

THE REMITTANCES-MICROFINANCE NEXUS: AN INNOVATIVE APPROACH FOR FINANCING DEVELOPMENT. INDICATIONS FOR ITALY AND MENA COUNTRIES

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1. The importance of remittance flows towards Developing Countries

The flow of savings accumulated by emigrant workers abroad and dispatched to their country of origin, known as remittances, represents a category widely underestimated by official statistics. As regards official data, in 2004 remittances towards Developing Countries (DCs) amounted to 126 billion dollars, with an increase of 8% with respect to the 116 billion dollars of 2003 (which in their turn registered an increase of 17% in relation to 2002). What is more important, the increase of 10 billion dollars registered in 2004 mainly benefited low income countries (an extra 6,7 billion with respect to 2003). Between 2001 and 2004, the quota of remittances channelled to low income countries as compared to total remittances towards DCs increased from 28% to 35%. This flow has been increasing steadily for some years (also due to improvements in registration) and this trend should continue in the immediate future. The available estimates show that in 2005 remittances towards DCs should reach 167 billion dollars¹ and this amount doubles when estimates of remittances dispatched through informal channels or through formal channels not captured by national statistics are considered.

As regards officially registered remittances, the flow directed to DCs in the aggregate exceeds international aid by a significant amount and is second only to Foreign Direct Investment (FDI), whereas for low income countries remittances are the most important source of financing (equal to 43.5 billions of dollars), preceding international aid (grants, including Technical Cooperation), which constitutes the only other relevant source of international financing. As is the case with other financial flows, generalisations on the theme of remittances must be made with caution, for five countries (China, India, Mexico, Pakistan and the Philippines) answer for a high percentage of total flows towards DCs.

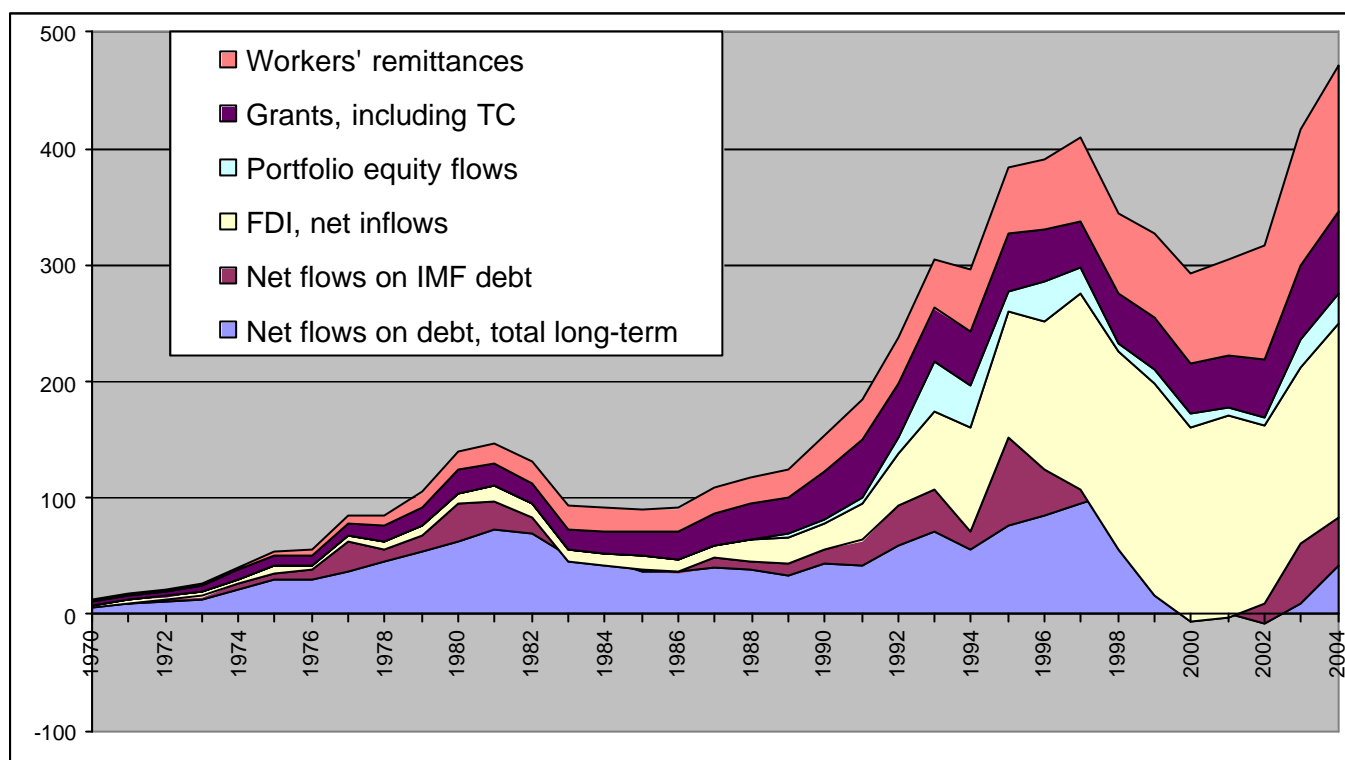
There is no doubt that the enormous potential of remittance flows for promoting local development and poverty reduction are still largely to be explored. For instance, recent estimates show that an increase of immigration in OECD countries equal to 3% of its workforce would bring about an increase in wealth (shared between migrants, consumers of OCDE countries, and DC families receiving remittances) superior to that which might be obtained from the liberalisation of trade². On the other hand, the potential risk of negative relations between migration, brain drain, remittances and development should not be underestimated. In any case, remittances have affirmed themselves as a theme of absolute relevance in the field of international finance for the development of DCs and the creation of mechanisms with which to ease and improve their transfer for development purposes has been introduced as a high priority on the international agenda.

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¹ The World Bank (2005), *Global Economic Prospects 2006. International Remittances and Migration*, Washington D.C.

² Forthcoming article, T. Walmsley, L. A. Winters, "An Analysis of the Removal of Restrictions on the Temporary Movement of Natural Persons", *Journal of Economic Integration*, quoted in Ç. Özden, M. Schiff (2005), *International migration, remittances, and the brain drain*, Palgrave Macmillan, New York.

Fig. 1- Net international financial flows towards DC (billions of dollars)



Source: The World Bank (2005), Global Development Finance, Mobilizing Finance and Managing Vulnerability, Washington D.C.

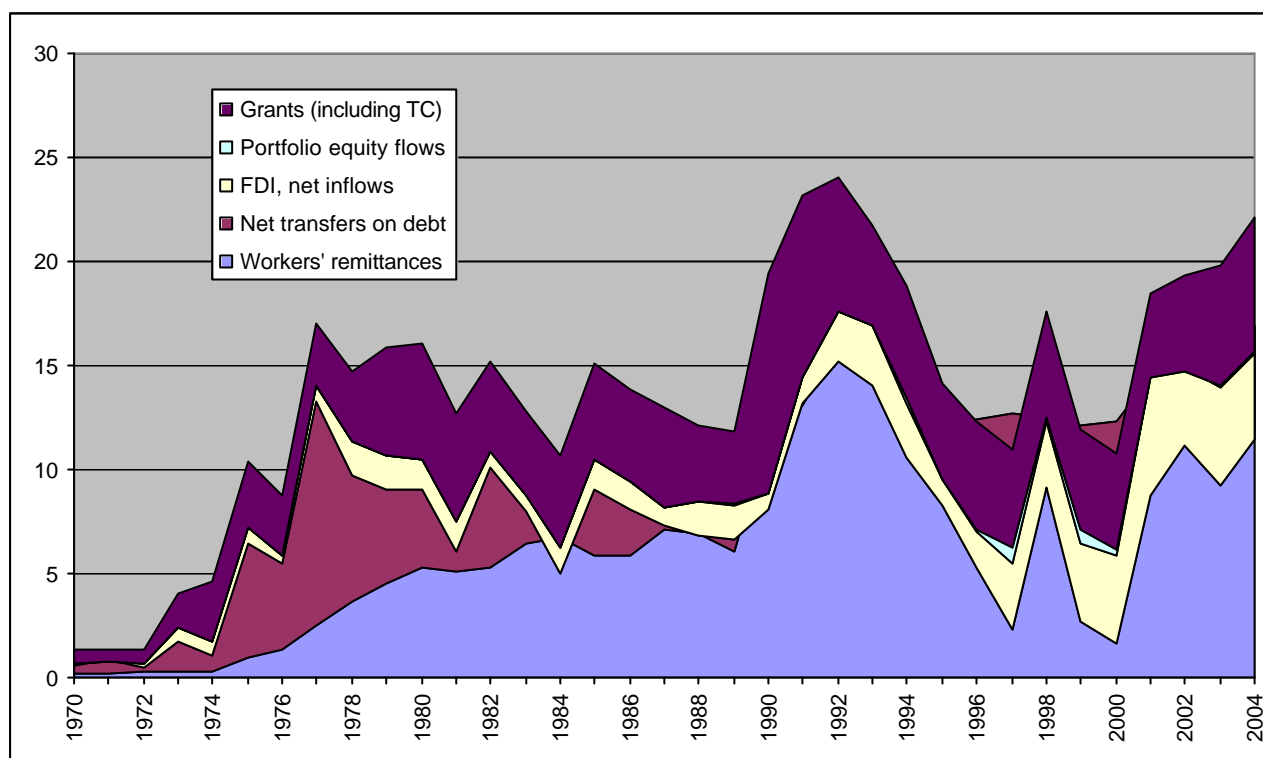
As regards the aggregate of 11 countries from the Middle East and North Africa (MENA³), given the inexistence of portfolio investments and the disappearance of transfers associated to foreign debt (which register a negative balance), remittances are by far the main source of external financing (17 billions of dollars in 2004), followed at a distance by aid (grants), (6.36 billion dollars) and FDI (4.1 billion).

Even more in detail, in the case of Morocco, in 2004, remittances, the first financial source from abroad (higher than the income from tourism and foreign direct investments), exceeded 4 billion dollars. As well as being less volatile compared to other flows, the weight of remittances on Moroccan economy is particularly significant also when taking into account the deficit in the trade balance which remittances cover in a quota which in recent years has never been inferior to 50%, reaching up to 83.7% in 2003.

In 2003, Morocco was the fifth country in the world for the value of remittances from abroad after Mexico, India, the Philippines and Pakistan. The data concerning the past two decades show a virtually constant trend towards an increase which has led the annual flow to increase seven fold, rising from the 5.1 billion dirham registered in 1982 to the 37.4 billion transferred in 2004. The average annual rate of increase is nearly 10%, with two major falls in 1988 and 2002.

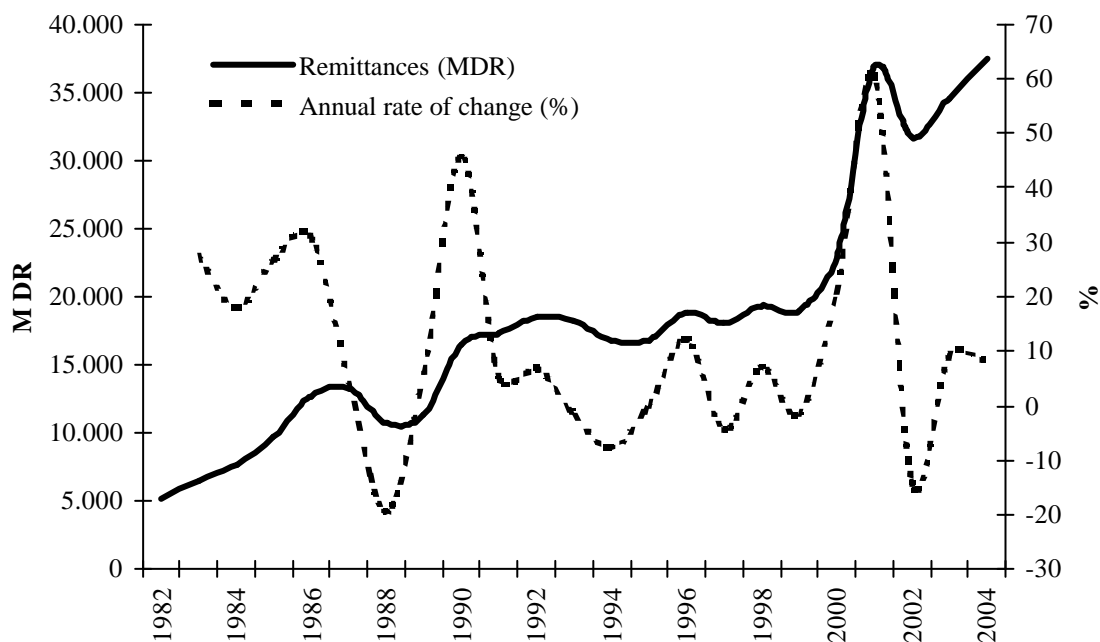
³ Algeria, Djibouti, Egypt, Iran, Jordan, Lebanon, Morocco, Oman, Syria, Tunisia, Yemen.

Fig. 2- Net international financial flows towards MENA countries (billions of dollars)



Source: The World Bank (2005)

Fig. 3- Remittances towards Morocco (millions of Dirham)



Source: elaboration on data by Royaume du Maroc- Offices des Changes

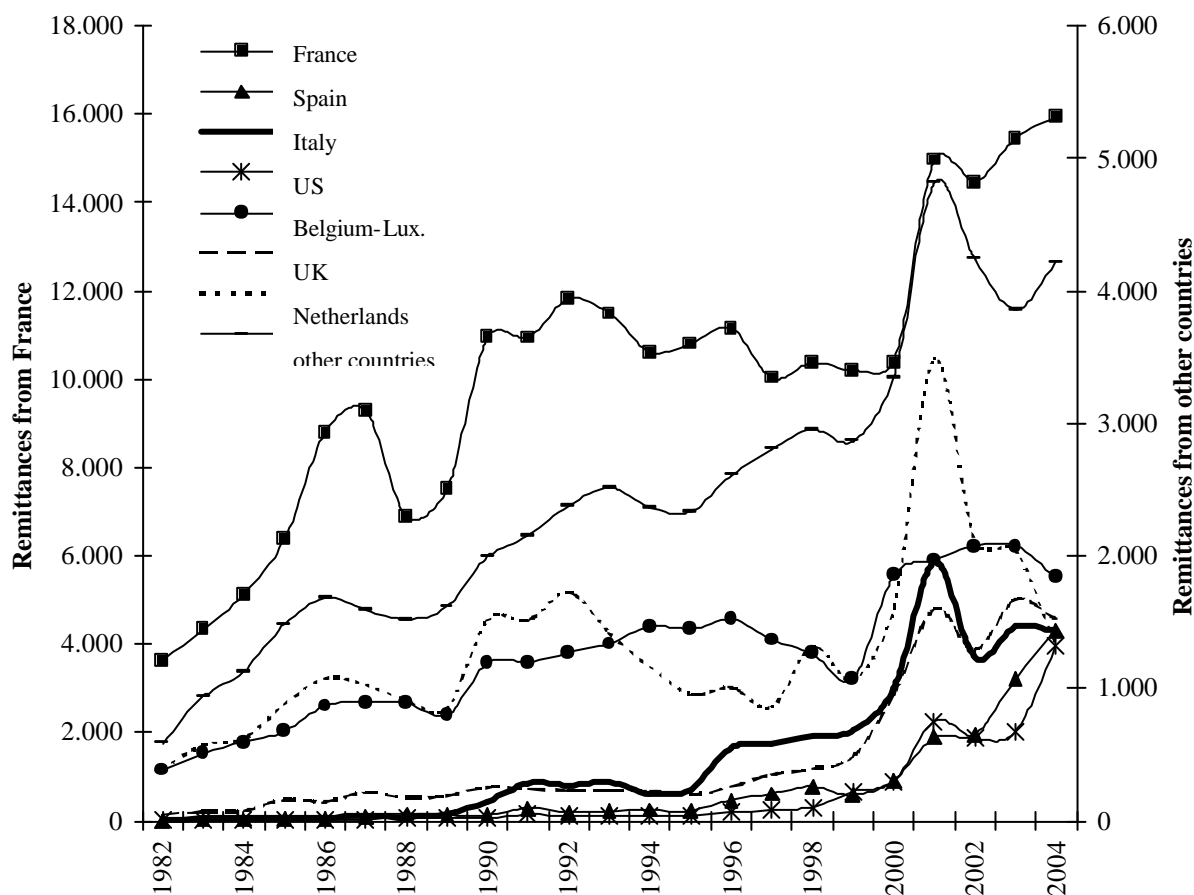
As far as the countries from which the remittances arrive are concerned, France is the country which hosts the highest number of Moroccan emigrants. Moroccans in France exceeded the number

of 1 million in 2002, equal to slightly less than 40% of the total number of Moroccan emigrants. This percentage has risen slightly over the past five years after having dropped 6 points between 1993 and 1997. Over the same period, the Moroccan communities whose numbers increased most are the Italian and Spanish ones which have more than tripled over the same decade with a growth rate highly above that of all other immigration countries.

In 2002, 287,000 Moroccan citizens registered in Moroccan Consulates in Italy accounting for 11% of the total number of Moroccans living abroad and bringing Italy second in the ranking of destination countries of migratory flows from Morocco. Italy is also the country which has registered the highest increase rate in the number of immigrants which has doubled over the last five years in which the data were collected.

The flow of the money-transfers from the different countries only partially follows the evolution of the migratory phenomenon. France remains the principal country from which remittances are sent with an annual flow which reached nearly 16 billion dirham in 2004 (equal to 1.43 billion euro). However, the weight of remittance flows from France has noticeably diminished with the differentiation of the origin of transfers which has been registered from the beginning of the Nineties. Whereas in the first years of the previous decade, nearly the total amount of remittances (86.5%) was sent from the three main destinations of migratory chains: France, the Netherlands and Belgium-Luxembourg, with the flow from France accounting for 71.2% of the total, beginning from 1990, following the expansion of migration from Morocco towards other European countries and North America, the consistency of flows from other countries started to increase, thus eroding mainly the French quota and, only in recent years, the Dutch one.

Fig. 4 – Origin of flows of remittances towards Morocco (million Dirham)



Source: elaboration on data by Royaume du Maroc - Offices des Changes

The relative consistency of flows from Italy, below 1% throughout the Eighties, started to grow in 1989 and, from the following year, it nearly doubled each year until 1996. After having reached a maximum peak of 15.9% in 2001 it subsequently stabilized around 12% of the total and was 11.5% in 2004.

The acceleration of the relative weight of the quota of remittances from Spain is a more recent phenomenon, which began in 1996 and continued after the year 2000 when the percentage of the total amount rapidly rose from 4% to 11.5% in 2004.

2. The importance of microfinance

The increase of the bancarization level of the poor segments of the population and of the micro enterprises of developing countries, in particular MENA countries, is one of the objectives of the programmes aimed at spreading microfinance institutions launched in these countries from the beginning of the Nineties.

The dissemination of banking services is limited, with strong inequalities in the distribution of branches between urban areas and the rest of the country, a generally low level of the use of credit and an excess of liquidity in the banking system. As a consequence, there is a high degree of self-funding as the sole source of resources for investments or combined with funds originating in the informal capital market. In both cases, these forms of funding do not guarantee the satisfaction of the needs of demand through a stable availability of funds necessary for the exploitation of new opportunities or for satisfying the possible sudden need of liquidity.

Microfinance can be a highly important instrument for facing these problems. It is an effective instrument for the financial inclusion of the population segments that run the highest risk of exclusion and poverty in the world (first of all, women), for the improvement of their family and social, as well as economic, status.

However, MENA countries are very far behind in this area and the development of microfinance has, so far, been less evident than in other parts of the world. In some countries of the region – Algeria, Iran and Syria – there are no microfinance programmes. According to cautious evaluations carried out by the World Bank, in this region 65 significant microfinance experiences have already been implemented and, out of these, only two have reached financial sustainability (that is to say the coverage of operational costs and of the cost of capital in order to make it possible to reinvest profits) and eight are close to reaching it. Furthermore, at least 1.4 billion dollars would be necessary in order to reach approximately 4.5 million poor entrepreneurs who wish to access microfinance services, while, presently, loans activated within the microfinance circuit amount to less than 95 million dollars. Out of 60 million people living on less than two dollars a day, only 112,000 have access to microfinance services.

Within the region, Morocco is an exception: in this country microcredit is developing as one of the possible solutions, both as an instrument to fight poverty and, in an economic development perspective, acting as a bridge between micro enterprises and the informal sector on one side and the banking system on the other. A peculiarity of Moroccan microfinance is that it lays its roots in urban environments as opposed to the remittance circuit which tends to have a capillary diffusion on the territory.

Microfinance programmes that work successfully tend to be characterized by some common elements:

- (1) Supply of short term small loans;
- (2) Simplified mechanisms for the evaluation of credit merit;
- (3) Fast and frequent disbursement of loans;
- (4) Low default rates (about 4%, which is less than half the rate on subprime loans made by U.S. lenders);

(5) Punctual services and handy location of branches.

Above all, microcredit can become the key for supplying various products and financial services essential to ensure a full economic citizenship to all individuals. In this sense, the transition from microcredit to microfinance is fundamental but not automatic.

Beyond its many merits, microfinance must face many challenges:

- Stimulating financial institutions operating in the field to satisfy the growing demand for small loans;
- Strengthening the development of mechanisms for the promotion of microfinance systems which should become self-sufficient resources for the funding of small enterprises;
- Facilitating access to productive resources for the poor;
- Setting up loan and financial facilitations for rural populations in order to favour rural development;
- Promoting mechanisms aimed at the active involvement of formal financial institutions in the supply of microfinance services.

Microcredit in itself is not financially sustainable if the conditions for guaranteeing repayment are lacking and if we do not want to condemn those who make use of it to a bond of passive and permanent dependence on the external grants they receive. In other terms, it is necessary to connect credit to insurance, to saving plans, to efficient money transfer services. This way both the goal of economic and financial self-sustainability and the social and political goal of expanding opportunities for the economic inclusion (and citizenship) of the poor become easier to achieve and a wider range of needs is satisfied.

The problems schematically described in relation to the bonds and perspectives of microfinance development in the MENA region are in many ways connected to the debate developed on an international level concerning the elaboration of cooperation policies and new forms of partnership capable of enhancing the consistent flows of remittances in favour of the development of developing countries.

In the specific case of the MENA region and of Morocco in particular, the connection which is presently lacking between the remittance circuit and that of microfinance could be of great strategic value, even for the orientation of development cooperation policy actions.

3. Opportunities for linking remittances and microfinance

The following indications are the result of a line of research set up by CeSPI in the late 1990s on the potential for linking migratory and economic circuits in a development perspective, focusing on the MENA region. In the last two years this line of enquiry has been supported by wide-ranging empirical research (developed in parallel programs promoted in partnerships with ICCREA Holding – Federasse, ABI, UniCredit, IOM, CNR, FEMISE, and the Italian Ministry for Foreign Affairs – MAE), which has shown the development perspectives of the involvement of different subjects, including private finance, in the management of remittance transfers.

Remittances play a key social role in the poverty reduction strategies of many beneficiary countries, making up for the insufficiency of the welfare systems and financing the local economy of areas with limited access to the formal financial system. The savings sent home by workers abroad are mainly channelled to supporting their families, who often belong to medium-low income levels.

The enhancement of the effectiveness of this important resource for stimulating economic growth and poverty reduction in DCs is a central issue in the debate on the creation of innovative instruments for financing development. The debate on the quality of remittances in terms of effective and efficacious resources for financing processes of economic growth and social and human development in DCs shows the potential for innovative projects in this field.

One of the main axes along which studies and experiments on suitable instruments for enhancing

the effects of remittances were developed regards redirecting quotas of resources from informal to official circuits through the bancarization of migrants and their families. Drawing immigrants towards banking services has a multiple effect on both the communities of origin and destination of migrants:

- In the society of destination, it contributes significantly to the process of integration of migrants as a step in the obtainment of “economic citizenship”, and brings about a relevant increase in the migrants control over his/her savings, both as regards investment in the country of destination and potential use in the home country;
- The quality of remittances is enhanced by the improved management of resources in the home country, as receivers of remittances’ access to the banking system stimulates savings and investment, increasing the quota not destined for consumption;
- In the country of destination, the banking sector’s opportunity of participating in the management of remittances can set off a process of increasing vicinity to segments of the population and economic activities at present excluded from credit and relegated to the informal sector, stimulating economic development and entrepreneurship;
- The approach to hitherto marginalized segments stimulates innovative dynamics, and widens the development prospects and the possibilities for use of liquidity on the part of the financial system;
- The need to interact with the financial systems of other countries contributes to the qualitative as well as quantitative development of DC’s financial sectors and to their integration in the global system;
- The formalisation of remittance flows contributes to creating the conditions for a possible linkage with resources channelled to the fostering of economic development, originating from national programs, international co-operation and decentralised co-operation.

The results of a recent program conducted by CeSPI-ABI show, however, that a surprisingly high rate of bancarization among migrant adults resident in Italy (57.3%, excluding the post office network) is not sufficient to guarantee the enhancement of the effectiveness of remittances through banking circuits and contribute to the development of the country of origin, as shown by the limited recourse to the banking channel for the transfer of remittances, especially as regards migrant communities originating from MENA countries.

Enhancing the effectiveness and impact of remittances in terms of development requires the use of articulated banking and financial services, of which the facilitation of remittance transfers surely are part, but which must also include services targeted to family and business needs in the communities of origin (thus making a step forward as regards the most common forms of social and migrant banking): housing loans; savings accounts (which meet with particular interest on the part of migrants, as shown by different research projects conducted by CeSPI); insurance services; business credit for receiving families. The process of responding to the needs of the migrant clientele should also widen and develop the financial sector in the country of origin, responding to the circular nature of the financial flows associated with migration.

Innovative banking strategies towards migrant clientele, which has become numerically relevant to the Italian banking sector, are strongly connected with the prospect of internationalisation of inter-bank relations and the services/products they offer. The responding to the presence of foreigners and their requirements constitutes, therefore, an important opportunity for embarking on new paths of financial internationalisation, within the wider scenario of internationalisation of the economy. Relevant support to this role of the Italian banks⁴. could be offered by Development Cooperation (coordinated by the public sector), as international experience has shown that market mechanisms

⁴ Only in a few cases are banks able to channel remittances to microfinance activities, and only in a few cases are microfinance structures capable of financing their activities through remittances.

alone are insufficient to bring together banking, remittances and microfinance Development Cooperation could make up the missing link between banks in migrants' country of destination (in the phase of the accumulation of savings) and microfinance institutions in migrants' home countries (in the phase of channelling resources towards productive investment). The emergence of new and significant strategies of cooperation and co-development which enhance the role of the diasporas in fostering economic and social processes of migrant's home countries requires more incisive action on the part of banks and their cooperation with the public sector, with local governments and with the migrant community.

In the same context, coordination with the microfinance institutions present in the MENA countries takes on a strategic value. The presence of these institutions in areas deprived of banking or even postal services renders them natural candidates for covering an important segment of the mechanism for channelling remittances, in the role of terminals or interfaces with families in a transnational territorial partnership of a circular nature.

The experience acquired in relations with the non-bancarized population and the building up of fiduciary relationships with the communities in which they operate allow microfinance institutions to take on a fundamental role in providing complete information to migrants and guiding them in the choice and use of services.

The entry of microfinance institutions in the remittance market would also create important opportunities for the development of the microfinance sector, which could thus widen its portfolio of clients and its liquidity base, as well as diversify supply through the development of new products to offer alongside counter services for the delivery of funds transferred from abroad, such as savings and insurance products or loans for financing housing or consumption.

Finally, the involvement of microfinance structures in remittance enhancing policies has a significant value also from the point of view of stimulating entrepreneurship among migrants who could find support for the development of potential productive investment projects more easily if offered operational opportunities in the area of funding of micro and small enterprises.

These initiatives have the advantage that they may be started up on a national level, if not local, without the need for international agreements. Public/private partnership mechanisms connected to the idea of enhancing remittances in favour of local development in which all the subjects belonging to the territory – central and local governments, banks, insurance companies, savings banks and funds, microfinance institutions, investors and savers, enterprises, immigrant associations and immigrants' families, NGOs – and present on the market can take part while providing concrete answers to the demand for sustainability of finance for local development through their activities. A significant advantage of these transnational partnership models on a local level is that they can directly sustain similar processes in similar situations in partner territories of developing countries, where the issue of public/private partnerships for the financing of development strategies on a local level is highly relevant, due to the delay with which the fiscal and financial decentralization process follows the political one which, in turn, follows the administrative decentralization process.

Compared to traditional forms of development cooperation, including the support to single microfinance institutions, this innovative approach has the further advantage of contributing to the guarantee of a stronger continuity as far as the participation level is concerned, improving ownership of initiatives for involved actors and encouraging their responsibility, contributing to guaranteeing a higher flow of resources and a long term financial sustainability.

The Italian banking system has proved it is interested in taking part in innovative forms of partnership. The use of pre-paid or rechargeable cards and the services connected to the transfer of remittances (agreements with foreign banks, trans-border/international money orders at favourable conditions, the use of pre-paid cards for the withdrawal of cash in origin countries) offer concrete opportunities for eroding the hegemony of money transfer firms in this market. At the same time, the weak network of Italian banks' international agreements – in particular, with reference to the

MENA region – can contribute to making the alliance with the system of microfinance institutions particularly favourable. Some initial positive experiences (such as the experience of BCCs in Ecuador) prove the potential of such an alliance. A similar systemic approach on a territorial level also means searching for alliances which link the remittance and microfinance circuits to other market segments (starting from the capital venture market, joint ventures and guarantee funds).

Naturally, apart from the reciprocal wariness among actors who are not used to working together and the different operational modes and strategies which have to combine with each other, it is also necessary to take into account some legislative bonds which often exist and significantly limit the range of action of involved actors, beginning with – in the case of MENA countries – many limits to the operational actions of microfinance institutions for collecting resources. This means that cooperation must also result in the articulation of proposals for modifying existing laws, drawing inspiration from positive experiences (such as the reform of article 290 of banking regulation in Peru).

In this perspective, the Moroccan case has various characteristics which make it a very interesting case study both for policy-oriented analysis and for experimenting pilot projects. The existence of a developed microfinance institution network is linked – as illustrated above – to a strong incidence of the migratory phenomenon which brings on remittance flows which are highly relevant for national economy.

In terms of operative working proposals, in a schematic form, a hypothesis could be the one illustrated below.

A proposal for a virtuous relationship between remittances and microfinance

