Family Remittances to Latin America: the marketplace and its changing dynamics.

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Introduction

Remittances have become a significant indicator of a country's integration in the global economy. Their impact on national economies has resonated at the household and the nation. In the first place households receive incomes from abroad to sustain their homes. In the second place, the national aggregate amounts have supported the balance of payments and foreign currency reserves of these countries. Overall, remittances have generated a multiplying effect through an increase in the demand for goods that recipients could not afford prior to receiving remittances, thus triggering a pattern of growth.

One key issue regarding remittances and its effects has dealt with transaction costs and markets. This paper looks at the changing characteristics of remittance markets, In particular, it pays attention to various dynamics in the transfer process, in transaction costs, and exchange rate speculation. The paper also highlights the importance of supporting banking institutions as mechanisms of development triggered by remittance transfers.

1. The market place of remittances and new dynamics

In a previous study we noted that

> most studies of remittances focus on the recipients of remittances as the "principal actor." However, new and lesser-known actors and activities have emerged with the surge in remittances, and have had direct or indirect developmental impacts. The marketplace for transferring remittances has grown apace with the increasing volume of remittances, attracting new companies and new services. (Orozco 2000)

The growth referred to has now expanded and deepened in various ways. The market of remittances has changed significantly in several ways:

- The proliferation of companies, small and large, offering transnational services for money transfer;
- A gradual decline in the transfer costs resulting from competition, and social demands;
- The expansion and extension of services and new initiatives oriented to migrants, from money transfer to delivery of commercial goods and other personal services;
- The sustained (and perhaps increasing) flow of electronic money transfers;
- A widening in access of services to public in remote areas; and
- The growing participation and interest of the banking industry in transferring money from migrants to their families and communities.

Today there are more companies transferring remittances than there were a few years before. In many countries, Western Union, MoneyGram, one local 'ethnic' business, and 'viajeros'(or 'econmenderos') were the only intermediaries working in the transfer. Nowadays there are perhaps hundreds of companies offering the transfer services, and they tend to vary in number and choice from the 'encomendero', 'viajero' entrepreneur to the large corporation like Western Union. Moreover, remittance companies are offering various alternative means to deliver money as well as services other than money transfer. There are a growing number of small and medium businesses seeking to tap into the market of remittances, introducing new technologies and electronic transfer mechanisms to reduce costs and increasing speed to enhance delivery. For example, one popular emerging service offered by companies is the provision of cards that allow migrants to transfer money on a regular basis without paperwork. Recipients claim the money by providing an identification number or by going to a bank to withdraw the money with proper identification.

Perhaps one of the most significant changes in the remittance market is the decline in transfer costs. Three years ago the cost of sending remittances to different Latin American countries averaged about 15.0% of the amount. Those transfer costs have now declined. In 1999, for example, Western Union charged, $22.00 for transferring up to $200.00. By 2001 that charge was dropped to $15. A similar decline, though to a lesser extent, is observed in the case of MoneyGram (see Tables 2 and 3).

These changes signal an increase in the number of companies in the remittance market and reflects more price competition resulting from businesses searching for new customers, including from among their competitors' clientele. The drop in Western Union prices shows that the company has had to reduce its transaction costs and adjust to increasing competition as well as to clients, social groups, and legal demands. Although Western Union's annual transfers remain the same or have increased in some cases, its market share has declined due to competition. The question as to why MoneyGram's prices have not declined as much may have to do with having an inelastic demand and clientele. Its main competitors and markets may be different from those of Western Union. This latter explanation may be plausible considering that companies control different markets and regions, as well as have different competitors.

Table 2. Transfer Costs for Sending Remittances with Western Union

Charge for sending...	$200		$300	
Year	1999	2001	1999	2001
Mexico	$20.00	$15.00	$25.00	$15.00
El Salvador	$20.00	$20.00	$27.00	$21.00
Dominican Republic	$22.00	$20.00	$30.00	$24.00
Guatemala	$22.00	$20.00	$29.00	$21.00
Colombia	$22.00	$20.00	$29.00	$15.00

Source: Orozco 2000 and data compiled by the author.

Table 3. MoneyGram's Transfer Costs

Quantity / Country	100-200		200-300	
	1999	2001	1999	2001
Mexico 10 Minute Service.	$16.20/18	15.00	$22.5/25	25.00
El Salvador	$18/20	20.00	$22.5/25	25.00
Dominican Republic	$18/20	20.00	$22.5/25	25.00
Guatemala	$18/20	20.00	$22.5/25	25.00
Colombia	$18/20	20.00	$22.5/25	25.00

Source: Orozco 2000, and data compiled by the author

However, the decline in prices is only one key change in the market. A recent Inter-American Dialogue study of 28 remittance companies transferring money to eleven Latin American countries shows that the cost of sending money varies significantly across companies and countries. Table 4 shows that the average transfer cost of money does not change significantly for amounts ranging between $150 and $300 (immigrants commonly send an average of $250 a month). But the table also shows that the transfer costs can vary significantly from a very low cost of $6.5 to a high $35 dollars. In fact, there is a significantly large standard deviation in the transfer costs. Overall, for a transfer of $250 or $300, over two thirds of companies fees range between $10 and $25, that is, between 4% and 10% of the amount sent.

Table 4. Transfer Costs of Remittances

Amount	Mean Charge	Minimum Charge	Maximum Charge	Standard Deviation
$150.00	17.415	10.5	29	4.00
$200.00	15.85	6.5	35	5.83
$250.00	18.17	6.5	35	7.2
$300.00	19.16	6.5	35	7.5

Source: data compiled by the author

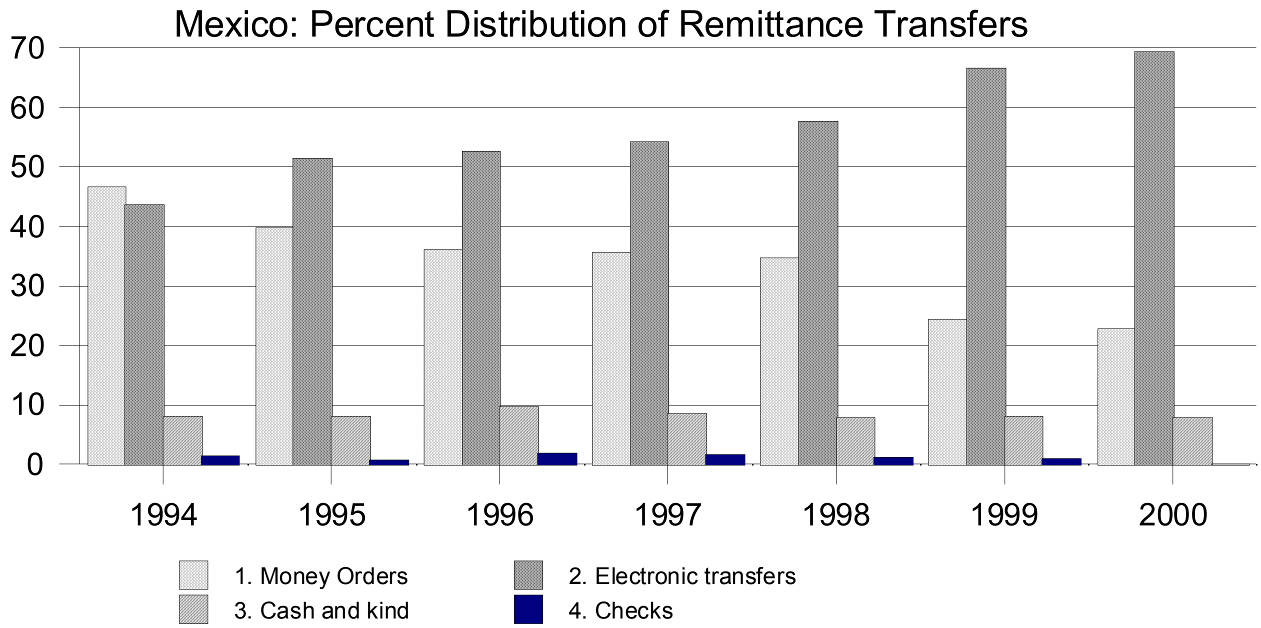
Moreover, the costs of sending money also vary from country to country. The variation may be connected to the level of competition and the demand of remittance transfer services. Mexico, El Salvador, and Colombia illustrate this variation. These countries share in common high levels of market competition and demand for remittance transfers. (Further research is necessary to better understand these variations.) For example, the Dominican Republic is a country and population with a high level of competition and demand for transfers, yet the transfer costs are among the highest, next to those of Nicaragua, Haiti, and Cuba, which have relatively lower levels of migrant remittances.

Table 5. Average Transfer Costs of Sending $250 to Ten Selected Latin American Countries

Country	Mean	Minimum	Maximum	SD	No.	HDI	Volume Sent
Mexico	13.55	9	35	7.5	13		$5,909,632,000
El Salvador	14.29	6.5	25	6.92	8		$1,373,800,000
Colombia	15.17	10	25	5.49	11		$500,000,000
Guatemala	16.9	6.5	25	7.61	5		$500,000,000
Ecuador	19.5	15	25	5.07	3		$840,000,000
Jamaica	20	15	25	7.07	3		$659,200,000
Dominican Republic	21.98	20	25	2.36	7		$1,518,700,000
Honduras	22.00	12	29	8.89	3		$400,000,000
Nicaragua	24.67	20	29	4.51	3		$600,000,000
Haiti	25	24	26	1	4		
Cuba	28	25	30	2.65	5		$800,000,000

Source: Data compiled by the author, Table 1 and Human Development Report.

Two other important developments in the market place of remittances are the continued and increased use of electronic transfer as a transaction method and the involvement of commercial banks in offering transferring services. One competitive strategy among companies has been to offer fast and secure ways to transfer currency to Latin America. As result, the use of electronic wire transfers has spread relative to the traditional methods of hand delivery of cash through encomenderos or viajeros. The Mexican case illustrates this phenomenon: electronic transfers to Mexico increased from 43% in 1994 to 70% in 2000 of all types of remittance transfers. This increase is reflected in other countries. The involvement of small companies plus the participation of Western Union-type businesses has further pushed this increase.



The increasing participation of commercial banks is another emerging trend. Until recently, banks were not transferring remittances directly and only worked with intermediary companies to facilitate the transaction. However, as banks discover the profit from transferring migrants' money as well as their long term potential as clients, these businesses are seeking to offer transfer services. Three Salvadoran banks, for example, have established offices in the U.S. to offer remittance transfers and do it at more competitive rates than remittance companies. Bancomex of Mexico charges $10, and Bancomer and BanSol of El Salvador charges $9, in all three cases for any transfer below $1500. Credit unions, however, are the most competitive of all companies, banks, and organizations: through their international remittance network (IRNet), credit unions charge from $6.5 to $10.00 for up to $1,500.

Table 6. Average Costs of Transferring $250 by Type of Intermediary

Type	Average Cost	Percent
Non-financial	18.84	7.54
Bank	10.60	4.24
Credit Unions	7.67	3.07

Source: Data compiled and processed by the author.

These various intermediaries offer different advantages and disadvantages. While the costs for banks and credit unions are lower, non-financial banks are far more easily available and accessible. Furthermore, banks and credit unions are less user friendly and have fewer locations.

Exchange Rates

Speculation with exchange rates is an embedded cost that allows intermediaries to increase their profit rate.. Remittance transfer companies often use different exchange rates from the official mark and speculate in ways that penalize recipients. The speculation rate between official and company rates can range between 1% and 4% of the value exchanged. Companies and partner agencies in the recipient country share the profit from speculating in the market. In concrete terms, the profit earned by a company and/or agency ranges from $2.25 to $10.5 for a transaction of $250. This profit earning is also significantly lower than what it was two years ago, however. In January 1999, the profit rate for transfers in Mexico via Western Union was 11.16%. Moreover, dollarization has also contributed to eliminate exchange rates speculation.

Table 7. Exchange Rates Offered to Customers Wiring Money to Selected Countries

COUNTRY	WU RATE	MARKET RATE	PERCENT DIFF.	PERCENT PROFIT	PROFIT FROM $250
Colombia	2220	2317.5	95.793%	4.207%	10.5178
Cuba	1	1	0.000%	0.000%	0
Dom Rep	16.3	16.2	100.617%	-0.617%	-1.54321
Ecuador	1	1	0.000%	0.000%	0
El Salvador	8.75	8.75	0.000%	0.000%	0
Guatemala	7.69	7.76	99.098%	0.902%	2.255155
Honduras	15.34	15.36	99.87%	0.13%	0.325521
Jamaica	44.29	45.45	97.448%	2.552%	6.380638
Mexico	8.81	9.19	95.865%	4.135%	10.33732
Mexico 1999[a]	9	10.13	88.840%	11.160%	27.9

Source: Western Union rates reported on April 25th. [a] Orozco 2000. Other companies refused to report their rates or were unable to provide one.

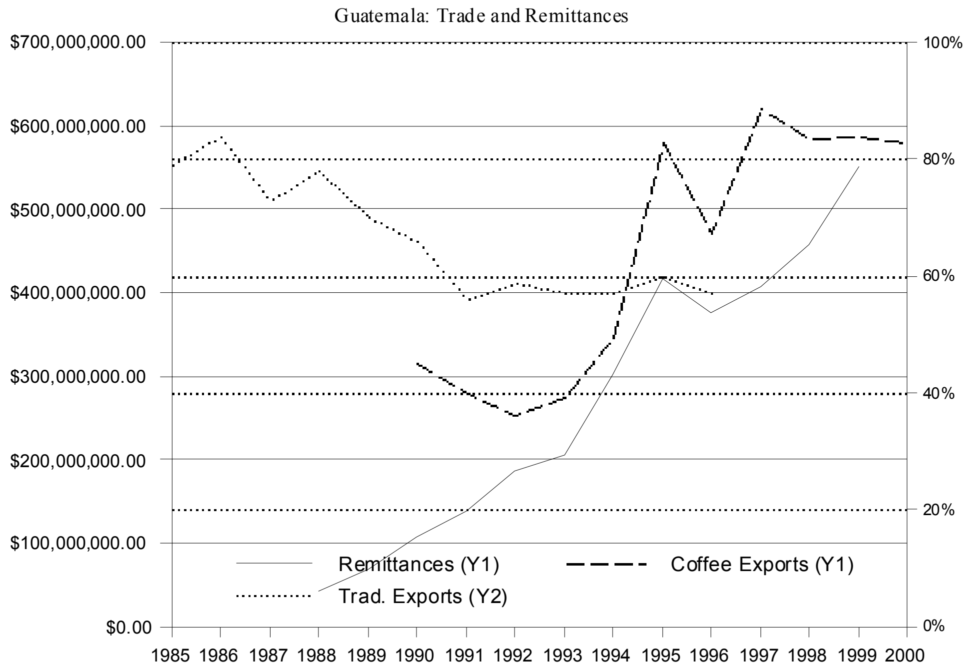
3. Development Opportunities

A look at the economies of Central America and the Caribbean shows changing patterns suggesting that there is an increasing shift in economic orientation from agricultural exports to labor exporting practices. Agriculture continues to be considered a key strategy for economic growth.

In most Central American and Caribbean countries agriculture has received special attention as a source of self-subsistence, foreign currency (through agricultural exports), and employment generation. However, despite all these supports, agricultural growth has significantly declined (Orozco 2001). Meanwhile, other factors of the economy have changed or become more relevant. Such is the case with labor migration, which has significantly increased in the past twenty years and has been especially influential through worker remittances.

Nevertheless, most governments continue to invest significant resources in the agricultural sector and have not analyzed or planned economic strategies targeting migrant remittances and capital in relation to economic growth and development. A case in point is the Guatemalan government's decision to provide $150 million in bonds to the coffee export industry to protect it from losses due to international price fluctuations. The total value of coffee exports is $550 million which is the same value as remittances (Inforpress 2001). But remittances have not received any government incentive or support for their development potential.

Remittances, thus, play an important economic role, and the players participating in this process



are to be regarded as agents of growth and change. Within this context, businesses and markets are an important agent in stimulating the flow of remittances.

The previous section identified a few changing patterns. There is more competition, transfer costs have declined, electronic transfers are on the rise, and banks and credit unions are expanding operations. However, it was also pointed that the costs continue to be high and variable, and exchange rate mechanisms continue to punish recipients and senders. These issues merit further attention. A cost-effective system of transfer will guarantee a stable and perhaps growing flow. Facilitating transfers through innovative and safe ways protects the currency.

The development potential and achievements of remittances raise the question as to whether market institutions can function as agents of development and, if so, how? Is competition enough to protect customers and consumers from market speculation, or is regulation and other societal intervention (e.g. education) also necessary? Protecting customers from market speculation is one step. To promote development through the transfer of remittances, a key premise should be to create incentives for both senders and recipients to use established financial institutions in order to increase the availability of capital, the basic factor generating growth, savings and investment. Banks and credit unions are major incubators of capital; they reproduce money through savings and interests, and senders and recipients must learn the advantages of channeling their resources through formal banking institutions.

The remittance market offers other opportunities for development. The offer of companies to make other type of transactions than sending remittances, such as paying for health insurance, school, or trade education, are important contributions. Moreover, companies can establish partnerships with migrant communities to strengthen their social base, while making profit in the market. They can engage in small investment projects with hometown associations or local businesses.

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