“A $100 Billion Idea”

Leveraging Migration for Financing Development[1]

This note outlines a few under-exploited market-based financing options that are directly connected to international migration. As much as $100 billion, or more, could be raised annually by developing countries via:

- Mobilizing diaspora savings
- Reducing remittance costs
- Reducing migrant recruitment costs
- Mobilizing philanthropic contributions from the diaspora

Remittances can be further leveraged for development financing via:

- Future-flow securitization of remittances
- Enhancing sovereign credit ratings
- Linking remittances to financial savings and insurance

1.1 Mobilization of diaspora savings via diaspora bonds

Many international migrants save a significant part of their income in destination countries. New estimates suggest that the annual savings of diasporas (approximated using data on international migrants) from developing countries amounted to $497 billion in 2013 (Table 1). A large part of these savings is held in bank deposits. A diaspora bond – a low denomination security with a face value of $1,000, say, carrying a 3-4% interest rate and 5-year maturity – issued by a country of origin could be attractive to migrant workers who currently earn near-zero interest on deposits held in host-country banks (Okonjo-Iweala and Ratha, 2011). Diaspora bonds could be used to mobilize a fraction – say, one-tenth – of the annual diaspora saving, that is, over $50 billion, for financing development projects.

The governments of India and Israel have raised over $40 billion, often during liquidity crises, by tapping into the wealth of their diaspora communities to support balance of payments needs and (in the case of Israel) to finance infrastructure, housing, health, and education projects. Several other countries – including the Philippines, Sri Lanka, Kenya, Ghana, Nepal and Ethiopia – have issued diaspora bonds with varying degrees of success.

While a diaspora bond can be issued by a sovereign government, in theory it can also be issued by reputed private companies. For the borrower, a diaspora bond can provide lower-cost and longer-term financing than would otherwise be available, especially in times of financial stress. A diaspora bond would have a lower interest rate than a sovereign bond sold to foreign institutional investors; because, first, the interest rate benchmark for a diaspora investor would be the deposit rate (zero or low) instead of LIBOR; and second, the risk spread on a diaspora bond would be lower, since the diaspora investors’ perception of country risk is lower (except in cases where the diaspora is fleeing the regime). A diaspora member would be able to use local currency and hence would have a lower perception of devaluation risk. Also diaspora members are likely to have better knowledge of their country of origin than foreign institutional investors.

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[1] Excerpted from Migration and Development Brief 24, April 13, 2015, World Bank, prepared by Dilip Ratha, Supriyo De, Ervin Dervisevic, Sonia Plaza, Kirsten Schuettler, William Shaw, Hanspeter Wyss, Soonhwa Yi, and Seyed Reza Yousefi.

Unlike foreign currency deposits that can be withdrawn at any time, a diaspora bond provides a stable, longer-term financing instrument.

Table 1: Estimated diaspora income and savings for developing regions, 2013

	Diaspora stock (millions)	Diaspora Income ($ billions)	Diaspora Savings ($ billions)
East Asia and Pacific	31	579	116
Europe and Central Asia	32	402	80
Latin America and Caribbean	34	645	129
Middle-East and North Africa	24	275	55
South Asia	38	402	80
Sub-Saharan Africa	23	181	36
All Developing Countries	182	2,484	497

Source: World Bank staff calculations using the latest bilateral migration matrix, data on skill level from the Database on Immigrants in OECD Countries (DIOC), and World Development Indicators database. For the estimation of diaspora savings and identification of candidate countries for diaspora bonds, see Ratha and Mohapatra (2011) and Ketkar and Ratha (2009).

Countries with a large diaspora stock in richer destination countries have a greater potential for successful issuance of diaspora bonds. Conversely, a country with fragile governance may have a lower potential for success. Chances of success are increased when the issuing country has a strong economic program and a portfolio of attractive projects to be financed by the diaspora bond. Understandably, the diaspora's trust in the government is a key factor for successful launching of a diaspora bond.

Among middle income countries, Mexico has the largest estimated diaspora savings of $53 billion, followed by China ($46 billion) and India ($44 billion). Among the low income countries, Bangladesh has the largest diaspora savings ($9.5 billion) followed by Haiti and Afghanistan (around $4.5 billion each). Many countries in fragile situations have sizable diaspora savings as a share of their GDP, for example, Somalia (81 percent), Haiti (53 percent) and Liberia (29 percent); these countries could potentially use diaspora bonds for reconstruction and development, provided that they put in place proper oversight for the use of funds.

A major challenge to the issuance of diaspora bonds has been the perceived high cost of registration with the US Securities and Exchange Commission. Also retail sale of these bonds is likely to cost more than selling bonds to a handful of institutional or high net-worth investors. In many cases, however, the interest cost saving will likely outstrip such costs.

Diaspora bonds should be available to all investors, not just migrant savers, and be distributed widely, not kept on the books of a few investment banks. That way, by ensuring greater depth and liquidity in the market for diaspora bonds, large sums could be mobilized for development at low, stable interest rates, without diminishing migrant workers' incentive to save (Mohieldin and Ratha 2014).

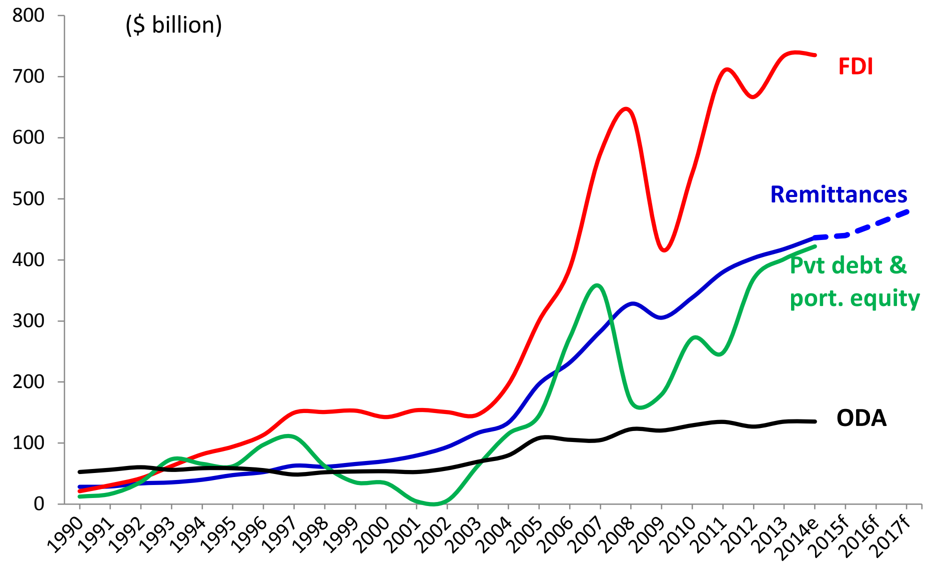
1.2 Reducing remittance costs

Remittance flows to developing countries reached $436 billion in 2014. The true size of remittances, including unrecorded flows through informal channels, is even larger. Remittances are over 3 times larger than ODA (figure 1).

Remittance costs have been declining over time but as of the last quarter of 2014, remained high at 8 percent of the amount transferred for all developing countries, and at 12 percent for Sub-Saharan Africa.

Taking the cue from the G20 5X5 objective, the development community should attempt to reduce remittance costs to less than 3 percent by 2030, with at least one reliable and accessible service available in each corridor at a cost significantly lower than the average for that corridor, through enhanced information, transparency, leveraging on new technologies, competition and cooperation with partners. Reducing remittance costs from the current average of 8 percent to 3 percent would translate into a saving of over $20 billion annually for the migrants and their relatives.

Figure 1: Remittance flows are larger than ODA, and more stable than private capital flows



Sources: Migration and Development Brief 24, Development Prospects Group, World Bank

Judging market and technology trends, this target seems achievable, even modest. The development community could arguably set a goal of reducing remittance costs to below 1 percent by 2030. The Remittance Prices Worldwide database shows that in the second quarter of 2014, the average cost of sending $200 was less than 1 percent for 56 providers and below 3 percent for 374 providers. Many leading remittance service providers have now reduced the fee for account-to-account transfers to zero in high-volume corridors such as India.[i]

An important barrier to lowering remittance fees arises from the costs associated with implementing anti-money laundering and countering the financing of terror (AML/CFT) requirements. Further development at the national level of a risk-based approach to AML/CFT regulation could help reduce these costs, Facilitating the use of more efficient technologies and fostering competition in the remittance market, while still complying with AML/CFT requirements, could reduce overall compliance costs. Presently, however, 'de-risking' by international banks has become a major threat to remittance services to fragile countries such as Somalia.

1.3 Reducing recruitment costs

Recruitment costs paid by migrant workers to recruitment agents, on top of the fees paid by the employers, are a major drain on poor migrants' incomes and remittances. They divert the money sent by migrants from the family to illicit recruitment agents and money lenders. Almost 10 million people use regular channels to migrate in search of employment every year. A large number of them pay illegal recruitment fees to the recruitment agents. According to a KNOMAD survey last year, worker-paid recruitment costs averaged $1,955 in Kuwait with Bangladeshis paying the highest, ranging between $1,675 and $5,154 (Abella and Martin 2014). A 2009 Bangladesh Household Remittance Survey conducted by the IOM found that over a half of the migrants paid over $2,000 in recruitment fees. Fees paid to smugglers for crossing international borders, a reasonable proxy for the black market recruitment fees, tend to be even more exorbitant. For example, according to the European Union, smuggling fees to Europe ranged from $5,000 in the case of Vietnamese workers to over $15,000 for Bangladeshi workers in 2013.[ii] On top of these direct fees paid to recruitment agents, migrant workers are often subjected to usurious interest rates of over 50 percent on loans taken to cover the costs of migrating (Abella and Martin 2014). In addition, recruitment agents are often reported to offer bribes to the employing company personnel, with amounts ranging between $300-1,000 per worker and these costs are recovered from the workers (Jureidini, 2014).

If the recruitment costs averaged $5,000 and they were reduced to $1,000 per migrant worker, the cost savings would be $4 billion for every 1 million workers. If half of the estimated 10 million benefitted from these cost reductions, the saving would total $20 billion per year. It is entirely plausible, therefore, that the savings generated by reducing recruitment costs for low-skilled migrant workers could match or exceed the amount saved by reducing remittance costs (ILO, 2015).

The development community should endeavor to eliminate illegal recruitment fees (in excess of genuine costs related to airfare, visa, and training costs). This would require effective regulation and monitoring of recruitment agencies implemented in collaboration between the sending and the receiving countries. Improving migrants' access to information can help improve the effectiveness of migration–related policies and regulations. Developing a bilateral matrix of recruitment costs, similar to the Remittance Prices Worldwide database of the World Bank, can be a very useful tool and metric for this purpose.[iii]

1.4 Diaspora philanthropy

There is no doubt that philanthropy is widely practiced by diaspora members, although these activities are not always organized or systematically channeled. Two relatively organized forms of diaspora philanthropic engagement are through Home Town Associations (HTAs) and diaspora foundations. Of these, the HTAs have received some attention from the development community (McKenzie 2014, Chauvet et al. 2013, Van Hear, Pieke, and Vertovec 2004, Orozco 2007). Some governments have attempted to channel collective remittances through HTAs by offering matching funds. Among the best-known matching fund schemes is Mexico's 3-for-1 program under which the local, state, and federal governments all contribute $1 each for every $1 of remittances received through a HTA overseas.

The scale of collective remittances or philanthropic contributions channeled through HTAs has been small. Resources have gone primarily to rural areas, where they have increased the supply of essential services (health, education, roads, and electricity). It is difficult to assess whether these investments—and the matching grants—have gone to the highest-priority projects or have been diverted from other regions with a great need of assistance from fiscally constrained governments (World Bank 2005). Meanwhile, proponents argue that HTA involvement ensures that programs are focused on community needs, and that the associations promote increased accountability and transparency of local and national authorities (Page and Plaza 2006). Duquette-Rury (2014) evaluates Mexico's 3X1 program, taking into consideration selective participation. She estimates the impact of participating in 3x1 over the 2002-08 period on changes in public goods infrastructure between 2000 and 2010. She finds that 3x1 program expenditures significantly and positively affect household access to sanitation, water, and drainage in participating rural villages. However, she also finds that households receive less family remittances as collective remittances to their municipalities increase.

HTAs face several limitations in serving as conduits for broader development projects: (i) they may not have the best information on the needs of the local community, or they may have different priorities; (ii) the capacity of HTAs to scale up or form partnerships is limited by the fact that their members are volunteers and their fundraising ability is finite; and (iii) they can become divided and weaken their own advocacy potential (World Bank 2006; Newland and Patrick 2004). Finally, a key to attracting contributions from the diasporas and the HTAs is good business environment, adequate port and customs facilities, low red tape, and trust in government at home (Plaza and Ratha, 2011).

Philanthropy at the individual or household level has not received as much attention from the development community. According to the literature on philanthropy, the determinants of giving behavior depend on demographic characteristics (age, education, gender), diaspora income and wealth, altruism and trust in the country, and the effectiveness of the institutions involved, in particular on the managerial capabilities of the HTAs and the project team back home (Havens and Schervish, 2006). For mobilizing charity from the individual diaspora donors, the challenge is one of being able to reach them, since relevant databases are not available in most countries. One possible mechanism to mobilize diaspora contributions is to approach the migrants when they use the remittance channel to send money. Indeed, modifying the remittance form to allow small donations for specific purposes (for example, fighting malaria in the community of the remittance-recipient) can be an effective way of mobilizing diaspora giving.

There are no global estimates of charitable giving by diaspora members. Some estimates of how much people give in big cities in the United States, based on the IRS data, range from 1.9%-5.4% of income. If the diasporas' propensity to give is even a half of 1 percent of diaspora incomes (as indicated in Table 1 above), it would exceed $12 billion annually. However, even in the case of mobilizing diaspora giving, AML/CFT concerns remain.

1.5 Remittances as collateral for international borrowing

The use of future remittances as collateral – future-flow securitization of remittances – can lower borrowing costs and lengthen debt maturity. An important element of a future-flow securitization structure is the creation of a special purpose vehicle offshore to issue the bond and shield it from sovereign interference. The dollar volume that could be raised via future-flow securitization can be very large. No recent data are available on the size of future-flow securitization of remittances, but as of 2008, over $20 billion had been raised by developing country banks using this technique, notably in Mexico, Brazil, and Turkey (Ketkar and Ratha 2009). In a noteworthy transaction, Banco do Brasil raised $250 million in 2002 through a bond securitized by future flows of remittances from Japan – the bond was rated BBB+, five notches higher than Brazil's sovereign rating of BB-; the interest rate on this bond was about 9 percentage points lower than the sovereign borrowing rate at the time.[iv]

Besides remittances, a wide variety of future receivables have been securitized – including exports of oil, minerals, and metals; airline tickets, credit card vouchers, international telephone calls; oil and gas royalties; and tax revenue. Securitization of diversified payment rights (DPRs) – which include remittances, aid, investment, and trade-related payments through the international payments system – is a more recent innovation.

Table 2: Securitization Potential in Sub-Saharan Africa

	Receivable ($ billion)	**Potential ($ billion)**
Fuel exports	182	36
Agricultural raw materials exports	20	3
Ores and metals exports	63	11
Travel services	26	2
Remittances	31	4
Total	322	56

Source: World Bank staff calculations. The data on receivables are based on average values for 2011-13. The calculation of potential size follow the methodology used in Ketkar and Ratha (2002).

Preliminary calculations show an enormous potential for future-flow securitization in Sub-Saharan Africa (Table 2). However, absence of securitization laws, especially the confusion surrounding bankruptcy laws, remains a major challenge to the realization of the potential of future-flow securitization in developing countries. And, unfortunately, securitization became a maligned term during the global financial crisis of 2009; although the problem was excessive borrowing, not securitization itself.

3.6 Remittances, country creditworthiness, and financial inclusion

Because remittances are large and more stable than many other types of capital flows (see GEP 2015), they can greatly enhance the recipient country's sovereign credit rating, thus lowering borrowing costs and lengthening debt maturity. Recently the rating agencies have started accounting for remittances in country credit ratings, but given data difficulties, there is still room for further improvement.

The joint World Bank-IMF low-income country Debt Sustainability Framework now includes remittances in evaluating the ability of the countries to repay external obligations and their ability to undertake non-concessional borrowing from other private creditors. When remittances are included in the calculation of a key indicator of debt-sustainability, the ratio of debt to exports, it improves significantly for countries that receive large remittances, such as Armenia, Guatemala, Lebanon, Nepal, and Pakistan.

At the micro-level, remittance receipts can also be used to judge poor people's creditworthiness. And they can be used to promote micro-saving and micro-insurance, all to enhance financial inclusion for the poor.

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[i] Some MTOs are toying with the idea of remittance fees being paid by merchants (where the remittances might be spent) rather than the migrants. The use of mobile phone technology and the internet has significantly increased the efficiency of remittance services. The remittance industry is now looking into using Bitcoin and other virtual currencies, which would improve efficiency even further.

[ii] These data were collected through Operation PERKŪNAS during September-October 2013 – see http://www.statewatch.org/news/2014/mar/eu-council-operation-perkunas-16045-13.pdf.

[iii] Under the auspices of the Global Knowledge Partnership on Migration and Development (KNOMAD), the International Labor Organization (ILO) and the World Bank are presently undertaking empirical research to assess the extent of labor migration costs.

[iv] See Ketkar and Ratha (2009). During 2002–04, when Brazil had difficulty accessing international capital markets, many Brazilian banks securitized future hard-currency diversified payment rights (or DPRs, including all hard currency receivables through the international payment system) to raise $4.9 billion.