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Cost of Sending Remittances from the UK in the Aftermath of the Financial Crisis

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Abstract

Reducing cost of sending remittances is a sustainable development goal, and the World Bank is coordinating an effort to reduce remittance costs. Remittances remained resilient during the financial crisis overall and have since risen. The cost of sending remittances from the United Kingdom, a major remittances source country, to a selected group of 10 developing countries finds uneven trends in the cost of sending small sums over borders, suggesting the need for more targeted and coordinated policies towards decreasing the remittance prices. In these corridors, major money transfer operators seemingly have trailed small operators in reducing the costs.

Keywords: cost of remittances; United Kingdom; developing countries; money transfer operators.

JEL Classification: F22, F16, F24

Introduction

The 2008-2009 economic recession reduced remittances in certain corridors such as Mexico-US, but overall remittance flows were resilient (Sirkeci et al., 2012a) and have since rebounded to exceed \$440 billion (USD) in 2016 (Martin, 2016:38). They have proved to be vital for those in disadvantaged parts of the world at the face of the adverse effects of the crisis. Nevertheless, prices for sending remittances are very high. "Across the globe, intermediaries take 9% of remittances on average; remittances to Africa cost 12.4%" (Clemens & Ogden, 2014:4). More recently, the cost has declined a

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little further towards the World Bank's cost goal of 3% average globally: 8% overall, about 6% in high-volume corridors such as US-Mexico and 12 % in low-volume corridors such as sub-Saharan Africa (Martin, 2016:48). Thus, a percentage point decline in remittance sending prices may result in up to \$6 billion (USD) getting into the pockets of families and communities left behind and in need.

There is pressure and will to reduce the cost of sending remittances. The G8 Summit at the L'Aquila in 2009 saw the leaders pledge to reduce the cost of remittances by half, from 10% to 5% in five years. Peter Sutherland, Special Representative of the UN Secretary-General for Migration, said "let us reduce the cost of remittances to almost zero, so that an extra \$35 billion can reach the hands of the world's poorest people. Let us put crooked middlemen out of business by pursuing ethical recruitment and innovations like insurance for migrants." (Sutherland, 2015:32).

It has been argued that cost of remittances decrease as the competition increases. It was claimed that "corridors with a larger number of providers exhibit lower fees whilst corridors with a higher share of banks among providers, on the other hand, exhibit higher average fees" (Beck and Peria, 2009). To some extent, this is also tested in this paper as the nine countries examined enjoy the services of the three large money transfer operators and several other small ones. Orozco once argued that fees charged by operators are often well above the marginal cost of remittance transfers (2003, cited by Solimano, 2005: 86). The fee is usually a combination of an explicit fee (a percentage or a fixed amount) and exchange rate spread. Orozco (2003) found that on average MTOs' fees were higher than the banks. However, since the early 2000s, cost of sending remittances has declined in many corridors (Orozco, 2006). For example, average cost of sending \$200 (USD) to Latin American countries dropped 3 percentage points from 8.6% in 2000 to 5.6% in 2005 (Orozco, 2006:2). There is great variation in these figures between countries though. For instance, according to World Bank data, average cost of sending remittances to Pakistan (through seven major corridors) declined from 8% in 2011 to 6.2% in 2014 (Ahmed, 2015:51).

In this paper, we have examined the cost of sending remittances from the United Kingdom to ten developing countries where remittances represent a substantial volume of foreign currency flows.



Data and Method

World Bank data¹ is used because it offers a set of global comprehensive and compatible data on transaction costs in the period from 2013 to 2015, which, in this paper, is described as post financial crisis period.

Top three money transfer operators are compared as they have a presence in all selected corridors. Quarterly and annual average transaction costs are used with a particular emphasis on the annual change. The cost of sending \$500 (USD) is chosen as a comparison amount. Although \$200 (USD) is usually taken as reference amount, given the relatively high prices in the UK and Pound Sterling being a strong currency, \$500 is taken as reference amount in this study.

The substantial share (about 25% to 30%) of the remittances market is controlled by the three largest money transfer companies while the market is overall very fragmented with high number of smaller firms.² Therefore we have looked at the cost of sending remittances through these MTOs while also comparing the sector average for all MTOs.

The United Kingdom is one of the largest sending countries and plays a significant role in this sector due to its strong banking sector. The UK is also generating substantial volume of remittances for key corridors such as into India and Nigeria. Therefore, it is useful to look at the prices in the UK to understand the trends. We have included the top 10 recipient countries where all major operators can be found: Bangladesh, Gambia, Ghana, India, Nepal, Nigeria, Pakistan, Philipinnes, Tanzania and Uganda

Cost of remitting and implications

It is argued that cost of remittances were not elastic due to fixed fee component and therefore cost reduction would greatly increase the inflow of remittances to certain relatively poor countries (Gibson et al., 2006a). As mentioned above, competition is one of the key drivers to reduce costs of sending remittances. For instance, evidence from the United States had showed that the cost of sending money to different countries was correlated with the degree of competition (Orozco, 2002; Orozco, 2006; Hernández-Coss, 2005).

¹ The data used here was obtained from The World Bank, Remittance Prices Worldwide, available at <http://remittanceprices.worldbank.org>.

² According to World Bank and financial media sources, Western Union is by far "the largest MTO with a market share of 30% in very competitive markets and up to 90% in very uncompetitive ones", while Money Gram is the second largest provider with an estimated market share typically between 10% and 30%. Ria Money Transfer is widely cited as the third largest operator.

At the same time, international political context and currency fluctuations have impact on remittance prices. For example, sending money from the US to Cuba were expensive due to the embargo whilst remittance prices varied significantly in Venezuela due to the political crisis in the country in 2003-2004 (Orozco, 2006:2).

Aggregate remittance volume and exchange rate are the two other important factors determinin the cost of remittance transfers (sending and receiving). Freund and Spatafora (2008) pointed out the high costs lead to use of informal sector while also arguing that "recorded remittances depend positively on the stock of migrants and negatively on transfer costs and exchange rate restrictions". They also argue that with more developed financial systems and less volatility in exchange rates remittance prices can be lowered. Similarly, high transaction costs were found to be reason for using informal channels (e.g. *Hundi*) instead of banks in Pakistan (Ahmed, 2015:51).

Availability of alternative and convenient channels is also important. For example, mobile money transfer systems (i.e. mobile phone-based financial transactions) reduce costs (of transaction, transport and time) (Munyegera & Matsumoto, 2016). Nevertheless, only a limited number of remittance receivers have access to cheaper and newer payment methods operating on mobile phones capable of using services like *Obapay* which offer sending any amount of money between mobile phones for 25 cents (Clemens and Ogden, 2014:4).

One further impact on cost of remittance is the possibilities of criminal gangs using available channels, the ways people transfer money. Suspicion of terrorist gangs using, for example, *Havillad*³, may lead to the closure or further scrutiny of the use of the system in Somalia (see Horst & van Hear, 2002).

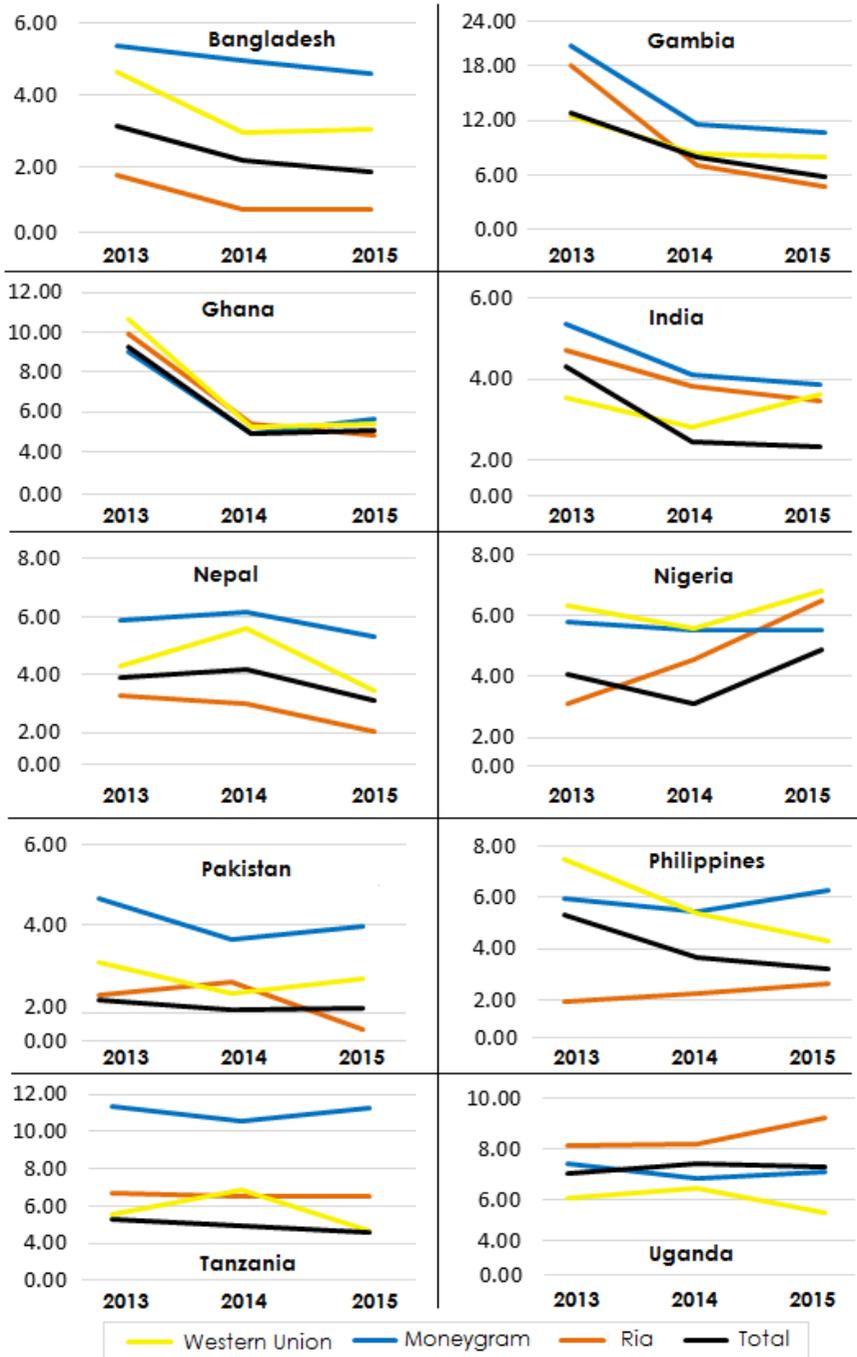
Declining costs of sending remittances from the UK

In the few years, immediately after the financial crisis, cost of remittances (i.e. cost of sending \$500 USD from the UK in this case) has declined in 8 of the 10 selected corridors. These are developing countries with significant volume of incoming remittances from the UK. Therefore, every little downward movement in remittance prices will make a significant difference to these economies, particularly in smaller countries such as Pacific nations and Nepal (e.g. Gibson et al., 2006b; Sirkeci et al., 2012b; Chen & Jayaraman, 2016). Overall, the smaller MTOs in the sector seemingly offer lower prices to

³ The term means transfer in Somali language; it is a kind of hawala system.



Figure 1. Cost of sending \$500 USD from the UK to selected countries



migrants compared to the than major players in the market. In 9 of the 10 selected remittances corridors, sector averages are lower than at least the two of the largest MTOs. Only one of the big three seem to manage to offer lower than market average prices in 6 of the 10 countries (See Figure 1).

It is interesting to see that even in markets with strong competition; the prices were not driven down significantly. For example in Philippines, where at least 16 MTOs operate, two of the three big MTOs increased their prices, but the average cost fell from \$5.30 to \$3.23. The third largest firm globally increased charges from \$1.96 to \$2.64 but remained as the least expensive.

After the crisis, in 2013, the highest prices were found in Gambia. There are 8 competing MTOs and the second largest MTO in the world used to charge over 20%. The cost of remittances in this corridor declined significantly from 2013 to 2014 about 40% on average. The third largest MTO saw about 60% reductions in remittance prices. Nevertheless the change from 2014 to 2015 was not that drastic and left Gambia one of the most expensive remittances destinations along with Uganda.

As suggested by the literature, political interventions play a significant role as well as market entry barriers which may reduce competition. For example, in our sample, Nigeria saw a small decline after the global financial crisis, but the prices increased sharply after 2014. These kinds of sharp and unexpected increases are expected after, an intervention such as the Nigeria's Central Bank's crack down on remittance companies imposing new and tougher rules to operate in the country. These rules include, for instance, mobile money transfer operators are required to be operational in 20 countries, have a net worth of \$1 billion, and have at least 10 years of experience working in the industry.⁴ Similar political interventions can be found behind the high costs maintained in Uganda, where the government wanted to impose a 10% tax on remittances.⁵

The volume of remittances was suggested as moderator of costs in the literature. Table 1 summarises the flows of remittances from the UK and in general to the selected 10 countries from 2013 to 2015. Accordingly, one would expect transaction costs to decline in Nigeria, India, Philippines, and Bangladesh. Nevertheless results are not uniform. While there is a decline in all these corridors over the period, for some major operators costs fluctuated and even

⁴ See: <https://qz.com/750156/nigerias-central-bank-wants-to-keep-remittances-expensive/>.

⁵ See: <http://www.bbc.co.uk/news/world-africa-22904176>.



increased. For example, the market leader's remittance prices went slightly up in India whereas others saw small decreases. In the UK to Nigeria corridor, on the other hand, except the second largest operator, all saw prices going up. Ghana registered an enormous growth (nearly 20 times) of remittances volume in the 3 year period and halved the remittance prices at the same time. However, price of sending remittances to Pakistan, despite about 60% increase in volume, decreased only slightly. Similarly cost of sending remittances to Tanzania did not decrease despite a sixfold increase in volume of receipts both from the UK and globally. Even though the volume and price may be correlated at global level, it seems fluctuating in the case of the UK and selected corridors for the period investigated.

Table 1. Volume of remittances received in selected countries, in US\$bn.

	2013		2014		2015	
	From UK	Global	From UK	Global	From UK	Global
Bangladesh	474	13,857	517	14,969	537	15,388
Gambia	29	181	30	181	30	181
Ghana	15	119	15	119	272	2,100
India	3,619	69,970	3,693	70,389	3,895	68,910
Nepal	111	5,552	119	5,878	137	6,730
Nigeria	3,729	20,890	3,770	20,921	3,700	20,459
Pakistan	1,079	14,626	1,272	17,066	1,644	19,306
Philippines	525	26,700	563	28,403	567	28,483
Tanzania	11	59	10	59	69	389
Uganda	254	932	275	1,029	283	1,049

Source: World Bank.

Conclusion

We have looked at selected countries where remittances constitute a significant portion of the GDP to see patterns in transaction costs from the UK. Reducing transactions costs have long been in the agenda, therefore, this analysis is worthwhile as we reveal the trends in remittances prices by the three market leading money transfer operators along with averages in the market. Overall, it seems smaller players have been able to offer lowest transaction costs compared to the big players.

Except Nigeria and Uganda, average costs of remittances (i.e. sending \$500 from the UK) were reduced in all countries between 2013 and 2015. In 6 out of 10 selected countries, the third largest MTO was able to offer lower costs than the all MTO averages

whereas the largest MTO was able to offer the lower costs in 2 out of 10 countries. The second largest MTO remained to be the most expensive in 8 out of 10 countries. Given the fact that these market leaders hold a large share of the remittances market, it is clear that small players offer cheaper deals. This is possibly due to small players strategies to gain share in a saturated market as there is hardly anyway to differentiate and clients are largely cost-conscious.

Unfortunately, over the three years period investigated, transaction costs increased in three countries, while significant reductions were achieved in several other countries. Reducing entry barriers in money transfer markets, hence allowing more small players' entry, may present an opportunity to reduce transaction costs further because these firms are likely to compete on price. Nevertheless, another major issue, which was not in the scope of this paper, needs to be looked into. Banking regulations and maintenance of accounts with banks are a concern for many in the sector and highlighted as one possible factor that drives costs up. All in all, it is clear that there is still room for improvement and reducing the costs which seems possible as many firms in the sector have been able to do so. It is also apparent that in certain countries large reductions were achieved. There is something to be learned across borders.

It was argued, with reference to a remittance receiving small nation, that money transfer operators that reduce the cost of transaction would see an increase in remittance volume from existing customers (Gibson et al., 2006a:20). The next step in this line of investigation may focus on this impact on volume of businesses for those operators competing on price.

High costs of remittance transfers are still determined by market entry barriers for money transfer operators, issues around legal statuses of migrants, availability and accessibility of banking services. Issues around money laundering and financing terrorism are still key concerns and contribute to high costs directly and indirectly. More sensitive policies are needed to reduce the insecurities of immigrants and to enable their access to banking services at lower costs. One final question should be raised about the will to reduce the cost of remittances. Do governments of receiving nations really want (and able) to facilitate reducing the costs? Or are short-term budget concerns preventing them to allow costs to be driven down further in medium to long term?



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