

JUNE 2024

# ARP 38 FINAL REPORT

## INFORMAL REMITTANCES CONTRIBUTIONS TO DEVELOPMENT

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# 01 LITERATURE REVIEW

## INTRODUCTION

This review explores the significant role of remittances in the economies of least developed countries. With migration continuing to be a global reality, the importance of remittances has grown, often surpassing foreign direct investment and official development assistance in low- and middle-income countries (World Bank, 2023). A substantial portion of remittances flows through informal channels, which could constitute 35-75% of the recorded flows (Fernandes et al., 2022).

This inaccuracy hampers effective policy-making, necessitating a deeper understanding of informal remittance flows. Our methodology includes a review of existing literature and primary data collection through interviews and surveys to provide a comprehensive understanding of informal remittances.

# 01

## DEFINITION OF REMITTANCES AND EXISTING RESEARCH

The World Bank defines remittances as the money transacted back to the home country by migrants, a crucial source of extra income for migrant families and substantial economic growth for developing countries (World Bank, 2023). Remittance worldwide increased from \$791 billion in 2021 to \$840 billion in 2023 (KNOMAD, 2023).

Researchers have examined various aspects of remittances, including factors contributing to remittances, determinants of remittance amounts, transaction costs, and impacts on developing countries. Altruism, investment, loan repayment, exchange, insurance, or a mix of these are identified as objectives of remittances (Rapoport & Docquier, 2006; Yang, 2011). Azizi (2019) found that altruism plays a more significant role among migrants from developing countries.

# 01

## OVERVIEW OF INFORMAL REMITTANCES

Informal remittances are transactions using methods outside the formal banking system or other officially regulated money transmitting financial institutions, such as mobile money or fintech. Migrants often resort to informal methods due to high costs and inadequate financial infrastructure associated with formal channels (Freund & Spatafora, 2005). Fernandes et al. (2022) highlight that informal remittance flows are less focused on by central banks, affecting integration into wider policy decisions and financial indicators. Informal channels are often preferred due to their affordability, accessibility, and reliability.

## METHODS TO MEASURE REMITTANCES

Measuring remittances typically involves tracking funds sent by migrants to their home countries. Central Bank Data and International Organisations provide formal remittance data. Estimating informal remittances is challenging and involves indirect methods like surveys, migrant studies, and economic models (Adams, 1991; Kubo, 2017). Increased digitization presents an opportunity to better understand and formalize these flows (Fernandes et al., 2022; Kpodar et al., 2023).

**01**

# THE IMPACT OF REMITTANCES ON DEVELOPMENT

## FINANCIAL

Remittances have a direct impact on financial development, enhancing local financial systems' ability in savings, investment, and international capital flows (World Bank, n.d.). Studies have shown that increased remittance inflows boost financial development in Sub-Saharan Africa (Donou-Adonsou et al., 2020) and promote household credit in developing countries (Fromentin & Leon, 2019). The impact of informal remittances on financial development remains under-researched (Virak & Bilan, 2022).

## ECONOMIC GROWTH

Remittances significantly affect economic growth in developing countries, constituting over 30% of GDP in some countries (World Bank, 2023). Meta-analyses and regional studies have demonstrated a positive effect of remittances on economic growth, although this varies by region (Cazachevici et al., 2020; Eggoh et al., 2019). Research often overlooks informal remittances, leading to potential biases in findings.

**01**

# THE IMPACT OF REMITTANCES ON DEVELOPMENT

## POVERTY AND INEQUALITY

Remittances are an important source of family income in developing countries, contributing to poverty reduction (Kóczán & Loyola, 2021; Liu et al., 2020). However, the impact on inequality is inconsistent; in some countries, remittances exacerbate inequality (Song et al., 2021). Informal remittances are more favored by low-income groups, potentially underestimating the role of remittances in poverty alleviation (Ahmed et al., 2021).

## OTHERS

Remittances influence family expenditures, education, health, food security, and business. Studies indicate positive effects on medical and educational expenses, while reducing food expenses (Mishra et al., 2022; Wang et al., 2021). Remittances also support health services, higher education, food security, and new enterprises (Arif et al., 2019; Piras, 2023).

# 02

## RESEARCH DESIGN

This section delineates the research design aimed at unravelling the complex dynamics of informal remittance flows within specific national contexts. Given the burgeoning significance of remittances in the global financial landscape, particularly in developing nations, this study focuses on Afghanistan, Nepal, Peru, and Senegal. While Senegal and Nepal exhibit a notable dependency on remittances within their economies, Peru and Afghanistan, despite lower remittance volumes, offer unique insights due to their distinct legal frameworks and socio-economic conditions.



## 02

# RESEARCH DESIGN

## CRITERIA FOR COUNTRY SELECTION

The selection of countries was guided by the need to understand diverse remittance environments across different developmental stages and regulatory settings.

The World Bank (2005) suggests that informal remittances could augment the reported flows by at least 50%, particularly in developing nations which might contribute significantly to unrecorded transactions.

Since 2015, remittances have eclipsed other forms of external financing such as FDI and ODA, becoming the predominant source of external finance for low and middle-income countries, excluding China (World Bank, 2022).

This trend underscores the integral role remittances play in integrating developing economies into the global financial system, notwithstanding their relative marginalisation in world trade and investment flows (UNCTAD, 2012).

The selection of **Afghanistan**, **Nepal**, **Peru**, and **Senegal** was also influenced by the availability of data and the feasibility of conducting interviews.

## 02

# RESEARCH DESIGN

## RELEVANCE TO INFORMAL REMITTANCES

### **Afghanistan: Dynamics and Regulatory Challenges**

Afghanistan's reliance on remittances, particularly from its substantial migrant population, underscores a significant contribution to its GDP. In 2020, remittances accounted for 4.1% of the GDP, although this figure dropped sharply in 2021 due to ongoing security issues. The predominance of the hawala system, used for approximately 90% of financial transactions, highlights the critical role of informal networks. This system, while effective in transferring funds amidst a lack of a stable formal banking system, raises concerns about money laundering and the financing of terrorism. The regulatory environment remains challenged by the lack of comprehensive oversight and the complexities introduced by political instability.

### **Nepal: High Dependency and Regulatory Constraints**

In Nepal, remittances are a crucial pillar of the economy, constituting 26.6% of the GDP in 2023. The government has implemented stringent regulations to monitor these flows and increase transparency. However, these measures have inadvertently pushed many, especially low-skilled migrants, towards informal channels due to lower costs and fewer bureaucratic hurdles. The significant role of over 50 remittance service providers illustrates a vibrant but complex ecosystem that could benefit from streamlined regulations and improved financial literacy initiatives.

## 02

## RESEARCH DESIGN

### RELEVANCE TO INFORMAL REMITTANCES

#### **Peru: Flexibility and Informal Flows**

Peru presents a more flexible regulatory framework for remittances, particularly for transactions under \$10,000. Despite this, a significant portion of remittance flows continues through informal channels, exacerbated by stringent regulations for larger transfers aimed at combating money laundering. The relatively low impact of remittances on the GDP suggests that while formal channels are well-regulated by financial authorities, there remains room to improve the efficiency and reduce the costs associated with these transfers.

#### **Senegal: Informal Channels and Economic Impact**

Senegal's remittance inflows are substantial, accounting for 9.4% of the GDP in 2023, with an estimated \$250 million flowing through informal channels annually. The formal remittance framework involves traditional bank transfers and services like Western Union but is often bypassed due to high costs. The regulatory framework, guided by the BCEAO and WAEMU, focuses on enhancing financial inclusion and facilitating easier remittance processes. However, the persistent use of informal channels suggests a need for policies that reduce transaction costs and simplify the regulatory environment to encourage more secure and formal remittance flows.

**02****RESEARCH DESIGN****RELEVANCE TO INFORMAL REMITTANCES**

The reliance on informal remittance channels in Afghanistan, Nepal, Peru, and Senegal, while providing critical economic support, poses challenges related to regulatory oversight, financial security, and economic stability. Each country's unique economic conditions and regulatory frameworks influence the choice between informal and formal remittance channels. Policymakers must address these challenges by creating incentives for using formal systems, enhancing regulatory frameworks, and improving financial infrastructure to better integrate remittances into the formal economy while safeguarding against risks associated with informal channels.

## 02 RESEARCH DESIGN

### SAMPLING METHODS

To gain comprehensive insights into the remittance sector, we employed a purposive sampling method. This approach involved selecting organizations and entities based on their involvement or influence in the remittance industry, such as financial institutions, regulatory bodies, and remittance service providers. Purposive sampling is particularly useful in qualitative research where the focus is on understanding specific issues deeply rather than generalizing findings to a larger population (Patton, 2002).

In addition to purposive sampling, we utilized network sampling, leveraging our connections with Graduate Institute community and those of the United Nations Capital Development Fund (UNCDF). This strategy helped us identify and access key participants through professional networks, which is an effective way to reach knowledgeable individuals in specialized fields (Atkinson & Flint, 2001). Our contacts at UNCDF were instrumental in facilitating introductions to potential interviewees.

Overall, we conducted interviews with six experts who specialize in migration and remittances. These participants were selected through recommendations from UNCDF, our academic advisors, and our personal networks. This targeted approach allowed us to ensure that our interviewees had substantial expertise and could provide valuable insights into the remittance practices in Afghanistan, Nepal, Peru, and Senegal.

We used a purposive and network sampling strategy to gather the broadest understanding possible on the sector at hand from multiple perspectives, thereby ensuring the depth and quality of the analysis of informal remittances as a sector and their impact on development.

## 02 RESEARCH DESIGN

### INTERVIEW QUESTIONS

**Semi-structured Interview Approach** The research utilised semi-structured interviews, a method well-suited for exploratory research where detailed inquiry into participants' experiences and opinions is crucial (Gill et al., 2008). This format offers flexibility, allowing for a natural conversation flow that can adapt based on the interviewee's responses, thereby providing a deeper understanding of the nuanced socio-economic contexts and personal motivations driving informal remittances (Kvale & Brinkmann, 2005; Orozco, 2003).

Interviews were designed to be time-efficient, generally not exceeding 45 minutes, with show cards used for in-person sessions to streamline the process.

For a detailed list of the interview questions developed under this methodology, please refer to Annex 1.

# 02 RESEARCH DESIGN

## INTERVIEW QUESTIONS

### Rationale for Choosing Semi-structured Interviews

- 1. Flexibility:** This format allows for a dynamic and natural interaction between the interviewer and the interviewee, facilitating an in-depth exploration of complex topics. The open-ended nature of questions enables participants to steer the conversation into areas that might not have been initially anticipated, providing rich qualitative data.
- 2. Depth of Understanding:** Semi-structured interviews provide the opportunity for respondents to elaborate on their answers. This is crucial when exploring nuanced areas such as the motivations for choosing informal over formal remittance channels and the socio-economic impacts of these decisions. Such detailed responses are invaluable for understanding the intricate realities that structured interviews might overlook.
- 3. Adaptability:** Interviewers can modify questions in real-time to probe deeper based on responses received. This flexibility is essential for thoroughly covering diverse aspects such as economic impacts, regulatory challenges, and personal experiences with remittance channels, ensuring comprehensive coverage of all relevant topics.

# 02 RESEARCH DESIGN

## INTERVIEW QUESTIONS

### Developing Profiles for Interview Respondents

To ensure the effectiveness of the semi-structured interviews, careful consideration was given to the selection of participants:

- 1. Geographical Specificity:** The study identifies regions or countries where informal remittances are prevalent, based on existing literature and reports. This helps in pinpointing areas with significant informal remittance activities for targeted insights.
- 2. Targeting Interviewees:** Participants are strategically selected based on their direct experience with informal remittances, relevance to the migrant corridors under study, and their role within the remittance ecosystem. This includes individuals from various sectors such as financial services, regulatory bodies, and the migrant community itself.
- 3. Time-efficient Survey Format:** The interviews are designed to be concise yet comprehensive, respecting the time constraints of professional respondents. For in-person interactions, show cards with response options are used to streamline the process and enhance the efficiency of data collection.



## 02 RESEARCH DESIGN

### LIMITATIONS

This study encounters several intrinsic limitations that could influence the breadth and depth of its findings. These constraints stem primarily from the nature of the sample, the availability of respondents, and the inherent challenges associated with ensuring the validity and reliability of information.

#### Sample Bias

- **Professional Bias:** The respondents, being professionals deeply embedded within the financial and regulatory sectors of Afghanistan, Peru, Senegal, and Nepal, provide insights that may not necessarily reflect the broader spectrum of experiences and perceptions among general remittance senders and receivers. Their expert views are invaluable, yet they tend to represent a more formal understanding of the remittance system, potentially overlooking the nuanced, everyday realities of typical users who rely heavily on informal channels.
- **Geographic Bias:** The selected respondents are based in countries with significant but diverse roles in the informal remittance market. These regions have unique economic and regulatory environments that may not be representative of other global contexts. Consequently, the generalisability of the findings is limited, as the results may not accurately portray the situation in countries with different socio-economic conditions or remittance behaviors.

## 02 RESEARCH DESIGN

### LIMITATIONS

#### Availability of Respondents

- **Time and Energy Constraints:** The availability of high-caliber professionals for interviews is often limited by their demanding schedules. This constraint may lead to shorter, potentially less informative interviews that could affect the comprehensiveness of the data gathered.
- **Response Rate Issues:** There is an inherent risk that some potential participants may opt not to engage with the study due to time constraints, privacy concerns, or lack of interest. This issue could lead to a reduced sample size, impacting the robustness and the representativeness of the findings.

#### Validity and Reliability of Information

- **Recall Bias:** Relying on participants' memory to provide historical data or describe past events introduces a risk of inaccuracies. Memories can be inherently unreliable, leading to data that may not accurately reflect past realities or current conditions.
- **Dynamic Changes:** The economic and policy environments in the studied regions are subject to rapid changes. Regulations, economic conditions, and political scenarios can shift significantly within the timeframe of the study. Such fluctuations may render the research findings less relevant or outdated by the time of publication.

## 02 RESEARCH DESIGN

### LIMITATIONS

#### Strategies to Mitigate Limitations

To address these limitations, the research design incorporates several strategies aimed at enhancing the reliability and applicability of the study's outcomes:

- **Diversifying the Sample:** Expanding the range of respondents to include non-professionals and individuals from varying backgrounds can provide a more holistic view of the informal remittance landscape.
- **Multiple Data Collection Methods:** Employing a combination of qualitative and quantitative approaches can enrich the data set and provide multiple perspectives on the same issue, thereby enhancing the overall reliability of the findings.
- **Continuous Updates and Validation:** Regularly updating the data to reflect current conditions and continuously validating findings against new information can help maintain the relevance and accuracy of the conclusions drawn.

By recognising and addressing these limitations, the study aims to ensure that its conclusions are as robust, reliable, and applicable as possible, providing valuable insights into the dynamics of informal remittances in the targeted regions.

## 02 RESEARCH DESIGN

### ETHICAL CONSIDERATIONS

All interviewee profiles have been anonymized in our descriptions. All the information provided by respondents for our project should be used for research purposes on remittances and should not be shared with other parties. All the publications based on the data provided for this survey should not disclose individual information and should only include aggregated information and insights in their publications and data dissemination.

However, we recognize the unique needs of international organisations participating in the survey. These entities may have specific requirements for attribution in our publications. We will carefully balance these needs with our commitment to confidentiality. Where appropriate and agreed upon, we may acknowledge the contributions of these entities, ensuring that any such recognition aligns with their preferences and consent, and does not compromise the integrity of the data or the anonymity of individual respondents.

## 02 RESEARCH DESIGN

### ETHICAL CONSIDERATIONS

In terms of the use of audio recordings, we emphasise a strong commitment to ethical standards, prioritising transparency and respecting the autonomy of our respondents. We will treat recorded responses with confidentiality and anonymity. All respondents will be thoroughly informed about the use of audio recordings before starting the interview. We will seek explicit consent and ensure that respondents are comfortable and their preferences are respected. These recordings are intended solely to enhance the accuracy of data transcription and analysis.

Our approach aligns with established ethical guidelines, which emphasise the importance of confidentiality, informed consent, and the ethical use of data (Wiles et al., 2008).

## 03



# PROFILE OF INTERVIEWEES

## AFGHANISTAN

The interviewee from Afghanistan is a researcher specialising in Political Economy with a focus on issues such as taxation, state-building, aid, conflict, and development. This individual has earned a PhD in Political Economy, studying at a major university in London. Currently, he is affiliated with a research centre at a university in the Netherlands that specialises in international conflict analysis and management. His professional experience includes roles in research at a major global data firm and collaborations with several notable academic and policy institutions. His work has encompassed various projects related to tax and development, including a significant position at a central bank in Afghanistan.

## 03



## PROFILE OF INTERVIEWEES

### NEPAL

The interviewee is currently a faculty member at a prominent university, where they have been teaching and supervising research activities in the Department of International Relations and Diplomacy for nearly four years. Their academic journey includes serving as a Senior Research Fellow at a well-known university in Chengdu, China, prior to their current position. Their experience spans both teaching and extensive research, providing a well-rounded background in international relations and diplomacy.

Our second interviewee from Nepal is a development professional who has rooted experience in the governance and migration sector. She has worked with different institutions varying from NGO, network, INGOs and currently in Development Cooperation. She has a master's degree in public policy & governance and she is passionate in contributing to build an equitable and just society.

## 03



## PROFILE OF INTERVIEWEES

### PERU

The interviewee is an international economics specialist at the Economic Studies Management, focusing on the balance of payments. They work at the Central Reserve Bank of Peru, bringing a wealth of expertise and knowledge in the field of international economics. Their role involves critical analysis and management of economic data, contributing to the overall financial stability and policy-making processes of the institution.

The interviewee has been with a prestigious research firm since 1981 and currently holds the position of Deputy Manager of International Economy, a role they have been in since 2006. With decades of experience, they have a deep understanding of international economic trends and policies. Their long-standing tenure at the Central Reserve Bank of Peru highlights their expertise and dedication to the field of international economics.



## 03



# PROFILE OF INTERVIEWEES

## SENEGAL

The interviewee is a visiting lecturer at the Geneva Graduate Institute, where they teach migration and health from an international perspective. They also serve as a Faculty Lead, supervising Applied Research Projects (ARPs) in global health. Holding a PhD in Social Sciences from the University of Lausanne, their research focuses on the internal and international mobility and migration of African health professionals and the impacts on health care provision.

# 04 ANALYSIS OF INTERVIEW RESPONSE

## OVERVIEW OF INTERVIEW RESPONSES

In our research, we tailored interview questions to extract both personal experiences and professional insights from individuals working within central banks, universities, and other institutions relevant to remittance systems in Afghanistan, Peru, Senegal, and Nepal. This approach ensured a rich collection of data, encompassing operational, regulatory, and strategic dimensions of informal remittances. By leveraging the deep knowledge and extensive experience of these professionals, our study aimed to capture a nuanced understanding of the informal remittance ecosystem, encompassing its economic and policy implications.

## BACKGROUND INFORMATION

Interviews began with questions regarding the interviewees' professional backgrounds to establish their connection to the study's focal countries and to informal remittance practices. This initial discussion was designed to enhance the relevance and reliability of the insights provided, setting the stage for more in-depth exploration of the subject matter.

## 04 ANALYSIS OF INTERVIEW RESPONSE

### EXPERIENCE AND INTEREST IN INFORMAL REMITTANCES

The core of our inquiry involved detailed questions about the professionals' direct experiences with and observations of informal remittances. These discussions not only shed light on personal engagements but also drew on broader industry practices, trends, and volumes. The semi-structured nature of the interviews allowed for an organic exploration of how these remittances impact economic development and financial stability in their respective regions.

### CHARACTERISTICS AND ADVANTAGES OF INFORMAL REMITTANCES

Characteristics and Advantages of Informal Remittances:

Given the interviewees' expertise, we delved into systemic preferences for informal over formal systems, exploring underlying reasons such as bureaucratic inefficiencies or service gaps in formal banking. We also prompted discussions on lesser-known innovations within informal remittance systems, such as unique risk management strategies or adaptations to market changes.

# 04 ANALYSIS OF INTERVIEW RESPONSE

## DIFFICULTIES AND RISKS

The interviews explored the complex landscape of risks associated with informal remittances, including legal implications and financial vulnerabilities. We also examined the broader international consequences, such as compliance with global financial regulations and impacts on international relations.

## LEGAL AND REGULATORY CONTEXT

A critical area of discussion involved the actual enforcement of laws, the effectiveness of governmental policies, and existing gaps in regulatory frameworks. Interviewees were encouraged to suggest regulatory changes or innovations that could bridge the divide between informal and formal systems, enhancing both security and transparency.

## FACTORS INFLUENCING CHANNEL CHOICE

The discussions extended to market-driven and personal factors influencing the choice between informal and formal channels. We also explored potential future shifts in these preferences, prompted by technological advancements, market dynamics, or macroeconomic conditions.

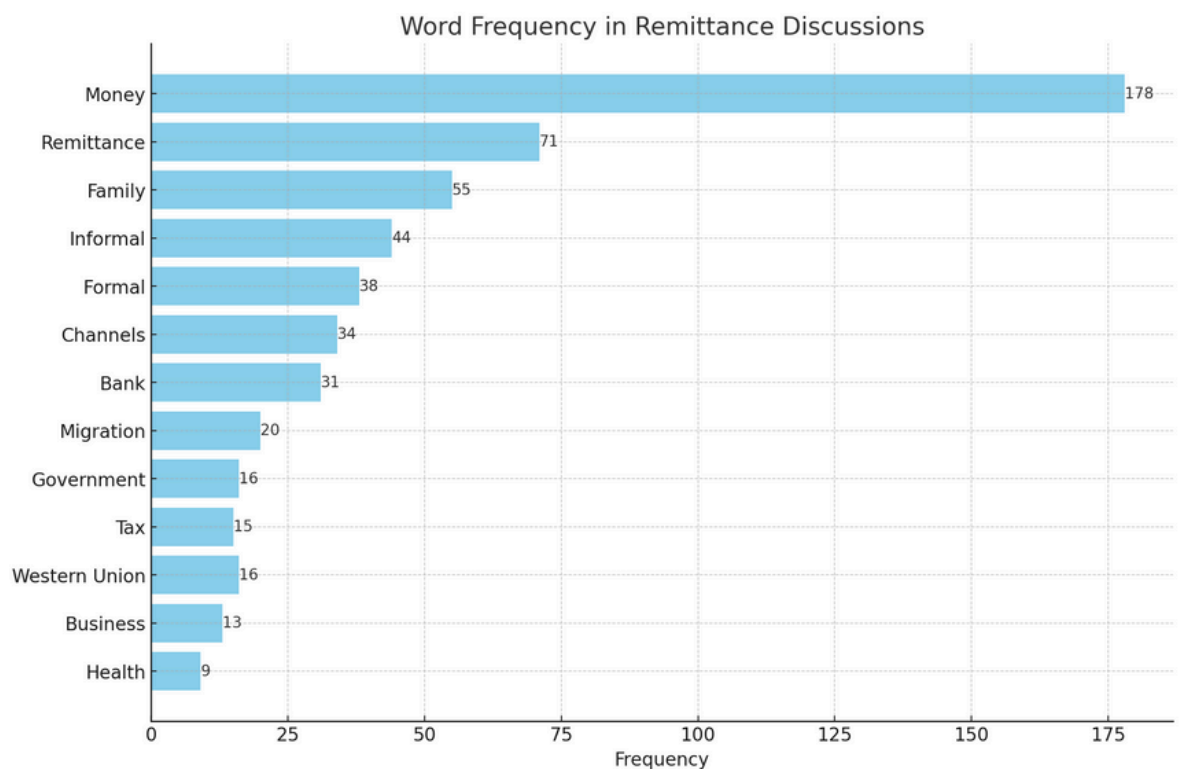
## 04

# TEXT ANALYSIS OF INTERVIEW TRANSCRIPTS

## TERM FREQUENCY STATISTICS AND ANALYSIS

We transformed the audio recordings of the interviews into textual transcripts for detailed analysis. After removing common pronouns and conjunctions, we focused on the frequency of significant nouns and adjectives.

Key terms such as “*money*”, “*remittance*,” “*family*”, “*informal*”, “*formal*”, “*channels*”, “*bank*”, “*migration*”, “*government*”, “*tax*”, and “*Western Union*” emerged prominently, indicating their central role in the discussions.



## 04

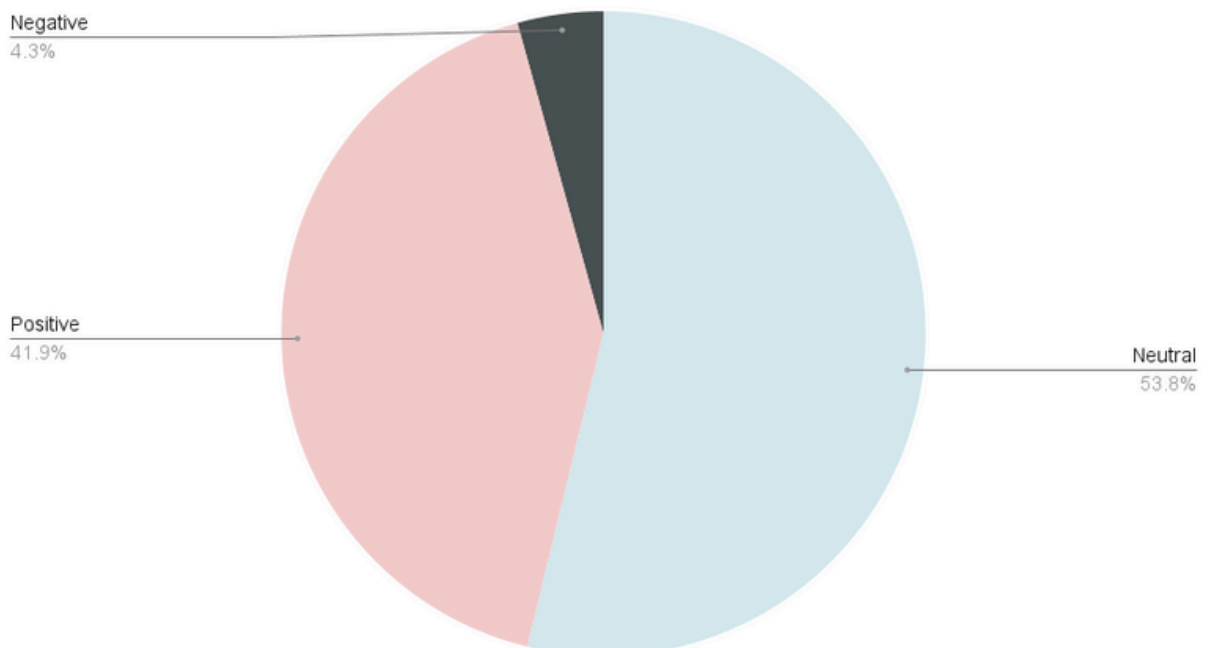
# TEXT ANALYSIS OF INTERVIEW TRANSCRIPTS

## SENTIMENT ANALYSIS

Further, a sentiment analysis was conducted to gauge the emotional undertones of the responses. The analysis categorized sentiments into positive, neutral, and negative:

- Neutral sentiments (53.79%) predominated, indicating a largely factual and unbiased discussion.
- Positive sentiments (41.9%) reflected favorable views on the efficacy and benefits of informal remittances.
- Negative sentiments (4.31%) highlighted concerns about security, regulation, and potential abuses within informal channels.

Sentiment Analysis



# 04

## INTEGRATION OF TERM FREQUENCY WITH SENTIMENT ANALYSIS



This section synthesises the findings from both term frequency and sentiment analysis to present a nuanced understanding of the perceptions surrounding informal remittances. The frequent occurrence of terms such as “money”, “remittance”, and “family,” when viewed alongside the predominantly neutral and positive sentiments, suggests that respondents generally perceive informal remittances as vital and advantageous within the financial ecosystem, albeit with some inherent risks.

## BALANCING VIEWS ON INFORMAL AND FORMAL CHANNELS



The analysis reveals a nuanced comparison between informal and formal remittance channels, reflected in the balanced frequency of terms “informal” and “formal” and the associated sentiments. Neutral sentiments often arise from objective descriptions of remittance mechanisms, while positive sentiments underscore the advantages of informal channels, such as cost efficiency and accessibility. This balance indicates that while formal channels are recognized for their security and regulatory compliance, informal channels are valued for their ease and lower operational costs.

# 04

## IMPACT OF INSTITUTIONS AND ENTITIES ON PERCEPTION

The specific mentions of entities such as "Western Union," and institutions like "bank" and "government" provide insights into the complex dynamics within the remittance landscape. Positive sentiments associated with these terms generally relate to the effectiveness and reliability of these entities in facilitating remittances. Conversely, the presence of negative sentiments highlights concerns over high fees, regulatory challenges, and potential inefficiencies within formal banking systems.

## ANALYTICAL INSIGHTS

The integration of term frequency and sentiment analysis offers a comprehensive view of how informal remittances are situated within broader economic and regulatory contexts. For instance, the emphasis on "money" and "remittance" aligns with the fundamental role these elements play in the lives of the respondents. The term "family" underscores the personal impact and dependency on remittances for familial support.

This integrated analysis not only highlights the significant role of informal remittances in financial practices but also points to a complex relationship of personal benefit, economic necessity, and regulatory environment. By understanding these dynamics, stakeholders can better navigate the challenges and opportunities within the remittance sector, potentially guiding policy adjustments and innovations to harmonise the benefits of both informal and formal remittance channels.



## 04

## REASONS FOR CHOOSING INFORMAL OVER FORMAL REMITTANCE CHANNELS

### **PUSH FACTORS: BARRIERS TO FORMAL CHANNEL USAGE**

High transaction costs stand out as a significant deterrent, especially fees associated with currency conversions, which can be prohibitively expensive. Additionally, the formal financial systems often require extensive personal and financial disclosures, posing a substantial barrier. Migrants, in particular, may be reluctant to share comprehensive personal data due to privacy concerns or potential legal repercussions.

In countries like Nepal, where remittances are a critical component of the economy, the government imposes stringent regulations to monitor these financial flows. Such regulatory vigilance, aimed at boosting revenue collection and maintaining robust economic records, can inadvertently push users towards informal channels. The requirement for detailed disclosures and the perceived intrusion into personal financial matters can make formal channels less attractive.

## 04

## REASONS FOR CHOOSING INFORMAL OVER FORMAL REMITTANCE CHANNELS

### PULL FACTORS: ATTRACTIONS OF INFORMAL CHANNELS

Conversely, informal channels offer several advantages that attract users, primarily revolving around cost, convenience, and trust. These channels typically incur lower transaction costs and minimal, if any, disclosure requirements, making them financially and procedurally more accessible, especially to migrants in low-skilled jobs who may also lack the literacy to navigate complex formal financial systems. The simplicity and speed of informal transactions, free from the bureaucratic entanglements of formal systems, enhance their appeal.

Furthermore, the reliance on human social networks for informal remittances capitalises on mutual trust and personal ties, facilitating smoother transactions. Such networks enable even those with minimal technical skills to engage in remittance activities, underscoring the community-based nature of informal channels.

## 04

## REASONS FOR CHOOSING INFORMAL OVER FORMAL REMITTANCE CHANNELS

### IMPACT OF EXTERNAL EVENTS ON CHANNEL PREFERENCE

Notably, external events such as the COVID-19 pandemic have also influenced channel preferences. Our interviewees from Peru highlighted a significant decrease in the use of informal channels during the pandemic, with travel restrictions reducing informal cross-border movements and, consequently, informal remittances from about 10–12% to 4-5%. This shift underscores the flexibility and adaptability of remittance behaviors in response to global crises, reflecting both temporary and potentially lasting changes in how people choose to transfer money.

The preference for informal over formal remittance channels is multifaceted, driven by both aversions to the complexities and costs of formal systems and attractions to the efficiency and community orientation of informal methods. These dynamics are further complicated by external factors such as global health crises, which temporarily reshape patterns and may influence long-term behaviors. Understanding these reasons provides crucial insights into the remittance landscape, offering potential pathways for policy interventions and system improvements that could make formal channels more competitive and appealing.

## 04 RISKS ASSOCIATED WITH INFORMAL REMITTANCES

Despite the theoretical risks associated with informal remittance channels, including the potential for scams, delays, losses, and fraud due to the lack of formal legal safeguards, the practical experiences reported by many users paint a somewhat different picture. According to our interview results, increased familiarity with these systems, coupled with robust connections within the migrant community, appears to significantly mitigate these risks.

### REDUCED RISKS THROUGH COMMUNITY NETWORKS

The backbone of the informal remittance system is the deep-seated trust within migrant communities. This trust, fostered by recurrent interactions and mutual assistance in sending money back home, effectively replaces formal legal frameworks. Such community-based networks provide a dependable structure that underpins the reliability of informal channels, making them a preferred choice for many migrants. As a result, for those embedded within these networks, informal channels are not merely a financial conduit but an integral part of their socio-economic existence.

### INADEQUATE INCENTIVES IN FORMAL CHANNELS

Conversely, formal remittance methods, despite their increased security, often fail to attract migrants due to critical drawbacks such as higher costs and less convenience. For many migrants, the primary objective is to maximize the financial support sent to families back home, making cost-efficiency paramount. The complexities and accessibility barriers associated with formal channels—such as the need for official documentation and navigating bureaucratic procedures—further deter their use, especially among those who may lack legal status or proper identity documentation in foreign countries.

# 04

## SUMMARY OF KEY REASONS FOR CHOOSING INFORMAL CHANNELS

THE PREFERENCE FOR INFORMAL OVER FORMAL REMITTANCE CHANNELS CAN BE ATTRIBUTED TO SEVERAL KEY FACTORS:

- *Cost-Efficiency*
- *Simplicity and Accessibility*
- *Community Networks*
- *Regulatory Environment*

In conclusion, the widespread preference for informal remittances among migrants is primarily driven by the lower costs, simplicity, and the supportive community networks that characterise these channels. While formal methods offer increased security, they often fail to provide sufficient incentives to outweigh the advantages of informal systems, especially in terms of cost-efficiency and ease of use. Understanding these dynamics is crucial for policymakers and financial institutions aiming to design more inclusive, effective, and secure remittance systems.

## 04

## POLICY RECOMMENDATIONS

### AFGHANISTAN: REGULATORY AND SOCIO-ECONOMIC STABILITY

In Afghanistan, our interviewee from the Central Bank highlighted the challenges in achieving the dual goals of price stability and financial system soundness amidst a backdrop of unlicensed financial service providers.

The broader issues such as money laundering and terrorism financing further complicate regulatory efforts.

The effectiveness of legislative measures is often undercut by socio-political instability, emphasising the need for policies that address the root causes such as poverty and political unrest.

The recommendation is to integrate financial regulation with socio-economic development initiatives, creating more resilient economic structures that discourage reliance on informal financial activities.

## 04

## POLICY RECOMMENDATIONS

### NEPAL: BALANCING REGULATION AND ACCESSIBILITY

Nepal's approach to remittance regulation, aimed at increasing transparency and state revenue through strict disclosure requirements and higher taxes, inadvertently pushes migrants towards informal channels.

This is particularly true for those in low-skilled jobs or without proper documentation, who find informal channels less burdensome and more cost-effective.

To counteract this, policies should focus on simplifying legal procedures, reducing transfer costs, and educating migrants about the benefits of formal channels.

A balanced regulatory framework could encourage the use of formal remittance systems, integrating these funds into the national economy more effectively and securely.

# 04

## POLICY RECOMMENDATIONS

### **PERU: ENHANCING FORMAL REMITTANCE FRAMEWORKS**

Peru presents a flexible approach to handling remittances, especially in transactions under \$10,000.

However, the need for detailed disclosures for larger amounts and the oversight by banking and insurance regulatory bodies does not fully prevent the use of informal channels, which still account for a significant portion of remittances.

The policy recommendation here is to enhance the efficiency and security of formal remittance channels through better interoperability among financial institutions, reducing transaction costs and fostering a regulatory environment that supports rather than hinders remittance flows.



# 04

## POLICY RECOMMENDATIONS

### SENEGAL: INCREASING FORMAL CHANNEL COMPETITIVENESS

In Senegal, despite the availability of formal remittance methods like bank transfers and services such as Western Union, the higher costs associated with these options drive many to continue using informal channels.

The policy recommendation is to reduce fees and improve access to formal channels.

Additionally, addressing the lack of comprehensive data on informal remittances is crucial for better economic planning.

Policies should aim to make formal channels more competitive by lowering costs and enhancing service accessibility, which could improve financial security and boost economic development.

# 05

## CONCLUSION

This study rigorously explored the dynamics of remittances in Afghanistan, Nepal, Peru, and Senegal, examining the pivotal roles both formal and informal remittance channels play in these economies. The analysis revealed that informal remittances are not only significant but often surpass traditional forms of external finance such as Foreign Direct Investment (FDI) and Official Development Assistance (ODA), crucially contributing to the integration of these countries into the global financial system.

Through purposive sampling, key stakeholders from financial institutions, regulatory bodies, and remittance service providers were selected to provide a nuanced understanding of the remittance landscape. The insights gathered from professionals across related sectors shed light on the operational, regulatory, and strategic dimensions of informal remittances, highlighting a significant dependence on these channels due to their lower costs, fewer bureaucratic hurdles, and less stringent disclosure requirements compared to formal methods.

# 05

## CONCLUSION

### KEY FINDINGS AND IMPLICATIONS:

- **Economic Stability:** Informal remittances contribute to economic stability by providing a steady influx of foreign currency, supporting household consumption, and fostering small-scale business development.
- **Poverty Alleviation:** These remittances enable recipient families to improve their living standards, facilitating investments in education and healthcare.
- **Community Support:** Leveraging community networks for remittance transfers not only strengthens social bonds but also ensures efficiency and reliability in the distribution of funds.

# 05

## CONCLUSION

### CHALLENGES AND POLICY RECOMMENDATIONS:

Despite the benefits, informal channels carry inherent risks, including lack of legal safeguards and potential for fraud. The study suggests several policy interventions to mitigate these issues:

- **Reducing Costs and Simplifying Regulations:** Lower transaction costs and streamlined procedures can make formal channels more appealing.
- **Enhancing Financial Literacy:** Increasing awareness and understanding among migrants about the benefits of using formal remittance systems is crucial.
- **Improving Financial Infrastructure:** Developing a more competitive remittance market with robust financial infrastructure can encourage the use of formal channels.
- **Addressing Socio-Political Factors:** Tackling underlying socio-political issues that compel reliance on informal systems is vital for fostering stable economic environments.

These recommendations are derived from the specific challenges and opportunities identified in each country's remittance environment. They emphasise the need for policies that not only regulate but also enhance the attractiveness and accessibility of formal remittance channels, taking into account the socio-economic contexts that drive individuals towards informal methods.

# 06 ANNEXES

## Annex 1 Semi-structured interview questions

### 1. Self-introduction

Today's interview is about the impact of informal remittances on developing countries, which is our ARP project in collaboration with the United Nations Capital Development Fund (UNCDF). Informal remittances are money transactions using methods outside the formal banking system or other officially regulated money transmitting financial institutions eg. mobile money or fintech as informal remittances.

We aim to evaluate the scale, dynamics, and impact of informal remittance flows from an economic perspective and to understand the reasons and methods behind these transfers by migrants, as the project underscores the potential for policy improvements and enhanced financial inclusion through the formalization of these funds.

### 2. Experience and Interest in Informal Remittances:

- "What has been your experience with informal remittances in your field?"

### 3. Characteristics and Advantages of Informal Remittances:

- "In your view, what makes informal remittances a preferred choice over formal channels in certain scenarios? "

- "Can you provide any specific examples from your experience or observations?"

\*Additional questions if she does not include this information:

- How do you compare these channels to formal ones in terms of security, convenience, and cost?

- In your opinion, what are the main reasons or motivations for using informal remittances?

### 4. Difficulties and Risks:

- "What challenges or risks are commonly associated with using informal remittances?" (For example, delays, losses, frauds, investigations, etc.)

- "Have you come across any strategies or methods that help mitigate these risks?"

# 06 ANNEXES

## **Annex 1 Semi-structured interview questions**

### 5. Legal and Regulatory Situation:

- “In your opinion, are there any legal and regulatory frameworks governing informal remittances?”
- “What are your thoughts on the adequacy and effectiveness of these regulations?”

### 6. Recommendation and Use of Formal Channels:

- “In your opinion, are formal remittance channels like banks or licensed institutions preferable and in what circumstances?”
- “What are the pros and cons you have noticed in comparison to informal methods?”

### 7. Factors Influencing the Choice of Channels:

- “What factors do you think are most influential in deciding whether to use formal or informal remittance channels?”

### 8. Impact on Economy and Society:

- “Could you share your insights on the impact of informal remittances on economic development, and society?”
- “Are there any specific studies or data that highlight this impact?”

### 9. Suggestions for Government and International Organisations:

- “What recommendations would you offer to the government and international bodies regarding the handling and regulation of informal remittances?”
- “What are the main challenges or opportunities for improving the situation of informal remittances?”

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