



**POLICY BRIEF**

# **Impact of Mobile Money on Remittance Costs, Flows and Monetary Policy in Uganda**

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## Key Messages

- Reduction in transaction costs is a very powerful tool to boost remittance inflows to developing countries as the high costs hold back flows.
- Increased use of Mobile Money for cross-border money transfers is a reprieve to lower costs. A reduction in costs of remittances to the level charged by Mobile Money operators can spur remittances by between 8.5-12.3% for Uganda.
- Evidence suggests that there are no significant differences in responses of output gap, inflation, and treasury bill rates to the changes in monetary policy during periods of low or high remittance growth.
- In the medium- to long-run, the first-best policy action is to eliminate impediments (such as information asymmetry, limited contract enforcement, and limited property rights) to intermediation to allow the additional deposits from remittances to be intermediated to the private sector.
- In the short run, the use of quantitative measures, such as cash reserve requirements can eliminate the excess liquidity from remittances.

## Context

Remittances are a major source of financing for many low-income countries. High costs, however, have held back remittance inflows. Estimates show that between 5% and 15% of remittances are lost due to the high costs.

Mobile Money has emerged as a powerful tool for cross-border money transfers.<sup>1</sup> Since it was launched in Uganda in 2012, cross-border transfers through mobile money increased tremendously. Inward remittances rose to US\$ 45.5 million in December 2021, up from just US\$ 6.5 million in 2013. Among the available Mobile Money products (deposits, withdrawals, person-to-person (p2p), person-to-business (p2b), airtime and data purchase), inward and outward remittances grew fastest in 2016-2022 with annual growth rates of 96.4% and 158.3%.

The increased use of Mobile Money is a reprieve to lower costs. Data from the World Bank shows that mobile money operators charge the lowest costs. In

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<sup>1</sup> Mobile Money is a mobile phone-based money transfer system operated by cellular phone providers in Africa. It allows users to exchange fiat money or cash for "e-float" on their phones, send the e-float to other cellular phone users, and exchange the e-float back into cash (Mbiti and Weil, 2011).

addition to enhancing competition, convenience, and security, mobile money also serves as a price discovery platform, enabling customers to initiate transactions directly from their handsets without the need to visit operators' outlets. This allows users to transact when exchange rates are favorable.

## The Problem

### **Would a reduction in costs spur more remittance flows? What would be the potential gains in remittances from the reduction in costs?**

Although additional remittances would be welfare-enhancing, could it challenge the conduct of monetary policy, particularly in a low-income country like Uganda, where monetary policy transmission and intermediation are weak? This study examines how remittances respond to mobile money-driven cost reduction and how the potential flows could affect the efficacy of monetary policy. In low-income countries, fiscal policy has often not been a potent macroeconomic stabilization tool. In fact, in some cases, it is a source of macroeconomic shocks as it is often procyclical, which aggravates macroeconomic imbalances. The impotency of fiscal policy places an undue burden on monetary policy to ensure macroeconomic stabilization. Yet due to limited central banks' autonomy in these countries, the ability of monetary policy is also limited. If large increases in remittances further limit the independence of monetary policy, then the reliance on it as a stabilization tool could be misguided. This study is thus very important, especially to inform the design of measures to enhance efficacy of monetary policy in the face of large remittance flows without compromising its welfare-enhancing ability.

## Results and Implications

- The estimated cost elasticity of remittances is negative, implying that a reduction in costs could spur more remittances. A 10% reduction in the costs could stimulate increases in remittances by 1.6%. The estimates suggest that reducing costs from the overall average of 14.1% charged by all operators to the 3.2% charged by Mobile Money operators in Uganda could increase remittances by 12.3%.
- The results show that a Mobile Money-induced reduction in costs is a powerful tool for spurring remittance growth.
- The results also indicate that the output gap, inflation, and treasury bill rates respond in similar ways in terms of magnitudes and directions during high or low growth rates of remittances. However, the responses of inflation and treasury bill rates are delayed, which suggests that there are differences albeit insignificant in the responses

of the real variables to changes in monetary policy in the face of large remittances.

### **Given the evidence, what are the policy recommendations?**

- The first-best policy action is to eliminate the impediments to intermediation, including elimination of information asymmetry, enhancing contract enforcement and property ownership rights.
- Central banks can also use quantitative measures, including the cash reserve requirements to eliminate the excess reserves.
- However, policies to deal with the impact of large remittances must not directly impact remittance inflows as they are welfare enhancing in recipient countries.

## **Bibliography**

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