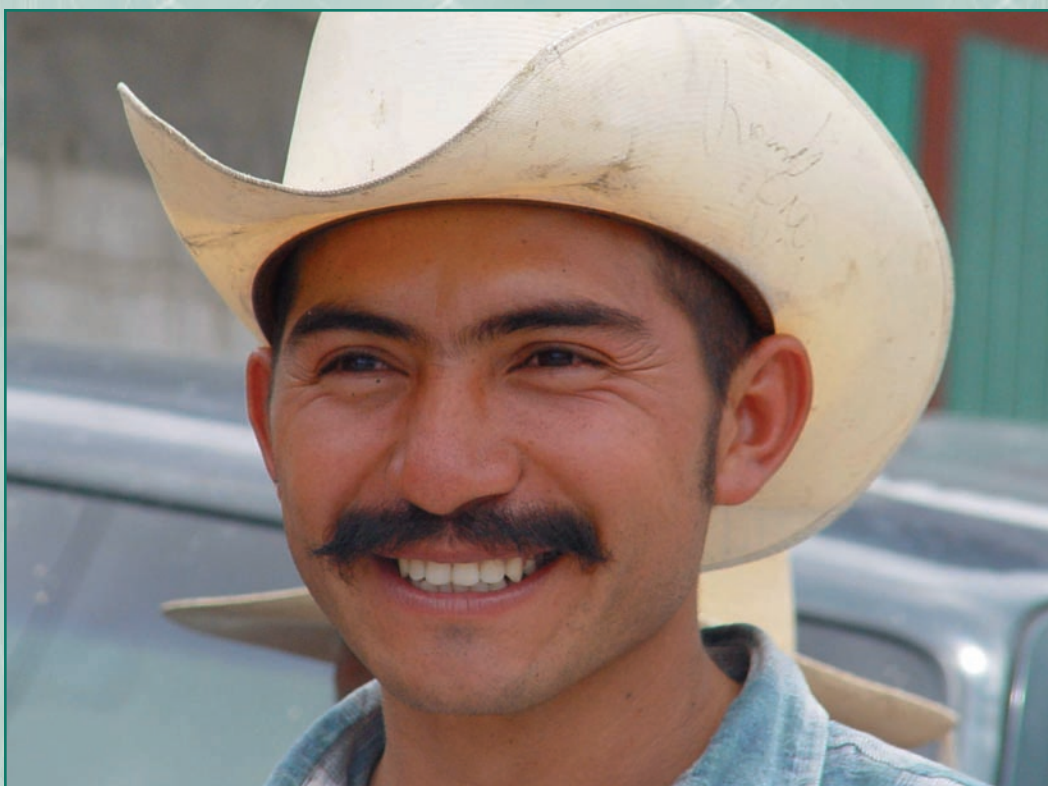


# The U.S.–Mexico Remittance Corridor

*Lessons on Shifting from Informal to Formal  
Transfer Systems*

*Raúl Hernández-Coss*





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# Foreword

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The World Bank would like to thank the Working Group of the APEC Initiative on Remittance Systems for the opportunity to prepare this case study. The case study seeks to contribute to the growing literature on remittance transfer systems and tries to underline the importance of the remittance flows to global development. Additionally, it emphasizes the need to create an adequate balance between the regulatory framework and the creation of incentives that foster the use of formal fund transfer systems. The protection of the integrity of the remittance flows from those which may be linked to criminal activities is also intended.

The work hereby presented is the first effort to analyze, from a bilateral point of view, the relevant issues between the economies that conform a remittance corridor, and has been possible thanks to the interaction of the research team with authorities of Mexico and the United States.

The case study of the United States-Mexico remittances corridor is analyzed following the three stages of the fund transfer process: Origination, Intermediary, and Distribution. Each stage presents different challenges and opportunities for the market players. The case study also intends to underline some of the critical themes that identify the corridor, the areas in which progress has been made in the past years, and the experiences that could serve other economies to transform their own remittance corridors into transparent and more competitive systems.

The World Bank is committed to support the remittance-receiving economies to maximize the productive impact of remittances and to protect their integrity, while it promotes the integration of the sender and the recipient parties to formal financial services.

**Margery Waxman**

*Director*

*Financial Market Integrity*





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**Raúl Hernández-Coss**

*Washington, D.C.*

*October 29, 2004*

# Acronyms and Abbreviations

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AML	Anti-Money Laundering
AMUCSS	Asociación Mexicana de Uniones de Crédito del Sector Social
ATM	Automated Teller Machine
BANAMEX	Banco Nacional de México
BANSEFI	Banco del Ahorro Nacional y Servicios Financieros
BANXICO	Banco de México
BASC	Business Anti-Smuggling Coalition
BBVA	Banco Bilbao Vizcaya Argentaria
BTS	Bancomer Transfer Services
CECOBAN	Cámara de Compensación Electrónica Nacional
CFATF	Caribbean Financial Action Task Force
CFT	Combating the Financing of Terrorism
CONAPO	Consejo Nacional de Población (Mexican National Population Council)
FATF	Financial Action Task Force on Money Laundering
FDI	Foreign Direct Investment
FDIC	Federal Deposit Insurance Corporation
FedACH <sup>SM</sup>	Federal Reserve Automated Clearing House
FFT	Formal Funds Transfer
FIU	Financial Intelligence Unit
FMM	Finance Ministers Meeting
GDP	Gross Domestic Product
HSBC	Hong Kong and Shanghai Banking Corporation Limited
HTAs	Home Town Associations
IADB	Inter-American Development Bank
IFT	Informal Funds Transfer
ILO	International Labor Organization
IMF	International Monetary Fund
IMF BOP	IMF Balance of Payments
INS	Immigration and Naturalization Service
IOM	International Organization for Migration
KYC	Know Your Customer
LCCU	Latino Community Credit Union
LOAC	General Law of Organizations and Institutions of Auxiliary Credit Activities
LSMS	Living Standard Measurement Survey
MCAS	Matricula Consular de Alta Seguridad
MSB	Money Services Business
MIF	Multilateral Investment Fund
MTO	Money Transfer Operator
NATF	The New Alliance Task Force
NGO	Nongovernmental Organization
OAS/CICAD	Organization of American States/Inter-American Drug Abuse Control Commission
OECD	Organization for Economic Co-operation and Development
OFAC	Office of Foreign Assets Control

PMI	Private Mortgage Insurance
PROFECO	Procuraduría Federal del Consumidor
RGO	Receiving Gateway Operator
SCI	Savings and Credit Institutions
SHF	Sociedad Hipotecaria Federal
SWIFT	Society for Worldwide Interbank Financial Telecommunication
UCC	Uniform Commercial Code
WB	World Bank
WOCCU	World Council of Credit Unions
WG	Working Group
WU	Western Union

# Introduction

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## Context

The Asia-Pacific Economic Cooperation (APEC) undertook an initiative to study the impact of alternative remittance systems (ARS), also known as informal funds transfer (IFT) systems, on APEC member economies. In September 2002, the APEC Finance Ministers established a Working Group (WG) on ARS to examine the economic, structural and regulatory factors that encourage the use of ARS in the APEC economies. The World Bank offered a technical report at the request of the APEC ARS co-chairs.

The report, entitled “Informal Fund Transfer Systems in the APEC Region: Initial Findings and a Framework for Further Analysis” (initial APEC report),<sup>1</sup> creates a framework for roughly estimating the magnitude of remittance flows, analyzes incentives for using formal versus informal channels and examines the role of formal financial sector establishments in the provision of remittance services that are compliant with anti-money laundering and combating the financing of terrorism (AML/CFT) standards. When the report was presented at the September 2003 APEC Finance Ministers Meeting (FMM), the FMM “urged the international financial institutions to continue their valuable work on remittances.”<sup>2</sup> Delegates attending the Deputies Finance Ministers Meeting advocated that the World Bank conduct economy-specific follow-up case studies, implementing the WG report’s recommendation to conduct such supplementary research.

The APEC Remittances Initiative Working Group continued its work on remittances in 2004, holding a successful remittance symposium, supporting additional country case

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1. The full report is available on the website [www.amlftf.org](http://www.amlftf.org)

2. Tenth APEC Finance Ministers’ Meeting Joint Ministerial Statement, 4–5 September 2003, Phuket, Thailand.

studies and presenting a summary of the main policy conclusions to the APEC Finance Ministers in September 2004.<sup>3</sup> This paper presents the first of two case studies prepared under the APEC FMM process.<sup>4</sup>

## Objectives

In recent years, as remittance flows and funds transfer systems have become a growing area of interest for international policymakers and researchers, the relevant concepts have become well documented.<sup>5</sup> At the same time that research continues on the nature of informal systems, efforts are under way to induce users to shift from informal to formal transfer systems in order to increase the transparency of remittance flows and enhance their contribution to development in the recipient countries. (Box 1 presents current terminology in the categorization of funds transfer systems.)

### *Transparency*

Many different kinds of flows, motivated by the varying goals of the senders, travel through remittance systems.<sup>6</sup> Better monitoring and evaluation of these flows is important for a number of public policy objectives. Remittances to some countries are of such a magnitude as to significantly affect the size and composition of financial assets, and reliable data on the magnitude and trends are needed to enable national monetary authorities to anticipate and manage their macroeconomic impacts. Moreover, informal funds transfer systems in particular have been identified as weak links in nations' AML/CFT regimes. Funds traveling through transparent formal channels, as opposed to opaque informal channels, can be better monitored and recorded consistent with AML/CFT standards, while protecting the integrity of remittances flows.

---

3. The APEC FMM welcomed the 2004 APEC Remittance Initiative report and expressed support for future activities proposed in the report, including a second Remittance Symposium and work toward improving data on remittances.

4. The other case study looks into the Canada–Vietnam remittances corridor.

5. Researchers have described the macroeconomic environment conducive for worker remittances inflow, incentives and factors that keep IFT systems popular, the general implications of these systems for the growing global task of AML/CFT and ideas for enhancing the development impact of these large international monetary flows. See World Bank, *Report and Conclusions of the International Conference on Migrant Remittances: Development Impact, Opportunities for the Financial Sector and Future Prospects*, London, UK, (2003); *Informal Funds Transfer Systems: An Analysis of the Hawala System* (2003); *Worker's Remittances: An Important and Stable Source of External Development Finance*. In *Global Development Finance* (2003); Orozco, *Worker Remittances: Market, Money and Reduced Costs*(2003); *Remittances and Markets: New Players and Practices* (2000); Sander, *Migrant Remittances to Developing Countries* (2003).

6. Personal remittances, such as migrant worker remittances, have not been widely associated with money laundering schemes, with the exception of “smurfing” (dividing transfers into smaller packages to evade reporting requirements on larger amounts). Larger transfers, such as those related to trade, generally have higher utility for money laundering schemes than do personal transfers of small amounts.

### Box 1. The Complexity of Definitions

Funds transfer systems may be characterized by different criteria depending on the perspective of the analyst. As the international standard setter on anti-money laundering and combating the financing of terrorism (AML/CFT), FATF generally describes “formal” funds transfer systems as those included in the regulated financial system, leaving all other methods in the “informal” category.

*“Formal” vs. “Informal”:* Formal systems are characterized by participation in the regulated financial sector (under FATF’s description). Such participation means that the institution involved in money transfer is supervised by government agencies and laws that determine their creation, characteristics, operations, and closure. Formal systems typically include banks and credit unions, money transfer operators (MTOs) and other wire transfer services, and postal services. Informal systems encompass everything else—ethnic stores, travel agencies, moneychangers, *hawala*-type systems, courier services, hand-delivery, and so on.

*“Legal” vs. “Illegal”:* A funds transfer system’s legal status depends on the laws in effect in the jurisdiction(s) in which it operates. Legal systems typically include all FFT systems in the regulated financial sector. Other funds transfer systems may or may not be legal in a particular jurisdiction. Some jurisdictions, by electing not to regulate or sanction various forms of funds transfer, effectively recognize or tolerate those forms. Where people have devised and used methods to transfer money that are simply ignored by the law, the funds transfer systems operate openly, without a prescriptive or prohibitive legal status.

*Licensing and Registration:* According to FATF’s Special Recommendation VI, all funds transfer systems (formal and informal) should be licensed or registered with governing authorities. Of course, mere licensing or registration does not mean that a system is supervised in the same way as institutions in the regulated financial sector. According to the June 2003 International Best Practices Paper, licensing implies that the regulatory body has inspected and sanctioned the particular operator to conduct such a business, while registration simply means that the operator has been entered into the regulator’s list of operators.

Further complicating attempts to categorize funds transfer systems is the fact that FFT systems may use the services of IFT systems, and vice-versa. This often means that legally operating services conduct illegal transactions, and vice-versa, somewhere along the path of a money transfer.

*Sources:* FATF, World Bank.

### *Development Potential*

The development contribution of remittances can also be enhanced to the extent that the shift of flows to formal institutions encourages greater saving and improves the allocation of investment resources. The formalization of remittance flows also provides a means of opening the access of lower-income families to a broader range of financial services, thereby providing them greater opportunities for improved earnings and management of their financial risks. It is difficult to participate in the mainstream economy without a savings or checking account. The provision by financial institutions of inclusive and integrated services for remittance customers, such as current account services, savings, credit, and mortgage products could greatly improve their economic prospects. Furthermore, remitting customers can represent a profitable growth opportunity for financial institutions, including microfinance institutions that can help to link commercial banks to retail clients in poor neighborhoods and rural areas.

**Table 1. Growth in Mexican GDP and Remittance Receipts, 1997–2003**  
(percent)

	1997	1998	1999	2000	2001	2002	2003
<i>GDP</i>	6.8	4.9	3.7	6.6	–0.1	0.7	1.3
<i>Remittances</i>	15.0	–2.2	24.6	11.2	35.3	10.3	35.2

Source: Banxico.

**Table 2. Relative Importance of Workers Remittances to the Mexican Economy**  
1998–2003

As percentage of:	1998	1999	2000	2001	2002	2003
Crude oil exports	74.5	66.7	44.2	76.7	74.9	78.0
Tourist expenditures	63.3	81.8	79.2	105.9	110.8	138.9
Foreign Direct Investment (FDI)	38.5	44.8	39.6	33.2	66.4	124.2
Gross Domestic Product	1.1	1.2	1.1	1.4	1.5	2.2

Source: Banxico.

## Scope and Focus of the Paper

The paper examines the experience of the U.S.-Mexico remittances corridor over the last eight years and seeks to derive specific lessons that could be applicable to other remittance corridors for shifting from informal to formal systems.<sup>7</sup> Mexico ranks among the top three remittance recipients in the world, and the U.S.-Mexico corridor is at an advanced stage of shifting from informal to formal systems. It thus represents a Mature Remittance Corridor in the terms of the APEC Remittance Initiative. In comparison with other recipient countries, which typically receive significant inflows from more than one country, Mexico has a unique bilateral relationship with the United States, from which the great bulk of its remittance receipts originate.

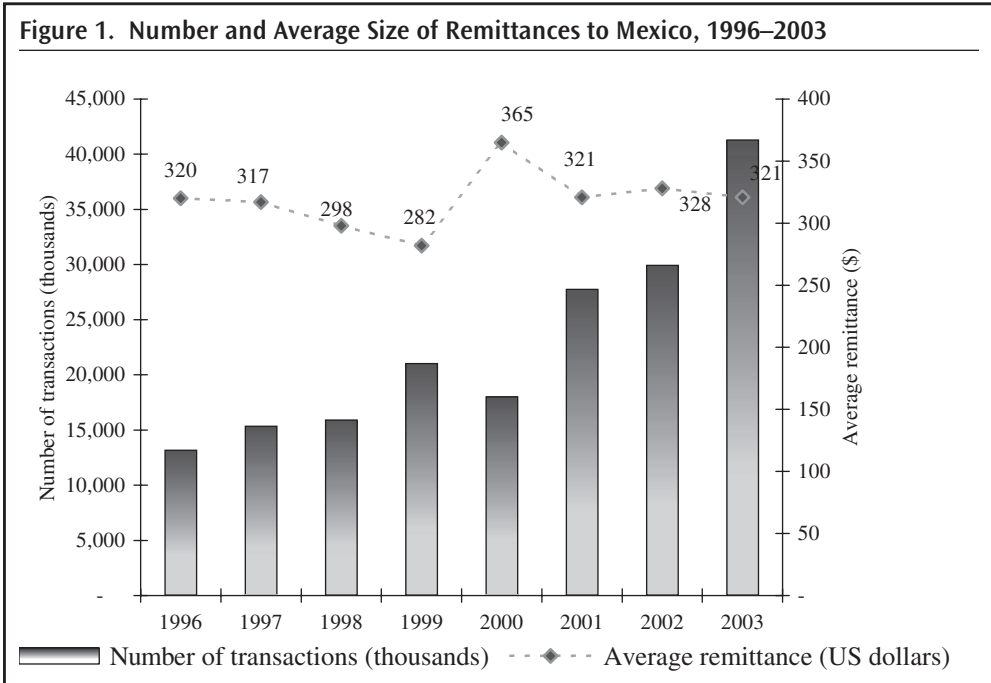
### *Significance of Remittances in Mexico*

From 1998 to 2003, worker remittances grew rapidly and became increasingly important to Mexico's economy (Tables 1 and 2).<sup>8</sup> In 2003, remittances were Mexico's second largest source of external finance after oil, eclipsing foreign direct investment (FDI) and tourism receipts. Recorded remittance flows received in Mexico during 2003 surpassed US\$13 bil-

7. While many aspects of remittances deserve further research, including the uses of remittance funds by the recipient, the scope of this project focuses primarily on lessons for moving from informal to formal systems.

8. The data presented here are remittance flows reported by the *Banco de México (Banxico)*, comprised principally of remittances made through formal channels. Not captured are flows through informal channels that go unreported. Although extremely difficult to estimate, a comparison of reported flows with IMF balance of payments data and other sources suggest that unreported remittances have been falling in recent years and are now a small proportion of the total.





Source: Banxico.

lion, an increase of 35 percent with respect to 2002, and were equivalent to 79 percent of total oil revenues and approximately 2.2 percent of the GDP in the same year. In 2003, the contribution to the economy from remittances exceeded that from FDI by more than US\$2.6 billion. Remittance growth has been driven primarily by the large number of Mexican workers who have crossed the border in search of higher paying job opportunities in the United States.<sup>9</sup> The number of reported remittance transactions exceeded 41 million in 2003, up 38 percent from the previous year (Figure 1). The average remittance amount in 2003 was US\$321—86 percent of those remittances were made by electronic transfer.<sup>10</sup>

### *The U.S.-Mexico Remittance Corridor*

The paper describes recent developments in the U.S.-Mexico corridor, as worker remittances have shifted from informal to formal channels, and identifies areas within the corridor that could be further developed to continue the momentum and enhance its development potential. A considerable amount of detailed research has been carried out in both the United States and Mexico on migrant workers, their families in Mexico, and the remittance processes and

9. The shift from informal to formal channels and better recording methods also results in the statistical capture of a larger proportion of total remittance flows. To that extent, the rate of growth shown by the Banxico data probably overstates the growth of actual total remittances.

10. Information provided by Banxico. The average size of reported remittances peaked at \$365 in 2000 and has fallen since. This ostensible decline may largely reflect, however, the improved scope of reporting with the statistical system now capturing smaller transactions that previously went unreported.

institutions linking them. The present paper does not pretend to address all the issues involved, but rather focuses on a few selected aspects of the remittance experience. For purposes of the discussion, the remittance process is broken down into three stages: the *First Mile*, when decisions are in the hands of the remittance sender; the *Intermediary Stage*, comprising the systems that facilitate the cross-border transfer of funds; and the *Last Mile*, where the funds reach the hands of the remittance recipient. By analyzing the objectives, obstacles, incentives, and changes occurring at each of these stages in the U.S.-Mexico corridor, this exercise seeks to draw lessons for other remittance sending and receiving countries that seek to encourage formalization of the flows.

With respect to the *First Mile*, the study team set out to explore why migrants have increasingly been opting to remit through formal electronic channels, as evidenced by the rapid growth of remittances recorded by Mexico's central bank (Banxico). Applying the analytical framework from the initial APEC report, the study examines the incentives that shape users' choices among the various available formal or informal remittance channels. This analysis identified four critical themes:

- The access of migrant workers to formal channels;
- The level of financial awareness among migrants;
- The impact of bilateral initiatives between the U.S. and Mexican governments to facilitate remittances; and
- The impact of regulations on the market.

At the *Intermediary Stage*, the study team hypothesized that the growth of the formal market has been spurred primarily by competition among private sector entities. The exploration of the intermediary stage confirmed that competition has been instrumental in driving down prices and making formal services more attractive for migrant workers. Critical themes that emerged in this exploration included:

- The entry of new market competitors into the corridor and the implications of remaining constraints on competition;
- The impact of new technology on competition and access to services;
- Competitive strategies among intermediaries to win over remitting customers; and
- The consequent declining role of IFT systems in the corridor.

The study team assumed that *Last Mile* issues play a critical role in determining how senders choose to remit at the First Mile. In this regard, recipients' access to distribution channels is a critical factor. The same incentives analysis was applied in the Last Mile as was utilized at the First Mile. The findings confirmed that formal channels had "paved the road" to Mexico's urban and regional centers, making formal channels more accessible and efficient. Other themes that emerged included:

- How remittance flows reflect long-established migration patterns between Mexico and the United States;
- The efforts of intermediaries to develop products that familiarize recipients with account-holding and good financial practices;

- The effects that remittances can have on communities in Mexico; and
- The critical need to extend the “paved road” into rural regions.

The report’s lessons and recommendations for shifting from informal to formal systems are derived from the analysis of the features and themes discussed in the First Mile, Intermediary Stage and Last Mile.

### *Outline of this Paper*

The remainder of the paper is organized into five sections. Sections I-III describe, respectively, the features of the First Mile, the intermediary stage, and the Last Mile. Section IV highlights the lessons learned from the U.S.-Mexico corridor. Section V puts forth the resulting policy recommendations. Finally, six annexes complement the report with a more detailed description of the operational features of the remittance corridor, an overview of the market, descriptions of the U.S. and Mexican regulatory frameworks, an incentives analysis, and a working document on some receiving-end issues based on the field research.



## At the First Mile

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As summarized in Box 2, the past decade has been marked by a rapid influx of Mexican workers into the United States, which in turn led to the strong growth of remittances back to Mexico described above. The typical remitter is a hard-working immigrant, documented or undocumented, who wants to improve the life of his or her family and community of origin by providing additional income. The typical remittance to Mexico occurs about once a month in amounts that have averaged between US\$280 and US\$370 over the past eight years. The longer a migrant stays in the United States, the more his/her remittances tends to decrease over time. Even so, studies show that immigrants who have been established in the United States for 20–30 years continue to send money to Mexico, albeit with less frequency (Suro 2003b).

The origination network at the First Mile consists of the intermediaries that collect the funds of remitters for transmission to recipients abroad.<sup>11</sup> The sender is the creator of the transaction.<sup>12</sup> Recipients may provide information about available channels by which they can receive a remittance, but ultimately the sender decides how a remittance is sent. The criteria applied by migrants in making that choice commonly include the relative accessibility and perceived reliability of the service provider, a judgment that may be influenced by cultural familiarity; and the cost, speed, and confidentiality of the transaction. Service providers, in turn, are motivated to supply and improve their offerings to remitters in response to perceived profit opportunities and competitive pressures, shaped in part by the regulatory environment.

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11. In the same way, distribution networks at the Last Mile encompass intermediaries that disburse funds to recipients.

12. From a legal perspective, it is the intermediary that is treated as the originator of the transaction, since it (rather than the remittance sender) carries the legal warranties that the payment is legitimate and compliant with all laws.

## Box 2. Immigration from Mexico to U.S.

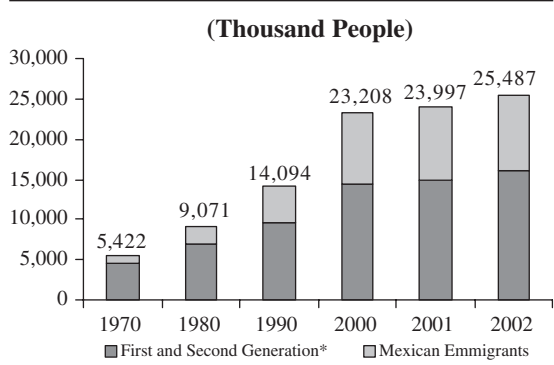
As shown in Figure 2.1, the Mexican-origin population living in the United States has grown tremendously over the past few decades in response to economic instability in Mexico and the greater job and income opportunities available in the United States (see Table 2.1).

According to CONAPO, the Mexican-origin population living in the United States grew from 14 million to more than 25 million people from 1990 to 2002 (see Figure 2.1).

In 2002, more than 9 million of the 25 million were themselves migrants from Mexico, and the rest were first and second generation Americans of Mexican origin.

For the United States this inflow has brought thousands of potential workers to fill roles in the labor force, while for Mexico it has contributed an important source of income to their Mexican families who have stayed at home.

**Figure 2.1. Mexican Origin Population Living in the United States, 1970–2002**



\*First Generation means population born in the US with Mexican parents, while Second Generation means population born in the US without Mexican parents, but Mexican origin.

Source: CONAPO.

**Table 2.1. Population and Economic Indicators in U.S. and Mexico**

	United States	Mexico
Population (millions)	291 (2003)	101 (2002)
Population Growth Rate (%)	0.92	1.5
GDP (US\$ billion)	10,988 (2001)	637 (2003)
GDP per capita (US\$)	35,060 (2002)	5,910 (2002)

Sources: U.S. Census Bureau, World Bank, Bureau of Economic Analysis.

The following discussion describes some of the principal forces that have been affecting remitter and service provider decisions in the United States and thereby changing the market for remittances from the United States to Mexico from a largely informal industry to one primarily based on electronic transfers through formal institutions.

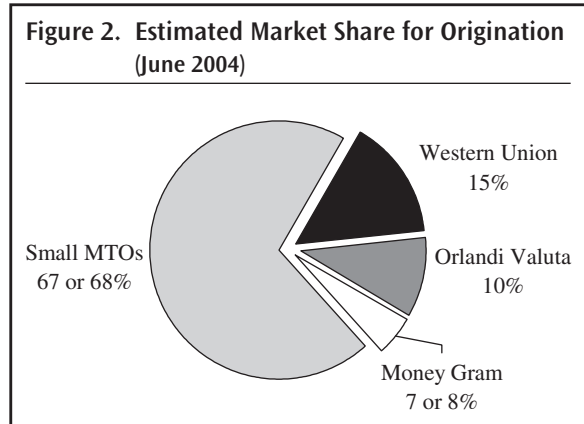
- Increasing accessibility of formal channels;
- Growing financial awareness among migrants;
- Improving market information; and
- Bilateral initiatives by the central governments and monetary authorities of the two countries.

The discussion also highlights some continuing obstacles, particularly the need to rationalize the regulatory framework governing the remittance process in the United States, as well as some challenges presented by the shift to formal systems.

### Increased Accessibility

Points of entry in the United States for a formal remittance include banks and credit unions, post offices, money transfer operators (MTOs) at their own outlets, individual businesses and chain stores (grocery, convenience, department) that serve as independent operators or as agents for MTOs. Data on the actual number or percentages accounted for by each of these points of entry are not available. The incompleteness of the data on

points of entry may derive in part from their very large number and the wide variety of access points to formal remittance systems in the United States (Figure 2). The perception that formal remittance systems have become more accessible in the past several years is supported by the rapid growth in the use of their services. As discussed further on, this growth reflects an evolution on the part of intermediaries, which have increasingly adapted to migrants' preferences and worked to attract their business.



Source: World Bank based on interviews with market players.

### The “*Matrícula Consular*”

Although half or more of Mexican immigrants to the United States are properly documented, many migrant workers find their access to formal remittance channels blocked by their lack of accepted identification documents. There is thus a need to promote alternative forms of identification that allow immigrants and their economic viability to be recognized. One effort in this regard has been the upgrading of the *Matrícula Consular de Alta Seguridad* (MCAS), an official identity document issued by Mexican Consulates for their nationals living abroad (Box 3). In response to concerns that use of the card could create a security risk for the United States, the Mexican authorities have taken measures to control the issuance of the cards, certify the identity of the card holder, and ensure that multiple cards are not issued under the same name.

Partly as a result of this effort, banks and credit unions have opened accounts for Mexican migrants, thereby extending the latter's access to financial services, including the sending of remittances, while increasing their own share of the remittance market. The MCAS is now recognized as a valid identity document in 32 states, more than 1,000 police agencies, 409 cities, 125 counties and 280 banking institutions, including Wells Fargo, Bank of America, US Bank, Citibank, HSBC, Washington Mutual, Union Bank of California, Harris Bank and Banco Popular, among others. Its acceptance by financial institutions has helped migrants to access financial services, including the sending of remittances.

### Box 3. The Mexican Consular Identification Card

An identification document for Mexicans living abroad has been issued for more than 133 years by Mexican consulates worldwide. Mexican consulates began issuing these certificates in 1871. They are now known as the *Matricula Consular de Alta Seguridad* (MCAS) (high security consular registration document).

Consular registration facilitates access to consular protection and services, while helping relatives and authorities of the sending state locate their nationals overseas. Considered evidence of Mexican nationality, the consular identification document has evolved from a paper certificate to a portable card, similar to drivers' licenses, with many security features. Likewise, its use has evolved from a means of accessing consular services to an identification document like a passport or state I.D. that allows the carrier access to services such as bank accounts and other financial products.

In order to obtain the MCAS the applicant must meet four basic requirements:

- ◆ Prove nationality by presenting a Mexican birth certificate, valid Mexican passport, or certification or declaration of Mexican nationality.
- ◆ Prove identity by presenting any official identification issued by a Mexican or foreign authority—passport, drivers licenses, state I.D. card, INS work permission, Mexican voter I.D., U.S. green card, official school records or police clearance report with a cancelled picture.
- ◆ Prove residency by presenting any of the following documents: utility bills, any official I.D. showing address, and pieces of official correspondence (U.S. or Mexican Social Security, U.S. Internal Revenue Service).
- ◆ Pay fee of \$26.

Consular registration is recognized by international law, and the cards are proof of such registration. Essentially, the *matricula consular* is not significantly different from other identity documents such as passports. The MCAS has the following security features:

- ◆ Visual and hidden security provisions to avoid falsification.
- ◆ Centralized system support to avoid duplication and confirm the authenticity of required documents and information.
- ◆ Stop List Data Base system validation. Robust verification procedure of nationality and identity.

The procedures and requirements are the same as those of the Mexican High Security Passport System.

*Source:* Ministry of Foreign Affairs of Mexico.

### *Continuing Obstacles to Formal Financial Services*

While access to formal channels has grown, remittance senders still face obstacles, some self-imposed, to using formal systems. Despite the massive size of the U.S. financial sector, many Mexican migrants have difficulty finding formal financial services that meet their needs. The desire for anonymity, for example, leads many migrants to avoid banking channels. Not surprisingly, migrant workers of dubious legal status are wary of doing business with institutions that appear attached to public authorities. Many Mexican migrants also choose to avoid the banking system for lack of confidence in the safety of their money. (This problem is also present at the Last Mile.) In general, Mexicans have traditionally been wary of the safety of banks, and Mexico's banking crisis in the mid-1990s further damaged the reputational capital of Mexico's banking system and heightened suspicions that banks generally were unreliable.



Personal connections and cultural familiarity play a key role in funds transfer system use among Mexican migrants. Remittances in the U.S.-Mexico corridor, and the informal systems that facilitate them, are largely an extension of cross-border social connections between migrants and their home communities. Because personal and cultural factors are important, the cold, formal appearance of banks, and the reticent manner in which they are frequently received, often intimidates migrants. Thus, ethnic and other important ties that migrants feel with some informal service providers ultimately contribute a greater sense of comfort and security that the money transmitted will actually be received by the intended beneficiaries, thus justifying in the remitter's mind the higher costs involved.

Systemic and social obstacles also prevent Mexican migrant workers from becoming financially assimilated, or even from learning of the full range of formal remitting options available. Because banks in the United States have not traditionally sought their business, many poor households and minority populations, including working-class Mexican migrants, continue to rely on alternative financial services, such as check cashers, payday lenders, and pawnshops, even though their high costs cut into the already meager paycheck of migrants and leave less money to remit home.

## Financial Awareness among Migrants

Although the choices of many migrants remain constrained by the social and cultural inhibitions mentioned above, remitters at the First Mile also benefit from being part of a close-knit migrant community, and they often learn from each other about the remittance channel that best suits their needs. Field work conducted by the study team in U.S. communities with high concentrations of migrant workers revealed that remitters were generally aware of how the combination of fees and foreign exchange rates affected prices and how to discern the best deal. In particular, migrants who held bank accounts were well informed about interest and exchange rates in the United States and Mexico and how they affected the value of their holdings and remittances.

Nevertheless, many senders can still benefit from better information and education about the channels, services, and products available to them.<sup>13</sup> Levels of financial education and awareness are not uniformly high across migrant communities. Programs that bring market information to the remitting community, as opposed to leaving remitters to research and discover options themselves, could have a tremendous impact on the remittances market (Box 4).<sup>14</sup> Such an effort is being made by a Mexican government agency, PROFECO, that periodically issues information on fees for sending money to Mexico from the main U.S. cities where these flows originate.<sup>15</sup> Continuing to raise awareness and education among remitters about their options for formal remittances services is key to sustaining momentum and further expanding the use of formal remittance channels.

13. One study indicated that although participants were very open to using new technologies and product innovations to lower costs for remitting, more than three in four respondents said they lacked knowledge about available options. See: Bendixen & Associates (2002).

14. Several organizations, including Fannie Mae and the YMCA, already have programs to inform migrant communities on critical aspects of finances, home owning, employment, education and government services. Incorporating remittance information in such programs would be a natural connection.

15. *Procuraduría Federal del Consumidor*.

#### Box 4. The New Alliance Task Force of the FDIC

To educate the young immigrants on their financial options, the Federal Deposit Insurance Corporation and the Consulate General of Mexico formed the New Alliance Task Force (NATF) in May 2003. Its mission is to improve access to the U.S. banking system among recent immigrants and to take steps to carry out the Action Plan outlined in the U.S.-Mexico Partnership for Prosperity Agreement.

The 55 members of the NATF include banks, community-based organizations, federal regulators, secondary market companies, and providers of private mortgage insurance. The topics covered by NATF working groups include financial education, bank products and services, mortgage products, and social projects.

By December 2003, 35,000 immigrants in the Midwest had participated in financial education classes or workshops, and in the preceding 18 months there had been 50,000 new accounts opened in Chicago containing \$100 million in deposits.

*Source:* FDIC, Chicago.

## Market Information

While the current remittances industry in the United States is generally well-developed and diverse, there are some major challenges to organizing information on that industry and bringing it to the attention of those who need it. Some of these challenges are described below.

*Service providers.* The first challenge in the U.S. remittances industry is to estimate how many entities actually provide remittances services in order to gauge the quality of market competition and the need for regulation. The available data or indicators are inadequate for making a reliable estimate of the number of points of entry for remittances in the United States. Requirements to register money transfer agents have been only marginally helpful, since they tend to focus on identifying the corporate heads of money transfer businesses and not on accounting for all their agents or branches. Also, many transfer agents simply do not register, partly because of linguistic and other barriers.

*Products and services.* Identifying available remittance products in the market is a second area that could benefit from further documentation. Doing so could help authorities to formulate appropriate regulations to govern their use. Services range from simple electronic transfer operations to more complex offsetting accounting schemes. Other remittance products include travelers' checks and money orders. The largest undocumented segment of remittance products are courier services based on personal contacts that are deeply engrained in cultural and ethnic enclaves of society. Although formal institutions can make inroads into these communities, it is difficult for formal institutions to rival the level of personal trust in some informal systems. The steady development of product innovations in the remittances market, such as stored-value cards, add to the difficulty of tracking remittance products.

*Market size and costs.* Quantifying the customer base for remittance services has its natural challenges. Remittance products appeal to, among others, unbanked, undocumented immigrants and those who have had bad experiences with the government and formal institutions. It is difficult to collect demographic data on such customers. Such data would help potential service providers to make their investment and marketing decisions.

Prices and the exchange rates for remittance transactions are determined at the First Mile points of entry.<sup>16</sup> In Mexico, PROFECO has been working through Mexican consulates in the United States, and through its website, to distribute information on remittance costs. This information is based on the average volume of transfers sent each Monday, as voluntarily reported by some of the biggest remittance companies. Although this data represent an advance, the information needs to be confirmed. Moreover, the average price derived from this data may not be a reliable indicator of costs to senders, since prices vary widely according to the number of competitors in each location.

Many remittance companies are currently unwilling to fully disclose price information. Efforts in the United States and Mexico to improve market information generally could contribute to the efficiency of the market by generating interest from the private sector and increasing the number of players in the industry. Also, by increasing the amount of information available on the fees charged by the various providers of remittance services and on the features of the services they provide, migrants would be able to choose those options that are most convenient in terms of cost, convenience, and other factors (Box 5).

## Bilateral Initiatives

Bilateral initiatives between the U.S. and Mexican authorities and industries have encouraged the shift from informal to formal systems. Recognizing the need for cooperative measures to manage the flow of remittances, the two countries have worked together to improve money transfer systems. Their agreements represent initial attempts to streamline the remittance process and to enhance the productive use of remitted funds. Following are some examples of the policy initiatives undertaken to promote the use of formal funds transfer (FFT) systems.

The U.S.-Mexico Partnership for Prosperity, a private-public alliance launched in September 2001, has set out an action plan to promote economic development in the poorer regions of Mexico. Although the Partnership is dealing with several important bilateral development issues, remittances is the area that has received the most attention. In this area, the goal of the agreement is twofold: first, to reduce the cost of transactions; and second, to facilitate the transformation of remittances into productive activities, generating access to more integrated financial services.

The strategy for reducing the cost of remittance services has been to promote competition by stimulating the entry of banks and credit unions into the First Mile market, encouraging the opening of accounts using the MCAS as a valid ID, increasing the information available regarding the different services offered to the customers, and enabling banks to compete with a more efficient and transparent price structure. For the transformation of remittances into productive activities, the Mexican Government is promoting banking for migrants and their families by supporting savings and credit institutions through the *Banco del Ahorro Nacional y Servicios Financieros* (BANSEFI) and the People's Network (*L@ Red de la Gente*). The latter, launched by BANSEFI, is a cooperative network

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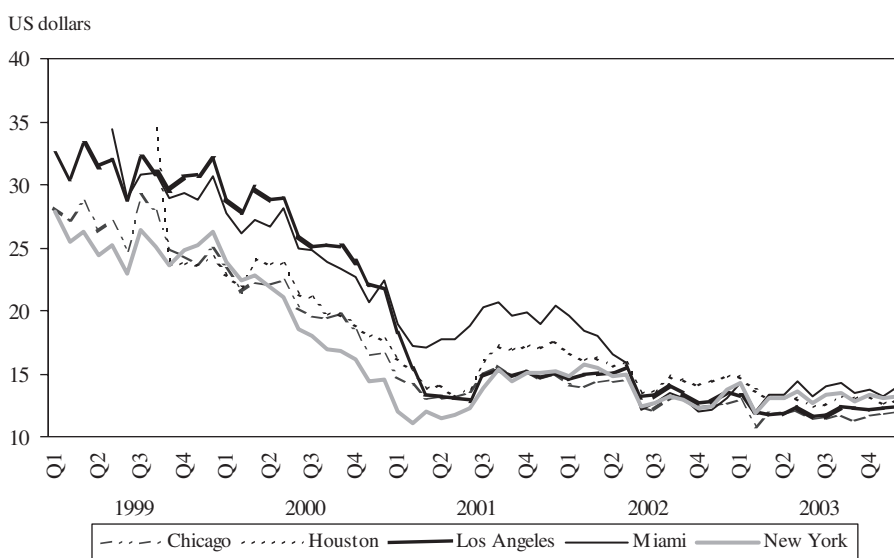
16. See Annex II for an overview of the general cost and price structure in the remittances market.

## Box 5. The Reduction of Transfer Cost

One of the main features of the U.S.-Mexico remittance corridor has been the declining transfer cost over the past eight years; however, there are certain characteristics that need to be considered when examining the decline in transfer cost. These include:

1. The cost reduction is different depending on the city of origin of the transaction. This could be explained in part by different degrees of competition among market players and the formation of regional corridors. Interviews with market players suggested discriminatory practices among markets. In the First Mile, when the competition is intense in one city, the transfer cost decreases in that city, but may increase in another city where the competition is less intense.
2. The cost reduction is different depending on the remittance product used. In some regional corridors the banks have shown the larger decline in cost (Figure B), while in other cities MTOs' products could have the lowest rate (Figure C).

**Figure A. Total Cost of Sending US\$300 from the U.S. to Mexico, 1999–2003**



Source: PROFECO

Following are two examples based on PROFECO's data of voluntary reporting cost by market players. In 1998, PROFECO began recording information on the transfer costs from cities in the U.S. to Mexico. Currently, PROFECO records information from 9 cities (Chicago, Los Angeles, New York, Dallas, Miami, Houston, Sacramento, San Jose and Indianapolis) and 71 products that are offered to remittance senders.

### **Sacramento, California.**

In May 2002, Sacramento presented the highest average transfer cost among banks—US\$22.61. In October 2004, the average cost reported was US\$10.24, representing a 55 percent decrease in transfer cost with respect to 2002. For those products offered by MTOs, PROFECO records two types of products: a transfer in minutes (*dinero en minutos*) and a 24-hour transfer (*dinero al día siguiente*). The former had a cost of US\$19.48 in January 2001, decreasing by 39 percent to US\$11.94 in May 2004. For the 24-hour transfer, the cost in January 2001 was US\$24.81. By February 2003, the cost had decreased to US\$9.16, representing a 63 percent decrease with respect to the 2001 figure.

(continued)

**Box 5. The Reduction of Transfer Cost (Continued)**

**Figure B. Total Cost of Sending US\$300 from Sacramento to Mexico, 2001–2004**

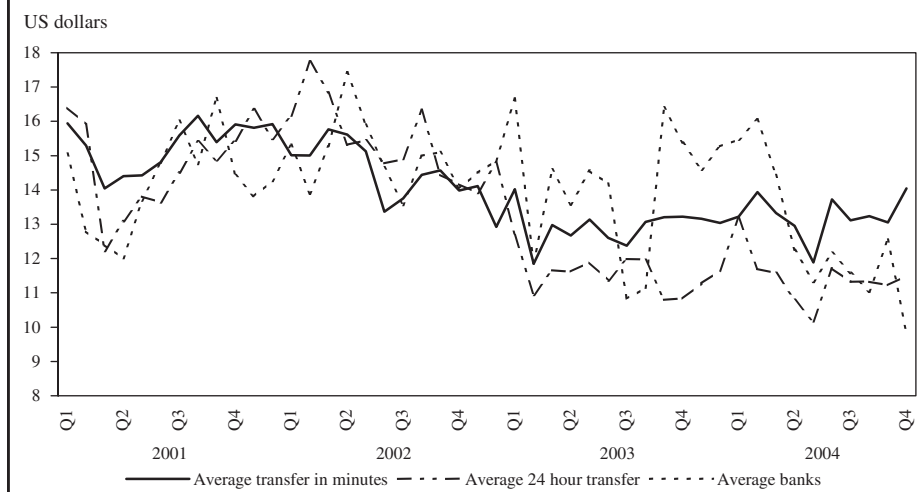


Source: PROFECO

**Chicago, Illinois.**

In January 2003, Chicago presented the highest average transfer cost among banks—US\$16.66. In October 2004, the average cost reported was US\$9.83, representing a 41 percent decrease in transfer cost with respect to 2003. For MTOs' transfer in minutes (*dinero en minutos*), the cost decreased from US\$16.16 in August 2002 to US\$11.88 in May 2004—a 26 percent decrease. For MTOs' 24 hour transfers (*dinero al día siguiente*), the cost in May 2004 was US\$10.16, representing a 75 decrease from the US\$17.74 cost in February 2002.

**Figure C. Total Cost of Sending US\$300 from Chicago to Mexico, 2001–2004**



Source: PROFECO

of delivery points, that includes credit unions, savings and loans, and other small financial institutions. This government-sponsored commercial alliance offers remittances as well as other financial services to people who generally do not have access to banks.

In another bilateral initiative, the U.S. Federal Reserve System is working to expand its Federal Reserve Automated Clearing House (FedACH) to support two-way credit transactions between the two countries and facilitate the transfer of all types of payments through formal banking channels.<sup>17</sup> This technological innovation will be further discussed in the section describing the intermediary stage.

## Harmonizing Regulations in the United States<sup>18</sup>

Given the particular vulnerability of financial transactions and institutions to fraud and mismanagement, regulatory oversight is essential to maintaining customer confidence and the development and integrity of the system.<sup>19</sup> One overall need in the United States, however, is to explore ways to make the regulations of its various domestic authorities compatible and consistent. The different layers of regulations imposed by federal and state authorities, as well as differences in regulations among the states, create regulatory impediments, including high costs of compliance, that may prevent some potential competitors from entering the market. Differing degrees of regulation applied to banks and MTOs may also affect the way in which remittance services are provided.

*Regulations by level of government.* Regulations differ from state to state, and often states do not offer reciprocity. Non-bank remittance companies, such as MTOs and their agents, are licensed and regulated by states. Consequently, a wire transfer service conducting business in several states must ensure that it stays compliant in each individual state. Competition is impeded to the extent that small service providers trying to enter the market are overwhelmed by the different sets of compliance standards and are unable to cope with associated costs and procedures (Box 6). Such a framework allows remittance companies to discriminate prices based on different local markets. AML/CFT compliance is the key issue at the federal level. Individual states also have passed statutes on this subject. Such laws may further complicate the regulatory landscape for fund transfer systems if state-level AML/CFT regulations are not harmonized with federal laws.

*Regulations by institution.* Regulatory disparities based on type of institution can also limit or distort competition. Several examples were cited to the study team. Banks, MTOs, and credit unions face different regulatory standards based on the nature of their charter or license. Banks are largely federally regulated, while remittance companies are licensed and regulated by states. MTOs are required by law in some jurisdictions, such as California, to present a transparent pricing structure, while banks and credit unions are not. Consumer protection laws may be stronger and more specific for some MTOs at the state level than for federally regulated banks. Migrants can cash paychecks at and send remittances

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17. “FedACH International” is a registered service mark of the Federal Reserve System.

18. Overviews of the regulatory frameworks in the U.S. and Mexico are presented in Annexes III and IV, respectively.

19. As noted above, one of the factors inhibiting some Mexican migrant workers from using formal channels is precisely their lack of confidence in impersonal financial institutions.

## Box 6. Examples of Inconsistencies in State Regulations

### *Licensing and Bonding Requirements*

- ◆ States' bonding requirements differ greatly.
- ◆ About 34 states require licensing for sales of both payment instruments and funds transmission, whereas 11 states require licensing only for payment instrument issuers.
- ◆ Some states have no licensing laws.
- ◆ A few states require a licensee to gain prior approval from the banking department to engage a new "agent" or sales outlet.
- ◆ Where states have receipt requirements, these often differ, as do contract requirements between licensees and authorized delegates or "agents."

### *Interpretation of Laws*

- ◆ Although all states have accepted the definition of money transmission as "transmission of funds by any means," states interpret the definition differently. For example, some recognize Internet schemes and others do not.
- ◆ The scope of the "bank exemption" in state laws regulating wire transfers is uncertain. Not all states exempt out-of-state or state-chartered banks that issue stored value and payment instruments in their state. Even if the bank is exempt as an "issuer," some states have taken the seemingly contradictory position that retailers of the issuer's instruments must be licensed.

### *Degrees of Enforcement and Regulation*

- ◆ California and Massachusetts do not regulate domestic money transfers; only foreign transfers.
- ◆ The severity of state sanctions for failure to operate with a license differs.
- ◆ Some states have no requirement for audited financial statements.
- ◆ A few states require fingerprinting of officers and directors of licensees.
- ◆ Only a few states conduct on-site examinations of licensees even though the statutes require that the licensees pay the expenses associated with these exams.
- ◆ A few states require duplicate filing of suspicious activity reports\* already filed with federal authorities and available to state governments.
- ◆ Even where a statute encompasses licensing of internet funds transmitters, enforcement at the state level tends to be poor.

\*Service providers develop criteria to indicate when suspicious activity occurs in a transaction or series of transactions that could be associated with illegal activity, such as money laundering or terrorist financing. Such reports are filed with authorities.

Source: Interviews with U.S. government officials.

through neighborhood *tiendas* without restriction.<sup>20</sup> Credit unions, in contrast, are put at a competitive disadvantage by restrictions against engaging in check-cashing services and remittances for nonmembers that are outside their field of association. Even though the National Credit Union Administration has taken steps to allow credit unions to expand their services, some restrictions continue to prevent credit unions from matching the convenient package of services offered in the *tienda*.<sup>21</sup>

20. These are one-stop convenience stores that service ethnic enclaves, often run by a member of the ethnic community. These shops may offer financial services, such as check-cashing, money order and remittance services, along with selling groceries and products from the migrants' home country.

21. The National Credit Union Administration is the federal agency that charters and supervises federal credit unions.

One approach to reducing unnecessary overlap would be for state and federal authorities to maintain different spheres of influence. States could focus on prudential and consumer protection regulations, for example, while the federal government focused on AML/CFT compliance. Each entity could avoid legislating in the other's sphere of influence, unless laws or regulations mirrored one another. Criminal law in the United States makes it a felony offense to operate a money-remitting service in violation of state licensing or federal registration requirements.<sup>22</sup> Since this law was revised in the USA Patriot Act, federal prosecutors have made more use of it. It is unique in that it ties together both state and federal regulations under the umbrella of one law, thereby taking a small step toward harmonizing federal and state regulations. States could also benefit from better regulatory coordination among themselves. A good example of this sort of coordination might be to use the process that created the Uniform Commercial Code (UCC), a source of model law for states to emulate, to develop standards for retail wire transfers.

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22. 18 United States Code 1960.



## At the Intermediary Stage

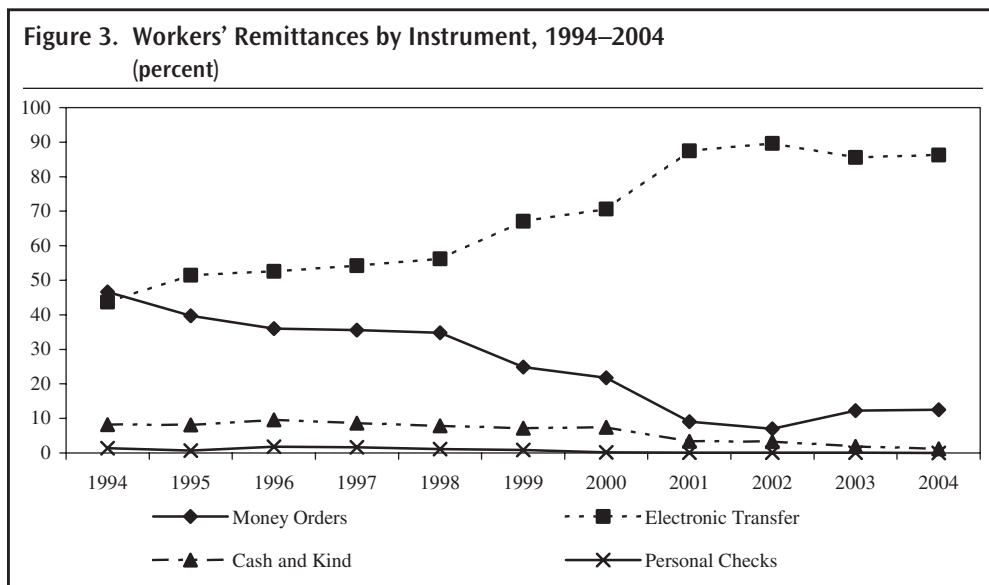
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The intermediary channel involves businesses and funds transfer services, whose principal motivation is profit. Intermediaries respond to the needs of consumers in order to develop and sustain the profitability of their businesses. In the U.S.-Mexico corridor, the remittance business has been characterized over the past several years by a rapid shift from informal to formal systems and the growth of efficient, competitive, formal intermediaries. At the intermediary stage, the key features for the U.S.-Mexico corridor are:

- Increasing competition;
- Technological advance;
- Innovation in services and products;
- The decline of IFT services; and
- Limits on competition.

### Greater Competition

The increasing size of the Mexican population living in the United States has meant a rapid growth in the number of potential remitters. The increase has led in turn to growing interest and competition on the part of fund transfer agents on both sides of the border. The well-established U.S.-Mexico migration relationship provides a reliable foundation for establishing and investing in remittance systems. Competition has diversified and created a dynamic market for remittances.



Source: Banxico.

In the past there was no real “market” for intermediaries in the U.S.-Mexico corridor. The role in the formal sector was dominated by MTOs, such as Western Union and MoneyGram. The emergence of banking institutions as competitors has challenged the dominance of both MTOs and informal operators, as evidenced by the growth of remittances by electronic transfers since 1998 (Figure 3).

In 1994 money orders represented more than 46 percent of the monetary value of all reported transactions, while by 2003 the share of money orders had decreased to 12 percent. In 1994, electronic transfers represented 44 percent of recorded remittances, with all other instruments representing the remaining 10 percent. By 2003, electronic transactions represented 86 percent of all recorded transfers, leaving other instruments with a 1 percent share.<sup>23</sup>

Initially, banks were typically associated with MTOs, usually Western Union, under exclusive contracts that allowed Western Union to conduct most wire transfers using Mexican banks as points of distribution.<sup>24</sup> This arrangement created a virtual monopoly over transfers through the formal system. Once the first banks began moving away from these contractual restrictions, banks became independently competitive in the market. New competition from banks has brought about lower prices, faster service, and more reliable transactions. As a consequence, there is now a “paved road” for remittances between the United States and the urban and regional centers of Mexico. Yet, while competition has increased with the entry of new players, there is still room to expand, in particular to the rural, underserved areas of Mexico.

23. Information provided by Banxico.

24. Key provisions of these contracts would prohibit one party from developing and marketing a product similar to the product being provided under the agreement.

A key asset for banks that want to tap into a remittance corridor is their branch networks for funds capture and distribution. In parallel with the formal transfer system, bank branch networks in the past were being extensively used as depositories, conveyors, and clearing houses for remittance funds managed by informal intermediaries. Banks have reacted to discourage this activity for two main reasons: (1) because of the potential reputational risk involving transactions for unknown operators that could be linked to illicit activities; and (2) to profit directly from the growing volume of remittance transactions. In some instances, banks may have closed the accounts of other intermediaries to reduce the latter's competitive threat.

When banks entered the market as key players, their competitiveness was built on the development of their own electronic networks, which reduced reliance on the MTOs.<sup>25</sup> These new networks have led to faster, more secure transactions and have also incorporated software to allow banks to conduct customer screenings for AML/CFT compliance.<sup>26</sup> Another advantage of banks is their ability to offer new products at a lower marginal cost than traditional remittance companies, which usually have only one product to offer.

## Technology

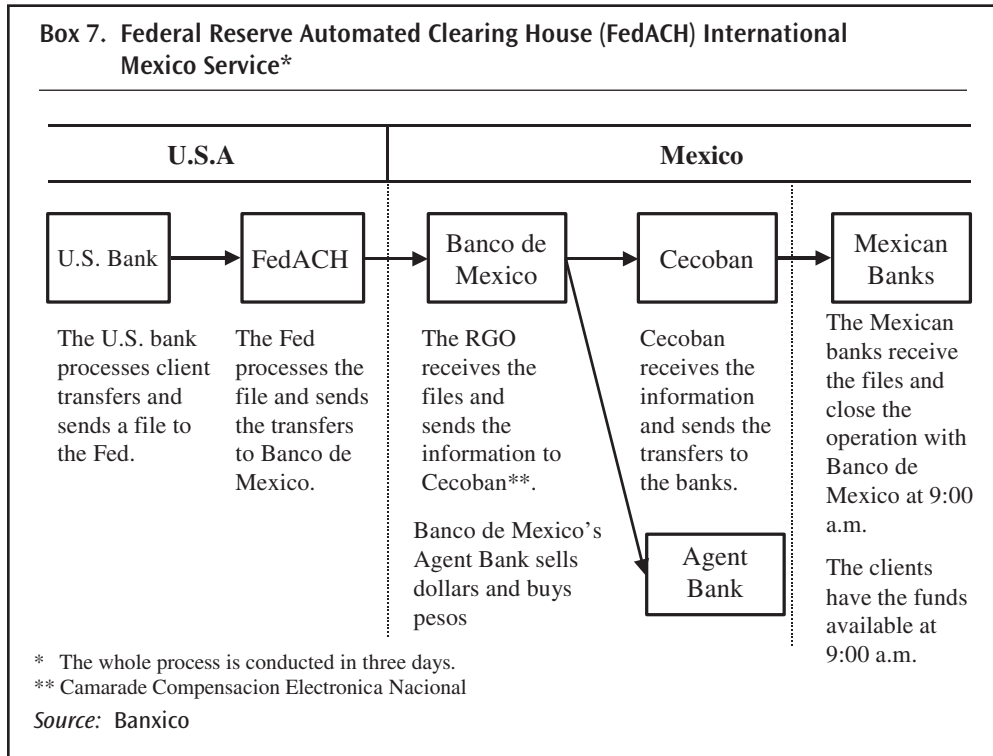
Competition and technology are closely related. Building and running a funds transfer network requires a massive investment of resources that few entities can make. Traditionally, this role was dominated by one or two market players that were able to capitalize on a virtual monopoly of network operations and selling network services to other market players. Because the systems operators controlled the technology that underpinned the formal remittance system, the development of the remittance business was tied to the development of the systems operator. As long as network technology was controlled by a single player, business expansion remained limited. Low-cost remittance technology was also available to large customers through banks, but these institutions traditionally operated through depositor accounts and had little interest in serving the unbanked.

A potentially significant addition to the U.S.-Mexico remittances market, from a technological point of view, is the FedACH International Mexico Service.<sup>27</sup> FedACH provides a "public highway" for bulk transactions between banks in the United States and Mexico. This clearinghouse is operated by the Federal Reserve System and the Central Bank of Mexico (Box 7) and reaches every bank in both countries as potential points of payment origination and receipt. Currently, this system works only in the direction of United States to Mexico. However, operators plan to have the system working also in the direction of Mexico to the United States sometime in 2005. The cost to banks for using the FedACH system is estimated at around US\$0.67 per transaction (Federal Reserve Financial Services 2004).

25. One of the key competitors in this regard is BBVA Bancomer, which developed Bancomer Transfer Services (BTS) as its own network platform and became the key competitor to Western Union in the corridor.

26. Many other MSBs also have such software.

27. FedACH International Mexico Service was an outgrowth of the Partnership for Prosperity agreement and was created to facilitate financial transactions, including remittances, between the two countries.



The service is economical, because it connects existing ACH infrastructure in both countries, thus leveraging the low-cost infrastructure of domestic bulk payments like direct deposits for the origination, delivery, and distribution of cross-border payments. One of FedACH's limitations is that it operates only from account to account, as opposed to "cash to cash."

It is too soon to know the impact that FedACH will have on the U.S.-Mexico remittances market. For smaller banks, that do not have the capital to invest in their own systems networks, it presents an opportunity to become full participants in the market. In the case of the largest banks that have developed their own systems, the time required for a transaction through FedACH may be too slow compared to that required to complete an operation through their own system.<sup>28</sup> One notable aspect of the Mexico Service is that it publishes the foreign exchange rate and spread on a publicly available website, including an archive of previous rates, thereby adding an important element of market transparency not present in most other services.

The speed of remittance transactions has also been increased by card-based products used at ATM machines. In some cases, the recipient is able to withdraw the money as soon

28. In its first months of operation, FedACH International Mexico Service has grown to become a leading channel for the delivery of U.S. government benefit payments in Mexico. More than 18,000 social security recipients have opted to receive their funds electronically directly into their bank accounts. The high adoption rate of these payments has already led to a significant reduction in the foreign exchange spread offered by the Mexico Service.

as the sender deposits it into the account.<sup>29</sup> ATM machines also represent a way for competitors to use technology to create wider distribution networks. Large MTOs, such as Western Union, have generally dominated distribution through an unrivaled network of agents that serve as distribution points, but ATM machines are now an available substitute in some places. However, multiplying ATM locations is a tremendous undertaking that is constrained by the recipients' familiarity to operate them. The main challenges are physically distributing the cash to the ATMs and the cost of maintaining them. Poor road infrastructure, security problems, and weak local economies to support them limit the expansion of ATMs into the rural areas of Mexico.

The development and spread of new technology and institutional innovations are key drivers in market competition for remittances and for extending services into rural areas. Microfinance projects (or microbanks, such as the *Asociación Mexicana de Uniones de Crédito del Sector Social*, AMUCSS), help money flow to rural areas where formal financial services are generally unavailable, providing economic opportunities in areas that are not technologically advanced.<sup>30</sup> In some small communities, satellite and internet technology has been used to bring communications and funds transfers to otherwise isolated locations lying outside of the reach of conventional systems operators.

Through BANSEFI and *L@Red de la Gente*, member institutions will have access to an important technology development program that is taking place in Mexico. Through BANSEFI, the Mexican Government is developing a technological platform for the SCI sector that will allow SCIs to provide efficient and varied financial services to the population. This platform includes front office and back office applications, as well as shared telecommunication infrastructure and a data center for the SCI sector.

Most recently, BANSEFI completed its integration into Cecoban, Mexico's ACH, enabling BANSEFI to make and receive electronic transfers on behalf of its members, including cross-border ACH payments through the FedACH International Mexico Service. BANSEFI and the FedACH Mexico Service have also signed a new cooperation agreement to provide a greatly enlarged distribution channel in Mexico for making bank-to-bank account transfers from the United States. Beginning in January 2005, BANSEFI will open a low-cost bank account for any Mexican to receive remittances in Mexico and have access to current account, savings and credit instruments (Federal Reserve Financial Services 2004).

## Innovative Services and Products

Technological advances have been important for creating profit-making opportunities for banking and credit institutions in Mexico's remittance industry. The latter have responded to these opportunities with the introduction of new services and products.

MTOs traditionally had several advantages over banks and other financial institutions. The first, mentioned above, was exclusive control over the networks. But other features,

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29. This is not true in all cases, however, depending on how the program is offered. Funds that pass through the Mexican *Cámara de Compensación Electrónica Nacional* (Cecoban), similar to the processing of funds transmitted through the FedACH Mexico Service, are often not available until the morning of the next business day.

30. AMUCSS is not yet a part of the BANSEFI network.

like accessibility, also made MTOs more attractive and easier to use to remit funds. One traditional advantage of an MTO is that there is no “account-holder” requirement. Customers can come in off of the street and pay a flat fee for a transaction without having to open or maintain an account. It should be no surprise that banks, in order to compete to become a primary channel through which money is remitted to Mexico, have sought to develop services with features similar to those of traditional MTOs.<sup>31</sup>

Banks, for example, now offer fee-only services. Some banks have developed a specialized remittance account, with no monthly fees and no minimum balance required. Other adaptations have included the introduction of more convenient locations and hours, cash-to-cash service, bilingual staff, and simple, transparent pricing structures. Banks are also using radio and print advertising (particularly Spanish-language radio programs) marketing at ethnic, religious, and community events, in order to cultivate ties to local organizations and businesses. Furthermore, the MCAS has been a significant step forward in solving the identification obstacle to opening an account. Innovations introduced in the First Mile can increase the speed and convenience of funds distribution at the Last Mile.<sup>32</sup>

Some formal remittance intermediaries have developed innovations or incorporated features that bestow other benefits while providing money remittance services. Some businesses, for example, have built on remittance services to create land investment and home investment opportunities for the remitter. Essentially, the sender remits funds home through a particular organization that uses the remittance as a mortgage payment on land or a home in Mexico.<sup>33</sup> Migrants, who hope one day to return to Mexico, take advantage of such schemes, and the remittance serves as an investment in property in Mexico.

## The Decline of IFT Services

In Mexico, IFT systems have played a social role, linking communities with migrants abroad. In the remittances market, IFT systems have competed like any other market player. They remain active, particularly in rural areas and towns bordering the United States, where they are known as *chiveros*. Having emerged as extensions of the larger informal social link between migrants and their homes, they make up a network of contacts that facilitates the mobility of people and nostalgic trade (Box 8). Although IFT systems in Mexico still are players in the remittance industry, the growth of formal systems portends a continuing decline in the IFT market share.

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31. The primary interest of financial institutions typically is not in the money transfers *per se*, but in forging a long term relationship with the sender.

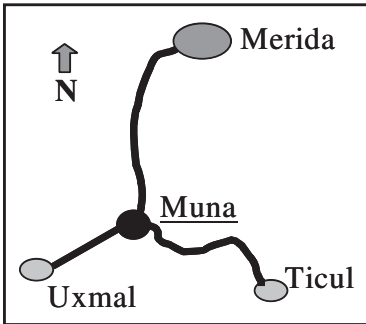
32. For example, a member of the Latino Community Credit Union (LCCU) in North Carolina can add the name of a second person resident in his or her home country on the account, enabling the latter to access the funds at any Plus network ATM. The LCCU also employs innovative promotional offers to encourage repeat business, including coupling the remittance transaction to the issuance of a raffle ticket or to earning points toward merchandise rewards. See Orozco (2004).

33. *Sociedad Hipotecaria Federal* (SHF) is a Federal program launched by the Mexican government to promote housing investments. Located in the federal housing agency, it provides credit and guarantees for construction and acquisition of low-income housing and the securing of mortgages. SHF has a special program wherein remittances from the United States are directly applied to mortgages on houses in Mexico.

### Box 8. IFT Systems in Mexico The Case of “Professor Pacheco”

In rural areas with no mainstream financial service penetration from banks, credit unions, or MTOs, a designated member of the community is often responsible for remitting funds. This member of the community is usually a person of integrity, like a teacher or school principal, who is well known to members of the community in and its emigrants abroad. Those emigrants who choose to send money home by means of an IFT are generally more concerned that their relatives receive the funds quickly and conveniently than with the cost of remittance. Informal funds transfer systems are frequently part of a social network linking the community in Mexico with the remitter in the United States, as in the case of “Professor Pacheco.”

In the town of Muna in Yucatan, Mexico, the authors interviewed Mr. Pacheco, a primary school-teacher responsible for receiving funds and disbursing remittances to recipients in his town. A mayoral candidate, he is highly respected and trusted by his community in Muna and by extensions of the community in the United States. Prof. Pacheco facilitates the “social linkage” between these two communities by receiving funds from overseas and making door-to-door deliveries of remittances. In doing so, he gets further acquainted with the members of his community and strengthens his reputation for honesty and trustworthiness.



\*A member of L@Red de la Gente.

Source: World Bank.

Muna is located two hours south of Merida, the capital of the State of Yucatan. There are three ways to receive remittances in the town of Muna:

1. Through a Banco Nacional de Mexico agency that was opened in December 2003.
2. Through the *Caja Popular Crecencio A. Cruz\**, which started this service in 2004.
3. Through the door-to-door service of Professor Pacheco.

Before the agency and the *caja* offered remittance payments, the only option beside Mr. Pacheco was to travel 20 minutes to the town of Ticul, where there is a bank branch.

## Limits on Competition

Notable progress has been made in recent years in the entry of new market competitors for the intermediation of remittance flows. The emergence of new networks and system operators has increased competition and helped to drive down prices. From 1998 to 2003, the average cost to send US\$300 to Mexico from major cities in the United States decreased steadily—from US\$26.12 in 1999 to US\$12.84 in 2003 (see Table 3). Nevertheless, the nature of the technology and the cost of innovation is such that the market continues to be dominated by a handful of operators. Building the volume of transactions needed to make the intermediation of remittances profitable requires a large capital investment. While large banks and big businesses have the capital to develop their own networks and run their own systems, many others in the market do not and must rely instead on contracts with the limited number of systems operators to run their services. The competitive

**Table 3. Remittance Costs from U.S. to Mexico (1999–2003)**  
(U.S. dollars)

Average cost of sending to Mexico \$300 from different U.S. cities (1999–2003)						
City of origin	1999	2000	2001	2002	2003	Percent reduction over period
Chicago	24.2	19.6	13.7	13.7	11.6	52.1
Dallas	27	25.4	16.3	14.6	13.1	51.5
Houston	22.4	20.4	15.7	14.9	12.9	42.4
Los Angeles	29.3	23.7	14.3	14.0	12.2	58.4
Miami	29.1	22.7	18.4	16.5	12.7	56.4
New York	24.7	18.5	13.5	13.9	13.2	46.6
Sacramento		19.6	15.1	15.2	14.1	28.1*
San Jose'			14.6	14.5	12.9	11.6**
<b>Average</b>	<b>\$ 26.12</b>	<b>\$ 21.41</b>	<b>\$ 15.20</b>	<b>\$ 14.66</b>	<b>\$ 12.84</b>	<b>50.8</b>

\*2000–2003 \*\*2001–2003

Source: PROFECO.

picture is thus a confused one, with some banks competing with an MTO to attract remitters, while at the same time using the MTO as their systems operator.

The availability of the FedACH International Mexico Service to all U.S. banks may improve competition and reach by reducing costs for intermediaries too small to mount their own systems, but its effectiveness in this regard remains to be seen. At least one large bank that could potentially compete in the market has up to now elected to avoid the remittances market because of the reputational risk associated with AML/CFT. However, this entity is now exploring the formation of partnerships with smaller remittance companies while assisting them to institute proper safeguard measures.

The implementation of AML/CFT standards by the largest banks has helped to improve market integrity. Banks have put in place know-your-customer (KYC) rules that have impacted on their distribution agents as well as on those small MTOs that partner with them. One bank with a significant remittance market share provides software towards this end to its originator-agents as well as permanent training. When, in 2001, the largest bank in the system was acquired by Citigroup, one of the main concerns of the new owners was to reduce the reputational risks of having small companies and individuals using its network to distribute remittances. As a result, the bank closed several accounts used by these companies and individuals, resulting in a loss of market share. The small companies and individuals were captured by other banks, and were required to comply with minimum standards of AML/ CFT compliance.



## At the Last Mile

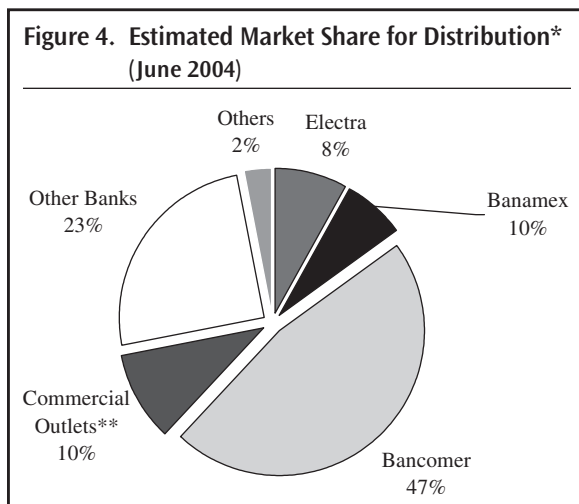
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The landscape of the Last Mile is an important factor for the sender when choosing a remittance system. Senders are influenced not only by incentives at their end, but also consider the reliability, costs and relative convenience of alternative remittance delivery options at the recipients' end. The key factors affecting remittance choices at the Last Mile of the U.S.-Mexico corridor include personal contacts, perceived reliability, accessibility, the regulatory environment and the provision of secondary benefits to the recipient. Developments over the past several years affecting these incentives and, consequently, the evolution of both formal and informal remittance systems have included:

- The increased number and variety of distribution channels;
- The maintenance of traditional links between sender and recipient communities;
- The gradual approach taken in Mexico to the regulation of remittances;
- The promotion of banking services to low-income recipients; and
- The effects of remittances on recipient communities.

### The Development of Distribution Channels

Remittances are delivered to recipients through a variety of outlets in Mexico (Figure 4). These include banking and microfinance institutions, MTOs, department stores, small neighborhood stores, telegraph offices, exchange houses, and post offices. In urban and regional centers, these outlets are plentiful. Microfinance institutions and credit unions are potentially a key link for bringing financial intermediation to rural communities through remittances, a point explored further on.



\*Distribution for electronic transfers

\*\*Include supermarkets and drug stores among others

Source: World Bank based on interviews with market players.

The geographical distribution of remittances has shown signs of spreading more evenly throughout the country. Guanajuato, Jalisco, Michoacan, San Luis Potosi, and Zacatecas are the five Mexican states that historically have been the chief sources of migrant workers to the United States and thus the chief recipients of remittances from the United States (Suro 2003b). (Recently, Mexico City joined the ranks.) Those states (home to 32 percent of the national population) continue to receive a disproportionate share (44 percent) of remittances to Mexico. Though this pattern continues, remittance flows have also increased recently to other parts of Mexico.

## Links Between Sender and Recipient Communities

According to a poll sponsored by the Inter-American Development Bank (IADB), nearly one in five Mexican adults receives money from relatives employed in the United States (Thompson 2003b). Recent research dispels the notion that remittance recipients are among Mexico's poorer population. A recent survey reveals that the monthly income of remittance receivers is virtually the same as the average monthly income of the total population, and that the education level of remittance receivers is also virtually the same as that of the overall population (Suro 2003b).

The families and communities affected by remittances are active participants in globalization. In addition to exchanging funds, they maintain ties between migrants and their origins, as people move north, and money moves south. The exchange does not stop with personal family remittances. Links between communities on either side of the border are also fostered through home town associations (HTAs), also known as *clubes de oriundos* (Box 9). HTAs are associations created and comprised by migrants to promote the well-being of their hometown communities of origin (Mexico) and of residence (United States) by raising money to fund public works and social projects. In Chicago, for example, the most successful fundraising activities employed by the HTAs are dances, picnics, raffles, *charreadas*, beauty pageants, and other cultural events that take place throughout the year. Remittances through these organizations are "collective remittances," as opposed to individual worker remittances personally sent between family members.

### Box 9. Home Town Association “3×1”

The “3×1” program channels community remittances from overseas into small-scale development projects in Mexico. Every dollar sent back is matched by three dollars from federal, state, and municipal governments to fund roads, schools, and other projects.

From 1993 to 2000, investments financed by the program totaled \$16.2 million. Typical projects have included road construction, street paving, irrigation, sewerage, and electricity. The program also funds works in churches, cemeteries, parks and civic squares, community centers, and athletic facilities. New investment projects include providing computers for high schools and dam and water-treatment projects. These small-scale projects have an average cost of \$56,000. Almost two-thirds of the projects have been located in small communities of less than 2,000 inhabitants. Investment decisions are made by a joint committee of local government and HTA representatives.

Observers have attributed the success of this small-scale program to the strong leadership of the HTA and the demonstrated commitment on the part of migrant clubs.

*Source:* “Migrant’s Capital for Small Scale Infrastructure and Small Enterprise Development in Mexico,” World Bank, January 2002.

## Gradual Approach of Regulators

When formal remittance channels in the corridor between Mexico and the United States began to develop rapidly about eight years ago, the growth was generated primarily by private sector market dynamics; governments were not heavily involved in regulating the expansion or attempting to steer it in a particular direction. At the Last Mile, Banxico has gradually applied new rules and regulations to the remittances market, after years of substantial growth and expansion (Box 10). This gradual approach to regulation has allowed the market to evolve and develop without weighty government intervention.

It is not clear whether regulators set out intentionally to adopt a gradual policy toward regulation, but the gradual approach has worked well, avoiding potential shocks that could be brought about by abrupt or premature application of regulations. Banxico was able to observe the market, learn its features, and gauge an appropriate level of regulation that has stimulated, rather than burdened, growth and expansion. Nevertheless, regulation

### Box 10. Current Regulations on Remittances by Banco de México

- Banco de México has attributions to issue regulation on funds transfer services applicable to financial institutions and to any other agent involved professionally in such activity.
- In October 2002, a set of rules was issued instructing all firms involved in funds transfer services, to register with Banco de México and to provide monthly data on the amounts transferred to Mexico through instruments used for workers remittances, classified by recipient state.
- The Rules have the following purposes:
  - To standardize the characteristics of the information that is received by Banco de México; and
  - The creation of a record of the enterprises that participate in the workers remittances market.

*Source:* Banco de México.

must keep pace with the market, and Mexico is now taking steps to augment its regulatory framework in critical areas, such as AML/CFT. New regulations were introduced at the beginning of 2004 aimed at strengthening the financial system and promoting transparency.<sup>34</sup> Subsequently, on May 14, 2004, a set of rules was approved by Congress to regulate the operation of auxiliary credit institutions (AICs) including exchange bureaus, and money transfer operators (MTOs)—and individuals including money services businesses (MSBs)<sup>35</sup>—to detect and prevent acts of terrorist financing and money laundering. (See Annex IV for an overview of the regulatory framework in Mexico.)

## The Promotion of Banking Services to Low-Income Recipients

Banks, *cajas populares*, and other SCIs are now having a substantial impact in the Last Mile. Not only has their emergence as independent competitors (as opposed to simply distribution channels for established MTOs) changed the competitive dynamic, but they can cross-sell customers, linking remittances to savings and investments. Although Mexico has the lowest banking penetration in the region (fewer than 20 million Mexicans have bank accounts), remittance recipients show a higher rate of account-holding than the population as a whole. According to the Pew Hispanic Center (2003), 33 percent of remittance recipients in Mexico have a bank account, compared to 22 percent of the general population.

Banks, MTOs, and other remittance outlets, typically concentrated in cities and regional centers, have established special hours to serve remittance recipients. Some large commercial banks<sup>36</sup> have made efforts to use remittance services to cross sell account-holding and credit services. In general, banks and other credit institutions have an advantage over MTOs in that they do not have to charge high transaction costs to stay profitable. Banks have also developed remittance products that are sensitive to whether customers on either side of the transaction are banked or unbanked. The resulting remittance mechanisms are not solely “cash to cash” or “account to account,” but can blend the two mechanisms. This small feature, and the fact that banks are offering it, has the potential to allow recipients to switch to account-holding mechanisms (Box 11). By charging low initial fees, they hope to draw remittance customers to other profit-generating products and services.<sup>37</sup> At least one micro-finance institution,<sup>38</sup> concentrated in urban areas, encourages remitters to open accounts when receiving remittances and to leave 15 percent of the funds in that account. As a result

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34. The Mexican Official Gazette of January 28, 2004 published reforms of the following Mexican laws: *Ley de Instituciones de Crédito*; *Ley de Ahorro y Crédito Popular*; *Ley de Instituciones de Fianzas*; *Ley General de Instituciones y Sociedades Mutualistas de Seguros*; *Ley del Mercado de Valores*; *Ley de Sociedades de Inversión*; *Ley General de Organizaciones y Actividades Auxiliares del Crédito*.

35. Money Service Businesses (MSBs) are known in Mexico as “*Centros Cambiarios*” and are enterprises that, in addition to their regular business (e.g. pharmacy), are engaged in the transmission of money, including remittances. The chief differences between these and Exchange Bureaus is that the latter may also engage in remittance operation from Mexico to other jurisdictions and the amount of their initial venture capital.

36. Banco Azteca and Citibank-Banamex are examples.

37. WOCCU cites this advantage as one reason for its competitive pricing, which falls in a range lower than industry averages.

38. *Servicios Financieros Comunitarios*.

**Box 11. Banking Products and Customer Targets**

United States	Product	Mexico
Banked	“Y” Account-to-Account	Banked
Banked	“X” Bi-national Accounts	Not Banked—Banked
Not Banked	“Z” Transfer	Not Banked
Not Banked	“Z” Transfer	Banked

This diagram shows the “access-product” relationship between the sender and the receiver in a U.S.-Mexico money transfer operation.

**Row 1:** The banked remitter sends money to the banked recipient through a regular bank-account transfer.

**Row 2:** A banked remitter may transfer money to an unbanked recipient, who then becomes banked because he or she needs to open an account in order to get a good value for the remittance received. The money goes through bi-national accounts if both parties have an account and through other products if the receiver does not have an account (for example, ATM cards, financial products).

**Row 3:** An unbanked remitter sends money to an unbanked recipient through a typical money transfer operation, usually through money transfer operators or informal systems.

**Row 4:** An unbanked remitter sends money to a banked recipient through money transfer operators or informal systems because there is a distribution cost when using a regular bank-account transfer. For example, there are additional expenses when the recipient needs to travel because there is no branch nearby.

*Source:* World Bank.

of this growing activity, Mexico’s urban and regional centers now enjoy a “paved road” for remittances.

However, banks and big businesses that have established themselves in the remittances market do not typically perceive sufficient profit opportunities in investing capital in rural remittance networks. There thus remains an urgent need to extend these services into rural areas, where the paved road currently gives way to a dirt track.<sup>39</sup> Specialized financial institutions, such as microfinance institutions, credit unions, and rural banks, could play a key role in linking underserved rural areas to urban centers where formal systems are common. Some credit unions and *cajas populares*, in particular, have made a concerted effort to use remittances as a lead into banking in rural areas (Box 12).<sup>40</sup> Such institutions around the world have developed new operational methodologies and products in recent years that

39. It is not unusual for rural remittance recipients in Mexico to travel half a day to the nearest city to find a distribution point for remittances. Upon arriving, the recipient may have to sleep outside on the sidewalk. When the bank opens in the morning, the recipient can pick up the funds and then spend another half day traveling home. Such journeys have implications for the productivity of the family, apart from the travel costs.

40. For example, WOCCU has already taken advantage of its existing association of rural credit union members in Mexico, linking them together as outlets for remittances. Other such initiatives would go a long way in connecting rural communities directly to points of distribution.

### Box 12. *Cajas Populares* and Rural Remittances

The *caja popular* is the Mexican equivalent of a credit union. *Cajas populares* aim to foster community development by promoting a culture of saving among Mexicans. This goal is achieved by marketing the savings idea to the unbanked populace with the intent of making them account-holders or members of the union. They are also very useful for recipients of remittances. Their presence enables many members to receive funds by electronic transfer. Thus, the *cajas* are developing remittance-linked savings and credit products.

*Caja Popular Mexicana* is an example of a credit union operating in Mexico. It serves approximately 700,000 members through 326 points of service. Some 60 percent of its operations are rural. The service was launched in August 2003 in 134 pilot branches. By November 2003, an additional 166 branches had been added.

- ◆ 1,900 individuals (93 percent women) received 2,977 remittances amounting to \$1.2 million in 2003.
- ◆ 82.5 percent of recipients are members.
- ◆ 5 percent of the funds received by members are deposited in savings accounts.
- ◆ 15 percent of the funds received by members have been used to pay off existing loans.
- ◆ 56 percent of non-members who received remittances have since joined the union.

One does not have to be a member to receive remittances. One incentive to using *Caja Popular Mexicana* is that it charges no additional fees for nonmembers who receive remittances. For the most part, *cajas* are empowering communities by making financial products such as checking and savings accounts, loans, and mortgages accessible to lower-income wage earners. They are a good alternative to banks, which low-income earners in Mexico perceive as being too expensive and requiring excessive documentation.

Source: WOCCU.

enable them to attract and greatly reduce the costs and risks of doing business with low-income customers. These specialized institutions may also enjoy better reputations among low-income groups and rural communities than do larger banking institutions. But these institutions lack the large revenues that banks have to develop new and innovative remittance products. IFT systems are also direct competitors for rural remittances. A Mexican government initiative in this area, conducted through *L@Red de la Gente* and BANSEFI, has resulted in a more than 100-percent growth in the number of accounts, to a total of more than 1.7 million, from 2002 to 2004. These account-holders now have access to financial products and services including remittance transactions.

*L@Red de la Gente* has presence in most of the localities that account for the largest migrant flows to the United States. BANSEFI and the SCI sector as a whole have more than 5 million clients out of a potential market of 20 million unbanked users. Its objective is to promote the development of SCIs in order to extend financial services, such as savings products, insurance, and mortgage loans, to even the lowest-income segments of the population. BANSEFI, which will act as a bank for banks in the Mexican SCI sector under the *Ley de Ahorro y Credito Popular* (Savings and Credit Institutions Law), is already engaged in remittances transfer through its 549 branches, half of which are located in areas where there is no bank within a 20 km periphery.

Along with the BANSEFI network, *centros cambiarios* have become a popular channel of distribution among Mexican remittance recipients, in particular in rural areas.<sup>41</sup> They have taken market share from banks and in some towns are the preferred distributor. In some ways they have replaced the informal distributors that used to play a role in the community. People are attracted to them because they appear less complicated than banks and sometime have more cash on hand to pay remittances than the banks.<sup>42</sup>

## Effects of Remittances on Recipient Communities

Overall, remittances have a positive effect on the recipient economy. Recent research presents evidence that remittances are increasingly used for investment purposes in developing countries, particularly in low-income countries (Ratha 2003), and that flows in the U.S.-Mexico corridor specifically account for about one-fifth of the capital invested in Mexican micro-enterprises (Woodruff and Zenteno).

On the other hand, anecdotal evidence from field interviews in Mexico suggest that remittances may also have some negative effects at the Last Mile.<sup>43</sup> Some senders, for example, expressed concern that their relatives in Mexico had become dependent on receiving funds regularly and had lost their incentive to find jobs or develop work skills. The influx of remittances has also had an inflationary effect in some communities.

Many migrants abroad purchase land and homes in Mexican communities in anticipation of an eventual return. Real estate dealers and contractors in Mexico reportedly charge high prices for the land and homes because they know that the purchasers may be making substantial amounts of money working in the United States. Such price inflation raises property values to levels inconsistent with local incomes, while some of these new homes and developments lie empty.

For the most part, however, recipients in Mexico feel that remittances provide an important augmentation to their earnings, and there is evidence that remittances help to alleviate poverty. Furthermore, the spending of remittance funds generate positive multiplier effects in the recipient economy (Stahl and Arnold 1986). Further research is needed to verify and quantify these impacts on the recipient economy and to assess how best to maximize the development impact of these flows.

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41. *Centros cambiarios* are enterprises that, apart from their regular business (e.g. pharmacy), are engaged in the transmission of money, including the payment of remittances. The difference between these and Exchange Bureaus is that the latter may also engage in remittance operation from Mexico to other jurisdictions and their initial venture capital.

42. Banks and the post office have sometimes limited the amount of cash they hold in their branches in remote rural areas as a precaution against robbery. This has limited their ability to pay recipients on demand. Consequently, recipients must often wait long hours for their money, sometimes staying over night to wait in line again the next morning. This practice significantly increases the total cost of receiving remittances.

43. Field work conducted in the Chicago and New York City Metropolitan area, United States, and in Mexico.





# Lessons from the U.S.-Mexico Remittance Corridor

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The U.S.-Mexico Remittance Corridor has transformed radically in the last eight years, from a corridor where informal funds transfer systems were prevalent to a corridor dominated by formal mechanisms for remittance transfers. This corridor is now characterized by more competition offering reliable, fast and formal remitting options at lower costs to a growing population of Mexican immigrants in the United States.

Based on an analysis of market incentives, using the APEC Framework, the report discusses the main factors that have driven this shift from informal to formal transfer systems. In the First Mile, Mexican migrants have had better access to formal mechanisms, mainly through banks. This has been a key factor for the integration of Mexican migrants into the formal sector. The use of the MCAS as a tool to access financial services, combined with higher levels of financial education among migrants, has been an important advance in the origination stage for remittances transactions. At the intermediary stage, increased competition, technological change, and product innovations have created a more competitive market for system operators and transaction facilitators. Finally, at the Last Mile, distribution networks have expanded in both urban and rural areas, streamlining remittance delivery and contributing to lower prices for remitters, and, more importantly, reliable delivery of funds to the recipient, which is a critical factor in the decision-making process of the sender.

Although clients are increasingly choosing to shift to formal transfer systems, informal channels also continue to serve the remittance market. While criminals may continue to devise methods for transferring illicit proceeds through some informal channels, IFT systems are not simply conduits for criminal behavior. IFT systems play a social role connecting migrants with their home communities and serve the legitimate needs of migrants and their families that either lack access or are uncomfortable with formal institutions.

Further research would improve understanding of informal operations and the associated integrity issues.

Following are the main lessons from the analysis of the U.S.-Mexico remittance corridor:

- 1) In the U.S.-Mexico corridor, remittances, and particularly IFT systems, are an extension of a larger cross-border social network.
  - Remittance flows parallel long-established migration patterns between Mexico and the United States. Funds transferred to home communities reflect a continuing bond between the migrants and their homes. IFT systems have developed in this socio-economic context. Consequently, unlike some other parts of the world where IFT systems have developed principally to support trade and commerce, IFT systems between the United States and Mexico have been fostered principally as extensions of social connections. Funds are one item, along with food, letters and other nostalgic goods,<sup>44</sup> that are transferred through these informal social networks.
- 2) In the U.S.-Mexico corridor, cultural familiarity and reliability are key factors along with cost in choosing a funds transfer system.
  - Given the social context of remittances, cost is not the only determining factor for choosing a funds transfer system among Mexican migrants. Anecdotal evidence and field interviews in both the First and Last Mile reveal that many migrants are as concerned with the perceived reliability of a channel as with the price and continue to prefer channels that are culturally familiar or operated through personal contacts, even if they are more expensive.
- 3) Nevertheless, despite cultural inhibitions, improved access to formal channels has encouraged large numbers of migrants to shift away from informal channels.
  - Migrant access to formal channels has improved for several reasons. One reason is better awareness in migrant communities about remitting options. In addition, many migrants who had been prevented from accessing formal channels for lack of acceptable identification documents, have been able to overcome this barrier through the use of *Matricula Consular* identification (MCAS) cards. Also, the range of formal channels offering remittance services to migrants has increased. More banks, as well as MTOs, are opening branches near migrant communities and making the physical atmosphere more welcoming to migrants by operating during convenient hours, hiring bilingual staff and developing products and services tailored to migrant workers' financial needs.
- 4) Increased competition has significantly reduced prices.
  - Prices generally remained stagnant in the market while one MTO dominated service through exclusive contracts with distributors. The breakup of these exclusive contracts and the entry of new major competitors in the U.S.-Mexico remittances corridor have been key developments leading to a steady decline in prices.
- 5) The development and spreading adoption of new technologies have reduced the costs and increased the efficiency of remittance intermediaries.

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44. "Nostalgic goods" refer to traditional goods, including food, clothing and mementos, that have been produced in the home country.

- Technological change has helped new competitors to successfully enter the market. Major advances have occurred in the development of new network platforms for facilitating and clearing transactions. The proliferation of ATM machines and the implementation of card-based remittances products have improved access and reduced the costs of serving clients. The FedACH will also provide a public network platform for account-to-account remittances among bankers.
- 6) More transparent pricing and better market data have enhanced competition in the remittance business.
    - When Banxico issued regulations to financial institutions for reporting and organizing remittances data, critical information about remittance flows and volumes became available to the public. This information has had a positive effect, calling consumers' attention to the market and generating private sector interest in its business opportunities. PROFECO's policy for transparent pricing structures has also benefited the consumer and spurred competition.
  - 7) The "paved road" for remittances between the United States and Mexico ends in Mexico's urban centers.
    - The market for remittance services between the United States and Mexico is well established and highly advanced, but distribution networks for formal remittances have not yet adequately penetrated into rural regions.
  - 8) Informal systems compete as a market player.
    - IFT systems operate in the market like any other industry competitor. They fill the vacuum for financial services to unbanked households at the First Mile, and they fill the vacuum for funds transfer services in rural regions at the Last Mile, where formal penetration is weak. Since remittances play a social role in Mexico, IFT systems also have a competitive advantage over formal systems because they more easily conform to the cultural traditions of migrants and recipient communities.
  - 9) While the U.S.-Mexico remittances corridor has become strong and well-developed overall, regulatory impediments could impede the market's further expansion and development.
    - At the First Mile, inconsistencies and overlaps in the layers of regulations by U.S. federal and state authorities increase costs and inhibit market growth and the entry of new competitors. At the Last Mile, Mexican regulations impede some institutions' access to payment systems. More generally, however, Mexico's gradual approach to the introduction of regulations on the remittance industry appears to have worked well in permitting institutions to adapt smoothly to changing market conditions. Remittances are not only an important source of external income for Mexico, but also allow migrants to exercise social and political influence on matters taking place in their home communities in Mexico.
    - The steady stream of remittance funds from the United States to Mexico has socio-political implications. The organization and impact of these collective remittances through groups such as Home Town Associations, have given migrants and expatriates a growing voice in their home communities.



# Policy Recommendations

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This study has shown that formal transfer systems in the U.S.-Mexico Remittance Corridor have grown rapidly over the past eight years and has also identified areas in the corridor for further development. A number of measures could be taken to further reduce the cost and to enhance the potential contribution of worker remittances for development. These policy recommendations aim to encourage the shift from informal systems to formal ones, while also establishing international standards for integrity and transparency in the market.

1. Researchers, regulators and policymakers should recognize and carefully consider the varying nature of remittances and IFT systems from region to region, as local nuances can have important policy, regulatory and market implications. Localized adaptations can encourage migrants to remain engaged with the home country and may reveal new opportunities for the private sector to introduce new products and services.
2. The introduction of formal and secure I.D. documentation, such as the MCAS, can facilitate the access of migrants to formal financial services and, hence, the entry of formal financial institutions into the remittance market.
3. Exclusive arrangements in partnerships between system operators and distributors should be discouraged in order to allow the entry, adaptation and growth of new competitors.
4. Measures to ensure transparent pricing help consumers to choose rationally among their remittance options and spur competition among service providers.
5. Credit unions and microfinance institutions can be important links in the chain for formal remittance systems to reach rural regions. Support to the establishment

of a rural remittances distribution network can contribute to the financial sustainability of such institutions and thus contribute to development of financial services in heretofore underserved communities. In Mexico, for example, micro-finance institutions and the *cajas populares*, could be offered direct access to federal clearing systems like FedACH.

6. The role that IFT systems in general play in filling a vacuum of financial services to the underserved should be appreciated by regulators. The registration and licensing of IFT operators could contribute to greater market transparency and integrity while also nurturing the building of bridges between underserved communities and the formal financial system.
7. A better harmonization of federal and state laws in the United States would help to reduce the cost of providing remittance services and thus contribute to competition and growth in the sector.
8. Collective remittances should be treated differently from personal remittances, and oversight mechanisms for transparency and accountability should be introduced in Home Town Associations to ensure that funds are properly spent.

# ANNEXES

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# Operational Features of the Remittance Industry

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This Annex provides a brief global overview of flows, describes the various stages of a remittances corridor, and discusses some aspects of the business side of a transfer system. In doing so, the Annex clarifies the key terms that are used in this APEC case study.

## Global Flows

Migrant worker remittances flow through both formal and informal fund transfer systems. In 2003, workers' remittances worldwide totaled an estimated US\$93 billion and were the second-largest financial flow to developing countries after foreign direct investment. In 2002, remittances were larger than both official and private investment flows in 36 developing countries for which data were available (World Bank 2003, Appendix A). In some regions, such as Latin America, worker remittances account for most of the flows going through fund transfer systems.

## Overview of Operational Features for Fund Transfer Systems

There are three stages involved in the basic operations of remittance systems: origination, systems operation and distribution.

### *Origination*

This is the “point of entry”—or “First Mile”—where originators receive the transaction request and funds from a remitting customer. Formal funds transfer systems generally aim

to have a wide network of originators that are conveniently located and customer-oriented. For example, in the United States, entry points include branches of money transfer operators (MTOs), money services businesses (MSBs), banks, agencies operating in grocery and other retail stores and many other creative outlets. The number of points of entry in the United States for remittances is unknown. Regulators' estimates, based largely on guesses, range from the tens to hundreds of thousands.

### *Systems Operation*

The systems operator creates the cross-border path, linking origination and distribution points. Systems operators typically accomplish this through a digital network platform that is specially developed to facilitate remittances transactions and connect a series of originators and distributors together. The persons and companies that provide this service are the key players of the "Intermediary Stage," effecting the transfer of funds from the originator to the distributor.

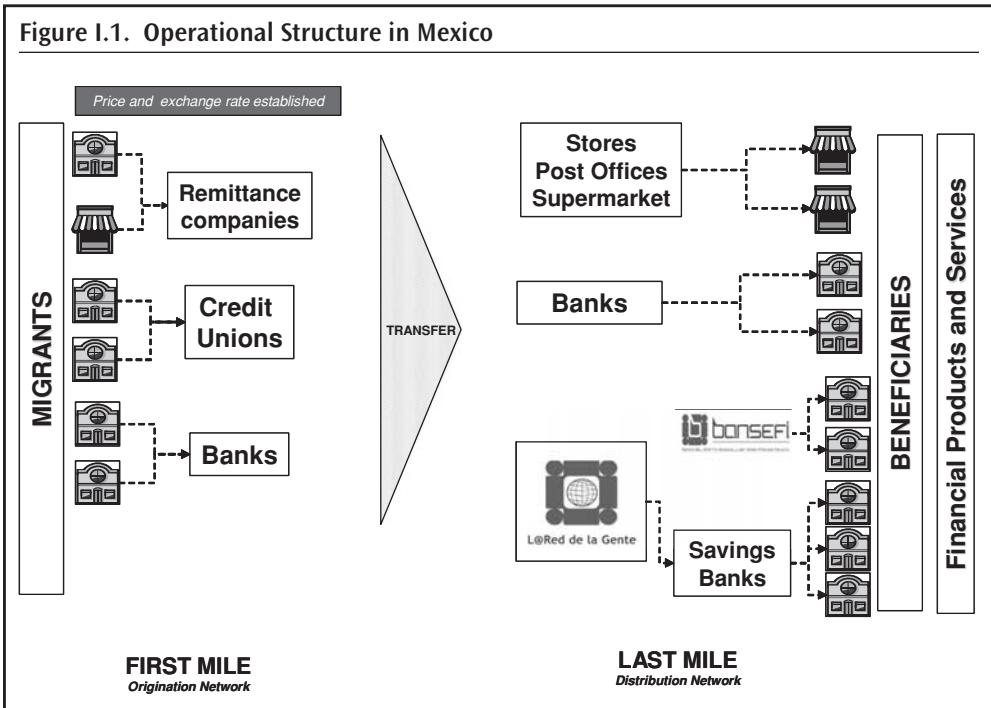
### *Distribution*

The distributor delivers funds to the recipient at the Last Mile. As in the case of an originator, the key criteria for choosing a distributor are reliability, convenience, location, and customer service. The available distribution channels in a recipient country are important factors in guiding a sender's choice of remittance system. While points of origination tend to be plentiful in sending countries, due to their more developed financial sectors, points of distribution in recipient countries can be scarce, especially in rural areas.

Some market competitors are able to dominate the industry with well-established distribution networks that other competitors cannot rival. It is this "Last Mile" challenge that requires attention if remittance receiving countries want to maximize the potential of remittances by expanding distribution channels that offer a variety of useful financial services to the remitter, such as savings accounts.

Together, the three functions represent a "channel," which may be configured in a variety of ways. Some remittance businesses own or control points of origination on one side of the border and contract with other businesses that own or control points of distribution on the other side of the border. These two may in turn contract with a systems operator to run the network between them. Thus, three market players may be involved in one channel and split the costs and profits among them. Some competitors may have diversified their market roles, occupying different niches based on agreements with other business partners. The competitive dynamic is complicated when, for example, a systems operator not only runs the network for third-party businesses, but also runs its own originators and distributors, and possibly outsourcing some specific operations. Originators and distributors, if not themselves formal financial institutions, will typically maintain accounts in formal financial institutions for clearing their transactions.

Figure I.1 shows how the features of these basic operations can take shape in an actual market, as illustrated in the case of Mexico. Entities at the First Mile fix prices and exchange rates and contract with entities at the Last Mile, such as banks, *L@ Red de la Gente*, or non-financial entities like post offices and supermarkets, to create an Intermediary channel. In rare occasions, the entities in the First Mile origination network are part of the same com-



Source: BANSEFI.

pany as the entities of the Last Mile distribution network. Recipients receive funds through branches of the Last Mile entities, which may also offer other financial products and services.

## Cost, Price, and Profit in the Remittance Industry

The relative costs associated with running the different functions of a formal channel typically break down as follows:<sup>45</sup>

- *Origination*—30 to 40 percent. Costs include staff, retail location, telephone line, and marketing.
- *Systems Operation*—40 to 60 percent. Costs include licensing fees, staff, office, network, operating platform, marketing, regulatory and compliance costs.
- *Distribution*—17 to 25 percent. Costs include staff, retail location, telephone line, and marketing.

The key link is the systems operator, who bears the burden of most expenses and claims the largest share of the revenue. Competition is keyed around the systems operator,

45. Industry averages provided by Grace and Evans (2003).

who controls the technology linking the sender to the recipient through originator and distributor networks.

Generally, the division of revenue follows the division of costs in remittance business relationships. Fees are paid up front by the sender. Distributors, who usually do not collect any revenue from the recipient, receive their compensation from the revenues collected by the originator. Profit from a remittance transaction comes from two main sources: explicit transaction fees and a spread on the foreign exchange conversion. Remittance services can also add to providers' profit through the cross-selling of other services or products at both the points of origination and distribution. This is particularly the case with banking institutions.

Money transfer operators charge high proportional fees to compensate for the cost of small transactions (Solimano 2003). As undocumented migrant workers become better assimilated into society, however, the formal remittances market may become more attractive to private sector financial institutions, thereby increasing competition, stimulating innovation, and reducing prices. Promoting competition is an important way to reduce prices. Remittance prices tend to be lower in countries with more competition (Inter-American Dialogue 2004), and increasing competition, as well as pressure from clients, social groups and legal demands. This has led to the drop in prices from the dominant money transfer operators in some remittance corridors (Orozco 2003a). This competitive dynamic is quite apparent between the United States and Mexico, where traditional MTOs are no longer the single dominant players in the market, and forcing prices to drop steadily in the past decade.

Growing competition, technological innovation, improving efficiency, profitability, and market expansion all feed on one another as the market develops. Given the high fixed costs of mounting a modern digital transfer network, a large volume of transactions is needed to realize the available scale economies. At the origination and distribution stages, where many migrants require intensive personal assistance to deal with language and other social barriers, remittances can be highly service-intensive and thus involve high operating costs. By offering these services, formal financial institutions, attracted by the growing remittance market and the opportunity to sell other services, are increasingly competing with informal remittance service providers for this business.

Other factors affecting the remittance market are government controls over the foreign exchange and government regulation of remittances in the receiving and sending countries. Where exchange rate administration and/or capital controls result in an official exchange rate significantly different from the free market rate, a strong incentive is created to use informal remittance channels as a means of evasion. Where the market rate itself is subject to large fluctuations, remittance operators will charge higher fees or spreads to the remitter and/or to the recipient to cover the risks involved. Government regulation of financial institutions and of remittance transactions, even though warranted by the risks of fraud and misuse, also raise the cost of doing business, and perhaps impede the entry of market competitors, thereby also raising the costs to the senders and receivers of remittances.

# Market Overview

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## Formal and Informal Remittance Systems

While the international market for remittances tends to be thin and poorly competitive (Solimano 2003), the remittances industry in the U.S.-Mexico corridor is characterized by a maturing and competitive market. The industry is growing with a diversifying assortment of competitors. For the purposes of this study, these competitors were classified according to the business nature of their institutions and whether or not their transactions are regulated by an official authority. By these criteria, banks and credit unions, money transfer operators (MTOs), debit and credit card companies, microbanks and some microfinance institutions, and postal administrations are treated as formal funds transfer mechanisms. Non-profit oriented microfinance institutions, ethnic stores and cash couriers are examples of informal funds transfer mechanisms.

## Formal Funds Transfer (FFT) Systems in the U.S.–Mexico Corridor

### *Banks and Credit Unions*

While MTOs still command a sizeable portion of the market, competition has been spurred on by the increasing entry of banks and credit unions, which have developed products and services to draw customers, including both banked and unbanked migrant workers, away from the MTOs. Banks and credit unions offer remittance services as one component of a wider array of financial services. When these institutions focus strategies and resources on remittance services, they have the capacity to offer the least expensive form of formal funds transfer (Orozco 2003b). In addition to low costs, banks can offer remitters access to other

financial services such as business and consumer loans, checking and savings accounts, insurance and so on.

Banks can offer either account-based remittances services (account-to-account), or wire transfer services (cash-to-cash,) or a combination of the two (account-to-cash). Many banks offer card-based products, such as ATM services, that allow customers to transfer funds from the United States to Mexico using credit card networks. Recipients are able to redeem remitted funds using a PIN number at the ATM.

Some banks charge a flat rate regardless of the dollar amount transferred. This fee reflects the costs to the bank of remittance transactions, which do not vary much with the size of the transaction. However, it results in higher cost in percentage terms to small remitters. In some cases, lower rates are charged to bank account holders than to persons not having accounts, as banks use remittance services to attract new depositors and creditworthy borrowers. The establishment of remittance programs by mainstream financial institutions is potentially an important way of opening the access of the currently unbanked immigrant population in the United States to a broader range of financial services. One challenge to be overcome in this regard, however, is that many Mexican immigrants carry with them a poor image of financial institutions, especially banks. Meanwhile, the entry of rural credit unions and microfinance institutions, including microbanks, into the business of distributing remittances to their intended recipients can bring broader financial services to currently unbanked Mexicans at home.

### *Money Transfer Operators (MTOs)*

Money Transfer Operators specialize in funds transfers, offering only remittance services. MTOs include businesses such as Western Union Financial Services Inc.<sup>46</sup> and MoneyGram Payment Services. Over time, they have established an expansive network of agents connected with a systems operator platform. This established network, coupled with the proprietary role of the systems operator, has made it difficult for new competition to spring up.

Their established network makes MTO services easily accessible to remitters and recipients. They are also able to compete on speed of transfer, convenience for senders and recipients, and the transparency of their price structure. Remitters find the reliable, no-hassle approach of the MTOs quite appealing, despite the relatively high costs of transfers. In addition, since MTOs are not depository institutions, they do not require the level of personal customer information that a bank does, which offers comfortable anonymity to Mexican remitters who want to avoid contact with more formal institutions because of legal status or general lack of trust.

### *Debit and Credit Card Companies*

Debit and credit card companies also compete in the remittances market (Box II.1). Some of the techniques they employ to reach their customers include internet services and the

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46. Western Union, in particular, is a dominant player worldwide, although in the U.S.-Mexico corridor, competition from banks has substantially cut into Western Union's share of the distribution market, and it is no longer the single dominant player in that market. Still, Western Union's greatest asset may be its highly recognizable name brand. Its operational history of 150 years and worldwide proprietary network of agents makes the entry of potential rivals on a global scale very expensive and highly risky. Nevertheless, Western Union does face competition in regions with heavy remittance activity, such as Mexico.

### Box II.1. Visa and MasterCard in the U.S.-Mexico Corridor

#### VISA

According to the Nilson Report, Visa was the leading international charge card, accounting for 50.4 percent of global purchase volume in 2003. Visa Giro is an innovative payment solution launched in 2002 by Visa International to facilitate the transfer of money to Latin America. Visa Giro promotes the Visa Electron or Visa's prepaid platforms and offers an opportunity for Visa's member banks to penetrate a new, unbanked market segment. The Visa Giro service works for person-to-person, business-to-consumer and Visa Payroll-to Visa debit reloadable cards.

#### MasterCard

MasterCard, which has a global market share of 29.0 percent, also provides senders and recipients with convenient and affordable remittance services. One innovative program is the MasterCard and Opportunity International partnership, which is aimed at improving the methods by which cross-border remittances are executed. Their co-branded card is called the OPPORTUNITY Card. Opportunity International is a non-profit microfinance organization. According to the OI network's chief executive officer, reduced funds transfer fees include a small contribution to the recipient's local community to assist education, healthcare, and other social projects.

Another MasterCard card-based innovation is the MasterCard MoneySend™ service powered by a Magex Management Payments Platform that provides person-to-person funds transfers. Again this product aims to reduce the inefficiencies encountered during cross-border funds transfers and remittance payments by introducing a more cost-effective and timely product. With MoneySend™, consumers can send funds instantly from one country to another using either a PC or mobile phone. Users simply need a MoneySend branded debit or credit card; no visit to the bank is required. Recipients are notified by an email or SMS message that the funds are available for immediate use. Unlike wire transfers, which can take up to 24 hours or more, transfers using MoneySend take place in seconds.

*Source:* Press Release October 18, 2002 Visa Latin America and Caribbean : "Visa Will Capture the Money Transfer Market in Latin America with Visa Giro," Opportunity International <[www.opportunity.org](http://www.opportunity.org)>, and Cross-border <[www.magex.com](http://www.magex.com)>.

mass mailing of ATM cards. Many credit card companies collaborate with other institutions to increase the number of money-remitting outlets in recipient economies.<sup>47</sup> Utilizing the ATM system is a key mechanism for competing with MTOs, since the time and resources spent building agency networks may be substituted by the distribution of ATM machines and magnetic cards that are cheap and easy to produce. Customers knowledgeable in their use find them a convenient mechanism for cash-to-cash, cross-border transactions.

One industry projection predicts that the number of holders of card-based money transfer products in developing countries will grow from 200,000 in 2002 to 13 million by 2006, and that the value of remittances made through these card-based services using ATMs will grow to US\$19.5 billion. The market share of these products would thus grow from 0.2 percent of remittance value in 2002 to 11 percent by 2006 (Breitkopf 2002).

According to some researchers, money transfer competitors that offer ATM or card-based money transfer products are likely to gain a significant market share in the remittance market. As the August 2002 report from Celent Communications states, "the use of

47. For example, with the Morgan Beaumont Morgan Money Card, remitters can withdraw funds at any ATM worldwide that is part of the Cirrus, Maestro or Mastercard networks. Some companies like IKobo have a similar arrangement with the Visa and Mastercard networks.

ATMs as cash delivery channels may unlock the global market opportunity to outsiders” (Bézard 2002)—meaning that new competitors can challenge the dominance of traditional MTOs’ distribution networks by relying on ATM technology.

### *Postal Administrations*

A number of postal systems are offering money transfer services.<sup>48</sup> In many economies, money orders are available through the postal system in physical or electronic form. However, although the built-in distribution network of the postal system could provide an ideal vehicle for remittances, it is not reliable in some economies. In Mexico, for example, thefts from post offices are common, particularly in rural areas. Post offices have also had liquidity problems and sometimes turn recipients away because disbursement funds are not on hand.

### *Microfinance Institutions and Rural Financial Institutions*

“Microfinance” in Mexico refers specifically to a relatively small group of microfinance institutions, most of them NGOs, that provide credit to microenterprises. Other terms, like “popular banking” or “social finance” refer to a broader range of financial service institutions, such as savings and credit cooperatives, *cajas populares* and other community-based entities. This collection of enterprises is being organized under a new non-bank financial institution law.

Retail-level microfinance providers are organized into the practitioner network *Prodesarrollo* and reach about 350,000 people. While the group encompasses 29 organizations, observers note that only 10 of these have serious potential to become financially sustainable. Only one of these institutions, *Compartamos*, has thus far transformed itself into a regulated financial institution, while the others remain unregulated.

Microbanks are formal, profit-oriented institutions that use microfinance technology (Zeller 2003). Microbanks seek to provide financial services to rural populations, specifically targeting marginalized indigenous communities. Their goal is to bring financial services to communities that have traditionally been deprived of them because of geographic remoteness from mainstream financial hubs. One of their main objectives is to use remittances as a means of creating access to financial services.<sup>49</sup>

## **Informal Funds Transfer Systems**

IFT systems can take many forms, but they tend to operate like any other market player seizing opportunities in response to the same market incentives and competing on the same criteria that formal channels do (convenience, speed, cost, reliability). When Mex-

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48. *Dinero Seguro* of the U.S. postal system, through partnership with Bancomer, Mexico’s largest retail bank, allows remitters to send money to their relatives in a matter of minutes.

49. For example, AMUCSS has established a network of 3 microbanks in Oaxaca, in the Municipality of San Juan Mixtepec, where they have 168 partners (clients) and Mex\$1.7 million in savings. Through this microbank, partners can receive remittances, save and invest them efficiently in a way that benefits their own communities. Some of these remittances are invested in community projects such as paving roads and building auditoriums.



ico experienced its financial crisis in the mid-1990s, IFT systems boosted their popularity by offering remittances in U.S. dollars. They appear particularly active in rural isolated regions, where big banks and MTOs are not established, and around U.S. border towns where border-crossing is commonplace. Even though IFT systems operate informally, they may commonly use bank accounts, for example for clearing transactions with other operators or to hold funds prior to their distribution to remittance recipients.

### *Ethnic Stores*

Ethnic stores are small businesses that operate essentially like MTOs. They have an advantage over more formal institutions, such as banks, since they are often owned and operated by persons whose own historic roots are in the same communities as their migrant-worker customers. These cultural ties give comfort to immigrants who are not accustomed to dealing with impersonal, formal institutions. They also offer greater confidentiality of information.

Anecdotal evidence suggests that some store owners are keen on leveraging the offer of remittance services to cross-sell their stores' other products. Store owners have been known to offer free money orders, but, with the booth to pick up the money order located at the rear of the store, remitters have to navigate through shelves of goods and products from their country of origin to get there. Since the store owner often belongs to the same local ethnic community, it is socially taboo to simply pick up a free money order without making another purchase as well.

### *Hand Delivery/Courier Services*

Funds can also be delivered in person or through a courier service. Some courier services utilize regular bus or shipping businesses to provide funds transfers, particularly in border towns. Customs laws limit the amount of money that couriers may legally bring into or out of an economic jurisdiction without making a customs declaration (for example, \$10,000 into and out of the United States). Mexican Consulate authorities and U.S. law enforcement entities estimate that couriers play a big role in the sending of money to Mexico, and officials confirm that couriers regularly transport bulk cash across the border as part of the drug traffic between the United States and its Latin American neighbors. It is reportedly very simple to send money and have it delivered instantly, like in the Hawala system, through Mexican "*paqueterías*" or courier shops. Many legitimate remitters reportedly shy away from such IFT systems, however, both because of the reputational risks and because thefts are commonplace.

A focused IFT systems study should also examine IFT activity between the northern and southern borders of Mexico, for migrants. While migrants from other Latin American nations used to move in a steady flow through Mexico on their way to the United States, southern Mexico has become a resting and staging area with local expatriate communities creating an atmosphere for IFT systems to spring up to serve these migrant populations.



# U.S. Regulatory Overview

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## Need for Industry Transparency and Information

Since many of the dominant MTOs and banks involved in fund transfers in the U.S.-Mexico corridor are U.S. businesses, the regulatory landscape for wire transfer services in the United States plays a critical role in the competitive dynamic of money transfers in the U.S.-Mexico corridor. The industry for money transfers in the United States remains largely opaque. There is little more transparency for this industry in the United States, which is the world's largest remittances sending country and the home to the world's largest wire transfer businesses, than there is in the developing countries that receive remittances.

The overall regulatory scheme for wire transfers in the United States is complex, characterized by a myriad of different state laws, along with overarching federal laws. As the following discussion will illustrate, this network of laws can create inefficiencies and impediments that lead to high compliance costs for service providers and barriers for competitors to enter the market.

## General Operating Regulations

State laws governing wire transfer services predate federal legislation. The principal rationale inspiring these laws is consumer protection. Each state passes its own laws for licensing agreements to provide money transfer services, and the laws vary between depository and non-depository institutions.

There are some common characteristics among states' laws. Generally, MTOs bear fiduciary responsibility to the money remitter, and there is a 100 percent reserve requirement to cover transactions. These laws do not recognize MTOs as depository institutions,

and the only amount of a transaction that can appear on an MTO balance sheet is the transaction fee. The remittance itself is viewed as the full property of the sender, handled by the MTO as a fiduciary. In this regard, attempts on the part of MTO-like businesses to devise schemes that “collateralize” remittances in the United States are problematic. Since the law does not recognize MTO ownership over the remittance itself, a business cannot practically put something up for collateral that it does not own. States also have bond requirements for MTOs that ensure that the amounts in the possession of the service provider are secure in the event of bankruptcy.

Licensing requirements differ among states, and state laws often do not offer reciprocity. Consequently, a wire transfer service that conducting business in several states must ensure that it stays compliant in each individual state according to its respective criteria.

Banks that provide wire service transfers are generally regulated under federal banking laws that require that banks operate in a safe and sound fashion. Banks tend to adhere to MTO operating regulations when conducting commercial wire transfers, even though they are not legally bound to do so, in order to ensure that their operations remain “safe and sound” relative to the industry standards for MTOs set out in a given jurisdiction.

At the federal level, the Electronic Fund Transfer Act of 1978<sup>50</sup> essentially describes consumer rights with regards to using wire service transfers. Federal Reserve Regulation E<sup>51</sup> was passed to implement the provisions of this law. This legal framework describes the rights and responsibilities of participants in electronic funds transactions, such as disclosure of terms and conditions of the transaction, documentation of transactions through receipts or account statements, limitations on consumer liability for unauthorized transfers, error resolution, and rights related to preauthorized transactions. The act covers only certain kinds of transfers. These include POS (point-of-sale) transactions, ATMs, direct deposit or withdrawals, internet transactions or those initiated by checks. Wire transfers, such as those conducted by Western Union, do not fall under the act; though remittance products such as a stored-value cards, through which funds are received via ATM, are covered.

Credit unions are regulated in a way that prevents them from conducting remittances directly with one another. While no regulation or law specifically sets this prohibition forward, the way in which regulations are implemented by the National Credit Union Association have effectively resulted in this outcome. Credit unions conduct remittances, but must do so through a bank or MTO intermediary. Some organizations provide a mechanism for credit unions to cooperate, but this added layer may increase costs and prevent credit unions from partnering directly with one another.<sup>52</sup>

## Regulations for Disclosure

Disclosure regulations are keyed around two facets of the remittances business: prices and exchange rates. Regulations in this regard are generally more rigorous for MTOs than for banks. Responding in part to pressure and lawsuits, many state-level regulations are firm

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50. 15 USC 1693

51. Federal Reserve System, 12 CFR Part 205

52. WOCCU is one example.

in demanding that MTOs have a transparent pricing structure and disclose the amount that will be paid out on the receiving end after factoring in fees and exchange rates. Federal regulations do not require banks to furnish such disclosure and transparency with respect to remittances, though some choose to do so.

While acknowledging that banks should also have to make such disclosures, some bankers argue that this regulatory adjustment should be gradual because the cost and technical difficulty of an immediate shift toward complete disclosure might scare banks away from the remittances market. In the case of a card-based product, for example, fixing the exchange rate for the transaction prior to the actual withdrawal of funds would create substantial risks for banks in a floating exchange rate environment. Banks would have no way of predicting what the exchange rate will be at an indeterminate future time, when the recipient chooses to make a cash withdrawal from a stored-value card. On the other hand, remittance recipients do not typically allow the funds to sit unclaimed for long, and a transparent pricing structure can be a competitive advantage for the service provider because of the greater confidence it gives customers.

## Bank Secrecy Act and U.S. Patriot Act

AML/CFT regulation in the United States, including the related regulation of wire transfers, is primarily a matter of federal law. Many individual states have also passed statutes that deal with this subject; however, this further complicating the regulatory landscape for fund transfer systems. Federal AML/CFT regulations for wire transfers originate with the Bank Secrecy Act and have been amended by related portions of the U.S. Patriot Act.

Under these statutes, a “covered” financial institution includes “a licensed sender of money” along with banking institutions. All covered institutions under the Act are required to establish an internal anti-money laundering compliance program. The minimum requirements of such a program include a designated compliance officer, appropriate policies and procedures, training programs for employees and an independent audit function to test the procedures. Further provisions of the Patriot Act include requiring that informal funds transfer systems register with the U.S. Treasury Department and be subject to on-site examinations. Depository institutions are subject to added layers of compliance, such as Know-Your-Customer policies for account holders and recipients in correspondent banks.<sup>53</sup>

Some states have gone beyond the requirements set by federal standards, apparently believing that more rigorous regulations were needed for security reasons. However, critics note that such regulations may unnecessarily burden the industry without adding value to the federal regulations that already apply.

International standards play an important role in shaping the way jurisdictions apply AML/CFT standards. The Financial Action Task Force has formulated Special Recommendations on Terrorist Financing that broadly describe the considerations that jurisdictions should keep in mind when formulating AML/CFT policy and regulations (Box III.1).

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53. Schott, USA Patriot Act Increases Anti-Money Laundering Responsibilities for All Financial Institutions; PricewaterhouseCoopers LLP.

### Box III.1. FATF's Special Recommendations on Terrorist Financing

Recommendations VI and VII of FATF's Special Recommendations on Terrorist Financing address alternative remittance systems and wire transfers:

#### VI. Alternative Remittance

Each country should take measures to ensure that persons or legal entities, including agents, that provide a service for the transmission of money or value, including transmission through an informal money or value transfer system or network, should be licensed or registered and subject to all the FATF Recommendations that apply to banks and non-bank financial institutions. Each country should ensure that persons or legal entities that carry out this service illegally are subject to administrative, civil or criminal sanctions.

#### VII. Wire Transfers

Countries should take measures to require financial institutions, including money remitters, to include accurate and meaningful originator information (name, address and account number) on funds transfers and related messages that are sent, and the information should remain with the transfer or related message through the payment chain.

Countries should take measures to ensure that financial institutions, including money remitters, conduct enhanced scrutiny of and monitor for suspicious activity funds transfers which do not contain complete originator information (name, address and account number).

The Special Recommendations, combined with the FATF Forty Recommendations on money laundering, set out a basic framework for detection, prevention, and suppression of terrorist financing and terrorist acts. Specifically, the objective of Special Recommendation VI is to increase the transparency of payment flows by ensuring that jurisdictions impose consistent AML/CFT measures on all forms of funds transfer. The Interpretative Note to Special Recommendation VI states:

Special Recommendation VI consists of three core elements:

- a) Jurisdictions should require licensing or registration of persons (natural or legal) that provide money/value transfer services, including through informal systems;
- b) Jurisdictions should ensure that money/value transmission services, including informal systems . . . are subject to applicable FATF Forty Recommendations (in particular, Recommendations 10-21 and 26-29) and the Eight Special Recommendations (in particular SR VII); and
- c) Jurisdictions should be able to impose sanctions on money/value transfer services, including informal systems, that operate without a license or registration and that fail to comply with relevant FATF Recommendations.

*Source:* FATF GAFI Financial Action Task Force on Money Laundering, 2003. <<http://www.fatf-gafi.org/>>.

## The Need for Regulatory Adjustments

The different layers of regulations between federal and state authorities, as well as the disparity in regulations among the states themselves, can create regulatory impediments that may prevent more competitors from entering the market and create added costs for compliance. Such increased costs and/or constraints on competition result in higher prices for remittance services.

One way of avoiding unnecessary conflicts and overlaps would be for state and federal authorities to agree on a clearer definition of their respective spheres of responsibility. States,

### Box III.2. Regulatory Enforcement Issues from a Bank Practitioner's Point of View

Along with making regulatory adjustments, one of the critical steps in ensuring compliance and sound operations among banks and MTOs in the area of funds transfer is applying adequate and uniform enforcement levels. In addition to what regulations actually say, the manner and degree in which regulations are enforced among the market competitors has important effects on how the market actually operates.

One bank practitioner pointed out, for example, that the balanced and uniform approach of the Patriot Act is correct in its compliance stipulations. However, in his view, banks in practice tend to be under much heavier scrutiny than MTOs. As a result, remitters generally know that “no questions” will be asked at an MTO, and that record keeping is far less rigorous than at a bank. For instance, an MTO outlet placed in a grocery store is not practically subject to the same scrutiny as a bank, where cameras record employee behavior, and signed forms are systematically filed and processed on location. The rigorous certification practice of bank personnel is also not the same for MTO employees. Consequently, compliance costs are lower for MTOs, and many people preferring confidentiality choose to go to the MTO.

Banks also tend to choose not to simplify or loosen their practices because this would be risky vis-à-vis bank regulators.

*Source:* Interview with a bank executive and head of the compliance office.

for example, could focus on licensing regulations, while the federal government focused on the AML/CFT regime. Each entity could avoid legislating in the other's sphere of responsibility, unless laws or regulations mirrored one another.

State regulations could also benefit from better coordination. A good example of such coordination was the process that guided the Uniform Commercial Code (UCC). Article 4A of the UCC governs wire transactions between banks but does not cover consumer transactions. Every state has enacted UCC Article 4A with only minor adjustments. If this kind of effort were also undertaken with regards to consumer remittance transactions, states could take a great step forward in reducing regulatory impediments and costs to entering the remittances market by providing a common standard for licensing requirements and determining parties' rights and responsibilities in a transaction (Box III.2).





# Mexico Regulatory Overview

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In Mexico, banks and other financial institutions are regulated in their operation at the federal level. Banxico has authority to regulate money transfer services that go through formal channels according to Article 31 of the Federal Banking Law.<sup>54</sup> This law also governs wire transfer services in Article 2.

## AML/CFT in Mexico

Mexico joined FATF in June 2000. Money laundering and its related offenses were criminalized in 1996 in Article 400 bis of the Federal Penal Code.<sup>55</sup> In 1997, a Financial Intelligence Unity (FIU)<sup>56</sup> was created to carry out money laundering investigations. Banks and other financial institutions<sup>57</sup> are subject to anti-money laundering regulations that require them to know and identify customers and maintain records of transactions.<sup>58</sup> Under these regulations, all unusual activities and transactions over US\$10,000 must be reported. Mexico continues to implement reforms with guidance from FATF standards, such as Special Recommendation VI and VII. Such reforms help Mexico to keep pace with international

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54. *Ley de Instituciones de Crédito*.

55. Money Laundering is punishable by imprisonment of five to fifteen years and a fine.

56. *Dirección General Adjunta de Investigación de Operaciones* (DGAIO), under the Secretariat of Finance and Public Credit (*Hacienda*).

57. Mutual savings companies, insurance companies, financial advisers, stock markets, and credit institutions.

58. General Law of Organizations and Activities of Auxiliary Credit Institutions (*Ley General de Organizaciones y Actividades Auxiliares del Crédito*-LOAC).

standards for AML/CFT. For example, the Federal Penal Code (Articles 139 and 140 BIS)<sup>59</sup> was recently amended to link terrorist financing with money laundering.

## New Regulations

On January 28, 2004, the Official Gazette published a set of reforms to several financial laws<sup>60</sup> aimed at strengthening the financial system and promoting transparency. Subsequently, on May 14, 2004, a set of rules was approved by Congress to regulate the operation of auxiliary credit institutions (AICs), including exchange bureaus, and money transfer operators (MTOs) and individuals, including money services businesses (MSBs)<sup>61</sup> to detect and prevent acts of terrorist financing and money laundering.

Under the new rules AICs, exchange bureaus, MTOs and individuals (including MSBs) must:

- Report to the Ministry of Finance any unusual, relevant and suspicious operations and transfers;<sup>62</sup>
- Establish internal policies of customer identification and KYC rules;
- Have computerized systems for the control of information sending;
- Keep records of every transaction for a minimum period of ten years;
- Develop training and information programs; and
- Maintain strict confidentiality regarding transactions reporting, and refrain from alerting customers about their inclusion in such reports.

In addition, there are specific requirements for:

- AICs and exchange bureaus, which are required to create a cooperative mechanism responsible for supervising the application of the regulations and to verify their operation;

and for:

- MTOs and individuals, including MSBs, which are required to designate one or more persons responsible for verifying the proper application of the law, supervising operations, and closing down accounts when suspicious activity is detected.

59. Articles 139 and 140 BIS of the Federal Penal Code (*Código Federal Penal*) in force.

60. *Ley de Instituciones de Crédito; Ley de Ahorro y Crédito Popular; Ley de Instituciones de Fianzas; Ley General de Instituciones y Sociedades Mutualistas de Seguros; Ley del Mercado de Valores; Ley de Sociedades de Inversión; Ley General de Organizaciones y Actividades Auxiliares del Crédito.*

61. Money Service Business (MSBs) are known as “*Centros Cambiarios*” and are businesses that, in addition to their regular business (e.g. pharmacy), are engaged in the transmission of money, including the payment of remittances. A difference between these and Exchange Bureaus is that the latter may also engage in remittance operations from Mexico to other jurisdictions.

62. Auxiliary Credit Institutions and Exchange Bureaus must report to the National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores-CNBV*), and Money Transfer Operators and Individuals (including MSBs) to the Fiscal Administration Service (*Sistema de Administración Tributaria-SAT*).

According to interviews with market players, there is some concern regarding the lack of capacity, especially for MSBs, to implement the required measures and to develop appropriate technology to comply with the new rules. This potential inability to keep pace with new regulatory standards might result in exclusion from the market in favor of the larger competitors that have sufficient capital to invest in new technology and adjust their operations accordingly. MSBs play a business and social role in many communities where financial access is limited or non-existent.

Although the government has not yet fully implemented the new rules, private sector entities have started to develop prudential requirements and due diligence practices in view of the new legislation. A concern in this regard is that, the private sector might implement the due diligence standards in a discretionary manner that could have the effect of squeezing out smaller competitors. Small competitors that rely on their relationships with larger banks to perform remittances may find that “due diligence” jeopardizes the relationship.

## International Cooperation

Mexico has a broad network of bilateral agreements with the United States including the Financial Information Exchange Agreement and the Memorandum of Understanding for the Exchange of Information on the Cross-Border Movement of Currency and Monetary Instruments. It has also created a Business Anti-Smuggling Coalition (BASC) that includes the establishment of a financial BASC chapter to deter money laundering.

In addition, Mexico participates in the Caribbean Financial Action Task Force as a cooperating and supporting nation and in the South American Financial Action Task Force as an observer member. It is also a member of the Egmont Group and the Organization of American States/*Comision Interamericana para el Control del Abuso de Drogas* (Inter-American Drug Abuse Control Commission) Experts Group to Control Money Laundering. Mexico is a party to the 1998 UN Drug Convention, the Convention against Transnational Organized Crime, the UN International Convention for the Suppression of the Financing of Terrorism, the Inter-American Convention Against Terrorism and the UN Convention Against Corruption.



# Incentive Analysis

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This annex analyzes some main incentives that have contributed to determining users' choices between FFT and IFT systems. The table, which follows the format of the initial APEC Report's "incentives analysis,"<sup>63</sup> was applied by the study team as a basis for identifying and discussing key features of the remittances corridor. The information was drawn from field research as well as from published documents and official reports. During two missions to Mexico, the study team visited Mexico City; Muna, Merida, Yucatan; Leon and Valle de Santiago, Guanajuato; Oaxaca, Asuncion Nochixtlan, Tlaxiaco and Tlacolula, Oaxaca; Morelia, Atacheo, La Purisima and Chuhayito, Michoacan. Some 49 interviews were conducted with Mexican authorities, private sector entities, the World Bank country office, migrants and their families and informal fund transfer operators. In the United States, the study team visited New York, Chicago and Springfield, Illinois and conducted 14 interviews with Mexican officials, hometown associations, private sector entities, IFT operators, migrants, a financial supervisory institution, Mexico-U.S. and community representatives.

## First Mile

A shift from informal to formal remittance systems is ultimately the result of customers' choices of one avenue for money transfer over another. Since transaction are created by the senders, an understanding of their incentives at the First Mile is key for identifying how formal channels may be strengthened to attract and keep money-remitting customers.

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63. APEC Working Group on Alternative Remittance Systems. 2003. "Informal Funds Transfer Systems in the APEC Region: Initial Findings and a Framework for Further Analysis." Paper prepared for the meeting of APEC Finance Ministers and Deputies, Phuket, Thailand, September 2–4.

<b>First Mile</b>	
<b>Personal Incentives</b>	
Anonymity/Secrecy	<ul style="list-style-type: none"> <li>◆ Some migrant workers believe that formal financial institutions, such as banks or credit unions, are connected with law enforcement or immigration authorities. Consequently, undocumented migrant workers avoid contact with these institutions.</li> <li>◆ In addition, Mexicans tend not to trust banks, a long-standing attitude exacerbated by the “Tequila Crisis.” As a consequence, Mexico has one of the poorest levels of banking penetration in Latin America.</li> </ul>
Cultural Familiarity	<ul style="list-style-type: none"> <li>◆ Among Mexican migrant workers, lack of cultural familiarity with formal financial institutions (such as banks) often lead them to opt for alternative financing mechanisms and informal remittance systems, many of which are run by entrepreneurs with common community origins and cultural roots.</li> <li>◆ Some formal systems, such as MTOs, have been popular when they successfully availed themselves to migrants by shedding the physical “impression” and aura of a banking institution, opening branches close to migrant communities, offering bilingual services and establishing convenient operating hours.</li> <li>◆ As an example we have Second Federal Savings a Mutual Savings and Loan Association serving the Chicago area with other branches in Cicero, Fox Lake and Aurora. They provide banking services and products geared to migrant communities and participate in events and with organizations that are committed to better serve and inform those communities.</li> </ul>
Personal Contacts	<ul style="list-style-type: none"> <li>◆ Personal contacts are a key aspect of the informal remittance channels from Mexican migrants because they represent a personal social link back home as do Home Town Associations (HTA).</li> <li>◆ The informal funds transfer systems operating between Mexico and the United States are an extension of the larger cross-border social connections between migrants and their home communities in Mexico.</li> <li>◆ Unlike IFT systems in other parts of the world that developed primarily to facilitate trade (for example, the <i>Hawala</i> system in the Middle East), the IFT systems between the United States and Mexico principally facilitate the movement of funds as well as letters, food, and other nostalgic goods. Sometimes the channel through which funds are remitted informally involves the same contacts and people who facilitated the migration of the worker.</li> <li>◆ Many HTAs are representative of a particular region of Mexico, whose emigrants over time have concentrated in a particular U.S. city and have organized themselves into an expatriate community. The team thus observed “regional corridors” within the U.S.-Mexico corridor.</li> <li>◆ The HTA represents a concerted effort to organize remittances in the United States for small-scale development projects in the home community in Mexico. According to Federation of Michoacan Clubs in Illinois, the personal and social link developed through the HTA gives migrants a way to stay involved in their hometowns.</li> <li>◆ The <i>Michoacanos</i> who are in the US are still very connected with their community in Mexico, and many hope to return to Mexico one day. They raise money among the immigrants to build public services in their communities in Mexico, including water and sewerage pipes, monuments, churches, streets, and so forth. The funds for these building projects are normally transported to Mexico by hand by someone from the community going to Mexico to visit the family.</li> </ul>

<b>First Mile</b>	
<b>Customer Service Incentive</b>	
Dispute Resolution	<ul style="list-style-type: none"> <li>◆ Consumer protection regulations commonly provide mechanisms for the resolution of disputes between customers and formal financial institutions. At the Federal level, the Electronic Fund Transfer Act of 1978 essentially describes consumer rights with regards to using wire service transfers. Federal Reserve Regulation E’s framework describes the rights and responsibilities of participants in electronic funds transactions. Such regulations can provide customers, including remitters, some confidence that he or she will not be taken advantage of.</li> <li>◆ Migrant workers often are not aware of these protections, however, or of the steps to be taken to use them. Moreover, the fact that formal systems often involve large companies with levels of bureaucracy or administration can leave the remitter feeling “overmatched” if a problem does occur.</li> <li>◆ Many formal funds transfer systems today have streamlined remittances operations to avoid disputes over costs, fees or remittances delivery.</li> </ul>
Accessibility	<ul style="list-style-type: none"> <li>◆ Gaining access to formal financial services for the migrant worker is a key issue in the United States.</li> <li>◆ The I.D. obstacle and the lack of a banking culture among Mexican migrants have impeded access to the formal system, particularly to banks, leading migrants to choose informal channels.</li> <li>◆ Banks in the United States have not generally sought the business of poor households and minority populations, including Mexican migrant workers. Alternative financial services, including informal remittance systems have served to fill the vacuum.</li> <li>◆ Many migrants get paid by check but are unable to easily cash the checks at banks without having accounts there. Therefore, migrants use other operators (such as those in supermarkets) that charge much higher fees to cash their checks.</li> <li>◆ Along with socioeconomic obstacles, migrants are hampered in their access to formal financial services by their lack of financial education.</li> <li>◆ Many migrants simply are not aware of the range of remittance services and options that are available to them and only take notice of those formal institutions that have made a conscious effort to advertise and establish a presence in migrant communities.</li> <li>◆ MTOs were traditionally the only institutions to adopt such a strategy, but some banks have begun to make efforts to this end in recent years.</li> <li>◆ The New Alliance Task Force (NATF) was launched in May 2003 by the FDIC Community Affairs program and the Consulate General of Mexico. The mission of the NATF is to improve the access to the U.S. banking system among recent immigrants and to take concrete steps to carry out the Action Plan outlined in the U.S.-Mexico Partnership for Prosperity Agreement.</li> </ul>
Discrimination	<ul style="list-style-type: none"> <li>◆ Many migrant workers, along with low-income and minority groups more generally, may have been prevented from realizing the full range of formal financial services by overt discrimination as well as by the indirect and unintended effects of marketing schemes and strategies that simply overlook them.</li> <li>◆ Overt discrimination by formal funds transfer systems has declined as an issue since formal sector institutions have recognized the potentially profitable market of migrant workers.</li> </ul>

*(continued)*

<b>First Mile (Continued)</b>	
<b>Customer Service Incentive</b>	
	<ul style="list-style-type: none"> <li>◆ Banks and other formal funds transfer systems are now recognizing the profit potential of providing remittance services to Mexican migrant workers and have made efforts to reach out to them, making service branches more welcoming, establishing branches with convenient hours in or near migrant communities, hiring bilingual staff, simplifying pricing structures, accepting the MCAS as valid identification, and developing remittance products and services tailored to migrant worker needs.</li> </ul>
Reliability	<ul style="list-style-type: none"> <li>◆ In choosing a remittance channel, senders must have some level of confidence that the intended recipients will receive the funds at the Last Mile.</li> <li>◆ Although the size and stability of the U.S. financial sector provides some confidence in its reliability, many Mexican migrants arrive with a long-standing distrust of banks and prefer the comfort of personal relationships and cultural affinity more often found in the informal remittance systems.</li> </ul>



<b>First Mile</b>	
<b>Economic Incentives</b>	
Speed	<ul style="list-style-type: none"> <li>◆ From a First Mile perspective there is not a notable difference in speed of service between formal and informal remittance systems.</li> <li>◆ Formal remittance systems between the United States and Mexico have become quite streamlined, making for fast service on demand.</li> <li>◆ Some FFT systems have pricing structures that vary according to the speed of service.</li> <li>◆ Stored-value, card-based products have been developed that make funds accessible to recipients at their pleasure.</li> </ul>
Cost	<ul style="list-style-type: none"> <li>◆ Cost, reliability, and familiarity of the channel are the key factors that sender's consider when choosing a remittance system.</li> <li>◆ Competition among formal funds transfer systems in the U.S.-Mexico corridor has grown rapidly over the past several years, and, consequently, prices for remitting through formal systems have been driven down considerably.</li> <li>◆ BANXICO has calculated that the average cost for sending a US\$300 remittance has fallen from US\$26.12 in 1999 to US\$12.84 in 2003.</li> </ul>
Secondary Benefits	<ul style="list-style-type: none"> <li>◆ Some formal remittance systems have developed innovations or incorporated features that provide benefits in addition to money remittance service. Some banks that have recently entered the market, for example, offer low minimum balance savings accounts to remitters.</li> <li>◆ Some businesses have built on remittances to create land investment and home investment opportunities for the remitter. When sending funds through a particular organization, the remittance can be used as a mortgage payment on land or a home in Mexico.</li> <li>◆ Under a federal program launched by the Mexican government and administered by the <i>Sociedad Hipotecaria Federal</i> (SHF), or Federal Housing Agency, remittances from the United States are directly applied to mortgages for buying houses in Mexico.</li> <li>◆ A Home Town Association called <i>Asociación Tepeyac</i> in New York City, fosters the use of banks as a savings and investment tool among migrants. These associations are approached by financial institutions for the promotion of their products.</li> </ul>
Legal/Regulatory Environment	<ul style="list-style-type: none"> <li>◆ The U.S. legal and regulatory for remittances allows international remittances to occur through businesses of all kinds.</li> <li>◆ Consumer protection laws apply to certain products and services and explain the rights and duties of all parties to a transaction in the event of mistake or error. Regulations also call for transparent pricing to the benefit of the sender.</li> <li>◆ Strengthened requirements for customer identification under AML/CFT regulations are unlikely to affect legitimate remittances in a negative way, unless the migrant senders want to avoid I.D. procedures altogether as discussed previously.</li> <li>◆ Harmonizing regulations between federal and state authorities, as well among states, is needed to reduce compliance costs and remove impediments to competition.</li> </ul>

**Last Mile**

The landscape of the Last Mile is an important factor for the sender as the choice of a remittance system is considered. Senders will be influenced not only by prices and incentives at their end, but will also consider manner in which the remittance will be received. Of utmost concern to the remitter, of course, is that the funds are actually received by the recipient.

<b>Last Mile</b>	
<b>Personal Incentives</b>	
Anonymity/Secrecy	<ul style="list-style-type: none"> <li>◆ Mexican recipients at the Last Mile do not deal with issues regarding immigration status, which removes one of the key incentives for maintaining anonymity and secrecy.</li> <li>◆ Some recipients may be concerned, however, that information about their remittance incomes not be available to other relatives, neighbors, or local officials.</li> </ul>
Cultural Familiarity	<ul style="list-style-type: none"> <li>◆ Some recipients, particularly in rural areas, may prefer to deal with local people with whom they feel a cultural affinity, rather than with impersonal bankers with whom they feel uncomfortable.</li> </ul>
Personal Contacts	<ul style="list-style-type: none"> <li>◆ IFT systems that deliver funds to a community in rural regions, tend to operate through a trusted well-respected member of the community. Personal contacts play a role in rural regions where formal funds transfer systems have not yet penetrated.</li> </ul> <p>In urban communities and regional centers, personal contacts play a lesser role in the delivery of remittances. Banks, MTO branches and department stores serve as points of disbursement for recipient.</p>

<b>Last Mile</b>	
<b>Customer Service Incentives</b>	
Dispute Resolution	<ul style="list-style-type: none"> <li>◆ Disputes may occasionally arise in the Last Mile regarding the remittance “pay-out.”</li> <li>◆ Since informal systems are generally social links through personal contacts, recipients often view them as more reliable and trustworthy and less likely to resolve disputes unfairly.</li> </ul>
Accessibility	<ul style="list-style-type: none"> <li>◆ Last Mile accessibility is one of the primary issues for remittances between the United States and Mexico.</li> <li>◆ Increased competition in the formal sector has created an efficient “paved road” for remittances from the United States to Mexico’s urban and regional centers, but formal financial institutions have not generally extended this road into the rural areas.</li> <li>◆ Banks and big businesses that have established themselves in the remittances market do not perceive profit opportunities for investing in rural networks for remittances. Thus, they tend to stay concentrated in urban areas and regional centers.</li> <li>◆ Rural recipients are thus faced with the option of relying largely on informal systems, which have filled the vacuum in rural areas, or traveling at considerable cost in terms of time and money to an urban or regional center where the closest FFT system operates.</li> <li>◆ Microfinance institutions, the <i>Cajas Populares</i>, credit unions and rural banks can become bridges between the urban financial sector and the rural areas, thus paving the road for remittances in Mexico.</li> </ul>
Reliability	<ul style="list-style-type: none"> <li>◆ Formal distribution channels in Mexico are largely stable and secure, as many of them are connected to large profitable businesses and banks that do business internationally. Mexicans have traditionally been wary of banks’ reliability, however, a scepticism exacerbated by the “Tequila Crisis.”</li> <li>◆ Periods of financial sector instability have thus contributed to the popularity of informal channels. Informal channels, particularly in the rural areas also tend to be better insulated from the kinds of shocks that destabilize the formal financial sector.</li> </ul> <p>The postal service extends into rural regions, and can serve as a formal remittance distribution network. However, there are mixed views regarding its reliability. Remittance theft from post offices are not uncommon, particularly in rural regions, and post offices also occasionally experience liquidity shortages. These sorts of episodes have driven some remitters away from using postal services.</p>

<b>Last Mile</b>	
<b>Economic Incentives</b>	
Speed	<ul style="list-style-type: none"> <li>◆ The speed of transfers along the “paved road” from the United States to Mexico’s urban and regional centers is generally the same for formal or informal systems.</li> <li>◆ The competition among formal channels has boosted the proliferation of fast and efficient technology to facilitate transfers, and distribution networks have opened specialized branches with early hours for the convenience of the customer.</li> <li>◆ The issue of speed is a factor in rural areas, however, and particularly in “emergency situations.” IFT systems are an established part of many rural communities, and the provider will deliver funds to the door. This is a faster and more efficient method than the day travel to the nearest FFT outlet.</li> <li>◆ There are micro-scale projects underway in some rural communities to utilize internet and satellite technology to create a remittance channel. This approach appears to have potential but has not yet occurred on a wide enough scale to determine how successful it will be.</li> </ul>
Cost	<ul style="list-style-type: none"> <li>◆ Fees for the remittance are established at the point of entry and paid by the sender. Recipient usually receive the funds with no additional charge, although there may be travel or other costs involved.</li> <li>◆ Last Mile issues can directly affect cost in the provision of IFT services in rural areas. IFT systems operate like any other market participant, filling market niches and seizing business opportunities. <ul style="list-style-type: none"> <li>◇ IFT systems may charge higher rates in some rural areas, because they essentially have a monopoly on remittance delivery services in that community.</li> <li>◇ This is also the case with “emergency” remittances, where rural recipients do not have the time to travel to a FFT distribution branch.</li> </ul> </li> </ul>
Secondary Benefits	<ul style="list-style-type: none"> <li>◆ At the receiving end, secondary benefits typically take the form of innovative business schemes or are offered through the cross-selling of financial services.</li> <li>◆ Some businesses that deliver remittances may also, for example, sell appliances. Deals are created where a percentage of the recipient’s remittance is used as a down payment for an appliance, such as a refrigerator. There are reports, however, that recipients are sometimes duped or coerced into such deals, leaving the recipient with less actual funds from the remittance, a new bill to pay, and/or an appliance that they did not really need.</li> <li>◆ While many large banks and MTOs view remittances as a fee-only product, some banks and microfinance institutions attempt to use remittances as a way to get recipients to open bank accounts and build credit. Recipients may be encouraged to leave a percentage of their remittance in a savings account. Not only can this provide additional income and risk-management possibilities for the remittance recipients, but the fee income and deposit mobilization can contribute to the microfinance institution’s own financial sustainability.</li> <li>◆ Through <i>L@Red de la Gente</i>, consumers have access to branches, to receive remittances in areas where the traditional financial system does not have coverage. <ul style="list-style-type: none"> <li>◇ Through this system, migrants can access financial services through their remittances as well as support assistance programs of the Mexican government (for example, housing, health, and education).</li> </ul> </li> </ul>

(continued)

<b>First Mile (Continued)</b>	
<b>Customer Service Incentive</b>	
	<ul style="list-style-type: none"> <li>◇ Mexicans in the United States have access to a savings accounts through <i>L@Red de la Gente</i> office in Chicago enabling them to direct remittances to purposes other than consumption.</li> </ul>
Legal/Regulatory Environment	<ul style="list-style-type: none"> <li>◆ In Mexico, banking and financial institutions are regulated in their operation at the federal level.</li> <li>◆ BANXICO has authority to regulate money transfer services that go through formal channels; to standardize the characteristics of the information that is received by BANXICO; and to create of a record of the enterprises that participate in the market.</li> <li>◆ BANXICO issued a set of rules in 2002 requiring all firms involved in money transfer operations to register and provide monthly data, including the amounts transferred to Mexico through instruments used for worker remittances, broken down by recipient state.</li> <li>◆ Regulations have created a consistent methodology for keeping statistics and tracking the delivery of flows by BANXICO, thereby adding transparency to the market. These rules have helped to strengthen formal remittance channels.</li> <li>◆ Mexico joined FATF in June 2000. Money laundering and its related offenses were criminalized in 1996, and a Financial Intelligence Unit (FIU) was created in 1997. Banks are subject to anti-money laundering regulations.</li> <li>◆ The Mexican FIU recently received new powers that provide it with enhanced capacity to fight money laundering and terrorist financing.</li> <li>◆ The Mexican Congress passed a decree on May 14, 2004, amending financial legislation to regulate the operation of Auxiliary Credit Institutions (AICs) so as to detect and prevent acts, omissions, or operations that could favor, help, or facilitate in any way terrorism or the financing of terrorism and money laundering.</li> </ul>



# Discovering the Road between the First and the Last Mile

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**T**his Annex describes some specific examples of the issues discussed in the main report. It consists of three sections:

- The first section, which is based on a survey conducted among Mexican Consulates in the United States, which identifies regional corridors within the U.S.-Mexico corridor, and provides further information on IFT systems. The survey was conducted in coordination with the Mexican Ministry of Foreign Affairs.
- The second section describes features of two regional corridors within the U.S.-Mexico corridor, focusing on the distribution stage of the remittance corridor. Some of the obstacles present in the Last Mile as well as some examples of new mechanisms that have been implemented to enhance the impact of the remittances flows<sup>64</sup> are highlighted.
- The final section details field work in Mexico City on cashing remittances.

## Regional Corridors Shaping the First Mile

Interviews and field research in the U.S.-Mexico corridor revealed migration patterns that have linked migrants' cities of origin in Mexico with their destination cities in the United States. A small survey conducted by the World Bank and the Ministry of Foreign Affairs maps the regional corridor by consular jurisdiction, the impact of the *Matricula Consular*

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64. This ANNEX is based on field work conducted in the US (New York, NY, and Chicago, IL), and Mexico (Oaxaca and Michoacan states).

(MCAS), and the use of IFT systems in those regional corridors. Based on the analysis of this survey, there are defined market niches for remittances that link a particular region in the United States with Mexican states. This is an important feature of the overall U.S.-Mexico corridor that could lead to new initiatives to take advantage of the configuration of these sub-corridors.

Table VI.A.1 describes the regional corridors between states in the United States, grouped by Mexican consular jurisdictions and the Mexican states where the migrants are from. For each consular jurisdiction, data are presented on the distribution of remittances among Mexican states. Table VI.A.2. shows the estimated number of Mexican living in each jurisdiction (including undocumented workers), the estimated annual remittance flows and the average remittance amount per migrant. For some of the jurisdictions, Consulates also provided rough estimates of the percentage of remittances flowing through informal channels.

## Where the Last Mile Ends

The information contained here describes remittances transaction from its origination to its distribution in two regional corridors.

### *From the Tri-State Area to the Mixteca Triangle*

This regional corridor includes migration flows and remittances going from the New York Metropolitan area to the mountains of Oaxaca, in the Mixteca region of Mexico. Research included interviews with migrants and their relatives; Home Town Associations (HTAs); the Mexican Consulate, banking commission, and Telecomm officials; banks; and savings and credit institutions (SCIs).

### *The First Mile*

Despite the recent recession in the U.S. economy, the remittance flow from the United States to Mexico has continued to grow. In 2003, it increased by 35 percent with respect to the previous year, reaching more than US\$13 billion. Remittances from migrants in the United States have thus become one of Mexico's most important sources of income. The Mexican Consulate in New York City<sup>65</sup> estimates that about 800,000 Mexicans live in New York, although members of the Mexican migrant community believe that the number is closer to 1.5 million. The Mexican states where the greatest numbers of migrants in New York originate are Puebla, Oaxaca, Guerrero, and within them an area known as the *Mixteca Triangle*, Morelos, Tlaxcala, Hidalgo, Veracruz, Estado de México and most recently Mexico City.

Non-governmental organizations like the *Asociación Tepeyac* in New York seek to encourage Mexican migrants to utilize formal financial services as a step into the mainstream U.S. economy. Financial institutions sometimes approach these associations for the promotion of their products, but there is still a general lack of trust among migrants in formal financial institutions stemming from negative experiences with financial institutions in Mexico and a fear of not having access to their savings in the event they are deported.

*(text continues on page 81)*

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65. The jurisdiction of the Consulate includes New York State, New Jersey and Connecticut.



**Table VI.A.1. Remittances Flows from the United States to Mexican States I, 2004**

Mexican States Remittances Recipients by Order of Importance																							
Consulate Jurisdiction	Baja California	Chiapas	Chihuahua	Coahuila	Distrito Federal	Durango	Estado de México	Guanajuato	Guerrero	Hidalgo	Jalisco	Michoacán	Nuevo León	Oaxaca	Puebla	Sinaloa	Sonora	San Luis de Potosí	Tamaulipas	Tlaxcala	Veracruz	Zacatecas	
AZ—Tucson (Pima and Pinal counties)		3rd														2nd	1st						
AZ—Yuma (Yuma and La Paz counties)	8th						7th	4th			6th	3rd		5th		2nd	1st						
CA—Los Angeles (Los Angeles county plus 14 counties)					4th 7%		7th 6%	8th 6%			1st 26%	6th 6%		5th 6%	3rd 7%								2nd 8%
CA—San Diego (San Diego county)	1st				4th			2nd			5th	6th		3rd									
CA—San Francisco (9 counties)																							
CA—San José (4 counties)					5th 6%		3rd 10%	6th 4%			2nd 20%	1st 25%		4th 10%									
FL—Miami (Florida state)							1st	3rd				2nd											
FL—Orlando (54 counties)		9th 5%			6th 6%	5th 7%	2nd 12%	3rd 8%	1st 18%		4th 8%			7th 6%				10th 4%				8th 6%	
GA—Atlanta (Georgia, Alabama, Tennessee and Mississippi)					5th	7th	2nd	1st	4th	10th	3rd			9th				6th					8th
MA—Boston (Massachusetts, Maine, New Hampshire, Rhode Island and Vermont)					7th			4th	3rd	1st	6th			5th			8th						2nd
MI—Detroit (Michigan state and North of Ohio)					5th	6th	1st		9th	2nd	3rd			4th	10th							7th	8th
MO—Kansas (Missouri, Kansas and Oklahoma)			1st		2nd		4th				5th	6th											3rd
NC—Raleigh (North Carolina and South Carolina)					10th 5%	7th 6%	3rd 11%	1st 12%	4th 9%		5th 9%			6th 8%	8th 5%							2nd 11%	
NE—Omaha (Nebraska, Iowa, South Dakota and North Dakota)							4th	5th			2nd	3rd						1st				7th	
NM—Albuquerque (32 North and Center counties)			1st	2nd	3rd																		4th

(continued)



**Table VI.A.2. Remittances Flows from the United States to Mexican States II, 2004**

<b>Consular Jurisdiction</b>	<b>Mexican nationals living in this jurisdiction (1,000)</b>	<b>Estimated undocumented workers (1,000)</b>	<b>Annual remittances flows (US \$ million)</b>	<b>Average remittance (US\$)</b>	<b>Estimated informal flows (% of total)</b>
<b>AZ—Tucson</b> (Pima and Pinal counties)	450	36	N/A	N/A	Mostly formal
<b>AZ—Yuma</b> (Yuma and La Paz counties)	69	14	N/A	N/A	N/A
<b>CA—Los Angeles</b> (Los Angeles county and 14 counties)	3,155	1,524	7,886.3	2,500	2%
<b>CA—San Diego</b> (San Diego county)	700	N/A	800.0	1,143	N/A
<b>CA—San Francisco</b> (9 counties)	700	N/A	N/A	N/A	N/A
<b>CA—San José</b> (4 counties)	750	600	N/A	N/A	N/A
<b>FL—Miami</b> (Florida state)	250	225	N/A	N/A	N/A
<b>FL—Orlando</b> (54 counties)	163	114	268.0	1,648	2%
<b>GA—Atlanta</b> (Georgia, Alabama, Tennessee and Mississippi)	600	480	918.3	1,531	17%
<b>MA—Boston</b> (Massachusetts, Maine, New Hampshire, Rhode Island and Vermont)	80	40	N/A	N/A	N/A
<b>MI—Detroit</b> (Michigan state and North of Ohio)	469	195	645.2	1,376	22%
<b>MO—Kansas</b> (Missouri, Kansas and Oklahoma)	172	N/A	N/A	N/A	N/A
<b>NC—Raleigh</b> (North Carolina and South Carolina)	500	450	750.0	1,500	N/A
<b>NE—Omaha</b> (Nebraska, Iowa, South Dakota and North Dakota)	220	63	111.8	508	N/A
<b>NM—Albuquerque</b> (32 North and Center counties)	401	60	53.8	134	N/A
<b>NV—Las Vegas</b> (Nevada State)	330	N/A	\$1,200.0	3,636	Mostly informal

*(continued)*

<b>Consular Jurisdiction</b>	<b>Mexican nationals living in this jurisdiction (1,000)</b>	<b>Estimated undocumented workers (1,000)</b>	<b>Annual remittances flows (US \$ million)</b>	<b>Average remittance (US\$)</b>	<b>Estimated informal flows (% of total)</b>
<b>NY—New York</b> (New York, New Jersey and Connecticut)	800	560	N/A	N/A	N/A
<b>OR—Portland</b> (Oregon State)	600	440	N/A	N/A	N/A
<b>PA—Philadelphia</b> (Pennsylvania, Delaware and 8 counties of the South of New Jersey)	180	145	271.0	1,506	3%
<b>PR—San Juan</b> (Puerto Rico and Virgin Islands)	12	N/A	N/A	N/A	N/A
<b>TX—Presidio</b> (14 counties)	94	N/A	N/A	N/A	N/A
<b>TX—Austin</b> (23 counties)	N/A	N/A	N/A	N/A	N/A
<b>TX—Brownsville</b> (3 counties)	240	96	96.0	400	8%
<b>TX—Dallas</b> (States of Arkansas, Oklahoma and 100 counties of Texas)	1,222	400	2,555.0	2,090	2%
<b>TX—Eagle Pass</b> (7 counties)	86	N/A	N/A	N/A	N/A
<b>TX—El Paso</b> (Counties from Texas's Southeast and New México's South)	668	100	N/A	N/A	N/A
<b>TX—Houston</b> (37 counties from Texas and Louisiana State)	1,131	N/A	N/A	N/A	N/A
<b>TX—Laredo</b> (6 counties)	163	10	N/A	N/A	N/A
<b>TX—San Antonio</b> (27 counties)	900	N/A	1,500.0	1,667	N/A
<b>WA—Seattle</b> (Washington and Alaska)	530	97	263.0	496	N/A

N/A: Not available

Officers of the *Asociación Tepeyac* referred to remittances as a form of foreign aid that helps the families back home to alleviate poverty, finance investment and achieve higher standards of living.<sup>66</sup> Migrants themselves, however, expressed some skepticism. The illegal status of many immigrants impedes their access to financial services and to investment possibilities in both the United States and Mexico. In general, migrants would like to invest money in Mexico, but are inhibited by the lack of trust in the government and the little information available to them on how to invest. Many migrants also feel that investments in Mexico are of no value to them since they cannot go back.

Members of the migrant community in New York expressed concern that the dependence of their families in Mexico on remittances could impair local initiative and reduce incentives for people to work toward improving their own lives. They also worried that remittances were inflating the value of land and the cost of services in their home towns. Because of the large remittance flows, the value of land in recipient towns has reportedly increased tremendously.

According to an executive of a HTA,<sup>67</sup> because of the large immigration rate to New York from Mexico, many migrants have built large houses that remain empty in his hometown of *Tulcingo del Valle*. It is very difficult to find people to rent those houses because of their inflated value. Land values have reportedly increased so much that it has become cheaper to buy land in Mexico City than in Tulcingo.<sup>68</sup>

Besides the migrants' influence on Mexican incomes from New York, Mexico's emigrants have now gained an unprecedented level of respectability and political influence. More can be done to make it possible for migrants to participate in the decision-making process back home. A law is currently being considered in Mexico to allow migrants living in the United States to vote in Mexican presidential elections. If remittances continue to grow at the rate of the last few years, migrants could become increasingly influential in the politics as well as of in the economy of their home country.

### *The Last Mile*

*Oaxaca.* According to the State of Oaxaca Office for Migrants,<sup>69</sup> some of the main issues affecting the State of Oaxaca in regards to remittances are the high cost of sending money; the loss of money in transit; the distance among branches for receiving and depositing remittances; the fact that people sometimes receive less money than was sent to them; that recipients are often enticed into buying unneeded furniture and appliances instead of being paid their money; and that many migrants are assaulted and robbed when coming out of the establishment where they receive their money.

In 2003, the State received an estimate of 750 million dollars from workers remittances (Figure VI.1).

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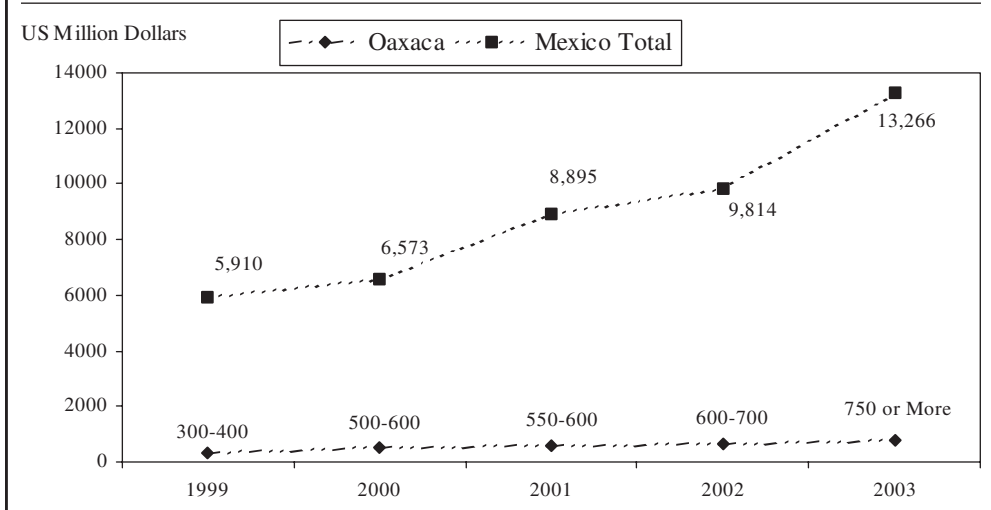
66. Meeting with Joel Magallán, Executive Director and Teresa García, Finance and Development Director, May 2004. According to them, an estimated 60 percent of the population of some Mexican towns have immigrated to the United States.

67. Casa Puebla.

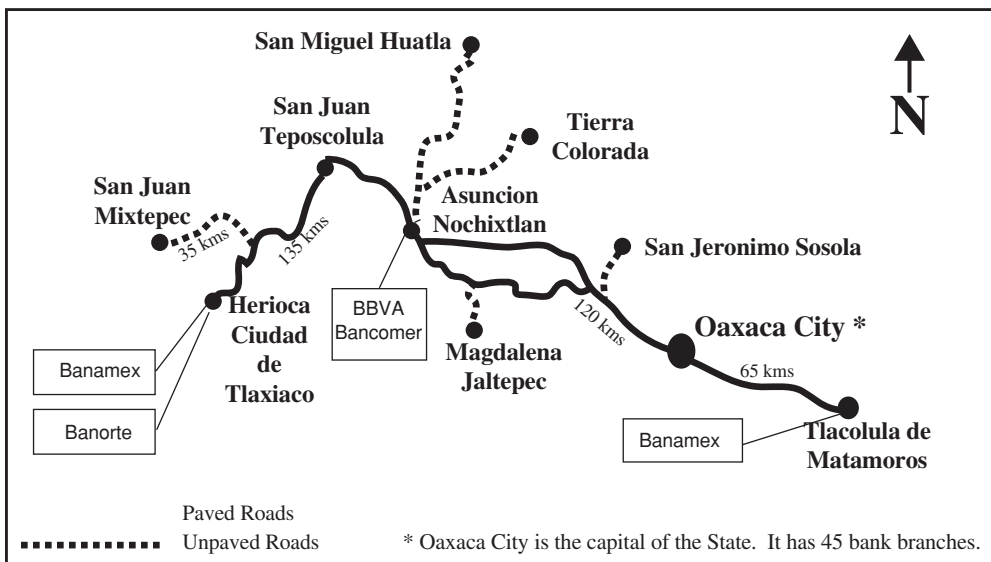
68. For reference look at: <http://www.tulcingo.net>

69. Coordinación Estatal de Atención al Migrante Oaxaqueño.

**Figure VI.1 Comparison between the Remittances to Oaxaca and Mexico in Total (1999–2003)**



Source: Banxico; Coordinación Estatal de Atención al Migrante Oaxaqueño.



Source: World Bank

*Asunción Nochixtlan.* With a population of 13,745 inhabitants,<sup>70</sup> Asunción Nochixtlán is a commercial district for 32 municipalities.



The largest Mexican bank<sup>71</sup> has 16 branches in the State, one of which is located in this town. It is the only bank branch there with the only ATM available within 100 square kms. The bank pays an average of 100 remittances per day, most of them during the morning (from 8:30 AM to 11:00 AM). For the branch, the cost of paying a remittance is approximately Mex \$20.00. The bank is promoting a new ATM card to reduce the lines and the time that tellers require to pay remittances.<sup>72</sup> However, in Nochixtlán there

are only two points of sale for ATM cards as well as a single ATM.

People cashing remittances described the use of the ATM as convenient, but mentioned that they prefer to have the cash with them rather than in an “ATM machine.” According to bank management, some remittances are used to open savings accounts, while the bulk of the remittances is used for construction and the acquisition of vehicles. The range of remittances paid goes from Mex\$900.00 to Mex \$20,000.00. Another use of remittances is to pay back the debt that migrants have for their travel to the United States.<sup>73</sup>



Most discussions of the cost of remittances focus on the origination cost, including the foreign exchange spread, and do not include the cost that recipients incur at the distribution stage. Table VI.1 provides anecdotal data on these costs based on interviews with some of the people from different communities receiving their remittances in Nochixtlán. There is evidence that distribution costs do affect the choices of the senders among remittance channels.

70. INEGI—XII Censo General de Población y Vivienda 2000.

71. BBVA Bancomer.

72. From March, when they started to promote the ATM cards, to July, the Bank had issued 100 ATM cards.

73. The cost of sending money from Nochixtlán to the US ranges between Mex\$30,000.00 and Mex\$40,000.00.

**Table VI.1. The Costs to Recipients of Receiving Remittances**  
(Mexican pesos)

Community	Transportation Cost (Mex\$)	Meal Cost (Mex\$)	Number of Hours	Additional Cost to the Remittance (Mex\$/US\$**)
<i>Magdalena Jaltepec</i>	\$60.00 (Both ways)	\$40.00 ( <i>Tlayudas</i> *)	3 hours once a month	\$100.00/\$8.79
<i>Tierra Colorada</i>	\$40.00 (Both ways on unpaved road)	\$20.00 (soft drink)	4 hours.	\$80.00/\$7.03
<i>San Miguel Huatla</i>	\$70.00 (Both ways on unpaved road. Includes a child)	\$20.00 (soft drinks. They bring their own food.)	2 hours of travel each way. 1 hour in town.	\$90.00/\$7.91
<i>San Jerónimo Sosala</i>	\$50.00 (Both ways)	\$30.00 (soft drink)	3 hours.	\$80.00/\$7.03

\*A traditional Mexican corn bread topped with beans, cream and cheese, sometimes including chicken.

\*\*Exchange rate calculated at Mex\$11.37 = US\$1.00. ([http://www.bloomberg.com/markets/currencies/americas\\_currencies.html](http://www.bloomberg.com/markets/currencies/americas_currencies.html)).

Source: World Bank.

A common way of paying remittances in Oaxaca is through local small businesses that operate as Money Service Businesses MSBs (*Centros Cambiarios*), such as drugstores. A good example is the “Farmacia Mixteca” in Asunción Nochixtlán, which receives orders to pay from small points of entry in the US, in many cases MSBs. This drugstore pays remittances in cash or through checks from a bank account that it keeps for these purposes. These MSBs compete with banks on the service of paying remittances, and therefore their operation is subject to the bank’s discretion to keep their accounts open.

*Tlaxiaco*. Tlaxiaco is the main city in the high mountains of the Mixteca region. It is the center for commercial activities for 35 municipalities and, as a district, has 103,382 inhabitants<sup>74</sup>. There are more than five SCIs at the location,<sup>75</sup> one exchange bureau, two MSBs (*centros cambiarios*), and two bank Branches.<sup>76</sup>

*Caja Universal*<sup>77</sup> has 7 branches in Oaxaca State. According to officials, 50 percent of their savings is from remitted funds. They have 4,000 members, of which between 60 to 70 percent receive remittances from relatives in the United States. Another main SCI in Tlaxiaco is *Sistema Cooperativo 15 de Agosto*,<sup>78</sup> which has 8,000 members<sup>79</sup> and has six more branches in the State. The minimum amount to open an account is Mex\$300.00, or about US\$30.00.

74. INEGI—XII Censo General de Población y Vivienda 2000.

75. Sinvacrem, SOFIC, Caja Solidaria La Mixteca, Caja Universal, Centenario, Sistema Cooperativo 15 de Agosto.

76. BANAMEX and BANORTE.

77. Institución de Ahorro y Crédito

78. Sistema Cooperativo 15 de agosto, S.C. de R.L.

79. 11,600 members including children.





*Tlaxiaco.* After the cash is gone. People waiting for the next business day to receive their remittances. (Picture: RHC)

*San Juan Mixtepec.* In Mixtec language, “*Ntzinu íchi*” means the last mile. The last mile seems longer here in the Mixtec region. San Juan Mixtepec is a town about 35 kms away from Tlaxiaco and has about 10,000 inhabitants. The road is unpaved, and the town has no access to financial services. About 50 percent of the population of San Juan (according to *in situ* interviews) works in the United States. Therefore, the basic population are old people and do not speak Spanish.

**Table VI.2. Value Paid on Remittances by Telecomm in some Communities in Oaxaca State from January to June, 2004\***  
(Thousands)

Community	(Mex\$/US\$)**
<i>Nochixtlan</i>	\$7,000.00 / \$659,631
<i>Tlacolula</i>	\$3,680.00 / \$323,659
<i>Oaxaca City</i>	\$50,000.00 / \$ 4,397
<i>Tlaxiaco</i>	\$15,000.00 / \$1,319
<i>Ejutla</i>	\$1,050 / \$92,348

\*Includes domestic and international remittances  
 \*\*Exchange rate calculated at MXP\$11.37=US\$1.00.  
 ([http://www.bloomberg.com/markets/currencies/americas\\_currencies.html](http://www.bloomberg.com/markets/currencies/americas_currencies.html)).

Source: Estimates from Telecomm officials in Oaxaca City.

In order to receive their remittances people have to travel to Tlaxiaco. The trip takes between 2 and 3 hours and is a dangerous one because people often get robbed and the road conditions are poor. *Telecomm-Telégrafos* (Telecomm)<sup>80</sup>, the government network that provides postal, telegraphic and telecommunication services, had an office in San Juan Mixtepec, but it had to close down because the couriers were being assaulted and robbed on the way to deliver the remittances. The delivery of remittances represents a very high operational cost for Telecomm (See Table VI.2). People have therefore turned to “*Cajas de Ahorro*”<sup>81</sup> in Tlaxiaco to receive their remittances, keeping part of them as savings in order not to bring all of the money back to San Juan.

80. Telecomm has 130 branches in the State of Oaxaca, it has the largest network in a Mexican State, 97 of them could pay remittances and it has 9 branches in Oaxaca City.

81. Sistema Cooperativo 15 de agosto, S.C. de R.L.

*Tlacolula.* The city of Tlacolula has 13,507 inhabitants and is the center for commercial activities for 20 municipalities.<sup>82</sup>

According to interviews conducted in Tlacolula, exchange bureaus are more popular among migrants to cash remittances because people prefer dollars to holding pesos. The first remittances received are used to repay lenders for the financing obtained to migrate to the United States, which is estimated to be around US\$20,000–40,000.

A large part of the money that Tlacolula receives is used to build houses, and in the last 10 years the value of land and of building materials has gone up. For example, a land parcel of 400m<sup>2</sup> has reportedly risen in price from US\$10,000 to US\$60,000 over this period of time. In fact many construction material businesses have developed, and the local residents attribute this to the great inflow of remittances that, to a large extent, are applied to construction.

Not all migrants are able to save money while in the United States; however, some learn new skills which they can use when they go back. Alejandro López is one example. He learned electrician skills and put them into practice when he went back to Oaxaca. His colleagues learned from him. Alejandro was also able to bring tools from the United States and do certain work that others could not, giving him added value. Others have said that, although they may learn new skills, they cannot apply them in Mexico because of lack of resources or of infrastructure. An example is Juan González, who worked in a pizzeria in the United States and learned how to make pizzas, but when he wanted to start his own business in Mexico could not do it because of lack of financing. In contrast, Altamirano González was able to save money and started his own handcraft business when he went back to Tlacolula.



## From Lake Michigan to Lake Cuitzeo

This regional corridor includes migration flows with their remittance component moving from the Chicago Metropolitan area to rural areas in the Mexican State of Michoacán. Research included interviews with migrants and their relatives; HTAs; a priest; officials in

82. INEGI—XII Censo General de Población y Vivienda 2000.

the Michoacán Office for Migrants; Mexican consular and banking commission officials; banks; and SCIs.

### *The First Mile*

The Mexican migrant situation in Chicago mirrors the experience of migrants in New York. In Chicago, the oldest, largest, most organized and politically connected Mexican community in the United States resides. The Mexican Consulate estimates that about 1.5 million Mexicans live in Illinois, with 1.2 million in the City of Chicago. According to the Michoacanos and Potosinos community in Chicago, the number of Mexicans who came into the United States in the last three years has increased compared to previous years, which in turn has increased the flow of remittances to Mexico.

In March of 2002, the Mexican Consulate of Chicago began to issue the new MCAS as identification for Mexican nationals living abroad. Since its issuance, the MCAS has been accepted by 44 banks in Chicago and 118 financial institutions across the nation. An average of 450 *matriculas* are issued daily, with a total of 150,000 issued in the year 2003 and an estimated 150,000 to be issued in the year 2004. Since the MCAS has been created with strengthened security features, this form of identification has been a principal factor in the “bancarization” of many Mexican immigrants in the United States, allowing them to open bank accounts and pay bills in order to start building a credit history.

Many large Chicago banks, however, remain wary of accepting the MCAS. Therefore, community banks, with a better knowledge of the regional market, have begun to open branches in supermarkets, meatpacking plants and schools in order to better accommodate the Mexican migrants. One example is the Cardinal Bank that opened in a high school where 70 percent of the school population is Hispanic, with 300 undocumented families. Some 43 percent of these families had no previous bank relationship. After just three years, Cardinal Bank had opened 600 new accounts—including remittances accounts—and 90 percent of these new accounts were opened by formerly “unbanked” students and families. Another example of a community bank is the Second Federal Savings bank, located at the heart of the Mexican neighborhood in Chicago. This institution has been lending money to immigrants for the last forty years. In the year 2000, according to the President/CEO/Chairman, the bank accepted the MCAS so that Mexican migrants could open bank accounts in order to remit money or underwrite home loans. Although the remittances business is not the main source of business for the bank, it has attracted customers and has familiarized them with the institution. Second Federal Savings is considered one of the leading banks working with immigrants because of its understanding of Mexican culture. In fact, the bank sponsors events for Mexican migrants and concerts in order to gain their confidence and build financial awareness in the community.

There has also been great progress regarding the financial education of Mexican migrants. In May of 2003, with the support of banks, community-based organizations, regulators and Mexican federations, the Consul General of Mexico launched the New Alliance Task Force. After only six months, the program reported 50,000 new accounts with US\$100 million in deposits.

There is a great deal of capital flowing from the State of Illinois to Mexico. Of the US\$13.3 billion of remittances that went to Mexico from the United States in 2003, US\$1.3 billion came from Illinois. According to the Community Affairs Office of the FDIC

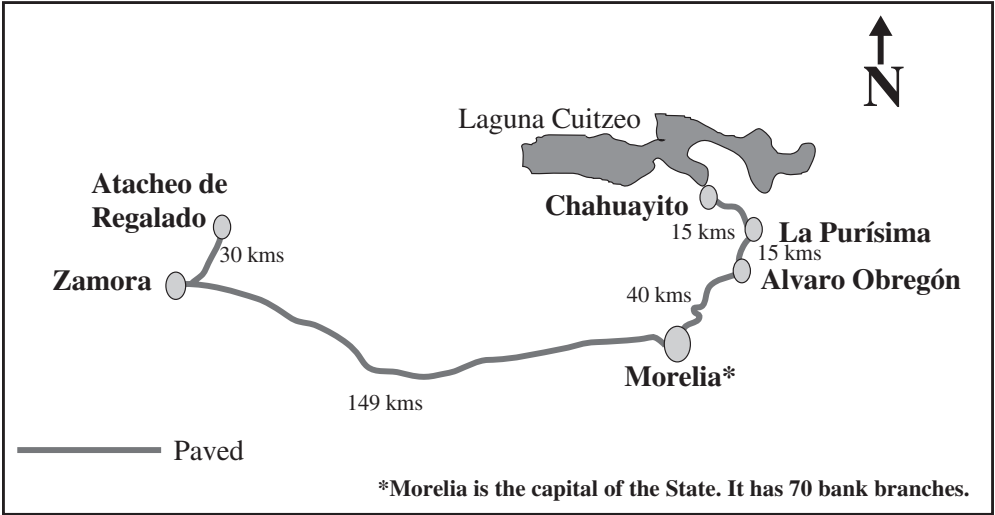
in Chicago, the Hispano-Latino population is projected to grow by 258 percent between the years 1995 and 2050, with a buying power that will jump from US\$491 billion in 2000 to US\$926 billion in 2007. Given that some 75 percent of Mexican remitters in the United States do not have bank accounts, many banks have recognized the potential of this particular market and have made efforts to win a market share. Since 2001, more than 30 Mid-west banks have introduced remittances services, driving down the price to remit money to Mexico by about 58 percent.

The “*Michoacanos*” that live in the United States are still very connected to their community in Mexico, and they hope to return one day. They raise money by working in the United States in order to build public services in their home towns in Mexico. The main public services they help to finance include water pipes, collecting pipes, churches and streets. The money that is used for these types of projects is normally transported to Mexico by hand when someone from the community goes to Mexico to visit family. A particular example of these public services is the construction of a church in the village of *La Purísima* (population of 4,000), which took a collective effort and an entire year of work to collect the necessary sum of US\$240,000.

One of the reported drawbacks of remittance flows, according to migrants in Chicago (echoing concerns heard also in New York), is that remittances have contributed to a culture of dependence among the young generation in Mexico. They grow accustomed to relying on the money that is sent by their relatives working abroad. This sort of dependency depresses the local economy, creates more unemployment, and increases the prices of goods.

*The Last Mile*

*Atacheo de Regalado*. With a population of less than 2,000 inhabitants, 15 km. north-east from the city of Zamora, Michoacán, *Atacheo de Regalado* could be a model for social communitarian organization, having implemented five productive community projects



Source: World Bank



*Atacheo.* Three examples of 3×1 programs: factory for loud speakers and baffles, turkey farm, and Father Roberto at the hydroponics green house. The town has planted tomatoes, and they expected to recover the investment in one year.

with remittances sent by migrants from the United States, mainly from Illinois under the “3×1” Project scheme.

Padre Marcos Linares and Padre Roberto, the priests of the *Templo del Sagrado Corazón de Jesús* of Atacheo (a church built with the money of collective remittances), have organized and directed the projects. These projects have had notable social impact and serve as examples of the productive application of remittances.

The projects have included a turkey farm, a goat farm, hydroponics green houses to grow vegetables and flowers for export, a factory for loudspeakers and baffles, and a bull-fighting ring. So far, there has been an investment of approximately 15 million pesos (US\$150,000). Additionally, two projects are planned, which require an investment of approximately 20 million pesos (US\$200,000) to build and run a “*rastro*” (meat factory) destined to process two thousand turkeys daily and to supply supermarket stores in the whole country. With another 40 million pesos, they plan to open a plant to pasteurize goat milk, with a capacity to process between 30 and 40 thousand liters daily for export to the United States. It is estimated that approximately 336 families have participated in the development and implementation of these projects.

*La Purísima.* La Purísima is a town located northeast of the city of Morelia, in the municipal-

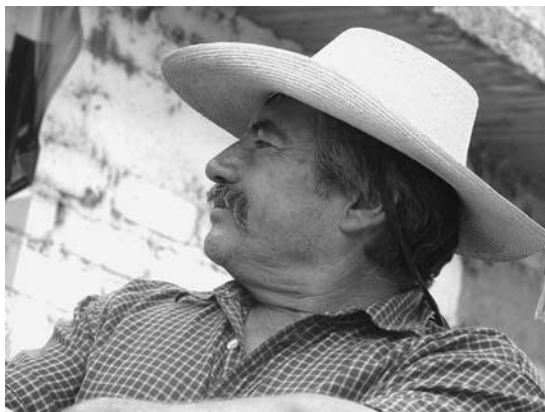


83. Profesor Alvaro Moreno.

ity of Alvaro Obregón. With a population of 4,000 it is mostly inhabited by women and children, since most of the male inhabitants have emigrated to the United States.

The particularity of La Purísima is the application of remittances to the town infrastructure. Thus, remittances have been used for ornate projects, such as the building of the town church in a collective effort which raised US\$240,000 for infrastructure projects, such as paving roads, under the “3×1” Program, and for the building of private homes.

As one arrives in La Purísima, the initial impression of the community is that of a “ghost town.” The streets are mostly deserted, checkered with an odd mixture of shacks and two-story California-style houses. Migrants have built these houses to be their home “when they come back,” says Alvaro Obregon’s Municipal President.<sup>83</sup> La Purísima is an example of the strong connection that the “Michoacanos” migrants have with their communities in Mexico and of the hope to return one day, which leads to the organization and transfer of collective remittances to their towns of origin.



*Chahuayito.* Chahuayito is a little town located northeast of La Purísima by *Laguna Cuitzeo*. Although a very small town, Chahuayito has a very high rate of emigration among men.

The Guzman’s, a local family that owns a small grocery shop, is an example of two generations of migrants. Mr. Sergio Guzmán, 53 years old, migrated to the United States for the first time 20 years ago. He used to send money back through money orders at an average cost of US\$20, which would

often get lost and never arrive to his wife in Chahuayito.

Oliverio Guzmán, the 27-year-old son, is the second generation of the Guzmans to emigrate and has been going back and forth for eight years now. He sends money back home through “Money Express” at an average cost of US\$15–17 and says he prefers to pay more for the assurance that money will arrive to his mother’s home, since Chahuayito does not have a bank or any MSBs.<sup>84</sup> He sends an average of US\$300–500 a month.

Oliverio makes an average of US\$1,800 per month and spends about



84. The closest access to financial services is in Alvaro Obregón the head of the Municipality, which has 4 exchange bureaus and is about 45 minutes away by public bus. The cost of traveling to Alvaro Obregón increases the cost of the remittance.

75 percent on his living expenses, sending the other 25 percent back home. Ms. Guzmán explains that this amount is just enough to cover necessary expenses. As an example, she told us that buying a cow costs between US\$800 and 1,400 and a horse costs between US\$150 and 300, representing important forms of saving and investment for Mexican rural families.

### *The Last Mile in Mexico City*

Mexico City has recently become a source of migration to the United States, and the remittance payment business as a result has proliferated greatly. One of the main remittance paying centers in Mexico City is in the neighbourhood of La Villa. Competition among market players is great in Mexico City, because the main distributors are present all over. Mystery shopping was conducted to find out the I.D. requirements, the efficiency among market players and the speed for cashing remittances sent from the United States.

Through this exercise, the study team was able to test the process of receiving remittances at the last mile and spot the strengths and deficiencies of the different service providers as well as confirm and refute anecdotal references from migrants interviewed both in the United States and in Mexico. Thus, it was found out that different providers have different requirements for the payment of remittances, but all of them pay the money when the name of the sender, the amount sent, and the name of the beneficiary are known, and a valid I.D. is presented. Some of these providers require at least the name of the sender or the beneficiary and the amount to be known, but always a valid I.D. in order to pay. Paradoxically, the MCAS at some banks in Mexico is not recognized by the tellers, which contrasts with its growing acceptance at some banking institutions in the United States.





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# Map of Formal Remittances Flows in the U.S.-Mexico Corridor

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Flows of remittances from migrant workers in the U.S.-Mexico corridor are linked to migration patterns. The arrows on the map indicate the direction of recorded formal remittance flows from four regions in the United States (West, Midwest, South, and North-East) to Mexican states that received the bulk of these flows.

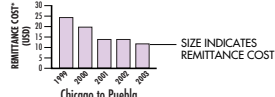
In the U.S.-Mexico remittances corridor, the price for sending remittances through formal systems has decreased over the last eight years. Based on PROFECO information, the map illustrates the average price for sending remittances from selected U.S. cities to certain states in Mexico.





# MEXICO COST IN THE REMITTANCES CORRIDORS FROM U.S. TO MEXICO 1999-2003

AVERAGE COST OF SENDING 300 USD FROM US CITIES TO MEXICO\*:



\*Source: PROFECO.

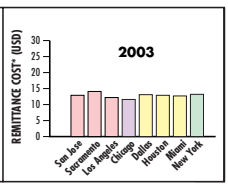
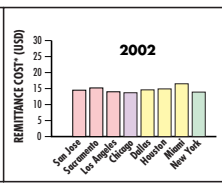
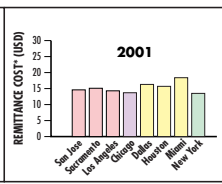
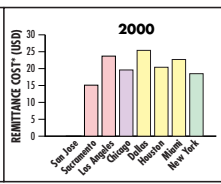
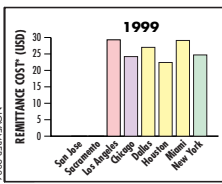
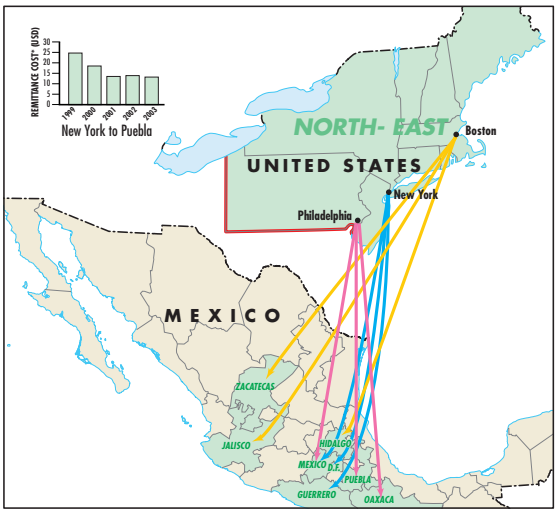
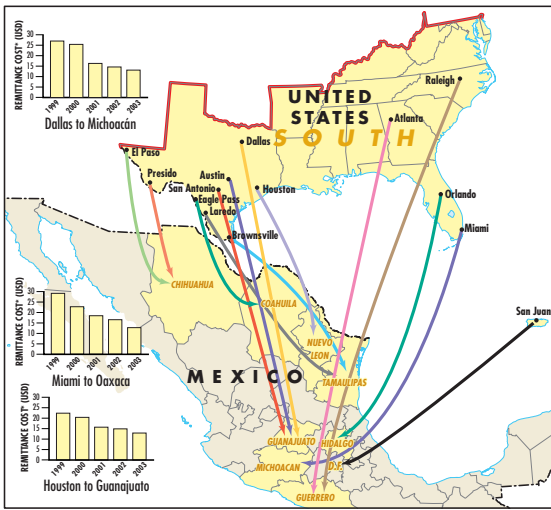
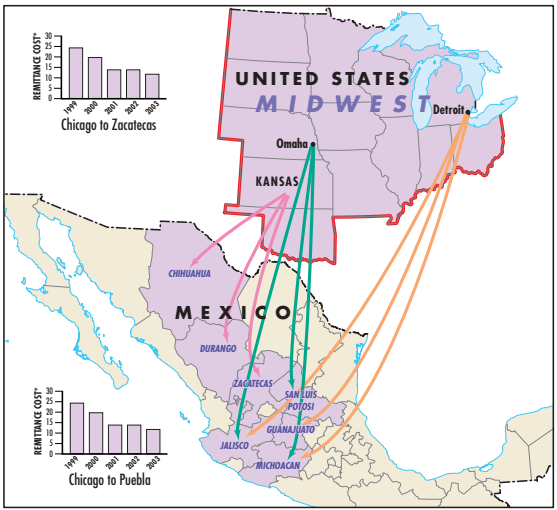
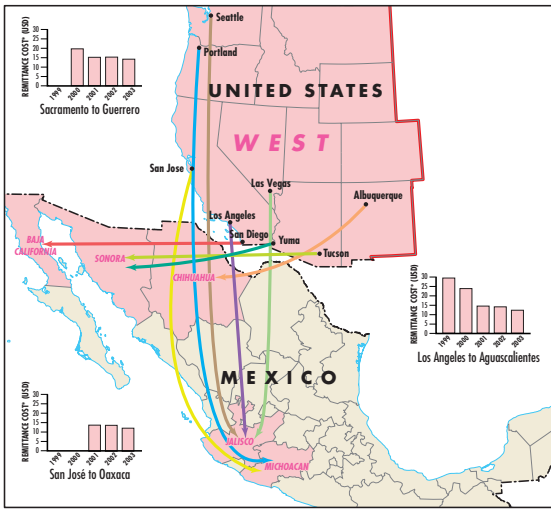
REMITTANCE CORRIDORS BETWEEN UNITED STATES AND MEXICO

- STATE BOUNDARIES
- REGION BOUNDARIES\*\*
- INTERNATIONAL BOUNDARIES

\*\*U.S. Census Bureau designations, U.S. Department of Commerce, Economics and Statistics Administration, U.S. Census Bureau.  
Note: Oklahoma is grouped with the South Census Region by the Census Bureau; however, because of the jurisdiction of the Mexican Consulate in Kansas City, Missouri, it is grouped here with the Midwest Census Region.



This map was produced by the Map Design Unit of the World Bank. The boundaries, colors, denominations and any other information shown on this map do not imply, on the part of the World Bank Group, any judgment on the legal status of any territory, or any endorsement or acceptance of such boundaries.







***The U.S.–Mexico Remittance Corridor: Lessons on Shifting from Informal to Formal Transfer Systems*** is part of the World Bank Working Paper series. These papers are published to communicate the results of the Bank’s ongoing research and to stimulate public discussion.

This bilateral case study on the United States–Mexico remittance corridor is part of the research component of the Asia-Pacific Economic Cooperation (APEC) Initiative on Remittance Systems.

This study explores the developments that have taken place, as this market has shifted, and identifies areas within the corridor that could be further developed to enhance its development potential. The discussion of the remittance process is broken down into the three operational stages of remittances transactions: the First Mile, when decisions are in the hands of the remittance sender; the Intermediary Stage, comprising the systems that facilitate the transfer of funds; and the Last Mile, where the funds reach the hands of the remittance recipient.

By analyzing the objectives, obstacles, incentives, and changes occurring at each of these stages in the U.S.–Mexico corridor, this exercise presents lessons for other remittance corridors seeking to achieve a comprehensive shift from informal to formal systems.

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