Remittances:
Make the Most of Them
CONTENT NOTE

Global Financial Education Program
FROM POVERTY TO PROSPERITY

Introduction

Being separated from family is never easy, but there are an estimated 150 million people worldwide who are making that sacrifice to earn better wages and send remittances home to their families. Recorded migrant remittances have skyrocketed over the past fifteen years from just $30.4 million in 1990 to $240 billion in 2006. The true size of remittances, including unrecorded flows, is even larger (Ratha 2007). Remittance flows are second in size to foreign direct investment and larger than official development assistance.

There are three types of remittances: intra-regional, domestic and international. Domestic remittances are the most common in developing countries. The majority of remittance receivers in Latin America and other regions are women. The main recipients of remittances from the U.S. in 2006 were Southeast Asia, Latin America, and Eastern Europe (IFAD 2007).

The typical amount of money a remittance sender sends to developing countries is $100-$300 per month. Approximately 80 to 90% of remittances go towards consumption, while 10 to 20% are used for formal or informal savings and investments (IFAD 2007). Remittances make up 10% of the household income of people sending money from the U.S. to Latin America and 50 to 80% of the income of people in Latin America receiving money from the U.S. (IDB 2004).

Many remittance receivers find themselves with an array of financial choices and options that they do not fully understand. They also lack trust in financial institutions to further explore these financial options. As a result, new financial products and service options offered by formal remittance service providers (banks, microfinance institutions (MFIs), credit unions, etc) are not used effectively or to their full advantage. For example, all too often remittances received through formal financial institutions are saved "under the mattress" rather than in a formal financial institution. As a result, many remittance receivers do not leverage their remittances to access other financial products such as loans to start up a small business. Consequently, they may miss out on an opportunity to improve their economic well-being.

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Financial education can help remittance receivers around the world to manage their money better and become more informed consumers of financial services. Financial education can provide remittance receivers with the knowledge and skills to evaluate their options and select the most appropriate financial products, to understand how product features differ, to calculate and compare costs and to determine what they can afford and what products are best suited to their needs. Financial education empowers the remittance receiver with the knowledge and skills to engage in a dialogue with the sender about different options for sending remittances through formal channels and how remittances can be used to meet the financial goals of both the sender and the receiver.

Stages of Migration Process

How the remittance is used often depends on where the sender is in the migration process, as well as the relationship of the sender with the receiver and level of communication between the sender and receiver about how to use the remittance. If the remittance receivers don't have financial goals of their own, they are more likely to perpetuate their dependency on remittances.

The motivation of a migrant to send money home usually depends on which stage of the migration process he or she is currently in. There are typically three stages in the migration process:

- **Stage 1: (Short Term)** The migrant is focused on paying off the debt of the trip. The receiver pays off the debt with the money sent. During this stage, there is little or no money left over from the remittance.
- **Stage 2: (Medium Term)** The migrant desires stability for family back home and sends money to cover basic household needs and home improvements.
- **Stage 3: (Long Term)** The migrant sends money home to invest in a productive project such as buying a house or starting a business. The receiver may use some of the money to achieve his/her own financial goal.

The length of time a migrant stays at each stage can vary according to the situation of each family. Understanding the stages of the migration process can serve as a tool to help remittance receivers identify where they are in the process and plan how to use their remittances wisely. It is important for the receiver to graduate or move from one stage to the next stage, until they reach the final stage and invest the remittance in a productive project such as buying a house or starting a business since this allows them to make the most of the remittance.

Current Behaviors of Remittance Receivers

Remittances are used mainly for basic needs such as schooling, food and healthcare. They are also used for education, housing, land purchase, investments, savings and unexpected events such as funerals and weddings.

A study done by the IDB/MIF in 2003 found that in Honduras, 77% of remittance recipients use the funds for general expenditures while 4% use the funds for savings, 4% for investment and 10% for education. In Guatemala, 68% of the remittance recipients use the money for general expenditures, 11% for savings, 10% for investments and 7% for education. Finally, in Mexico, 78% of remittance recipients used the money for basic needs such as rent, food and medicine, 10% for savings, 8% for investments, 1% for the purchase of land and 7% for education (WOCCU 2004).

In a regional technical assistance project implemented by the Asian Development Bank (ADB), the objective was to understand remittance flows in specific Southeast Asian sender and recipient countries. The main difference between Southeast Asian sending behavior and Latin American sending behavior is that in Southeast Asia, remittance sending behavior remains consistent over time and does not diminish the longer the migrant stays in the host country as it does in Latin America.

According to a study by the ADB, in the Philippines 60% of remittance receivers first use their remittances for food, followed by education and savings. In Indonesia, 72% of remittance receivers prioritize their spending on food, followed by housing and education. Savings, followed by education and food, is the number one priority of 81% of remittance receivers in Malaysia.

Unfortunately, many remittance receivers do not manage their remittances in a way that makes the most of their remittances. For example, they combine the remittance income with other sources of income causing remittances to be used only for daily or basic financial household needs instead of using them as means to accumulate assets and generate additional income. Often times, the remittance income is taken for granted and the receiver does not save a portion of it.

In many cases, remittance receivers assume that they will continue receiving the remittance for an indefinite period of time and begin to depend on the remittance as a frequent and consistent source of income. However, in many cases the remittance income may not always be consistent or frequent. Studies show that migrants who are further along in their life-cycle and have fewer family responsibilities in their home country remit less money home (Pozo 2002) than those migrants who are not as far along in their life-cycle. For example, although half of the Latino immigrants who have been in the U.S. for ten years or less are regular remittance senders, the money flow declines the longer they stay. Also, the frequency of the remittance may decrease over time. A study in Mexico showed that in cases where the remittance sender has been away for five years or less, the remittance receivers are nearly twice as likely to report receiving regular remittances as receivers whose family members have been away for longer (Pew Hispanic Center 2003).

Productive Ways to Use Remittance

Given the possibility that the remittance could be inconsistent or decline, it is important for remittance receivers to have a contingency plan so they are prepared if and when they stop receiving the remittance. If the money from remittances represents more than half of the receiver's total income, then he or she may depend too much on the remittance. It is important to recognize the proportion of income that the remittance represents in order to avoid dependency on it. Some suggestions for remittance receivers to minimize dependency on remittances include:

- Behave as if they won't receive the remittance next month
- Have other sources of income (small business, salaried job)
- Cover basic household needs with income from a business or job
- Manage the remittance as a separate source of income

In addition to reducing dependency on remittances, there are many strategies that receivers can use to make the most of their remittances. For example, if migrants are in stage one of the remittance process, receivers can look for a more affordable loan than a loan from the money lender to pay off the trip of the migrant. One option for making good use of the remittance is to use it to generate additional income by starting a business. This can help receivers invest in their future and ensure they will have an income even if they stop receiving the remittance. Another strategy for maximizing the benefits of the remittance is to prioritize saving and create an emergency fund.

STRATEGIES FOR REMITTANCE RECEIVERS TO SAVE A PORTION OF REMITTANCES

- Decide to save a portion of the remittance.
- Agree with family here and abroad to save a portion of the remittance.
- Decide what amount they want to save every day or week based on their financial goals.
- Find ways to spend less and save the remittance to reach their financial goals.
- Find people who save their remittances and ask them for ideas about how to save the remittance.
- Don't carry a lot of cash—avoid temptation to spend it!
- Try to avoid claiming the remittance on market days.
- Spend carefully. Look for opportunities to save money by bulk buying of non-perishables.
- Cut costs such as household expenditures, debt payments and optional expenses.

A remittance can also be used to access other financial products. For example, a remittance can be used as a guarantee or collateral to obtain a business or housing loan at some financial institutions. A remittance can also be received in a savings account, allowing the receiver to earn interest on the portion of the remittance left in the account. These products are two examples of financial products that can help receivers better manage and leverage their remittances.

Options for Receiving Remittances

There are many options for receiving remittances. Remittance service providers fall into two categories: informal and formal.

Informal Remittance Service Providers are organizations that provide transactions involving only money transfers or remittances. This type of provider includes money transfer operators (MTOs), retail shops, and couriers.

Formal Remittance Service Providers are organizations that provide several types of financial transactions or services, including money transfers/remittances, loans, deposits and insurance. This type of provider includes commercial and rural banks, MFIs, cooperatives and credit unions.

In the best case scenario, the choice of remittance channels is made through a mutual agreement between the sender and receiver, but often times the decision is made by just the sender. Senders may look at cost and convenience while recipients look mostly at convenience. Remittance transfers by informal remittance service providers involve a minimum amount of paperwork which is often easier and more appealing for clients that lack documentation. Speed is also important to both senders and receivers, and despite the higher transaction costs associated with MTOs, many people still choose MTOs as their preferred remittance service provider instead of banks or MFIs because of their speed, reliability, convenience and customer service. Others choose banks or MFIs because these remittance service providers allow clients to have access to numerous financial products.

Remittances can serve as an entry point to the financial sector and then as leverage for other financial products ranging from personal savings to loans. On page 6, are key points for remittance senders and receivers to consider about the two types of remittance service providers.

Remittance Service Provider	***Advantages***	***Disadvantages***
Formal	▪ Security (money is safe) ▪ Liquidity (for savings) ▪ Large, long-term loans ▪ Cost ▪ Reliability ▪ Privacy ▪ Income (money earns interest) ▪ Choice of products ▪ Allows clients to build a credit history ▪ Operates within banking laws if registered ▪ Access to financial advice and other financial products	▪ Can be far away for rural residents ▪ Restricted hours ▪ Minimum deposit requirements may be too high ▪ Charge fees on many accounts ▪ Long lines take time
Informal	▪ Access ▪ Proximity ▪ Speed ▪ Trust (it may be located at the local store and the client may have known the person for a long time)	▪ They don't offer other financial services that might help receivers make the most of their remittances. ▪ It might be unsafe to claim the remittance in that place ▪ It is more expensive for the family members abroad

To help remittance receivers choose the best remittance service provider for their needs, it is important to ask the remittance service provider questions related to accessibility, cost, safety, convenience, ease of use and other factors and then communicate their findings to the sender. Some questions for remittance receivers to consider include the following:

- Can they receive the remittance directly into a savings account?
- Will they receive a bank statement for their account with remittance deposits?
- Can they receive the remittance with an ATM or debit card?
- What other products will be available to them if they receive the remittance here?

- Can they receive a loan for a small business or a house if they receive the remittance here?
- Does the remittance service provider have branches in the city where their family member lives abroad?
- How expensive is it to send the receiver the money?
- How long does it take to receive a remittance from the city where the sender lives?

Benefits of Receiving Remittances Through Formal Channels

The advantages of using banks/MFIs for remittance transfers include the ability to purchase linked products and have access to a range of financial products such as savings accounts, loans, mortgages, credit cards and insurance. Banks and MFIs provide greater security and are able to charge lower transaction costs than informal remittance service providers. They also offer a range of remittance products such as cash-to-cash, in which the sender gives the money transmitter cash and then the receiver is paid out in cash by the receiving agent; cash-to-account, in which the sender provides cash to the money transmitter and it is deposited in the receiver's account; and account-to-account, in which money is transferred directly from the remittance sender's account to the receiver's account (GAO 2005).

Many formal financial institutions also offer debit cards, which are the least expensive of any remittance transfer method and have become a popular way to send and receive remittances. For example, remittance transfers can be transferred through two debit cards linked to the same account. In this system, both the sender and the receiver have a debit card linked to the same account and the sender can transfer funds from a checking or savings account into the remittance account or deposit funds directly into that account.

Despite the benefits of using formal remittance service providers, less than 5% of remittance transfers in Latin America are done through deposit institutions such as credit unions, banks or MFIs (Orozco 2004). A study by the Pew Hispanic Center (2003) showed that 70% use Western Union or MoneyGram, 11% use banks and 17% use informal means (mail or couriers).

Many remittance receivers don't want to save their remittances in a formal financial institution due to lack of trust or access to financial institutions. However, formal financial institutions can provide many benefits for clients who participate in the remittance transfer process. These benefits include:

- Ability to save part of remittance in a savings account, earn interest and be less tempted to spend it

- Access to other products such as loans or insurance
- More security than informal remittance service provider because thieves may not know the receiver is taking out remittance
- Lower transaction costs and thus cheaper to send
- Possibility to receive remittance through debit card, pre-paid card, or ATM, which is faster, often cheaper, and more convenient
- Range of products that can meet financial goals in short, medium, and long term according to different stages of migration process
- Remittance can be deposited directly to savings account
- Ability to receive bank account statements detailing all transactions including deposit of remittance, withdrawals, and account balance. This can help better manage the remittance.

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