NANYANG TECHNOLOGICAL UNIVERSITY SINGAPORE

NTU-SBF Centre for African Studies
Nanyang Business School

# Africa Current Issues

## Remittances in Africa: A Port in the Storm?

Vol . 2020 - 29

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# Remittances in Africa: A Port in the Storm?

The spread of the Coronavirus across the globe left no aspect of global money flows untouched. In Africa, where the full impact of COVID-19 on health has yet to take hold, the economic impact is acute. Business and consumer confidence plunged, commodity prices wilted and government finances buckled under the combined pressure of increased health expenditure and plummeting tax revenue. An increasingly uncertain economic outlook halted fixed investment plans in several African countries. Inward portfolio flows into equities and bonds reversed, in pursuit of safe-haven assets. The longer-term forecasts for foreign direct investment (FDI) and EM portfolio flows are grim. Remittances, defined as money transferred by migrant workers to dependents in their home country, are an often-overlooked source of foreign exchange revenue for African countries. Unfortunately, they stand to bear the full brunt of the pandemic-driven global downturn.[1]

For many in emerging markets (EM), and particularly for the most vulnerable, remittances from family and relatives abroad are their only sources of income.[2] Job losses and reduced wages linked to COVID-19 put these vital capital flows under severe pressure. The impacts, flowing across African economies, will hit living standards and consumption.[3] Understanding the nuances of remittances in Africa and the likely impact of COVID-19 on these vital flows will be key to navigating the inherent business risks, as well as mitigating some of their most negative effects. To identify these risks, this article unpacks the dynamics of remittances on the continent, breaks down the flow of funds into key components and identifies the main players. It then explores the likely socio-economic impacts, the knock-on effects for business and the future of remittances in Africa.

## 1. The dynamics of remittances in Africa

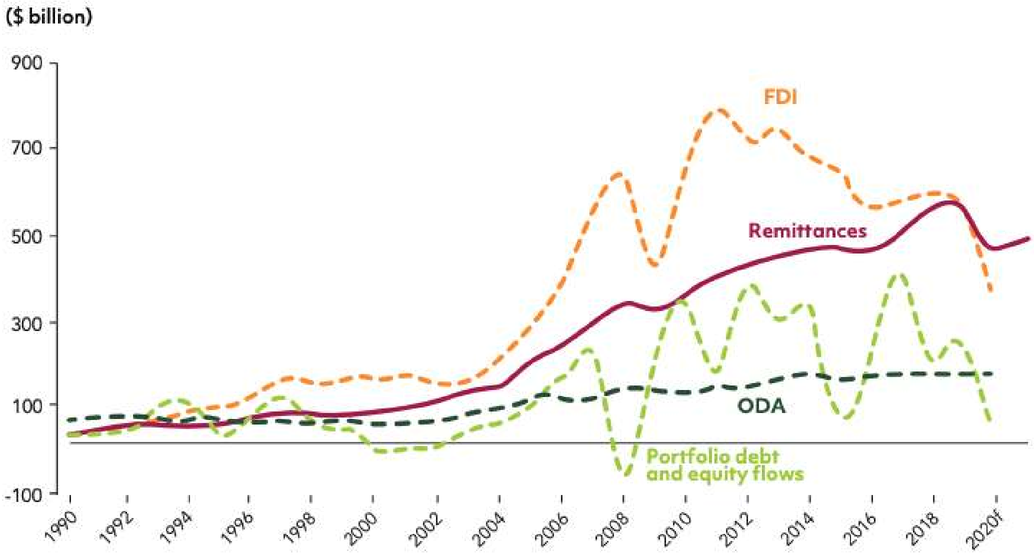
*"Remittances are a vital source of income for developing countries. [They] help families afford food, healthcare, and basic needs." – David Malpass, World Bank*

### The power of remittances

The World Bank estimates that remittances directly impact more than one billion people annually, either as senders or beneficiaries. About 75% of annual remittance flows go to meet the immediate needs of the recipients.[4] These funds fill needs for mobility, communication, food, housing, education, and healthcare. In some cases, they even become start-up capital. The Bank expects remittance flows to exceed a cumulative USD 6.5 trillion between 2015 and 2030. These flows will stimulate economic activity and improve the quality of life in rural areas.[5]

In 2019 alone, global remittances amounted to USD 554 billion, larger than all other cross-border financial flows[6] to poor countries (Figure 1). Fuelled by more than 200 million expatriate workers across the globe, each with an average of 4 beneficiaries, remittances have a powerful multiplier effect. The World Bank estimates that these flows make up approximately 60% of a recipients' family income, and are the only source of funding for as many as 20% of poor households.[7]

*Figure 1: Remittance flows to low and middle-income countries between 1990 and 2018*




Source: World Bank (ODA = official development assistance)

For many poor countries, remittances make an important contribution to foreign exchange. Africa, where government safety nets are often insufficient, is particularly dependent on these flows for social support. Remittances to sub-Saharan Africa (SSA) surged 10% to USD 48 billion in 2018. This growth contracted by 0.5% in 2019 as the global economic slowdown began to take hold.[8] By region, SSA is the smallest in terms of absolute dollar remittances. Inward transfers to South and East Asia are nearly six times as large. Flows to Latin America are twice that of SSA. Even the Middle East and North African receipts, at USD 59 billion in 2019 (estimated) are greater than Africa. Yet people in the African region, with 86% of its employment in the informal sector, are the most dependent on remittances.

Although the size of the official remittance market is significant, these figures account only for funds flowing through official channels. They do not capture all transactions by migrants fulfilled via informal transfers through friends, relatives, transport companies, or hawala networks.[9] Hawala (also called hundi) is a funds transfer system popular in North Africa, the Middle East and the Indian subcontinent. It relies on the honour of a huge network of money brokers who facilitate money transfers across regions on behalf of individuals, and settle obligations among themselves. Such trust-based systems may circumvent exchange laws in some jurisdictions, but offer users lower costs and prompt access. Hawala is essentially the transfer of rights to a specific amount of money without physically moving it. Such systems allow huge unregulated transfer volumes. In some African countries, mobile banking and payment platforms such as Paga and M-Pesa deploy digital technology to increase financial inclusion, including international funds transfers. The true volume of global remittances through all channels is estimated to be at least double, and perhaps up to ten times as large as reported by authorities.[10]

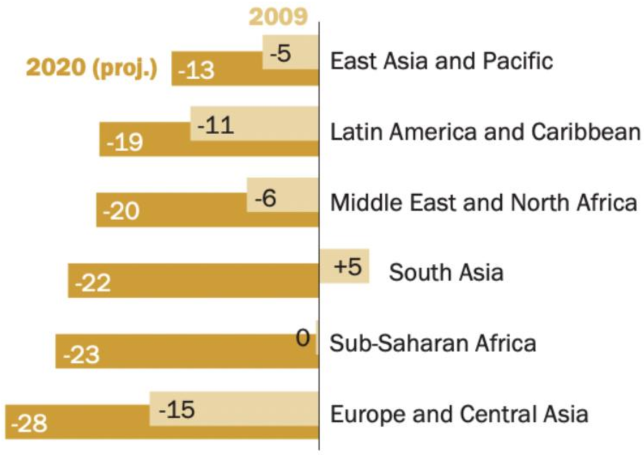
Regardless of actual market size, the outlook for this segment is troubling. A recent working paper by the IMF[11] found a strong positive relationship between remittance growth and GDP growth. This relationship is particularly important in sub-Saharan economies, where war, political upheaval, and economic strife generated large-scale migration in search of better opportunities. The impact of COVID-19 is set to rattle the remittance market, and despite its resilience through previous economic downturns, volumes may plunge. The humanitarian and economic growth fallouts will be significant.

**The impact of COVID-19**

The World Bank expects the COVID-19 pandemic to impact remittances in several ways[12]: First, the pandemic impairs migrant incomes as a result of business closures, job losses, or being paid less due to working fewer hours. These outcomes reduce the amount of money workers are able to send home. Second, business shutdowns ordered to prevent the spread of the disease reduce physical access to formal remittance service providers.

Due to the unfolding crisis, the Bank dramatically lowered expected global growth rates and commensurately, remittance flow volumes. For 2020, the Bank expects global remittances to contract by approximately 20%, the sharpest decline in history. The logic behind this is that COVID-19 is a global phenomenon that simultaneously hits both emerging and developed markets. The pandemic leads to declines in wages and employment of migrants. These workers are typically the most vulnerable to job and wage cuts resulting from an economic crisis in their host country. Remittances to sub-Saharan Africa are expected to fall by 23.1% to just USD 37 billion – a substantial USD 11 billion decline from 2019 (Figure 2).

*Figure 2: % Decline in remittance inflows to by world region in 2009 and 2020*




Source: World Bank.

While the institution expects a 5.6% recovery in low and middle-income country remittances in 2021, the outlook remains uncertain, given rising concerns about COVID-19 vaccine timelines and the potential for "second wave" outbreaks.

### A darkening outlook

Historically, remittances tend to be counter-cyclical, with workers sending more money home during times of crisis. For example, remittances to Yemen more than doubled between 2011 and 2019 amidst the civil war in that country.[13] Even after the 2009 global financial crisis (GFC) hit, global remittances contracted only 5%. With remittances barely affected, Africa escaped relatively unscathed. During this period, African GDP growth remained positive, albeit at a much lower trajectory. Remittance flows were a significant source of financial support for many.

Africa seems unlikely to escape this time. The World Bank predicts that the continent will suffer its first recession in a quarter of a century.[14] The Bank anticipates that remittance flows to Africa will contract by nearly a quarter during the current crisis, due to the synchronised nature of the downswing.[15] This suggests that African economic growth will be particularly hard hit, and not receive the remittance support it did during the GFC.[16]

Financial headwinds face the continent, over and above unemployment increases and remittance volume contraction. Financial market volatility, oil price swings and currency precariousness in EMs interact to make it difficult for remittance service providers to price foreign exchange. The geographic spread of the African diaspora populations in areas subject to lockdowns compounds this issue. These uncertainties inevitably add to the cost of remittances.

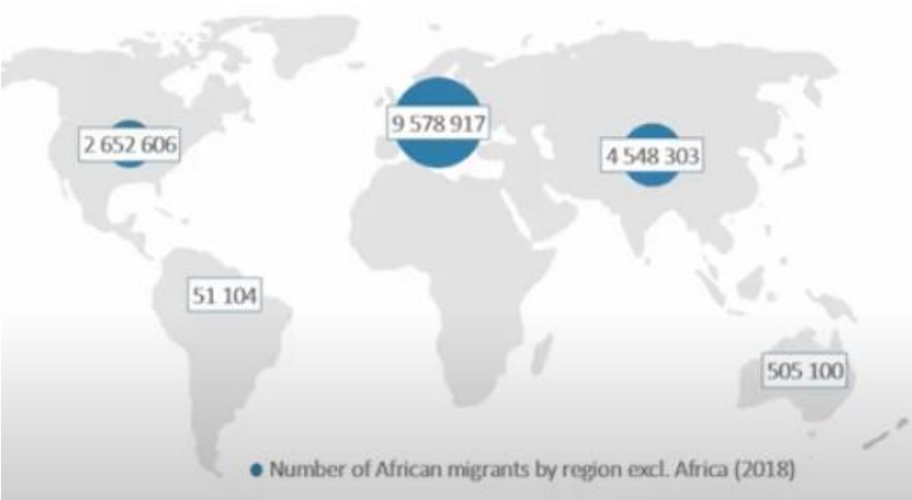
### 2. Following the money

Thirty-six million African citizens, roughly 2.5% of its population, lived outside their home continent in 2019. A large proportion is employed and remits funds to their home country.

**Remittance origins**

The bulk of African remittances originate in Europe (Figure 3). Many of its more than 9.5 million (formally documented) Africans send remittances home. Of these migrants, 88% live in five European countries – France, Italy, Spain, the United Kingdom and Germany.[17]

*Figure 3: Number of African diasporas by region*



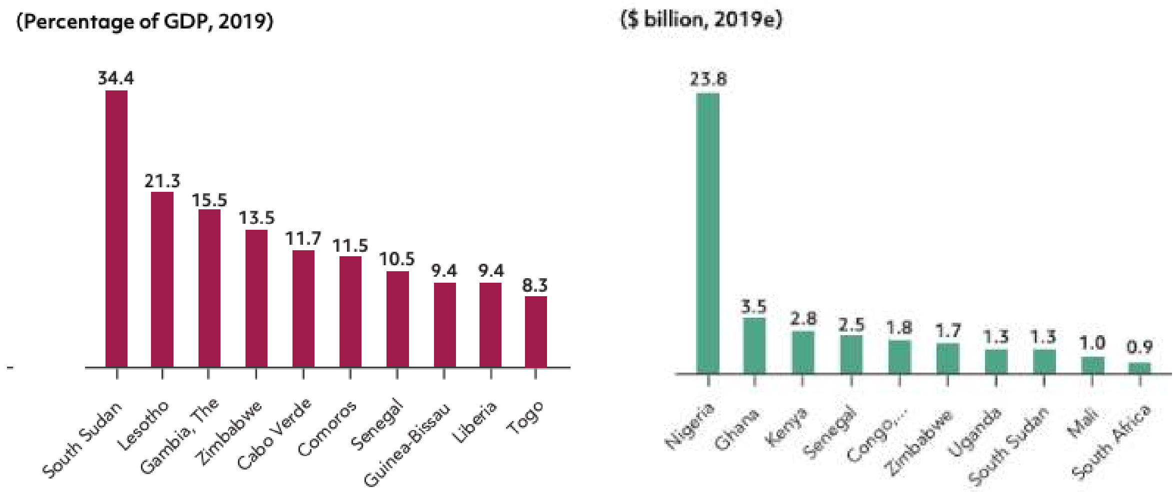

Source: Cenfri

Pew Research notes that Africa is particularly vulnerable to migrant job losses in these five countries. All were hit particularly hard by the coronavirus, and experienced extended periods of shutdown.[18] These restrictions severely limited opportunities for many African migrants to earn an income. Although formal data is not yet available, one remittance operator (Leon Isaacs of DMA Global) reported an 80% fall in volume within a single week. Among the most severely impacted industries are construction, hospitality and the services sectors, which employ many members of the African diaspora.[19]

**Africa's overdependence**

Highlighting the continent's dependence on remittances, this flow of cash amounts to more than 5% of GDP for at least 13 African countries. For some, like South Sudan who recently began reporting remittance figures, they total more than a third of its annual gross domestic product (Figure 4). In pure flow terms, however, Nigeria receives by far the largest share of Africa's remittances at nearly USD 24 billion, with Kenya and Ghana a distant second.

*Figure 4: SSA remittances as % of GDP and in USD*



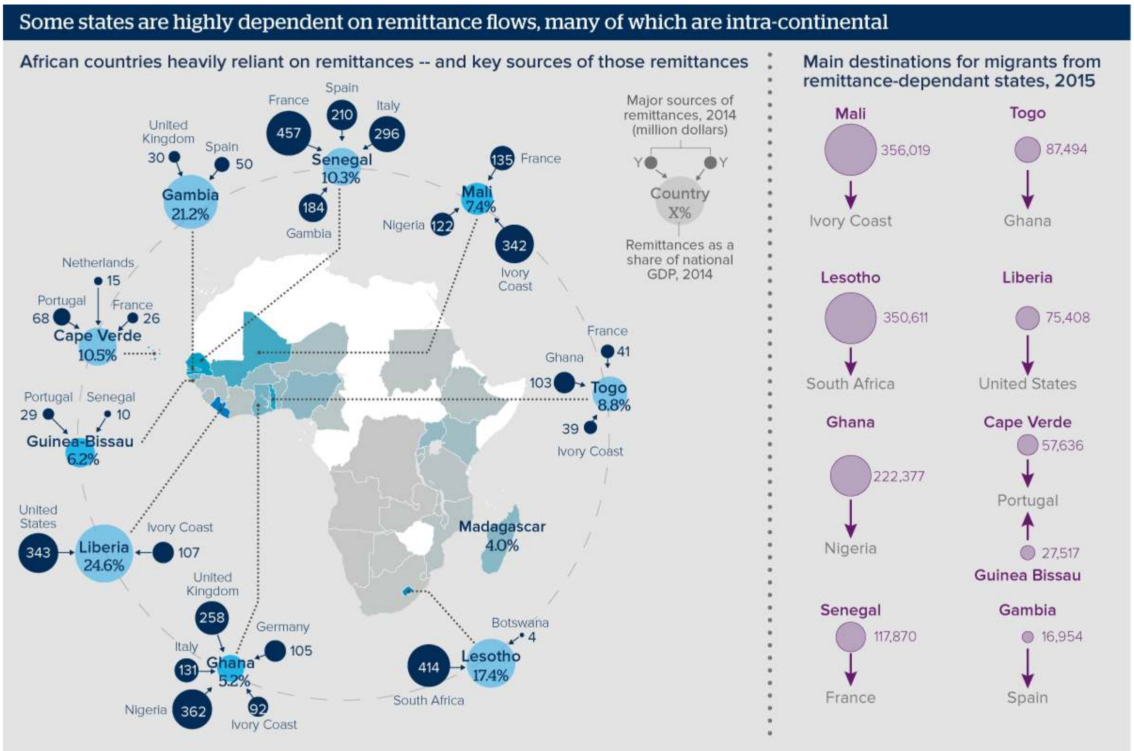

Source: World Bank

Understandably, the most vulnerable countries are those with the least diversified economies and those with the highest dependence on remittances for their contribution to GDP. In this instance, two countries particularly at risk are Lesotho and Zimbabwe where remittances contribute 21.3% and 13.5% of GDP respectively. A large proportion of the migrants from these countries work in South Africa, with many in the mining industry. The combination of slowing Chinese growth and falling commodity prices severely affected this sector. More recently, mines that reopened after the country eased its level 5 lockdown are now being forced to close again, as COVID-19 cases rise among miners.[20]

**The most vulnerable**

Many migrants from Lesotho and Zimbabwe are employed in the informal economy within Africa. Some may be domestic workers or informal traders that entered the host country illegally. As such, the state does not protect them in terms of labour rights or financial aid in the event of losing their job. Not only those working in developed markets send desperately needed money home. The World Bank estimates that migrant workers within Africa remit as much as USD 14 billion annually, while Ecobank reports that intra-African remittances accounted for 20% of the continent's remittance flows in 2018 (Figure 5).

*Figure 5: Primary remitting countries to select African countries*




Source: World Bank

Intra-African flows are also likely to come under significant pressure after the recent oil price rout. Many African migrants (often from neighbouring countries) work in the oil and gas industry. Petroleum producers such as Mozambique, Nigeria, Ghana and Angola are set to be heavily impacted.

In other parts of the continent, countries ravaged by war, famine and natural disasters face hardships beyond the pandemic. In Kenya, where remittances are the largest source of foreign currency, inward transfers fell by almost 10% year-on-year in April.[21] Many workers were laid off in the Middle East due to the oil price collapse. This comes at a time when the country battles a locust plague that threatens subsistence livelihoods and food security. The story in Somalia, which has been battling floods and where half of all households rely on remittances to survive, is quite similar.

Those less vulnerable countries are those with a well-diversified economy, or with small diaspora communities. Remittances make up less than 1% of their 2019 GDP for South Africa, Namibia, Zambia, Ethiopia, Tanzania and Cameroon. Even so, intra-country remittances, such as between provinces, will suffer as a result of the pandemic. The twelve-month mining strike in the South African platinum belt in 2012 demonstrates this issue. Falling remittances severely impacted Recipients in Mozambique and Lesotho. The families of miners in several of the country's provinces (particularly the Eastern Cape from which many miners hail) experienced rising poverty as remittances plummeted and area businesses, from vehicle dealerships to butchers, closed their doors after demand dried up.

### 3. The Business of Remittances

Remittance is big business the world over. Historically, two main players, Western Union and MoneyGram dominated the official market in Africa, until new digital technologies, the mobile money explosion and slowly easing regulatory constraints ushered in a plethora of new entrants.

#### Key industry players

Originally, domestic and international banks with the physical presence and access to technological infrastructure needed to facilitate transfers dominated Africa's official remittance markets. Due to their high fee structure and pressures to increase financial inclusion, banks gradually ceded market share to international specialists such as Western Union and MoneyGram. However, exclusive agreements between banks and authorised dealers enabled them to set fees well above the global average.[22] To increase competition, governments eased market restrictions. A host of new, non-traditional players entered the market. Many were furniture, clothing and food retailers with a multi-country presence. These retailers allowed remitters to deposit cash in-store, which the recipient could withdraw at a branch of the store located in their home country.

As technology and telecommunications advanced, mobile money transfers exploded on the continent. Mobile network operators such as MTN Group and UBank (MoMo), Globacom (Glo Xchange), Airtel, Vodafone and Safaricom (M-Pesa), and Orange enabled these systems. Specialists like Mukuru, WorldRemit, Azimo, TransferWise, WeChat and Payoneer piggybacked their "mobile-wallet" payment services on this mobile transfer architecture.

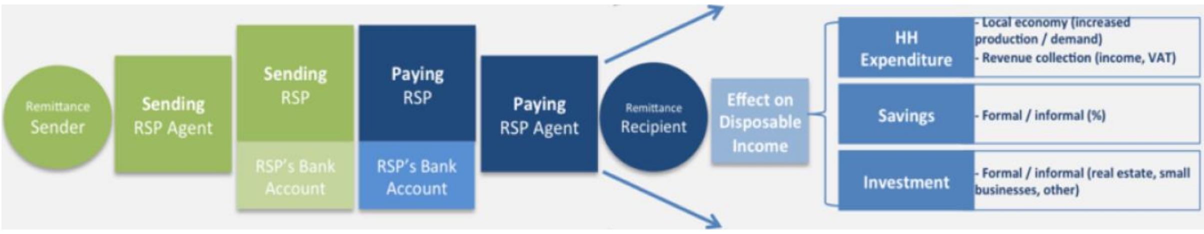
**How transfers work**

While remittances are simple in principle, they are somewhat complicated and costly in practice. Money transfer intermediaries charge fees for accepting funds from the remitter, with various other charges accrued along the value chain diluting the remittance amount.

As an example, a sender approaches a remittance service provider (RSP) to transfer USD 100 to a recipient in their home country. The sending agent transfers the funds into its bank account and from there, to the paying agent's bank account, after which it is deposited into the recipient's account. The sending and paying RSP are often branches of the same company, or have an exclusive service agreement, which enables them to maximise profit.

They often add charges such as a currency-conversion fee. Some operators require the beneficiary to pay a fee when collecting remittances. Bigger remittance agents (especially banks) can also earn an indirect fee in the form of interest, by investing funds in the market between collection and delivery. All in, the commissions for such remittances can be as high as 20%[23] meaning that the recipient receives only USD 80 of the 100 USD sent (Figure 6).

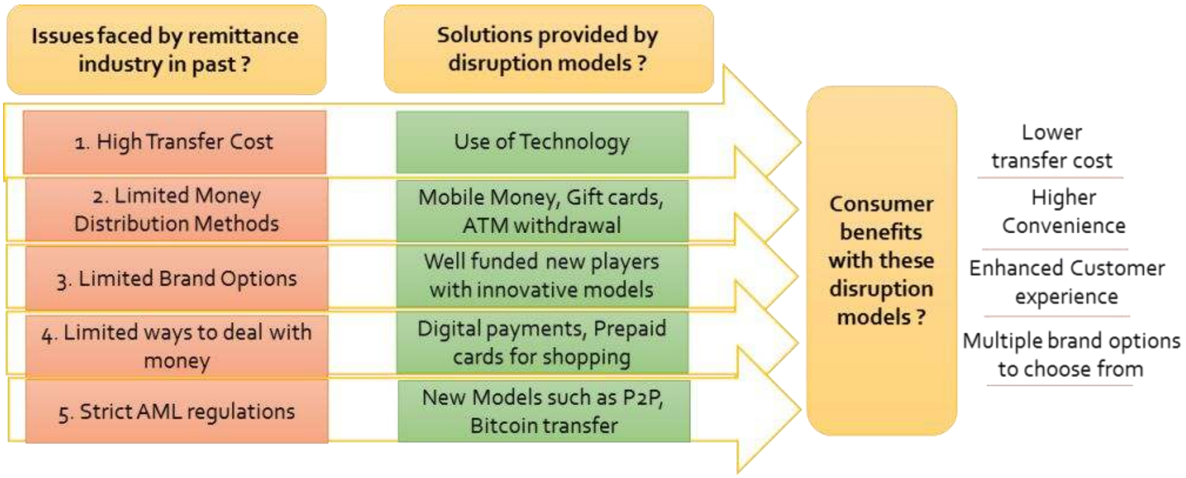
*Figure 6: The remittance value chain*




Source: The Dialogue

The remittance market (and model) is constantly evolving, reducing transfer times, increasing efficiency and driving costs lower, with technology as the enabler (Figure 7). The principle of digital money transfer remains consistent with hawala – transferring money without moving it. Newer technologies include blockchain, an open digital ledger of transactions designed to operate outside official monetary channels. Bitcoin, the best known of the many crypto currencies, was created to bypass third party intermediaries such as banks and remittance providers. Commercial banks seek to insert themselves in the transaction chain to avoid revenue losses, while reserve banks grapple with the governance and legalities associated with these new technologies. New remittance models promise to reduce cost in developing regions. However, until better governed and more widely adopted, they may remain tools for a select group and often used for nefarious purposes.

*Figure 7: Disruptors in the remittance industry*

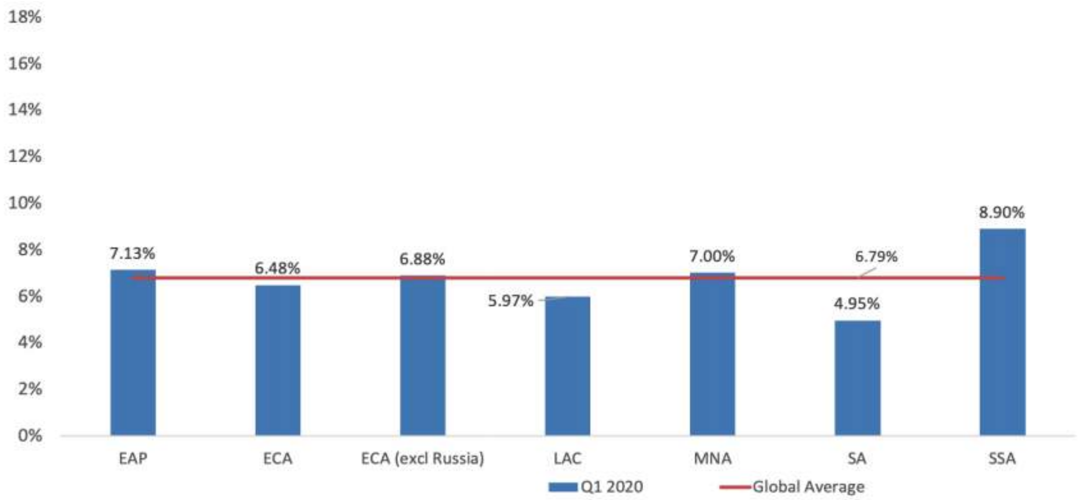



Source: Medici Global

**The cost of transfers**

Sending money to SSA remains the most expensive. The average cost of 8.9%[24] of the value sent compares to a global average of 6.8% (Figure 8). That is nearly two full percentage points more than the next highest region, the Middle East and North Africa. At an average charge of approximately 9% for the expected USD 38 billion remitted to Africa in 2020, the continent will lose approximately USD 4 billion this year to remittance intermediaries. This comes at a time when recipients urgently need funds to offset the impact of COVID-19.

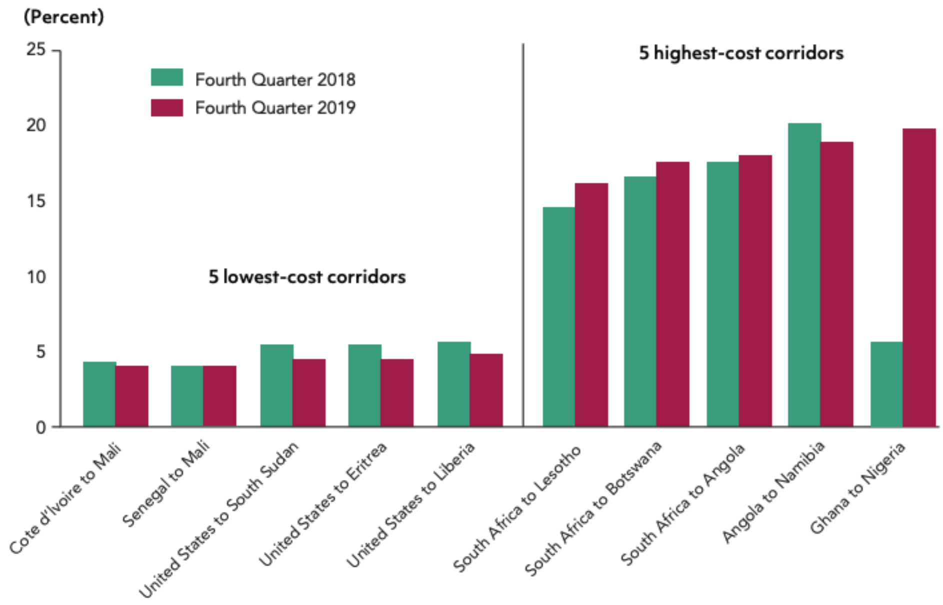
*Figure 8: Average remittance charge by region of the world*




Source: World Bank

Of equal concern is that the most expensive transfers are among African countries, often bordering countries. The costliest remittance corridor is between South Africa and eSwatini (formerly Swaziland), which costs an average of 20%. While the funds transfer rate between Ghana and Nigeria is similar, in other African jurisdictions such as Côte d'Ivoire to Mali and Senegal to Mali, remittance costs are as low as 3.6% (Figure 9).

*Figure 9: Highest and lowest cost remittance corridors to Africa*

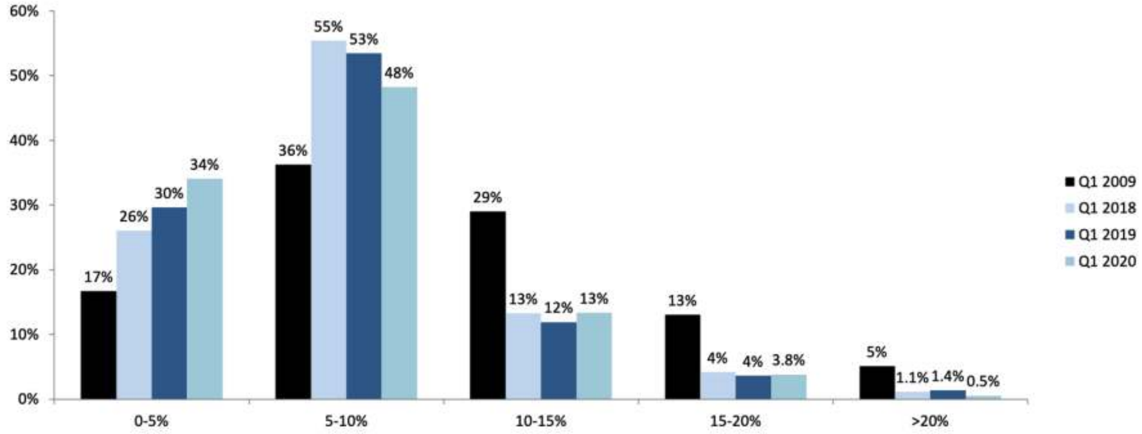



Source: World Bank

In 2015, the United Nations declared June 16 the International Day of Family Remittances, to raise awareness of the importance of remittances and to gather support for reducing the fees. In support of its Sustainable Development Goals (SDG), the UN and several non-government organisations (NGOs) seek to reduce transaction costs for migrant remittances to less than 3 per cent, then to eliminate remittance corridors with costs higher than 5 per cent by 2030.

Reducing remittance costs will help realise the UN SDGs of extinguishing poverty and hunger, promoting good health and wellbeing and promoting education and gender equality at a household level. At a national level it will accelerate economic growth and generate decent jobs, ultimately leading to financial stability and independence.[25] There are several reasons for the marked disparities between regions. One driver is a regulatory framework that enables charging more than 5% for two thirds[26] of money transfers (Figure 10).

*Figure 10: Distribution of average total remittance cost*

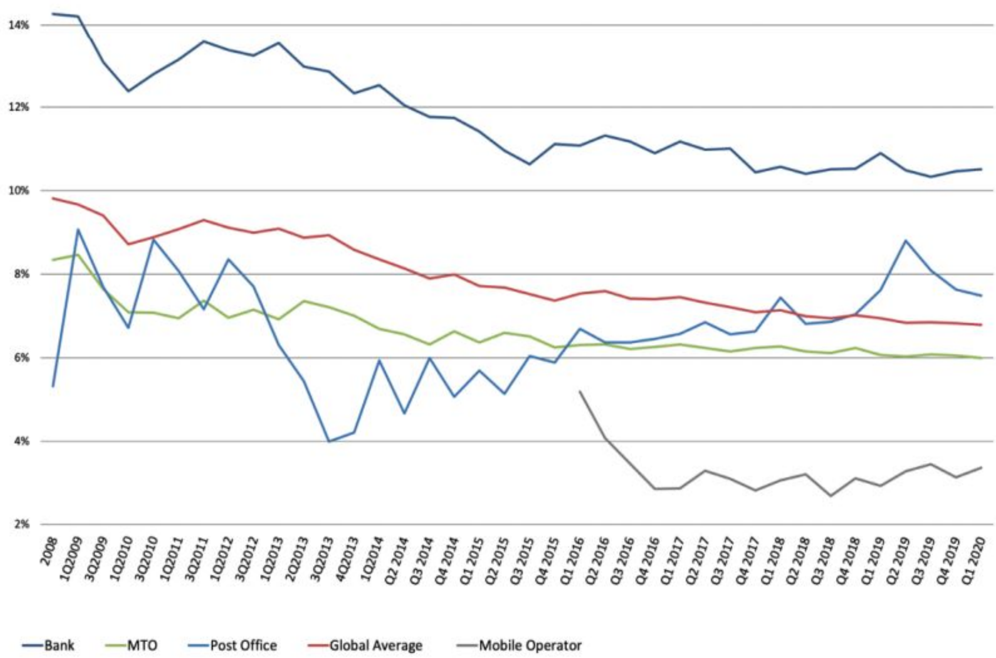



Source: United Nations

**The regulatory landscape**

Progress on lowering remittance costs has been slow. Countries must accelerate regulatory reform and liberalisation. Mobile money is currently the most cost-efficient, and while their costs are declining, banks remain the most expensive channel for money transfers (Figure 11). Although official data for the costs of transfers via Hawala networks is not available, they are generally understood to be well below bank rates.

*Figure 11: Total average cost over time by remittance service provider (RSP) type*




Source: World Bank

In the past, many African countries allowed only banks to pay remittances. According to the African Development Bank (AfDB), banks still facilitate more than half of transfers, either as a standalone service or in partnership with big players like Western Union or MoneyGram.[27] Some countries force recipients to establish government owned post-office accounts. Lowering remittance costs will require introducing more competition, renegotiating exclusive partnerships and providing new players with access to existing physical and technological infrastructure.

The take-up by Africans of mobile money through mobile network operators is a positive development, reducing costs and expediting smooth money transfers. Mobile money helped drive fund transfer costs down to roughly one third of that of banks. Following this success, a new stage of disruption is emerging. This involves promoting secure mobile digital technology and crypto currency transfers through social media platforms. This trend will challenge regulators.

**Scope for disruption**

The COVID-19 crisis could become a catalyst for urgently needed market reform. Governments already intervene to protect their citizens. The Central Bank of Kenya announced emergency measures to encourage mobile money technology (versus cash) to curb the spread of COVID-19. All charges for transfers between mobile money wallets and bank accounts were eliminated, transaction limits were raised, and charges for mobile money transactions were waived for amounts up to USD 10. In Uganda, MTN zeroed fees on mobile money transfers for 30 days from March 20 to promote cashless payments. In Ghana, Senegal, South Africa, and Zimbabwe, money transfer operators and cash pickup services either closed or reduced their opening hours.

African countries scrambled to unlock emergency funding to manage the growing health crisis. Governments approached international lenders and even floated the idea of “diaspora bonds”. The diaspora bonds concept offers migrants a discount on their home country’s debt in return for remitting their foreign exchange earnings to the government. This scheme is likely a non-starter, as default risk is rising across Africa. Moreover, governments are in many instances why those migrants left their home country in the first place. Most migrants would rather ensure their hard-earned funds benefit their family directly, even if this costs more. As such, rather than trying to float new and exotic debt instruments, the fastest and easiest way for governments to provide support to citizens is to impose stricter rules on transfer margins and open the market to more competition.

## 4. The future of remittances in Africa

It’s a sad irony that in the worst crisis in living memory, remittances are falling precipitously at a time when they are a critical source of aid. Historically, they served as a countercyclical crutch and source of external financing for households and governments. The crisis also comes at a period when FDI to low and middle-income countries is expected to contract by almost 40%. Foreign portfolio outflows may dramatically increase as investors choose lower-yielding, safer asset classes and geographic allocations. Now more than ever, remittance reform must work to benefit both senders and recipients by reducing cost layers.

### The outlook

The pandemic, aided by adoption of more modern technologies, will greatly reshape the remittance industry. Much lower volumes will mean smaller profits for RSPs, who are likely to lower margins to gain market share: a positive development for recipients. The shift, will accompany what will be exceptionally difficult times for recipients. For many, their only source of income is drying up, and governments are scarcely able to provide even a temporary bridge. At best, governments will act to deter industry collusion that artificially inflates margins.

The march of technology makes further decline in remittance costs inevitable and COVID-19 may expedite long overdue reform. Simply by reducing remittance commissions, the continent could unlock billions of dollars for its most vulnerable citizens at a time when governments have limited fiscal space to provide financial aid. The industry must begin preparing itself for greater oversight and reduced margins. These trends will benefit consumption, employment and economic growth. Rather than wait for government to impose such reforms, the private sector should take the lead. A failure to take the initiative will see new entrants with more efficient technologies, which could undermine existing players and ultimately put those at the upper end of the cost curve out of business.

### The role of technology

Remittances remain a lucrative business model. Remittance companies managed to capture 40% of fintech deals on the continent and become involved in all ten of the biggest fintech transactions in Africa.[28] A new digital wave fuelled by the rising popularity of social media and embrace of blockchain and digital currencies (Bitcoin and Ethereum) is gathering momentum, having overcome the initial pushback and some regulatory hurdles.

Facebook, [29] the world’s largest social media operator, plans to introduce its new Libra crypto currency to facilitate money transfers over its platform. MasterCard, Visa, eBay, Uber, Spotify, and Vodafone, all founding members of the Libra Association, will oversee its rollout. Many central banks, slow to understand the technology, have yet to draft regulations for its implementation and management. Of particular concern are managing the volatility of digital currencies and identifying an institution that can act as a backstop in the event of collapse. Nevertheless, once such challenges are ironed out, and traditional currencies become more digitised, the new technology promises to further reduce remittance costs in line with the World Bank’s SDGs. New technology offers greater speed, convenience, and choice, which drives price and feature competition.

**Threats**

While the pandemic poses great threats, the industry has survived many pandemics and wars over hundreds of years. As remittance volumes fall and sector regulation tightens, some weaker RSPs may not survive. While these forces may bring about sector consolidation, the industry as a whole will emerge stronger. Technological advances such as cryptocurrencies, blockchain and mobile transfers will have a similar impact. Rising nationalism and pushbacks against immigration are other force that may reshape the sector – already the US has halted all new work visa applications until the end of 2020 – and cap the significant growth enjoyed by the industry even after the pandemic passes. All of these threats, however, also present significant opportunities.

**Opportunities**

The pandemic will accelerate the embrace of new technologies and force margins lower to the benefit of recipients. It will also force governments to more actively oversee the sector, breaking up monopolies and unfair practices. Over the longer term, intra-African remittances are likely to become more important. This may be due less to travel restrictions than to the rise of nationalism and ethnocentrism. In many countries around the world, popular attitudes toward migration and immigrants appear to be hardening. This trend presents an opportunity for African countries to encourage the return of many diaspora communities, who will not only return with their hard-earned capital, but also skills and knowledge that could stimulate domestic economic growth.

The above confluence of factors comes as the African Continental Free Trade Area (AfCFTA) agreement is due to commence in 2021. AfCFTA promotes intra-African trade and regional integration.[30] The initiative is set to fuel job creation and the intra-continental movement of people. This has the potential to act as a valuable offset for the fall in remittances from outside the continent.[31] It will also stimulate economic growth in the region, meaning fewer Africans will need to leave their country or continent in search of a livelihood.

**Conclusion**

The world currently faces unparalleled upheaval. The economic and financial impact of COVID-19 is particularly severe in Africa, where many of its citizens depend extensively on remittances from family members working abroad to sustain themselves. The current effect on remittance flows may well have a lasting impact on the continent as a rise in nationalism and protectionism in developed markets force many in the diaspora to return. This in no way suggests that the remittance industry will contract.

Instead, African initiatives like AfCFTA intend to create employment opportunities on the continent and encourage the movement of people. This would fuel acceleration in intra-African remittances, which would offset a fall in money flows from developed markets.

To evolve, the remittance industry needs to face greater competition. If regulators fail to act, competition will emerge with the introduction of newer technologies and more efficient transfer platforms. Current operators that embrace this dynamic and adapt by lowering costs, broadening reach and improving ease of transfer will flourish – higher volumes will more than make up for lower margins. By lowering the cost of sending money, the industry can provide vital support for Africans dependent on remittances and alleviate pressures on governments to deliver financial support and grants. This approach will also position them strategically for the inevitable recovery and a surge in intra-continental money flows. As difficult as it may be to appreciate today, the pandemic has the potential to reconfigure the global remittances industry to the benefit of all, and Africa is positioned to lead the trend.

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Editor: Dr. A. Lee Gilbert

Editor-in-chief: Prof. Sam Park

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