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DIRECTIONS IN DEVELOPMENT

Migrant Labor Remittances in South Asia

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1 2 3 4 08 07 06 05

ISBN-10: 0-8213-6183-X
ISBN-13: 978-0-8213-6183-2
eISBN-10: 0-8213-6184-8
DOI: 10.1596/978-0-8213-6183-2

Library of Congress Cataloging-in-Publication Data

Migrant labor remittances in South Asia / Samuel Munzele Maimbo ... [et al.].
p. cm – (Directions in development)
Includes bibliographical references and index.
ISBN 0-8213-6183-X
1. Emigrant remittances—South Asia. 2. Alien labor, South Asian—Arab countries. 3. Banks and banking—South Asia. 4. Infrastructure (Economics)—South Asia—Finance. 5. South Asia—Economic conditions. I. Maimbo, Samuel Munzele. II. World Bank. III. Directions in development (Washington, D.C.)

HG 5720.3.A3M54 2005
332.1'78—dc22

2005043744

Migrant Labor Remittances in South Asia

Acknowledgments

This study was prepared by a World Bank team led by Samuel Munzele Maimbo under the overall guidance of the South Asia Regional Initiatives Progam Team, notably Alastair McKechnie and Ejaz Syed Ghani, and the South Asia Finance and Private Sector management of Joseph Del Mar Pernia and Simon C. Bell.

The peer reviewers, from whom the contributors benefited greatly, were Leora Klapper, Dilip K. Ratha, and John Wilson. Kazi Iqbal and Karina Karaan provided research assistance, and excellent administrative support was provided by Maria Marjorie Espiritu.

The study draws on numerous interviews with public and private sector officials from selected South Asian countries. We are thankful to them all for their candid opinions, comments, and suggestions.

As authors of an exploratory study of this nature, whose primary objective is to highlight the key policy discussion issues about remittances rather than an exhaustive paper on the subject as it affects every country in the region, we take full responsibility for failing to account for all the fascinating remittance innovations that are rapidly emerging in the region.

Abbreviations and Acronyms

ACH	automated clearing house
AML	anti-money laundering
ATM	automated teller machines
BMET	Bureau of Manpower, Employment, and Training
BOESL	Bangladesh Overseas Employment and Services, Ltd
CTF	counter-terrorist financing
CIRC	Corporate and Industrial Rehabilitation Corporation
FDI	foreign direct investment
GDP	gross domestic product
IMF	International Monetary Fund
IT	informational technology
LSMS	Living Standards Measurement Survey
MSBs	money service businesses
NFTS	Nationwide Funds Transfer System
NRFC	nonresident foreign currency
NRH	nonreceiving household
NRIs	nonresident Indians
NRPs	nonresident Pakistanis
ODA	overseas development assistance
OPF	Overseas Pakistanis Foundation
POSB	Post Office Savings Bank
RBI	Reserve Bank of India
RRH	remittance-receiving household
SAR	South Asia Region
SBI	State Bank of India
SBP	State Bank of Pakistan
SLBFE	Sri Lanka Bureau of Foreign Employment
UAE	United Arab Emirates
VSAT	very small aperture terminals

Executive Summary

Bangladesh, India, Pakistan, and Sri Lanka have all experienced a sharp increase in remittances during the past decade. At the end of 2003, Bangladesh, India, Pakistan, and Sri Lanka were all among the top 20 receivers of remittances, with estimated receipts of US$3.2 billion, US$17.4 billion, US$4.0 billion, and US$1.3 billion, respectively (table 1; a billion is 1,000 million).

This paper provides a strategic overview of key issues relating to the remittance industry in the South Asia region.

The paper builds on recent World Bank research on remittances that prominently features the South Asia region.[1] Rather than duplicate that work, this study focuses only on the region's distinguishing characteristics, namely:

- A large migrant population of semiskilled and unskilled workers largely concentrated in the Persian Gulf countries, particularly Saudi Arabia and the United Arab Emirates, contributing to rising remittance flows
- The presence of dedicated public institutions and government financial incentives aimed at facilitating and providing support for temporary migration and remittance inflows

Table 1 Workers' Remittances (US$ billions)

	1999	*2000*	*2001*	*2002*	*2003*
Total	14.0	16.0	15.9	21.4	25.9
Bangladesh	1.8	2.0	2.1	2.8	3.2
India	11.1	11.7	11.1	13.7	17.4
Pakistan	0.1	1.1	1.5	3.6	4.0
Sri Lanka	1.0	1.2	1.2	1.3	1.3
Total, as a % of GDP	2.6	2.7	2.6	3.4	3.5
Bangladesh	3.9	4.2	4.5	6.0	6.1
India	2.5	2.6	2.3	2.7	2.9
Pakistan	1.7	1.8	2.5	6.0	5.8
Sri Lanka	6.8	7.1	7.5	7.9	7.1

Sources: Authors' calculations based on IMF, *Balance of Payments Statistics;* World Bank, *World Development Indicators.*

- The existence of large state bank branch networks with immense potential for a more effective and efficient remittance financial market
- The widespread use of trade-related informal remittance channels by both legal and illegal migrants

The Development Impact of Remittances

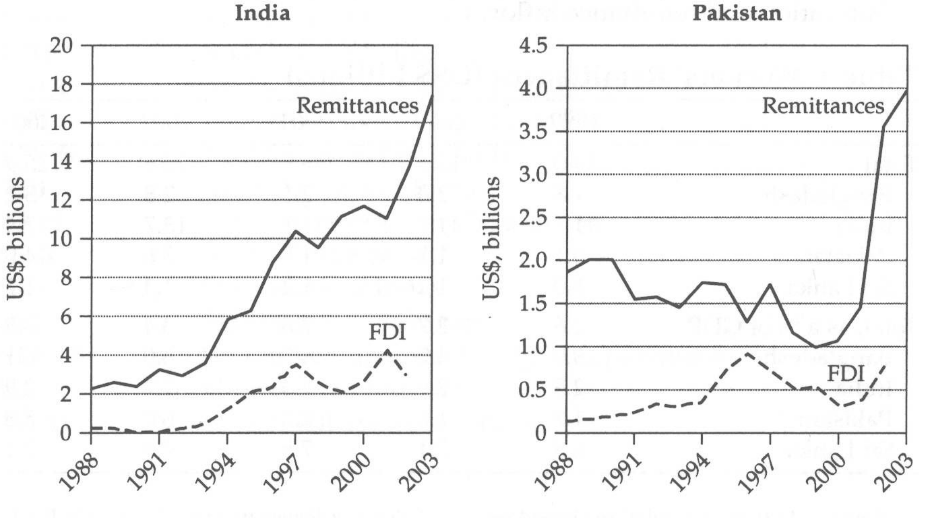
That this increase in the quantity of remittances is taking place at a time of declining overseas development assistance (ODA) flows to the region is of additional importance. Interest in the development impact of remittances has increased because they continue to be the largest financial flow to the region after foreign direct investment.

The increase in remittance volumes has renewed academic and public policy interest in their potential to reduce poverty and economic vulnerability, improve family welfare, and stimulate local economic development in the face of much lower, sometimes temperamental, foreign direct investment flows (figure 1).

Despite this increasing interest, the specific development impact of remittances is still unclear and requires further research and debate. The following questions are particularly important:

- What proportion of remittance monies is spent on consumption versus investment? Does the proportion vary with the income and educational level of the remittance-receiving family?

Figure 1 Worker Remittances and Other Inflows



Source: Authors' calculations based on World Bank data.

- What kinds of productive investment activities are remittances spent on? How does this vary by setting (urban or rural), and by district, region, or country?

Addressing the questions listed above is methodologically challenging because of three factors. The most important of these is that remittance income is fungible; that is, remittances can be spent on anything. This makes it very difficult to associate remittances with any specific changes in household patterns of consumption or investment. Second, remittances have multiple effects on the local economy. For example, an increase in the volume of remittances in a community may lead to higher spending on housing, which in turn helps to generate more income and employment opportunities for unskilled construction workers. Third, a robust theoretical and analytical framework for determining the development impact of remittances is largely absent. Because remittance research is often based on data collected at just one point in time, it is difficult to measure how remittances change patterns of investment over time.[2]

This study analyzes the impact of international remittances on poverty using a growth-poverty model. This model, which has been used by a host of poverty researchers,[3] assumes that economic growth—as measured by increases in mean per capita income—will reduce poverty.

The results are interesting. The analysis finds that, when the estimated values for unofficial remittances are added to official remittance figures, total remittances (official and unofficial) reduce the level of poverty in South Asia. On average, the point estimates for the poverty headcount measure suggest that a 10 percent increase in total remittances (official and unofficial) will lead to a 0.9 percent decline in the level of poverty in South Asia. This means that for a "representative" country where exactly one-half of the population lives below the poverty line, a 10 percent increase in total remittances (official and unofficial) will bring the proportion living in poverty down to about 0.48 percent.

The Public Infrastructure for Remittances

All the countries in the region have taken active steps to support the migration of their nationals. The public infrastructure to support the search for employment abroad, the migration of successful applicants, and their subsequent stay is, in principle, in place. In all four countries, the public infrastructure includes emigration legislation, government ministries and departments, and a plethora of incentives for nonresident nationals.

- *Legislation:* Legislation such as the Emigration Act of 1983 (India) and the Emigration Ordinance of 1979 (Pakistan) form the legal basis for today's migration practices and influence the ease and convenience of

dealing with the resulting government ministries and departments. These provide the basis for the support governments provide to premigrants, migrants, and returnees.
- *Government departments:* The Bureau of Manpower Employment and Training (Bangladesh), the Bureau of Emigration and Overseas Employment (Pakistan), and the Bureau of Foreign Employment (Sri Lanka) provide a range of pre- and postmigration services and facilities. For first-time migrants in particular, premigration training, visa application processing, and other services are highly prized. However, these bureaus have a mixed record in terms of their effectiveness and efficiency. The lack of resources limits their outreach and the types of services that they offer. As government institutions, perceptions of bureaucracies persist even where corrective actions have been undertaken.
- *Incentives:* The most notable government actions directed toward migrants have been the plethora of incentives that have been announced in successive budgets that specifically target migrants. These incentives include special access to the merit-based quota system assigned in all public professional colleges and universities; generous duty-free import limits for items of personal convenience; preferential allocation of investment opportunities such as initial public offerings to be subscribed in foreign currency; eligibility for special lotteries such as those for prime plots in public housing schemes at attractive prices; and tax exemptions.

Consistently improving the effectiveness of the public infrastructure will substantially aid the development impact of remittances.

Formal Financial Institutions

There are several types of formal financial institutions that dominate the official remittances market in the region.

State Banks

The South Asian remittances market is unique for the presence of an extensive branch network of state commercial banks. These banks have long dominated the official remittances business through monopolistic national foreign-currency legislation and large bank branch networks.

Today, for example, India has over 32,000 rural commercial bank branches; Bangladesh has four nationalized banks with at least 3,346 branches in total; and Sri Lanka's largest state bank alone has 326 branches, 81 counter services, and 188 pawning centers. Physically, the infrastructure for an active far-reaching remittance network is already present. The challenge lies in making it more effective and efficient for that purpose.

Foreign Banks

Foreign banks have also noted the huge remittance potential in the region. Previously reluctant participants, they are slowly investing in this business, albeit largely for the higher-income migrants—doctors, accountants, lawyers, and other professionals. Foreign banks have hitherto largely been inhibited by their limited branch networks, which are primarily centered in major cities. They have been careful about heightened anti-money laundering and counter-terrorist financing standards, and concerned about the changing remittance business model.

Profits from remittance transactions have been declining. The removal of foreign exchange controls, the competition from money transfer companies, and the pressure to make even speedier deliveries have reduced exchange gains, pushed down upfront commissions, and minimized the potential interest gains from cash floats.

Local Banks

It is largely the local banks that are taking the lead in the remittance service market. Investing heavily in various remittance application technologies—credit cards, debit cards, Internet banking, and telebanking—the local banks are surely changing the nature of the remittance market.

The increase in the number of automated teller machines (ATMs) has been impressive. In Sri Lanka for example, the total number of ATMs operated by commercial banks increased to 705 at end of 2003 from 622 at end of 2002. In Pakistan one ATM network has over 392 ATMs in 26 cities; the other has 130.

Yet the true potential for the ATMs to act as a remittance conduit or platform is yet to be realized. The majority of ATM transactions are only customers withdrawing cash from their own accounts. Only a limited number of transactions are customers using ATMs other than those installed by their own banks. Until this happens more frequently, the possibility of using the networks for remittance purposes will remain limited.

Money Service Businesses

The strongest remittance competition in the market comes from the emergence of licensed money service businesses (MSBs)—nonbank financial institutions that accept cash, checks, or other money instruments, or "stored value," in one location and pay the equivalent amount in another.

Leading MSBs such as Western Union and Money Gram have extensive agent locations in the region that support their operations. However, Internet-based businesses such as e-exchange and Remit2India are having a positive impact on the way business is managed.

Post Offices

In the wake of declining traditional postal business, post offices in the region are exploring the possibility of participating in the remittance business more actively. Long used to delivering money orders to rural families, post offices are now investing in electronic money orders, partnering with money service businesses, and investing in Internet-based technology.

The potential benefits for postal involvement are substantial. With 154,149 post offices and 554 sorting offices, India Post has the most extensive postal retail network in the world. Sri Lanka Post has 625 main post offices, 3,423 sub–post offices, and 632 agency post offices.

However, as long as the postal systems are plagued with operational losses, the absence of management information systems, limited access to funds for investing in technology, and negative publicity—such as stories of insufficient cash on hand and delays in effecting payment—client demand and usage will remain low. Reliability, credibility, and efficiency are essential ingredients to a remittance business.

Informal Financial Institutions

Informal remittance systems—courier services, in-kind remittances, and *hawala* systems—have a long history in the region. Originally developed at a time when conventional banking instruments were either absent or weak, informal channels offered a speedy, low-cost, convenient, accessible, and (when necessary) anonymous option.

- *Courier services:* These are the simplest and oldest way of moving value in the region. Physical transfer of cash by migrants either on their own behalf or on behalf of others is said to be high. This is not unique to the region, as such transfers are still observed in other regions.
- *In-kind remittances:* Some migrants choose to invest in durable goods such as refrigerators, stoves, televisions, VCRs, and other valuable commodities such as gold or precious stones, which they send to their families for sale or personally carry home at the end of their contracts.
- *Hawala:* Also referred to as *hundi* or *chit*, *hawala* systems owe their popularity to the long history of trade in the region. *Hundi*, a form of bill of exchange or promissory note, was used in the region before the advent of modern banking. The interface between traders and *hawala* dealers also owes much to the region's traditionally complex framework of regulating import and export transactions. Until very recently burdensome legislation regarding international payments, rebates, refunds, and other financial payments encouraged the use of informal alternatives.

Overall, migrants use informal systems for a variety of reasons, particularly their reliability, lower cost, speed, convenience and accessibility, and for some the anonymity that informality can provide users and recipients alike.

Stongly based in trust and rooted in age-old cultural traditions, informal systems deliver cash much faster than conventional banking systems at a much more cost-effective rate. Importantly, the convenience of door-to-door collection and delivery services is invaluable to migrants working long shifts and recipient families in communities with absent or weak formal financial services.

Unfortunately, the informal system's success—speedy transactions with minimal or no documentation—has also been its undoing. The anonymity associated with such transactions has long raised concern with law enforcement communities. This has led some countries to issue an outright ban on these systems; others have proceeded to or are considering issuing new regulations in an effort to improve the transparency of the sector.

Conclusion and Recommendations

Remittances from migrant workers are increasingly important and are a stable source of external finance for countries in the South Asia region.

This preliminary analysis of migrant remittances to the region has been based on a review of widely dispersed data, documentation, and interviews. Its purpose is to stimulate and inform discussion on the role remittances play in the region and to help stakeholders design, develop, and implement appropriate policy. By exploring the actual and potential impact of remittances in the region, and the capacity of the public and private infrastructure to facilitate that impact, this study identifies opportunities for greater contributions.

With an extensive state and private bank network already in the region, a key component of the requisite building blocks for an effective remittance industry is already in place. However, much more needs to be done to maximize the network's full potential, including:

- *Shared payments systems platforms:* Greater investment in open architecture payments system information technology is required. Recipients should increasingly be able to receive remittances from any state or private bank branch or ATM machine, whether or not they hold an account with that institution. The potential for nonbank financial institutions, such as post office networks and money transfer businesses, to connect to banks' branches and technological advantages promises great potential for expedient, cost-effective remittance networks and services.

- *Public-private partnerships:* Strategic partnerships between the public and private sectors across infrastructure, products, and services are necessary for countries in the region that seek the types of gains attained elsewhere.
- *Cross-selling:* It is essential that, as the profitability of the conventional formal financial sector remittance business model continues to decline, formal financial institutions invest in cross-selling complementary financial services and products. Encouraging recipients to open and maintain bank accounts that might lead to short- and long-term auto and housing loans, for example, should be part of a business strategy for banks.

In the long run, strengthening the formal financial sector for remittance purposes will facilitate the move away from informal remittance systems, which, though beneficial to the direct users, may not have as effective an impact on the macro level as formal remittance transfers.

High transaction costs, long delays in transferring remittances, foreign currency controls, and overly bureaucratic policies and procedures for simple money transfers have no place in a vibrant and still-growing remittance industry.

Notes

1. See El-Qorchi, Maimbo, and Wilson (2003); Ratha (2003, 2004); Maimbo (2003).

2. For example, using data collected in a series of 14 interviews with 469 households in rural Pakistan over a five-year period (1986–7 to 1990–1), Adams (1998) found that the availability of remittance income helps to increase investment in rural assets by raising migrant households' marginal propensity to invest. Contrary to the common notion that remittances are primarily used for consumption, the results suggested important statistical effects on the accumulation of rural assets. This is because households receiving remittances tend to treat them as transitory income, and the marginal propensity to invest transitory income is higher than it is for total labor income (excluding remittances and rental income).

3. See, for example Ravallion (1997) and Ravallion and Chen (1997).

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1
International Remittances: Impact, Policy, and Costs

As volumes of international remittances have swelled, policy makers have become increasingly concerned with their impact on poverty and economic development. Over the past decade, the literature on the macro- and microeconomic implications of migrant remittances has grown with the financial flows. Only recently, however, has that research taken decidedly regional and global perspectives.

In a much-quoted study of remittances, Ratha (2003) underscored the importance of remittance flows for developing countries and delineated their regional patterns. In a follow-up study, Ratha (2004) observed that workers' remittances continued to rise in 2003 to an estimated US$93 billion, up from US$88.1 billion in 2002. Latin America and the Caribbean region continued to lead in the volume of remittance receipts—receiving US$30 billion, nearly a third of remittance flows to all developing countries. South Asia, East Asia, and the Pacific each received some US$18 billion, whereas Sub-Saharan Africa received just US$4 billion. Bangladesh, India, Pakistan, and Sri Lanka all are among the top 20 receivers of remittances, with estimated receipts of US$3.2 billion, US$17.4 billion, US$4.0 billion, and US$1.3 billion, respectively (table 1.1). These four countries made the South Asia region the second largest regional recipient of remittances in the world after Latin America and the Caribbean.

The figures above ensured that remittances remained the second-largest financial flow to developing countries in 2003 after foreign direct investment, more than double the size of net official development assistance. Moreover, remittance volumes increased, despite expectations to the contrary based on weak labor markets and the tightening of border controls in the industrial countries after the terrorist attacks of September 11, 2001. Ratha (2004) attributes the continued increase in remittances to three factors. First, more remittances are being diverted from alternative channels to formal channels as a result of efforts to curb money laundering. Second, the increased focus on remittances has brought better reporting of data in many developing countries. And third, the fear of being deported or investigated may have prompted some migrant workers to remit their entire savings to their home countries.