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Testimony of
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Thank you, Chairman Oxley and Ranking Member Frank and members of the Committee for this opportunity to testify today on the issue of financial remittances from the United States to people abroad. This is an extremely important issue, one on which the Department of the Treasury has focused for some time. It is an area in which government can be of great assistance. But it is also an area where well-intentioned, but ill-advised, interventions in the marketplace could do much harm.

The Importance of Remittances

For the most part, remittances are simply money sent back home. Migrants to the United States, and elsewhere, have been sending money back home for generations. These financial flows have grown as the world has become more inter-connected, in part because more people are working in countries other than their native country. In part, this is also true because it is easier to stay in touch and send money to family back home.

As Secretary Snow noted on September 22, 2003, "[t]hese flows reduce poverty and help achieve other development goals in education and health. Actual flows are believed to be significantly higher given that remittances often flow through informal channels. The use of informal channels indicates that there is room for improvement in our formal financial systems and that we can reduce the cost of remittances thereby increasing the flows significantly."

Both the Administration and the private sector realize just how important these flows have become. According to some estimates, in 2001, people all around the world sent $72 billion back to their homelands in developing countries. This is just what is reported formally. The total amount is likely larger and exceeds the total amount of official development assistance that is provided to poor countries.

The single largest bilateral remittance market is the U.S.-Mexico market. Last year, Mexican-Americans sent an estimated $10 billion to their families back in Mexico. Current projections are that this figure will rise to somewhere around $13 billion this year.

For many countries, remittances are a substantial share of national income. In Latin America and the Caribbean, for example, remittances in 2001 equaled 7.9% of the gross domestic product (GDP) of Ecuador, 8.5% of the GDP of Honduras, 9.3% of the GDP of the Dominican Republic, 13.5% of the GDP of Jamaica, 13.8% of the GDP of El Salvador, and 16.2% of the GDP of Nicaragua.

Remittances have important consequences for the families that receive them. Although firm data is difficult to come by, most estimates are that the average remittance is between $200 and $300 and that the average remitter sends money home 8 to 10 times per year. Amounts between $1,600 and $3,000 can be a significant addition to a family's income, especially in poorer countries. Families use this money for a variety of purposes, from buying food to buying consumer durables to investing in education to investing in housing to investing in small businesses. This is an important point.

There is a rather paternalistic view that remittances are used for so-called non-productive purposes. This idea is wrong. Remittances are used for the same variety of purposes that people here in this country use income, first and foremost, in improving the living standards of their own family. Just as in the United States, families devote a large share of that income for investment in physical and human capital. For example, one large bank that is active in this market told us that they estimate that 17% of remittances in the Mexican market are used to finance home improvement and construction. As another example, one study has shown that families in El Salvador that receive remittances keep their children in school longer than families that do not receive remittances.

The Cost of Remittances

Perhaps the most talked about aspect of remittances is cost. In my view, such a discussion can be incomplete.

First, remittance providers compete for business in many ways. Cost is one factor. Other factors are speed, reliability, security, and convenience. Some distribution services have a higher price than others. But they may differ in other ways. They may be offering more services. For example, some non-bank services charge more than banks, but they may be more convenient to use, especially for the recipients. In some countries, banks simply do not have branches in rural communities. Using a bank might cost the sender less, but it might require the recipient to walk several miles to the nearest bank, rather than to the nearest distribution agent of the non-bank. Which costs more? Hard to say just by looking at the price of the transmission in isolation.

Second, although many factors determine price, the government should not be one of them. It is common to lump remittances together into one category, one type of financial service. But remittances to one country may be a very different service than remittances to another country. Remitting money to Mexico is considerably easier than remitting money to a country with which we have more limited commercial and geographical relationships. Even within a particular country, remitting money to a major city is a different proposition from remitting money to a remote, rural village.

Whatever the physical barrier, however, our experience has shown that market forces are remarkably adept at surmounting them. More stubborn to surmount are governmental barriers. A significant element in the progressive improvement in service and cost of remittances to Mexico has been the removal of barriers to financial commerce under the North American Free Trade Agreement (NAFTA). Fundamentally, as long as there are no barriers to competition and an adequate financial infrastructure exists, competition will drive remittances costs down, toward a level of costs that reflects value rendered for service provided and one that takes into account the specific costs and benefits associated with a specific remittance market.

Promoting Competition in Remittances

Therefore, our focus has been on promoting competition in remittances as the most effective means of reducing costs while improving services. There are three main components to this effort: (1) promoting competition in the United States for the origination of remittances; (2) promoting competition in the recipient countries for the receipt and distribution of remittances; (3) where appropriate, improving the links between the U.S. financial system and the financial system in recipient countries. In addition, we encourage investments in financial infrastructure – both the physical and regulatory infrastructure – to support all three of these efforts. Finally, overlaying all our efforts with remittances is a constant effort to ensure that effective anti-money laundering and anti-terrorist financing safeguards are in place to prevent the abuse of remittance services for criminal or terrorist ends.

Promoting Competition in the United States

Promoting competition in the United States may be the easiest of the three. The fact is that there are few domestic, artificial barriers to competition in remittances. Workers can send cash through the mail, they can send a money order, they can use a money transfer business, they can use a bank or other financial institution.

We should not, however, take this competition for granted. It would be easy for well-intentioned, but ill-advised, government initiatives in this area to hurt competition. It is important that we do not raise the costs of providing remittances services to the point where suppliers drop out of the market. Many providers offer remittance services as one of many products. For example, grocery stores and convenience stores offer the services. We must avoid raising compliance costs to the point where these providers decide to discontinue the service.

Promoting Competition in the Recipient Countries

Our assessment is that while there are relatively few artificial barriers to competition in remittances in the United States, there are often many such barriers in recipient markets. Artificial barriers to competition come in many forms and vary from country to country. To cite one example, a country in South America forbids credit unions from receiving remittances, forcing credit unions in that country to organize into a bank just for the purpose of receiving remittances. As another example, another country requires any entity offering currency exchange to register with the country's central bank, and money transmitters are defined as providing currency exchange services. Yet the central bank only allows banks and traditional currency exchangers to register, not money transmitters. This limits competition, preventing money transmitters from legally offering their services in that country. We are working to identify such barriers and to persuade foreign governments to remove them.

It is also important to underscore the importance of good banking policy in the recipient countries. For example, Mexico's prompt action to resolve failed banks, Mexico's openness to foreign ownership of banks, and other pro-competition policies in Mexico are widely credited for the low cost of remittances to Mexico, in comparison with the cost of remitting money from the United States to most other countries in Latin America and the Caribbean.

Improving Linkages Between Financial Systems

To create strong, reliable and safe channels through which remittances can flow, the linkages between the U.S. financial system and the financial systems of recipient countries must improve. For example, the Federal Reserve has been working on extending the international automated clearing house ("ACH") services to several countries, including Mexico. The work being done in Mexico will be piloted in November of 2003. When the extension enters full production in 2004, it will make available a channel for every bank to send remittances and other payments at a very low cost from banks in the United States to banks in Mexico. The Federal Reserve is working on similar extensions of international ACH services to other countries with well-developed and well-supervised banking systems. The Department of the Treasury has supported and encouraged these efforts.

As another example of our efforts to improve linkages, the Treasury Department has financial advisors in several countries throughout Africa who work to assist reform-minded Finance Ministers and Central Bank Governors on the means to strengthen financial regulatory and supervisory practices. A goal of theirs is to help ensure that the flow of remittances is handled in a trustworthy and transparent manner, and thereby help boost the confidence in the banking system and help protect against fraud, money-laundering and the flow of funds into the hands of terrorists. In addition, such transparency efforts should have a positive affect on encouraging a more competitive environment for financial institutions in these countries.

I would parenthetically note that our advisors in Iraq are taking initial steps with Iraqi commercial banks to help facilitate remittance flows from Iraq's diaspora that want to contribute to their families as they help build new lives for themselves in Iraq.

Encouraging Investment in Infrastructure

To support all three of these areas, we encourage investments in the physical and regulatory infrastructure that is so integral to effective competition in financial services. For example, we work both in the United States and in developing countries to promote safe and sound bank regulatory practices. This is important to ensure that remitters and recipients trust banks and credit unions with their money. As another example, some countries have worked with the Inter-American Development Bank to expand the bank ATM infrastructure to underserved rural areas to help increase access to financial services. As a third example some countries have worked with the Agency for International Development and the World Council of Credit Unions to expand the reach of credit unions into rural areas and to integrate local credit unions into a wider international network to help facilitate the flow of remittances. Efforts like these increase the distribution channels for remittances and facilitate competition.

Progress

Our experience has been that promoting competition works. In December of 2001, the Department of the Treasury and the Department of State began working collaboratively with the Government of Mexico under the auspices of the Partnership for Prosperity to promote competition in the U.S.-Mexico remittances market. In the months since, we have seen several major banks enter the remittances market, expand their product offerings in the market, and reduce their fees.

In May 2003, the Department of the Treasury and the Philippines Government reached a similar agreement to collaborate jointly on improving the efficiency of sending remittances back to the Philippines. This effort has just commenced, but it has already seen an increase in private sector interest in extending remittances services to Philippine-American communities in the United States.

Also, we are encouraged by actions of foreign governments to remove artificial barriers to competition. For example, in June the Government of Singapore announced that in order to facilitate the provision of remittance services, it will allow banks (i.e., foreign banks) which are otherwise prohibited from opening branches to open outlets to provide remittance and foreign exchange services.

On the multilateral front, with our encouragement, the World Bank, the Inter-American Development Bank, and the Asian Development Bank have been actively examining remittances around the world. We believe that their efforts are helping to increase understanding of the role and importance of remittances and is an important step toward increasing competition.

Conclusion

Remittances are quickly becoming the central source of new foreign capital for many countries. It is funding that almost by definition gets into the hands of those who need it most, the families of those whose hard work earned the money. We are working with the private sector and the governments of recipient countries to promote competition in financial services, especially remittances, to increase the amount of that money that reaches the recipient families. We will continue to work, as appropriate, to improve the payment systems that link our economies together. It is important to continue to promote such competition and linkages. It is just as important, however, not to kill remittances with kindness. Well-intentioned, but ill-advised, mandates and regulation in this area risk raising costs and forcing suppliers out of the market. That, in turn, would likely reduce remittance flows, not increase them. Let us build upon our success in making it easier for families to build financial security at home and abroad.

Thank you again for providing me with the opportunity to discuss this important issue with the Committee today.

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