



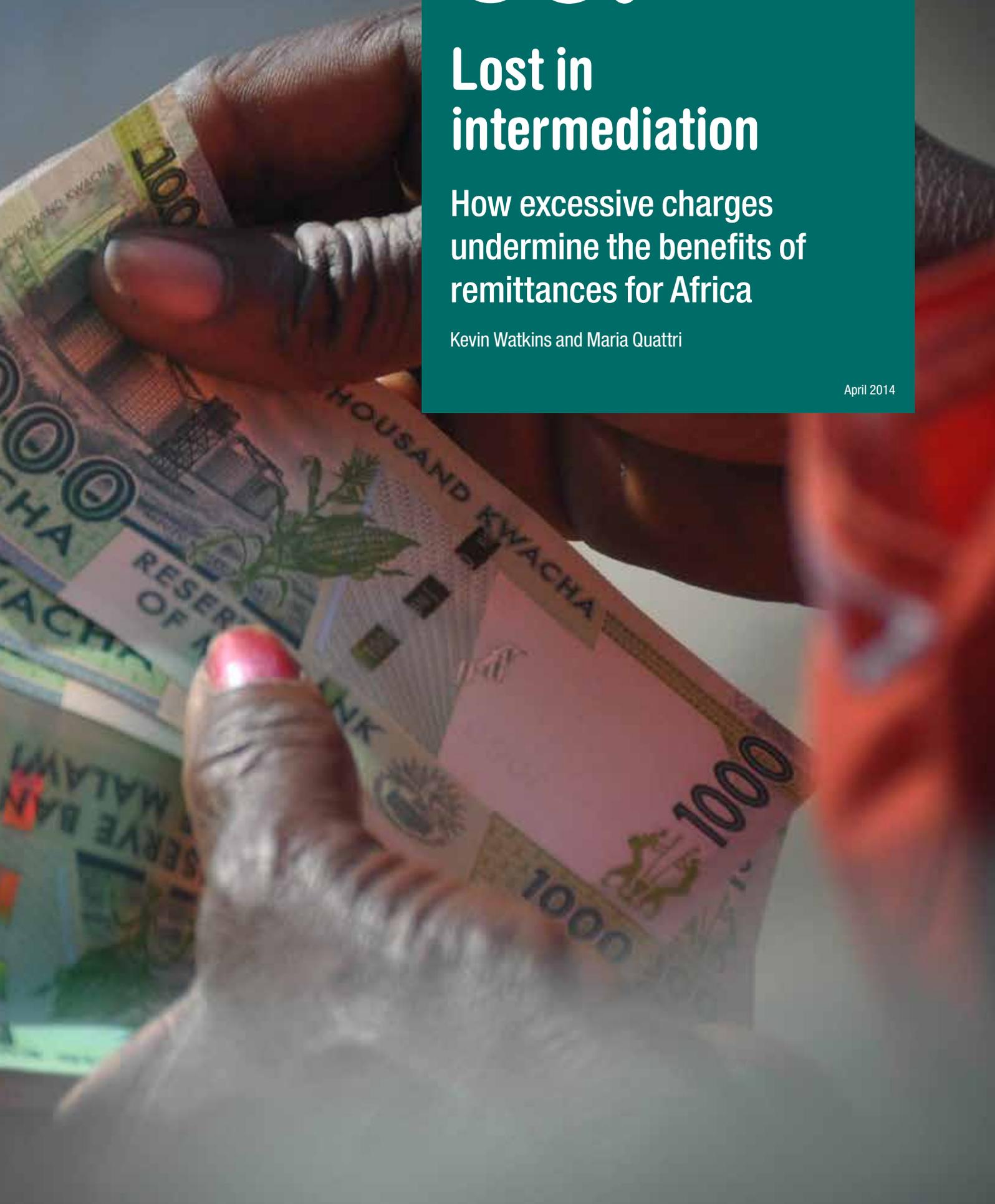
Report

Lost in intermediation

How excessive charges
undermine the benefits of
remittances for Africa

Kevin Watkins and Maria Quattri

April 2014



Overseas Development Institute

203 Blackfriars Road
London SE1 8NJ

Tel. +44 (0) 20 7922 0300

Fax. +44 (0) 20 7922 0399

E-mail: info@odi.org.uk

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How excessive charges undermine the benefits of remittances for Africa

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Key messages

- Remittances from African migrants play a vital role in supporting health, education, food security and productive investment in agriculture. Yet many of the benefits of remittance transfers are lost in intermediation as a result of high charges. Africa's diaspora pays 12% to send \$200 – almost double the global average.
- In effect, Africans are paying a remittance 'super tax'. Reducing charges to world average levels and the 5% G8 target would increase transfers by \$1.8 billion annually. That figure is equivalent to the sub-Saharan African cost of paying for the education of some 14 million primary school age children – half of the out-of-school total; improved sanitation for 8 million people; or clean water for 21 million.
- Weak competition, concentration of market power and flawed financial regulation all contribute to high remittance charges. Just two money transfer operators (MTOs) – Western Union and MoneyGram – account for two-thirds of remittance transfers. We conservatively estimate that the two companies account for \$586 million of the loss associated with the remittance 'super tax', part of it through opaque foreign currency charges. 'Exclusivity agreements' between MTOs, their agents and banks restrict competition and drive up prices, as do African financial regulations favouring banks over other remittance payment options.
- Governments and regulatory authorities in sending countries should do far more to promote competition and encourage innovation. Financial regulators – such as the UK's Financial Conduct Authority – and legislative bodies should actively review the practices of MTOs. All regulators should demand higher standards of transparency for foreign exchange charges, as envisaged in the Dodd-Frank legislation adopted by the US. African governments should do more to secure a better remittance deal for their citizens. Prohibiting exclusivity agreements is one immediate priority, along with ending the stranglehold of banks on remittance payments.

Abbreviations

AIR	African Institute for Remittances	MTO	Money transfer operator
DRC	Democratic Republic of Congo	ODA	Official Development Assistance
EAP	East Asia and the Pacific	OECD	Organisation for Economic Co-operation and Development
FAO	Food and Agriculture Organization of the United Nations	OFAC	Office of Foreign Assets Control
FATF	Financial Action Task Force	OMTI	Orange Money Transfer International
FDI	Foreign Direct Investment	RSP	Remittance service provider
FinCEN	Financial Crimes Enforcement Network	SA	South Asia
FX	Foreign exchange	SSA	Sub-Saharan Africa
GDP	Gross Domestic Product	SWIFT	Society for Worldwide Interbank Financial Telecommunications
IDA	International Development Association (World Bank)	UN	United Nations
IFAD	International Fund for Agricultural Development	UNCTAD	United Nations Conference on Trade and Development
IMF	International Monetary Fund	UNESCO	United Nations Educational, Scientific and Cultural Organization
LAC	Latin America and the Caribbean	UNHCR	United Nations High Commissioner for Refugees
MENA	Middle East and North Africa	WU	Western Union
MFI	Micro-finance institution		
MG	MoneyGram		

Contents

Abbreviations	4
List of tables and figures	6
Executive summary	7
Introduction	9
1. Africa in the global remittance economy	10
2. Migrant remittances – wide-ranging benefits	14
3. The high cost of remittances to Africa	17
4. Unlocking the benefits of remittances for development	27
Conclusion	29
Technical annex	30
References	31

List of tables and figures

Tables

Table 1: Remittance flows to SSA	11
Table 2: Estimating the share of Western Union and MoneyGram in Africa's remittance 'super tax'	21
Table 3: Current charges and implied losses through the remittance 'super tax' from the UK	22
Table 4: Cost of transferring \$200, 3Q2013	24

Figures

Figure 1: Rising trends: actual and projected remittance flows to sub-Saharan Africa (\$ billion)	10
Figure 2: Reported use of international remittances: Kenya and Nigeria (% of total remittances received)	15
Figure 3: Concentration of market power: % of pay-out locations by company, Western Union and MoneyGram	18
Figure 4: Average % cost of transferring \$200 by type of remittance service provider	19
Figure 5: Average % cost of sending \$200 by product type	19
Figure 6: Average % cost of transferring \$200 by region	19
Figure 7: Africa's disadvantage: % cost of transferring \$200	20
Figure 8: % of pay-out locations by type of provider	20
Figure 9: % of MTO pay-out locations by company	20
Figure 10: Remittance charges from the G7 (excluding Japan): total average % cost of transferring \$200	21
Figure 11: Western Union remittance charges to the UK: % cost of transferring £120 (or \$200) for selected SSA countries	23
Figure 12: MoneyGram remittance charges from the UK: % cost of transferring £120 (or \$200) to selected SSA countries	23

Executive summary

Remittances – the money sent home by migrant workers – play a vital role in Africa. They help to pay for health, education and productive investment in agriculture. During periods of crisis they provide a financial lifeline. For many economies in the region, remittance transfers now occupy an important position in the balance of payments. Yet Africa is failing to secure all of their potential benefits. No region faces higher charges for remittance transfers. In effect, Africa's diaspora face a 'remittance super tax' that hurts families and holds back development.

There is no justification for the high charges incurred by African migrants. In an age of mobile banking, internet transfers and rapid technological innovation, no region should be paying charges at the levels reported for Africa. In this report we argue that market concentration in the global money transfer industry, financial regulation in Africa, and high levels of financial exclusion are driving up costs.

Remittances to Africa are rising. In 2013, transfers to the region were valued at \$32 billion, or around 2% of GDP. Projections to 2016 suggest that remittances could rise to over \$41 billion. With aid set to stagnate, remittances are set to emerge as an increasingly important source of external finance.

Charges on remittances to Africa are well above global average levels. Migrants sending \$200 home can expect to pay 12% in charges, which is almost double the global average. While the governments of the G8 and the G20 have pledged to reduce charges to 5%, there is no evidence of any decline in the fees incurred by Africa's diaspora.

Remittance corridors *within* Africa have some of the highest charge structures in the world. Migrant workers from Mozambique sending money home from South Africa, or Ghanaians remitting money from Nigeria can face charges well in excess of 20%.

Why does Africa face such high remittance charges? That question is difficult to answer because of the highly opaque nature of remittance markets and the complex range of products available. Much of the relevant commercial information needed to establish detailed structures is unavailable.

However, three factors combine to drive up charges. The first is limited competition. Global markets are dominated by an oligopoly of money transfer operators (MTOs) and regional markets by a duopoly: Just two companies – Western Union and MoneyGram – account for an estimated two-thirds of remittance pay-out locations in Africa. As in any market, limited competition is a barrier to cost reduction and efficiency gains. Second, there is evidence of 'exclusivity agreements' between MTOs, agents and banks. These agreements restrict competition in an already highly concentrated market.

Third, financial exclusion and poor regulation in Africa escalate costs. Few Africans have access to formal accounts (which limits access to pay-out providers) and most governments require payments to take place through banks, most of which combine high costs with limited reach and low efficiency.

No measure would do more to strengthen the development impact of remittances than a deep cut in charges. Cutting the 'remittance super tax' would enable Africa's diaspora to make a bigger contribution to the region's development. It would also strengthen self-reliance. Unlike aid, remittances put money directly into people's pockets, providing a source of investment and support for consumption.

In this report we estimate the additional finance that would be generated under a range of charge-reduction scenarios. We build these scenarios by comparing current charges in Africa with two benchmarks: the current global average charge of 7.8% and the 5% target charge set by governments. We treat the gap between current charges and these benchmarks as indicative of the lower- and upper-bound estimates for the 'remittance super tax'. Converting that gap into financial terms, we estimate that Africa is losing between \$1.4 billion and \$2.3 billion annually as a result of high remittance charges.

Tracing this implicit loss through the remittance system is a hazardous enterprise. Africa's diaspora is linked to families, friends and communities through a complex web of intermediaries. The commercial terms on which MTOs interact with African banks are not widely available. Similarly, the real costs associated with regulatory compliance, foreign currency trade, agent fees and other dealings are largely unknown.

Despite these limitations it is possible to derive some indicative figures. Using market share (as defined by share of payment outlets) as a proxy for indicative shares in the 'remittance super tax', operations involving MTOs would account for between \$807 million and \$1.3 billion of our estimated global loss. As market leaders, Western Union and MoneyGram would account for \$586 million of the revenue loss associated with the gap between African and world average charges.

Detailed research for the United Kingdom identifies a number of distinctive features of the remittance market for Africa. As in other remittance-sending countries, the charges incurred by Africa's diaspora are high relative to global average charges. Using one of the major remittance channels – credit/debit card-to-cash – we identify what appears to be an 'Africa charge' – a consistent fee of around 8% for Western Union applied across countries regardless of the size of the market, regulatory costs or market risk. The same analysis conducted for credit/debit card remittances through MoneyGram reveals that there are marked variations in the charges applied by the two major MTOs in the same country. This is suggestive of limited competition or market segmentation *within* the receiving country, and imperfect consumer information. Evidence from the UK identifies foreign exchange conversion fees as a significant, and often arbitrary, share of overall costs – information on these fees is not always provided to consumers in a readily accessible form.

As one of the largest sources of remittance transfers to Africa, the UK contributes to the loss of finance through high charges. Some \$5 billion was remitted to Africa from the UK in 2012. Reducing average UK remittance costs to the global average

would increase transfers by \$85 million, rising to \$225 million if charges were lowered to 5%. The bulk of these losses can be traced to large MTOs in the UK. On a conservative estimate, Western Union and MoneyGram secure \$49 million in payments through charges above world market averages.

The potential for development gains through lower remittance charges can be illustrated by reference to current aid flows. For comparative purposes we use a mid-range figure between our upper-bound and lower-bound estimates of \$1.8 billion. This is equivalent to half of the aid provided to Africa by the UK, the region's third largest bilateral donor, or some 40% of transfers to Africa through the World Bank's International Development Association (IDA) – the largest source of multilateral aid for Africa.

Viewed from a different perspective, a diversion of revenues associated with the remittance super-tax into education would provide, at current financing levels, sufficient resources to put around 14 million primary school-aged children into school – almost half of the out-of-school population for the region. Alternatively, it could finance access to improved sanitation for 8 million people, or the provision of safe water for 21 million people.

This report calls for a number of measures to lower Africa's 'remittance super tax', including:

- Investigation of global MTOs by anti-trust bodies in the EU and the US to identify areas in which market concentration and commercial practices are artificially inflating charges.
- Greater transparency in the provision of information on foreign-exchange conversion charges, drawing on the example of Dodd-Frank legislation in the United States.
- Regulatory reform in Africa to revoke 'exclusivity agreements' between MTOs on the one side, and banks and agents on the other, and promote the use of micro-finance institutions and post offices as remittance pay-out agencies. Governments and MTOs should work to promote mobile banking as a strategy to support the development of more inclusive financial systems.
- Engagement by Africa's diaspora and wider civil-society groups to put remittances at the centre of the development agenda. The public interests represented by Africa's diaspora and remittance receivers should be placed above the commercial interests of MTOs and banks in the regulation of remittance systems.

Introduction

Economic remittances from migrants are an important and growing source of finance for Africa. These remittances represent a source of opportunity and, for many, a financial lifeline during periods of hardship. Yet Africa is failing to realise the full potential of remittances.

Migrants from Africa, the world's poorest region, face the highest charges on remittances. At an average of just over 12%, these charges are almost double the global average (excluding Africa). If remittance charges were reduced, there would be a double benefit: the overall flow of transfers would increase and a greater share of the transfer would reach the intended beneficiaries.

The excessive charges levied on African remittances raise wider questions. Migrant workers make enormous sacrifices to secure the higher income that comes with changed location. They bring far-reaching benefits to destination countries, generating economic growth, meeting demand in labour markets and creating more diverse societies. Many take considerable risks in moving to higher-income countries. Yet the international community and Africa's own governments are failing to support their efforts to

improve their lives, support their families, and promote self-reliant development.

This paper makes the case for putting remittances at the centre of international cooperation on development. It is divided into four parts. The first looks at the level of remittances to Africa and at the drivers of migration. Part 2 provides a summary overview of evidence on the benefits of migration. Part 3 looks at the high costs of remittances to Africa, examining underlying global and regional remittance-market structures and highlighting the domination of two global money transfer operators (MTOs). While there is no evidence of collusive pricing or other cartel-type behaviours, the remittance market is characterised by limited competition, restrictive business practices and extensive rent-seeking. Part 4 looks at strategies to increase the development impact of remittances. While highlighting a wide range of potentially innovative options – including diaspora bond issues and partnerships between diaspora and local governments – it offers a simple message: namely, no measure would have a greater impact than deep cuts in the costs of intermediation.

1. Africa in the global remittance economy

Remittance flows to developing countries have increased rapidly over the past decade. They reached \$414 billion in 2013 – some four times the level in 2000 (World Bank, 2013a). To put these transfers in context, they represent around three times the level of aid. In addition, remittance transfers – unlike aid – are on an upward trajectory and are projected to reach \$540 billion by 2016 (World Bank, 2013a).

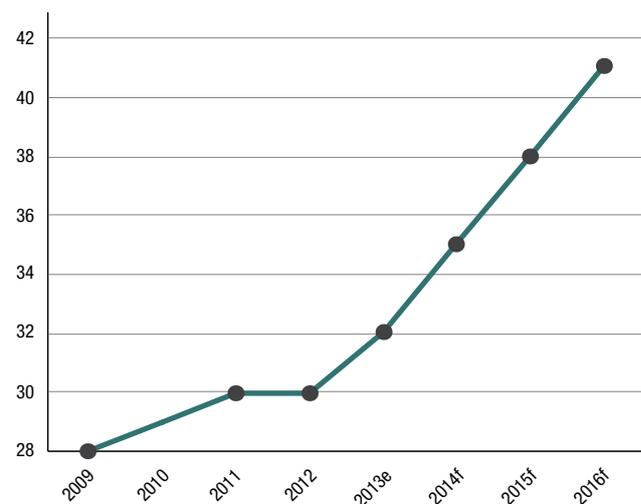
Africa has been part of a global remittance boom. In 2013, African migrants remitted around \$32 billion – equivalent to around 2% of regional GDP (World Bank, 2014). Although sub-Saharan Africa (SSA) currently receives around 8% of reported global remittances, transfers grew by some 6% between 2012 and 2013. World Bank projections suggest that remittances to the region will grow at around 8.6% over the next few years, reaching \$41 billion by 2016 (Figure 1). While official development assistance (ODA) still exceeds remittance transfers, the gap will narrow if these projections are correct.

Despite the projected growth estimates, remittance transfers to Africa have been increasing far more slowly than those to other regions. From 2009 to 2012, remittances to SSA were growing at an average rate of just 2% a year (World Bank, 2013a). This is less than half of the average for all developing regions and just one-fifth of the increase reported for South Asia. Only Latin America has reported a lower rate of increase, reflecting the impact of the US recession. The high charges incurred by African migrants, the focus of this paper, have almost certainly limited SSA's rate of growth.

Levels of dependence on remittances vary across Africa (Table 1). Nigeria accounts for 68% of total transfers to the region – some \$20 billion in 2012 – and is the world's fifth largest recipient in absolute terms (World Bank, 2013a). Four countries report remittance transfers in excess of \$1 billion: Nigeria, Senegal, Kenya and Sudan. Measuring remittances as a share of GDP provides a different perspective. There are nine SSA countries in the region for which remittances constitute more than 5% of GDP, rising to over 20% for Lesotho and Liberia.

Data on remittances have to be treated with caution. Reporting systems suffer from a number of deficiencies, most of which contribute to under-estimation.¹ Balance-of-payments accounts in many countries capture only part of remittance transfers from rich countries. There is also a large informal remittance system that operates through traditional *hawala* (informal transfer) providers. In addition, only a small share of the transfer associated

Figure 1: Rising trends: actual and projected remittance flows to sub-Saharan Africa (\$ billion)



Source: World Bank Migration and Development Brief 21, October 2013.

with intra-regional migration is captured in official data. This is because transfers through personal delivery and informal arrangements dominate, reflecting the high charges associated with intra-African remittances. SSA is believed to have the highest share of remittances channelled through unregulated modes of transfer. Indeed, surveys of migrants and remittance recipients and other secondary sources suggest that unregulated transfers could exceed official transfers (AIR, 2013).

Patterns of migration

Remittance transfers are a sub-set of consumer transfers across countries. In terms of reporting conventions, they are 'personal transfers' to friends and relatives who live abroad. Most of the senders are foreign-born, though second-generation diaspora remittances are also significant. The transfers occur through electronic payments to designated recipients in receiving countries through remittance service providers (RSPs).²

The bulk of remittance transfers can be traced back to the global phenomenon of migrants sending money back to their country of origin. It follows that an understanding of why people

¹ Remittance data are drawn principally from central bank reporting systems that often fail to identify remittance transfers. More importantly, they do not capture the unknown, but almost certainly very large, transfers that occur through informal arrangements. On the under-reporting of remittances see, for instance, Sander and Munzele Mainbo, 2003, and Shonkwiler et al., 2008.

Table 1: Remittance flows to SSA

Millions of \$ (2012)		% of GDP (latest available year, 2010-2012)	
Nigeria	20,568.29	Liberia	23.41
Senegal	1,366.85	Lesotho	22.64
Kenya	1,227.62	Gambia, The	15.37
Sudan	1,126.13	Senegal	11.43
Uganda	976.60	Togo	10.61
Lesotho	601.87	Cabo Verde	9.13
Ethiopia	524.20	Nigeria	7.86
Mali	444.45	Guinea-Bissau	5.49
Liberia	372.39	Mali	5.02
Côte d'Ivoire	325.09	Uganda	3.69
Togo	320.71	Kenya	2.98
Mauritius	246.59	Rwanda	2.57
Benin	179.18	São Tomé and Príncipe	2.41
Cape Verde	176.80	Benin	2.36
Rwanda	156.20	Niger	2.35
Ghana	151.50	Burundi	1.88
Burkina Faso	130.35	Côte d'Ivoire	1.63
Niger	122.36	Sierra Leone	1.61
Cameroon	109.22	Mozambique	1.55
Mozambique	99.12	Ethiopia	1.50
Gambia, The	89.25	Burkina Faso	1.31
Sierra Leone	79.01	Guinea	1.18
Tanzania	75.34	Swaziland	0.84
Guinea	74.77	Cameroon	0.83
Botswana	54.85	Sudan	0.68
Swaziland	46.89	Malawi	0.66
Zambia	45.55	Zambia	0.35
Guinea-Bissau	42.18	Ghana	0.34
Burundi	42.15	Tanzania	0.24
Seychelles	25.90	Botswana	0.13
Namibia	16.51	Namibia	0.12
Malawi	16.01	Seychelles	0.11
São Tomé and Príncipe	6.50	Mauritius	0.01
Angola	0.19	Angola	0.00

Sources: Data source for remittances in millions of dollars: World Bank Migration and Remittances Data, Bilateral Remittances Matrix 2012. Data source for remittances as percentage of GDP: World Bank World Development Indicators (2014).

move is critical for any analysis of the relationship between migration, remittances and development. Michael Clemens of the Centre for Global Development has argued persuasively that migration can be thought of as a financial strategy to diversify household risk (Clemens and Ogden, 2013). That strategy requires people to absorb up-front investment costs in order to generate a stream of future revenue. Viewed through this lens, migration is an investment in human capital that aims to help households manage risk and vulnerability, and remittances are the pay-out from that capital. Yet, as Clemens notes, migration is not often studied as a substitute for, or complement to, other financial strategies that support development.

People bear the costs of migration partly because of constraints on other alternatives, but also because of the potentially high returns from relocation in today's highly inter-connected but unequal global economy. The simple arithmetic of average income gaps highlights the potential for large returns. In terms of real (Purchasing Power Parity) income, average incomes in the UK are 22 times higher than in Tanzania. Average incomes in the Democratic Republic of Congo are around 1% of those in Belgium. Incomes in France are 48 times higher than in Niger. Unsurprisingly, against this backdrop, the average annual remittance sent by an African migrant from the OECD in 2009 was greater than average annual per-capita income in SSA (Mohapatra and Ratha, 2011).

Such comparisons illustrate the consequences of the 'accident of birth'. When it comes to opportunity and the prospects for a life free of poverty, the three most powerful determinants are 'location, location, location'. Despite the wealth convergence that has occurred under globalisation, wealth disparities *between* countries still account for around three-quarters of global inequality (Lakner and Milanovic, 2013). It follows that migration, far more than aid or even trade, has the potential to act as a force for a more equitable pattern of globalisation.

This is especially true for Africa. While the region has now enjoyed some 15 years of strong economic growth, convergence is starting from a low base – and growth has been uneven. For the 414 million people in SSA living on less than \$1.25 a day (World Bank, 2010), the opportunity to migrate, or to receive remittances from a migrant relative, offers unparalleled benefits. Average consumption among Africa's poor is far below the level in other regions, at around \$0.70 cents a day. Securing a job on the minimum wage in the UK (£6.31 in 2013 or around \$10.40) would represent a nominal income gain of around 1,400% for someone living below the poverty line in Africa.

Migration policy in rich countries is one of the primary barriers to the benefits of migration. Across Europe, governments have been adopting legislation to restrict unskilled migration and repatriate irregular migrants. The failure of various schemes to get migrants to return home through cash incentives and more stringent rules is indicative of the value of migration to those involved.

While it is beyond the scope of this report, there is something of a paradox in the current direction of policies in countries

receiving migrants. Economic evidence suggests that migration bestows significant benefits on destination countries, and demographic trends are increasing the potential gains over time. Yet rather than develop a regulatory system to maximise the joint benefits of migration, most governments are concerned to appeal to voters influenced by anti-immigration parties, such as the United Kingdom Independence Party, the Front National in France and Italy's Northern League.

Current approaches to migration raise fundamental concerns at many levels. For example, many rich countries have actively recruited health professionals and other skilled workers from Africa. According to one estimate, one in every five Africans with a post-secondary education is now working in an OECD country – a significant brain drain (Gupta et al., 2007a). Yet rich countries have closed the door on poor Africans with the most to gain. These are practices that actively reinforce the very global inequalities that drive migration.

International media attention tends to focus on migration from Africa and other developing regions to rich countries. Yet in Africa, as in other regions, most migration is intra-regional. Figures on population movement are notoriously unreliable. However, best estimates suggest that there are now some 22 million people born in Africa living outside their country of origin and that around two-thirds of these live in other African countries. There are some 3 million Nigerians living in other countries in the region – at least twice the number estimated to be living in the US and Europe (Orozco and Millis, 2007). There are also far more Senegalese migrants living in Gambia than in France (Orozco et al., 2010).

Regional migration patterns are shaped by well-established seasonal work patterns, cross-country labour markets and ethnic, kinship and other social networks. The Burkina Faso–Côte d'Ivoire corridor (Côte d'Ivoire's cocoa sector relies on labour transfers from Burkina Faso) is one of the top 20 migration corridors in the world, used by about 1.3 million migrants. In southern Africa, workers from Mozambique and Zimbabwe provide a labour force for agriculture and mining in South Africa. Other important corridors are those linking South Africa to Zimbabwe, Mozambique and Lesotho; Mali to Côte d'Ivoire; and Democratic Republic of Congo to Rwanda (World Bank, 2011a; Plaza and Rapha, 2011).

Behind the headline estimates of migration numbers are a vast array of distinctive migration patterns. Migrant remittance transfers from OECD countries to Africa originate from workers who have relocated on a permanent or temporary basis, from refugees and from 'irregular' migration. Once again, the data are limited. But the past decade has seen the development of already established migration corridors from the Horn of Africa, North Africa and West Africa into southern Europe. The migrants using these corridors are acutely vulnerable and take high risks to relocate, reflecting the perceived returns to migration and the distress that forces them to uproot (Box 1).

2 For a useful description of the global remittance system see cfpb (2011).

Box 1: Distress movements and irregular migration

In February 2014, international media reports carried another episode in an all-too familiar story. The Italian navy rescued over 1,000 Africans from almost certain death at sea, some 220 kilometres south-east of the island of Lampedusa – the site of over 300 deaths in October 2013 (BBC NEWS Europe, 2014).

Beyond the immediate human tragedies, such events underline the power of the economic forces that drive migration. Every year, tens of thousands of Africans try to make the journey to Europe as irregular migrants. Using up their savings and risking smugglers, hazardous crossings, capture and summary return, they are motivated by the pursuit of a better life for themselves – and an opportunity to support their families.

Legislation governing migration in the EU draws a distinction between formal labour movement, the provision of sanctuary for refugees, and the ‘irregular’ flow of migrants outside the formal rules (Betts, 2008). However, migration policies are being overtaken by the wider forces that drive people to move, including conflict, state failure, poverty and, increasingly, ecological pressures on land and water resources – pressures that will intensify with climate change. There are four primary drivers of forced migration

- *Violence, armed conflict and human rights abuse:* according to UNHCR (UNHCR, 2013), there are some 2.8 million refugees in SSA – over one-quarter of the world total - and another 5.4 million internally displaced people (UNHCR, 2014). Violent conflict has been a powerful catalyst for migration in such countries as Somalia and the Democratic Republic of Congo.
- *High levels of poverty and acute vulnerability:* SSA has the highest and deepest levels of poverty in the world. Just under half of the region’s population – 483 million people – live on less than \$1.25 a day. The average distance of the poor from the \$1.25 line, as measured by the poverty gap, is three times the level seen in South Asia.
- *Interlocking political and economic failures:* political instability in Zimbabwe and Côte d’Ivoire led to marked economic reversals, with an associated loss of livelihoods and increase in poverty. Mass migration from Eritrea is linked to underlying failures in political and economic governance.
- *Climate-related stress:* Africa’s poor are acutely vulnerable to climate-related shocks, such as drought, flooding and rainfall variability. The 2011 drought in the Horn of Africa contributed to forced migration on a large-scale.

2. Migrant remittances – wide-ranging benefits

At the macroeconomic level, remittances are just like any other financial transfer. They represent a source of foreign-exchange earnings that can be used to finance consumption or investment. However, remittances differ from other flows in two key respects. First, they are less volatile than foreign direct investment (FDI) and other private capital flows. Second, unlike aid and FDI, remittances go directly to recipient households, augmenting the resources at their disposal and generating strong multiplier effects across local markets.

Evidence from Africa reinforces a wider body of research on the role of remittances in supporting social and economic development. The most comprehensive overview of the evidence available has been provided by Dilip Ratha and others at the World Bank (see, for instance, Ratha et al., 2011, and Ratha, 2013). In this section we draw on that overview and a wider body of research.

Macroeconomic benefits

Remittances offer a range of benefits, from a national economic perspective. Empirical evidence on the role of remittances in supporting economic growth is mixed, partly because of the complexities associated with disentangling labour market effects from investment effects (Pradhan et al., 2008). What is clear in the case of Africa, however, is that remittance flows have cushioned the impact of external economic shocks, such as the slowdown that followed the 2008 global financial crisis (African Development Bank Group (AfDB), 2009). Remittances have enabled governments to increase foreign-exchange reserves, cover current-account deficits and finance debt servicing.

Counter-cyclical financing effects are particularly important for Africa. More than any other region, SSA is extremely vulnerable to exogenous shocks. Variations in rainfall, droughts and floods have a marked bearing on the economic cycle. Wider global economic conditions, such as the 2008 spike in food prices and the economic downturn that followed the financial crisis, also impact heavily on African growth. One of the benefits of remittance transfers is that they often increase in response to economic shocks.

Recent IMF research on remittance patterns from Italy documents a strong counter-cyclical effect: remittances increased during downturns in the business cycle of the recipient country (Bettin et al., 2014). The same effect is observed during periods of humanitarian emergency: remittance flows tend to rise as

economies contract (and usually long before humanitarian aid arrives). While remittance flows fall during economic downturns in the sending country, the effect is typically less pronounced than that for other flows. Remittance transfers fell at less than one fifth of the rate of private capital flows during 2009, for example.³

What of the wider relationship between remittances and economic growth? The evidence points in different and sometimes contradictory directions. Remittances increase the real disposable income of households, thereby raising aggregate demand. They also contribute to financial deepening. However, some commentators argue that outward migration simultaneously reduces labour supply, puts upward pressure on wages (through remittance effects) and reduces incentive to work through a so-called ‘reservation wage’ effect (UNCTAD, 2012). While the empirical evidence is inconclusive, it does not point with any consistency to a negative relationship between growth and remittances.

Benefits for households

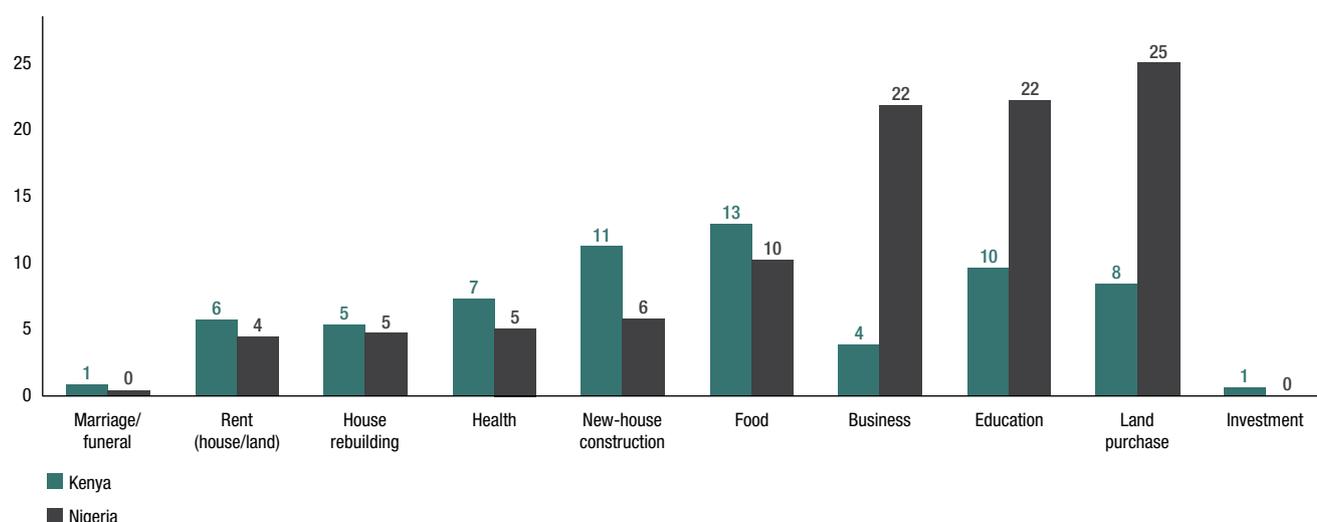
Beyond the macroeconomic effects, remittances generate very large social and economic benefits for recipient households (Baird et al., 2011). The relationship between poverty and migration operates in two directions. In one direction, high levels of poverty often act as a spur to migration. Evidence from Mali and Senegal suggests that decisions to migrate are taken collectively, rather than by individuals to reduce household vulnerability (Azam and Gubert, 2006). Extended families and village bodies sometimes pool their resources to pay for the migration expenses of their most skilled young men to secure remittance transfers that support investment, and that protect consumption during shocks. In the other direction there is a pull factor: remittances confer opportunities to escape from poverty, improve opportunities for health and education and boost productivity.

Several studies have looked at the impact of remittances on poverty.⁴ While somewhat partial and fragmentary, evidence for Africa points to significant poverty reduction effects (Adams and Page, 2005). One study documents a decline of 11% in the poverty headcount for Uganda that is linked to remittances (Ratha, 2007). IMF research also documents a positive association between the share of remittances in GDP and reduced poverty (Gupta et al., 2007b). Survey evidence from Ghana indicates that remittances are counter-cyclical and, over time, help to smooth

3 Global private flows to developing countries declined by 27% in 2009 (World Bank, 2011b) while remittances declined by less than 5% (UNChronicle, 2013).

4 See Mohapatra and Ratha (2011) for a detailed review of the evidence; see also Agunias (2006).

Figure 2: Reported use of international remittances: Kenya and Nigeria (% of total remittances received)



Source: Mohapatra and Ratha (2011: 20). Data are from Mohapatra and Ratha (2011) calculations and are based on household surveys conducted in Kenya and Nigeria in 2009 as part of the Africa Migration Project.

household consumption and welfare, especially for food crop farmers. Controlling for other variables, receiving international remittances halved the likelihood of a household being poor, and increased household spending on health and education (Adams and Cuecuecha, 2013).

Remittances to Africa are used to support a wide-range of activities. Studies from a cross-section of countries provide a window on these activities. Figure 2 compares the top ten priorities cited in respondent surveys for Kenya and Nigeria. In both countries, education, food and (in Nigeria) business figure prominently. While the evidence from Africa is patchy, research from other regions suggests that remittances can contribute to improved school attendance and more years of schooling.⁵

Just as remittances can buffer national economies against external shocks, so they can reduce the vulnerability of poor households. Remittance transfers can provide households affected by drought, floods and damaging events with a lifeline. For example, Ethiopian households that receive remittances are less likely to sell productive assets to cope with food shortages. Evidence from Ghana, Mali and Senegal documents households using remittance income to smooth consumption during distress episodes generated by economic shocks. This safety net function enables recipient households to mitigate impacts on nutrition and avoid the distress sale of assets. Recent research using panel-based evidence from 42 countries in SSA has added to the empirical evidence on consumption-smoothing effects (Arezki and Brückner, 2011). Using variations in rainfall to examine the impact on remittances, researchers found that the associated income shocks had significant positive effects on remittances.

Evidence from Somalia provides a powerful illustration of the social insurance and safety net functions of remittances. During

2011, humanitarian aid agencies responded far too slowly to a famine that eventually claimed some 260,000 lives – half of them children below the age of five. By contrast, the Somali diaspora increased remittance transfers at speed, keeping many people alive, reducing levels of malnutrition, and providing a foundation for economic recovery.

The most authoritative recent estimates put the value of remittances to Somalia at around \$1.2 billion annually (FAO, 2013). That figure is more than double the country's reported export earnings and 57% greater than average annual aid (for 2008-2011). Some 41% of households report receiving remittances, with typical values ranging from \$1,000 to \$6,000. The top-ranked uses of remittances were (in order of importance) food purchases, non-food expenses (including house rent), school fees and medical expenses. Three-quarters of all respondents studied are reported to use the money they receive through remittances to pay for food expenses. In addition, some 80% of all new business ventures in Somalia are funded by remittances (PR Newswire, 2013).

The counter case

Various counter-arguments have been put forward to contest the benefits of remittances. It has been claimed that increased remittance transfers can harm economic growth and lead to a deterioration of institutional quality.⁶ In principle, large inflows of remittances can cause the real exchange rate to rise (the so-called 'Dutch Disease' effect), which can impair growth – but there is little evidence of such effects in Africa (Rajan and Subramanian, 2005; Gupta et al., 2007). To the extent that remittances raise productivity through investment and financial deepening, they provide their own antidote to exchange-rate appreciation.

5 See, for instance, Borraz (2005); Cox Edwards and Ureta (2003); Lopez-Cordova (2005); Parinduri and Thangavelu (2011); Yang (2004).

6 On Dutch Disease effects see Acosta et al., 2009.

The evidence on institutional quality is, at best, inconclusive. One recent paper uses econometric analysis to examine the relationship between remittance transfers and governance indicators, and observes a consistently negative causal association (Abdih et al., 2010). The authors trace the erosion of institutional quality to accountability relationships. By acting as a buffer between a government and its citizens, so the argument runs, remittances enable households to purchase public goods rather than rely on government provision, which reduces the household's incentive to hold the government accountable. A government can 'free ride' on this increase in consumption and appropriate more resources for its own purposes, rather than finance the provision of public services. Among the many difficulties with this argument, the authors appear to assume that there is a direct substitution effect for public goods (with households reducing demand for government provision as remittance income rises), and that increased private welfare reduces demand for government services. Their paper also fails to recognise the need for caution in tracing causal relationships through highly imperfect data sets.

Another claim is that remittances are associated with 'moral hazard' in recipient communities (Azam and Gubert, 2005).

Remittance receivers, so the argument runs, will be able to maintain consumption while working less. There is no empirical evidence to support this perspective, which is based on some questionable theoretical propositions.⁷ More credible is evidence that, in some contexts, male migration is associated with an increased labour burden on female household members. Under some conditions, remittances may also increase demand for child labour as receiving households with labour shortages seek to undertake new investment activities. Moreover, the increasing number of skilled female migrants entering the US from Latin America, for example, has been identified as a major concern because of the psychological effects on children and migrant mothers (Suarez-Orozco et al., 2002; Orozco, 2012).

None of this evidence detracts substantively from the large actual and potential benefits associated with remittances. Governments need to guard against the risks of Dutch Disease and an erosion of institutional governances, but these risks can be contained through macroeconomic policies, transparency and accountability. Similarly, while remittances may generate some perverse effects in labour markets, these too can be countered through public policy.

⁷ The underlying assumption appears to be that remittance receivers target a specified level of consumption, rather than optimising their own welfare.

3. The high cost of remittances to Africa

The high charges associated with remittance transfer to Africa have long been recognised as a constraint on development. Yet international efforts to reduce those charges have achieved limited results – in fact, recent evidence suggests that remittance charges may be rising (World Bank, 2013a).

Both the G8 and the G20 have pledged to strengthen the development benefits of the remittance system. The L'Aquila summit of the G8 in 2008 adopted some clear principles backed by a quantitative goal. Political leaders promised to facilitate 'a more efficient transfer (...) enhance cooperation between national and international organizations and (...) make financial services more accessible to migrants.' The communique included a commitment to work towards a halving of the average global cost of remittance transfers, from 10% to 5% over five years – the so-called '5X5' objective. In the final declaration of the Cannes Summit in November 2011, the G20 heads of state also committed to work towards the reduction of the average cost of transferring remittances to 5% by 2014.

The '5X5' commitment has been widely restated and taken up in a number of forums, to no discernible effect on the remittance charges incurred by African migrants. At one level, the persistence of high charges in remittance markets is something of an enigma. New business models and new technologies are transforming financial services across the world. The extension of mobile phone ownership and rise of mobile banking is reducing dependence on fixed location access points and mobile transfers have been associated with increased financial inclusion and reduced costs. One of the most striking examples comes from Africa. The M-PESA network in Kenya is now one of the world's largest mobile money operators. Launched in 2007 by Safaricom, the country's largest mobile-network operator, M-PESA is now used by over 17 million Kenyans – some two-thirds of the adult population.

Yet despite the pervasive coverage of such mobile networks across Africa, technological innovation has yet to drive down costs in remittance markets. The barriers to cost-reduction include an oligopolistic international market reinforced by financial regulation in favour of a small number of banks.

The global remittance market

The profile of remittance intermediaries varies across countries and regions. Most transfers occur through money transfer operators (MTOs). Banks have shown little interest in entering the market for remittances, partly because the sums involved in

individual transactions – typically between \$150 and \$300 – have been viewed as too small for the inter-bank system.

MTOs typically link remittance senders to receivers in Africa through an agent. The portfolio of transfer options range from 'cash-to-cash' to 'debt/credit-card-to-cash' and 'account-to-cash', with consumer preferences dictated by cost, convenience and information.

When Africa's migrants send remittances home, they enter markets characterised by a concentration of market power. The 'big four' MTOs are Western Union, MoneyGram, Ria Financial services and Sigue. Western Union alone accounts for an estimated one-fifth of international remittance transfers – some \$80 billion in 2011. MoneyGram, the second largest company, transfers around \$20 billion annually. In the case of Africa, the two companies exercise what amounts to a duopoly in most countries (see below).

Remittance trade generates large revenues. In 2012, Western Union reported an operating income margin of 28% on \$3.5 billion in transaction fees and \$988 million in foreign exchange revenues (Western Union, 2012). MoneyGram reported margins of 20% on revenues of \$1.4 billion (MoneyGram, 2014). Both companies have registered strong growth in revenues, reflecting a wider increase in cross-border remittances. The Middle East and Africa have been Western Union's fastest growing market, with 7% growth in 2012. Revenues on foreign exchange transaction have grown at a prolific rate, with Western Union achieving 16% growth in 2012 (Western Union, 2012).

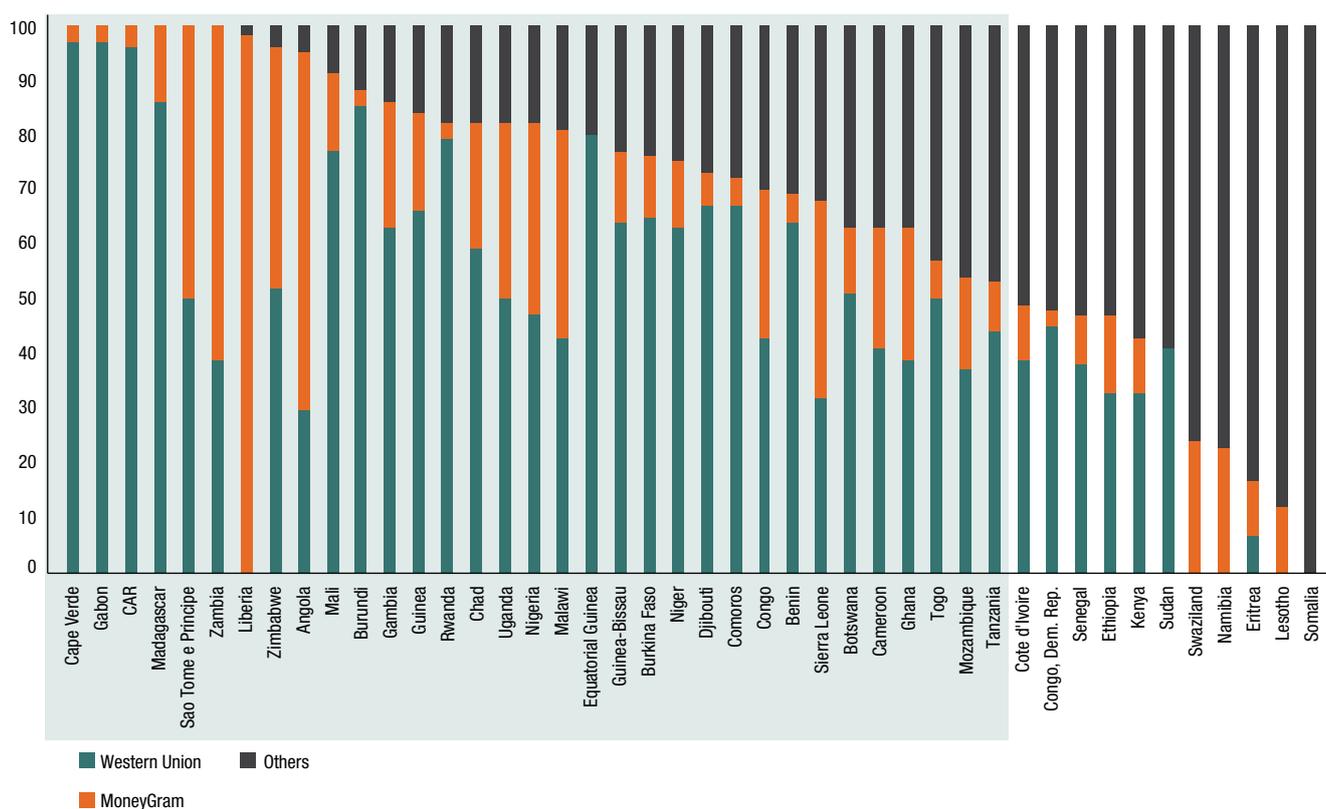
Given the very large margins on offer, why are other firms not entering the market at scale? There are a number of barriers to entry. One of the biggest is presence on the ground. Western Union has 510,000 agents globally (Western Union, 2012), many of them operating in areas beyond the reach of banks and formal financial institutions. MoneyGram has 336,000 agents worldwide (MoneyGram, 2014). Market share is closely related to the number of agents – and Western Union has expanded its network by a factor of five in the past few years (The Economist, 2012). Exclusivity arrangements between MTOs and commercial banks represent another barrier to entry (see below).

From global to regional – remittance markets in Africa

Remittance markets in Africa are dominated by a duopoly of Western Union and MoneyGram. Using pay-out locations as a proxy for market share, there are 22 countries in which *either* Western Union *or* MoneyGram account for more than half of the total (Figure 3).

8 This figure includes North Africa.

Figure 3: Concentration of market power: % of pay-out locations by company, Western Union and MoneyGram



Note: Shaded area represents countries in which market share is $\geq 50\%$.

Source: IFAD Sending Money Home to Africa, 2009.

In another 11 countries, the two together represent over half of locations. Western Union has some 30,000 agents in the region.⁸

It is beyond the scope of this paper to provide a detailed account of remittance-market structures. Remittance service agencies provide services to clients and charge fees either directly or through agents. Recipients receive transfers in stores, banks, post offices or, in some cases, micro-finance institutions (MFIs). The role of the main actors can be briefly summarised.

Commercial banks. In several African countries, banks are the only agency authorised to conduct money-transfer operations, and typically partner with large MTOs. In countries where only banks are authorised to pay remittances, half are agents of Western Union and MoneyGram, the largest MTOs in Africa. According to one market survey, banks in partnerships with Western Union service about 41% of payments and 65% of all pay-out locations (IFAD, 2009). There are 29 countries in Africa where banks account for over half of the in-bound remittance payments. In Ethiopia, Niger and Nigeria the share exceeds 80%, rising to 100% for South Africa, Mozambique, and Lesotho.

Money transfer operators (MTOs). These offer both cash-to-cash transfers as well as electronic money transfer services. MTOs operate through networks of agents and partnerships with correspondent banks in recipient countries.

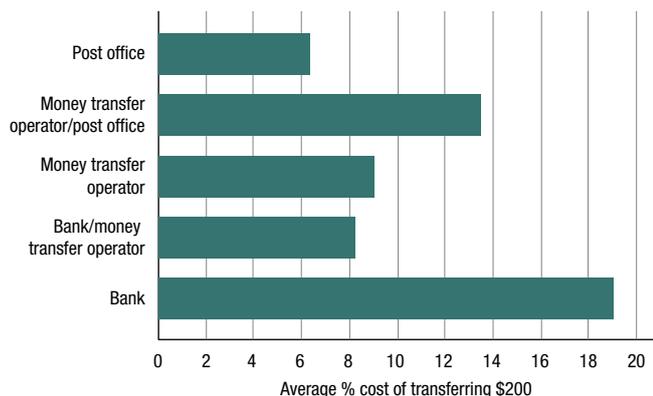
Non-bank financial institutions. This umbrella category includes credit unions, cooperatives and MFIs. Under the regulations operating in most African countries, these institutions

can only serve as payment agents for MTOs. Few are authorised to pay remittances directly. While far more Africans have accounts with MFIs than with formal financial institutions, the former account for only 3% of remittance pay-out locations (McKay and Pickens, 2010). Only a small number of countries – including Kenya and Ghana – authorize micro-finance institutions to carry out international money transfers (World Bank and European Commission, 2013).

Post offices. While commercial banks are inaccessible to the poorest in many countries, post offices have far higher levels of coverage. One survey estimates that more than 80% of post offices in SSA are located outside the three largest cities in the region (Clotteau and Anson, 2011). This provides postal networks a unique opportunity to become a link in the remittance transfer chain. However, in total, only about 20% of all post offices in Africa are authorised to pay remittances (Clotteau and Anson, 2011).

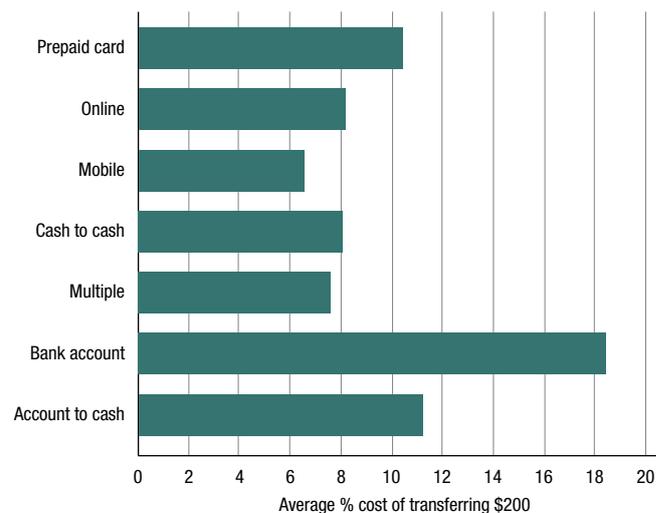
Data provided by the World Bank have made it possible to construct a more detailed picture of remittance transfer costs. In Africa, as in other regions, bank transfers are associated with the highest charges, with post-office and online transfers incurring the lowest charges. Between these options are an array of charges (see Figures 4 and 5). In a World Bank sample survey for the last quarter of 2013, bank charges averaged 19% – more than twice the average level for MTOs. Post offices represented the lowest cost option. However, this option is associated with limited reach because of the regulatory environment.

Figure 4: Average % cost of transferring \$200 by type of remittance service provider



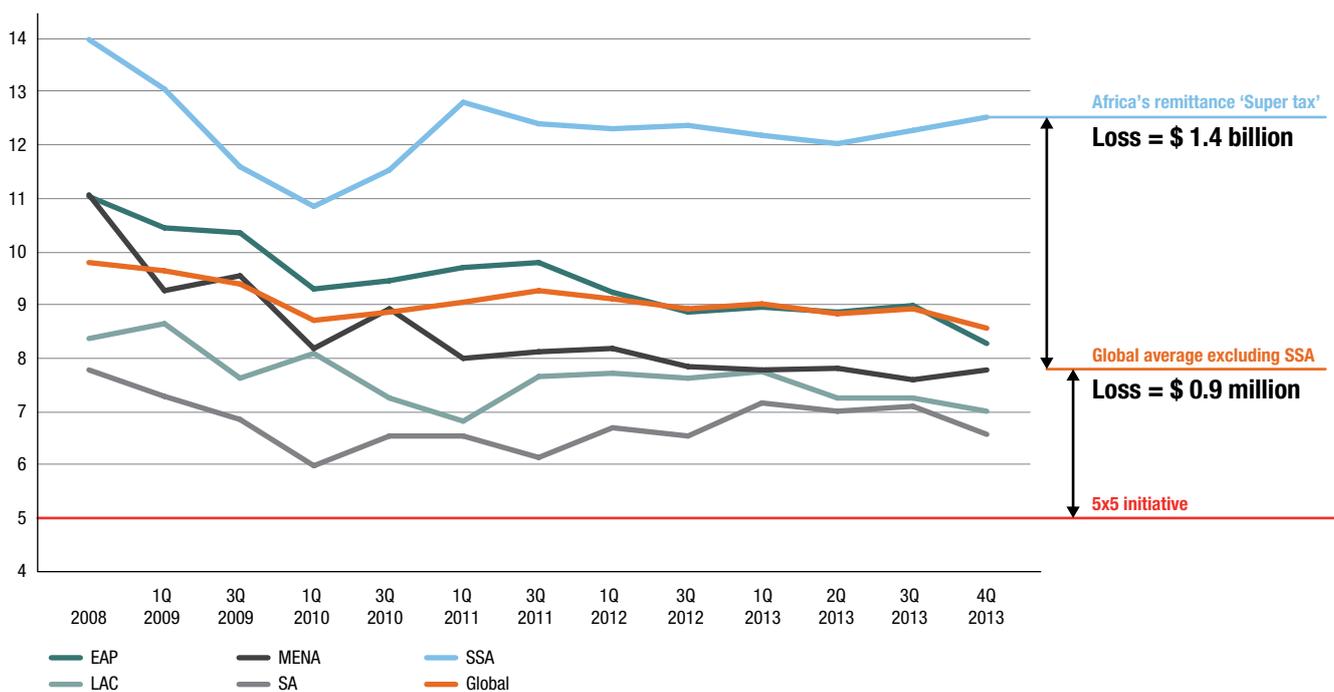
Source: World Bank Send Money Africa, January 2014.

Figure 5: Average % cost of sending \$200 by product type



Source: World Bank Send Money Africa, January 2014.

Figure 6: Average % cost of transferring \$200 by region



Source: Remittance Prices Worldwide database of the World Bank.

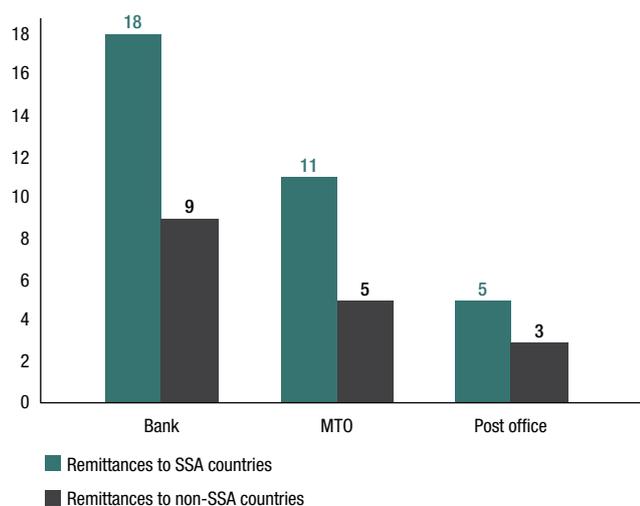
Africa's remittance super-tax

Charges on remittances to Africa are well above the levels reported for other regions – and they have increased since 2010 (Figure 6). On average, an African migrant sending \$200 home will pay around \$25, or 12.3%. This compares with a global average (without SSA) of 7.8%. Typically, Africa's diaspora pays twice as much as its South Asian counterpart when sending money home.

Beneath the headline figures there are marked variations across agencies. Charges are highest for banks and lowest for post-offices. Across the spectrum of service delivery mechanisms, charges for Africa are far higher than the global average (Figure 7).

Africa's disadvantage in charging can be thought of as a 'remittance super tax'. While not a tax in a literal sense, the charging gap between Africa and the rest of the world can be thought of as a levy. The distinctive feature of this levy is that it

Figure 7: Africa's disadvantage: % cost of transferring \$200



Source: Remittance Prices Worldwide database of the World Bank, 2013.

diverts revenues away from households and towards MTOs and other intermediaries that link remittance senders and receivers.

We estimate the 'super tax' transfer by reference to two benchmarks. The first, a lower-bound estimate, is the gap between charges for Africa and global average charges. In setting the second benchmark, we follow a method used by the World Bank and others that estimates the gain that would accrue if charges were lowered to the 5% international target level.

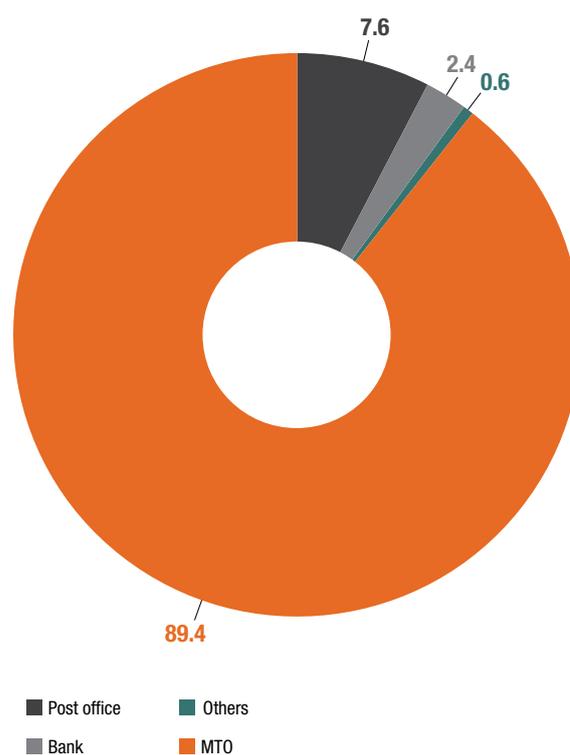
Our estimate for the 'remittance super tax' transfer (set out on the right-hand side of Figure 4) is \$1.4-2.3 billion. This implies a mid-range loss estimate of \$1.8 billion.

Part of the derived loss that we identify occurs through the operations of MTOs and other intermediaries. It is not possible to estimate with any precision how the loss is distributed across the remittance intermediaries. This is because there is insufficient information on charge structures for different forms of transfer, the volume of each type of transfer, and the costs associated with financial regulations and banks in Africa.

However, an adjusted form of our benchmarking does provide a plausible picture of how the \$1.8 billion loss is distributed. Market share provides one proxy indicator (Figures 8 and 9). MTOs account for just under 90% of remittances, with Western Union (40%) and MoneyGram (24%) accounting for two-thirds of the total. Another company specific proxy indicator is the charge reported for Western Union and MoneyGram on the World Bank's 'Remittance Prices Worldwide' website. This charge can be compared with the global average to derive an 'Africa loss' effect. Taking the \$1.8 billion global loss figure as a reference point and using a simple extrapolation from market share, MTOs would account for around \$1.6 billion.

Table 2 summarises the results of our derived loss approach applied to the two largest MTOs (see the technical annex for details). The estimated ranges are fairly large – \$365–807 million, reflecting the variance in benchmarks. The lower end of the range (based on reported charges) would appear to be implausible, given

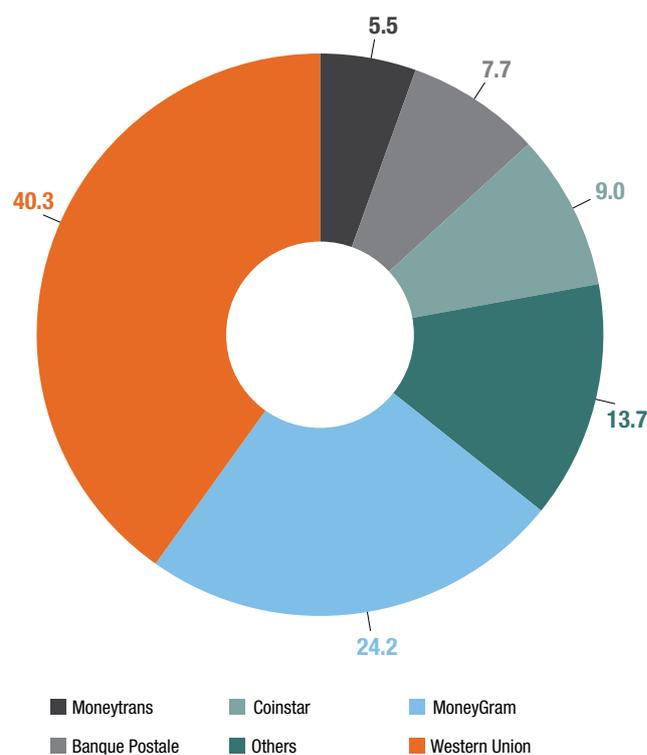
Figure 8: % of pay-out locations* by type of provider



Notes: * We here use the % of remittance pay-out locations as a proxy for 'market share', and throughout.

Source: IFAD Sending Money Home to Africa, 2009.

Figure 9: % of MTO pay-out locations by company



Source: IFAD Sending Money Home to Africa, 2009.

Table 2: Estimating the share of Western Union and MoneyGram in Africa’s remittance ‘super tax’

	Reported charge and market share estimate*	Market share estimate**
Western Union (WU)	\$185 million	\$504 million
MoneyGram (MG)	\$180 million	\$303 million
Total for WU and MG	\$365 million	\$807 million
Mid-range figure	\$586 million	

Notes: * Based on respective % of remittance pay-out locations (40.3% for WU and 24.2% for MG) and on their average charges on remittances to SSA (9.4% for WU and 10.4% for MG). For details, see Technical annex 3; ** Based on share of remittance pay-out locations. For instance, for Western Union: $US\$1.4bn \times 0.894 \times 0.403$
Data source: World Bank ‘Remittance Prices Worldwide.’

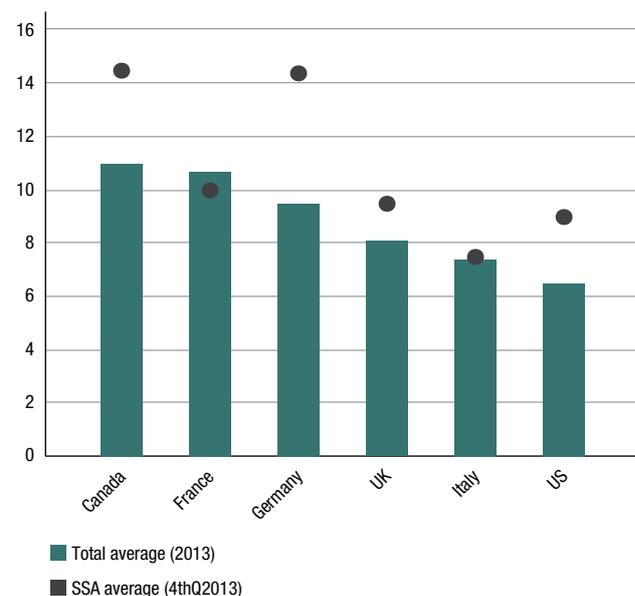
Western Union’s and MoneyGram’s market share (from which we derive the upper-bound estimate). The mid-range figure for the loss from transfers through the two companies, their agents and associated banks is \$586 million. It is important to recall that any figure derived from reported remittances is likely to constitute an under-statement, because of the under-reporting of remittance transfers (World Bank, 2013a).

Whatever its distribution, the ‘remittance super tax’ is effectively a levy on development and self-reliance. It hurts remittance senders and receivers, as well as national economies, in two respects. First and foremost, it diminishes the resources available for household spending in areas such as education, health, food security and productive investment. Second, other things being equal, a higher charge is likely to reduce the size of remittance transfers, which has both household and wider macro-economic effects.

How significant are our loss estimates in terms of wider external financial flows? Comparisons with aid are instructive. The mid-range loss estimate of \$1.8 billion annually is equivalent to just over half of the aid to Africa provided by the UK, the region’s third largest bilateral donor. It represents 40% of transfers to Africa through the World Bank’s International Development Association (IDA) – the largest source of multilateral aid. With aid budgets under pressure, reduced remittance charges could unlock increased development finance.

Viewed through a different prism, \$1.8 billion would be sufficient, at current levels of per-pupil spending, to put almost 14 million of Africa’s children into school. To place that figure in context, it represents around half of the out-of-school total in SSA.⁹ Alternatively, the savings that would result from cutting the ‘super tax’ would be sufficient to provide improved sanitation

Figure 10: Remittance charges from the G7 (excluding Japan): total average % cost of transferring \$200



Source: Remittance Prices Worldwide database of the World Bank.

to 8 million people, or clean water to 21 million people.¹⁰ While these figures are only indicative of possible investment outcomes, they illustrate the scale of the opportunity cost associated with the high charges on Africa’s remittances.

Variations across OECD countries

One of the most striking features of remittance charges for Africa is their variability across OECD countries (Figure 10). Average costs in the two largest remittance markets – France and the UK – are around 10%. Levels in Germany are considerably higher. It is not obvious why charges should vary to this degree. Given that most of the companies involved are global and that remittance operations are relatively simple, some uniformity in charging might have been anticipated. Looking beneath these headline figures reveals a number distinctive charging systems, with low levels of variation on basic fees and high levels of variation on foreign currency conversion charges (Box 2).

9 There were just under 30 million primary school-age children reported as being out of school in SSA in 2013. Average annual per-pupil spending in sub-Saharan Africa is \$131 (UNESCO, 2013/4).

10 Figures for access to improved water and sanitation are based on Hutton et al. (2007), and Hutton and Bartram (2008).

Box 2: Remittances from the United Kingdom

With a large African diaspora population, the UK is a major source of remittance to Africa. In 2012, some \$5 billion was transferred – around 15% of the global total. It follows that the terms under which African migrants transfer money from the UK have far-reaching implications for development.

Western Union and MoneyGram are the largest sources of remittance transfers to Africa from the UK. Partial data available from the World Bank point to a marked variation in charge levels – and in the charge profile. MoneyGram charges 15% on average (with 4 percentage points of the charge coming through a foreign currency conversion levy). Western Union’s average charge is 10% (with 3 percentage points charged on foreign currency conversion). On the basis of the commercial market information currently available, it is not possible to determine the reasons for the charging differentials.

Research undertaken for this report looked behind the average at the country-level pattern of charges. We focused on ‘on-line credit’ and ‘debit-card-to-cash’ transactions: among the cheapest reported remittance avenues. We looked at charge structures for 15 countries in sub-Saharan Africa and 4 comparator countries (Figures 11 and 12). In doing so, we followed the convention of counting both direct charges in the form of fees and the foreign exchange margin, as determined by the difference between the exchange rate applied by the money transfer operator and the inter-bank exchange rate. The technical details of the exercise are provided in the technical annex.

Our exercise is obviously limited in scope. We do not track changes over time, nor are we able to access historic data on foreign exchange spreads. Even so, our findings raise a number of questions that may have a bearing on wider aspects of the global remittance economy.

- *There appears to be an ‘Africa rate’ for fees, independent of country characteristics.* The uniform-rate basic charge applied by Western Union is around 8.3%. Given the differences in country conditions, the reasons for the uniform fee are difficult to establish: operating conditions in Kenya are clearly very different to those in Sierra Leone, yet Western Union applies a uniform charge. In addition, the fee structure appears to be independent of the volume of trade. It is equivalent in Nigeria (\$3.8 billion in remittances) and Rwanda (\$4.2 million in remittances). MoneyGram appears to operate a tiered band approach. For most countries the band is well above the Western Union level, at 14.6%. In only two cases – Ghana and Kenya – does it match the Western Union basic fee charge.
- *There are large variations in foreign exchange charges.* Foreign currency conversion charges range from 0.6 to 6 percentage points above the fee for Western Union, and they can reach 8 percentage points above the fee for MoneyGram. There are marked differences in foreign exchange fees applied by the two companies. Once again, the fee structure is not obviously related to risk or country conditions. Migrants from Tanzania and Ethiopia face lower charges, respectively, than migrants from Kenya and Botswana when remitting from Western Union. If underlying market conditions do not explain the price differentials, the variations may be related to inadequate consumer information or company policy on the margins targeted for currency conversion.
- *There are marked disparities in fees between Western Union and MoneyGram.* These disparities apply in countries where one company has an overwhelming market share (Western Union in Rwanda) and in countries – such as Uganda, Zambia and Zimbabwe – where there is a more even market split. Differential charges in one country may be explained by market segmentation, with one company dominating either in a geographic area or in a specific product group. This is an area that requires further research to understand the relationship between charge structures and market conditions.

Based on the profile of remittances in 2013, we estimate that the UK is responsible for \$85 million to \$225 million of the losses incurred by Africa through the ‘remittance super tax’. Using the proxy measures outlined for the wider global estimate, between \$49-130 million of the figure may be associated with transfers involving Western Union and MoneyGram (Table 3).

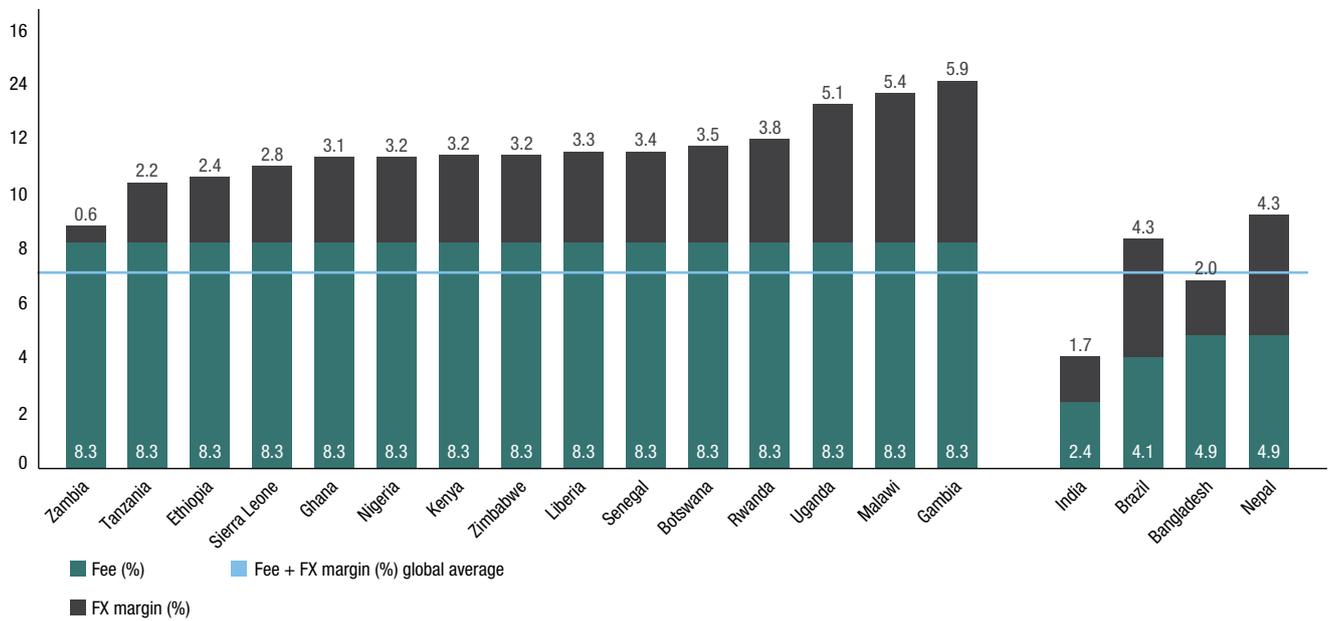
Table 3: Current charges and implied losses through the remittance ‘super tax’ from the UK

Amount of remittance: \$5 billion in 2012

Current charges	9.5%	\$475 million
Charges at global average (excluding SSA)	7.8%	\$390 million
Charges at 5%		\$250 million
Implied losses through ‘remittance super tax’		\$85 – 225 million
Mean value		\$155 million
Estimated share of losses from WU and MG*		\$49 – 130 million
Of which		
Western Union		\$31 – 81 million
MoneyGram		\$18 – 49 million

Note: *Based on the % of remittance pay-out locations (see Table 2 notes).

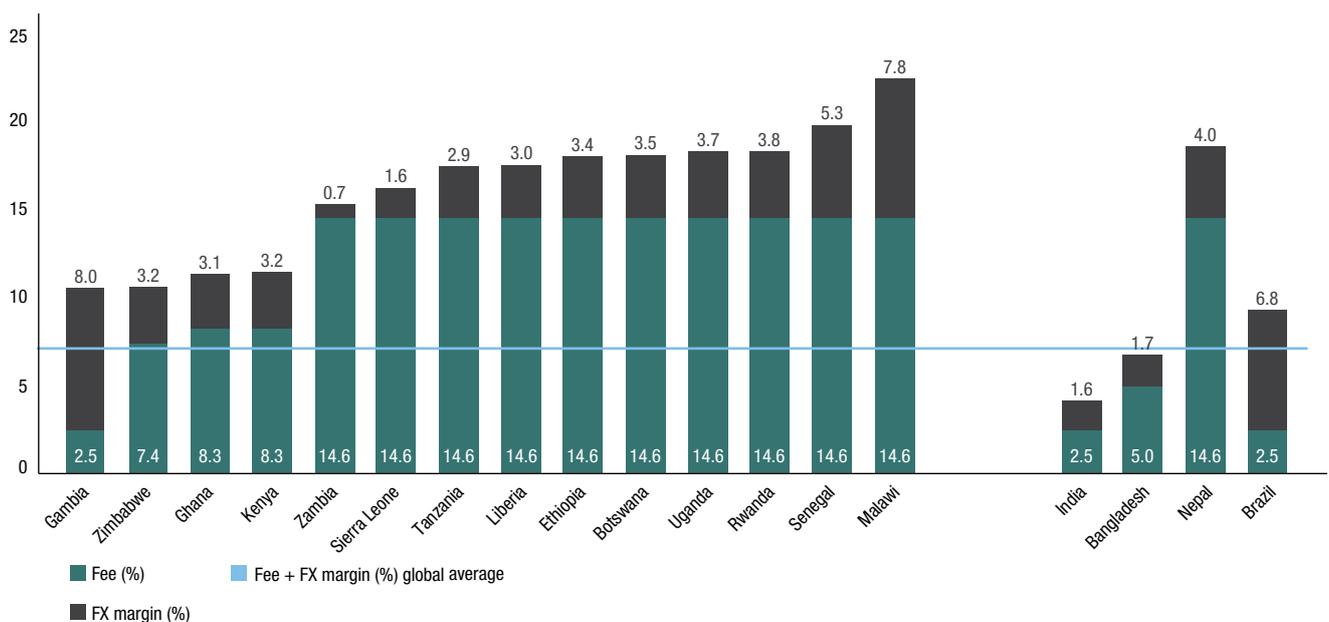
Figure 11: Western Union remittance charges to the UK: % cost of transferring £120 (or \$200) for selected SSA countries



Note: Pay online with debit/credit card; delivery method: cash. The global average (excluding SSA) of fee and foreign exchange margin for the online service offered by MTOs is 7.12%.

Source: WU website; data collected on 21 March, 2014.

Figure 12: MoneyGram remittance charges from the UK: % cost of transferring £120 (or \$200) to selected SSA countries



Note: Pay online with debit/credit card; delivery method: cash. The global average (excluding SSA) of fee and foreign exchange margin for the online service offered by MTOs is 7.12%.

Source: MoneyGram website; data collected on 21 March, 2014.

Africa's high charge remittance corridors

It is not just on international remittances that African migrants face excessive charges. People crossing borders within the region as seasonal workers or traders face charges far higher than those for OECD-Africa corridors.

All of the world's top ten remittance-charging corridors are to be found in SSA, with South Africa and Tanzania figuring in all but one of these corridors. Workers from Malawi, Mozambique and Zimbabwe employed in South Africa, and Ugandans remitting money from Kenya face charges well in excess of 20% if they conduct the transfer through banks. MTOs have lower charge structures, but these are still well above OECD-Africa levels. As illustrated in **Table 4**:

- there are ten countries in the region with remittance corridor charges for banks in excess of 20%: migrant workers from Malawi remitting through banks in South Africa and Ugandans sending money home from Tanzania pay one quarter of the remittance in charges
- there are nine intra-Africa corridors with MTO fees in excess of 15%, rising to 39% for Nigerians remitting money home from Ghana.

The very high charges levied on remittance corridors to and within Africa reflect the central role of banks – the most costly transfer vehicle.

Factors that contribute to higher prices

Why are remittance charges for Africa so high? The opaque nature of commercial operations makes it difficult to answer that question. The cost structures facing MTOs in Africa are largely unknown, and there is little systematic evidence on the relationship between foreign-currency conversion operations and risk factors, such as currency volatility. Similarly, no MTOs publish the terms of commercial agreements with African banks.

While there is considerable variation across remittance corridors, several inter-connected factors combine to maintain Africa's high charge structure. These include a lack of transparency on the part of RSPs, limited competition, regulatory practices that restrict market entry and – critically – a lack of financial inclusion in Africa itself.

Lack of transparency on foreign-exchange costs

Exchange-rate provisions illustrate the transparency problem. Currency conversion fees are one of the key factors influencing overall charges (see the UK example in Box 2). It follows that transparent information about exchange rates can help remittance senders to make informed choices and facilitate competition among RSPs.

The exchange-rate 'spread', which determines the charge, is the percentage difference between the retail rate provided by RSPs and the inter-bank rate. For providers, the spread is a source of revenue and shareholder value that is set in order to price risk, maximise profit or attract consumers (cfpb, 2011).

For Africans sending money home, 'spread' charges can represent up to half or even more of total costs. Yet MTOs vary in the degree to which they provide transparent information in an accessible form. Few provide clear descriptions of their policy

Table 4: Cost of transferring \$200, 3Q2013

Africa's ten most expensive bank remittance corridors

Destination	Source	Total % cost
Angola	South Africa	21
Zimbabwe	South Africa	21
Zambia	South Africa	21
Nigeria	Ghana	22
Mozambique	South Africa	23
Botswana	South Africa	23
Kenya	Tanzania	24
Rwanda	Tanzania	24
Uganda	Tanzania	24
Malawi	South Africa	25

Africa's ten most expensive MTO remittance corridors

Destination	Source	Total % cost
Rwanda	Kenya	8
Lesotho	South Africa	15
Swaziland	South Africa	15
Zimbabwe	South Africa	15
Botswana	South Africa	16
Angola	South Africa	16
Zambia	South Africa	19
Mozambique	South Africa	19
Malawi	South Africa	27
Nigeria	Ghana	39

Source: World Bank 'Remittance Prices Worldwide Third Quarter 2013' dataset.

on spread charges, or on the share of the total fee represented by these charges. In a visit to the UK web-site of Western Union to investigate currency charges, we were unable to find detailed information on the currency component of the remittance charge. The company also reserves a high degree of discretion with respect to currency conversion margins: 'Western Union applies a currency exchange rate if we convert your funds to a different currency. Any difference between the exchange rate you're given and the one we receive will be kept by Western Union (and, in some cases, our agents).' Many of the European banks involved in remittance provision are unable to specify the exchange rate for African currencies (World Bank and European Commission, 2014).

Consumer groups in the US have campaigned for enhanced disclosure. For example, the Consumer Financial Protection Bureau has called for a rule that would require all MTOs to provide detailed information on exchange rate fees (Cfpb, 2014). In a similar vein, Consumer International has called for regulatory bodies to require MTOs to itemise online and in retail outlets all applicable fees, costs and taxes including transfer fee, the foreign exchange rate applied and referencing the applicable spread (Consumers International, 2012).

One example of questionable practice on exchange rate fees comes from Ghana. When the country's national currency, the Cedi, was devalued in January, 2013, RSPs transferring to the country initially reflected the new rate in their charges. However, over the course of 2013 they allowed their conversion rate to diverge from the inter-bank rate, pushing the costs of remittances up from 10% to 16% (World Bank, 2013b). This outcome raises concerns at a number of levels. If the divergence occurred in just one major provider, the rise could have reflected the limited availability of information for consumers. However, if the divergence was applied across several operators it would point to the possibility of collusive pricing.

Exclusivity agreements

Exclusive agreements involving the major MTOs on the one side and their agents and commercial banks on the other are another driver of high charges because they restrict competition. Such agreements are common in Africa.

Exclusivity agreements with banks allow, and in some cases require, MTOs to conduct transactions through nominated banks (Ratha et al., 2011; UNCTAD, 2012; IFAD, 2009). One survey in Nigeria, carried out in 2007, found that 21 of the 25 banks operating in the country had exclusive agreements with either Western Union or MoneyGram. Acting as a sole international remittance partner for 15 banks, Western Union accounted for over two-thirds of monthly bank remittance transaction. In 2008, the Nigerian Central Bank ruled that: 'exclusivity clauses aimed at protecting the interest of the International Money Transfer Operators, constitute a restraint on competition and unnecessarily increase the cost of money transfer services to the users' (Central Bank of Nigeria, 2008).

Regulatory authorities in some countries are actively reviewing exclusivity agreements. Both Ghana and Nigeria have now adopted rules prohibiting exclusivity, though many sole agreements continue. Senegal has also instructed banks to remove exclusivity clauses. These cases illustrate a wider reform currently extending beyond SSA. In January 2013, as part of a wider financial liberalisation programme to combat the legacy of corruption and inefficiency inherited from the previous regime, central bank authorities in

Tunisia revoked all bank exclusivity clauses. Banks in the country are now required by law to offer services from more than one MTO.

Exclusivity agreements are also widely applied by MTOs to their agents. It is common practice for Western Union and MoneyGram to require their agents to work for them as sole remittance providers. The MTOs themselves cite a number of grounds in defence of such arrangements. These range from the prevention of 'free riding' by competitors seeking to reap the benefits of initial investment in training and the development of outlet locations, to compliance with regulatory measures on money laundering, fraud and criminal activity.

While not without foundation, these arguments do not address the central concerns raised by agent exclusivity. With just two companies accounting for two-thirds of agent outlets in Africa, exclusive arrangements severely restrict competition in what is a highly concentrated market.

Here, too, several countries are reviewing legislation. One example comes from the Gambia, where Western Union and MoneyGram together provide around 96% of money transfer services. Following a complaint from a local agent contracted to MoneyGram, the country's Competition Commission has reviewed exclusivity clause arrangements. These agreements prohibit local agents from contracting with other providers for up to six months after the expiry of a contract. The findings of the Commission are instructive. Its investigation determined that 'the leading providers of money transfer services are exploiting the monopoly situation...that is restrictive and anti-competitive in nature.' The Competition Commission has directed exclusivity clauses to be removed on the grounds that they 'constitute an abuse of the dominant position enjoyed by Western Union and MoneyGram' and a barrier to the development of a competitive remittance service system that is responsive to customer needs (Investigation Report to Competition Commission, 2011).

Financial regulation in Africa

Africa's banks are, for the most part, poor at intermediation. This is reflected in high interest-rate spreads, a limited geographic reach and portfolios dominated by a lucrative trade in treasury bills. Regulatory directives often drive up costs by requiring banks to finance government debt and, in some cases, loss-making enterprises, on subsidised terms. Imposing high costs on the remittance trade helps to finance inefficient banking operations geared towards the subsidisation of government debt.

Few of Africa's banks offer dedicated services to remittance senders, particularly those who need to send small amounts from one African country to another. More broadly, the payment system infrastructure is not equipped in most countries to handle money transfers. Small value transfers are conducted using products and platforms of the Society for Worldwide Interbank Financial Telecommunications (SWIFT), which process payments through correspondent bank networks.

11 Order 13224 (United States Department of the Treasury, 2001b) is designed to block the assets of individuals or companies providing support to terrorist organisations; Order 13536 (United States Department of the Treasury, 2010) deals specifically with Somalia.

12 The federal regulatory system comes under the remit of the Treasury Department through the Office of the Comptroller of the Currency, the Financial Crimes Enforcement Network (FinCEN), and the Office of Foreign Assets Control (OFAC), agencies that ensure compliance with the Bank Secrecy Act and the USA Patriot Act. The activities of the FinCEN focus on preventing money laundering practices, while the OFAC is involved in monitoring transfers from certain entities or countries.

However, the existing international correspondent banking networks in several African countries are not well adapted to process low-value retail flows (Mohapatra and Ratha, 2011).

Regulatory authorities in some countries have allowed banks to impose what amounts to a levy on remittance. One example is the application of a 'lifting fee' – a charge incurred by the remittance receiver over and above payments made by the sender. According to the World Bank, the application of the lifting fee on transfers from the US to Kenya has the effect of doubling the effective charge, to 16% (World Bank, 2013a).

Low-levels of financial inclusion

Financial exclusion compounds the adverse effects of the wider regulatory environment. Most Africans are 'unbanked' and the formal financial system has a limited reach, especially in rural areas. The entire region has fewer pay-out locations than Mexico (IFAD, 2009). Yet financial regulators have, for the most part, preferred to consolidate the central role of banks in paying remittances, rather than devolving authority to providers with a larger client base.

Around 80% of adults in SSA – some 301 million people (excluding South Africa) – have no account with a formal financial institution (World Bank, 2011c). Far more people are connected to MFIs than to formal institutions. For example, out of a population of nearly 90 million, only 7.1 million Ethiopians have deposit accounts. Access to finance in rural areas is limited to 31 MFIs, providing financial services to 2.9 million clients (IMF, 2013). Similar patterns are repeated in other countries. However, while MFIs have greater reach, financial regulation precludes all but a few from providing remittance payments. The same is true of post offices, which have far larger branch networks in most countries than banks.

Anti-money laundering provisions

Emerging security legislation to counter money laundering and the financing of terrorist groups could have the unintended effect of inflating remittance charges. In particular, the application of more stringent rules on due diligence and more severe penalties run the risk of reducing competition in an already restricted market.

The regulatory environment for remittance providers has undergone major changes over the past decade. Authorities in OECD countries have sought to bring remittance operators under the broader rules governing banks and financial institutions. At the same time, the globalisation of criminal networks and perceived threats posed by terrorist financing have led to a

concerted drive to combat money laundering. The Financial Action Task Force (FATF), an inter-governmental body established in 1989, has played a prominent role in framing multilateral standards and monitoring national plans. The most recent set of recommendations was adopted in 2012 (FATF, 2012).

An important backdrop to reform has been the merging of financial regulation and national security provisions in the US. Legislation adopted in the aftermath of 9/11 has had far-reaching implications. The US Patriot Act (2001) (United States Department of the Treasury, 2001a), along with two Executive Orders,¹¹ greatly increased the potential risks for financial institutions associated with remittance organisations.¹² One of the more widely publicised consequences of the regulatory burden and risk associated with the new legislative environment was the decision by a number of banks to close accounts serving Somali remittance providers (Hurlburt, 2012). More generally, a series of high-profile anti-money laundering investigations and large fines imposed on banks has produced a regulatory 'chill' effect.

Developments in Europe have to some degree mirrored those in the US. While the EU has a more fragmented regulatory landscape, the Payments Service Directive (2007) and Anti-Money Laundering Directive (2005) provide for a more stringent regulatory environment. There is an increased emphasis on firms identifying and managing money-laundering risks. US legislation has also had consequences for Europe. In May, 2013, Barclays announced that it would close all but 19 of its clients in the remittance transfer business, including those in Somalia – a move that would have had disastrous consequences. An injunction preventing Barclays from closing the account of the largest MTO serving the Somali regions – Dahabshill – has provided a temporary stay, but no long-term resolution is in sight.

The wider danger is that more stringent reporting requirements will further limit competition in remittance markets. If smaller, informal remittance providers are unable to operate through correspondent banks, their ability to compete against the major global companies will be compromised. In addition, the costs of complying with 'know your customer' requirements has the potential to increase regulatory costs and create another barrier to market entry. MTOs will inevitably pass the cost of anti-money laundering operations on to consumers. One proposal to address this issue, framed by the FATF, envisages a minimal threshold for remittances requiring detailed information on senders.

4. Unlocking the benefits of remittances for development

Remittances are set to remain a major source of development finance for Africa – and Africa’s diaspora will remain an important stakeholder. Yet it is hard to escape the conclusion that a large gap remains between potential and realised benefits. Closing that gap will require action on several fronts.

There is no shortage of innovative projects and programmes. Remittance transfers figure prominently in a wide range of interventions supported by the World Bank, the African Development Bank and bilateral donors to strengthen the efficiency of bank payment systems, promote branchless banking and support the development of a regulatory environment aimed at strengthening competition. The scope of innovation is well captured in a recent World Bank publication (Mohapatra and Ratha, 2011), and financial inclusion has been a central theme. For example, IFAD and the Universal Postal Union have supported the development of post-office remittance services in 16 corridors in West Africa, spanning Benin, Burkina Faso, Mali and Senegal. While relatively small in scale, the project has reportedly reduced the cost and time of remittance transfers (IFAD).

Mobile technologies are now being applied more widely to remittance transfers. Orange Money Transfer International (OMTI), which was launched in 2012, has linked up with MFS Africa – a company that operates across the region – to enable customers to make payments to mobile accounts. OMTI has reportedly established a network of 1,000 agents in Malawi. However, it is not clear that market entry has reduced charges.

That outcome points to a major concern. New technologies introduced into an uncompetitive market will not automatically generate price-reducing benefits for consumers. Mobile banking companies are increasingly entering remittance markets through partnerships with the major global MTOs. M-Pesa, the Kenya mobile banker linked to Vodafone, has teamed up with Western Union and MoneyGram. Western Union is also expanding its range of mobile services in Africa through a mobile money company called eTranzact, which has operations in Nigeria, Ghana, Kenya, Zimbabwe, South Africa, Côte d’Ivoire and the UK. Customers of eTranzact will now be able to interact with Western Union on their mobile phones, receiving Western Union mobile money transfer from 23 ‘sender’ countries. In the absence of changes in underlying market conditions, there is no immediate reason to anticipate major price reductions.

Regulation is one of the underlying conditions. M-PESA’s records in driving down the costs of retail banking and expanding access is instructive. Several distinctive features in the regulatory environment stand out (Vaughan et al., 2013). First, financial regulators stood aside once the initial payment architecture had been put in place, allowing a wave of competition into the

retail banking system. Second, the companies involved invested in informing people about the services on offer, including the provision of transparent financial information. Third, growth has generated its own momentum. M-PESA has since been extended to savings and loans products.

Unfortunately, financial regulators have shown little inclination to promote the use of devolved mobile banking for remittances. The technologies themselves could be easily adapted for use by licensed post offices and micro-finance institutions. Emerging delivery models involving ‘M-wallets’, essentially mobile money accounts, are gradually replacing formal banking in Africa – but principally in domestic transfers. With two-thirds of pay-out locations serviced by banks in partnership arrangements with Western Union and MoneyGram, mobile banking arrangements are mediated through high-cost formal banks. Regulators in Africa have justifiable concerns over their ability to manage the foreign currency risks and anti-money laundering concerns that might accompany mobile remittance operations (UNCTAD, 2012). However, there are clearly vested interests that could be compromised by a more competitive market.

Initiatives involving the diaspora and governments could play a role in strengthening the flow of benefits from remittances. Remittances are not just an economic transfer. They represent a social link between people. Migrants around the world have created ‘home town associations’ through which they retain links and provide support to communities – and Africa’s diaspora is no exception (Orozco et al., 2010; Hernández-Coss and Bun, 2007).

Some initiatives have attempted to promote diaspora philanthropy through public finance incentives. One example is Mexico’s ‘3X1’ programme. Established in 1999, the programme generates a remittance-leverage effect. For every \$1 contributed by a diaspora member through a dedicated Mexican Home Town Association in the US, municipal, state and federal governments each allocate an additional dollar, with the programme used to fund projects. At the end of 2010, it was operating in 28 of Mexico’s 31 states and had approved 2,488 projects, ranging from education, health, road paving and drainage to sports programmes. The benefits of the programme are, however, contested. Supporters point to a range of development investments, while critics argue that the funds are weakly targeted to the poorest municipalities and that there is evidence of political bias in allocation (Aparicio and Meseguer, 2011). An important question in the African context is whether national and local governments have the fiscal space to provide matching grants. Governance concerns would also have to be considered in a number of countries, especially those lacking transparent public financial management systems.

Diaspora savings represent another potential source of development financing. With governments across Africa seeking long-term, affordable financing for infrastructure, these savings are an attractive proposition. Several have issued diaspora bonds to supplement aid, grants and sovereign debt. In 2008, Ethiopia issued a Millennium Bond under-written by the country's National Bank. Another bond – for \$4.8 billion – was issued in 2011 to mobilise financing for the Renaissance Dam (Kayode-Anglade and Spio-Garbrah, 2012). The earlier issue failed to achieve its targets and the latter was eventually sold principally into domestic markets. In both cases, authorities appear to have over-estimated the 'patriotic discount' – the willingness of migrant to accept risks that are not commensurate with yield.

Past failure is not a predictor of future outcomes. In March 2014, Nigeria announced a bond issue of up to \$300 million. The issue has been carefully prepared with the involvement of international banks. It will be registered with the US Securities and Exchange Commission with a coupon rate of around 350 basis points above US treasury bills. At that level it appears likely that the bond will be over-subscribed. This is a potential win-win scenario. The Government of Nigeria stands to secure financing at levels below the rate available on sovereign debt markets (around 8-9%) and the diaspora would have access to an asset generating higher returns than the close-to-zero real interest on bank deposits in the US (Kay, 2014).

All of these initiatives may have a role to play – but none can substitute for the single most effective measure needed to strengthen the benefits of remittances. The most pressing need is to develop more competitive and transparent markets in which innovation can take off.

Five priority areas for reform stand out.

- **Regulatory authorities in OECD countries should actively review the practices of money transfer operators.** There is no evidence of active collusive pricing and other cartel-type arrangements on the part of global MTOs. However, in a market characterised by such extreme concentrations of economic power and such limited competition, there is a risk of monopolistic abuse. EU and US anti-trust bodies should also investigate whether exclusivity arrangements involving MTOs artificially inflate charges and prevent consumers benefiting from competition. In the case of the UK, which we have reviewed in this report, the Financial Conduct Authority should review provisions for the pricing of currency conversion. Investigations by parliamentary committees – such as the Finance and Services Committee and the International Development Committee – could play a role in informing debate and increasing awareness within the diaspora community.
- **Money transfer operators should be required to meet more transparent standards on their foreign exchange operations.** The Dodd-Frank legislation adopted in the US could provide a blueprint (Richard, 2011). The legislation was created, in part, to protect American taxpayers against abusive financial service practices. In the context of remittances, it requires service providers to disclose details of their charging structures, including foreign currency conversion fees. The new Remittance Transfer Rule will cover information on exchange rates, fees and taxes incurred by both the sender and receiver. It will also require federal agencies to provide clear guidelines on low-cost remittance providers. These are all principles that could be adapted in the EU and other OECD remittance sources.
- **African governments (and money transfer operators) should revoke exclusivity arrangements with banks and agents.** Whatever their intention, exclusivity arrangements have the effect of reducing competition and increasing the cost of market entry for new companies. MTO exclusivity arrangements with agents create highly segmented markets characterised by limited competition. Similarly, exclusivity arrangements between MTOs and banks have the same effect as restrictive business practices that are outlawed in other areas. Governments should use their regulatory powers to limit the scope for exclusivity, both with respect to banking and the activities of MTO agents.
- **Regulatory authorities should empower post offices and micro-finance institutions to play a greater role in remittance markets.** While financial regulators and central banks need to protect consumer interests and manage foreign exchange risks, current arrangements are outmoded. Post offices and micro-finance institutions are far more accessible to most Africans, especially in rural areas. Well-designed and effectively monitored licensing systems could facilitate the development of a far more devolved and competitive remittance payments system. Allowing more actors to perform money transfers will introduce greater competition, with potential benefits for price and service quality.
- **Diaspora groups and civil-society organisations should make remittances a core development issue.** Many of the concerns raised in this report relate to market structures, regulatory arrangements and institutions. But the barriers to reform are not only legal and technical. Political economy considerations are also important. Current remittance-market conditions create winners and losers. The winners include major global companies with a strong political voice, their shareholders and stakeholders in formal banking systems. The losers – remittance senders and recipients – are, for the most part, highly dispersed and have a weak political voice. Effective action to publicise the development costs associated with remittances, mobilise public support for reform and push the issue to the centre of the development agenda could play a vital role in shifting an unequal power relationship, and in galvanising reform.

Conclusion

Remittances already play a significant role in Africa's development. They could, however, play a far greater role. No measure would do more to unlock the full potential of remittances than a cut in charges. Achieving this goal will require some significant changes – in banking regulations, in the practices of money transfer operators, and in approaches to new technology. The introduction of more competitive markets with

appropriate safeguards for financial integrity is long overdue. Yet despite a number of high-level initiatives, there is little evidence of charges coming down. This picture is unlikely to change until the reform of remittances is taken up as a development priority by governments in Africa, the G20 and civil-society groups, including African diaspora organisations.

Technical annex

1. Computation of fee (%) and foreign exchange margin (%).

$$\text{Fee (\%)} = \left(\frac{\text{LCU fee}}{\text{LCU amount}} \right) * 100$$

LCU = Local Currency Unit

$$\text{FX margin (\%)} = \left(\frac{\text{FX Interbank} - \text{FX MTO}}{\text{FX MTO}} \right) * 100$$

FX = Foreign Exchange

$$\text{Total Cost} = \text{Fee (\%)} + \text{FX margin (\%)}$$

2. Estimated losses from SSA's remittances 'super tax' (2013)

	Percentage	Value (\$ billion)
Global remittances to sub-Saharan Africa (SSA)		32
Intermediary charges on remittances to SSA (average)	12.3	3.9
Costs for SSA if (fee + FX margin) were reduced to		
Global average (excluding SSA)	7.8	2.5
5% of remittance flows	5	1.6
Estimated losses for SSA are in the range		[1.4 – 2.3]

3. Estimated costs from Western Union and MoneyGram based on reported charges and market share of pay-out locations

(Market share for all MTOs is 89.4% in market of \$32 billion)

	Reported charges: Fee + FX margin (%)	Market share (%)	Value of charge (\$ million)
Western Union	9.4	40.3	1,084(a)
MoneyGram	10.4	24.2	720
Costs for SSA if (fee + FX margin) were reduced to 7.8% (global average)			
Western Union			899(b)
MoneyGram			540
Estimated loss associated with gap between global average charge and company charge			
Western Union			185(c)
MoneyGram			180
Total			365

Notes: (a) 1,084ML= 32bn X 0.894 X 0.403 X 0.094; (b) 899ML= 32bn X 0.894 X 0.403 X 0.078; (c) 185ML= 1,084ML – 899ML.

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Overseas Development Institute

203 Blackfriars Road
London SE1 8NJ

Tel +44 (0)20 7922 0300

Fax +44 (0)20 7922 0399

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