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How to Increase Informal Flows of Remittances

An Analysis of the Remittance Market in Pakistan

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Introduction

Remittances to developing countries sent through official channels were estimated at US$ 406 billion in 2012 (World Bank, 2012). This represents a growth of 6.5 percent over 2011, and is projected to rise by 8 percent in 2013 and 10 percent in 2014. Current remittance flows are over three times the amount of official development assistance (World Bank, 2012). In Pakistan, remittances through official channels have grown from just around US$ 1.5 billion in 1997/98 to slightly over US$ 13 billion in 2011/12 (State Bank of Pakistan, n.d.; see also Table 1). In the first six months (July–December 2012), they were slightly over Rs 7 billion—an increase of 12 percent over the corresponding period in the previous year (July–December 2011).

An earlier study (Amjad, Arif, & Irfan, 2012) analyzes the possible reasons for this manifold increase and in its preliminary findings suggests that the increase is primarily due to (i) a shift from unofficial (and unrecorded) channels (*hawala*) to official channels; (ii) an increase in the number of migrants abroad; and (iii) a rise in migrants' skill levels, resulting in higher wages and incomes abroad. The study also makes the important observation that the inflow of remittances is not just from Pakistani workers abroad but from the larger Pakistani diaspora, many of whom may have acquired nationality of their country of residence.[1] The study also infers that official remittance flows also reflect shifts in the diaspora's savings and assets to their home country.

[1] The US State Department defines diasporas as migrant groups that share the following features: (i) dispersion, whether voluntary or involuntary, across sociocultural boundaries and at least one political border; (ii) a collective memory and myth about their homeland; (iii) a commitment to keeping the homeland alive through symbolic and direct action; (iv) the presence of the issue of return, although not necessarily a commitment to do so; and (v) a consciousness and associated identity expressed through diaspora community media, the creation of diaspora associations or organizations, and online participation (International Monetary Fund, 2011).

Amjad et al. (2012) also attempt a rough estimate of the volume of remittances coming through both official and unofficial channels. This is based on estimates of the size of the Pakistani diaspora, as reported by different sources, as well as the average volume of remittances sent, based on recent survey data. The range of these estimates suggests that total remittances could be as high as 180 percent of official recorded remittances. Using an alternative methodology based on a range of estimates of the size to unofficial remittances and household survey data on amounts received through unofficial channels (Pakistan Social and Living Standards Measurement Survey for 2007/08), Amjad et al. (2012) guestimate that total remittances could be even higher than the 180 percent suggested by the "high-scenario" estimate of total remittances.

The importance of remittances to the Pakistan economy needs to be put into perspective. At around 55 percent of the total export of goods and services (around US$ 26 billion in 2011/12) and corresponding imports (US$ 40 billion), official remittance flows provide critically needed support to the country's precarious current account balance. These flows also inject additional aggregate demand into the economy (at around 5.5 percent of GDP), which not only spurs economic growth but, based on earlier evidence, favourably impacts employment and poverty (see Amjad, 2012). In addition, Amjad (2010) argues that remittances that come through official channels have a much greater multiplier income impact on the economy than those through hawala or unofficial channels because the latter in most cases represent transactions within the sending and receiving countries with little 'real' additional income and foreign exchange accruing to the labour sending country.[2]

For these important reasons, there is a pressing need to put in place policies that would facilitate the maximum possible amount out of total remittances to flow through official channels. Identifying the key factors and policies that could help realize this objective is the study's main purpose. The analytical framework adopted builds on the one developed in the earlier study (Amjad et al., 2012) and also draws on a more recent study that analyzes the remittance market in

[2] Afram (2012, p. 43) provide a useful description of how this informal hawala or *hundi* market works: "A typical *hawala* transaction consists of a remitter, a recipient, and two intermediaries, that is, *hawaladars*. When transferring the funds to the home country, the migrant-remitter makes payment to an intermediary *hawaladar* in the remitting country. The *hawaladar* then contacts their partner service provider in the recipient country who then arranges for the payment in local currency to the beneficiary. The beneficiary is required to present a pre-agreed identification document or code. When this transaction is conducted, the agent in the remitting country is indebted to the agent in the recipient country. Their transactions are settled through similar transactions going in the opposite direction, cash payments, or bank account transfers. In some cases, their positions also can be transferred to other intermediaries."

India (Afram, 2012). In addition, the study examines measures adopted in Bangladesh and the Philippines to increase remittance flows through official channels as well as some recent initiatives taken in India.

The remittance market in Pakistan[3]

The remittance market for sending foreign exchange into Pakistan using remittance transfers both by overseas workers and the rest of the Pakistani diaspora, as well as by other agents for both legal and illegal transfers, can be broken down into the following:

1. Remitters from overseas who demand Pakistani rupees in exchange for a foreign currency to be paid in Pakistan through official or unofficial channels.
2. The remittance market within Pakistan that transfers both officially recorded remittances through banking and other recognized channels under an overall regulatory framework supervised by the State Bank of Pakistan (SBP), as well as unofficial remittances through domestic networks linked with foreign networks abroad.
3. Receivers of remittances—mainly households and families—that are sent through official or unofficial channels, who use these remittances for their own needs or to upkeep or purchase new assets for the remitter.

Any attempt to divert the flow of remittances from unofficial to official channels requires an analysis of each of the above three segments of the remittance market to determine why remitters prefer one channel to the other. Clearly, given information and data constraints, it is only possible to analyze the proximate causes of these choices. We attempt this as follows:

- We identify and analyze the factors responsible for the very large increase in official remittances from 1997/98 to 2011/12 by enlarging the scope of Amjad et al. (2012) and examining in more detail inflows from individual countries and regions.
- We examine recent household survey data to identity the extent to which remittance transfers are made through official rather than unofficial sources, identify the characteristics

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[3] We use a broader framework to define the remittance market in Pakistan than that used by Afram (2012) in that he defines it as representing the formal financial institution and regulatory framework for the transfer of remittances while we examine the entire remittances process and cover both the official and unofficial or unrecorded flow of remittances.

of households that prefer one channel to the other and their reasons for this, and use these findings to understand better the working of the informal hawala/hundi remittance market.

- We examine the foreign exchange regulatory framework that governs the flow of formal remittances in Pakistan by comparing it with selected countries and, based on their experience, identify measures to encourage flows through official channels into Pakistan that could lead to a better and more efficient remittance market with a greater share flowing through official channels.
- Based on the analysis above, we suggest practical measures that could lead to a more efficient and better functioning remittance market in Pakistan that also encourages the flow of remittances through official rather than unofficial channels.

Part I

Explaining the increase in flow of official remittances: 1997/98 to 2011/12

Kock and Sun (2011) analyze the factors responsible for the rapid increase in official remittances to Pakistan over the period 1997–2008. Their methodology departs from most previous studies that have used aggregate data, in that they model remittance behavior at a more micro-level and focus on per capita remittances instead of aggregated remittances or the growth of remittances. Their argument is that remittances need to be explained essentially by individual behavior since the amount remitted is "determined by the economic fortunes of the remitter and the recipient, among other variables" (p. 13).

Kock and Sun's (2011) model uses average remittances per worker and four sets of explanatory variable: (i) job skill index, (ii) investment return, (iii) a proxy for recipients' economic conditions in Pakistan, and (iv) a proxy for the real value of remittances. The regression estimation is based on a panel of 15 countries with bilateral remittance flows to Pakistan, using data from 1997 to 2008. Their results show that, besides the rapid increase in the out-migration of workers, immigrants' skill level, investment return in the host country and in Pakistan, exchange rates (real and nominal), and Pakistan's economic conditions all play a strong role in explaining remittances. Somewhat surprisingly, they find that changes in domestic economic fortunes (represented by the output of major agricultural crops as a proxy) were pro-cyclical although they do not detail the reasons for this.

A major weakness of Kock and Sun's (2011) study is that their model does not take into account increases or decreases in official remittance flows caused by shocks or interventions that lead overseas workers and the broader Pakistani diaspora to shift their mode of sending remittances from one channel to another. These shocks or interventions can result in (i) a temporary increase or decrease in official flows, and (ii) a shift in the trend level of remittance flows. These shifts in the level or growth of remittances cannot, therefore, be explained solely by the factors that Kock and Sun (2011) identify.

We identify five major shocks or interventions that could explain both significant fluctuations and an upward shift in the official remittances flow during 1997/98 to 2011/12. These are:

1. The freezing of foreign exchange accounts following the nuclear test carried out by Pakistan in May 1998, which was a major blow to the confidence of nonresident Pakistanis.
2. The 9/11 attacks on the US caused anxiety among the Pakistani diaspora leading them to transfer part of their savings/assets to Pakistan especially from the US, as a fallback in case living in the US or other Western countries became unbearable or unsafe.
3. Following 9/11, the US authorities' and other financial institutions and countries increased surveillance of the Pakistani diaspora's incomes and transfer of money abroad, especially through nonofficial channels.
4. Anti-money laundering measures adopted by Pakistan in 2002 post-9/11, which included the registration of money exchange companies for a considerable fee (between Rs 100 million and Rs 200 million), forcing smaller companies to merge with larger companies to be able to pay the registration fee.
5. The collapse of the real estate boom in Dubai in 2009, in which both Pakistanis living there and in Pakistan had heavily invested, which led to a large number of Pakistani professionals and workers returning to their home country.
6. The Pakistan Remittances Initiative (PRI) launched jointly by the Ministry of Finance, the SBP, and the Ministry of Overseas Pakistanis in early 2009 to encourage remittances through formal channels, including incentives for Pakistani banks to increase such flows.

The impact of shocks and interventions on the flow of official remittances

Let us now examine the evidence based on Table 1.

Following the nuclear test in May 1998 and subsequent freezing of foreign currency accounts in Pakistan, we see an immediate decline in total official remittances from almost US$ 1.5 billion in 1997/98 to US$ 1.06 billion in 1999/2000, which continues till 2001/02. The decline occurs across all countries, and we can assume that a large part of it was then remitted through unofficial channels.

Following 9/11 in September 2001, total official remittance flows double from US$ 1.09 billion in 2000/01 to US$ 2.4 billion in 2001/02, especially in the case of flows from the US—from US$ 134.8 million to US$ 779 million. This amount from the US rises further to US$ 1.2 billion in 2002/03, after which it remains around the same till 2005/06. The jump in official remittances from Dubai and Abu Dhabi follows broadly a similar pattern.

This increase in remittances in the case of the US appears strongly to represent a shift in the transfer of remittances from unofficial to official channels as well as the transfer of savings and assets by the Pakistani diaspora in the US back to Pakistan. As confidence among the Pakistani diaspora in the US is gradually restored, these official remittance flows begin to even out.

There is an initial fall in official remittances from Dubai following the crash of the building boom and financial crisis in 2008/09—from US$ 970 million in 2008/09 to US$ 851 million in 2009/10. This is, however, followed by a sharp increase the next year to US$ 1.2 billion and a further increase to US$ 1.4 billion in 2011/12. In the case of Abu Dhabi, there is no initial fall but a sharp continuous increase from 2009/10.

After the initial decline, the subsequent increase in remittances from Dubai reflected to some extent returning migrants' accumulated savings. The large increase, especially in subsequent years, however, was most probably due to panic selling of real estate by Pakistanis living in Pakistan who had invested in Dubai and were now bringing back into Pakistan what was left of their investments.

To what extent has the PRI increased flows since its launch in early 2009? A careful look at flows from individual countries shows that the increase in official remittances was most marked in the UK's case, where it increased from US$ 605 million in 2008/09 to US$ 1.5 billion in 2001/12. Following this initiative, there is also a significant increase in Saudi Arabia and the United Arab Emirates (UAE), where aggressive marketing by Pakistani banks taking advantage of the PRI's financial incentives helped to divert remittances toward official channels.

More specifically the PRI initiated the following steps to increase the flow of remittances through official channels (Khaleej Times, January 19, 2013:

- Preparation and implementation of a national strategy on remittances;

- Playing a catalytical role in mobilizing and energyzing the financial sector in Pakistan resulting in its playing a major role in attracting remittances through formal channels. The initiatives taken by the PRI included bringing in new players (commercial banks, microfinance banks, exchange companies, Pakistan Post) and increasing competition between them to provide more efficient services and introducing new innovative products and services to facilitate transfers at lower costs and in minimal time.

- Creating separate efficient remittance payment highways with a manifold increase in developing formal links with financial institutions abroad (from less than 20 to over 400) and adding as many as 10,000 physical locations in Pakistan for receiving remittances through banks, exchange companies and post offices since the establishment of the PRI.

- Establishing formal links with the increased number of financial institutions abroad allowed these institutions to offer Pakistanis the initiatives being offered by the State Bank of Pakistan to encourage transfers through formal channels mainly the reimbursement of the cost of transfers (Saudi Riyal 6 on a transfer of Saudi Riyal 100) which was not possible earlier.

- Rreduction of remittance delivery time with remittances being received instantly or at least very quickly in contrast to a lag of many days earlier. The beneficiaries can also claim compensation (65 paisa per Rs 1000 daily) for the delayed period from the concerned bank.

- Serving as a focal point for overseas Pakistanis through round-the-clock call centers with toll free lines.

Table 1: Official remittances from countries of origin

Country/region	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
TOTAL	1,489.55	1,060.19	983.73	1,086.57	2,389.05
Saudi Arabia	474.76	318.49	309.85	304.43	376.34
UAE	207.70	125.09	147.75	190.04	469.41
Dubai	(101.01)	(70.57)	(87.04)	(129.69)	(331.47)
Abu Dhabi	(75.53)	(38.07)	(47.30)	(48.11)	(103.72)
Other GCC countries	160.85	197.28	224.32	198.75	224.29
US	166.29	81.95	79.96	134.81	778.98
UK	98.83	73.59	73.27	81.39	151.93
Other EU countries	35.87	26.48	24.06	21.50	28.80
Other countries	66.38	34.03	35.28	67.71	256.24
Encashment FEBCs	251.87	184.64	70.24	64.98	48.26
	FY 2003	**FY 2004**	**FY 2005**	**FY 2006**	**FY 2007**
TOTAL	4,236.85	3,871.58	4,168.79	4,600.12	5,493.65
Saudi Arabia	580.76	565.29	627.19	750.44	1,023.56
UAE	837.87	597.48	712.61	716.30	866.49
Dubai	(581.09)	(447.49)	(532.93)	(540.24)	(635.60)
Abu Dhabi	(212.37)	(114.92)	(152.51)	(147.89)	(200.40)
Other GCC countries	474.02	451.54	512.14	596.46	757.33
US	1,237.52	1,225.09	1,294.08	1,242.49	1,459.64
UK	273.83	333.94	371.86	438.65	430.04
Other EU countries	53.53	74.51	101.51	119.62	149.00
Other countries	658.05	497.14	417.25	573.31	642.11
Encashment FEBCs	46.12	45.42	16.25	12.09	2.68
	FY 2008	**FY 2009**	**FY 2010**	**FY 2011**	**FY 2012**
TOTAL	6,451.24	7,810.95	8,905.90	11,200.97	13,186.58
Saudi Arabia	1,251.32	1,559.56	1,917.66	2,670.07	3,687.00
UAE	1,090.30	1,688.59	2,038.52	2,597.74	2,848.86
Dubai	(761.24)	(970.42)	(851.54)	(1,201.15)	(1,411.26)
Abu Dhabi	(298.80)	(669.40)	(1,130.33)	(1,328.82)	(1,367.62)
Other GCC countries	983.39	1,202.65	1,237.86	1,306.18	1,495.00
US	1,762.03	1,735.87	1,771.19	2,068.67	2,334.47
UK	458.87	605.59	876.38	1,199.67	1,521.10
Other EU countries	176.64	247.66	252.21	354.76	364.79
Other countries	530.39	609.00	577.37	653.26	562.14
Encashment FEBCs	2.40	0.48	1.02	0.07	13,186.58

EU = European Union, FEBC = foreign exchange bearer certificates, FY = financial year, GCC = Gulf Cooperation Council.

Source: State Bank of Pakistan (n.d.).

The impact of an increase in Pakistani emigrants and rise in skill levels on official remittance flows

While the preceding analysis helps establish that the flows in remittances post-9/11 have clearly been impacted by shifts in remittances from unofficial to official channels, we need to separate this impact from the rise in remittances resulting from an increase in the number of Pakistanis working abroad and, as Kock and Sun (2011) argue, an increase in their skill levels.

Kock and Sun (2011) use official data on Pakistanis workers leaving for abroad for employment by their country of destination and then aggregate these figures to estimate the total numbers working abroad. They use the same data to classify these workers by their level of skill. It should be pointed out that these flows do not take into account the number of returning migrants from these countries and, therefore, do not reflect net migration to these countries. To overcome this problem, we use estimates of the stock of Pakistanis abroad, as given by official sources, but it is important to keep in mind that these estimates also include students from Pakistan as well as family members who may not be working.

Table 2 provides estimates of the Pakistani diaspora abroad, which gives us an approximate idea of the recent increase in stock. These estimates are for all countries as well as for Saudi Arabia, the UAE, the US, and the UK, which together account for almost three fourths of all Pakistanis abroad and for the same share of total remittances.

If we examine the data in Tables 2 and 3, it is clear that, for the years post-2004, there has been a significant increase in the numbers of Pakistani diaspora; when these figures are adjusted for the number among them working, the number of workers abroad also rises. These figures are in line with the very significant increase in flow of overseas migrants between 2007 and 2012 (see Table A1 in the annex). Remittances per head have also increased sharply since 2004 (Table 3).

Table 2: Stock of overseas Pakistanis/Pakistani diaspora (millions)

Country	2004[a]	2010[b]	2012[c]
All countries	4.0	6.3	6.7
Saudi Arabia	1.1	1.5	1.7
UAE	0.5	1.0	1.2
US	0.6	0.9	0.9
UK	0.8	1.2	1.2

Sources: (a) Pakistan, Planning Commission (2005). (b) Data supplied by the Ministry of Foreign Affairs, Islamabad, at the authors' request. (c) Khan (2012, February 15).

Table 3: Official remittances per Pakistani diaspora/per working Pakistani (US$)

Country	2004	2010	2012
All countries	1,049	1,777	1,968
Adjusted	(1,614)	(2,733)	(3,027)
Saudi Arabia	570	1,780	2,168
Adjusted	(713)	(2,225)	(2,710)
UAE	1,425	2,038	2,374
Adjusted	(1,781)	(2,547)	(2,967)
US	1,425	2,038	2,374
Adjusted	(2,850)	(4,076)	(4,748)
UK	465	1,188	1,267
Adjusted	(930)	(2,376)	(2,534)

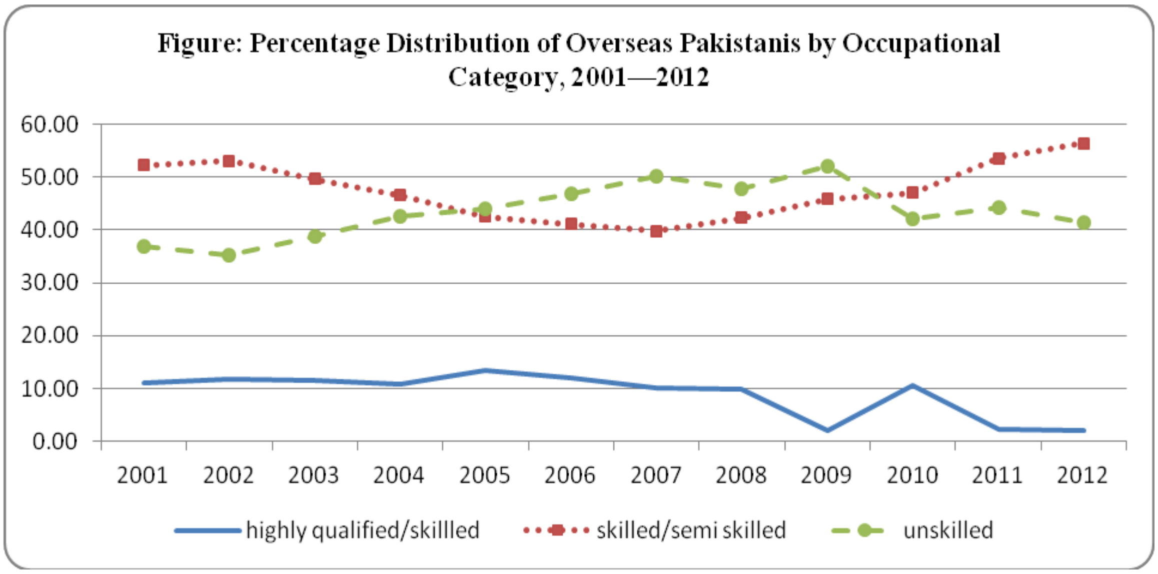
Note: Adjusted for number working out of total stock: 0.65 for all countries, 0.8 for Saudi Arabia and the UAE, and 0.5 for the US and UK.

Source: Tables 1 and 2.

Kock and Sun (2011) point out that there has been an increase in the number of skilled as compared to unskilled workers going abroad. As Figure 1 shows, the share of skilled/semi-skilled increased from around 40 percent in 2007 to just over 55 percent in 2011/12. However, the official figures do not show an increase in the number of highly qualified and highly skilled emigrants (Figure 1). Indeed, there is a sharp fall in 2009, which, after a recovery in 2010, falls again in 2011/12 and rises in 2012. Contrary to this, the press has frequently reported that a large number of professionals (doctors, engineers, scientists, bankers, IT experts, chartered accountants, teachers, etc.) have been going abroad in recent years to work in the US and EU, but also in Saudi Arabia, the UAE, Qatar, Bahrain, Kuwait, the UK, Canada, Australia, Malaysia, South Africa, and Japan.

Countries in the EU include Germany, France, Spain, Italy, Ireland, and Norway ("Changing profile of overseas Pakistanis", 2011). Clearly, the official figures fail to capture these outflows, perhaps because such categories of workers might not have officially registered themselves as going abroad to work.

Figure 1: Percentage distribution of overseas Pakistanis by occupation, 2001–12



Note: The highly qualified and highly skilled are grouped together, and the skilled and semi skilled are grouped together.

Source: Bureau of Emigration and Overseas Employment, Pakistan.

The figures in Table 4 are, however, revealing as they clearly show that the increase in remittances between 2004 and 2012 cannot be explained solely by the increase in number of workers abroad or by an increase in their skill level because the differences between their growths are just too wide to support such a contention. For example, for all countries of the 230 percent increase in remittances, only 70 percent can be explained by the increase in number of workers. Even if we take into account a significant increase in the share of professionals and higher skills by 2012 and the corresponding increase in their share of remittances—even to the extent of it doubling—this would still leave a large unexplained gap.

Table 4: Percentage increase in number of workers/remittances, 2004–12

Country	Increase in number of workers	Increase in amount of remittances
All countries	70	230
Saudi Arabia	55	487
UAE	140	300
US	50	80
UK	50	308

Source: Tables 1 and 2 (the latter adjusted for labor force participation rate: 0.65 for all countries, 0.8 for Saudi Arabia and the UAE, and 0.5 for the US and UK.

As Table 4 also shows, this difference is especially pronounced for Saudi Arabia and the UK and to a slightly lesser extent for the UAE. For the US, this shift caused by 9/11 may have worked itself through by 2004 but probably brings out the continuing transfer of assets and savings to Pakistan. These finding reinforce our earlier finding that the increase in remittances is not just for the reasons pointed by Kock & Sun (2011); rather, it also represents a significant shift from informal to formal channels for sending remittances.

Factors responsible for the higher number of professionals and better skilled workers going abroad: Reaping the demographic dividend?

Pakistan is currently passing through a demographic transition (Nayab, 2006), which has resulted in a "youth bulge" and an increase in the working-age population as a share of the total population. To reap the "demographic dividend" of this change, the economy needs to create productive and remunerative employment for young workforce entrants.

Unfortunately, after a short-lived growth spurt during 2002/03 to 2005/06, the economy has been mired in stagflation, growing at around 3 percent while it would require a growth rate of between 7 to 8 percent to productively employ new entrants into the labor market. Inflation has remained in double digits and only started to come down during the second half of 2012. It must also be kept in mind that Pakistan has increased substantially its investment in higher education over the last ten years, increasing enrollment almost fourfold to about 1.2 million in 2011/12 (Ministry of Finance, 2012).

With the economy slowing down, there is increasing evidence that young professionals and skilled workers are leaving for employment abroad. Three factors have spurred this demand: (i) increased demand for labor in Saudi Arabia, Abu Dhabi, and the Gulf Cooperation Council (GCC) countries, which were not affected by the financial collapse in Dubai; (ii) new job opportunities in Europe (especially in Italy, Spain, and Norway), possibly due to its fast-aging population; (iii) job opportunities in the US and UK which, despite the economic slowdown, remain attractive job markets for professionals and higher-skilled workers, for whom demand has continued to grow at the expense of unskilled workers; and (iv) the emergence of Australia as an attractive job marker for Pakistani professionals.

Is Pakistan, therefore, reaping the demographic dividend through the migration of professionals and higher-skilled workers? Amjad (in press) draws attention to this possibility, but it is clearly an area that needs further investigation.

Illegal transfers and remittances

Official remittance flows are also associated in the public perception with the transfer of illegally gotten gains, which are transferred back to Pakistan through remittances and thus legalized since the latter's sources are not questioned. These flows include:

- The so-called 'whitening' of 'black' money[4] generated in Pakistan, which is then converted into US dollars or other foreign currency through domestic moneychangers, sent abroad, and then sent back as remittances through existing or fictitious Pakistanis living abroad.
- The receipt of kickbacks and commissions on deals with international companies in contracts awarded to them in Pakistan, which are then transferred back in part or whole as remittances.
- The under-invoicing of imports of machinery and goods and services to avoid full payment of import duties, after which the nonpaid amount of the cost of the import is sent back through a domestic moneychanger in foreign currency leading to an outflow of resources from Pakistan.
- Illegal earnings through the drug trade (or other related activities) that are transferred back to Pakistan in the form of official remittances and thus legalized.

Amjad et al. (2012) rightly argue that, as far as the 'whitening' of 'black' money is concerned, such transactions would not result in a net addition to the total size of official remittance flows. This is because converting domestic currency into a foreign currency would need buyers of the local currency. These transactions, if made through remittances, would require a Pakistani working abroad or a member of the larger Pakistani diaspora to 'demand' these rupees and then send them back as remittances. Since he or she would only do so if already

[4] This covers all kinds of bribes and undeclared income for avoiding taxes.

planning to transfer money to Pakistan, when such a remittance is sent it does not add to the total amount of remittances flowing into Pakistan.

On the other hand, the transfer of part of or all illegal foreign exchange earnings—from kickbacks, the drug trade, and other sources—as remittances does lead to an increase in official remittances. However, the transfer of such illegal earnings, including non-taxed earnings by Pakistanis abroad, might not occur through the official remittance channel for fear of being detected; hence, those making such transfers prefer the use of the unofficial hawala route.

Has the amount of illegal transfers increased in recent years? One example is the real estate collapse in Dubai in 2009, in which many Pakistanis had invested both their legal and illegal earnings. It would appear that a part of these assets, or what was left of them after the crash, was transferred back to Pakistan as official remittances. This would explain the increase in 2009 and 2010 of official remittances into Pakistan at the time when the number of migrants working in Dubai was falling. Clearly, however, a significant part of this amount may also have come through illegal channels.

Similarly, anecdotal evidence suggests that some of the illegally gotten wealth in Afghanistan by the Afghan political elite is transferred into Pakistan through the channel of official remittances, mainly to buy businesses, real estate, and property in Pakistan. It is difficult, however, to gauge the amount of these flows, which again appears to be mainly channeled through Dubai.

How large, then, are these illegal flows being remitted through official channels and how much through illegal channels? While it is extremely difficult, if not impossible, to quantify them, one needs to be somewhat cautious in inferring that illegal flows account for a significant part of the rapid growth in official remittances in the past decade. For one, as we examine in Part III, official remittance flows have increased not only in Pakistan but also Bangladesh, the Philippines (see Figure 1), and India (see Figure A1 in the annex). Indeed, it would be a strange coincidence that the worldwide growth in official remittances has been due substantially to increases in the transfer of illegally earned funds abroad. Again, we therefore caution against a generally held view that official remittance increases are in any way significantly related to an increase in illegal flows, though clearly a part of these flows represents such activities.

An important conclusion that we would like to draw from our analysis in this part of the study is that the remittance market is complex and highly segmented by region and by countries. Therefore, policy measures and direct initiatives and interventions should, in large measure, target countries and regions if the flow of official remittances is to be encouraged and increased.

Part II

Households receiving remittances: Why do they prefer official or unofficial channels of transfer?

What factors underlie the demand for unofficial or hundi transactions, and how can these be influenced? Understanding the practices, procedures, and regulatory structures of the international value transfer system with particular focus on third-party settlement is, therefore, immensely important. Similarly, understanding the behavior of overseas migrants and their families toward the use of banking or nonbanking channels to transfer money home is important to attract more money through official channels. So, an important question is whether migrants, who send remittances home through hundi, are socioeconomically different from those who use the banking channel to transfer money.

Investigating the behavior of migrants and their families in using unofficial or official channels to transfer money requires a dataset that has some basic information about migrants using one channel or the other for these transfers. For this purpose, we use micro-data from two household surveys carried out in 2009 and 2010. The first, the Household Survey of Overseas Migrants and Remittances (HSOMR) carried out in 2009, comprises a small sample of 548 households—randomly selected from nine districts of the country—each of which had a member employed in Saudi Arabia at the time of the survey. The second is the Pakistan Institute of Development Economics' (PIDE) panel survey conducted in 2010 in 16 districts—the Pakistan Panel Household Survey (PPHS), with a sample size of more than 4,000 households. Both surveys collected information on overseas migrants' personal characteristics, their earnings while abroad, remittances transferred home, channels used to transfer money, and their reasons for using these channels, particularly for not using the banking channel.

To supplement the PIDE household survey-based information, some in-depth interviews were also carried out in the district of Gujrat among families that had a member working abroad at the time. The aim of these interviews was to identify the factors that underlie the use of hundi to transfer money. Thus, the study uses both qualitative and quantitative information to understand whether users of hundi are different from users of the banking channel.

Based on the literature on overseas migrants' remittance-sending behavior, we attempt to examine the relationship between the methods used to transfer money and four characteristics of migrants and their families: (i) migrants' place of origin or their families' place of residence in

Pakistan (urban or rural), (ii) migrants' education level, (iii) their skill level, and (iv) the duration of their stay abroad.

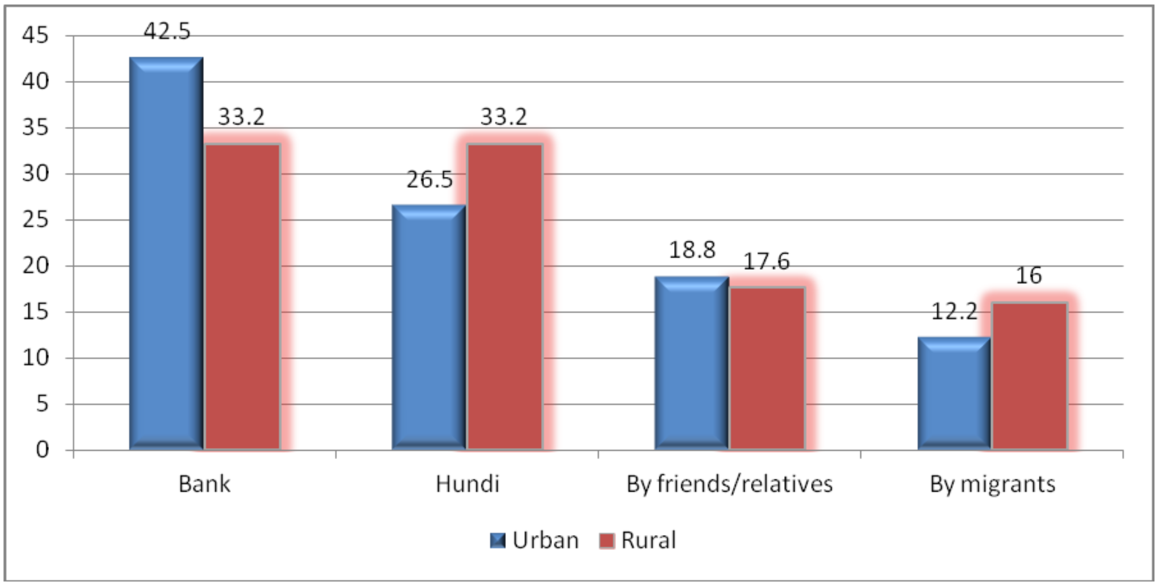
The basic hypotheses tested are whether:

- urban migrants use the banking channel to transfer money more than their rural counterparts;
- migrants' education level has a positive association with the use of the banking channel;
- because of its strong correlation with education, skilled and professional workers use the formal channel to transfer remittances more than unskilled workers; and
- the longer the duration of their stay abroad, workers are likely to be positively associated with the use of the formal or banking channel for money transfer because of increased awareness about the benefits of using it.

We apply bivariate and multivariate techniques to analyze the datasets mentioned above. Take first the case of overseas migrants' rural-urban origin. The majority of Pakistani migrants came from a rural background and their families live in these areas, thus money is transferred there on a large scale. Using data from the Household Income Expenditure Survey, Irfan (2011) finds that "the distribution of remittances underwent to shift wherein the share of rural areas in total remittances increased from 49 percent in 1996–97 to 72.4 percent in 2007–08." So, the question is whether the practice of rural migrants in terms of using channels to transfer money from abroad is different from that of their urban counterparts. Banking facilities in Pakistan are better in urban centers than in rural communities, and urban migrants are also likely to be more educated than rural migrants, making it more possible that urban-origin workers will remit money home through the banking channel.

Figure 2 does indicate that urban families have received more money from abroad through banking sources (43 percent) than rural families (33 percent). This difference may be statistically significant,[5] but more importantly, the use of the banking channel in urban areas to transfer money is very low (43 percent), let alone in rural areas.

Figure 2: Methods used to transfer money from abroad by rural and urban origin of migrants (percent)



Source: Arif (2009).

In the PPHS 2010, migrant families were asked why they did not use the banking channel. Table 5 shows the responses of urban and rural migrant families, and helps us better understand migrants' remittance-sending behavior. In the survey's questionnaire, some of the possible reasons suggested for not using the banking channel included the high transaction cost involved, the nonavailability of a bank, the long distance to the nearest bank, the long waiting times involved, and uncooperative behavior of bank staff. However, as Table 5 shows, neither rural nor urban respondents cited the nonavailability of a bank or/and the distance to the nearest bank as reasons for not using the banking channel. In fact, approximately two thirds of the rural families surveyed could not give reasons for not using the banking channel. However, about a quarter of the rural sample said that it took a long time to withdraw money from the nearest bank. The situation of urban households is not much different: the high transaction cost involved is given as the main reason (Table 5). Nonetheless, according to the survey data, there is no major difference in transaction costs between banking and hundi channels (see Table A2 in the annex). The

[5] In fact, it is significant and we examine this later in this section.

reported distance to nearby banks in Table A2 also cannot be considered for long, given the availability of better transport sources.

Based on the qualitative work carried out in Gujrat and the survey data used (PPHS 2010 and HSOMR 2009), we find that migrants and their families appear hesitant to use the banking channel. Migrants account for this hesitation, saying that "the banking procedure is difficult for us. We get money through hundi at our doorstep." There seems to be a strong perception barrier to using the banking channel.

The in-depth interviews also reveal that migrants abroad with households, particularly in the Middle East, live in groups and usually have an informal group leader who manages the transfer of money through informal sources. Further, this type of common living arrangement creates a network among the migrants, which enables them to send money home through a mutual friend visiting Pakistan. Thus, opening new bank branches in high-migration rural or urban areas, as is generally believed, may not be the only solution to channeling more remittances through banks.

Table 5: Percentage distribution of households who received remittances through hundi and reasons for not using a bank

Reasons	Overall	Urban	Rural
High transaction cost	9.78	40.00	3.90
Long time required	20.65	-	24.68
Security	1.09	-	1.30
Family finds it difficult	7.61	13.33	6.49
No bank available	-	-	-
Bank too far away	-	-	-
Bank staff does not cooperate	3.26	13.33	1.30
Others	57.61	33.33	62.34
Total	100.00	100.00	100.00
N	92	15	77

Source: Pakistan Panel Household Survey (2010).

Table 6 presents data on migrants' education levels and the methods used to transfer money during the year preceding the PPHS 2010. The table also categorizes the use of formal or informal sources of money transfer by migrants' skill levels, i.e., as skilled workers and unskilled workers. The skilled category includes professionals and clerical workers. There is no linear relationship between migrants' level of educational attainment and their use of the banking channel to transfer money, although migrants with a college or higher level of education are more likely than other categories to use this source. Despite this difference, it is important to note that about a third of migrants with a college or higher level of education did not report using the banking channel. There is no marked difference between skilled and unskilled workers in their use of hundi, although it is modestly higher in the latter's case.

Table 6: Migrants' level of educational attainment and the methods used for money transfer

Education/occupation	Bank	Hundi	Others
Up to 5	45.28	47.17	7.55
6–10	28.57	63.27	8.16
10 or above	68.75	25.00	6.25
Skilled workers	34.72	58.33	6.94
Unskilled workers	42.27	50.52	7.22

Source: Pakistan Panel Household Survey (2010).

The relationship between the methods used to transfer money and migrant workers' duration of stay abroad is also not as expected. Table 7 indicates a negative association between migrants' period of stay abroad and their use of the banking channel. Longer stays abroad appear to enable workers to find informal ways of sending money home. It is not easy to explain why, but there could be several reasons. For example, long-stay migrants' preference for informal channels may be associated with their legal status abroad. Illegal workers are more likely to use the nonbanking channel than legal workers. It can also be argued, however, that illegal workers are likely to be new migrants rather long-stay workers. Nonetheless, studies carried out in the 1980s tend to characterize illegal workers as 'over-stayers'—those who stayed abroad without following the legal procedure.

Table 7: Migrants' duration of stay abroad and methods used to transfer money (percent)

Duration of stay abroad	Bank	Hundi	Others
Up to 3 years	63.38	22.54	14.08
4–6 years	12.90	83.87	3.23
7–10 years	22.22	77.78	0.00
11 years or more	30.23	65.12	4.65

Source: Pakistan Panel Household Survey (2010).

To determine the independent effect of the socioeconomic factors given above on methods used to transfer money, we also carry out a multivariate analysis, applying a logistic regression to the PPHS 2010 micro-data. The unit of analysis is a household with a member working abroad. If the household received money during the last year through a banking source, it is assigned a value of 1 and 0 otherwise. The dependent variables include migrants' age, household size, duration of stay abroad, migrants' education level, skill level, land ownership, and region (rural or urban).

Estimating the share of unofficial/unrecorded remittances

The results of this analysis are presented in Table 8, and our findings are not very different from what has already been discussed. Rather, they give a better message. For example, while a college or higher level of education does not emerge as statistically significant, migrants with a middle or matriculate level of education are even less likely than those with a lower level of education to use the banking channel to transfer money. Skill level does not show a significant correlation with the use of formal sources, while the duration of stay abroad has a negative association with the use of the banking channel. Two demographic variables, household size and migrants' age, have a significant association with the use of formal sources of money transfer. The larger a household, the less likely it is to receive remittances through the banking channel. Age also has a negative association with its use, but the positive and significant association of the age term with the use of formal sources indicates a curvilinear relationship.

Table 8: Effects of demographic and socioeconomic factors on methods used to transfer money transfer from abroad (logistic regression model)

Correlates	Coefficient	Standard error
Age of migrant (years)	-0.214*	0.100
Age-squared of migrant	0.002*	0.001
Years spent abroad (of migrant)	-0.059**	0.031
Education level of migrant (up to primary as ref.)		
6–10	-0.894*	0.449
Intermediate or above	0.120	0.770
Skilled worker (yes = 1)	-0.408	0.447
Household size (number of members)	-0.114**	0.059
Region (urban = 1)	1.603*	0.552
Land (acres)	0.310*	0.109
Constant	7.304*	2.931
LR chi^2	47.76	
Log likelihood	-73.806	
Pseudo-R^2	0.2445	
N	147	

Note: * denotes significance at 5 percent, ** denotes significance at 10 percent.

Source: Authors' estimates based on Pakistan Panel Household Survey (2010) micro-data.

Finally, what are the policy implications? These are outlined in the last part of this paper but a major finding of this analysis is that migrants who use hundi to send home remittances are not systematically different in socioeconomic terms from those who use the banking channel for this purpose. It is thus difficult to identify the migrants with certain characteristics who might be identified as a target group for using the banking channel.

In interpreting these results, however, two important caveats should be kept in mind, The analysis presented in this section is based on a relatively small household survey and that a deeper investigation requires a relatively larger survey which the study recommends.

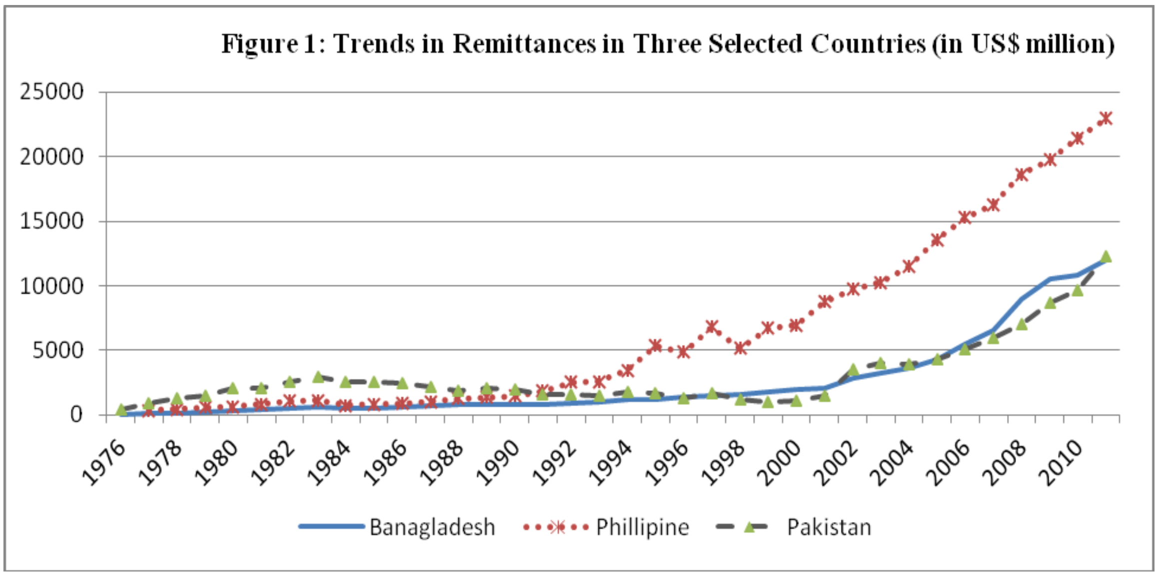
The second that the survey was conducted just a year after the launch of the PRI and that the extent to which the increased services offered in subsequent years i.e. post-2010 by the PRI had on emigrants behavior needs further investigation. Our view is that it should have led to an increase in the perception and practice of overseas Pakistanis in sending their remittances through official channels.

Part III

Remittances: A comparison of three countries

As Figure 3 shows, the annual inflows of official remittances have increased markedly in Bangladesh, Pakistan, and the Philippines, particularly during the last decade. They have also grown substantially in India (see Figure A3 in the annex). The average growth in remittances varies across the three countries, but the growth has been phenomenal particularly in Bangladesh and Pakistan (Table 9). In the case of Pakistan, the 1980s was a 'golden' period when the country received around half the remittances inflow to South Asia compared to 12 percent in 2009, though of course the absolute amount has increased substantially.

Figure 3: Trends in remittances in three selected countries (US$ million)



Source: Remittances data, World Bank, Development Prospects Group (2011).

Bangladesh's situation is quite similar. According to the country's Bureau of Manpower, Employment and Training, a total of 8.24 million migrants went abroad for employment during 1976–2012. During this period, the destination of Bangladeshi migrants has not remained static, and Bangladesh has been able to explore new markets for its labor. While Saudi Arabia remains the top destination in the Middle East, the UAE, Kuwait, Oman, Qatar, Bahrain, and Libya have also become important receivers of Bangladeshi workers over time. In the 1990s, Malaysia and Singapore also became major destination countries (Siddiqui, 2005).

Trends in the various categories of skill have fluctuated, with the share of unskilled and skilled workers—accounting for about 61 and 36 percent of all workers in 2012—rising. The share of professionals has declined over time (Farid, Mozumdar, Kabir, & Hossain, 2009; Bangladesh, Bureau of Manpower, Employment and Training, n.d.). About 92 percent of Bangladeshi migrants reside in Asian countries, but the share of remittances from these countries is only 70 percent. Contrary to this, only 2 and 5 percent Bangladeshi migrants reside in North America and Europe, while their respective share in total remittances is 11 and 18 percent. This suggests that the rise in the stock of overseas Bangladeshi workers and regional diversity in their destinations are among the major factors accounting for the rising trend in remittances inflows (United Nations Development Programme, 2009).

Table 9: Trends in average remittances growth rates in three selected countries (percent)

Period	Bangladesh	The Philippines	Pakistan
1981–85	10.2	8.4	5.2
1986–90	9.7	12.9	-4.3
1991–95	9.3	30.8	-2.1
1996–2000	10.4	8.1	-6.1
2001–05	17.4	14.5	39.7
2006–10	20.8	9.6	17.8
2006	25.8	12.4	19.6
2007	20.9	6.9	17.1
2008	36.2	14.4	17.4
2009	17.7	6.0	23.8
2010	3.1	8.4	11.2
2011	10.6	7.2	26.6

Note: The five-year average growth rates have been calculated on the basis of annual growth rates.

Source: Remittances data, World Bank, Development Prospects Group (2011). For Pakistan for 2011, Table 1.

The Philippines is a major recipient of global foreign remittances. According to World Bank (2010) estimates, the annual inflow of remittances increased from US$ 626 million in 1980 to US$ 7 billion in 2000 and to US$ 22.9 billion in 2011. The magnitude of remittances is also significant in proportion to the size of the Philippine economy. The share of overseas Filipino workers' (OFWs) official remittances in GDP increased from 4.7 percent in 1994 to 10.7 percent in 2010. Remittances to the Philippines come from all over the world, including the US, Japan, Singapore, and Hong Kong. In 2011, 42.2 percent of the remittances were sent from the US, followed by Canada with 10.3 percent, and Saudi Arabia with 8 percent (The Philippines, Senate Economic Planning Office, 2012). Although the US is not among the top ten OFW destinations, its large share in remittances is due to two key reasons. First, according to the Philippines Overseas Employment Administration, a significant number of remittance centers in other OFW destination countries route their remittances through US correspondent banks. Second, 43 percent of the OFWs deployed to the US work in highly skilled professional/technical jobs that receive higher wages relative to OFWs in other countries (Global Pinoy Remittance and Services, n.d.). The estimated stock of overseas Filipinos in 2010 was about 9.5–12.5 million.

Framework for country comparisons on policy initiatives

The key issue addressed in this paper is how to increase the flow of official remittances into Pakistan. This section examines the lessons we can draw from the experience of other major remittance-receiving countries, especially Bangladesh and the Philippines, and to a smaller extent, India. There is a large body of literature on this subject especially covering the last 40 years since the start of migration flows to the Middle East, following the increase in oil prices in the early 1970s. This research identifies a number of critical variables that influence this flow, including migrants' preference for sending remittances through official or unofficial channels. These are discussed in the following subsections.

Macroeconomic conditions in the home country, especially the exchange rate

Financial liberalization, which eases access to and the transfer of foreign currency by individuals living within or outside the country, as well as an exchange rate that is not overvalued, have an important positive impact on remittance flows, including through official channels. Kock and Sun (2011) also find that, for Pakistan, the exchange rate plays a significant role in explaining the increase in official remittances into the country.

A recent study by the World Bank (2012) points out that an unexpected depreciation of the home currency can lead to a major surge in remittances as migrants send their savings abroad to purchase land, houses, and other durable assets. In contrast, a strong currency can delay sending remittances as witnessed in the Philippines between February 2010 and August 2012. In South Asia, including Bangladesh and India, the significant depreciation of the home currency since mid-2011 has led to a high growth rate in remittance flows. In the case of Pakistan too, the steep depreciation post-2008 could be a factor in the large increase in official remittances, which may have outweighed the economy's depressed conditions and the security situation.

An important question that does arise in this context is, to what extent should measures to liberalize the foreign exchange regime be adopted just to attract remittance flows (metaphorically, "the tail wagging the dog")? The answer to this question depends of course heavily on the conditions prevailing in individual countries, but it has proved a major concern especially in Pakistan where allowing not only nonresident but also resident Pakistanis to open foreign currency bank accounts has been alleged to be as a convenient way of 'whitening' illegal or 'black' money. It is termed as the "dollarization" of the country.

In South Asia, countries do allow nonresidents to open foreign currency accounts but the rules and regulations governing these accounts vary from one country to the next, especially as regards drawing on these accounts to purchase local currency or sending them out of the country. Our review also shows that the foreign exchange regulatory frameworks in Bangladesh, the Philippines, and India do not allow residents to open foreign exchange accounts or to purchase foreign currency in the kerb market to deposit in their foreign exchange accounts and then transfer it abroad.

However, remittance-receiving countries have adopted specific policies to ease the transfer of foreign exchange by residents as long as they can prove that the local currency amount has been legally earned. An initiative taken by the Reserve Bank of India in this context needs special mention. From 2004, resident Indians could officially transfer up to US$ 200,000 abroad for almost any purpose, family- or investment-related, with very few restrictions as long as they could show proof (e.g., income tax returns) that the rupee amount had been legitimately earned (see Reserve Bank of India, 2012). This move has almost eliminated the kerb market for the purchase of foreign currency by individuals or families in India.

An important question that clearly needs further analysis is whether allowing resident Pakistanis to open foreign exchange accounts is in the overall national economic interest, but such an investigation is beyond the scope of this study. What can, however, be said is that Pakistan today has an extremely liberal foreign exchange regime, which clearly plays an important role in attracting remittances into the country. The sharp decline in the official exchange rate from near Rs 60 per US dollar in early 2008 to nearer Rs 100 per US dollar in early 2013 has also played an important part in increasing the flow of official remittances over these years.

Cost, speed, and ease of sending remittances

A key driver of the flow of remittances, especially of the choice to send remittances through official channels, is the cost involved. These costs have decreased in recent years but still vary across countries and for South Asia are now on average 6.5 percent of the value of the remittance (World Bank, 2012). However, this average hides considerable variation according to the place from where remittances are sent, their destination, and the financial channel used. Table 10 shows the wide variation in the cost and speed of transferring 750 Saudi Arabian riyals from Saudi Arabia to Pakistan.

Table 10: Cost of remitting SAR 750 from Saudi Arabia to Pakistan, September 2012

Firm	Fee	Exchange rate margin (%)	Total cost (%)	Total cost (SAR)	Transfer speed
Al-Rajhi Bank	0.00	1.50	1.50	11.27	2 days
Enjaz Bank	0.00	1.54	1.54	11.56	2 days
Tele Money (MTO)	0.00	1.54	1.54	11.56	2 days
Saudi American Bank	0.00	2.21	2.21	16.61	< 1 hour
Express Money (MTO)	0.00	2.45	2.45	18.39	< 1 hour
Western Union (MTO)	25.00	1.62	4.95	37.16	< 1 hour
Money Gram (MTO)	22.00	2.57	5.50	41.29	< 1 hour

MTO = money transfer operator.

Source: World Bank (2013).

Besides costs, other factors are also important. As Part II of this study showed, Pakistani overseas workers were considerably reluctant to send remittances through official channels regardless of their educational qualifications or whether the amount was being sent to homes located in rural or urban areas. This behavior is proof of a strong a lack of confidence in the working of the financial system in their home country. Is it a deep-rooted fear that additional 'costs' may be incurred when collecting their remittance through banking channels? Is it that they do not want "others" to know that they are receiving these funds? Or is it simply the convenience of home delivery of remittances through hundi and hawala? How other countries have overcome these concerns is examined in more detail when we analyze the practices and initiatives taken in Bangladesh and the Philippines.

Attracting remittances to acquire assets (land, houses, bonds) or set up educational and health facilities for families of workers overseas

In most countries, governments have set up organizations and welfare institutions that offer opportunities to overseas workers to acquire land/houses through schemes that they have launched as well as to contribute to the establishment of schools, colleges, and hospitals in towns or rural areas that have a concentration of families of overseas workers. Pakistan has set up a number of such organizations, the most prominent of which is the Overseas Pakistanis

Foundation (OPF), though its record remains somewhat controversial in the use of money invested by overseas workers and of donations for welfare purposes. Again, we examine the record of similar organizations set up in Bangladesh and the Philippines for similar purposes.

Attracting remittances to foster higher and inclusive growth in migrants' home countries

A major development challenge is to attract remittances for investment in setting up businesses—small, medium, and even large firms—that would enhance economic growth and create new job opportunities. Similarly, investments by overseas workers in various types of government-sponsored bonds and in the stock market can supplement domestic savings for investment, including in badly needed infrastructure projects. Pakistan's record in this context is not very impressive and, again, we examine the experience of Bangladesh and the Philippines.

Strengthening remittances-transfer infrastructure, including through the use of new technologies (especially IT and mobile phones) to channel remittances.

As the pace of innovation quickens and new technologies rapidly emerge, they offer considerable opportunity for expanding access to and lowering the cost of channeling international remittances. In Pakistan, the rapid expansion of mobile phone use, with almost 60 percent of the population owning one, has led to mobile cash-out services or bill payment through mobile phones. Although internationally the promise of mobile remittances is still in its early stages, we review some of the initiatives, especially taken in the Philippines, in this regard.

Policy initiatives: The experience of Bangladesh, the Philippines, and Pakistan

Policy initiatives in Bangladesh

A number of studies appear to show fairly convincingly that the amount of remittance inflows into Bangladesh through informal channels has decreased significantly in recent years. A remittances survey conducted in 2002 found that about 54 percent of remittances came through the informal channel, including hundi (40 percent), friends and relatives (5 percent), and by hand (8 percent) (Siddiqui & Abrar, 2003). A study conducted by the International Monetary Fund (IMF) (2011) claims that the share of "unrecorded" remittances was 59 percent during 1981–2000. The World Bank's (2006) Global Economic Prospects report estimates that the share of informal remittance inflow was 54 percent in 2006. The two latest studies, however, conducted in 2010 by the Bangladesh Bank and Financial Action Task Force (a global anti-money laundering body), show that 17 to 24 percent of total remittances to Bangladesh come through informal channels, while this rate was about 54–60 percent five years ago (cited in Byron, 2010).

Government initiatives to facilitate the transfer of remittances through official channels

The two major players involved in the transfer of official remittances in Bangladesh are the Ministry of Finance and the Bangladesh Bank. Besides financial institutions, some nontraditional players are now also involved in improving formal remittances inflows, including microfinance institutions (MFIs) and the Refugee and Migratory Movements Research Unit. The country's largest MFIs, BRAC and Grameen, have developed hundreds of branch offices in rural areas and also have corresponding relationships with different international banks.

The Government of Bangladesh has also established different savings and investment facilities for overseas Bangladeshis to attract formal remittances. These policies and reforms can be divided into four major groups: (i) macroeconomic reforms, (ii) better provision of financial services, (iii) development of attractive investment instruments, and (iv) legislation framed to curb money laundering and encourage the entry of nontraditional players into the remittance market. The two regulatory instruments that apply to remittances include the Foreign Exchange Regulation Act 1947 and the Money Laundering Prevention Act 2002.

(i) Macroeconomic reforms

In 2000, Bangladesh relaxed controls on foreign currency transactions by allowing authorized dealers to transact dollars with the Bangladesh Bank. In 2002, the Ministry of Finance liberalized the exchange rate policy, making it free-floating and allowing the market to decide the exchange rate, which has helped curb hundi transactions significantly (Siddiqui, 2004).

(ii) Better provision of financial services

The Bangladesh Bank has established a strong network with foreign banks. Nationalized commercial banks (NCBs) have established overseas branches in the US, Europe, and the Middle East, while both NCBs and private commercial banks (PCBs) have made agreements with foreign banks and Western Union to smooth the transfer of remittances. The Bangladesh Bank permits banks in the country to establish drawing arrangements with foreign banks and exchange houses to facilitate remittances from Bangladeshi nationals living abroad (Bangladesh Bank, n.d.). In 2001, the Ministry of Finance issued a circular to all NCBs instructing that remittances must reach clients within three days of receipt of the draft/telegraphic transfer. For this purpose, NCBs and PCBs are encouraged by the Bangladesh Bank to switch over to an electronic funds transfer system, reducing the time taken to remit money as well as associated bureaucratic procedures.

In the past, remittance delivery could be delayed if the remittance was withheld in NCBs' international 'nostro account' for certain periods. According to the Bangladesh Bank's instructions, it is now mandatory to recover remittances on a daily basis (Siddiqui, 2004). In addition, the Bangladesh Bank has permitted new exchange houses to be opened in countries where there is a large concentration of Bangladeshi migrants. The bank also maintains weekly data by exchange houses, which has generated competition among NCBs and their exchange houses, and sets a mandatory annual minimum target for the latter (Hasan, 2006).

(iii) Savings and investment facilities for nonresident Bangladeshis (NRBs)

The government offers the following savings and investment instruments to attract remittances.

Nonresident foreign currency deposit. This deposit account can be opened in any bank operating in Bangladesh and foreign banks with an authorized dealership license. The account can be opened in a foreign currency for one month, three months, six months, or one year. The interest is determined by the interest accounted on the value of the Eurocurrency, and the interest accrued is tax-free. This initiative has improved the flow of formal remittances.

Wage earners' development bond. Remittances from Bangladeshi migrants abroad can be invested in takas (BDT) in a five-year wage earners' development bond, which carries an annual interest rate of 12 percent. The bondholder can surrender and encash the bond at the paying office after six months from the time of purchase, on which he/she is paid the principal amount together with interest on the premature encashment rate. This rate varies from 9 to 12 percent, depending on the bond's holding period. The interest accrued is tax-free.

Nonresident investor's taka account (NITA). Investors can open a NITA using money remitted from abroad to invest in shares and securities of the country's capital market. The capital and profit money is tax-exempt and the bank directing the account can work as a nominee.

US dollar premium bond. This bond is issued for three years in the name of a nonresident account holder against remittances from abroad to that account. The bondholder is entitled to draw interest on a half-yearly basis at a 7.5 percent (fixed) rate per annum in takas at the USD/BDT rate. However, the bondholder may surrender the bond before maturity and encash it at the paying office in which case a lower interest is paid. For investments of US $10,000 and above, subject to an initial investment of US$ 10,000 in one instance, the purchaser concerned is provided with a death-risk benefit. If he/she buys bonds worth US$ 1,000,000 (1 million) or above, he/she will be treated as a commercially important person (CIP) and will be entitled to all the corresponding facilities.

Like foreign investors, NRBs have also been provided facilities to invest in Bangladeshi companies. A quota of 10 percent has been fixed for NRBs in primary public shares, beside which the Ministry of Expatriates' Welfare and Overseas Employment has fixed a quota for emigrant Bangladeshis in government housing projects. Similarly, the Privatization Commission gives overseas Bangladeshis the chance to purchase denationalized industries at lower prices.

(iv) Income tax facilities for NRBs

The government's National Board of Revenue has undertaken various initiatives in the context of income tax rules for NRBs to increase the flow of remittances. The following measures provide NRBs with income tax rebates:

- The amount of remittance transferred by NRBs through the banking channel enjoys full exemption from income tax (Finance Law 2002).
- No tax identification number certificate is required on the purchase of fixed assets by NRBs (Finance Law 2002).
- Between 1 July 2002 and 30 June 2005, source capital for investment in business, industries, and commerce was accepted without any query concerning the source; this rule also applied to NRBs (Finance Law 2002).
- Between 1 July 2002 and 30 June 2005, the agricultural processing industry was fully tax-exempt. This advantage also applied to the same industries established by NRBs (Finance Law 2002).
- The interest income earned by NRBs on nonresident foreign currency deposit accounts is fully exempted from tax.
- Wage earners' development bonds purchased by NRBs are exempted from income tax.

- NRBs and foreign passport holders (and their family members) do not require income tax clearance before leaving the country after visiting Bangladesh.
- Tax holiday facilities are available for five or seven years, depending on the location of an industrial enterprise set by an NRB.

In October 2010, the central bank organized a three-day international seminar on anti-money laundering activities in Dhaka, in which 40 countries participated. The seminar's main aim was to assess how informal remittances could be controlled (Byron, 2010). More recently, the Asian Development Bank (ADB) has, with Japan's assistance, launched a remittance investment project to provide safe, affordable remittance services to thousands of Bangladeshi migrant workers and their families (cited in Microfinance Gateway, 2011).

Evaluation of policies and reforms in Bangladesh

Although no micro-level research was found to evaluate these policies and reforms, macro-data from the Bangladesh Bank on remittance flows highlights some interesting features. From 2002 onward, the formal remittance inflow from the UK and US has grown at an abnormally high rate. This unusual growth is attributed to increased surveillance by the countries' governments and the banking sector's improved services since 2001 (Siddiqui, 2004).

According to a senior World Bank economist, Zahid Hossain: "It appears that the measures taken by the Bangladesh Bank to make the formal channels more attractive have paid off." The chairman of the Krishi (Agricultural) Bank, Khondker Ibrahim Khaled, has pointed out that, previously, remittances came only through state-owned banks, whose services were very poor. Remittances could take up to one-and-a-half months to reach the recipients, but the situation had now improved, he added. Similarly, former Bangladesh Bank governor, Salehuddin Ahmed, stated that the central bank was trying to increase the inflow of remittances through formal channels, although there were still some irregularities at the branch level (cited in Byron, 2010).

Policy Initiatives in the Philippines

Remittances enter the Philippines through a number of formal and informal channels, including the banking system, informal wire transfer businesses, cellular phones, and by hand. There is no specific and consistent record of the informal remittances inflow. Based on a 1982 dataset, Tan and Canlas (1989) find that 55 percent of remittances came through informal channels. In a later study, Alburo and Abella (1992) find this rate to be 50 percent in 1990. Calzado (2007) reports informal remittances to fall in the range of 20–25 percent in 2006. The National Statistics Office estimates show that, out of the total cash sent, 52 percent was sent through the banking channel in 2002, compared to 46.2 percent in 1995. According to the Bangko Sentral ng Pilipinas BSP), the country's central bank, 95 percent of total remittances in 2007 were recorded by the banking system, compared to 72 percent in 2001 (Global Pinoy Remittance and Services, n.d.). The 2011 Survey on Overseas Filipinos shows that 78 percent of remittances come through the formal channel: 71.9 percent through banking and 6.2 percent through door-to-door delivery.

Initiatives taken by the Philippine government

The Philippine government has taken a two-pronged approach to facilitating the flow of remittances from overseas. One is to improve financial services while the other is to enter into bilateral agreements.

(i) BSP

According to the BSP, officially reported remittances have grown significantly partly as a result of the financial sector's improved efficiency and owing to the OFW population's recent shift toward more highly skilled jobs, i.e., professional and services-related (Global Pinoy Remittance and Services, n.d.). The BSP has put in place sound financial laws on the subject of remittance flow (Gonzaga, 2009, p. 1). The Republic Act No. 7653 authorizes the BSP to implement financial regulations regarding fund transfers made through formal channels such as banks, private remittance companies, and other remittance agents. Under this law, OFWs and their families are protected from fraudulent dealings such as exorbitant remittance fees and inaccurate exchange rates (De Vries, 2011).

The central bank has also held successful dialogues with banks and remittance agencies to lower cash transfer charges (Calzado, 2007). As a result of these measures and innovative practices, more OFWs now resort to formal channels for remittances. The shift is driven primarily by improvements in cost, speed, and service by banks and money transfer companies; the growing financial literacy of remitters; the closure of unregulated money transfer businesses in the wake of 9/11; and the Anti-Money Laundering Council's strict implementation of the "know your customer" reporting provision in the law. This provision requires both sellers and buyers of foreign currencies to fill and sign an application form and to present government-issued identification documents such as a driver's license or social security identity, among others (Calzado, 2007).

Although loan growth remained stagnant after the Asian financial crisis, the remittances market is now a highly competitive business in the Philippines (Global Pinoy Remittance and Services, n.d.). Philippine banks have continuously expanded their operations and formed strategic alliances with foreign banks to compete more effectively. An important achievement is their improved accessibility and cost efficiency. Overall, eight of the country's ten largest banks have some form of remittance operation in the US either through their own remittance centers or branches or through strategic partnerships with other institutions. Several Philippine institutions, including Metrobank and the Philippine National Bank (PNB), offer the convenience of door-to-door remittances in order to gain a competitive advantage. Several other banks have tied their remittance services to loans and savings products as a means of introducing banking services to the rural population (Global Pinoy Remittance and Services, n.d.).

In addition, banks have diversified their services by adopting mobile phone systems, point-of-sale terminals, and payments for healthcare and tuition. The GlobeTel Communications Corporation's G-Cash program uses short message service (SMS) to execute transactions and cash centers to pay out the funds received. As of March 2006, there were 1.3 million registered G-Cash users (Vargas-Lundius & Villarreal, 2008). In 2007, Metrobank partnered with the internet-based company Xoom.com to permit their OFW customers to remit money via the Internet. The Banco De Oro, through its affiliation with one of the Philippines' largest retailing conglomerates, the SM Group, permits remittance beneficiaries to collect their remittances at SM supermalls and hypermarkets so that they can use the money immediately for purchase in those stores. In Hong Kong, the PNB has partnered with Citibank and the convenience store chain 7-Eleven in using Citibank technology and 7-Eleven outlets to make OFW remittances more convenient. The tie-up has effectively added 480 7-Eleven outlets to the PNB's nine remittance offices in Hong Kong, allowing Filipinos to send money from virtually any location there.

(ii) MFIs

MFIs have also penetrated the remittances market to a large extent and spurred high competition, pushing down the cost of remitting and increasing the share of the formal financial sector (Vargas-Lundius & Villarreal, 2008). The Philippines-based MFI, Alalay sa Kaunlaran, Inc. (ASKI), launched its international operations on 22 July 2010 through ASKI Global Ltd. to give migrants and their families financial access, and enhance money transfer competition by providing knowledge, technical assistance, and building partnerships with immigrant associations. ASKI's setting up of an office in Singapore to provide microfinance services to Filipino domestic workers is a response to financial inclusion since OFWs who are in less-skilled occupations abroad are excluded from many nonfinancial activities (e.g., training in value formation, business development, and social leadership). Another MFI with a similar approach is CARD-MRI, the Philippines' largest MFI, which was serving nearly 1.5 million clients in end-2010. CARD-MRI has set up an office in Hong Kong and provides microfinance services to domestic workers, such as financial literacy seminars, small loans, and savings and investment products (Rispens-Noel, 2011).

(iii) Government initiatives

The Philippines has a number of well-established incentive-based programs, including savings and investment facilities and tax discounts to encourage formal remittances. Since 1985, the incentive-based Balikbayan program has encouraged overseas Filipinos to visit their homeland as a way of recognizing their contribution to the economy (Embassy of the Philippines, n.d.). The passage of the Dual Nationality Law in 2003 has enabled overseas Filipinos to reacquire their lost Filipino citizenship and enjoy incentives that include the right to own private lands for commercial and other productive uses (Calzado, 2007).

The Pag-IBIG Overseas Program is a voluntary savings and investment program that aims to provide OFWs opportunities for saving, availing a housing loan, and earning dividends. Members contribute a minimum amount equal to US$ 5 every month, and can avail housing loans of up to PHP 3,000,000. Members who want to avail a higher loan amount are required to upgrade their membership (Pagibig Financing, 2010).

The government also provides investment facilities to social enterprises. For example, a dairy cooperative, the DVF Dairy Farm (in the Nueva Ecija province north of Manila) encourages interested individuals, overseas Filipinos, nongovernment organizations, and corporations to invest in the dairy business as passive investors, for retirement purposes, and/or as an entrepreneurial undertaking. Another initiative is the National Reintegration Program, the aim of which is to optimize migrants' earnings, savings, investments, and other aspects of financial literacy during their period abroad (Rispens-Noel, 2011).

The Tax Reform Act 1997 or Republic Act No. 8424 was promulgated to provide tax breaks to OFWs. According to Section 23, nonresident citizens shall be taxed only on income derived from the Philippines; thus, OFWs are exempted from paying taxes on their earnings from overseas sources (De Vries, 2011).

The Philippine government has also signed a number of bilateral agreements to promote formal remittances. For example, during President Gloria Macapagal-Arroyo's visit to the US in May 2003, the US government undertook to provide the following facilities in bilateral agreements (Abenoja, 2007):

- Linking the US Federal Reserve with the Philippines Bank for a direct system of automated payments and clearing-houses.
- Launching an outreach/financial literacy program for Filipino and Filipino-American communities, bankers, and other remittance service providers and consumers by the US Federal Deposit Insurance Corporation to create awareness.
- Helping credit unions and cooperatives in the Philippines to interconnect with the World Council of Credit Unions' international remittance network system.
- Establishing a system that would tap the US and Philippine postal system in providing low-cost, front-end remittance channels in cooperation with the Rural Bankers Association of the Philippines.

The ADB has also provided technical assistance to increase the remittance volume and establish convenient formal channels by improving the regulatory environment.

Policy initiatives in Pakistan

There is no specific and consistent official information on the nature of foreign remittance inflows into Pakistan through informal (hawala/hundi) channels. Gilani, Khan, and Iqbal (1981) showed that informal remittances had a share of 84 percent of the total, including 48 percent through the hawala channel, 27 percent carried by hand, and 9 percent in kind. A study by the International Labour Organization (ILO)/Asian Regional Team for Employment Promotion

(ARTEP) in 1987 estimated that 43 percent of remittances were sent via unofficial channels. According to the Task Force on Overseas Pakistanis' report, "prior to September 2011, formal channel remittances accounted for approximately 19 percent as against 81 percent from informal channels." Shaukat Aziz, then the finance minister of Pakistan, painted a similar picture, indicating that only 20 percent of remittances entered the country through formal channels ("Cheap and trusted", 2001).

El-Qorchi, Maimbo, and Wilson (2003) estimate the proportion of unrecorded remittances by econometric modeling on the basis of the size of black market premium on exchange ratios. They find that informal remittances increased from 40 to 50 percent during 1985–2000. A joint study by the IMF and World Bank in 2003 also estimates that the share of unrecorded remittances is about 55 percent. According to Nenova, Niang, and Ahmad (2009, p. 75), "ten years ago, about 15 percent of international remittance flows came through formal channels, compared with over 70 percent currently." The study also states that, "various estimates of international informal remittances put hawala flows at around the $2.5 billion mark, in an overall international flow of $9 billion" (p. 75). The estimates of Arif (2009) and Amjad et al. (2011) show that about half the remittances are transferred through informal channels. Based on the Pakistan Social and Living Standards Measurement Survey 2007/08, Irfan (2011) suggests that households receive only 45 percent of total remittances through official channels.

Two features are notable. First, the share of informal remittances has declined marginally over time in Pakistan, and second, Pakistan has not successfully enhanced its share of formal remittances to the same extent as Bangladesh and the Philippines. Below, we summarize the policy initiatives undertaken by Pakistan to enhance the share of formal remittances, but which probably have not brought about the degree of success it had expected.

The main players in the formal remittances market are banks, exchange companies, and the Pakistan Post Office, while informal channels consist of hundi and hawala as well as money carried by hand. Banks constitute the major channel for the formal transfer of remittances from abroad with an 89 percent share in 2012 (Amjad et al., 2012). The two major actors involved in the regulatory framework and new policies that govern formal formulation in the Pakistani remittances market are the Ministry of Finance and the SBP.

Additional incentives by the SBP

Since the early 1980s, the SBP has been actively working with local and international banks to support a vibrant remittances market. In the 1980s, it encouraged Pakistani banks to establish branches in Middle Eastern countries to where most Pakistani overseas workers had migrated. The foreign exchange regime was liberalized and overseas Pakistanis were given the option of opening foreign currency accounts in Pakistan, allowing the free inflow and outflow of foreign currency from these accounts. At present, 95 branches of various Pakistani banks are functional abroad.

After 9/11, the SBP took further action to formalize remittances, such as setting up centralized home remittance cells and forming exchange companies in 2002. Banks were instructed to submit their remittance targets to the SBP, and an SBP taskforce monitored their progress. A complaints and monitoring cell was also set up to address public concerns. The formation of exchange companies has significantly increased the flow of formal remittances with hundreds of small moneychangers being brought into the regulated sector. They now account for 17 percent of formal remittances (Nenova, Niang, and Ahmad, 2009).

The SBP Foreign Exchange Manual (2002) states that there are no restrictions on incoming remittances, but that all transactions have to be reported to the SBP, identifying the amount and source. The SBP has now moved to develop its automation system and e-banking infrastructure to reduce the time and charges involved in processing remittances, in which regard, the Payment and Electronic Fund Transfer Act was enacted in 2007.

The PRI, launched jointly by the SBP, the Ministry of Overseas Pakistanis, and Ministry of Finance in early 2009, aims to enhance the flow of remittances through official channels. It has framed a strategy based on an objective analysis of the ground realities of the remittances market, focusing on wider participation by the financial sector.

The steps taken by the PRI have been outlined earlier in the paper.

To further elaborate on the initiatives taken by PRI has been its role in persuading and encouraging banks to extend their reach at the global level. In addition, global money transfer operators such as Western Union, MoneyGram, and Express Money have also been involved with the PRI's help. The PRI has been instrumental in improving payment systems such as over-thecounter cash facilities and inter-bank settlements. Another PRI initiative has identified areas where the major part of transfers is made informally. The PRI has also encouraged banks to open dedicated home remittance centers, and microfinance banks and the postal network to participate in the transfer of remittance payments.

The PRI through the SBP has taken number of steps to develop payment systems architecture. A real-time interbank settlement mechanism (PRISM-RTGS) is now used to transfer and settle inter-bank home remittance transactions. This has enabled banks to transfer inter-bank transactions into beneficiaries' accounts as quickly as possible. Apart from the RTGS, remittance transactions are also settled through payment switches. These steps have reduced remittance delivery times. In order to provide a reliable and immediate 24-hour contact point that is accessible seven days a week, the PRI has also established a call center (Shabbir, 2012). The International Association of Money Transfer Networks awarded the PRI the Money Transfer Award 2011 for the "Asia Pacific including South Asia" region.

In 2009, the PRI and Pakistan International Airlines (PIA) signed an MOU to enhance remittances inflows through official channels (State Bank of Pakistan, 2009b). In order to encourage the flow of remittances through formal channels, the government announced in 2009 that banks' marketing expenses would be reimbursed to attract remittances at given rates (Table 11; State Bank of Pakistan, 2009a). However, this system was discontinued and the earlier system of reimbursing the banking charges for remittances (US$ 6 per remittance) to the sending bank was continued.

Table 11: Reimbursement by size of remittance

Remittances mobilized by an overseas entity from any one particular jurisdiction (equivalent US$)	Marketing expenses reimbursement (as % of remittances mobilized in equivalent US$)
Up to 100 million	Nil
> 100 million to 400 million	0.50% on incremental amount (i.e., on remittances above 100 million)
> 400 million to 800 million	0.75% on incremental amount (i.e., on remittances above 400 million), plus amount calculated in the above slab
> 800 million to 1,200 million	1% on incremental amount (i.e., on remittances above 800 million), plus amount calculated in the above slab.
Above 1,200 million	1% on total remittances mobilized

Source: State Bank of Pakistan (2009a).

Initiatives by the Government of Pakistan

The Pakistani government has provided certain incentives and facilities to overseas migrants, such as exemption of customs duties on personal baggage and special immigration working clearance counters (which, however, rarely function). However, fewer incentives have been provided to improve the share of formal remittance flows. According to the Import Policy 2009, an overseas Pakistani, including a dual nationality holder, can import a three-year-old vehicle (car, bus, van, truck, or pick-up, including 4 x 4 vehicles) or gift the vehicle to a family member under the Personal Baggage, Transfer of Residence, and Gift Schemes. In 2010, this scheme was relaxed to allow the import of even five-year-old vehicles, but reverted to three-year-old vehicles at the end of 2012.

OPF

The OPF, a government organization for the welfare of overseas Pakistanis and their families, has been operational since 1979. The organization works in many areas to assist overseas Pakistanis, including the establishment of education and health institutions, and housing and industrial schemes, investment opportunities, and providing the necessary information and assistance to overseas Pakistanis. However, all these schemes appear to have been ineffective as far as the diversion of remittances though formal channels is concerned.

The OPF's two major schemes to improve the inflow of formal remittances are the introduction of foreign exchange remittance cards (FERC) and a pension scheme for overseas Pakistanis. Under the first scheme, five categories of cards are issued to overseas Pakistanis who remit foreign currency equivalent to US$ 2500–50,000 per annum. Cardholders are given various incentives, including separate counters for special handling at international airports in Pakistan, free issuance and renewal of passports on an urgent basis, and duty credits on some specific personal items. Table 12 gives the type of card, details of incentives, and amount of transfer under this scheme for January 2001–December 2012.

Table 12: FERC category, details of duty credit and issuance, and remitted amount under FERC scheme (January 2001–December 2012)

Type of card	Amount remitted (US$ or equivalent in foreign currency)	Duty credit (Rs)	No. of cards issued since January 2001	Amount remitted ($ '000) since January 2001
Silver	2,500 or more	10,000	35,434	174,162.1
Silver-plus	5,000 or more	20,000	9,388	65,852.8
Golden	10,000 or more	30,000	31,721	542,649.2
Golden-plus	25,000 or more	50,000	2,935	93,971.8
Platinum	50,000	100,000	1,680	155,450.3
Total	-	-	81,158	1,032,086.1

Source: Overseas Pakistanis Foundation.

The second scheme to encourage the inflow of formal remittances is a voluntary and self-contributing pension scheme that offers conventional and Islamic pension plans. Under this scheme, an overseas worker has to send the desired amount through a bank. The details of this scheme are given in Table 13.

Table 13: Type of pension plans and their benefits

Type of plan	Mature for payment	Expected pension payment on maturity per annum (Rs)	
		Conventional plans	Islamic plans
Lump-sum payment plan (one-time lump sum contribution of Rs 120,000)	After 5 years	18,492 (15%) 1,541/pm	14,400-18,000 (12-15%)
	After 10 years	29,784 (25%) 2,482/pm	24,000-30,000 (20-25%)
	After 15 years	47,964 (40%) 3,997/pm	36,000-48,000 (30-40%)
Annual payment plan (contribution @ Rs 24,000 per annum till maturity)	After 10 years	40,260 (16%) 3,355/pm	28,800-38,400 (12-16%)
	After 15 years	80,268 (22%) 6,689/pm	64,800-79,200 (18-22%)

Source: Overseas Pakistanis Foundation.

Unfortunately, there is no data available on how many Pakistanis are actually registered under the pension scheme, making it difficult to speculate on the impact of this incentive.

Conclusions and Policy recommendations

Setting up an efficient, transparent, and well functioning remittances market in Pakistan

The Pakistan economy and a significant proportion of its population depends on the flows of remittances from overseas workers and the broader Pakistani diaspora. At over US$ 14 billion in official remittances expected in 2012/13—which is just over half the projected total export value of goods and services and corresponding imports of around US$ 40 billion—they provide critical support to a precarious current account situation. Remittances to households also have a favorable impact on poverty reduction and job creation. Also accounting for around 5.5 percent of GDP, remittances inject much needed additional aggregate demand into an economy that has been mired in stagflation over the last five years.

Given the important role that remittances play, a major objective of policymaking is to ensure that remittances flow through official channels since this would maximize the development benefits to the economy. The main purpose of this study was to identify factors that would facilitate the transfer of remittances through official channels. To do so, we have analyzed the remittances market and its major players both outside and within Pakistan to identify factors that drive remittances to be sent through official or unofficial channels. We have also compared Pakistan's remittances market with those in Bangladesh, the Philippines, and to some extent India, mainly to identify policy measures and new initiatives taken in these countries to attract remittances through formal channels.

An important contribution of this study is its analysis of remittances within an overall framework of a remittances market that encompasses both formal and informal players. This helps us better understand its functioning dynamics and identify factors that might explain the growth of remittances as well as forces that influence its flows through official and unofficial channels.

We build on the earlier study by Amjad et al. (2012) and critically examines the results of Kock and Sun (2011) who attempt to explain the growth of remittances during the period 1997–2008. Our study covers the period between 1997/98 and 2011/12.

The main conclusions of the study are as follows:

- In explaining the manifold increase in official remittances since 2001/02, it is just as important to examine the economic shocks and policy interventions that may have impacted these flows as it is to look at the increase in number of overseas workers leaving Pakistan in this period, their skill composition, and economic conditions within and outside Pakistan.
- The major shocks and policy interventions that we have identified are:
    - The freezing of foreign exchange accounts in the aftermath of Pakistan's nuclear test in May 1998.
    - The 9/11 attacks on the US, which created a sense of insecurity among the Pakistani diaspora and caused US authorities and banking and other financial institutions to scrutinize the flow of remittances far more closely.
    - The collapse of the real estate boom in 2009 in Dubai and the accompanying financial crisis, which led to a number of Pakistani professionals and workers leaving Dubai, while Pakistanis who had invested in Dubai pulled out their investments or what was left of them back into Pakistan.
    - The PRI, launched jointly by the Ministry of Finance, State Bank of Pakistan, and the Ministry of Overseas Pakistanis, and the initiatives taken and incentives offered to Pakistani banks to increase the official flow of remittances, which has clearly contributed to its growth since 2009.
- An important finding of this study is that the remittances market is complex and geographically segmented; identifying the major factors that resulted in increases in official remittances requires examining each segment of this market to draw appropriate conclusions and policy measures and initiatives, rather than studying them at the aggregate level. The segments identified are:
    - The remittances market originating from (i) Saudi Arabia, (ii) Abu Dhabi, and (iii) Dubai.
    - The remittances market originating from the US.
    - The remittances market originating from the UK.

- Since these three segments and sub-segments account for over 70 percent of official remittances, analyzing each in depth provides important insights into their functioning and contribution to the large increase in official remittances. These main findings are:
    - The remittances market originating from Dubai is the most complex as it serves as a major global hub of the hundi network and is closely integrated with remittance inflows from the US and the UK. The official flows of remittances from Dubai mask investments by Pakistanis living in Pakistan as well as illegal earnings channeled back into Pakistan. The real net extent of these two flows is difficult to gauge but in examining movements and increases in flows, they appear to be significant.
    - The remittances market in Saudi Arabia and Abu Dhabi, once the post-9/11 impact on the flow of official remittances works through, reflects both an increase in the number of migrant workers from Pakistan as development activities financed by rising oil prices were expanded, as well as aggressive marketing by Pakistani banks with PRI support.
    - The US remittances market is where, besides Pakistani overseas professional workers, a significant part of the Pakistani diaspora resides, and its movements reflects both income transfers as well as the transfer of savings and assets to Pakistan. Since different factors influence the two flows, these need to be analyzed separately.
    - The PRI's initiatives launched since early 2009 appears to have yielded sound results especially in tapping remittances flowing earlier through unofficial channels from the UK and Saudi Arabia as well as in identifying new countries as sources of remittances. In the case of the UK market this was done by diverting flows from UK financial institutions to Pakistani banks since the former appeared to transfer funds that were not reflected in official flows.
- A striking and important finding of the study, based on recent household surveys for 2009 and 2010, is that households receive almost 40 percent of their remittances through unofficial channels. Even more striking is the finding that, whether migrants are better educated or the receiving households live in rural or urban areas, makes no great difference to which channel they use. In interpreting these results, however, two caveats must be kept

in mind. First, that the results is based on a relatively small household survey. Second, that it is very possible that these results may change as the PRI became more effective post-2010.

- Based on its analysis of the factors that have led to an increase in remittances—as well as diversion from unofficial to official channels—including as a result of very recent PRI incentives, the study concludes the following:
  - At less than US$ 1 billion, the official flow of remittances in 1999–2000, following the freezing of foreign currency accounts in Pakistan after the nuclear tests, can be taken as its lowest point in terms of the share of flows through official channels. Based on estimates by earlier studies, these could be taken to constitute around 20 percent of total flows.
  - Post 9/11, given the heightened scrutiny and continuing economic boom in the West as well as increased economic activity in the Middle East, official remittances increased sharply. The combined effect of these factors was that, by 2005/06, the share of flows through official channels could have gone up to 60 percent of total remittances.
  - The continuing increase in remittances after 2005/06, despite the global financial meltdown and real estate collapse in Dubai in 2009, can be explained by (i) the increased activity in Saudi Arabia and Abu Dhabi; (ii) the significant increase in outflow of Pakistan professionals to the US, UK, and Europe; and (iii) the PRI. These factors, we believe, could have increased further official remittances to around 70 percent or at least maintained them at around 60 percent of the total.
  - Our tentative conclusion is, therefore, to scale down our estimates of the flow of remittances through unofficial channels to nearer 30–35 percent compared to the much higher estimate (up to 80 percent) in Amjad et al. (2012). It must be emphasized again that these estimates are inferred from global, regional, and national developments and interaction with "knowledgeable sources" rather than hard evidence and should be treated accordingly.
- The case studies of Bangladesh and the Philippines, where the share of informal remittances has gone down, suggest that their banking systems have focused on speed, transfer cost reduction, and income tax relief for nonresident foreign currency account holders. In addition, they appear to have undertaken measures to facilitate investment by their

diaspora in real estate and industrial enterprises through the provision of tax holidays and without any requirement for a national tax number. The passage of the dual nationality law in Bangladesh, for instance, has helped in that direction. Both countries have engaged nontraditional actors, such as MFIs, to operate in the remittances market, while Bangladesh also introduced a premium bond.

- Drawing on the experience of Bangladesh, the Philippines, and to some extent India, the study concludes that the major difference between Pakistan and these countries is that, while their measures and financial infrastructure have instilled increasing confidence in their migrants and recipient households to route remittances through official channels, there remains a major 'confidence gap' among Pakistani migrants and their households in the use of official channels to transfer remittances.
- It is necessary to examine some of the measures undertaken by these two countries to divert remittances from informal to formal channels. Notwithstanding the fact that Pakistan has introduced policy changes, compared especially to Bangladesh there has been relatively less progress in reducing hawala transfers. For instance, the implications of abolishing withholding tax on nonresident foreign currency accounts in Pakistan needs to be discussed with the relevant bodies such as the SBP and Ministry of Finance to understand their rationale. In addition, there is need to examine the feasibility of subjecting the vehicle import facility extended to migrants to the condition that remittances be sent through formal channels for at least the preceding year.
- A financing mechanism whereby the country can borrow from its own expatriates is not a new proposal. India opted for diaspora bonds at the time of the liquidity crises in the 1990s to support its balance of payments needs, and succeeded in raising about US$ 40 billion. The merits and complications of issuing such bonds to raise foreign exchange from the Pakistani diaspora need to be examined. The perceived concerns of the diaspora—such as the depreciation of the Pakistani rupee, high level of inflation, and other obstacles related to macroeconomic stability and governance—have to be addressed. The design of the bond must reckon with the economy's ground realities. Mechanisms have to be evolved to dispel expatriates' fears, which may necessitate the involvement of international financial institutions and possibly the need for their extension of partial guarantees.

- One suggestion is that having a bank account be made mandatory for all migrant workers. Keeping in view the recent success of the Benazir Income Support Program in beneficiary women's use of the banking system, this recommendation is implementable. It will help to break down psychological barriers and attract more remittances through the formal channel. Moreover, Pakistani banks need to be proactive and develop closer links with migrant communities abroad, particularly in the Middle East.
- There is a need to address global factors that permit and facilitate capital flight could have a positive and significant impact on the official inflow of remittances. Improving governance and curtailing corruption within the country will downsize the demand for foreign currency abroad. Examining the skills and occupational classification of the diaspora, particularly in the OECD, might reveal some of the structural reasons that they prefer hawala to official channels. It is possible that a section of the diaspora wants to conceal their income because of the host country's taxation system, and hence opts for hawala.
- Finally, the study suggests two further areas of research. These are the role of foreign exchange companies in the remittance market in Pakistan. The second to undertake a more comprehensive survey of families receiving remittances in Pakistan. Both these studies would not only assist in identifying measures needed to increase remittances through formal channels but as in better documentation of the Pakistan economy.

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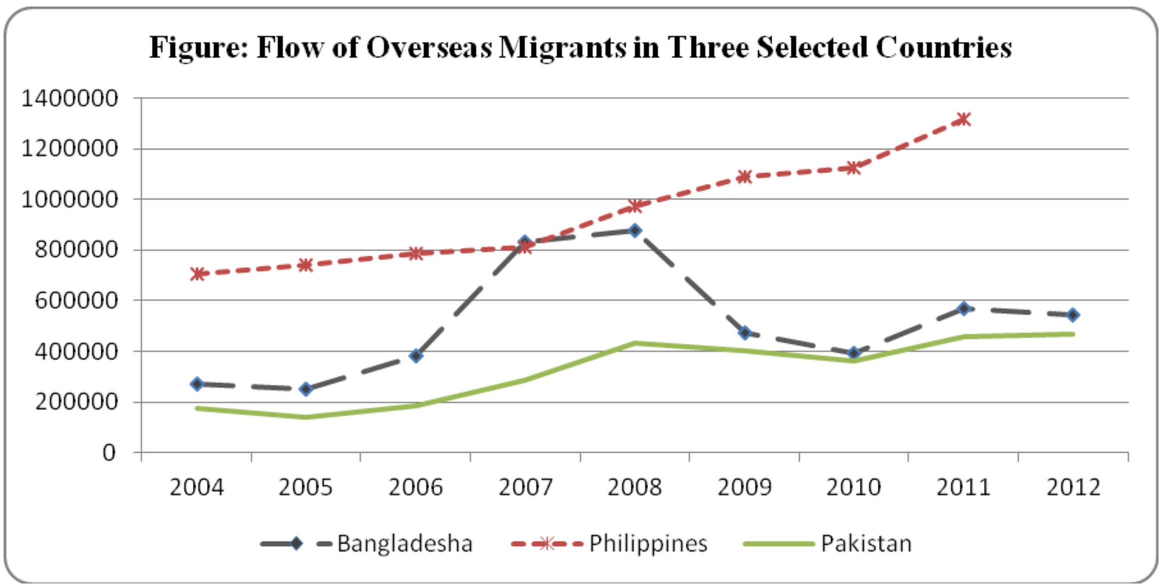
Annex

Table A1: Flow of overseas migrants

Year	Bangladesh [a]	The Philippines [b]	Pakistan [c]
2004	272,958	704,586	173,824
2005	252,702	740,360	142,135
2006	381,516	788,070	183,191
2007	832,609	811,070	287,033
2008	875,055	974,399	430,314
2009	475,278	1,092,162	403,528
2010	390,702	1,123,676	362,904
2011	568,062	1,318,700	456,893
2012	544,106	--	470,332

Sources: a = Bureau of Manpower, Employment and Training (n.d.); b = The Philippines, Senate Economic Planning Office (2012); c = Bureau of Emigration and Overseas Employment, Pakistan.

Figure A1: Flow of overseas migrants in three selected countries



Sources: For Bangladesh, Bureau of Manpower, Employment and Training (n.d.); for the Philippines, Senate Economic Planning Office (2012); for Pakistan, Bureau of Emigration and Overseas Employment.

Table A2: Outflow of overseas Pakistanis by occupational category (numbers)

Year	Highly qualified	Highly skilled	Skilled	Semi-skilled	Unskilled	Total
2001	3,155	10,846	64,098	2,768	47,062	127,929
2002	2,618	14,778	74,968	3,236	51,822	147,422
2003	2,719	22,152	101,713	4,601	82,854	214,039
2004	3,291	15,557	77,033	3,840	74,103	173,824
2005	3,737	15,467	57,793	2,675	62,463	142,135
2006	5,708	16,332	71,898	3,375	85,878	183,191
2007	8,178	20,975	110,938	3,243	143,699	287,033
2008	9,713	33,173	177,791	4,209	205,428	430,314
2009	4,954	3,260	182,657	2,465	210,192	403,528
2010	7,081	31,650	165,726	5,181	153,266	362,904
2011	6,974	3,018	171,672	73,247	201,982	456,893
2012	6,861	3,035	191,354	74,071	195,011	470,332

Source: Bureau of Emigration and Overseas Employment, Pakistan.

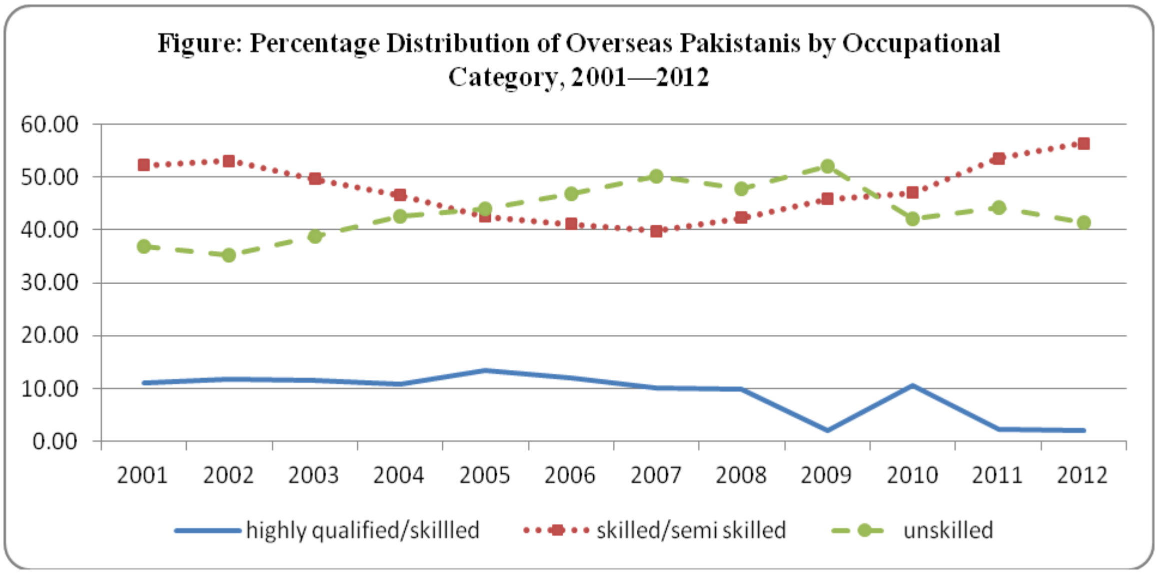
Table A3: Percentage distribution of overseas Pakistanis by occupational category, 2001–12

Year	Highly qualified/skilled	Skilled and semi-skilled	Unskilled
2001	10.94	52.27	36.79
2002	11.80	53.05	35.15
2003	11.62	49.67	38.71
2004	10.84	46.53	42.63
2005	13.51	42.54	43.95
2006	12.03	41.09	46.88
2007	10.16	39.78	50.06
2008	9.97	42.29	47.74
2009	2.04	45.88	52.09
2010	10.67	47.09	42.23
2011	2.19	53.61	44.21
2012	2.10	56.43	41.46

Note: The highly qualified and highly skilled were grouped together, and the skilled and semi-skilled were grouped together.

Source: Bureau of Emigration and Overseas Employment, Pakistan.

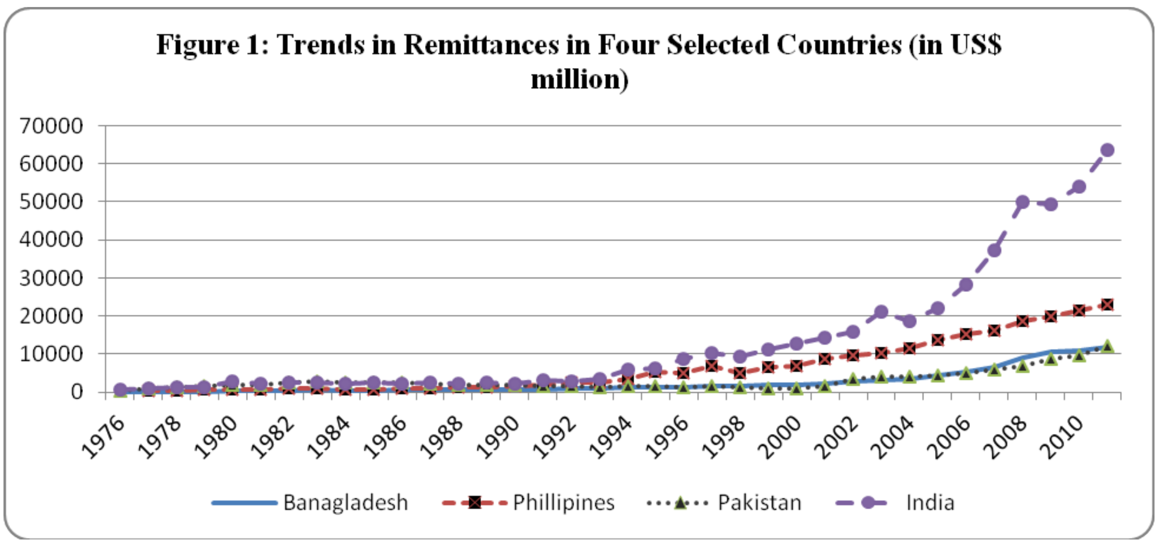
Figure A2: Percentage distribution of overseas Pakistanis by occupational category, 2001–12



Note: The highly qualified and highly skilled were grouped together, and the skilled and semi-skilled were grouped together.

Source: Bureau of Emigration and Overseas Employment, Pakistan.

Figure A3: Trends in remittances in four selected countries (US$ million)



Source: Remittances data, Development Prospects Group, World Bank (2011).

Table A4: Cost, distance, and time spent on dealing with banks and hundi system

	Total sample	Province					Region	
		Punjab	Sindh	KPK	Balochistan	AJK	Urban	Rural
Bank								
Time involved in each transaction (days)	4.44	4.16	5.68	2.80	2.00	8.38	4.64	4.19
Average cost of each transaction (Rs)	696.85	1,049.02	533.18	30.61	325.3	183.33	690.38	704.72
Distance to bank from home (km)	5.22	5.47	2.91	8.54	3.06	7.82	3.20	7.71
Average time spent drawing money from bank (hours)	4.20	3.19	3.07	10.98	2.05	2.00	5.79	2.30
Friendly behavior of bank staff (yes = 1)	92.80	99.50	90.10	100.00	60.00	62.50	93.80	91.60
Hundi								
Time involved in collecting money (days)	1.76	2.56	1.15	1.34	1.67	1.29	1.91	1.69
Average cost of each transaction (Rs)	702.48	1,927.85	396.5	10.89	767.33	17.00	582.17	769.32

Source: Household Survey of Overseas Migrants and Remittances (2009).

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