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New England Community Developments

Emerging Issues in Community Development and Consumer Affairs

# Leveraging Immigrant Remittances for Development

*By Alvaro Lima and Peter Plastrik*

*The views expressed in this paper are the authors' and are not necessarily a reflection of the official opinion of the Federal Reserve Bank of Boston and/or the Federal Reserve System.*

Ronaldo de Assis Moreira, the 26-year-old Brazilian soccer superstar who plays for Barcelona and is better known as Ronaldinho, has come a long way from the poor suburbs of Porto Alegre where he was raised. Like some one million fellow Brazilians, he makes his living outside of his homeland. Unlike most of them, however, Ronaldinho has access to the best financial services and advice that money can buy. It is unlikely that he goes to the corner grocery every month and pays a high fee to send a $100 remittance back to family members in Brazil. Similarly, he would have little difficulty accessing advice on what to do with any money that he may want to save, invest, give away, or use to buy insurance.

**Some observers have suggested that one way to draw immigrants into the financial system is for banks to tap the $300 billion global remittance market.**

But many Brazilians and other immigrants working in the United States are not well integrated into the financial system and, as a result, contend with extremely limited and costly financial services, a lack of trusted vehicles that promote savings, and few opportunities to receive advice on how to manage money well.

Some observers have suggested that one way to draw immigrants into the financial system is for banks to tap the $300 billion global remittance market. Indeed, several U.S. banks have begun to offer remittance services with the hope of being able to sell additional financial services to remitters.

Our nonprofit, the Innovation Network for Communities, believes this is a good approach but that the size of the remittance market and its extensive global linkages

## Inside

present opportunities that go beyond cross-selling financial products. We believe that the remittance market can also be leveraged to promote economic development for immigrant communities in the United States and immigrants' home countries simultaneously. In particular, we suggest that there are three ways to leverage remittances for development:

• Offer bundled financial services paired with financial education to immigrants. Banks can offer remittance services as a way of attracting immigrant customers to other services and can partner with community organizations to teach immigrants how to make the best use of the banking system.

• Create investment pools for home-country development. Portions of remittance flows that are not used to meet households' basic needs can be pooled with philanthropic monies and invested in economic development projects in immigrants' home countries.

• Create investment pools for U.S. community development and immigrant wealth creation. Portions of remittance flows can be pooled with philanthropic monies and invested in economic development and asset-building programs benefiting immigrant communities in the United States.

In this article, we explore how to tap the remittance market in order to maximize benefits for immigrants. We begin by describing the global remittance market and highlighting the difficulty banks face in trying to move remittance customers up the value chain of financial products. Then we provide an overview of initiatives that seek to leverage remittance systems to bring immigrants more fully into the financial system and/or to capture some of these funds for economic development. Finally, we propose a new model that can leverage remittances while serving immigrant communities by: (a) marketing a full array of financial services to immigrant remitters and (b) working with banks and community organizations to create charitable funds that will invest in the economic development of immigrant communities and immigrants' home countries. Our prototype, called Diaspora Capital Services, focuses on the Brazilian community in Massachusetts but can be adapted for other ethnic groups across the United States.[1]


## The Flow of Remittances[2]

The average size of a remittance is small, but remittances are a major component of the international flow of funds because of the large number of remitters and the frequency with which they send money. The World Bank estimates that about $232 billion was remitted globally through formal channels in 2005 and that more than 70 percent went to developing countries. For those nations, remittance flows represent a major source of international finance—in many cases, larger than total foreign aid and second only to foreign direct investment.[3]

Conservative estimates put the number of people receiving some form of economic benefit from remittances at one billion—almost one-sixth of the planet's population. World Bank estimates suggest that for every 10 percent increase in remittances to developing countries, the number of people living in poverty is reduced by 1.2 percent. A study by Irma Adelman and J. Edward Taylor found that for every dollar received in remittances, Mexico's gross national product increases by $2.69 for urban households and $3.17 for rural households.

It also appears that immigrants could extract broader benefits from the remittances they send abroad. According to the Inter-American Development Bank (IADB), only a small portion goes toward economic development at home. However, a survey by the IADB suggests that 15 percent to 20 percent, or about $12 billion, of remittances could be used to help home countries.

Researchers estimate that Latin America is the largest recipient of U.S. remittances. Immigrants in the United States sent $28.5 billion to Latin America and the Caribbean in 2003, accounting for 75 percent of remittances to the region. The top three countries in Latin America to receive remittances from U.S. remitters in 2001 were Mexico, El Salvador, and the Dominican Republic. According to a survey of Latin American immigrant households in the United States, 6 million immigrants, or 42 percent, sent remittances on a regular basis in 2003, and two-thirds of these sent money at least once a month.

## The Remittance Market in the United States

Current options for remitters to transfer funds abroad fall into three categories: informal channels, wire transfers by money transfer companies (MTCs), and remittance services at regulated financial institutions. Approximately 17 percent of U.S. remittances to Latin America are made via informal channels, with mail and hand delivery being the most common. The vast majority of remitters, 79 percent, rely on MTCs such as Western Union and Money Gram. MTCs have a strong presence in immigrant communities and are often located in grocery stores and other convenient places. Most are open evenings and weekends, and many provide one-stop shopping by offering other financial services, such as check cashing and money orders.

While quick and convenient, MTCs charge the highest prices for remitting funds. First, a service charge is levied—in most cases, a flat fee—resulting in a regressive pricing model that enacts a sizable charge on small remittances. A second charge is assessed via the foreign exchange rate. The cost of transferring money can represent a significant loss to immigrants and their families. Latin American immigrants in particular pay a high percentage of their remittances in the form of fixed, pretransfer fees because of their frequent, small transfers. For example, in a survey of 100 institutions, the cost of remitting $200 to Latin America ranged from $5 to $37.37.

There are several reasons why banks are attracted to remittance flows. The fee revenue can be substantial and highly stable. Remittance flows are not severely affected by economic downturns in either the sending or receiving countries. In addition, many remitters are loyal customers, sending money every month and recommending a remittance service to others. Also, remittances are often used to meet basic needs, so remitters make sending remittances a priority regardless of other financial pressures. A recent study of Mexican remitters found that 76 percent of respondents send remittances to help family and friends meet expenses related to health care, food, and daily maintenance.

Remittance programs can also generate a new customer base for a bank's other services. Cross-selling averages for program participants tend to be higher than those for other bank customers. Remittance programs can also improve a bank's image in the community and may help fulfill regulatory requirements, specifically the community development test of the Community Reinvestment Act (CRA).

At the same time, there are advantages for remitters who use banks. Bank remittance services generally have lower fees—on average 35 percent less than MTCs. The Pew Hispanic center has estimated that if the price of sending a remittance to Latin America was reduced to 5 percent of the transaction, remitters and their families would save over $1 billion a year. Some banks with remittance programs also offer financial education, which can facilitate immigrants' use of financial services that allow them to build wealth, establish credit, and obtain reasonable loans.

## Gaps in the Immigrant Financial Services Market

Most remitters come from the large, low-income segment of immigrants; they are not the Ronaldinhos. The remittance economy is an example of globalization at the "bottom of the pyramid," linking low-income communities in developed and developing countries. See Figure 1 (page 4) for the breakdown of Brazilians that send and receive remittances.

**If the price of sending a remittance to Latin America was reduced to 5 percent of the transaction, remitters and their families would save over $1 billion a year.**

Remittances are the point of entry into the world of financial services for many poor individuals, families, and communities. Once they begin sending or receiving remittances, they have joined the global financial service system. Most of them, however, do not continue to move through the value chain of financial services to use savings, investment, credit, and insurance products. Our research has identified four gaps in the remittance market that prevent immigrant remitters, especially those with low incomes, from moving up the financial services value chain:

***The Trust Gap.*** Immigrants may lack trust in financial institutions for many reasons, including bad experiences with banks in their home countries. When it comes to finding out information about financial services, immigrants' trust resides with community and religious organizations and community leaders.

***The Information Gap.*** Financial institutions often have a limited understanding of immigrants' culture and consumer habits, hold misperceptions about these customers, and do not differentiate among immigrants from different countries. At the same time, many immigrants have not used banks in their home countries and lack a basic understanding of the benefits that bank services offer.

***The Education Gap.*** The more that consumers progress along the financial value chain, the more knowledge is needed to decide between alternative products and plan their financial future. Because immigrants have a difficult time accessing the advice needed to make decisions about complex financial services they have low participation rates in these products.

***The Product Gap.*** Financial services need to be created, adjusted, and bundled specifically for immigrant markets. Often banks do not undertake this kind of customization, leaving a gap between products offered and consumer needs.

These four gaps result in a mismatch between immigrants' financial needs and the products and services that financial institutions offer. As a result, immigrants are kept at the margin of the financial sector.

## Innovations in the Remittance Market

Innovative approaches to leveraging remittances can be divided into three practices: bank-to-bank partnerships, financially induced capture, and diaspora philanthropy.

### Bank-to-Bank Partnerships

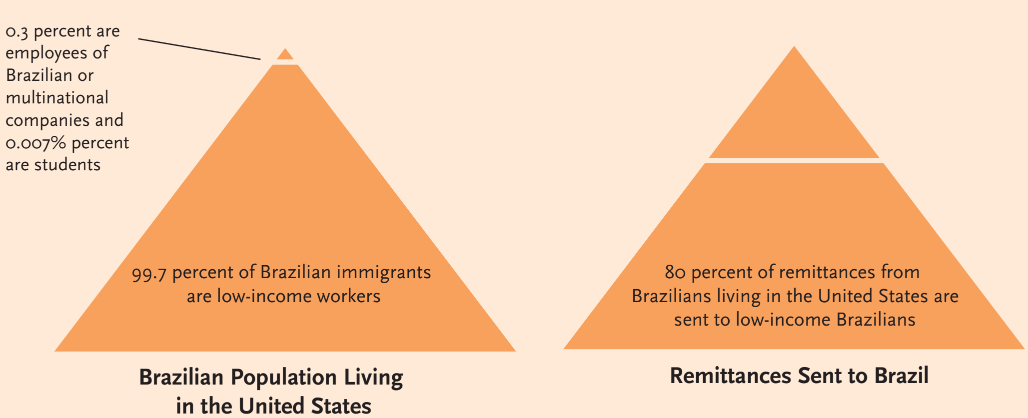
Several U.S. financial institutions have established a relationship with one or more foreign banks for the purpose of creating low-priced remittance services. Remittances are made by transferring funds directly between accounts at partnering banks. While some U.S banks have chosen to use ATMs to provide a direct distribution network for remittance services, programs that employ financial institutions in both sending and receiving countries carry little risk for senders, recipients, and partner banks. Among these types of partnerships are the Citizens Bank's program for New England's Cape Verdean population, Wells Fargo Bank's remittance program, and Bank of America's SafeSend program for Mexican immigrants.

### Financially Induced Capture

Financially induced capture is the process whereby foreign governments and banks provide a financial incentive for expatriates to invest in the economic development of their home country. Remittance bank accounts and bonds, offered in India and Pakistan, use preferential interest or exchange rates as an incentive. In Latin America, several Mexican banks and Banco Cuscatlan in El Salvador have offered remittance bonds with preferential interest rates.

Some governments have tried to get remitters to use remittances for production rather than consumption purposes by offering reduced tariffs for the importation of machinery and equipment used to establish microenterprises in the home country. In some cases, private sector players have contributed to these efforts. For example, Mexico's largest

Figure 1 **Globalization at the Bottom of the Pyramid - Brazilian Example**




Source: University of California, Davis (1999 data) cement producer, CEMEX, is allowing remitters in the United States to send investments in construction directly to the company at favorable exchange rates; this allows senders to avoid some fees.

Matching programs in partnership with hometown associations (HTAs) are also used to attract investments from expatriates. The state government of Zacatecas in Mexico offers a three-for-one matching fund: for every dollar contributed toward economic development, the federal, state, and municipal governments each contribute an additional dollar. In another example, the U.S. Agency for International Development has provided funding to the Transnational Development Fund administered by the Pan America Development Foundation to provide HTAs matching grants when remitters invest in economic development.

### Diaspora Philanthropy

Diaspora philanthropy is similar to the practice of matching programs for HTAs except that the matching funds are provided by philanthropic organizations. This is a relatively undeveloped field, and few donors are aware of the possibilities.

## A New Model for Leveraging Remittances

We have developed a conceptual model to increase immigrant participation in the U.S. financial system as well as leverage remittances for economic development in both the home country and the remitter's U.S. community. There is a role for a community-based financial advisory service to act as a social broker and bring together an immigrant community with financial institutions in both countries and philanthropic organizations. Our model, which we call Diaspora Capital Services, taps partner resources to draw immigrants into the financial system—through product offerings and financial education—and to create incentives for remitters to contribute to investment pools in the host or home country. Specifically, the model we propose includes the following functions:

• Assess the financial services opportunity and need among targeted immigrant communities—for example, the 150,000 Brazilian immigrants living in New England. Evidence suggests that each community should be approached separately because the remittance market is segmented by national origin and current location.

• Organize a particular immigrant community's leadership around the strategic intention of moving immigrants up the financial services ladder and establishing a philanthropic fund controlled by the immigrant community and designated for use in the home country, the U.S community, or both.

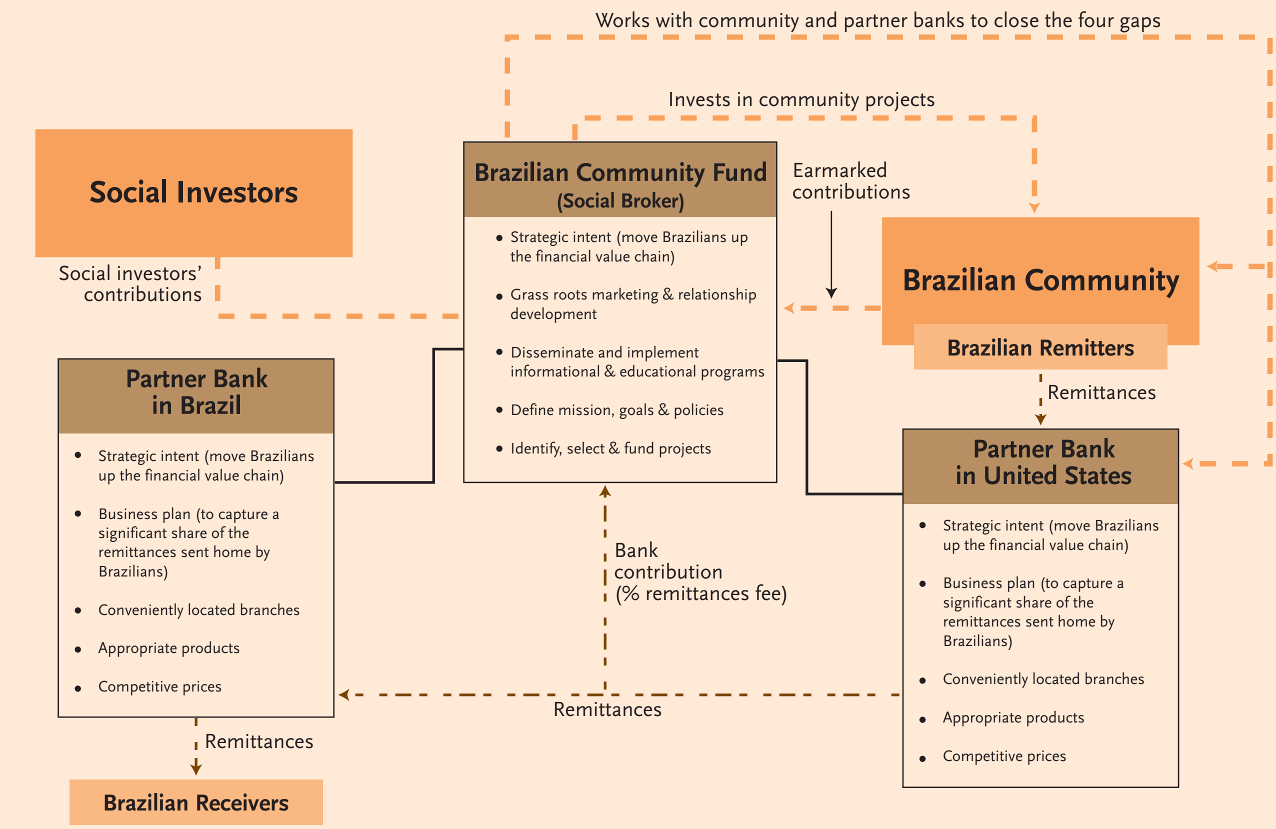
• Identify partner financial institutions in the United States and the immigrants' home country and help them tailor products and services to this market. The assumption is that it will take a combination of the home country and U.S. financial institutions to create an effective, cost-competitive two-country service system for the immigrant community.

• Secure commitments from the financial institution partners to support a long-term social marketing program that will contribute financial resources to an immigrant-community philanthropic fund while offering competitive prices for remittances and other financial services.


• Identify community groups that can provide financial education geared toward the immigrant group and attract philanthropic funding to strengthen the organization, provide a matching benefit for investors, and/or provide grant funding to the immigrant fund.

• Implement educational programs in the immigrant community about the financial services avail-

Figure 2 **Diaspora Capital Services Model**




able and the development fund.

• Identify the charitable purposes of the immigrant fund (for example, scholarships for college) and select a professional financial manager for the funds (an experienced community foundation would be one option).

## Prototype

We have adapted this model for the Brazilian community in Boston and are working toward implementing it soon. Currently, we are in discussions with banks in Brazil and in New England in order to identify financial institution partners. Figure 2 depicts a hypothetical Boston-based Brazilian community fund's activities and the relationships among the various entities and individuals.

## Impact Scenario

We estimate that Brazilian immigrants in New England sent $120 million home in 2005. If we assume they paid a 5 percent transaction fee on average, it is likely that they paid $6 million in remittance fees. The social brokering service that an organization like Diaspora Capital would provide could lead to significant contributions to an immigrant-community philanthropic fund while reducing the costs of remittances. Below we take a high-level look at the benefits that the organization could provide to Brazilian immigrants in Greater Boston:

• The financial institutions, as part of a social marketing program, could earmark 0.5 percent of their transaction fees for contributions to the immigrant-community philanthropic fund. This could put $600,000 into the fund annually.

• If remitters earmarked 1.0 percent of their remittances for the fund, that would put $1.2 million more into the fund.

• If foundation and government programs for immigrants agreed to match contributions to an immigrant philanthropic fund on a one-to-one basis, the size of the immigrant fund would double.

• If the fund's capital was in the form of an endowment, each $1 million in total contributions would generate roughly $50,000 in annual grants in perpetuity.

## Conclusion

Our model for leveraging the large remittance market differs from other models in that it has the potential to better integrate immigrants into the financial system as well as attract remittances and other funding toward investment pools for economic development. One can tweak our Boston-based model, varying the types of financial incentives offered investors, the purposes of the immigrant fund, or the immigrant group and location.

The model centers on the role of a social broker in bringing together the different stakeholders, including U.S. and foreign banks, immigrants, community groups, foundations—and potentially others, such as corporations or governments. Each of these stakeholders has a significant interest in tapping the remittance market and stands to benefit greatly from partnering with one another.

The role of the social broker will be to bring these partners together and ensure that any collaboration has a strong mission to benefit immigrant communities in the United States and immigrants' hometowns. And this brings us to the other way in which this model differs from other innovations in the remittance market: our model proposes a community-based financial advisory service that leaves the control of both the mission and the operations of the organization in the hands of the community. This should help other immigrants have access to the types of financial services that are available to, say, a Ronaldinho.

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For more information on the considerations for financial institutions interested in establishing a remittance program, see "International Remittances: Information for New England Financial Institutions," Public and Community Affairs Discussion Papers, Federal Reserve Bank of Boston, July 2005.

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## Notes

[1] In modern diasporas, ethnic minority groups reside in host countries but maintain strong sentimental and material links with their countries of origin. *(A New Field of Study)*.

[2] There are three variables needed to calculate total remittances: workers' remittances, compensation of employees, and migrant transfers. Workers' remittances are the value of monetary transfers sent home from immigrants working abroad for more than a year. Compensation of employees is the gross earnings of foreigners residing abroad for less than 12 months. Migrant transfers are the net worth of migrants who move from one country to another. *(Balance of Payments)*.

[3] In 2002, remittances to developing countries exceeded both official development aid and private debt and equity flows. In 2001 Mexico, France, and India were the largest recipients of remittances, with inflows of $9.9 billion, $9.2 billion, and $19.1 billion respectively. *(Balance of Payments)*.

# New England Updates

**Third Quarter 2006**

*by Ricardo Borgos*

## Across the Region

In July, the federal government approved a prescription-drug-buying collaborative that allows the states of **Maine**, **Vermont**, and Iowa to pool their Medicaid drug orders for the purpose of driving down the prices they have to pay manufacturers. The collaborative, known as the Sovereign States Drug Consortium, is the nation's first state-administered Medicaid supplemental drug rebate pool. Although the federal government is barred from entering into such negotiations itself, the national Centers for Medicare and Medicaid Services have approved the states' arrangement. The consortium began buying drugs last November, saving Maine $1 million to date, and is projected to save Vermont $4 million this year.

New England received assistance for agricultural losses resulting from heavy rains in the spring and summer. The U.S. Department of Agriculture gave natural disaster designation to **Vermont** in June and to **Connecticut** and **Rhode Island** in August, making farmers eligible for low-interest emergency loans. In June, Vermont allocated $8.9 million in state funds to help local farmers who have been affected by heavy rains, low milk prices, and high fuel costs. In July, the U.S. Small Business Administration designated five Connecticut counties (Fairfield, Hartford, Litchfield, Middlesex, and New Haven) disaster areas because of June flooding, making affected homeowners, renters, and businesses eligible for the agency's low-interest loans.

## State Highlights

### CT Connecticut

In July, the state announced a new program to provide financial aid to Connecticut's struggling dairy farmers. The Dairy Farm Reinforcement Program is designed to help offset financial losses related to federal price controls and high energy costs. The program consists of grants, loans, loan guarantees, help with energy conservation, and a call for the Milk Regulation Board to propose new legislation to improve the long-term viability of dairy farmers. Governor M. Jodi Rell noted that the dairy industry in Connecticut has declined from 367 farms and eight milk-processing plants in 1990 to 165 farms and five milk-processing plants today. The dairy industry employs 2,200 people in Connecticut and produces approximately 50 percent to 60 percent of the milk consumed in the state.

Governor Rell signed a bill in August establishing an office to help identify, clean up, and redevelop brownfield sites. This one-stop shop will help current and potential owners of brownfields to apply for state funds and comply with state and federal clean-up requirements. The bill also creates a task force to develop long-term solutions for dealing with brownfield sites. More information can be found at www.ctbrownfields.com.

ME

## Maine

Governor John Baldacci signed LD 1987, An Act to Increase Awareness of Prescription Drug Pricing, in June. The law provides consumers with easy access to price comparisons of prescription medications across different pharmacies in the state.

The state's Creative Economy Council unveiled Maine's Creative Economy Community Handbook and a report on the state's creative economy in June. The report defines the creative economy as including artists, artisans, performers, architects, software engineers, entrepreneurs, researchers, and financiers. The creative economy comprises 8.3 percent of Maine's workforce, or 67,446 people, who earn an average of $48,557 per year—33 percent higher than the state average of $32,661. The report makes several recommendations for sustaining job and economic growth in the sector, including increasing the state's research and development activity, improving infrastructure, investing in the creative workforce, and supporting art education, downtowns, and creative partnerships. The Council's handbook provides the tools and knowledge necessary for communities to start or expand the creative economy at the local level.
To view the handbook and report visit http://www. econdevmaine.com

Maine launched a statewide 2-1-1 telephone help line in July, which will provide individuals with easy access to information about health and social services. Maine is the 15th state to offer 2-1-1 service to the entire state and the seventh to offer that service 24 hours a day, seven days a week. The 2-1-1 program is a public-private partnership between the State of Maine, the United Way, and several nonprofit and community partners.

MA

## Massachusetts

In July, the federal government agreed to continue a Medicaid waiver program that is a critical financial underpinning of the state's new universal health insurance program. As a result of the agreement, the Commonwealth will continue to receive $385 million annually over the next two years to subsidize coverage of low-income residents. The agreement also provides the state $225 million annually to expand Medicaid coverage for state residents.

In July, the state made available $700,000 in discretionary funding to faith-based and community organizations in Boston to help stem violence in the city. Organizations were told that they could apply for the funding on an expedited basis and the state would review applications to ensure that all state and federal guidelines are met. This funding is on top of $3 million to pay for similar programs that Governor Mitt Romney asked the legislature to approve in June and is still pending.

Governor Romney signed legislation in August to expand the residential options of low-income elders and disabled individuals. As a result, more people will be able to stay in their homes and communities, rather than rely exclusively on nursing homes. MassHealth currently spends about $1.6 billion per year to care for about 32,000 individuals, or 70 percent of all residents in nursing facilities. The Equal Choices law permits flexibility to spend the money on care in a home or community setting. The legislation also provides preadmission counseling for all MassHealth members and private payers seeking admission to a long-term-care facility. The bill is expected to save about $134 million over the next five years because community-based services are less costly than nursing facilities.

NH

## New Hampshire

In September, the Community Development Finance Authority (CDFA) began requesting applications from qualified organizations for participation in the Community Development Investment Program (CDIP). CDIP is a tax-credit program for affordable housing and community/economic development projects that are sponsored by nonprofit organizations, cooperatives, and certain municipal entities. During the application round, the CDFA Board could award up to $6.3 million in state tax credits over fiscal years 2007, 2008, and 2009. Assistance may be in the form of a grant, loan, credit enhancement, equity investment, or some combination. The application deadline is November 20, 2006. For more information visit http://www.nhcdfa.org.

In August, the New Hampshire Main Street Center (NHMSC) awarded $357,120 to nine designated Main Street Communities for projects that will help improve economic conditions in their downtowns. The funds come from a federal grant from the U.S. Department of Housing and Urban Development. For each federal dollar, the projects leverage nearly $13 in private investment and an additional $4.75 from other public monies, for a total estimated private investment of over $4.6 million. NHMSC helps 19 Main Street Communities strengthen their downtown areas by promoting historic preservation and public-private partnerships.

RI

## Rhode Island

In July, Governor Donald L. Carcieri signed the Rhode Island Home Loan Protection Act, antipredatory legislation that establishes fee thresholds and other protections for borrowers. The new law sets restrictions on how lenders are permitted to collect fees and points on high-cost loans. Any loan that meets the high-cost criteria would now automatically require that the borrower obtain credit counseling. The law also prohibits lenders from extending high-cost home loans to borrowers without verifying the borrower's income and ability to pay. The safeguards are aimed at protecting consumers who have less-than-perfect credit from taking on mortgages they cannot afford and losing their houses to foreclosure. The Governor cited research from the Center for Responsible Lending that found predatory lending costs Rhode Islanders about $65 million a year. With the law's passage, Rhode Island becomes the 32nd state in the country to enact an antipredatory-lending law.

In August, a new collaborative was announced that will help minorities and non-native English speakers improve their financial literacy by teaching skills in English-language reading, writing, speaking, math, and accounting. Project FLIP (Financial and Functional Literacy Incentive Program) is a joint effort of Rhode Island College and the Northern Rhode Island Chamber of Commerce. The program targets northern Rhode Island because of its lack of financial training programs and large percentage of residents with limited English-speaking skills. The 50-week English-language program includes 24 weeks of functional and financial literacy classes intended to help students acquire the necessary levels of math and general accounting skills.

VT

## Vermont

In July, the state announced approximately $1.5 million in public grants that are expected to leverage over $16 million in other resources to support housing projects. The Vermont Community Development Program grants will help create new housing units, rehabilitate existing housing units, and promote plans for future housing opportunities. The largest award, amounting to $695,000, will be used to create 29 new units and preserve eight units of affordable housing in two locations in Brattleboro. The new units will be created in an existing building, which will be readapted for a mix of housing and office space.

In August, the Vermont Housing Finance Agency (VHFA) unveiled a $10 million mortgage loan initiative to help low- and moderate-income consumers buy homes and provide incentives for developers to create more housing in communities designated for residential growth. The mortgage loans are 30-year mortgages with a 4.75 percent fixed interest rate. The program is accompanied by the launch of two new insurance products for VHFA borrowers by the Mortgage Guaranty Insurance Corporation: a job-loss protection benefit offered at no cost to VHFA borrowers; and, for qualified buyers, low-cost mortgage insurance that carries a premium approximately 35 percent below conventional programs.

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Photographs of Brazilian businesses in the Boston metro area done by Anna Afshar Steiger and Fabienne Anselme Madsen

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