



c/o GK Partners
Downstream Building, 1 London Bridge, London SE1 9BG

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Tel: + 44 (0)20 7785 6343 +44 (0)20 7587 3900
Email: info@remitaid.org faal@remitaid.org
www.gkpartners.co.uk www.remitaid.org

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Introduction to RemitAid™: Remittance Tax Relief for International Development (By Gibril Faal)

1. Remittances as a Form of Self-Help Development Finance

The World Bank reports that in 2005 remittances to developing countries sent through formal financial channels was about US\$167 billion. A consensus has now emerged that remittances are an important form of international development finance. We argue that remittances are particularly important for sustainable development because the process involves self-help by people who originated from developing countries. The special significance of remittances is illustrated *inter alia* by the following:

- **Comparative Size of Remittances:** Firstly, the relative size of remittance inflows shows that migrants and the Diaspora are the foremost financial contributors to development. In many developing countries, the volume of remittances is several times that of Official Development Assistance (ODA) and Foreign Direct Investments (FDI). For African countries such as Senegal and Ghana, remittances represent 10-15% of national income.
- **Enduring Self-Help Financing:** Secondly, unlike ODA and FDI, remittances are a form of continuous and enduring self-help finance generated and distributed by migrants and the Diaspora – not disbursements by foreign benefactors. ODA to developing countries tends to increase in times of natural or politico-economic catastrophes, whilst in contrast, FDI tends to increase in times of politico-economic stability. The World Bank reports that remittance inflows are on a steady and growing pattern, with the tendency to increase further in times of crises in the developing countries.
- **Absence of Financial Counter-Flows:** Thirdly, remittance inflows to developing countries are not countered by outflows characteristic of typical ODA and FDI financing schemes. ODA and FDI related outflows from developing countries include: interest, debt and dividend payments; retention and repatriation of funds to pay for donor country expatriates and professionals as well as product and service suppliers. Unlike ODA and FDI, financial counter-flows are not an inherent part of remittance financing.
- **Direct Financial Empowerment:** Fourthly, remittances are payments made directly to the beneficiaries in developing countries without the undue need for governments, corporate and other bodies to act as intermediaries. The directness of the financial relationship is an effective form of increasing financial and civil society empowerment. The beneficiaries of remittances are generally ordinary private citizens, families and local community groups.
- **Relevance to Millennium Development Goals:** Fifthly, remittances generally contribute to the relief of poverty and amelioration of human welfare in developing countries. The inflows are generally spent on food, shelter, education, health services, business start-up, community projects, land and property development etc. These activities funded by remittances are in line with Millennium Development Goals (MDGs) as well as charitable objectives.

2. Benefits and Imperfections of Remittances

Remittances have a number of economic and socio-political benefits relevant to development. We have analysed the range of direct and indirect micro and macro-economic benefits, but have also identified the negative impacts and structural imperfections inherent in Diaspora and migrant remittances. Consequently, we have designed a scheme (i.e. RemitAid™), which mitigates the structural imperfections and optimises the effectiveness of remittances as a form of development finance.

- **Direct Impacts:** Remittances contribute towards poverty reduction and job creation, and the direct economic impacts include the following:
 - Financing of essential human needs
 - Increase in household income
 - Investment and stimulation of micro-enterprise and SME
 - Acquisition and development of real estate
 - Investment in larger and technological enterprises

- **Indirect Impacts:** Remittances contribute to general economic development, and the indirect impacts include the following:
 - Foreign currency availability
 - Balance of payment advantages
 - General economic multiplier effect
 - Circulation of moneys in deprived areas
 - New business and enterprise opportunities
- **Structural Imperfections of Remittances:** Despite the numerous direct and indirect economic and poverty alleviation effects, Diaspora and migrant remittances as a form of international development finance currently suffer from a number of structural and inherent imperfections. These imperfections include the following:
 - Non-receipt of remittances – a new indicator of poverty
 - Dysfunctional migration practices
 - Dependency on external remittances
 - Limited investment in economic production
 - Causation of inflationary pressures
 - Misapplication of funds by recipients
 - Retention of hard currencies in host countries

3. RemitAid™: Framework for Mitigating the Imperfections and Improving the Impacts of Remittances

RemitAid™ is a scheme about remittance tax relief for international development. It seeks to mitigate the structural imperfections and negative impacts of remittances and to reform and improve the structure of the remittances sector through the financial instrument of tax incentives. This shall *inter alia*, result in the creation of a RemitAid™ Development Fund to finance the types of productive, equalitarian and poverty reduction schemes which private remittances do not normally fund. The key characteristics of RemitAid™ are as follows:

- **Practical Diaspora Partnership Initiative:** RemitAid™ is a Diaspora initiative which focuses on practical ways of harnessing and optimising the impact of the financial resources of the Diasporans and migrants from developing countries. It is also a mechanism that strengthens remittances as a form of self-help development finance, through a three way Diaspora-Public-Private partnership and collaboration.
- **Use of Standard Tax Incentive Tools:** RemitAid™ is a scheme through which Remittance Tax Relief (RTR) is claimed for remittances spent on international development – similar to existing tax relief schemes. In the United Kingdom, where the RemitAid™ idea originates, tax relief schemes such as Gift Aid, Venture Capital Trust (VCT) and Enterprise Investment Scheme (EIS) are used as financial incentives to stimulate and support charitable giving, investment in high risk ventures and economic regeneration respectively. Remittance Tax Relief (RTR) is a feasible mechanism for stimulating remittance expenditure on productive and regenerative ventures and other activities that contribute significantly to the attainment of the Millennium Development Goals (MDGs). The remittances that shall qualify for tax relief shall be those sent to developing countries (as defined by OECD), through formal regulated money transfer channels, for expenditure on activities that contribute towards MDGs and charitable objectives.
- **Simple Operational Framework:** The operational framework (see attached diagram) shall facilitate simple, transparent and low cost collection of remittance tax rebates from national tax authorities. Organisations and schemes that contribute to MDG and charitable objectives in developing countries (e.g. health centres, health insurance schemes, schools and enterprise support agencies) shall be designated as 'Recognised RemitAid™ Receivers (RRRs)', using accreditation frameworks which already exist in the receiving countries. (This would be in line with ODA FDI schemes which operate within in-country regulatory frameworks). Remittances sent and received by RRRs shall trigger a rebate claim. The RemitAid™ Agency shall collect verifiable and auditable documentary evidence from participating Money Transfer Agencies (MTAs). The cost of collecting the evidence shall be minimal as MTAs already generate, file and maintain such evidence for anti-money laundering (AML) and other regulatory purposes. The RemitAid™ Agency shall collate and present the evidence to tax authorities to validate RTR rebate claims.
- **Innovative Pooling of Tax Rebate:** One of the innovative aspects of RemitAid™ is that, unlike other tax incentive schemes, the tax rebate collected is pooled together in a common fund – instead of being paid directly to individual remitters or charities. The absence of direct financial gain for the individual remitters eliminates almost completely, motive, means and opportunity for fraudulent scams such as 'round tripping' and multiple rebate claims. The pooling of the rebates also creates substantial sums of moneys usable to fund a variety of major development programmes.

- **New Independent Development Fund:** The pooled moneys, i.e. the RemitAid™ Development Fund (RDF) shall be invested so as to create an enduring financial asset as well as a substantial annual income. The income shall be disbursed in the form of loans, grants and investment capital to fund productive, poverty reduction, enterprise, community and Diaspora projects and schemes. Remittances as a form of development finance is independent of both FDI and ODA. As such, the RemitAid™ Development Fund which arises from it shall be recognised as an independent capacity-building fund that supplements and complements remittance inflows, ODA and FDI by funding schemes not normally covered by everyday remittances. As with Gift Aid in the UK, the introduction of RemitAid™ shall be a political choice made by governments as a way of reforming and strengthening the remittance sector, for the purpose of supporting sustainable development and the Millennium Development Goals.
- **Management and Corporate Governance:** The RemitAid™ Development Fund shall be managed on a professional basis similar to charitable trust funds, but governance and control shall remain with the primary stakeholders, including representatives of Diaspora and migrant workers (i.e. the remitters), national tax authorities in host countries, regional and international development agencies etc.

4. The Benefits of RemitAid™

Apart from the emergence of a new independent fund, the RemitAid™ scheme has other benefits including:

- Increase in the productive and regenerative uses of remittances
- Increase in the volume of remittances used for developmental purposes
- Increase in the use of formal channels for remittance flows
- Promote emergence of appropriate enterprise development and business support services
- Stimulate development of health insurance and other financial and investment products
- Encourage wider use of collective remittances for community projects
- Promote Diaspora and migrant engagement in public private partnerships
- Create tax relief parity between remitters, Gift Aid donors and other tax incentive beneficiaries
- Promote Diaspora and migrant integration in host countries
- Increase appreciation of Diaspora and migrant contribution to international development

5. Development of the RemitAid™ Idea and Scheme

The idea was developed in 2003 by Gibril Faal (Director of GK Partners and Chairman of African Foundation for Development [AFFORD]) and was first communicated to the Chancellor of the Exchequer (UK's Finance Minister), Gordon Brown in 2004. At a meeting "to discuss the UK priorities for Africa leading to the Gleneagles G8 Summit" in June 2005, Mr Faal raised the issue again with the Chancellor. As a follow up, in July 2005, AFFORD formally called for the UK government to introduce remittance tax relief for international development. Since then further progress has been made but more research, awareness-raising and advocacy work is required. Some of the tasks already undertaken are listed below.

- **Origins and Conceptualisation:** The RemitAid™ idea emerged out of: experience of working on social enterprise, regeneration, enterprise support and international development; analyses of how the tax regime supports economic development strategies; assessment of the structural shortcomings of remittances; understanding that reform of the remittance sector requires measures beyond reduction of transaction costs (which results from a free and vibrant money transfer market – not regulation); understanding that innovative policy tools are needed to mitigate the imperfections of this substantial global financial sector.
- **Research and Analyses:** Review and analyses of literature on remittances; gap analyses of areas of further research needed; development of working definition and classification of Diaspora and migrants; pilot survey of Diaspora and migrant remittance patterns; initial research and analyses of the economic, social and political aspects of remittances; scoping of cost-benefit and risk factors; analyses of strategic, operational and legal factors, etc.
- **Stakeholder Consultations:** Identification of needs, wants and expectations of primary and secondary stakeholders; consultations with remitters, Home Town Associations, Diaspora groups, UK government officials, Finance Ministers and officials from developing countries; African Union Commissioners and officials, development experts from different disciplines, international organisations, and other stakeholders.
- **Partnership Building:** Technical consultations with economic, financial, development, tax and legal experts on how to further develop operational and legal framework for a UK, EU and OECD based remittance tax relief scheme.
- **Endorsements and Resolutions:** Endorsement and support from leading organisations and personalities; resolutions from conferences related to the United Nations High Level Dialogue on International Migration and Development (UNHLDIMD) including the 'First Ministerial Conference of Least Developed Countries on Migrants' Remittances' (8-10 February 2006, Cotonou, Benin) and 'International Organisation for Migration (IOM) & African Capacity Building Foundation (ACBF) Workshop on Migration, Development and Poverty Reduction' (8-10 August 2006, Dakar, Senegal).

6. Proposed Operating Framework for the RemitAid™ Remittance Tax Relief System

