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EXECUTIVE SUMMARY

Lost in intermediation

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How excessive charges undermine the benefits of remittances for Africa

Key points

- 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 to the 5% G8 target would increase transfers by $1.8 billion annually. That figure is equivalent to the cost of paying for the education of some 14 million primary school age children in sub-Saharan Africa – 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.

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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 (Figure A). 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%.

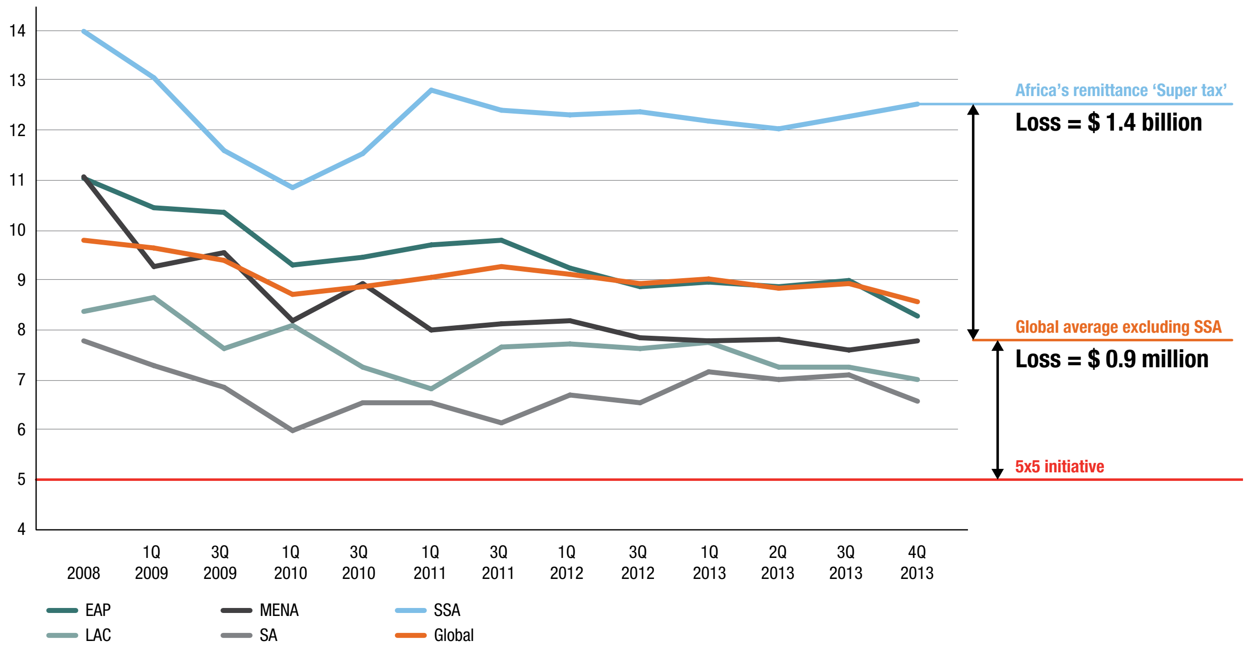
Why does Africa face such high remittance charges? That question is difficult to answer because of the highly opaque nature of remittance markets and the complex range of products available. Much of the relevant commercial information needed to establish detailed structures is unavailable.

However, four 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 sub-Saharan African markets by a duopoly. Just two companies – Western Union and MoneyGram – account for an estimated two-thirds of remittance pay-out locations in Africa (Figures B and C). As in any market, limited competition is a barrier to cost reduction and efficiency gains. Second, there is evidence of 'exclusivity agreements' between money transfer operators, agents and banks. These agreements restrict competition in an already highly concentrated market. Third, financial market regulation, the high costs of intermediation and limited access to financial institutions in Africa represent additional cost-escalators.

Fourth, financial exclusion and poor regulation in Africa escalate costs. Few Africans have access to formal accounts (which limits their choice of 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 the region's development. It would also strengthen self-reliance. Unlike aid, remittances put money directly

Figure A: Average % cost of transferring $200 by region



Source: Remittance Prices Worldwide database of the World Bank.

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.

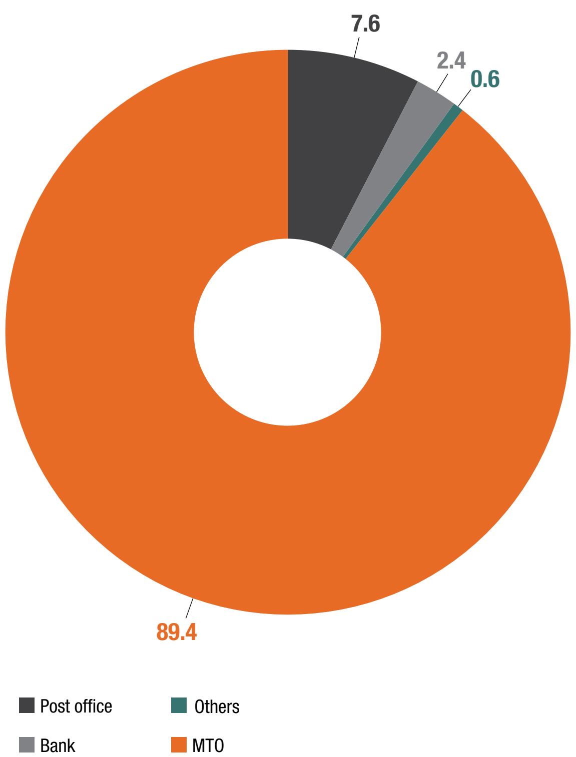
Despite these limitations it is possible to derive some indicative figures. Using market share (as defined by share of payment outlets) as a proxy for indicative shares in the 'remittance super tax', operations involving money transfer operators would account for the bulk of the associated losses. We conservatively estimate the share of Western Union and MoneyGram at around $807 million, based on their share of the pay-out locations.

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 (see Figure D, overleaf) 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 sending 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.

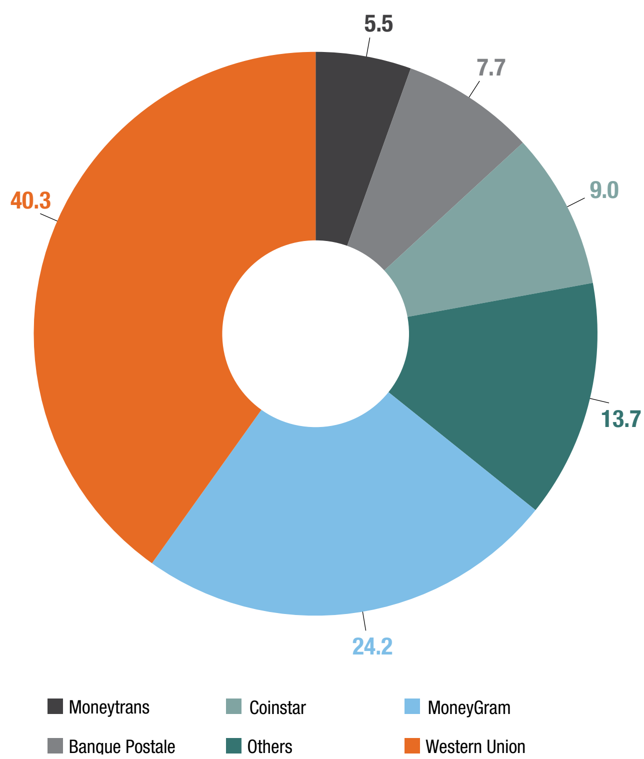
The potential for development gains through lower remittance charges can be illustrated by reference to current aid flows. For comparative purposes we

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



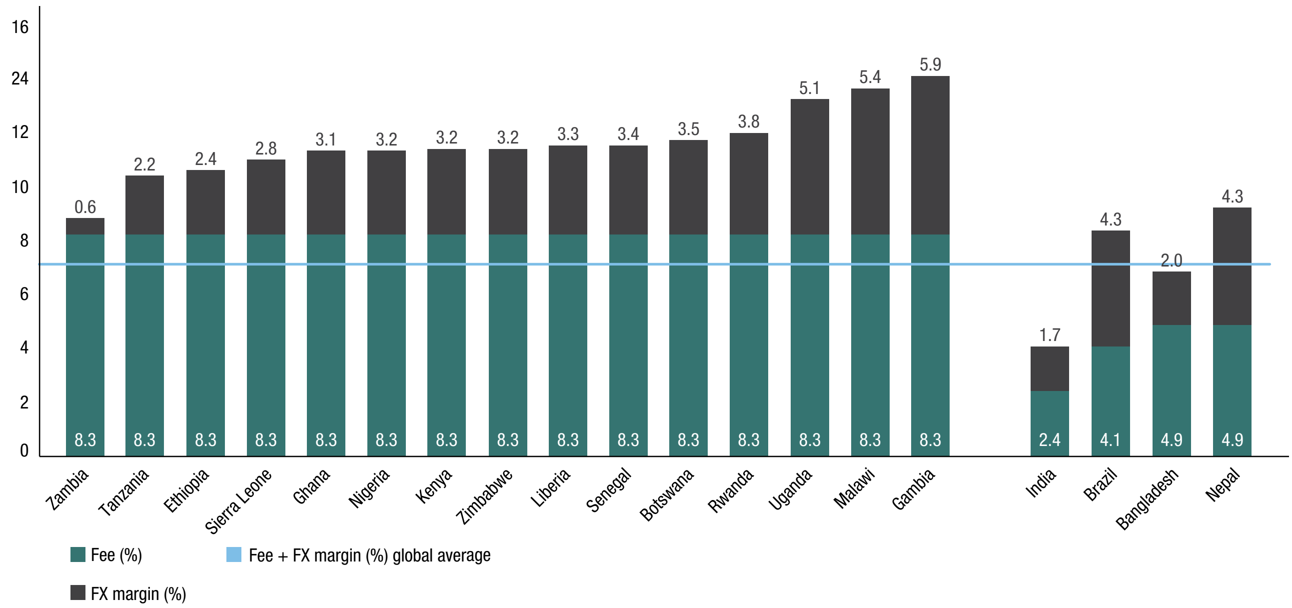
*Notes: * We here use the % of remittance pay-out locations as a proxy for 'market share', and throughout.*
Source: IFAD Sending Money Home to Africa, 2009.

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



Source: IFAD Sending Money Home to Africa, 2009.

Figure D: 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.

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.

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