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REMITTANCES IN CENTRAL AMERICA
THE ROLE OF CABEI

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*The report "**Remittances in Central America: CABEI's role**" identifies effective lines of action to support Central American countries in leveraging the impact of their remittance flows on economic and social development.*

*This Report has been prepared under the leadership of **Phd. Florencia Castro-Leal**, CABEI Chief Economist, and was written by **Rodrigo Méndez Maddaleno**, Economist.*

*Special thanks to: The World Bank team, **Dilip Ratha** (Lead Economist, Migration and Remittances and Head of KNOMAD) and **Sonia Plaza** (Senior Economist, of the Global Finance, Competitiveness and Innovation Practice), and to **Mario García Lima** (Manager of solutions for Guatemalans abroad) from Banco Agromercantil, for their input and valuable comments on preliminary versions of this document. **The World Bank** team was not involved in the analysis and eventual policy recommendations of the study.*

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INDEX

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EXECUTIVE SUMMARY

1 Remittances in Central America[1] are the most important international flow to the region, with about 9% of GDP on average in the last twenty years and reaching in 2020 USD 33,723.5 million. Remittances in the region surpass Foreign Direct Investment (FDI) by 2.6 times, and official development assistance by 15.2 times. Honduras, El Salvador, Nicaragua, Guatemala and the Dominican Republic have the highest ratio of remittances to GDP, 24.1%, 24.0%, 14.7%, 14.6% and 10.4% respectively, concentrating about 96% of total remittance flows to the region.

2 Given the relevance of remittances, their development impact has been quantified. Remittances are associated to a reduction in the Gini coefficient between 0.20 p.p. and 0.26 p.p. Similarly, a 10% increase in remittances is associated to a 3.5% of the proportion of people living in poverty. Moreover, remittances are often linked to recipients' expenses on health, education and entrepreneurship. Meanwhile, growth and remittances depict an ambiguous relationship, which could be attributed to the countercyclical nature, that is, remittances increase when countries experience crisis. Considerable remittances flows could be linked to a real exchange rate appreciation, reducing the profitability of the tradable sector (Dutch Disease).

3 Countries leverage remittances flows to achieve their development objectives. At the international level, the global agenda for leveraging remittances incorporates a multidimensional approach. Different areas of intervention include: i) more access to capital markets for recipient countries with instruments like diaspora bonds; ii) more access to financial services to households and businesses with checking and savings accounts, microfinance, etc.; iii) facilitate transactions by improving the payment system with mobile money, Fintech and risk mitigation; and, iv) improve monitoring of remittances flows to collect and analyze statistical data for public policy design.

4 This report analyzed and identified different interventions to support countries in leveraging remittances to aid in reaching their development objectives.

5 Diaspora bonds are a financial instrument issued by a country, sub sovereign or private entity, and, as indicated by their name, they are directed to the diaspora of migrants. India and Israel have been the most successful countries issuing these bonds, between the both of them have raised around USD 35 billion. The main constraints on the implementation of this instrument are: scarce knowledge of the financial vehicle, lack of knowledge of the diaspora preferences from the issuers, and limited planning when being issued. Additionally, a successful implementation requires a specific institution designated and responsible for issuing and for fund mobilization to development projects. Diaspora bonds in Central America could be effective if associated to specific projects, for example hospitals.

DID YOU KNOW?

In 2020, remittances to Central America were more than USD 30 billion.

[1] For the term "Central America" CABEI follows SICA's definition which includes Dominican Republic.

6 Financial inclusion of migrants and their families is crucial given that most remittances are sent through financial intermediaries. Therefore, it is essential to facilitate bancarization of migrants and beneficiaries of remittances. Major impact efforts could be directed to flexibilization of credit policies to authorize remittances flows as guarantee of collateral to access credit and the creation of instruments to allow securitization of future flows. In order to get the maximum benefit of bancarization, it is important to implement financial education programs aimed at senders and recipients, as well as increase financial services coverage by making it easier to open new bank branches in remote areas, support mobile banking, credit unions or other entities. Moreover, it would be vital to migrants and their families to bolster credit instruments for housing and/or home improvement, and formal entrepreneurship.

7 In Central America, the costs of sending remittances are estimated at about 4%-5.5% of the total amount, and it can be broken down into two parts, the first is a fee by the sending agent to cash the migrant check, 2%-3%, and the second is composed of transaction (TRX) and exchange rate (FX) fees. In order to reduce sending costs an alternative is to use FINTECH and digital platforms like Xoom or Paypal, which could lower total costs by up to 50%. The main constraint to this mechanism is that it requires migrants to have a bank account in the United States (or the country where they live). Because only 15% of migrants are bancarized, this mechanism only offers benefits to this population. Other important efforts have focused on the bancarization of migrants by digital means, like the recent initiative by Banco Agromercantil of Guatemala, or on reducing TRX and FX fees, like the recent initiative Banco Bienestar of México that reduces the first fee through an agreement with the Federal Reserve and the second fee by using the Central Bank's wholesale exchange rate.

8 Investment projects to leverage remittance flows in Central America are a very promising mechanism. There are numerous successful experiences to finance house construction and improvement, facilitating financial access to credit through intermediaries, programs like Caso Bancolombia y FOMIN, or in coordination with hometown associations, to implement programs like 2x1. Similarly successful are projects to enhance credit access for formal entrepreneurship and MSME's, in coordination with aforementioned associations, to implement programs like "One Village One Product".

9 The findings of this report include identifying lines of action for CABEI's significant role. In the short term, CABEI's major impact efforts could focus on: i) supporting investment projects aimed at housing construction and improvement, and financing formal entrepreneurship and MSME's; ii) promote financial inclusion with financial education and alphabetization programs, and bancarization, for senders as well as recipients of remittances; and, iii) support initiatives to reduce transaction costs by minimizing transfer TRX and foreign exchange FX fees. In the medium term, CABEI's major impact could concentrate on: i) deepening financial inclusion by supporting FINTECH initiatives, and encourage flexibilization of the regulatory framework of supervisory agencies to authorize opening bank accounts with the Personal Identification Number (requiring only one form of identification, for example, id card or passport), and authorize remittances flows as collateral to improve access to credit; ii) dedicate efforts to the design and issuance of diaspora bonds to support specific development projects, like hospitals, and promote generation and dissemination of remittances statistics.

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I. INTRODUCTION

10 The Report "Remittances in Central America[2]: the role of CABEI" responds to the need identified by CABEI to support countries by leveraging international remittance flows. The justification comes from the high volume of remittances generated by migrants and received by their families in the region, the high transaction costs, and their high resilience, observed particularly during the current pandemic crisis.

11 In this context, it is essential to define the Bank's role in supporting both governments and migrants who generate remittances, as well as beneficiaries in the receiving country. In order to leverage the impact of these resources on economic and social development.

12 The analysis carried on this Report suggests the Bank could focus on the following areas: i) promotion/issuance of diaspora bonds; ii) increased financial inclusion, both for recipients and senders; iii) use of financial innovations to reduce transaction costs; and iv) support to governments for specific projects (e.g., 2:1 or 3:1 housing, entrepreneurship, etc.) to leverage remittances.

[2] For the term "Central America" CABEI follows SICA's definition which includes Dominican Republic.

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II. RECENT TRENDS IN REMITTANCES

13 Worldwide remittance recipients are: India with more than USD 80 billion, followed by Mexico near USD 40 billion and the Philippines around USD 35 billion ***(see Table 1)***.

14 Remittances as a percentage of GDP versus remittances in dollars alters the order of countries in the listing (***see Table 2 in contrast to Table 1)***. The countries that show the highest proportions are Tonga (42.0%), Tajikistan (28.6%) and Kyrgyzstan (28.5%). It should be noted that this data does not account for cross-border worker transactions. In particular, such is the case of Mexicans who live near the United States border and who cross it practically every day for work in this country.

15 Remittances are understood to be money transfers by emigrants to their country of origin. Economists usually refer to balance of payments statistics, so it is common to understand remittances from three different inputs. One component is remittances sent from workers living abroad to their families; the second is compensation to formal employees (money that someone earns working formally outside their country of origin); the third is generated through the movement of migrants, which are the assets and liabilities that migrants carry with them when they move from one country to another (Carling, 2008).

16 The most common remittance payment methods used by workers living abroad are (Garcia, 2021):

- Traveler's checks make up less than 1% of transactions.
- Transfers and cash, equivalent to between 90% - 95% of transactions.
- Payment in kind (appliances, clothing, other goods), equivalent to between 5% - 10% of transactions.

17 Countries in the region where remittance represent a high proportion as percentage of GDP are Honduras (24.1%) in 5th place, El Salvador (24.0%) in 6th place, Nicaragua (14.7%) in 17th place, Guatemala (14.6%) in 18th place, the Dominican Republic (10.4%) in 25th place, and Mexico (3.8%) in 61th place worldwide as a percentage of GDP. Costa Rica and Panama are not included in the list since their remittances represent less than 1% of GDP.

Tabla 1 *Major remittance recipient countries (USD 2019 - 2020)*

Position	Country	Millions of USD
1	India	83,332.1
2	**Mexico**	**40,166.79**
3	Philippines	35,167.5
4	France	26,837.6
5	Egypt	26,781.4
6	Nigeria	23,809.3
7	Pakistan	22,245.0
8	Bangladesh	18,362.7
9	China	18,294.3
10	Vietnam	17,000.0
15	**Guatemala**	**11,340.4**
21	**Dominican Republic**	**8,219.3**
30	**El Salvador**	**5,918.6**
31	**Honduras**	**5,729.9**

Note: For Guatemala, El Salvador, Honduras, Dominican Republic and México values are for 2020. For remaining countries data is from 2019.

Source: Own elaboration with information from the World Development Indicator.

DID YOU KNOW?

About 85% of remittances are sent through transfer agents.

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18 During the last twenty years, remittances have shown an upward trend, mainly due to an increase in migration to the United States. When comparing remittances against other international flows such as Foreign Direct Investment (FDI) and cooperation and development aid funds, remittances are 2.18 times FDI and 15.2 times cooperation in 2019 ***(Figure 1)***.

19 For Central America remittances have represented an average of 9.0% of GDP from 2000 to 2019, where highest values were reached on 2007 and 2019, around 10.5% of Central American GDP. Meanwhile, in relative terms, FDI has been falling, from a maximum of 7.5% to 4.2% of GDP. Remittances flows to the region are concentrated in the following countries: Guatemala (34.3%), El Salvador (17.9%), Honduras (17.3%), Nicaragua (5.6%) and the Dominican Republic (24.9%), accounting for 96.8% of the total.

20 In 2020, as a result of the economic crisis of COVID-19, the growth of remittances was affected, at the beginning of the pandemic negatively to later recover and place in some countries above the 2019 closing. Nevertheless, remittances amounted to USD 33,723.5 million at the end of 2020[3]. The main two factors that initially affected the decline in remittances were the containment measures that prevented both their sending and receiving, and the increase in Hispanic unemployment in the United States, the main source of remittances for Central America.

21 Remittance flows in 2020 reached a year-on-year variation of close to +5.0% for the region ***(see Figure 2)***. This recovery is partly due to the fact that remittances occur in a countercyclical manner, increasing due to the negative shock on income in the countries that receive them and also fulfilling an insurance function for the recipients (Yang, 2011; Frankel, 2011; Brown & Jimenez-Soto, 2015). Among other factors in the recovery of remittances, mention has been made of the fact that migrants used their savings to continue sending them and a significant proportion of migrants obtained access to cash transfers in the countries where they were located (WB, 2020). According to authorities from a commercial bank in Guatemala, remittances started went from USD 375 to USD 415 in June, coinciding with stimulus from United States government (Garcia, 2021).

22 In terms of the impact of remittances, studies have been carried out at the micro and macro level. Some results within the literature are (Adams & Page, 2005; Yang, 2008; 2011; Brown & Jimenez-Soto, 2015; WB, 2019): the account for changes on the GINI coefficient between -0.2 p.p. and -0.26 p.p., accounting for direct and indirect effects. Other studies show that a 10.0% increase in official per capita remittances reduces the proportion of people living in poverty by 3.5% and can also reduce the severity of poverty by approximately 3 percentage points. Likewise, although remittance use may vary within households, evidence shows that an increase in the amount received has resulted in investment directed to human capital and even in some cases entrepreneurial endeavors. At the macro level, results are more ambiguous on the impact of remittances on economic growth. This is due to two reasons: first, these flows can cause a real exchange rate appreciation reducing the profitability of the tradable sector, which is known as Dutch disease; second, the countercyclical nature of these may indicate inverse relationships with growth of recipient countries.

Tabla 2 *Main countries receiving remittances (% of GDP, 2019 – 2020)*

Posición	Country	% of GDP
1	Tonga	42.0
2	Tajikistan	28.6
3	Kyrgyz Republic	28.5
4	Nepal	26.9
5	**Honduras**	**24.1**
6	**El Salvador**	**24.0**
7	Haiti	22.8
8	Bermuda	21.4
9	Lesotho	20.8
10	Samoa	17.2
17	**Nicaragua**	**14.7**
18	**Guatemala**	**14.6**
25	**Dominican Republic**	**10.4**
61	**Mexico**	**3.8**
88	**Colombia**	**2.1**
132	**Republico of Korea**	**0.4**
146	**España**	**0.2**
157	**Argentina**	**0.1**

Note: For Guatemala, El Salvador, Honduras, Nicaragua, Dominican Republic and México values are for 2020. For remaining countries are for 2019.

Source: Own elaboration with information from the World Development Indicator.

DID YOU KNOW?

Remittances in C.A. were 2.18 times the amount of FDI in the region

[3] This statistic corresponds to SECMCA's latest publication on accumulated remittances at the end of 2020. Thus, this may differ from other reports like CEPAL (2020) where the figure for 2020 is USD 33,949.0. The discrepancy between the final numbers is mostly CEPALs own estimations for Costa Rica and Panama's remittances amount at the end of 2020.

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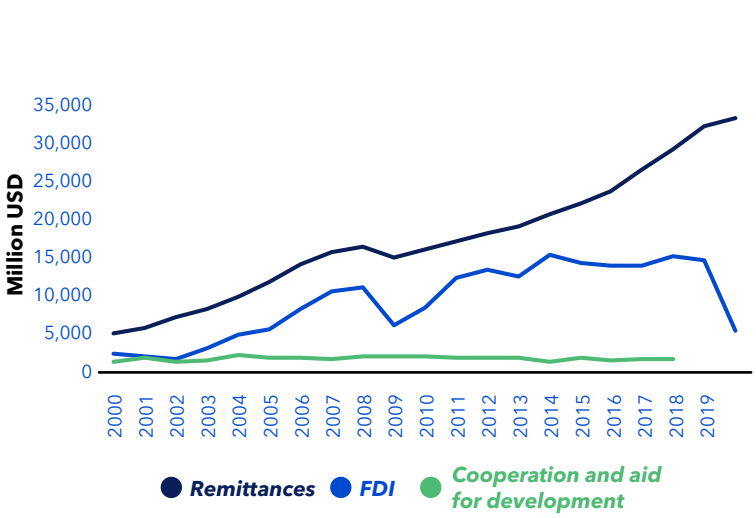
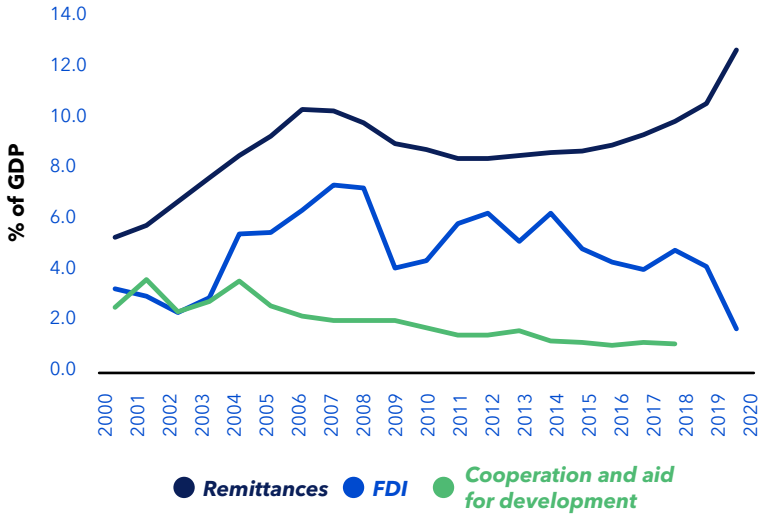
Figure 1 *Remittances are the main flow of international resources to the region (2000-2020)*

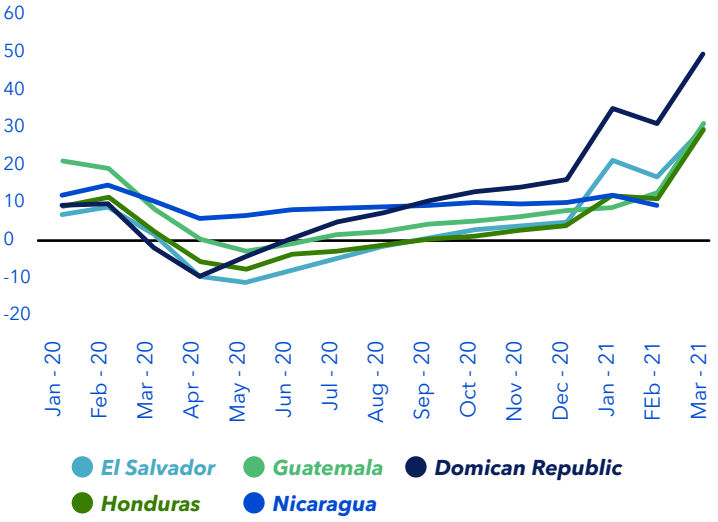


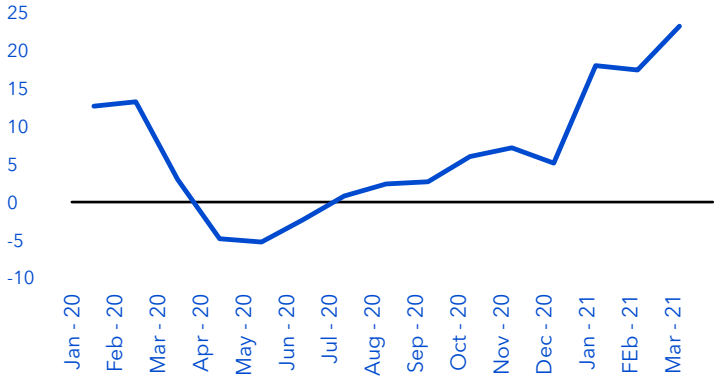


Note: *The data on Official development assistance and aid for 2019 and 2020 is not available. Data for Panama corresponding to 2020 is not available.*

Source: *Own elaboration with information from the World Development Indicator and SECMCA.*

Figure 2 *Remittances behavior 2020-2021 (accumulated inter-annual variation, %)*





Note: *Interannual monthly comparison shows steeper falls, for example, on April numbers oscillate between -40.0% to -9.1% (CEPAL, 2021).*

Source: *Own elaboration with information from SECMCA*

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III. PUBLIC POLICIES FOR REMITTANCES

23 Given the large amount of remittances received and their impact on people's well-being, attention has turned towards how to leverage these flows in order to reach different development goals. In this regard, different public policies are presented below with the purpose of expanding the options and consider the role a multilateral institution such as CABEI could play.

24 What does it mean that remittances impact or benefit development? It is thought of as how these money transfers contribute to the migrants family members independent development, creating ways of life that do not depend on future flows (Carling, 2008). According to the World Bank, the development benefit is when remittance flows have been leveraged in a way in which it has helped communities improve their wellbeing and achieve development objectives.

25 Remittances impact depends on the initial economic capacity of recipients ***(see Table 3)***. Someone with low-income will use that extra income for consumption. Remittances may represent benefits like building a house or more education depending on the beneficiary capacity to save. Therefore, the impact of remittances on development varies and depends on the recipient's characteristics.

26 The World Bank alongside the international community has made a commitment to migration through the "Global Compact for Safe, Orderly and Regular Migration". This initiative includes leveraging the development impact of remittances, reducing the cost of sending remittances, promoting the financial inclusion of migrants, and mobilizing resources from the diaspora (WB, 2016; 2019). In this context, ***Table 4*** lists some of the priority areas and activities related to remittances.

27 Among the activities carried out by the World Bank to leverage remittance resources and reduce the cost of transactions are: the interoperability of the retail payment system; the reduction of entry barriers to new companies by offering efficient technologies; measures to facilitate compliance with anti-money laundering and terrorism financing measures; and monitoring the costs of sending remittances. Thus, a comprehensive agenda has been identified to accompany efforts to reduce the cost of sending remittances ***(see Table 5)*** (WB, 2019).

Table 3 *Distribution of the benefits of remittances*

Expense Type	Immediate benefits to recipients	Future benefits to recipients	Secondary benefits to recipients	Independent development of remittances
Purchase of local goods and services	X		X	X
Purchase of imported goods	X		X	
Spending on education	X	X		X
Savings in banks		X	X	X
Building housing		X	X	
Starting a business		X	X	X

Source: Taken from Carling (2008). Interrogating Remittances: Core Questions for Deeper Insights and Better Policies.

DID YOU KNOW?

Leveraging remittances may have a positive development impact on recipient communities.

29 The literature also mentions some other policy measures that can be implemented to increase the impact of remittances on development. In this sense, it may be that the migrant prefers that the money sent is invested in education or other investments that have a higher return in the receiving households. Along the same lines, preferences can also lead to the desire to save a certain percentage (Mbiti & Yang, 2009; Ambler, Aycinena, & Yang, 2015).

29 On cross-cutting themes, it is important to recognize some possible negative effects of remittances on labor markets and at the macro level by price distortion ("dutch disease"). This resource misallocations can be approached in through employment programs and promotion of economic sectors able that generate jobs; accompanied by competitiveness enhancing programs.

Table 4 *Leveraging Economic Migration for Development*

Priority	Activity
Support the Sustainable Development Goals related to migration: Reduce the cost of remittances (MDS 10.c.1), leverage remittances for development (MDS 17.3.2) and mobilize resources	Regulatory, legal, or policy reforms related to retail payments that include remittances (e.g., licensing and supervision of transfer operators). Strengthen regulations that affect the remittance market (e.g., taxes, fintech, competition). Develop access to capital markets for countries and companies; financial inclusion for households and small businesses; payment system. Improve the regulatory framework and institutions to deal with the diaspora (investment promotion agencies and consulates). Assist governments in the implementation of "diaspora bonds" and remittance-backed bonds to maximize development finance.
Generation of knowledge	Support in the preparation of migration profiles, data collection on internal and external migration and remittance flows. Strengthen statistical capacity through the provision of tools and training.

Source: Taken from Leveraging Economic Migration for Development: A Briefing for the World Bank Group (Ratha et al, 2019).

Table 5 *Global agenda for leveraging remittances*

Agenda	Global action lines
Access to capital markets for countries and companies	Sovereign risk rating. Bonds with future remittance flows as collateral. Diaspora bonds.
Access to financial services for households and small businesses	Deposits and savings products. Mortgages, consumer loans, microfinance. Credit history for clients of microfinance institutions. Insurance products.
Retail payment system	Payment platforms/instruments (mobile money, cryptocurrencies). Liquidation, capital adequacy, disclosure, cross-border arbitration. Risk mitigation, measures to combat money laundering and financing of terrorism.
Monitoreo, análisis, y proyecciones.	Size, runners, channels. Against cyclicality. Effects on poverty, education, health, investment. Public policies (costs, competition, exchange rate controls).

Source: Taken from Leveraging Economic Migration for Development: A Briefing for the World Bank Group (Ratha et al, 2019)

DID YOU KNOW?

Reducing transaction costs and promoting financial inclusion may leverage remittances to achieve development goals.

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IV. ACTION LINES TO LEVERAGE REMITTANCES IN CENTRAL AMERICA

30 The following guidelines present possible alternatives for CABEI's role and explore instruments that could be promoted to amplify remittances development impact on Central American countries. CABEI´s goal is to support economic and social development objectives of its member countries, through bolstering benefits for remitting migrants and receiving relatives.

1. DIASPORA BONDS

31 The "diaspora bond" is a debt instrument issued by a country, or potentially a sub-sovereign entity, or even a private institution, in order to access diaspora resources. Israel and India are examples of countries that have managed to capture substantial amounts of resources through this type of instruments, around USD 35 billion (Ketkar & Ratha, 2010).

32 Israel created the Israel Development Corporation to issue Diaspora Bonds. India used the State Bank of India. Israel has used the funds raised to invest in transportation, energy, telecommunications, water, and other essential infrastructure projects. India has drawn on diaspora resources in times of balance of payments crisis. Israel's bonds initially had a menu of options, such as: denominations from USD 100.0 to USD 1,000,000.0, with fixed or floating rates, and maturities of 1 to 20 years. While India initially offered fixed rate bonds, a term of five years and a minimum investment of USD 2,000.0.

33 Potential diaspora bond buyers regularly are high skilled migrants, many of whom are in OECD countries. In the case of the Central American region a majority of migrants are in the United States. A necessary condition for the bond market to function and to be attractive for the diaspora, is that the issuing country has minimum governance. The experiences of Israel and India show that it is necessary for countries to register bonds with the Securities Exchange Commission. Some restrictions on these instruments are: a) little knowledge of the financial vehicle; b) lack of knowledge of the diaspora (geographical location, how much they save, how much they invest); and, c) lack of planning for the issuance of these titles (Ketkar & Ratha, 2010; 2011).

34 How can the "diaspora bonds" be made operational in the Central American region? It is essential to create or assign responsibility to a specific authority that is in charge of issuing the instruments and/or channeling the investment of resources. This institution could be created, or the responsibility could be assigned in alliance with institutions such as CABEI and other banks that want to join, to provide confidence to the diaspora. The role of multilateral banks may be to offer guarantees (total or partial) on these bonds. Additionally, governments could securitize future flows as collateral for bonds, through exports, remittances and/or other sources of hard currency (Ketkar & Ratha, 2011).

DID YOU KNOW?

Israel and India are the most successful countries in issuing diaspora bonds, between them they have raised around USD 35 billion.

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2. FINANCIAL INCLUSION

35 The notion that the financial intermediation of remittances leads to inclusion is because transfers made through formal financial institutions, would allow both the sender and the recipient to access other financial products and services. Whereas they would not have been able to have access otherwise. The intersection between financial intermediation and remittances at a minimum considers the following potential benefits (Orozco & Fedewa, 2005):

- Expansion remittance transfer services coverage, through the provision by the financial institution offering them to its clients or members, as well as to the communities where it operates.
- Reduction of remittance transfer costs, through a competitive price offered by the financial institution for its product, making it attractive for both the person who sends and the person who receives it.
- Expansion of accessibility to different financial services, through the publication, design and promotion to recipients by the financial institution. The range of service options may include savings, loans, insurance, pension funds, among others.

36 It has been observed that the impact of remittances on financial inclusion is ambiguous and depends on several factors. Giuliano and Ruiz-Arranz (2009) argue that remittance flows improve inclusion in countries with underdeveloped financial systems. In this context, its function is to eliminate existing financial frictions, releasing liquidity constraints and encouraging investment. They can also potentially increase credit to the private sector by increasing loanable funds in the banking system. However, these effects could be offset, since remittances are used primarily for consumption and not for savings (Marinez, Mascaró, & Moizezowicz, 2008).

37 In El Salvador and Mexico studies have found that a person who receives remittances is more likely to open a bank account than someone who does not. However, the probability of having debt with a bank or requesting a loan is not statistically significant between those same groups (Marinez, Mascaró, & Moizezowicz, 2008). The latter is attributed to the fact that banks risk policies do not usually accept remittance flows as collateral, making it difficult for them to be subject to credit [4].

38 To increase financial inclusion, banks should focus on supporting the financial system implement the following results:

- Support the design of credit policies that allow accepting remittances as an income guarantee or collateral, so recipients can access loans. Thus, allowing historic remittances payments to compensate for the lack of credit history of the people.
- Support financial education programs for both the communities that receive and those that send remittances.
- Support reducing regulatory costs to open new banking agencies in receiving communities.
- Promote greater coverage of remittance payers through the use of tools such as mobile banking, cooperatives or other entities better positioned to serve communities.
- Ensure access to IDs for migrants and their families to have access to bank accounts and mobile money services
- Improve financial data collection and analysis.
- Support the strengthening of debtors rights and the improvement of the mechanisms for the fulfillment of contracts.
- Create the pertinent instruments that allow securitizing the future flow of remittances through financial institutions, so that the funds can be used to obtain loans.
- Create the appropriate loan instruments for migrants and their families for construction or improvements in housing, enterprises, etc.

DID YOU KNOW?

Financial inclusion consists of expanding the offer of financial services for both senders and recipients of remittances.

[4] Interview Mario Arturo García, Manager of Solutions for Guatemalans Abroad at Banco Agro Mercantil.

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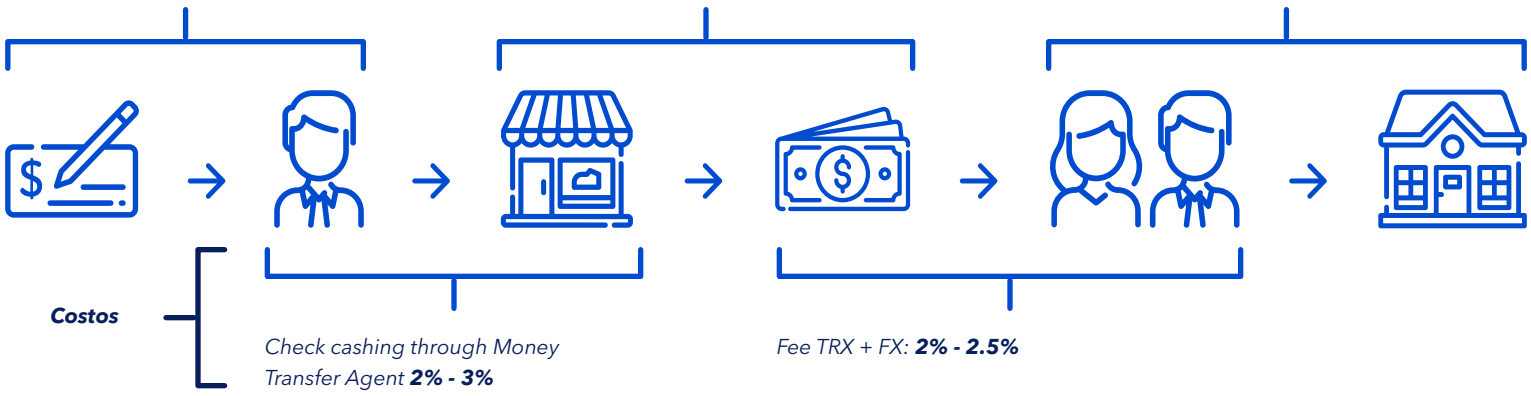
3. REDUCTION IN TRANSACTION COSTS

39 In order to reduce transaction cost of sending remittances, it is important to learn about the process and the steps it takes to understand where the costs originate and how to approach each step. The process of sending remittances is shown in ***Figure 1***.

- ***Sending the remittance:*** this process involves two steps according to the migrant's level of formality. Step 1 in this case is the collection of the salary and step 2 is the choice of the service method:
  - Traditional method: This is the method used by the majority of migrants, about 85% of the total, and its main characteristic is that the sender looks for physical places that allow them to make transactions and that in turn reduce their risk of deportation. This results in the use of Money Transfer Agents that function as intermediaries (grocery store, appliance store, etc.). In this case, the agent offers the service of cashing the check carried by the migrant with a commission charge of between 2% - 3%.
  - Digital service methods or other methods: These methods cover only about 15% of senders. Thanks to access to a formal account, the remittance can be sent through bank transfers or using digital services through applications such as PayPal, Xoom, among others.

Figure 1 *Steps to send a remittance and costs*



Nota: TRX Fee refers to the commission charged for the transaction; FX refers to foreign exchange profit.

Source: Own elaboration with information provided by García (2021).

40 Although the process of sending remittances seems simple, behind lies the complexity of the migratory reality. The following describes the stages of the process involved in the transactions related to a remittance (Garcia, 2021):

- ***Language barrier:*** The majority of migrants tend not to speak the language of the destination country (in the case of Central Americans it is English as their main destination is the United States).
- ***Lack of personal identification:*** during the trip to the country of destination, the migrant usually does not carry identification documents (identity card or passport). This is essential to send a remittance and the first requirement is that the Sending Agent can identify the sender. Understanding by sending agent, the financial agent who receives the remittance and sends it to the family member. In this sense, there are consular services that issue an identification card (or unique identification document) which would greatly facilitate them to send remittances.
- ***Type of work accessed by the migrant:*** the majority of migrants tend to access jobs where the employer does not request that they have a work permit or that they be a citizen. Therefore, the payment is usually received as a cash check or cash payment; this is the case for about 85% of migrants. It is estimated that the remaining 15% receives payment through a deposit to a formal bank account. In order to receive a paycheck, the migrant must have obtained a Tax Identification Number issued by the Internal Revenue Service -IRS- (this varies within states).
- ***Payment of the remittance***: the current payment of the remittance to the recipient is normally generated through entities of the financial system and can be through closed remittance-bank channels or open channels through services such as Western Union, Money Gram, among others. In both cases, the sending agent remits the amount of money defined by the migrant (after cashing the check) and the cost combining transaction (TRX) and exchange rate (FX) fees is generated, which means a total cost of between 2% - 2.5% of the remittance.

41 It is essential to note that considering the previous description, the total cost of sending the remittance for most migrants can be between 4% - 5.5% of the total. In addition to the difficulties that migrants encounter, there are other considerations on the part of the recipients. One of the main ones is usually the destination and use of the amounts received, about which there is little record. This is due to the fact that mainly the recipients tend to prefer the payment in cash, so it is assumed that the majority of the remittance will be directed to consumption expenses.

BOX 1. INITIATIVES TOWARDS GREATER ACCESS TO BANK ACCOUNTS FOR MIGRANTS

The private financial sector is launching Important efforts towards financial inclusion of migrants. One example is by Banco Agromercantil in Guatemala, which recently launched "Cuenta Fácil Remesas". This financial product allows for Guatemalans living abroad to open a bank account digitally, without any physical forms, and it asks for a minimum amount to open the account and a minimum balance to keep the account active. The requirements are basic, the person opening the account must be a Guatemalan citizen and have only one valid ID (passport or id card). The process is simply completed via the Bank's website, and the customer fills out an application, attaches the identification document and a selfie.

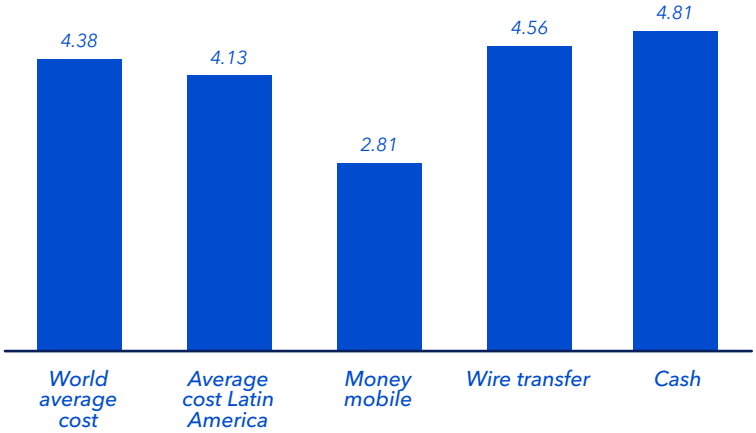
Source: https://elperiodico.com.gt/cultura/gente-negocios/2021/05/04/bam-lanza-cuenta-facil-remesas-para-guatemaltecos-que-trabajan-en-el-extranjero/

42 Bancarization is low among migrants and their families. It is estimated that less than 50% of recipient households have a bank account, which is why it has been one of the objectives of the financial system to achieve the bancarization of migrants and remittances recipients ***(see Box 1)***, and then offer different services designed for that market.

43 It is critical to recognize that there is a trend towards the growth of digital financial ventures/innovations, known by the name of Fintech. These are digital platforms and automated processes that affect the way in which financial business is traditionally developed, which includes sending and receiving remittances. In Latin America these have focused on payment systems and mobile money services[5], however, remittances-focused ventures are scarce (Berkmen et al, 2019).

44 The average cost of sending remittances worldwide during 2020 was 4.4% and at the Latin American level it was below 4.1% (see Graph 3). However, when evaluating the cost according to means of payment, it is found that bank transfer or cash are above the world average cost, 4.6% and 4.8% respectively, while mobile money is around 2.8%, almost two percentage points lower.

Graph 3 *Transaction costs by type of payment method (percentage)*



Note: The calculation is made based on an average transaction of USD 200.0; includes commissions and exchange rate.

Source: Own elaboration with information from the World Bank, Remittance Prices Worldwide, available at http://remittanceprices.worldbank.org

DID YOU KNOW?

Cashing a check through a sending agent raises remittance cost by 2% - 3%.

[5] Fintech companies affect all the functions of the financial system, which are: i) payments, including cross-border; ii) savings and investment; iii) loans; iv) risk management related to income, savings and transactions; and v) receipt of financial advice.

45 In Central America, Fintech solutions could have significant impact for remittances payment, considering that their size is around 12% of GDP. Currently, it is estimated that for the Northern Triangle countries the average transaction cost is around 5%. If mobile money could be deepened, this would imply a reduction in cost, eliminating or reducing the participation of the payment agent, that is, up to 2.5% less. However, the main limitation to be able to access mobile money services is access to an account within the US banking system or to services such as Paypal, Xoom, among others. As mentioned above, this type of solution would be aimed at 10.0% - 15.0% of migrants with access to bank accounts in the country where they are located.

46 Mexico's government has made significant efforts recently to reduce the transaction cost of remittances (Government of Mexico, 2021; Ortiz, 2021). The Mexican government has approved a service called "Directo a México", through the Banco de Bienestar and Banxico, in agreement with the United States Federal Reserve. This initiative allows you to send money from an account of a banking institution in the US to a bank account at Banco Bienestar in Mexico with additional benefits. Mexicans living abroad will be able to open a Bank account remotely through their smartphone or computer with only two requirements, their personal id and an email account, in order to be able to send/receive remittances. Other benefits are:

- The fee for sending the money is between USD 3 - USD 5, and the receiving bank does not charge a commission for the payment of the remittance.
- Applies a favorable exchange rate, using as a reference the one applied by Banxico for wholesale operations. This allows the transfer to be made directly to the beneficiary's account and the funds can be accessed from any ATM or debit card. Among other facilities, the migrant is also allowed to open a bank account in Mexico online and free of charge.
- The network has more than 2500 points in the Mexican territory, which can be accessed for the payment of remittances, and also, for those beneficiaries who have a deposit account or debit card, the funds are available immediately.

47 The main challenge faced by these types of initiatives continues to be bancarization of people living abroad, returned migrants and their families.

48 Therefore, It is important for institutions such as CABEI to promote initiatives for expanding the use of new technologies that will reduce the cost of transactions related to remittances. Additionally, this would allow generating greater competition against traditional remittance channels. This can be done through support programs for Fintech ventures and projects that strengthen the regulatory framework and encourage the use of these technologies. Another way to increase the use of digital payment methods is by supporting the generation of alliances between money transfer operators (Western Union, MoneyGram, etc.) with already established networks and mobile payment providers. Additionally, efforts can be made towards creating mechanisms that allow for instant clearing of checks at lesser fees than usually charged by traditional channels.

4. INVESTMENT PROJECTS TO LEVERAGE REMITTANCES

49 Given CABEI's nature as a multilateral bank oriented to the execution of projects, another dimension to consider may be through the execution of programs aimed at the investment of remittances by the recipient families. In this sense, CABEI could support projects that focus on:

Financial intermediation for housing construction and repair. These programs support broader interventions that involve what in the literature is called "Hometown Associations", where each dollar invested by the beneficiaries is complemented by dollars invested in the form of loans at preferential rates by the government or cooperation. Likewise, these credit operations can be complemented with urbanization projects, drainage, among others.

- An example is a project supported by the Inter-American Development Bank (IDB) implemented Colombia, which aimed at developing the housing market for low-income households through remittances. This project had the following components: improving knowledge of the remittance market; identify whether it is possible to improve the regulatory framework for the use of remittances as collateral for mortgage loans; design and implement financial and non-financial products that support the channeling of remittances towards the improvement or purchase of a home; and, support with a marketing and sales strategy. IDB joined forces with institutions such as BANCOLOMBIA, the Casa de Compensación Familiar de Antioquia and the Asociación de Cajas de Cambio (FOMIN, 2006).

Financial intermediation for entrepreneurship. These programs help beneficiaries access loans to finance new businesses. This can be achieved through the expansion of guarantees so that private banks account for the flow of remittances as collateral. Likewise, programs can be supported so that the financing of ventures is also through the "Hometown Associations", emulating in a certain way programs such as those implemented in Japan of "One Village One Product" or China with the "Town Village Enterprises".

DID YOU KNOW?

The impulse of FINTECH can lower the cost of sending remittances, for migrants with a bank account in the country of residence.

CABEI Central American Bank for Economic Integration

V. CABEI'S ROLE IN LEVERAGING REMITTANCES IN CENTRAL AMERICA

50 Evidence suggests the following interventions have the greatest potential to leverage remittances.

51 In the ***short term***, the role of CABEI may include the following effective interventions:

Investment projects

- Financial intermediation for home construction and improvement (example FOMIN and BANCOLOMBIA, and Programs like 2x1)
- Financial intermediation for formal entrepreneurship, start-ups and for MSMEs, to support recipients and communities to reduce reliance on remittances (programs like "One Village One Product")

Financial inclusion

- Finance technical assistance to support financial education of the diaspora and remittances recipients
- Support and disseminate initiatives for greater financial inclusion (bancarization) of migrants and their families who benefit from remittances (Banco Agromercantil of Guatemala)

Reduce transaction costs

- Support reduction of foreign exchange TRX fee and transfer FX fee (Banco de Bienestar in México)

52 In the ***medium term***, the role of CABEI may include the following effective interventions:

Financial inclusion and Reduction of transaction costs

- Promote flexibilization of regulatory framework of supervisory agencies: i) to authorize opening of bank accounts with Personal Identification Number (requiring id card passport or , but not both), and ii) to authorize use of remittances flows as collateral to allow for financial inclusion and access to credit
- Support and disseminate initiatives that broaden the use of new technologies aiming at reducing remittances transaction costs (FINTECH)

Diaspora bonds

- Support the design and issuance of diaspora bonds from the countries, if there is appetite, to allow them to tap and channel remittances to fund specific projects aiming at achieving development objectives (hospitals, health centers, roads, etc.)

Promote and support data generation, publication and dissemination for monitoring remittances

- Support the registration of remittances to facilitate their analysis and improve the design of public policies.

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