FINDEV BLOG 03 November 2020

Can Focused Policy Reforms Help Bring Back Remittances?

How the Ethiopian government is tackling the challenge of declining remittances and economic contraction

Photo credit: Muya Ethiopia, 2018 CGAP Photo Contest.

The COVID-19 pandemic has seriously disrupted African economies, including the vital flow of remittances. The latest World Bank figures predict that sub-Saharan Africa will finish 2020 with a 9 percent decline in remittances compared to 2019, and forecast a more gradual but prolonged decline into 2021. A new report by UNECA (United Nations Economic Commission for Africa) and the ONE Campaign warns that nearly 5 million people could be pushed into extreme poverty due to the continent's economic contraction.

Policy reforms in Ethiopia

To respond to these worrying developments, the Ethiopian government is pursuing policy reforms to stabilize its economy as well as formalize remittances to keep them flowing for its vulnerable citizens. The recent reforms include:

1. **Expanding the telecommunications market.** Like many other developing countries, Ethiopia has long had a centrally planned economy, with state-owned monopolies controlling critical sectors. Remittance service providers (RSPs) are tied to the sole operator licensed to provide telecommunications, state-owned Ethio Telecom. However, recent legislation will open up this market, introducing competition to spur development.

2. **Expanding the financial services market.** NBE has also issued a new directive which recognizes

non-bank operators as financial institutions. This step will enable fintech companies to provide a limited range of financial services.

3. **Demonetization.** Most recently, in late September, Ethiopia announced the demonetization of its existing currency, a move aimed at combating the counterfeiting that threatens to destroy the economy. People will have three months to exchange existing birr notes for new ones with enhanced security features.

Each of these reforms could affect the remittances sector in Ethiopia significantly. Under the previous monopoly arrangement, remittance service providers were limited to Ethio Telecomm's network coverage and were also powerless to negotiate prices. The introduction of competitive forces is intended to expand availability and choice, and to drive down costs. The entrance of fintech players, also, could dramatically increase access to remittances, especially for Ethiopia's rural dwellers, who represent more than 70 percent of the total population.

While the impact of the demonetization on formal in-bound remittances could be minimal since these are usually handled over the counter and out of bank accounts, informal flows could be hit much harder in the short-term. Informal remittance dealers may end up stuck with old currency that they cannot readily convert, as an earlier directive limits the cash any company or individual can keep on-hand to a maximum of ETB 1.5 million (~$41,000), and cash withdrawals from banks are capped at ETB 100,000 (~$2,737).

The large volume of informal remittances has long been seen by formal RSPs as a major barrier to their viability in Ethiopia. Although not specifically aimed at shifting remittances from informal to formal channels, the demonetization, along with the other policy reforms, could well end up advancing that shift, especially as lockdowns affect people's mobility and ability to use informal channels which require in-person contact.

Range of options available to policymakers in Ethiopia to mobilize remittances

How else can Ethiopia respond to the crisis? The following options could help mobilize remittances.

1. **A remittance guarantee scheme**, pursued in partnership between NBE, commercial banks and host-country consulates, could give migrants with a sound history of regular remittances greater access to credit, with repayments deferred until after the crisis.

2. **Government incentives to reduce transaction fees** for banks, mobile operators, RSPs and payment infrastructure providers could make formal remittances more attractive. A cashback incentive for remittance senders is one option: 3 to 5 percent of the transaction amount could be rebated, effectively eliminating the transaction cost and providing the necessary motivation to try something new. The government could also consider ways to structure incentives for increasing digital and financial literacy among migrants and their loved ones.

3. **Widen efforts already underway to loosen state ownership of key sectors and functions.** The central bank may consider allowing microfinance institutions to receive international remittances. This would expand coverage, especially within rural locations where MFIs are often the preferred (or only) option for financial services. Beyond MFIs, access could be expanded via agency arrangements with grocery stores, gas stations and other merchants.

4. **Expedite implementation of the planned centralized biometric national ID system** to be connected to the national financial system. Such a system will make it easier for migrants to open bank accounts, minimizing the need for in-person visits thanks to the possibility of electronic know your customer (KYC) processes. For both electronic and traditional KYC, the central bank should take a tiered approach, with more relaxed requirements for lower monthly remittances.

5. **Develop use-cases for digital payments.** Digital merchant and bill payments are currently available to only a tiny fraction of the population, so remittance recipients still need to visit an agent to withdraw the funds in cash so they can actually use those remittances to pay for the things they need. The government should encourage remittance recipients to receive their money into bank accounts or mobile wallets, and encourage development of digital payments, starting with expenses such as utilities, where the government is the merchant.

In addition to these recommended steps, a migrant-centric response should focus on building digital financial literacy, developing a consumer protection agenda which includes transparency of forex and other fees, and the establishment of a 24/7 call center for inquiries and complaints from migrants and their families. All of this will take time as well as collaboration with host countries to facilitate migrants' ability to use formal and digital remittance channels.

Ethiopia is taking many steps to implement critical reforms. At UNCDF, we are supporting the National Bank of Ethiopia (NBE) in these reform efforts, and believe that the Ethiopian experience holds useful lessons for other nations as the policy agenda around remittances takes on heightened urgency.

VIEW ALL BLOGS

Contributed by a global financial inclusion community member. **Share your lessons learned** WRITE FOR US

VIEW 1 COMMENTS

Comments

Comments on this page are moderated by FinDev Editors. We welcome comments that offer remarks and insights that are relevant to the post. Learn More