Common Market for
Eastern and Southern Africa

# Reducing the Costs of Transfer of Remittance remains a **Critical Policy Issue for Africa**

Special Report

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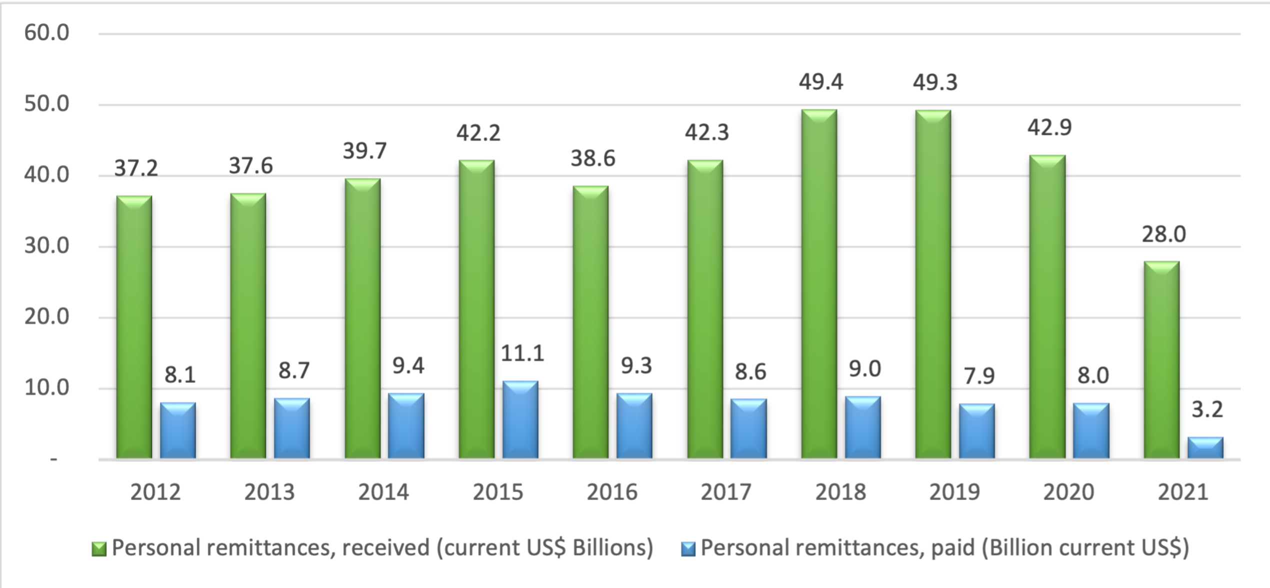
## Introduction

The World Bank estimates that in 2021 about 150 million Africans were living outside their country of origin, two thirds of which were on the Continent. The global amount sent as remittances to Sub-Saharan Africa increased from USD 37.2 billion in 2012 to a peak of USD 49.4 billion in 2018 before falling to USD 27.95 billion in 2021, the decline largely attributed to the adverse effect of COVID-19 pandemic on diaspora remittances. Similarly, remittances paid increased from USD 8.1 billion in 2012 to a peak of USD 11.1 billion in 2015, remaining fairly constant at about USD 8 billion across the year but declined to USD 3.2 billons in 2021 (Figure 1).

**Figure 1: Personal remittances, received/paid (current US$ Billions)**

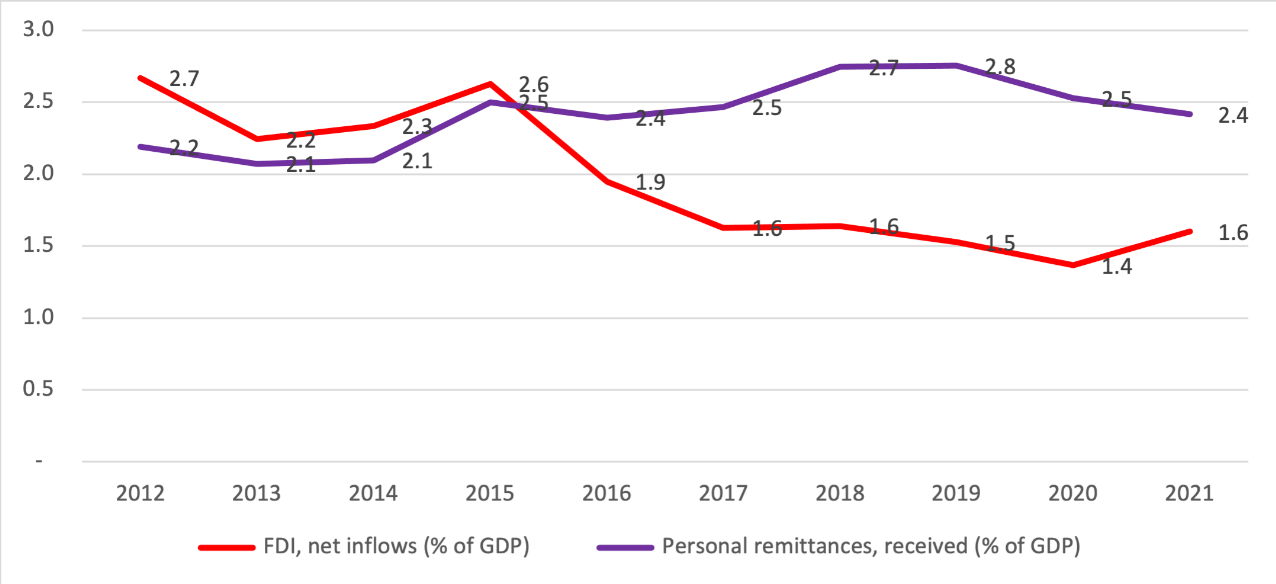



*Source: World Development Indicators*

However, even with this decline in 2021, remittances across individual countries were resilient and stable for several reasons. Firstly, in several countries, there was concerted policy push towards digitization and use of formal channels during the pandemic that resulted in improved data capture on remittances. Secondly, lock downs and travel restrictions made it difficult to use informal channels that involved person to person interactions which meant a boost on flows through the formal channels. Also, most migrants in remittance source markets work in sectors that are considered to offer essential services and hence had least disruption on their incomes during the pandemic. Finally, migrants in economically stable host countries frequently send altruistic transfers during a crisis, even if it means depleting their savings in order to support families back home.

Remittances are also an important source of foreign exchange to many African countries, in some countries surpassing Foreign Direct Investment. Remittance as a percentage of GDP have outperformed FDI net inflows since 2015 through to 2021 for Sub-Saharan African countries (Figure 2).

**Figure 2: FDI and Remittances as percentage of GDP**




*Source: World Development Indicators*

Official data on remittance remains relatively scanty and significantly underestimates the true size of remittances to African countries due to the use of informal channels.

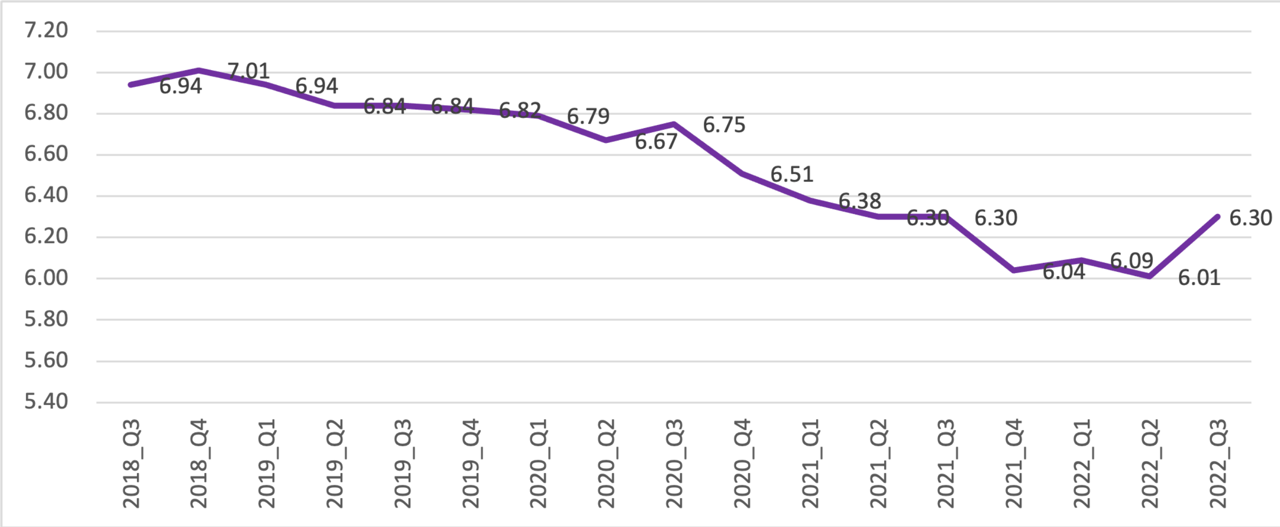
## Benefits of Remittances

Remittances flows are a significant, stable, and resilient source of income to many households in Africa. Reducing the cost of sending money from the diaspora is therefore important in enhancing the role of remittances. The key benefits of remittances are among others: (i) Reducing poverty – Remittances are particularly relevant and expensive to Africa's underserved rural poor population, which receive an estimated 30 – 40% of all remittance flows. For this group, remittances if channeled to productive investment play a significant role in uplifting many households from poverty. They tend to increase resources devoted to investments and increase the pool of funds available for small business startups. These resources, with appropriate instruments can also be used to fund longer term development and infrastructure projects; (ii) Remittances have been associated with improving health and education outcomes, by releasing resources to these sectors; (iii) Remittances help sustain consumption and investment during economic downturn, making remittances countercyclical to economic shocks compared to other private flows (BIS & World Bank, 2022). Migrants tend to send more money back home during economic down turns as has been experienced during the COVID-19 pandemic. Similar trends have been documented for countries going through wars where remittances tend to be a significant source of foreign exchange (World Bank, 2020). That is, remittances help smooth consumption and acts as a form of insurance for households facing shocks to their incomes and livelihood caused by drought, famine and other natural disasters; (iv) Remittances in hard currency acts as collateral for banks and small firms seeking foreign financing, thereby increasing their access to international capital markets; and generally (v) Remittances provide livelihoods to many on the continent.

## Costs of Remittances Transfer remain High

Despite all the above benefits, transfer costs for remittances remains significantly high across the globe and above the UN SDGs target of 3 percent to be reached by 2030. The Global average cost for sending remittances has been well above 6 percent over the last four years, increasing to 6.30 percent in Quarter 3 of 2022 (Figure 3).

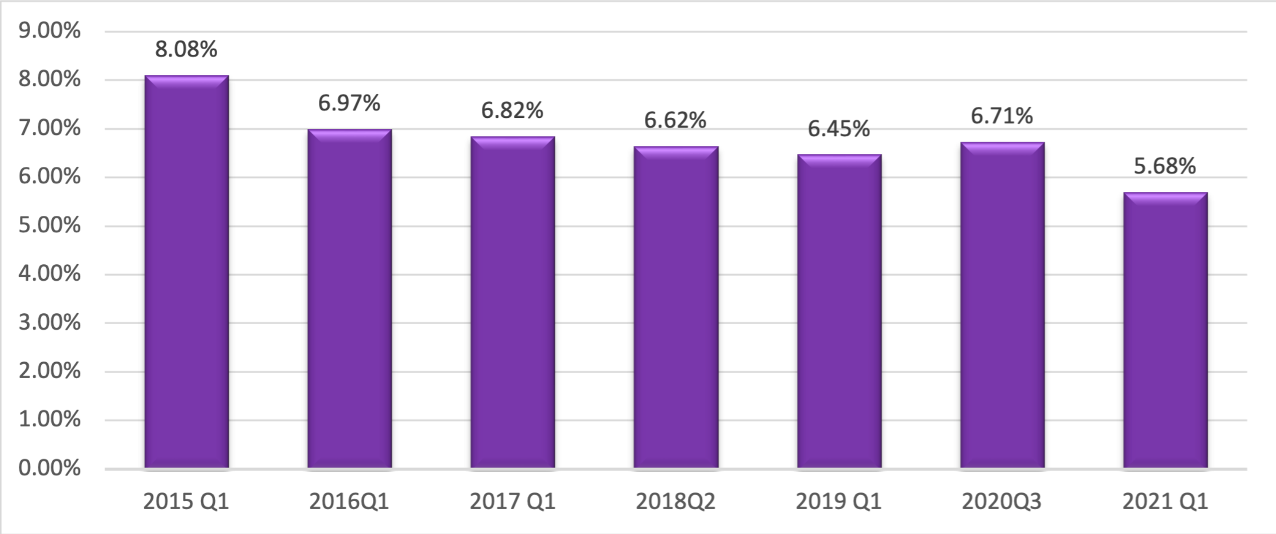
**Figure 3: Global Average (%) Cost of Sending $200 in Remittances**




*Source: World Bank (2022), Remittance Prices Worldwide*

A similar picture is depicted for remittances from the EU to African countries with costs remaining above the 5 percent (Figure 4).

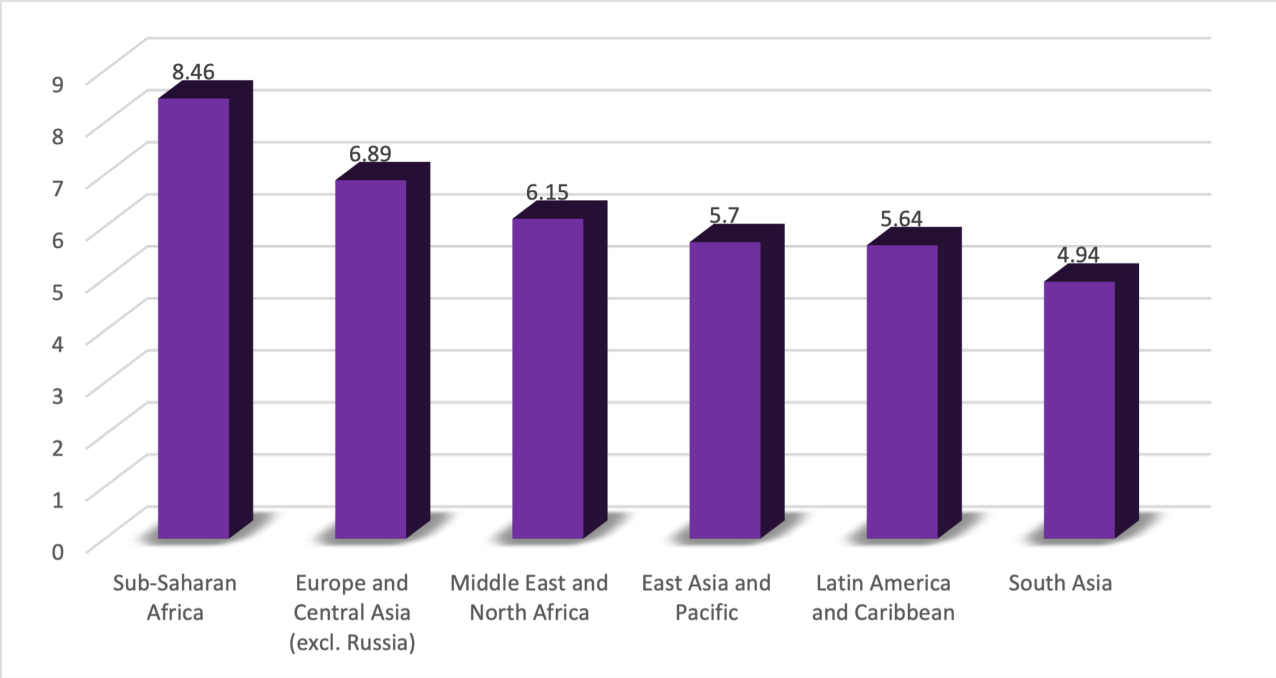
**Figure 4: Average Total cost (%) to send USD 200 from EU to African countries.**




*Source: World Bank (2021), Remittance Prices Worldwide*

According to the World Bank (2020b), the remittance costs to Africa remain higher compared to other corridors. By the 3rd quarter of 2022, the average cost of sending $200 to Sub-Saharan was highest at 8.46% followed by Europe and Central Asia excluding Russia at 6.89%, then Middle East and North Africa at 6.15 percent (Figure 5).

**Figure 5: Average Costs of Sending $200 (%) to a Particular Region of the World**




*Source: World Bank (2022), Remittance Prices Worldwide*

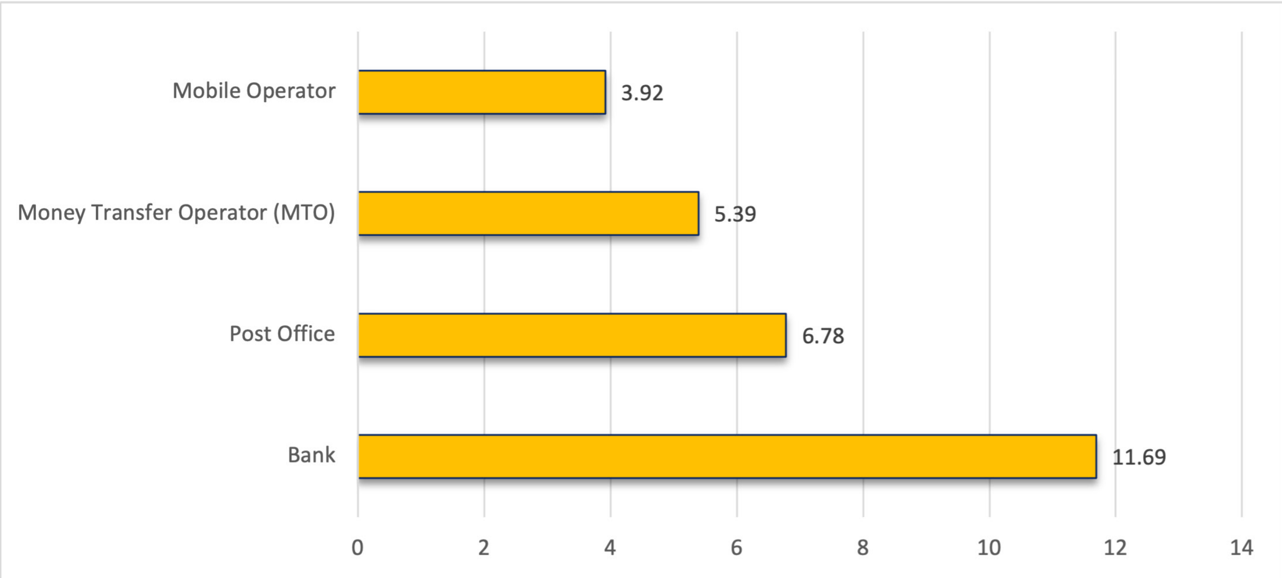
Similarly, high remittance costs exist between African countries partly because of the limited access to formal remittances and banking services by the African diaspora (GPFI, 2021). Reducing the high cost of remittance transfer is therefore an important policy concern since remittance releases resources available to the poor migrants and their families back home to do other things, and generally improves financial access by the poor. High costs of transfer also promote use of informal channels that are cheaper, faster, and more accessible because such channels use common language, share historical and cultural ties, and do not require sender/receiver identification. However, informal channels are riskier, hamper productive financial intermediation and cannot be effectively tapped for economic development, and are prone to illegal activities due to their undocumented nature e.g. smuggling, money laundering etc (GPFI, 2015).

## Reasons for High Remittance Costs

The main reasons why the costs of remittances remain high includes, the fact that the African remittance market is characterized by limited or lack of competition among the remittance service providers (RSPs). Themajor money transfer companies (Western Union and MoneyGram) control about 65% of all remittance payout locations. Both companies have protected returns to their initial investment by requiring that agents sign exclusivity agreements that prevent agents paying out remittances from offering the same service on behalf of other companies. With about 80% of African countries restricting the type of institutions able to offer remittance services to banks and the two companies dominating, this lack of competition has ensured costs of remittances transfer remains high. The entry of other RSPs particularly through financial technology (FinTech) companies or digital money transfer operators (MTOs) has been associated with lowering costs (Beck et al. 2022).

According to the World Bank (2022), by the third quarter 2022, sending $200 is most expensive via banks at 11.69%, followed by post offices (6.78%) and MTOs (5.39%) and cheapest via mobile operators (3.92%) (Figure 6).

**Figure 6: Total Average Cost of Sending $200 (%) 2022_Q3**




*Source: World Bank (2022), Remittance Prices Worldwide*

Another reason for the high cost of remittances is the low utilization of mobile money for remittances transfer in Africa due to among others, the low level of digitization and mobile phone penetration,limited or lack of financial inclusion, and limited or lack of interoperability among digital payment infrastructure and regulatory frameworks between sending and receiving countries. In addition, in Africa, there is lack of access to technology supporting payment and settlement systems that create barrier of entry and in turn keeps cost of transfer high. Also, there are burdensome regulatory and compliance requirements that keep costs high (World Bank 2020a).

## Conclusion and Policy Implications

The formal remittance market in Africa is characterized by uncertainty about the volume of remittances, limited competition, high transfer costs and slow uptake of innovation. Measures to reduce the cost of transfer of remittances include among others, increased market competition, consumer protection, increased involvement of post office services and other non-bank institutions and encouraging the extension of mobile transfer services to cross-border remittances. Encouraging competition is key to expanding financial access since it forces innovation and pushes players to expand access to the financially marginalized. Competition depends on the regulatory environment, capacity and resources of the regulator, number and types of players and their operational efficiency and the range of services they can provide. There is significant scope to reduce costs of remittance transfer by encouraging competition that will foster innovation.

Governments should continue to investment in physical infrastructure required for digital transformation. These may include investment in clean energy to ensure stable access to electricity, private sector investment in mobile network infrastructure and infrastructure investment that would ensure increased internet connectivity. Governments should promote digital economic transformation through issuing digital IDs that could promote use of digital payment platforms and provide the much-needed digital public infrastructure. Bring these remitted funds into the formal financial system to increase their development impact. Governments to come up with appropriate financial instruments that can be used as vehicles to tap remittances and channel the same to development activities (e.g., use of diaspora infrastructure bonds). Encourage use of Micro-Financial Institutions (MFIs) when receiving or sending remittances as opposed to informal channels. MFIs have proven to have the ability to offer services to people with low income and provide a regulatory framework than encourages the poor to use MFIs.

Finally in all the above policy options, the policy dialogue platform provided by the COMESA Committee of Governors of Central Banks has a critical role to play. Governors need to continue harmonizing policies at the regional level to encourage use of mobile money for remittances transfer in order to increase competition in the remittance market. Central Banks should continue to provide enabling environment to foster competition through among others transparent licensing processes for digital RSPs, supporting partnerships among different RSPs including banks, non-banks, Fintechs, and mobile operators. Such partnerships could foster interoperability of payments and information technology systems among RSPs required for reducing costs of transfers. Central Banks should continue to promote digital financial literacy to both diaspora and remittance recipients in order to boost better use of remittances. With better financial education and a broader range of financial services to choose from, remittance recipients/senders are empowered to make financial choices that can advance them towards financial independence. Central Banks should also continue to collaborate with other external actors that are keen in reducing the cost of remittance transfer at regional and international level.

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