new payments technology; and (c) devising ways to encourage remitters to send larger amounts (table 6.5). As a way to enhance competition, governments can encourage postal systems and other state-owned distribution alternatives to open their networks to multiple MTO partnerships on a nonexclusive basis. In addition, they should avoid overregulation, excessive monitoring, or reporting requirements that could drive out smaller competitors that lack the economies of scale to absorb the cost of compliance.

Developing a shared network would be a powerful way to increase competition. Cooperation on infrastructure and competition in service provision would allow network benefits to accrue to the consumer.¹⁹ The technology required to set up a payment-processing infrastructure with large capacity is no longer an expensive proposition. A functioning payment infrastructure could be extended to a new country at a minimal cost and in a matter of weeks.²⁰ There have been some attempts to set up shared networks in the remittance-source countries (for example, the United States–Mexico FedACH system, box 6.4). Also some governments in remittance-receiving countries have facilitated the establishment of payment networks that are shared by savings banks, credit unions, and microfinance institutions operating in poor and remote areas (for example, BANSEFI in Mexico²¹ and Apex Link in Ghana).²²

Table 6.5 Policies to reduce costs, regulate informal providers, and provide remittance-linked financial services

	Source country	Recipient country
<i>Reducing costs</i>		
Increase competition	X	X
Avoid exclusive arrangements	X	X
Harmonize regulation and capital requirements (same policy for all players)	X	
Introduce and harmonize electronic payment systems (card-based products)	X	
Improve data on corridors	X	X
Voluntary code of conduct	X	X
Bundling of transactions	X	X
<i>Regulating informal providers</i>		
Make formal sector operations more convenient and user friendly	X	X
Improve banking access	X	X
<i>Leveraging remittances</i>		
Improve banking access	X	X
Encourage microfinance institutions and credit unions to provide remittance services	X	X

Another way to address the issue of high fees in the remittance industry would be to develop best-practice guidelines for remittance service providers. Several such guidelines have been issued by Credit Union National Association, Inter-American Development Bank, and World

Savings Bank Institute, which urge service providers to disclose fees, exchange rates, and the time of delivery. At the end of 2004, the World Bank and the Bank for Committee on Payment and Settlement Systems (CPSS) set up a task force, with participation from the IMF, to develop voluntary principles for remittance service providers, regulators, and supervisors for improving transparency in the market (box 6.5).²³

Such guidelines would have to be voluntary. Central banks generally are not willing to impose such guidelines or to cap remittance fees and foreign-exchange commissions. A recent survey (de Luna Martinez 2005) revealed that in only 9 of 40 countries—Brazil, Bulgaria, Indonesia, Pakistan, Philippines, Russian Federation, Thailand, Tunisia, and República Bolivariana de Venezuela²⁴—did central banks even have the legal power to do so. All 40 central banks indicated that even if they had the power to limit fees, they would not do so, preferring to leave fee-setting to financial institutions in response to market competition.²⁵

Raising consumer awareness through financial literacy efforts and publicizing information on costs (as Mexican authorities have done through the PROFECO initiative) will strengthen competition among remittance service providers. In April 2005, Britain's Department for International Development

Box 6.4 United States–Mexico FedACH

United States–Mexico automated clearinghouse was created as part of the U.S.–Mexico Partnership for Prosperity to reduce the cost of sending remittances between the two countries. In 2002, the central banks of the United States and Mexico undertook a cooperative effort to link their automated clearinghouse (FedACH) systems. The cross-border service began operating in February 2004. Today, approximately 23,000 payments are sent from the United States to recipients in Mexico through this channel each month. The cost of a remittance transaction is just \$0.67; the exchange-rate spread is only 0.21 percent. Since July 2005, the cross-border

service has made funds available to a recipient on the first business day after a payment is originated.

But FedACH has not been as popular with the banking community as was expected. It suffered from some technical weaknesses—for example, insufficient coding flexibility for certain remittances. Also, major international banks that earn significant remittance fees from their own proprietary payment systems and from foreign-exchange commissions have been slow to join FedACH. And other cross-border ACHs between the United States and Canada and between the United States and Europe have had similar difficulty attracting participation from banks.

Box 6.5 The World Bank/CPSS task force on general principles for international remittance systems

At the end of 2004, the World Bank and the Bank for International Settlements' Committee for Payment and Settlement Systems (CPSS) convened a task force, with members from central banks of sending and receiving countries, international financial institutions, and development banks, to address the need for international policy coordination in remittance systems. The task force is expected to issue

general principles for international remittance systems in the first half of 2006. The purpose of the principles is to promote a sound, efficient, and competitive market in remittance services. The recommendations of the task force are expected to cover market environment, consumer protection and transparency, market infrastructure, and public policy.

(DFID) launched a website that provides information on remittance costs and options in several countries.²⁶

Assisting remittance service providers to adopt new payment systems technology and instruments would help lower their service costs. Some technologically advanced methods of sending transfers already exist. Card-based instruments, such as stored value cards (similar to phone cards), credit cards, and debit cards, are now frequently used to send remittances to urban locations that have access to card-processing machines. Systems such as iKobo.com use the Internet to make remittances. PayPal and other services move money between virtual accounts, although they do not (yet) focus on immigrants' transfers. Similar technology has been adapted by an operator in the Philippines to send fast—and reportedly cheap—remittances using a cell phone (box 6.6).

Migrant workers need easier access to the formal financial system

Improving migrant workers' access to banking services could reduce transaction costs, and at the same time, help to develop the financial system in the countries where remittances are received. Sending and receiving countries alike could support migrants' access to banking by providing them with the means to establish their identity.

In receiving countries, the factor that exerts the greatest effect on remittance costs (and on

the choice of remittance channel) is the reach of the remittance agent's distribution network. Recipients in rural areas underserved by banks may have to pay high costs for receiving remittances, especially through formal channels. Partnerships between remittance operators and institutions that have wide networks in rural areas (such as post offices) would help reduce such costs.²⁷ In countries where residents are allowed to hold foreign currency deposits, permission to deliver remittances in U.S. dollars (or the same foreign currency sent by the remitter) would significantly reduce (if not eliminate) the exchange rate spread on remittances (as seen in the case of dollarized economies such as El Salvador).

Remittances and financial institutions

Banks and smaller financial institutions, such as credit unions and microfinance institutions, can deliver convenient and possibly low-cost, remittance services in developing countries, especially in rural areas. In contrast to cash transactions, remittances channeled through bank accounts may encourage savings and enable a better match for savings and investment in the economy. Remittances, in turn, can be used to support business and consumer loans, insurance, and other financial products for remittance recipients.²⁸ Some institutions are exploring ways to target remittances to specific uses such as school fees or medical

Box 6.6 Smart's phone-based remittance system in the Philippines

The largest mobile phone company in the Philippines, Smart Communications, has developed an innovative remittance system based on cell-phone text messaging. Cell phones are widespread in the Philippines, in use by at least 30 percent of the 84 million Filipinos. A standard Smart remittance works like this: A Filipino in Hong Kong, China, deposits money to be remitted with one of Smart's remittance partners, which then sends a text message to the beneficiary in the Philippines, informing him or her of the transfer. The remittance is credited into a Smart Money "electronic wallet" account by any Smart mobile customer. The money can be withdrawn from an ATM using the Smart Money cash card, which can also be used as a debit card for purchases. Smart's partners in the Philippines—among them McDonald's, SM malls, SeaOil gas stations, 7-Eleven

stores, and Tambunting pawn shops—will also pay out cash to Smart customers.

Smart has already formed remittance partnerships with Travelex Money Transfer; Forex International Hong Kong; Dollar America Exchange in California; CBN Grupo in Greece, Ireland, Japan, Spain, and the United Kingdom; New York Bay Remittance; and Banco de Oro Bank in Hong Kong, China.

The system's simplicity keeps fees down. Fees at origination vary from country to country. In Hong Kong, China, it is about \$2. In the Philippines, it is 1 percent plus the cost of the text message.

The Smart system also appears to be secure. The use of different PINs for the cell phone and the Smart account make it difficult for a thief to access the funds. An ID is required when collecting cash.

bills. Others are exploring insurance products, for example, to ensure a stable flow of income to the remittance beneficiary in the event that the sender suffers an income shock.

Credit unions in El Salvador, Guatemala, Honduras, Nicaragua, Mexico, and Jamaica that are members of the World Council of Credit Unions (WOCCU) encouraged WOCCU to establish the International Remittance Network (IRnet) in July 1999 to facilitate remittance flows from the United States to Latin America. That initiative has lowered remittance costs by raising customer awareness of remittance fees and by generating some competition in the remittance market. To send up to \$1,000, IRnet charges a flat \$10—much less than the fees charged by major MTOs. Besides fee income, IRnet institutions hope to use remittances to build relationships with customers. It is reported that 14–28 percent of nonmembers who visited WOCCU-affiliated credit unions to transfer funds eventually opened an account; 37 percent of credit union members saved a part of their remittance receipts (Grace 2005).

Smaller nonbank financial institutions face challenges in entering the remittance market because of regulatory constraints—such as licenses for transactions involving foreign exchange and access to national payment systems. For prudential reasons, access to payment and settlement systems is typically restricted to well-capitalized and well-established banking institutions. Microfinance institutions and smaller institutions generally must enter into corresponding banking relationships with commercial banks²⁹ and with international remittance providers (such as the IRnet or the major MTOs).

A survey of central banks found that 35 of 40 developing-country authorities were not enthusiastic about allowing small financial institutions to have access to clearing and settlement systems (de Luna Martinez 2005). Central banks appear to believe that most nonbank financial institutions in developing countries lack the technological infrastructure required to participate directly in clearing and settlement systems. Also, central banks believe that giving nonbank financial institutions direct access to

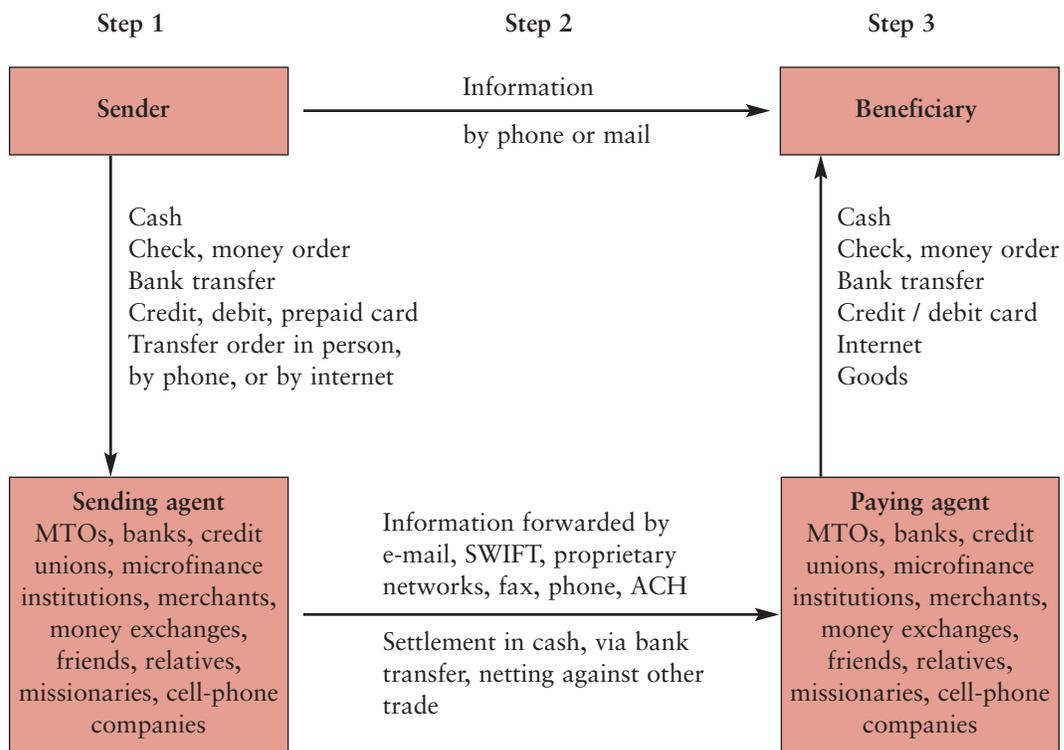
central banks' clearing and settlement systems may not help reduce the remittance fees charged by those institutions. According to the survey, only five countries—Azerbaijan, Belarus, Bolivia, Philippines, and Thailand—are contemplating granting access for clearing and settlement systems to a few large nonbank financial institutions (mostly post offices).

Even if microfinance institutions were to offer remittance services, they might face restrictions on taking deposits and offering loan and insurance services, again for prudential reasons. Given these constraints, sources of funds for such institutions tend to be expensive and their capacity to offer financial products limited.

Annex 6A.1 A stylized remittance transaction—structure, players, instruments

A typical remittance transaction takes place in three steps: (1) initiation of remittances

by a migrant sender using a sending agent, (2) exchange of information and settlement of funds, and (3) delivery of remittances to the beneficiary. In step 1, the migrant sender pays the principal amount of the remittance to the sending agent using cash, check, money order, credit card, debit card, or a debit instruction sent by e-mail, phone, or Internet. In step 2, the sending agency—which may be an MTO, bank, or other financial institution, money changer, or merchant (gas station, grocery store)—then instructs its agent in the recipient's country to deliver the remittance. In step 3, the paying agent makes the payment to the beneficiary. In most cases, there is no real-time fund transfer; instead, the balance owed by the sending agent to the paying agent is settled periodically according to a mutually agreed schedule. Settlement usually occurs through commercial banks acting through the national clearing and settlement system. A portion of informal remittances is settled through goods trade.



Annex 6A.2 Licensing and registration requirements for remittance service providers

Country	Net worth(\$)	Audited financials required?	Bond	Comment
United States²⁷				
California	Min. \$500,000 in equity	If available	Discretionary depending on size of business. Min. \$200,000.	Fee \$5,000 plus \$50 per agent
Florida	100,000 plus \$50,000 per location up to \$500,000	Yes	1% of annual turnover, max \$250,000; can be set at \$500,000 in exceptional circumstances; may be waived upon request	Application fee \$500 plus \$50 per agent; renewal \$1,000 plus \$50 per agent up to \$20,000.
Illinois	Depending on locations: 1 = \$35,000 25+ = \$500,000	Yes	Greater of \$100,000 or the average daily outstanding for 12 months, maximum \$2,000,000	Fee \$100 Licensing + \$100 \$10 per location; \$100 renewal
Massachusetts	None	No	\$50,000 (or 2x amount of outstanding transactions)	Fee \$250
New Jersey	(1) Min. \$100,000 plus \$25,000 per location (or agent) in NJ up to \$1,000,000 (2) \$50,000 for foreign money transmitter plus \$10,000 per location (or agent) up to \$400,000		(1) Not less than \$100,000 and not more than \$1,000,000 (2) Foreign remitters: depending on business volume, \$25,000 to \$100,000; commissioner may require up to \$900,000 In general: investments not less than outstanding payment instruments; this can be waived by the commissioner	Application fee \$1,000 Licensing fee up to \$4,000 Biennial fee \$25 per location up to max. of \$5,000
New York	Liquidity equivalent to outstanding payments	Yes, 2 years	\$500,000 unless the superintendent lowers the amount	Fee \$500 Licensing + \$1,000 investigation.
Pennsylvania	\$500,000		\$1,000,000	Application fee \$1,000 Renewal fee \$300
Texas	\$25,000 per location up to \$1,000,000	Yes	\$100,000 for first location, \$50,000 for each additional, max. \$400,000	Fee \$500 licensing + \$2,500 investigation fee
Virginia	\$100,000–\$1,000,000 as determined by the commission		\$25,000–\$1,000,000 as determined by the commission	Licensing fee \$500 Renewal fee \$750
Wisconsin	“Suitable to conduct business” Should not be lower than \$10,000	No	\$10,000 for 1st location + \$5,000 for each additional Max. \$300,000	Fee \$500 license (annual) + \$300 investigation + \$5 per location (annual)
Canada	None	No	None	Reporting threshold: Can\$3,000 STR and CTR above Can\$10,000
France	Min. €2,400,000 plus capital to cover first year's expenses	Yes, 3 years	None	Full bank license; the ownership structure must be adequate AML procedures scrutinized
Germany (federal legislation)	€125,000 capital Net worth must be sufficient to cover exposures	Yes	None	Reporting threshold: €2,500 STR; AML laws must be followed; 2 managing directors must have suitable backgrounds

Annex 6A.2 (continued)

Country	Net worth(\$)	Audited financials required?	Bond	Comment
Italy	€750,000	Yes	None	Reporting threshold: €12,500 STR; the license is only required by the service provider, not by his agents
United Kingdom	None	No	None	Register normal business; Moneys may not be held for more than 3 days, as a bank license (deposits) would be required in this event

Source: For United States, www.rubinsanchez.com; Canadian Bankers Association; French Central Bank, Banque de France, Comité des Etablissements de Crédit et des Entreprises, d'Investissement (CECEI), Committee for Credit Institutions and Investment Companies; German Financial Supervisory Board, Bundesanstalt für Finanzdienstleistungsaufsicht; Italian Law 106; Bank of England.
Note: Licensing and registering approaches may differ. See FATF Typologies Report (FATF 2005). STR = suspicious transaction report; CTR = currency transaction report; SAR = suspicious activity report; AML = anti-money laundering.

Annex 6A.3 A brief history of some remittance service providers

This annex describes the historical role of three key providers of remittance services—Western Union, MoneyGram, and Bank of America. The intention is to shed light on their business strategies.

Western Union

Western Union descended from the New York and Mississippi Valley Printing Telegraph Company, originally formed by a group of businessmen in Rochester, New York, in 1851. The Western Union Telegraph Company was subsequently formed in 1956 following the acquisition of several competing telegraph systems. Having completed the first transcontinental telegraph line by 1861, the telegram network started providing the Western Union Money Transfer service nationally by 1871.

Historically, Western Union has been involved in a wide range of telecom and other products. These included introducing the New York Stock Exchange stock ticker in 1866, offering a nationwide standard time, introducing teletypewriters in 1923, offering the

first intercity fax service, and launching the telex. It also launched the first domestic communications satellite, Westar I in 1974.³⁰ Today, Western Union is primarily a remittance company.

Western Union has always followed the strategy of developing its own proprietary products. For money transfers, Western Union has developed its own software and network of exclusive agents. It has been able to develop this network by being the first truly global remittance company. Currently its network comprises slightly more than 220,000 locations in about 195³¹ countries (including the network of its subsidiary Orlandi Valuti). The growth rates in Western Union's international remittance transactions (excluding Mexico) were 32 percent, 25 percent and 24 percent for the years 2002, 2003, and 2004, respectively.

MoneyGram

The MoneyGram money transfer service was started in 1988 by Integrated Payment Service, a U.S.-based division of First Data Corporation (FDC), a data processing company owned by American Express at the time

of inception.³² FDC divested its MoneyGram operation in December 1996 through an initial public offering of its common stock to comply with the company's agreement with the Federal Trade Commission as part of a merger with FPMC.

In 1998, Travelers Express, a division of Viad Corp. acquired MoneyGram. On June 30, 2004, the Travelers Express business was spun off from Viad Corp.,³³ and became an independently traded company called MoneyGram International, Inc. Travelers Express and MoneyGram Payment Systems, Inc. continue as operating companies under this new corporate umbrella.

Whereas Western Union insists on a strategy of exclusive partnership with its agents, MoneyGram allows its agents to represent other remittance companies as well, as shown by its partnership with the World Council of Credit Unions and Bancomer Transfer Services.

Bank of America

Bank of America (BoA) was established in 1929 as an outgrowth of the merger between the Bank of Italy and the Bank of America, Los Angeles. California became the fastest-growing state after World War II, with the highest use of checking accounts. To cope with the transaction volume, the bank invested heavily in information technology and is generally credited, together with GE and SRI, with inventing modern centralized bank operations; BoA has a number of financial transaction processing technologies, such as automatic check processing, account numbers, and Magnetic Ink Character Recognition (MICR), and, based on these technologies, credit cards linked directly to individual bank accounts. Because of the efficiency of these technologies, BoA had significantly lower administrative costs than other banks and was able to expand further, until it was the world's largest bank by the early 1970s.

In 1959, BoA invented the bank credit card, the BankAmericard, which changed its name to VISA in 1975. A consortium of

other California banks founded MasterCard (now MasterCard) in order to compete with the BankAmericard.

BoA offers remittance services along with regular savings and loan products to its customers. It has a banking relationship with 44 percent of all Hispanic households; it opened more than 1 million checking accounts for Hispanic customers in 2004. The bank offers remittances under the SafeSend brand to its customers wishing to send money to Mexico. In early 2005, it announced that it would eliminate the \$10 transfer fee for all checking account holders for remittances from the United States to Mexico to attract new business from migrant customers.

Notes

1. Western Union reports an average fee of 6–8 percent and an additional foreign exchange spread of 2 percent on its global remittance services. The average size of a Western Union remittance (covering personal remittances as well as small business-to-business remittances), however, is around \$700, much higher than the average transaction size (under \$200 reported in household surveys of migrants by, for example, a Pew Hispanic Center study on Mexican migrants in the United States and a Genesis Analytics study on South Africa). A World Bank survey of African diaspora in Belgium found that the average monthly remittances were 154 euros in the case of Senegalese migrants, 126 euros for Nigerian migrants, and only 78 euros for Congolese migrants.

2. For example, if a Brazilian bank received remittances on October 11, 2004, delayed payment to the beneficiary for two weeks, and invested the funds in the overnight money market, it would earn a float of 2.85 percent (IOM 2005). Humphrey, Keppler and Montes-Negret (1997) note widespread use of floats by banks, especially in the Russian Federation.

3. Some banks have announced even more aggressive price cuts recently. Bank of America, for example, eliminated fees for United States–Mexico remittances, to attract customers from the Mexican migrant community. Banks have also been providing free remittance services in some other corridors as well. It is worth noting, however, that there are hidden fees—account maintenance fees, minimum balance requirements, taxes on interest income—involved in such transactions besides the cross-selling of loan and deposit products.

4. According to the Piper Jaffray *Global Money Transfer Report* (2005), Western Union has said that it

can add a new agency for \$1,000–\$1,500 (the cost of setup, terminal, software, and training), while Dolex requires \$12,000–\$15,000 to establish a new branch.

5. In the case of banking institutions (also gas stations and grocery stores), remittance services may be cross-subsidized by other product lines, which renders remittance costs hard to determine.

6. The leading MTOs are Western Union, with a reported 13 percent market share, and MoneyGram, with a 3 percent market share. Vigo and Dolex are the third and fourth largest MTOs, respectively, with about a 2 percent combined market share. See Aite (2005) for their U.S. market shares.

7. Western Union has sustained high margins by taking the initiative to enter underserved markets, building a strong distribution network, and leveraging its brand name. Overall, the company has provided remittance services to millions of individuals in previously underserved markets.

8. This methodology is similar to that suggested by Humphrey, Keppler, and Montes-Negret (1997) for pricing payment services. These calculations do not include the costs of advertising and security.

9. This analysis is less conclusive with respect to the sensitivity of remitters to exchange-rate commissions. Migrants do have fairly accurate knowledge of the exchange rate used by their remittance operator, but they may be less informed about the premium involved in this rate. The estimate of cost-elasticity from the New Zealand study is based on responses from a small random sample of new Tongan migrants to questions about how they would react to a potential change in costs. It was not based on actual reactions.

10. This example assumes no change in the exchange rate.

11. There is no standard definition of a retail payment. Here it is defined as a transaction originated by, or payable to, an individual, the counterparty being an individual, a firm, or a government agency. It also includes frequent, small-value business-to-business payments. See also BIS (1999).

12. As measured by the International Country Risk Guide, credit risk is based on foreign debt as a percentage of GDP, foreign debt service as a percentage of exports of goods and services, current account as a percentage of goods and services, the import cover of international reserves, and exchange-rate stability.

13. The regression that generated these results is based on remittance fees from a single large MTO, so the results are not representative of costs in the remittance industry as a whole. Also the low R^2 suggests that the regression does not fully explain the cost structure.

14. The remittance price estimates provided by Western Union and MoneyGram on their Web sites often differ from the actual transfer fees. For this study,

we gathered remittance price data by visiting Western Union and MoneyGram agents in Washington, New York, Brussels, Paris, London, and Singapore and by calling agents in other cities in various parts of the world. At various points, seven individuals were collecting remittance fee data in various corridors (for example, North America to Latin America and Asia, the EU to Africa and South Asia, the Gulf to South Asia, Eastern Europe to Central Asia, and East Asia to Southeast Asia). We collected daily foreign exchange data (for Western Union transfers to a broad range of countries from the United States and the United Kingdom and for Moneygram transfers from the United States to the same countries) on four consecutive business days in early June and calculated the FX spread by comparing these data to the exchange rates quoted on Bloomberg.

15. Lack of competition has been a persistent problem in this industry. In December 1996, MoneyGram was spun off from First Data Corporation, the holding company of Western Union, as part of an agreement with the U.S. Fair Trade Commission. See the annex for a history of remittance service providers.

16. In July 2005, the European Commission proposed that banks in the European Union be required to register the name, address, and bank account of anyone making an international money transfer. The requirements, which the commission hopes will come into force in January 2007, are the latest EU response to terrorism following the bombings in London on July 7, 2005.

17. OCC Advisory Letter 2004-7, www.occ.treas.gov/ftp/advisory/2004-7.doc.

18. Abuses include money laundering, the transfer of corrupt payments, payment of human smuggling fees, tax evasion, customs offenses, violations of currency controls, subsidy frauds, smuggling, illegal arms sales, and funding of terrorism. International trade is subject to many of the same abuses, but it is widely recognized that efforts to curb them must not interfere unduly with vital trade.

19. This is easier said than done, however, because major remittance service providers that have invested in their own proprietary networks and used them to expand their market share may not willingly share them. Furthermore, even if a shared network were developed with public funding, it may not easily gain participation by key banks and financial institutions (box 6.4). Federal Reserve Bank (2004, pp. 33–37) lists major proprietary payment networks.

20. Visa reported that in 2004 it set up a Visanet system in Iraq within eight weeks and for less than \$200,000 (Brocklehurst 2004).

21. BANSEFI has a commercial alliance (L@Red de la Gente) with 62 regulated saving banks and MFIs operating mostly in areas where commercial banks

have no presence. This network provides a common platform for collecting and distributing financial products; for example, it facilitates migrant remittances as well as government transfers for pension and social and education programs, and it offers savings accounts and mortgage and consumer loans, small business lending, and health insurance products to the poor. Its IT network is aimed at offering the advantage of scale economies to its members.

22. Apex Bank in Ghana was set up (with support from the government and the World Bank) to provide banking services in rural areas. The Apex Bank has developed Apex Link, a domestic funds-transfer scheme among 75 rural and community banks. The Apex Bank is also collaborating with some financial institutions for the payment of foreign inwards remittances through the rural and community banks to beneficiaries in the rural areas.

23. The International Remittance Protection Act proposed by U.S. senator Paul Sarbanes in September 2004 marks an effort to improve disclosure of fees and exchange-rate commissions in remittance transactions.

24. In the European Union, the fees that financial institutions charge their customers for money transfers between EU countries cannot be higher than the fees charged for domestic money transfers.

25. In some cases, consumer rights legislation has enabled customers to challenge price gouging. In 2002, Western Union paid \$30 million to settle two class-action suits stemming from its use of different exchange rates for converting remittances than the rates it received in the international money market (Aite 2005).

26. The related websites are www.profeco.gob.mx and www.sendmoneyhome.org.

27. For example, BANSEFI and Apex Link (as mentioned earlier).

28. This correspondent banking relationship between MTOs and some commercial banks, which had been working smoothly for a long time, came under pressure recently because of a misunderstanding of the know-your-customer rules. More than 300 small MTOs that collected remittances and then wired them through a correspondent bank were told in February 2005 that such transfers were no longer permitted. On March 30, 2005, FinCEN, FDIC, the Federal Reserve, and the Office of the Comptroller of Currency issued a joint statement that such transactions were indeed legitimate.

29. Source: www.rubinsanchez.com, representing the legislations for the different states of the United States.

30. Historical data on Western Union from www.westernunionalumni.com/history.htm.

31. PR Newswire, February 1, 2005.

32. See www.sec.gov/divisions/investment/noaction/firstdata011304.htm. In 1992, AmEx and First Data completed an initial public offering that resulted in approximately 40 percent of the common shares of First Data being held by the public. Over the next five years, AmEx sold its remaining shares to third parties, and by 1997 AmEx had no reportable ownership interest in First Data.

33. Source: www.MoneyGram.com.

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