Lowering Barriers to Cross-Border Payments

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Thanks for the chance to speak at the Sumaq Summit and good morning. I'm honored to join this distinguished panel on financial services transformation.

My plan for the next few moments is to talk about international payments with respect to Latin America, with particular emphasis on the increasing importance of remittances and some of the new options for sending money from one country to another in our hemisphere. I'd also like to share some thoughts on potential ways for improving international payments and creating an environment for continuing progress.

Before we look to the future let's take a look at where we stand today with regard to international payments. The good news is that sending money across borders is much cheaper and more accessible than it used to be. The era when people had only one option, that being to carry cash by hand back to family members in their home country, is over. Even so, I believe that we can do a lot better. The many participants in the international payments business need to develop a process to coordinate their efforts that would lead to new products and services, with the aim of reducing barriers and lowering costs further — much further, in fact.

Today, the typical customers for cross-border payments services are Latin Americans working and living in the United States. This demographic group is rapidly growing in number and is becoming much more prosperous. But many of those who send, or need to send, remittances are new arrivals who have little or no knowledge of the options available to them. Nearly 60 percent of the people who send remittances have not completed high school, and more than half speak little or no English. The typical remittance customer works long hours, lives a frugal lifestyle and saves money as cash outside the traditional banking system. This person may lack documentation to open a U.S. bank account and typically will avoid financial institutions as they fear retaliation.

As you can imagine, Latin immigrants are hard to reach as they are making every effort to be invisible. This issue becomes even more problematic when you add new legal hurdles that must be overcome. These hurdles, of course, are related to the new laws designed to stop money transfers to terrorists. But it is imperative that U.S. banks figure out how to turn new arrivals from Latin America into customers. These immigrants, just like you or I, need banks, and I would submit banks need them because they are an economic force and will be an even bigger source of revenue for banks in the future.

When disadvantaged people living in unfamiliar territory have no bank account, serious problems can occur. Here in the Atlanta area, criminals have recently begun to prey upon immigrants who get paid in cash at the end of the workday.

It's our job as policy makers, bankers and businesses people to help immigrants become aware of financial education opportunities, understand how our financial system works and invite them to join the world of financial services. We cannot afford to miss this chance because, from Canada to Argentina, powerful demographic and market forces have permanently altered business patterns. And there is no turning back.

Growing importance of remittances

One of the points I want to emphasize this morning is the growing importance of remittances. Remittance flows to developing countries now typically exceed official development assistance and are similar in magnitude to foreign direct investment. In 2003, Latin American and Caribbean countries received $38 billion in remittances, compared with $23 billion just two years earlier. The largest market for remittances is Mexico, which received $13 billion last year, with almost all of the money coming from the United States. Money sent from the United States is increasingly important to many Latin and Caribbean economies. For instance, remittances from abroad in 2002 amounted to about 30 percent of the Gross Domestic Product of Nicaragua, according to Inter-American Dialogue.

Some of this data may reflect better tracking as officials pay more attention to remittances. But, clearly, the flow of money into Latin American countries is surging, and, interestingly, the volume has increased dramatically during a time of recession and slow economic recovery here in the United States.

As these trends have surfaced, policy makers have responded to the demand for lower remittance costs. One example is the Partnership for Prosperity, announced by the Bush administration and Mexico's Fox administration in September 2001. A primary goal of this collaboration between Mexico and the United States is to remove obstacles that inhibit the flow of capital between the two countries. The partnership calls for U.S. banks to aggressively market accounts to Mexican workers and offer remittance services. It also calls for the respective central banks to work together to facilitate a better payments process between the two countries.

There's evidence the Partnership for Prosperity already has delivered results. According to Inter-American Dialogue, the average transfer fees and foreign exchange charges for sending a $200 remittance to Latin America has dropped below $20, which is about half of what it was just three years ago.

In my opinion, more options, or good old competition, is the key to lowering remittance rates further. Because immigrants in the United States without bank accounts have a harder time finding safe places to store their cash, they frequently send money home in small increments of less than $200. Fees for small remittances typically are higher than for bulk payments.

Lowering remittances costs just a little can make a big difference. For instance, reducing the cost of remittance from about 10 percent to 5 percent of the amount being sent would free up more than $1 billion next year for some of the poorest households in the United States, Mexico and Central American countries, according to the Pew Hispanic Center. That's a lot of money — a regressive tax, if you will — paid by some of society's least prosperous families. Imagine the good that would be accomplished if we could put $1 billion back into their hands collectively — or, better yet, back into their bank accounts.

Role of the Fed and others

My organization, the Federal Reserve, has an interest in helping banks gain immigrant customers. Money that comes into the banking system gets reinvested and multiplied throughout our economy, which helps all of us. The Federal Reserve Bank of Atlanta represents the Southeastern part of the country, which has deep ties throughout the Americas. The Atlanta Fed also has a role in the Federal Reserve System for making policy to facilitate payments to Latin America and other parts of the world.

For the past few years, the Federal Reserve has worked closely with our Mexican counterpart, Banco de Mexico, in line with the Partnership for Prosperity. We have made progress clearing the way for an efficient interbank mechanism to carry out payments between United States and Mexican banks. What the Federal Reserve and Banco de Mexico have developed is basically an electronic highway called the Mexico Service.

This unprecedented banking link between the two countries has the same automated clearing house, or ACH, framework as direct deposit in the United States and international links to Canada and several countries in Europe. A big advantage of the Mexico Service is that it potentially connects any bank account holder in the United States with any bank account holder in Mexico, with transparent fees and exchange rates that are guaranteed within 1 percent of the wholesale rate. The cost per transaction to the banks is less than $1.

The Mexico Service has been open for government payments since last October, giving us enough time to measure performance. Our first test was to market the service to about 38,000 Social Security beneficiaries living in Mexico, including both U.S. and Mexican citizens. These customers were accustomed to receiving checks from the U.S. Treasury. When we started offering them the option of electronic payment, some skeptics told us these beneficiaries would prefer the old ways of payment. But, after six months, nearly 35 percent chose to convert from paper checks to electronic payment. Another 30 percent or so opted to switch to private bank electronic payment services, which is OK by me.

I'm encouraged by this result because it indicates that Mexican citizens are open to new ways of sending and receiving money and suggests that barriers to international payment will continue to fall. But we have a lot of hard work ahead of us, especially when it comes to reaching the vast population living throughout the United States and Latin America who, for whatever reason, don't have bank accounts.

New ideas and creativity are needed

Where do we go from here? The Inter-American Development Bank put forth a goal to cut in half the cost of sending remittances and increase by 50 percent the number of families receiving remittances through banks and credit organizations by 2010.

I think that goal is aggressive but attainable, especially in light of the movement since the Partnership for Progress began in 2001. But we have to pull together and recognize that the remittance marketplace is extremely complex and dynamic. I think it's helpful to appreciate that there are multiple levels of payments, with different facets and outlets and room for diverse participants.

For instance, Western Union and other companies that transfer money across borders have a wide footprint in many parts of Latin America, including Mexico. Accordingly, they have a significant share of the international payments business. They transfer money by wire, and this method may not interact with the banking system. There is little doubt that non-bank money transfer companies will remain important participants and can help meet broad goals to lower payment costs. The Federal Reserve looks forward to working with them as we proceed together.

Retail banks in the United States and Mexico now have the benefit of the Fed's ACH service. It's our job to help them understand it, but we can't tell them that they have to use it or how to use it. Ultimately, banks have to be creative. We need our friends in the financial services community to take what we're offering and leverage the benefits of these very inexpensive transmission costs and transparency to expand their customer base among Latin Americans. Success will require banks to get out and begin talking to customers and be open to new ideas, even if all the answers aren't yet clear.

To succeed, we need to talk, understand our differences and overcome obstacles. In this spirit of cooperation, the Atlanta Fed is hosting a conference this October to explore different ways to leverage electronic payments into Latin America.

I believe we share a common goal to reduce international payment costs and provide banking services to millions of people who don't currently have bank accounts. On another level, what we're talking about is improving people's lives by giving them better choices for their money and at the same time opening the banking industry to new opportunities for growth. Progress will take time. But if we succeed — and I believe we will — I believe we can make the world a bit smaller and better, one banking customer at a time.

Thank you for your attention.

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