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Remittances

Turning overseas remittances into sustainable investments

Private transfers from a migrant worker (i.e. a worker living in a foreign country for one year or longer) to a recipient in his/her country of origin. When remittances are not used for immediate consumption needs, they can be saved and invested to the benefit of the local economy of the worker's country of origin.

Key words: Remittances; Diaspora Direct Investment; FDI; diaspora bond; inclusive finance; productive sectors

How does it work?

Remittances are private unrequited transfers (i.e. payments for which no economic asset or benefit is obtained) sent from abroad to families and communities in a worker's [country of origin](#) (or [home country](#)). In the absence of social protection systems, remittances are mostly used by households for everyday consumption purposes and access to basic services such as health, education, and housing. They also may be a vital source of income for people whose livelihoods are threatened by natural disasters or other calamities. Remittances remain important sources of donations to those beyond the immediate family circle through formal or informal philanthropic initiatives. However, when they are not used for immediate consumption needs or passed on to charities, the savings and remittances of those living in the diaspora can be turned into investments. They can offer governments and companies an additional means to finance infrastructure and business operations, while rewarding [senders](#) (i.e. migrant workers) with a financial return. While remittances cannot be (and should not be) equated with other international financial flows, such as [FDI](#), export receipts or [ODA](#), the [Addis Ababa Action Agenda of the Third International Conference on Financing for Development](#) recognizes the positive contribution they can make. The focus is thus on options for using remittances to increase the available capital for "sustainable" investments in developing countries. Despite the benefits they offer a number of ethical (i.e. their underlying emotional and charitable connotations) and practical challenges remain, including issues of taxation, misuse and corruption.

The process is simple: the [sender](#) pays the remittance to a sending [operator](#) in any form accepted (cash, check, money order, credit/debit card, or instruction sent by e-mail, phone or Internet), the [operator](#) instructs his or her agent in the [receiver's](#) country to deliver the remittance—usually in cash—to the [receiver](#). Remittances thus originate from a monetary transfer that can be formal (through an accredited intermediary) or informal. Formal channels, which encompass money transfer operators (e.g. [Western Union](#), [MoneyGram](#), and so on) and/or banks are complemented by a plethora of informal means. For example, the *hawala* involves a broker who delivers cash at the request of a counterpart in another country who is serving a client. Travelling co-workers or community members who have a bank account and agree to receive cash from a [sender](#) are the most common means of informal transfer. However, new players using online and mobile platforms (e.g. TransferGo, Exchange4free, OrbitRemit and Money Express) are disrupting the MTO (Money Transfer Operator) model, with the promise of lowering transaction fees.

The desire of [diasporas](#) to assist those people who have remained in their homelands can be turned into a driver for much needed savings and investments in the countries of origin. Countries that have understood this potential have established legal frameworks to facilitate [diaspora](#) investments, including through the issuance of debt instruments and the establishment of intermediary agencies. The following instruments help to make the simple monetary transaction described above into a saving or investment decision.

- **Diaspora bonds:** Sovereign debt instruments traded in the home or destination country. They are traditional bonds sold by the [home country](#) to its own [diaspora](#) as an alternative to borrowing from capital markets. The first diaspora bonds were issued by China and Japan in the 1930s; Israel and India entered the market in the 1950s; while in the 2000s Ethiopia, Nigeria and Ghana were the first in Africa to do so. Diaspora bonds do not need to be limited to [diaspora](#) investors. Proceeds can be used to finance major public sector projects including energy, housing, and other economic infrastructure.
- **Diaspora investment, insurance and pension funds:** Financial vehicles that offer [senders](#) financial services such as shares in investment funds or pension packages. Established by governments or financial institutions, these funds can facilitate [diaspora](#) investment and retirement plans in the home country. Diaspora funds can invest in short-term debt securities and/or in equities. These types of funds are being experimented with in Kenya (Kenya's Abroad Investment Fund), and Rwanda ([Rwanda Diaspora Mutual Fund](#) and Global Diaspora Investment Fund). Social housing and real estate funds have also started to market their products to diasporas.
- **Diaspora venture capital (and impact investing):** Programmes that attract a country's [diaspora](#) to fund the growth of small businesses, while earning social and financial returns. These vehicles invest mostly but not exclusively in social enterprises—often SMEs—operating in healthcare, education, clean energy, financial inclusion and agriculture. An example is the [India Investment Initiative](#) established by the Calvert Foundation with the

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Financial Results



[Generate Revenue](#)

Instruments Used



[Debt and Equity](#)



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Sources of Finance

PRIVATE

NATIONAL

INTERNATIONAL

Related SDG



Related Sectors

FINANCE

support of USAID.

- **Insurance funds:** Insurance products (i.e. health and life insurance policies) can be sold to members of diasporas. The insurance premiums are paid by workers overseas to the benefit of family members living in the country of origin. Access to health insurance is more effective than direct transfers to cover health expenditures.
- **Diaspora Direct Investment (DDI):** In effect a form of FDI, DDIs are direct investments from companies connected to the diaspora in productive activities in the home country. DDIs are facilitated by top executives working in foreign firms in the diaspora or by entrepreneurs, owners and shareholders operating overseas. For example, with support from development partners, the Government of Moldova's Program for Attracting Remittances into the Economy (2010-2014) attracted US\$4.6 million of non-reimbursable financing that was leveraged in US\$10.2 million of investment in local enterprises.
- **Securitization of future remittance flows:** Banks can be allowed to leverage future remittance receipts to obtain capital. While no official data are available, estimates indicate that more than US\$20 billion could have been raised by banks in Brazil, Mexico and Turkey using future remittances as collateral.
- **Other services (diaspora banking):** Financial products customized to members of the diaspora's needs, including special categories of deposit accounts in multiple currencies and transnational loans. For example, MFIC, a US-based financial services corporation, has partnered with microfinance lenders and remittance transaction operators in El Salvador, Guatemala and Bolivia to provide transnational mortgages to immigrants in the USA and Spain. If held in the home country, diaspora banking saving products can expand the operations of local financial institutions.

Governments, development partners and financial institutions have a long menu of options to facilitate the productive use of remittances. Measures include the provision of information, the creation of one-stop windows (virtually or abroad), the organization of events/training overseas, the establishment of matching networks, and the establishment of matching funds and guarantees for the above financial mechanisms. An example is the Tres por Uno Programa of Mexico that helps to organize communities of Mexicans abroad for a multiplicity of purposes.

Stakeholders

- **Sender(s):** Any person working outside his home country sending financial resources to his home country. There are estimated to be 232 million international migrants (ILO), approximately half being economically active.
- **Receiver(s):** Anyone who receives remittances from a family member or friend living abroad.
- **Operator(s):** Agents and financial intermediaries specializing in offering money transfer services at market rates. These intermediaries sometimes operate in partnerships or through banks.
- **Informal dealer(s):** Any informal dealer or intermediary that personally facilitates the transfer from the senders to the receiver.
- **Financial institution(s):** Any financial institution that offers financial services to members of the diaspora, including investment/mutual/pension funds, venture capital funds and other financial intermediaries.
- **Regulator(s):** Governments (in the host or home country) and other independent bodies which set the legal framework for the international transfer of money, including through legislation governing transfer limits, taxes and duties, and the accreditation of financial operators.

Potential in monetary terms (revenues, realignment, savings, cost-reductions)

Remittances constitute a significant share of financial flows reaching developing countries. In 2014, global remittances totalled US\$583 billion (World Bank), of which US\$436 billion were transferred to developing countries. Remittances exceed by three times the sum spent on ODA and rivals total FDI in developing countries. India (US\$70 billion), China (US\$60 billion), the Philippines (US\$27 billion) and Mexico (US\$23 billion) are the top receivers. In Latin America and the Caribbean, remittances surpass FDI and ODA combined, while in Africa, their value is 50 per cent higher than ODA. Moreover, the value of remittances could be double the recorded figure, if transfers via informal channels (estimated to be worth between 20-55 per cent of total remittances in developing countries) were accounted for. A few countries, including several in Central Asia, are highly dependent on remittances, with a share of remittances to GDP above 30 per cent.

However, only scattered data are available on the use of remittances in the saving and investment vehicles mentioned above. While systematic data collection is required to arrive at a realistic estimate of remittance flows and their use at global and national levels, national surveys allow ballpark figures to be estimated. These surveys suggest that only from 4 to 8 per cent of remittances are invested in business activities while from 4 to 12 per cent of the total are saved, implying that only a small share of the total is used for investment. But this is still a large amount in value terms. However, in order to create investment/savings products of a sufficient scale to attract diaspora investment, remittances would need to be aggregated into saving and financial instruments. The share of remittances that is invested increases if investment in housing and real estate (including in land) is added.

The potential of remittances as a saving pool to finance investment projects is comparatively high for countries with low saving rates. The World Bank estimates diaspora savings as a percentage of domestic savings in 2011 reach 51 per cent in Pakistan and as high as 157 per cent in Ethiopia. Remittance flows along with the estimated average income and savings rates of migrant workers constitute the main determinants of the size of the potential market for diaspora investment products.

A few countries have proactively tapped their diasporas to effectively mobilize resources for national development and infrastructure projects. Israel, thanks to its relatively financially literate and wealthy diaspora, mobilized close to US\$25 billion in 30 years through the issuance of diaspora bonds, which for over two decades represented between 20 and 35 per cent of the country's outstanding external debt. India raised over US\$11 billion through three bond issues in 1991, 1998 and 2000.

During certain phases of development and when there is a less favourable environment for other forms of investment, the share of DDIs can become substantial: diaspora investment is estimated to have accounted for up to 25 per cent of FDI in Armenia (1998-2004) and 26 in India (1991-2001).

High transaction costs reduce the potential for generating remittances for direct investment. The cost of sending money varies from 6.1 per cent of the value of the money remitted in Latin America and the Caribbean to 11.7 per cent in Sub-Saharan Africa with the global average cost estimated at 8 per cent. Unless these costs are reduced, the financial products sold by the home country will not be competitive with those available in the host country and elsewhere.

When is it feasible?

At a minimum, the relevant legal provisions include the legislation governing the transfer of money across borders and the accreditation and supervision of financial intermediaries and money transfer operators. The legal framework that governs the financial sector regulates the issuance of financial products, including diaspora bonds, and the requirements for the participation of migrant workers resident overseas in pension, investment and mutual funds. For certain investments, the legal framework governing [FDI](#) and double taxation might also be relevant.

The extent to which the home country's financial system has been deepened sets a limit to the products that could be offered to its [diaspora](#). For example the existence of a money market or functioning stock exchange will determine the range of products that can be sold in the home country. In situations where money and equity markets are illiquid, home governments may also consider issuing financial instruments overseas, including through the intermediation of multilateral development banks. Financial literacy among migrants and their families is an important asset.

An understanding of the size of a [diaspora's](#) savings, using proxy variables such as (a) the size of the diaspora; (b) the average income of diaspora members, and (c) their propensity to save, is critical for the design of saving and investment products. A regulatory review and assessment of the benefits/costs of the various instruments taking into account investment needs and priorities (e.g. large public investments versus financing for SMEs) would also be required.

Minimum investment and running costs

The initial investment and upfront costs related to the launch of investment products for [diasporas](#) vary depending on the market(s) where the product is sold (additional markets, additional costs), the issuer (the more creditworthy, the cheaper), the size (the larger, the cheaper) and the characteristics of the product (the simpler, the cheaper). Economies of scale, competition among financial operators and low taxation are key variables determining running and upfront costs of launching investment/saving products for diasporas.

Upfront costs include the establishment/accreditation of a financial institution and/or the marketing costs for selling financial products overseas. Running expenses of the instruments listed above encompass portfolio management, accounting and pricing, shareholder services, and other administrative costs. These expenses are paid by the investors. In the case of pension/mutual/investment funds, expenses are calculated as a ratio of the fund's annual expenses expressed as a percentage of its assets. The OECD estimates that the operating costs of pension and mutual funds vary from 0.1 per cent in Denmark to 1.2 per cent in Mexico and are higher in developing countries. The running costs of [venture capital](#) and [impact investing](#) are usually higher due to the costs related to the screening and monitoring of individual investments. In the case of diaspora bonds, the fees paid by the issuer can reach up to 4-5 per cent of the face value of the bond issuance, depending on the characteristics of the bond and of the issuer.

Appropriate context

- In countries with a high emigration rate/sizeable emigrant population and high savings rates (among migrant workers).
- When remittances make up a critical share of the GDP and the alternative sources of funding are costlier.
- In the context of fragile states and rebuilding processes.

Appropriate time

- To replace [ODA](#) or when considered as [ODA](#).
- To replace the government in providing social security and access to basic services.

What are the main risks and challenges?

Pros

- Capacitates and equips migrants to invest their savings in the well-being of their community of origin.
- Diaspora investments are less prone to capital flight in times of political/economic crisis; more generally the [diaspora](#) is ready to accept a higher risk premium than the market.
- Countries may be able to price financial products geared to the [diaspora](#) at a discount, as diaspora investors are willing to accept lower returns; Israel, India and Lebanon were able to price bonds for their diasporas at discount rates.
- Promote [public-private partnerships](#) and the relationship between migrants and their [home countries](#).

Cons

- Increases the dependence of households or communities on external flows.
- Remittance-dependency can lead governments to accept poor working and living conditions for their emigrants out of fear of forgoing the funds they send back.
- Government involvement in the management of savings and investment products is an important element in these products but it might also be counterproductive in attracting private investment.

Risks

- High transaction costs associated with the transfer of money reduce the financial resources available to families in the home country.

- Insufficient political will to promote accessibility, competition and transparency in the money transfer market, including by reviewing legal and policy frameworks to eliminate barriers, especially for international transfers of small amounts.
- Government involvement in setting up the investment vehicles generates opportunities/risks for corruption; those vehicles should be shielded from government interference;
- Currency exchange risks.
- The introduction by the host country of taxes and/or bans on cross-border cash or bank transactions.
- Informal channels can attract individuals and groups engaged in criminal activities such as money laundering, gambling, smuggling, or the financing of terrorism.
- Remittances are private savings. If governments adopt mandatory requirements or raise taxation on remittances, the volume might be reduced.
- Failure to build trust between the proposed funds and the diaspora, due to the latter's scepticism towards funds that are publicly/government owned.
- The role of the State in the provision of basic services (e.g. health, education) may be undermined, and public expenditure diverted to other sectors.
- Failure to invest remittances in projects that promote sustainable development.

Challenges

- The cartel-like behaviour of dominant firms makes reducing the cost of money transfers difficult.
- Regulations remain a major barrier to the entry of new money transfer providers, especially from the mobile phone sector. Barriers include legitimate provisions for combating money-laundering and the financing of terrorism.
- Countries have not agreed on a global framework for regulating remittances.
- The illiquidity of developing countries' financial markets and the unfavourable environment can reduce the options available for channelling diaspora investments and require capacity development.

How can the design be ameliorated to improve the impact?

Remittances can reduce the level of poverty by directly augmenting the incomes of poor recipient households and increasing aggregate demand, thereby increasing employment and the wages of the poor ([World Bank](#)). The potential positive impact of using remittances for productive investments could be even higher, lowering the risks associated with dependent behaviours (e.g. the use of remittances to buy imported goods). However, achieving this impact depends on the sectors where these resources are invested and on the criteria and principles followed. Given that remittances have emotional, ethical and charitable connotations, extra diligence should be guaranteed on the standards and principles used in their allocation. For example diaspora bonds should meet international Environmental and Social Governance (ESG) criteria, while the proceeds from bonds could be allocated to green projects (in accordance with the [Green Bond Principles](#) and the [Climate Bond Standards](#)-see, [Green Bonds](#)). In addition to allocation principles:

- A coherent regulatory framework and greater international cooperation favouring competition, transparency and consumer protection is needed to reduce the costs of remittances and thus to free capital.
- Modern technologies and product innovation can help to deliver financial services that are accessible to the large majority of migrant workers, notably by offering tailor-made, affordable financial services, such as micro-savings and deposit accounts, micro-insurance and international mortgages.
- Financial literacy and entrepreneurial skills are essential in promoting a more productive use of remittances, but the senders and receivers often lack these skills. Financial institutions and the education system should promote financial literacy and entrepreneurship at both ends of the market.

Guidelines and Case Studies

Guidance

[Developing a Road Map for Engaging Diasporas in Development](#)

[Diaspora Direct Investment: Policy Options for Development](#)

Case studies

[Diaspora bonds: Israel and India](#)

[Mobile transfers: Money Express](#)

[Venture capital/impact investment: Calvert and the India Investment Initiative](#)

Our work

[International Guidebook of Environmental](#)

Sustainable Development Goals

Environmental finance

[Our Perspective](#)

[Finance Tools](#) null



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We should reach a consensus on the fact that macroeconomic policies in low-income economies need to also jettison the conventional wisdom of undue restrictiveness.

