

Informal Transfer Payments: Economic & Regulatory Implications

by

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Issues Addressed

- Why do Informal Channels Develop?
- Over-regulation and its impact on remittance transactions
- Economic implications of Over-regulation
- Policy Issues and Recommendations

Categories of Informal Transfer Payments

Informal transfer payments can be divided into two categories:

- Payments made by migrant workers
- Payments made by non-migrants

Sub-categories of Payments by Non-migrant Workers

Non-migrant payments can be divided further into other sub-categories:

- Payments made for terrorist activities
- Payments made for tax evasion from one jurisdiction
- Payments made for drug dealing and other money laundering
- Payments made for circumventing currency control

Why do informal channels
develop?

Why do informal channels develop for migrant workers?

- Constraints faced by migrant workers – such as lack of work permit, etc. – preventing them going through the official channels

Why do informal channels develop for migrant workers?

- Absence of a wide network of bank branches and points of access for recipient of funds from abroad

Remittance of Migrant Workers

It is estimated by the World Bank that world-wide there were 175 million migrants in 2005. The remittances from these migrants were in excess of \$232 billion. Some \$167 billion of these remittances were estimated to have been sent to emerging economies. Within some economies, these remittances constitute up to one third of their gross domestic product.

Example with Respect to China

- In 2002 China's "Non-formal" amount of foreign exchange reserves increased by \$8.2 billion.
- For the Province of Fujian the police estimated 10 billion yuan is transferred each year to Fujian Province through underground banks.
(stated on Sina Chinese Website)

Recent Trends

There has been a rise in international migration. As the number of migrant workers has increased, the flow of remittances has risen.

Future Outlook

As the demographic picture becomes more skewed and the proportion of retired versus the working population rises, there will be more demand for migrant workers. This trend can in turn lead to further increases in remittances from additional migrant workers.

Characteristics of Transfer Payments for Terrorism Purposes

- Transactions made by terrorists are usually substantial and involve underground networks which play an essential part.
- This is to be contrasted with payments by migrant workers who tend to use family connections and the amount transferred are small yet regular.

- Funds to finance terrorist activities have been going through formal channels, e.g. investment banks.

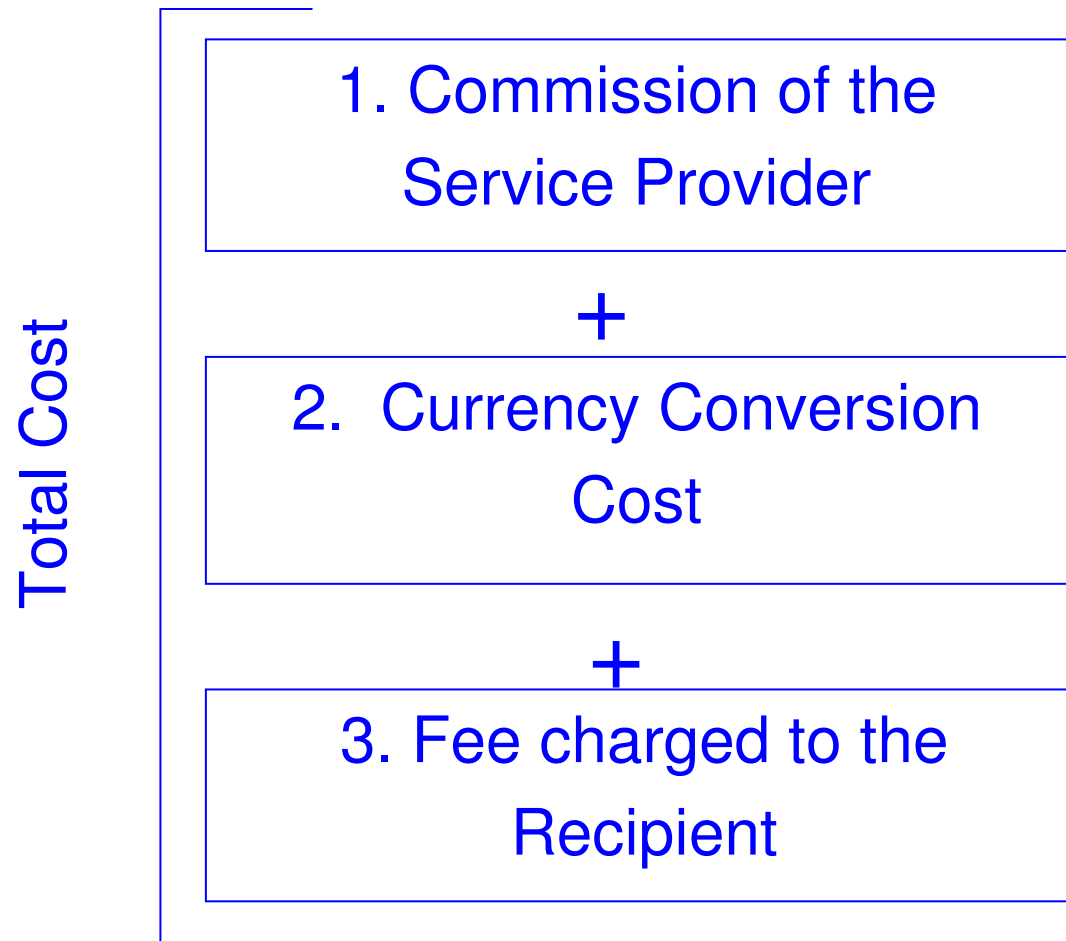
Cost of Informal Transfer Payment Transfers

- Informal transfers tend to have a much lower transaction cost than official channels – namely than that of the commission of official financial intermediaries such as banks.

Speed of a Wire Transfer Through a Correspondent Bank

- A wire transfer through a correspondent bank could take a minimum of five working days which could become lengthier in time adding weekends, public holidays and different time zones.

Variables Contributing to the Cost of a Transfer Payment



Why do informal channels develop when there is foreign exchange control?

- The presence of an unofficial currency rate in the foreign exchange market brings about informal transfer payments to overcome the rules.

Political causes and consequences of informal transfer payments

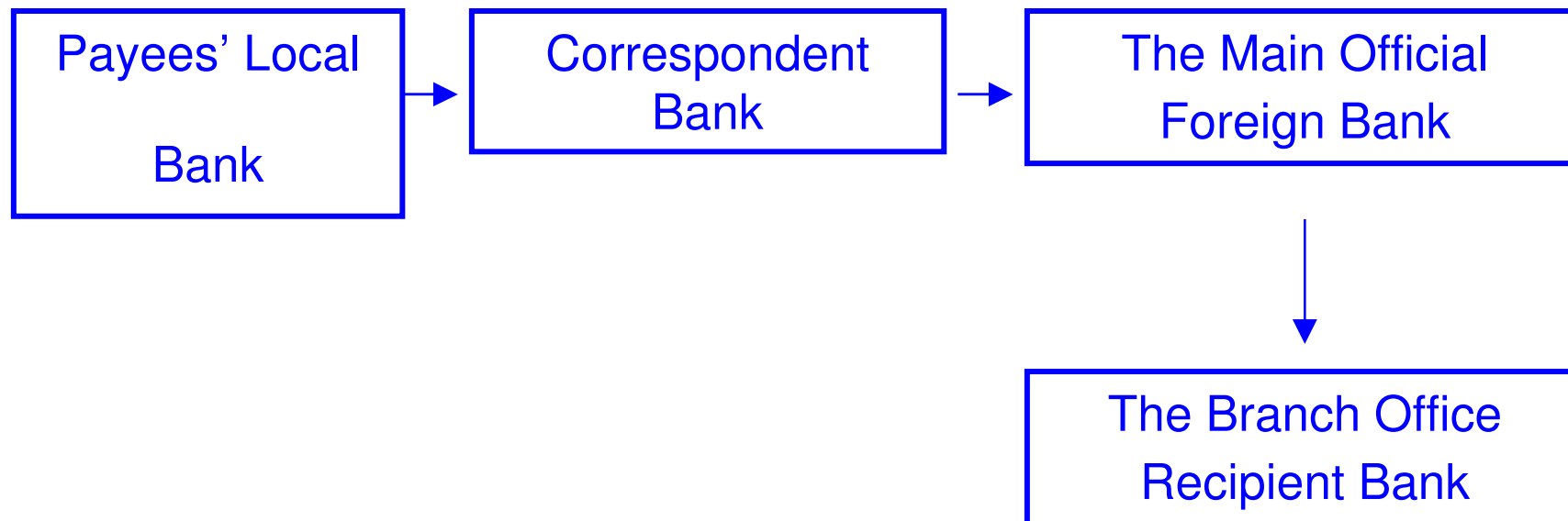
- Informal transfers can be brought about for political reasons and cause terrorism. Such funds would provide for terrorists' activities.

- The more the official exchange rate deviates from that of the market and the more distortive regulations pertaining to foreign exchange transactions prevail within the recipients' country, the more attractive the informal transfer payment becomes.

Characteristics of the Informal Transfer Payment System

- The primary reason for using Informal Transfer Payment is its efficiency in terms of both speed and cost effectiveness even though it may be more risky.
- It is much speedier than the traditional means of transmitting namely through payment by cheque or wire transfers.
- In the Informal Transfer Payment system, usually no records are produced of the individual transactions – only a cumulative total is kept of the amount owed to one broker by another broker.

Remittance Transfer Process Using Correspondent Bank



Settlement Method of Informal Transfer Payment

- The amount owed can be settled among the two parties in different ways. It does not necessarily have to be in the mode of cash payment.

The Economic Impact of Remittances

- How Transfer Payments Can Influence the Growth of the Economy
- How New Innovations in Transfer Payments can circumvent regulations

How Transfer Payments Can Influence the Growth of the Economy

Improved mechanisms can be put in place whereby the developmental effect of remittance inflows can be maximized. Through the introduction of new savings and investment instruments for households receiving transfer payments, a bigger share of payment flows can be directed towards funding investments that could enhance economic activity and bring about GDP growth.

New Innovations in Transfer Payments

Examples of Innovation

- The US government has reduced some of the constraints that barred Mexican workers from opening accounts in the USA. The workers can now use ID's issued by Mexican consulates.
- Agreement between USA and Mexico to use their respective central bank's clearing systems to reduce the cost of money transfers through banks.

Innovations in Remittances Affecting Developing Countries

- Person to person transfers – VisaDirect and MoneySen
- Stored Value in Mobile Phones in a “low-technology penetration” economy – Celpay in Zambia and the DRC
- Stored Value in Mobile Phones in a “high-technology penetration” economy – G-Cash in the Philippines used for domestic transfers
- Prepaid Cards

Prepaid Cards

La Caixa in Spain has developed a new system in conjunction with banks in the following countries:

- Argentina
- Colombia
- Dominican Republic
- Ecuador
- Morocco
- Peru

La Caixa Methods

- La Caixa provides two cards, one for the migrant worker and the other for the relative of the migrant worker. The migrant deposits money into the card from their regular account, from his phone or on the internet. The relative can receive money at an ATM or an online debit card in shops.

Fund Transfer through Cell phones

- In the Philippines, Globe Telecom has devised an innovative method for transferring funds through cell phones. Funds via a licensed agent can be credited to a cell phone and subsequently remitted to another cell phone using a pin number.

Innovative Methods - Internet Banking

Recipient resident in Country A
has a bank account in Country B

Money transferred in
Country B
Funds are credited
into the account of the
recipient resident in
Country A

Account of the recipient in
Country B is credited

Recipient in Country A accesses his
account in Country B & pays his
credit cards and bills in Country B

- A special issue of the newsletter of the UK Department for International Development (DFID) in collaboration with USAID enlists the new innovations until 2006.

Regulatory Aspects of Remittances & Consequences of Over-Regulation

Over-regulation as a
consequence of terrorism
financing issues

Over-regulation

- In the UK, certainly over-regulation has developed since the incident of 9/11. The twin towers were attacked in the US, but the overburdening of the regulation happened in the UK. The bombings that happened in the UK were internal and were carried out by British born individuals. The latter did not require cross border remittances.

Characteristic of Financial Regulation post 9/11

- In a court of law, an individual is innocent unless proven guilty.
- In the banking sector in the UK, all individuals are treated as guilty until proven innocent.

Over-regulation can lead to the
flight of capital

- Most regulations are set with the objective of consumer protection. In the UK, the regulations that have been introduced under the guise of “terrorism financing issues” not only do not protect the consumer, they inconvenience the consumer and are most intrusive. In practice, banks also tend to take advantage of the situation and try to extract masses of personal information from their customers under the guise of anti-money laundering or anti-terrorism laws which is subsequently utilised for marketing of their banks’ products to the customers.

Policy Recommendations

Policy Recommendation

- The formal transfer system has become prohibitive and intrusive.
- Over-regulations encourage the use of informal transfers.

Policy Recommendation

- Stringent regulations that have been imposed since 9/11 should be relaxed if the use of informal transfer payments has to be discouraged in favour of formal transfer payments.

Relaxation of Exchange Control

- If a country wishes to increase the use of official channels in place of informal transfer payment, it is important to adopt policies that will equalise the official and market exchange rates – say, by removing restrictions on the size of transfers etc.

Policy Recommendations

- Governments should examine the roots and underlying causes of terrorist activities as opposed to imposing arbitrary restrictions, subjecting banks to futile regulations - blocking financial flows, etc.

Concluding Remarks

- The more regulations are imposed, the more informal channels for transferring funds will be developed.
- This will encourage the use of formal channels which are in turn easier to regulate and monitor and trace any payment if there were less regulations.