

**PRIVATE MONEY FOR PUBLIC GOOD: THE IMPACT OF
REMITTANCES ON ECONOMIC DEVELOPMENT IN
MEXICO AND EL SALVADOR**

by

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ABSTRACT

This research project explores the linkages between remittances and economic development in Mexico and El Salvador. Incorporating micro-level data in the form of case studies as well as macro-economic indicators, the research analyzes the impact of remittances on economic growth, poverty, and inequality from 1995 to 2005. By including both quantitative and qualitative data, the objective is to transcend the empirical analysis and investigate the broader social framework of remittances. The results of this interdisciplinary model show that while remittances may be positively correlated with economic growth under specific empirical circumstances in each country, they cannot be connected conclusively with reductions in poverty and inequality. Based on these findings, policy makers are encouraged to create an environment that will enable recipient households to direct remittances to more productive ends for long-term economic development, or as the title of this project suggests, to channel private funds for public benefits.

Keywords: remittances; Mexico; El Salvador; economic development; poverty; inequality

Subject terms: Emigrant remittances—Latin America; economic development—Latin America

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CHAPTER 1: INTRODUCTION

Introductory Remarks

With the global dominance of trade liberalization, migration has become an increasingly important option to provide income for poverty reduction and improved livelihoods in Latin America. Along with the rising tide of migration, remittances, or the transfer of goods and monies from migrants to family members in their home country, constitute a powerful force for economic development and are now seen to be a principal motivator for migration (Kapur, 2004). While many migrants in the 1980s were compelled to leave Latin America because of the lack of economic opportunity, persistent social inequality and political repression, migrants in the 21st century are accepting the high costs and risks of migration because the funds they send home can support their families and inject much-needed capital into their communities.

This research project explores the linkages between remittances and economic development¹ in two Latin American countries: Mexico and El Salvador. Using a cross-case analysis methodology, I compare one dependent variable, official reported remittance data with three independent variables measuring economic growth, poverty and income inequality. In order to augment

¹ For the purposes of this paper, the World Bank's definition of economic development is used, where the GDP per capita is the primary indicator used to measure the process of increasing the economic productivity and average material wellbeing of a country's population. <http://www.worldbank.org/depweb/english/beyond/global/glossary.html>

the GDP data used to measure economic growth, I assess the macro-level impacts of remittances using additional indicators such as inflation, exchange rate and trade patterns. To reflect the realities at the community level, I include a micro-level assessment of issues specific to economic growth in communities, such as the impact of remittances on human and physical capital, and also discuss the existing research highlighting the impacts of remittances on poverty and inequality. As a complement to the statistical data comparison, the project incorporates region-specific research from household surveys and ethnographic case studies for each of the focus countries. While migration patterns are not the focus of the project, they are inextricably linked to remittances and are used to support the economic data. By including both quantitative and qualitative data, the objective is to transcend the empirical analysis published by the institutional economists who dominate the remittance field and explore the broader social framework of remittances, including the motivations for migration, the social costs associated with migration and the consequences of remittances at the community-level.

To provide a theoretical anchor for the empirical data, the project evaluates rival perspectives on the impact of remittances for economic development, contrasting the views of those who stress the positive impact of remittances with those take the more pessimistic view that growth in remittance transfers serves to reinforce and even exacerbate social and economic inequalities. I do not seek to isolate a causal connection between the dependent and independent variables, but examine the hypothesis that remittances are the

product of a complex and multi-dimensional process embedded in the specific historical, economic and social factors of each country. The intention of the interdisciplinary analysis is to demonstrate the complex interplay of remittances and economic development at both the micro- and macro-levels for two countries and provide generalizable results in order to encourage the adoption of a country-by country approach to policy.

The research outcomes of this project indicate that while remittances and economic growth may be correlated under specific empirical circumstances within Mexico and El Salvador, it is difficult to connect remittance transfers reliably with poverty and inequality across countries. To supplement the existing data, more in-depth research is required to isolate the impact of remittances across communities in each country. From a broader policy perspective, this research suggests that international institutions and governments must ensure that the policies they implement consider the country- and community-specific realities of migration and remittances. As Kapur points out, remittances are not a development mantra, but "...are a function of the characteristics of migrants and the households they leave behind, their motivations, and the overall economic environment" (2004, p. 9). This project provides an academic deliverable illustrating different patterns between the independent and dependent variables across countries, and the incorporation of multiple data sets at both the macro and micro levels offer valuable comparisons.

Methodology and Research Questions

The methodology is based on a cross-case comparison involving two countries and incorporating both qualitative case study data with quantitative data. For the purposes of this project, the case study method is defined as, “the intensive study of (multiple cases) where the purpose of the study is to shed light on a larger class of cases” (Gerring, 2007, p. 37). The comparative case study methodology² lends itself to the subject of remittances because it permits the investigation of the linkages between remittances and economic development and helps to draw out the key features of the remittance patterns in each country. The reliance on two cases as opposed to a single in-depth case allows for insights that can be gleaned from analyzing their similarities and differences, and accommodates the lack of detailed remittance data available on an individual country basis.

The project explores the relationship between remittances and economic development in Mexico and El Salvador and answer some key sub-questions, including, how do remittance patterns vary between countries given changes in their economic environments? How do macro-economic, poverty and inequality data compare with remittance receipts and expenditures? How does the local-level experience as articulated by the micro-economic and case study data compare with the macro-economic data?

² For a review of the analytic strategies related to the case study approach, see: Yin. (2003) *Analyzing Case Study Evidence*. Case Study Research and Design Methods. SAGE Publications.

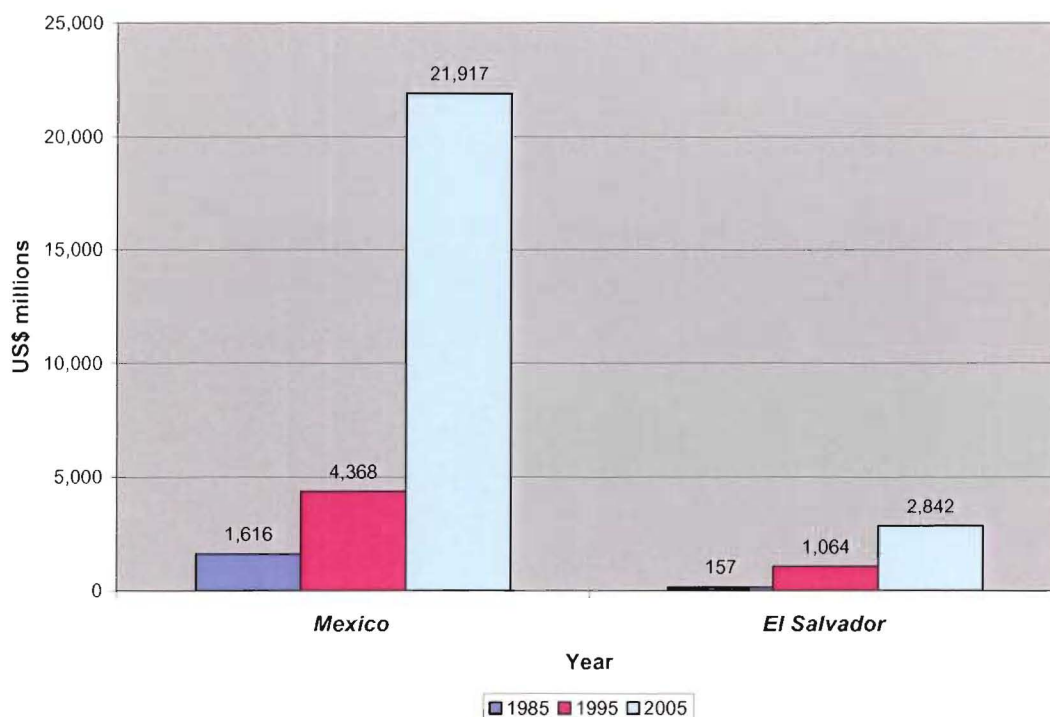
In order to frame the research, the project begins with a brief background on recent remittance research and a literature review, followed by a discussion of data accuracy and a rationale for selecting the case studies. A review of micro-level remittance data first illustrates the impact of remittances on specific regions and communities. The project then scales up to include an analysis of national-level data in a time series of economic, poverty and inequality indicators for each country for the twenty year period 1985 - 2005. Finally, the project concludes with a summary of how the research findings augur with the theoretical remittance debate and includes recommendations for policy makers regarding the role that remittances can play in each country, as well as across the Latin American region and for developing country economies generally.

Background

Since the 1970s, migration from Latin America, either South-South migration to neighbouring countries or North-South migration to developed regions such as North America and Europe, has increased exponentially. Recent projections show that, “the number of immigrants worldwide is expected to grow from around 183 million this year to 283 million in 2050” (Eaves, 2006, p.92). Inherent to the migration trend, the global transfer of remittances is also growing rapidly. Latin America and the Caribbean (LAC) is the fastest growing and highest volume remittance market in the world. For the year 2007, the World Bank forecasts that flows to the LAC region have grown to \$60 billion and over \$318 billion worldwide (Ratha, 2007).

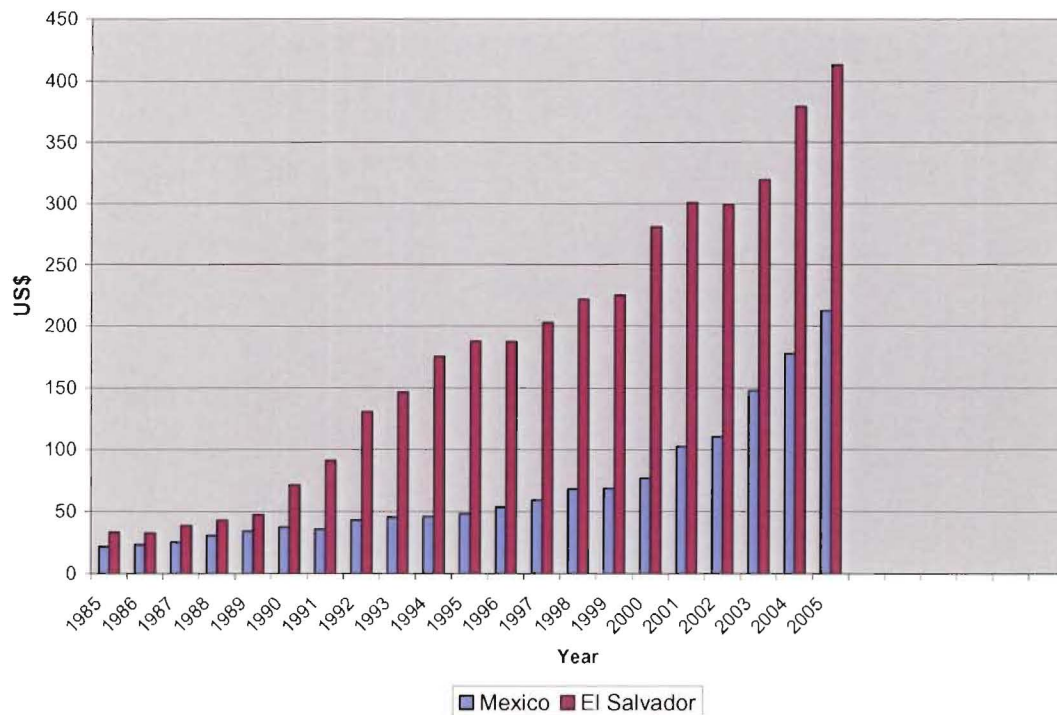
With regard to the case countries, as shown in Figure 1 remittances sent to Mexico increased 172% between 1985 and 1995 and almost 400% between 1995 and 2005. In El Salvador, remittances grew by almost 600% between 1985 and 1995 and approximately 165% to 2005. Figure 2 depicts remittances per capita for the time series 1985 – 2005, showing that remittances to El Salvador clearly have a higher impact on per capita income than in Mexico.

Figure 1 Mexico and El Salvador: Remittances 1985, 1995, 2005



SOURCE: World Bank Development Indicators 1985 – 2005

Figure 2 Mexico and El Salvador: Remittances per capita 1985 – 2005

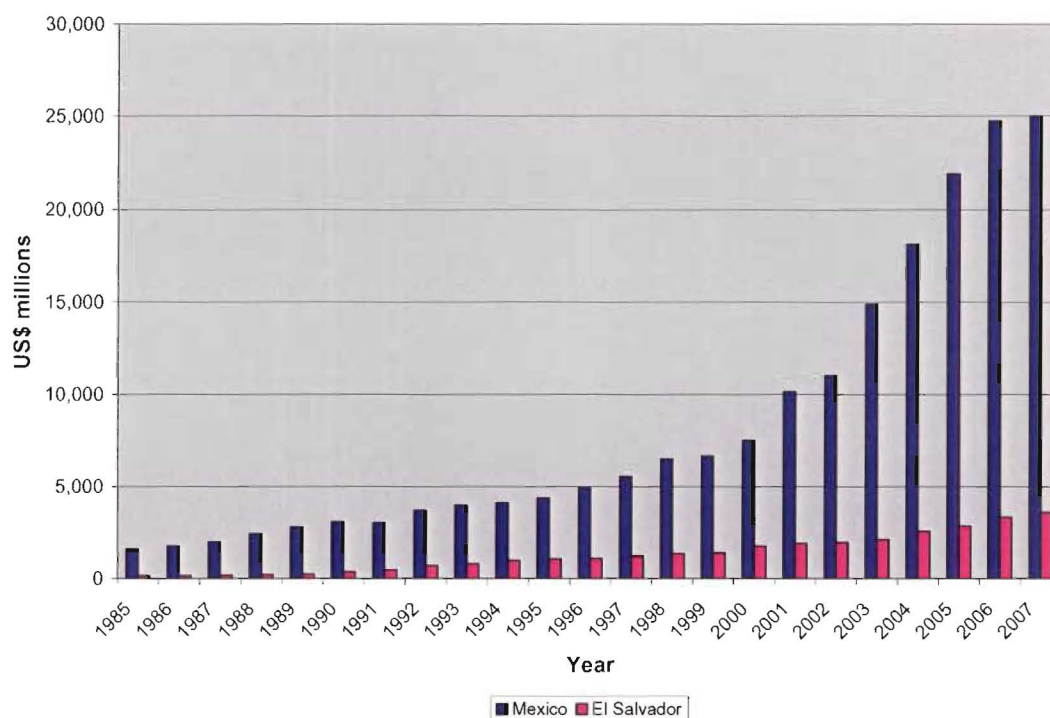


SOURCE: Own calculations using World Bank Development Indicators 1985 – 2005

Although the time series of data included in this research ends at 2005, the last year for which comprehensive remittance, poverty and inequality data are available, it is significant to mention the 2007 forecasts for growth in remittances received because of the changing trend that it may foreshadow. The World Bank estimates that Mexico will remain one of the world's largest recipients of remittances for 2007, with inward flows projected to reach US\$25 billion, however this represents just a 10% increase over 2006 figures (World Bank, 2007). For El Salvador, the growth trajectory is showing similar signs of deceleration, with remittances forecast to reach US\$ 3.6 billion in 2007,

representing annual growth of 7.5%. Figure 3 demonstrates the trend of remittances for each focus country up to and including 2007.

Figure 3 Mexico and El Salvador: Remittances 1985 - 2007



SOURCE: World Bank Development Indicators 1985 - 2005

In the context of the twenty-year time series, it is clear that the high growth rates of the past five years were disproportionate with the past. The projected 2007 growth rates of 10% for Mexico and 7.5% for El Salvador are likely to be more sustainable and do not necessarily portend any future cessation. If, as some research demonstrates, remittances tend to increase consumption faster than production and are increasingly relied upon as a stable source of external capital (Kapur, 2004), then the slower growth represented by the 2007 remittance

figures may indeed raise questions about the long-term ability of remittances to drive economic growth.³

Literature Review

A theoretical divide persists in remittance literature separating those who emphasize the positive impacts of remittances on economic development from those who stress a more nuanced or even a potentially harmful relationship. Those who promote the positive impact of remittances on economic development, primarily economists, argue that rates of poverty decline as remittance transfers increase (de Haas, 2005; Taylor, 1999; CIC, 2004). While development-centred researchers focus on the growth that can come from remittance transfers, others, mainly anthropologists and sociologists, promote a dependency model and caution that the social costs of migration and remittances may not always outweigh the benefits (Binford, 2003; Cohen, 2001; Reichert, 1981). The vast majority of literature to-date has been generated by the development proponents – economists with a macro-level perspective who view remittances as a potential solution to development, while those who are more skeptical about the long-term benefits see the negative impact that remittances can have on employment levels and income inequality over time (Maimbo and Ratha, 2005).

³ While there is no single explanation for the slower growth of remittances to Mexico and El Salvador in 2007, some predict that the weakening of the U.S. economy, particularly in the construction sector where so many migrants work, coupled with the tightening of U.S. immigration laws, have contributed to the stagnation (Ratha, 2007).

Proponents of remittances for development have tried to dispel the negativity by arguing that dependency perspectives were based on poor analysis and inadequate methodologies that have largely been disproven since the 1970s (Durand *et al.*, 1996; Zarate-Hoyos, 2004). In contrast, dependency theorists insist that those who promote remittances as drivers of economic development must be careful not to consider migration as a substitute for sound economic policy (de Haas, 2005) and that remittances must not replace the role of government in the arena of job creation, economic growth, and infrastructure development.

At the micro or community level, the bulk of theory on remittances and economic development is polarized between these two extremes. Some researchers argue that the numbers tell a complete story, that “migration and remittances are important components of poverty reduction policy,” (Zarate-Hoyos, 2004, p.564) and that remittances are spurring economic growth through increased consumption, micro-enterprise development, increased savings and trade with the Diaspora community (Taylor, 1999; Orozco 2002; Adams, 2005). In contrast, others stress that the numbers only tell part of the remittance story, that the social and political context of each recipient country is a better determinant of the extent to which remittances will lead to development, and that there are negative effects, such as the exclusion of the poorest classes of society and exacerbated income inequalities, which may crowd out the perceived benefits (de Haas, 2005; Ruiz, 2006).

In summary, the bulk of the literature agrees that, “the effect (of remittances) is generally beneficial, but the local specificities in factor markets produce different results” (Bracking, 2003, p. 637). From both the macro- and micro-levels of analysis, there is general agreement that an ongoing policy effort is required to continue to lower remittance transfer costs and increase regulatory measures to maximize the benefits of remittances. The bulk of the institutional research now focuses on mobilizing what are essential private funds for public uses, and calling for the creation of new opportunities to channel remittances into more productive long-term uses, which can be facilitated in part by expanding the formal banking system to offer services specifically for remittance senders and receivers. (Ozden and Schiff, 2006 and 2007; Maimba and Ratha, 2005; Terry and Wilson, 2005).

Data Accuracy and Collection Methodologies

In view of the fact that workers’ remittances represent the central data set of this analysis, it is important to acknowledge the controversy surrounding the accuracy of remittances and related data as well as explain some of the methodological discrepancies. Not only is there a lack of consensus on the definition of key terms such as migrant and remittance, there are also methodological issues around remittance data collection. In order to define migrant, for example, there must first be agreement on how to define nationality or resident. The definition of nationality for statistical purposes ranges from an ethnicity-based approach as used by many European countries, where a person may be classified by their parents’ ethnicity, to a country-of-birth approach as

used in the United States where someone is classified by their place-of-birth or country-of-citizenship (Page, 2006). The definition of remittance also varies from one that includes only pecuniary transfers to a broader definition that can include in-kind or non-monetary transfers (Ozden and Schiff, 2007). According to the International Monetary Fund (IMF), remittances for the purposes of the Balance of Payments (BoP) Yearbook data collection are understood as “personal transfers” and include, “all current transfers in cash or in kind between resident households and non-resident households” (Reinke, 2007, p. 6). This project relies upon the BoP definition of remittances for all data analysis.

Aside from definitional obstacles, there are also issues around which money transfers are included in the official remittance data sets. Statistics only measure the officially recorded remittance flows, ignoring the large proportion of remittances that are transferred informally, and governments struggle to accurately quantify the volume of undocumented migrants and informal remittance transfers (World Bank, 2007; Terry and Wilson, 2005; Ozden and Schiff, 2005 and 2007; Adams and Page, 2005). Furthermore, the money and in-kind goods that migrants bring home to their families during a visit may not be included in remittances as currently defined (Reinke, 2007), but if these migrants had sent that same money via a courier or financial institution it would be considered as a remittance transfer for statistical purposes. Not only are there varying calculations of what constitutes remittance income from country to country, some countries, including Canada, do not report remittance data in national statistics.

In an effort to coordinate the definitions for key terms used to compile remittance statistics, the World Bank and IMF are leading a revision of the BoP manual, which is used to compile annual data reported directly from each member country's Central Bank, and have initiated an *International Working Group on Improving Data and Remittances*. One of the first achievements of the Working Group was to introduce the term "Personal Transfers" in the BoP Yearbook starting in 2007. This term will incorporate all household-to-household transfers, both cash and in-kind, regardless of employment or migration status, replacing the problematic term "Workers' Remittances" that has been used to-date (Reinke, 2007). Workers' remittances represent goods and financial instruments transferred by migrants living and working in a new economy for more than one year, but exclude those migrants who reside temporarily in another country. Despite this progress, the Bank warns that, "...data comparison and aggregation have to be approached with caution" (Ibid, p. 3). Given that many migrants often follow a circular migration pattern whereby they leave their home country for a few months and remit money regularly, then return to participate in their local communities and home lives before migrating again (Cohen, 2001), the exclusion of remittances from temporary workers as in the term "Workers' Remittances" remains problematic. In order to provide a more complete picture of transfers, the BoP remittance data discussed throughout this project includes both workers' remittances and employee compensation, capturing those who are new migrants earning money abroad .

Rationale for Case Selection

The selection of Mexico and El Salvador is based not only on the importance of remittances and migration to their social, economic and political fabric, but also on the abundance of both national- and community-level data available from 1985 - 2005. While remittances represent a different share of the GDP in each country, comprising 16.7% in El Salvador and less than 2.9% of GDP in Mexico for 2005, they are two of the largest recipients in the fastest-growing remittance-receiving region in the world.

The breadth and depth of analysis available for these two countries alone can provide insight for other regions and influence the nascent international remittance research. Table 1 highlights some of the key indicators for each country as of 2005, the last year for which complete data is available.

Table 1 Macro-Economic, Remittances and Poverty Data 2005

	Mexico	El Salvador
Population	103,089,133	6,880,951
Immigrant pop. in OECD countries (thousands of persons) ¹	9,420	892
GDP per capita, PPP (current international \$)	10,811	5,255
Workers' Remittances and Compensation of Employees (US\$ million)	\$21,917	\$2,830
Workers' Remittances and Compensation of Employees (% of GDP)	2.9%	16.7%
Official Development Assistance and Official Aid per capita (% of GDP)	0.02%	1.17%
Foreign Direct Investment (Inflows as % of GDP)	2.4%	3.1%

SOURCE: World Bank Development Indicators 2005

¹Data from OECD Factbook 2007

While each country experiences significant migration each year, much of it undocumented as migrants travel illegally in the United States, the migrant-sending population differs in composition. As shown in Table 2 below, data from household surveys for Mexico (2002) and El Salvador (2000) show that unlike in Mexico where the majority of migrants come primarily from the lowest (1st) quintile of income distribution, El Salvador has a more even distribution of migration across income levels. Geography may partly explain the differences in the economic class of the migrant-sending population between the two countries, because Mexico is geographically contiguous with the United States (Kapur, 2004), the primary migrant destination, while El Salvador is not. The shorter distance to the migration destination translates into lower migration costs.

Table 2 Remittance-Receiving Households by Income Distribution (% of population)

Income quintiles	Mexico (2002)	El Salvador (2000)
1	60.66	33.96
2	14.86	19.35
3	12.43	15.37
4	7.89	16.59
5	4.07	14.66

SOURCE: Acosta, *et.al.* 2008

There is also evidence that the countries differ in the methods of transfer used to receive remittances. In Mexico the predominant transfer method is a money transfer organization such as Western Union (Orozco, 2003), while in El Salvador, most of the remittances are sent informally through *viajeros* or couriers (Gammage, 2006). Finally, there are important linkages between these two countries from a macro-economic perspective. Much of the literature indicates that remittances provide stability during times of crisis. In order to illustrate this

proposition and explore the pattern of remittance transfers during periods of volatility or decline, it is important to include countries that each suffered economic and political crises over the twenty-year period from 1985 – 2005. As opposed to a country such as Haiti or Honduras, where remittances represent larger proportions of the GDP, El Salvador has been included because the remittance phenomenon has been more closely studied in regions and communities throughout the country, resulting in a more extensive body of micro-level data. In addition to the difference in migration population by income quintile, another contributing factor in selecting El Salvador is that when assessing the impact of remittances on the exchange rate and on inflation over time, comparisons can be made between the impact on a dollarized economy (El Salvador) and the impact on the Mexican peso. From the perspective of the sub-national data, while there are similarities in the case studies available for each country, no single case study can reflect an average village and both countries are characterized by uneven regional development.

CHAPTER 2: MICRO-IMPACTS

The following chapter focuses on the impacts of remittances on specific elements of each country's economy, while later sections explore the macro-economic picture and assess the degree to which micro-impacts are replicable at a national level. For the purposes of this project, the micro-impacts refer to the dimension of the specific data set and the extent of the focus region. For instance, a case study may focus on a wide range of economic factors that have particular micro-level implications for one community, while data from a particular facet of the economy, i.e. education or labour statistics, may highlight the impacts of remittances across communities. The micro-impacts discussed in this project are based primarily on community-level case studies and ethnographic research, but also incorporate household survey data where indicated.

Economic Growth

As defined by the World Bank, economic growth can be realized exogenously by introducing new resources, or endogenously by increasing the productivity of existing resources. The following section explores research at the community level in each country to identify the impact of remittances on endogenous growth, with a focus on human and physical capital.

Mexico

There is considerable evidence for Mexico that the long-standing migration and remittance networks dating back to the late 19th century have played an important role in the economic development of recipient communities, particularly with regard to physical and human capital. What is less clear in the evidence is whether the physical and human capital inputs can be tied directly to economic growth.

With regard to physical capital, many researchers have concluded that the magnitude of remittances from the United States, or “migradollars” sent to Mexico have the potential to act as an engine for economic development. However, earlier evidence from the 1980s and early 1990s took a dependency approach and focused on individual sending communities in the United States to reveal that remittances were more of a “palliative” solution that could lead to economic dependency for the recipient family members and did not necessarily provide the capital required for sustained growth (Reichert, 1981). To further support the dependency approach, community-level research in Mexico by investigators such as Massey and Durand, along with other studies of various Mexican communities in the late 1990s⁴ revealed that as much as two-thirds of all remittances are spent on consumption, leaving little left over for productive long-term investment such as enterprise development or education. However, in response to his own research Durand has since argued that the evidence from the 1980s and 1990s ignored the potential multiplier effects that consumer

⁴ For more detailed data on remittance spending patterns at the community level, refer to Durand and Massey, 1992; Lopez, 1986; Massey *et al.*, 1987; Massey and Parado, 1994.

spending can have on economic production and growth. While the amount of remittances directed at productive uses is small on an individual family basis, contributing mainly to activities such as farming, handicraft production and clothing manufacturing, the aggregate of the physical capital available for production may be impressive. Based on an estimate of US\$2 billion remittance dollars in the economy in 1988, Durand estimated optimistically using a 3.25 multiplier ratio that the production impact generated over time would total \$6.5 billion, or about 3.5% of GDP⁵, including significant stimulus for manufacturing, agriculture and services sectors. Similar research by Adelman *et al.* seeking to quantify the multiplier effect of remittances at the community level concluded that for every \$1 of remittances, \$1.78 could be generated in village income as a result of the increased demand for goods and services (Adelman, 1988).

Along similar lines, research from Woodruff and Zenteno in 2007, connects remittances positively with micro-enterprise development.⁶ Based on a sample set drawn from each of the 31 states and the Federal District of Mexico (Mexico City) their work demonstrated that migration from Mexico is associated with a higher rate of investment and a significantly higher capital/output ratio across the country. Other research in this area quantifies the impact of remittances on micro-enterprise investment across urban Mexico, estimating that remittances were responsible for almost 20% of the capital invested in micro-enterprises (Kapur, 2004). As is common throughout Latin America where

⁵ Calculation based on GDP (current US\$) data from World Development Indicators 1988.

⁶ Woodruff and Zenteno restrict the definition of micro-enterprise to those firms with fewer than 15 workers (including the owner) in the manufacturing sector and fewer than five workers in other sectors.

interest rates can be punitively high, entrepreneurs finance investment predominantly through personal savings and loans from family members and friends. While the research suggests that migration networks provide access to much-needed physical capital, leading to higher investment levels and profits, remittances are not necessarily connected to higher sales or the relief of capital constraints in the long-term.

The impact of remittances on human capital, such as labor force participation is of particular importance because of evidence that Mexican migrants to the United States are more highly skilled than non-migrants (Chiquiar and Hanson, 2005). Thus the void in the labor market or “brain drain” resulting from migration is significant not only because of the resulting shortage of skilled workers, but also because there is compounding evidence that women in households with migrants abroad or receiving remittances are shown to be less likely to work outside the home (Hanson, 2007). These emigration-induced reductions in labor supply have resulted in higher wages in Mexico (Hanson, 2007), thus also affecting economic productivity.

With regard to education, remittances can provide much-needed capital for families from the lower end of the income distribution levels and may be used for expenditures such as education where there are opportunities to fund priorities outside the realm of basic consumption. Nevertheless, the research citing the impact of remittances on education in Mexico diverges yet again. On a micro-level, research from Fernando Borraz in 2005 indicates a positive yet small effect of remittances on schooling in the specific circumstance where children

range in age from 10 to 13 years of age, reside in small communities with fewer than 2,500 inhabitants, and whose mothers have a very low education level. In contrast, McKenzie and Rapoport (2007a) assess rural migration patterns from the 1920s across Mexico and conclude that children in families receiving remittances tend to acquire less education overall than those that do not receive remittances, with a stronger effect on 16 to 18 year-olds.

El Salvador

In contrast to the positive correlation between remittances, physical capital and economic productivity demonstrated for Mexico, there is cautionary evidence from the community-level that the same impacts cannot be imputed on a national-scale in El Salvador. If applying Durand's research connecting remittances with productivity in El Salvador based on data for the same year of 1988, the \$211 million in recorded remittances would translate into approximately \$686 million in productivity, or an additional 16% of GDP over time. Given that the economy of El Salvador only grew about \$42 million (1%) between 1988 and 1989, and with the acknowledgement that more research is required to investigate the remittance impact specifically, it is unlikely that remittances generated the same multiplier effect in El Salvador as purported for Mexico.

According to a micro-economy wide model developed by Taylor et al. to assess the role of remittances on economic development in specific communities across the country, the benefits of migration for remittance recipient families are unevenly distributed. The research found that, "...the impacts of migration are captured almost entirely by migrant households and there is evidence that non-

migrant households may be adversely affected by impacts of migration on local labor markets in the short run” (Taylor, 1999, p. 80). The authors go on to explain that the influx of foreign currency, while increasing the demand for consumer products, can also alter the prices of local goods because of higher production costs.

With regard to human capital, there are similar findings in El Salvador to those of Mexico demonstrating the impact of remittances on the labour market. Migration and remittances caused gaps in the labour market both from the vacancies left by the departing migrants and the drop of women in the formal labour force in particular as a result of the impact of remittances on household income. As in Mexico, migrants in El Salvador were shown to be positively selected and had a greater role in the domestic workforce prior to departing (Funkhouser, 1992). However, unlike Mexico where the labour force gaps led to upward pressure on wages, there is evidence from El Salvador, particularly from the 1980s during the economic decline, that the labour market shortages were beneficial in offsetting the structural unemployment (Ibid).

Unlike Mexico, where the micro-level data offers conflicting results, there is evidence of positive correlations in El Salvador between remittances and education. Research by Edwards and Cox shows that rural families that receive remittances in El Salvador differ significantly from other rural families because of the lower likelihood that their children will leave school. (Edwards and Cox 2003). Data was assessed from the 1997 National Household Survey in El Salvador included 8,387 families and revealed that particularly in rural areas families

receiving remittances appear to differ from other rural families in that their children show less risk of leaving school across all grade levels (Ibid).

Poverty

Distinct from the impacts on economic growth, there is evidence that remittances can also have an impact on poverty levels, particularly when targeted collectively at community development initiatives. Given that national-level indicators are primarily used to measure poverty by headcount, and there is no formal framework to assess the impact of remittances on poverty reduction (Chimhowu *et al.*, 2005), it is difficult to quantify the impact of remittances on poverty at a micro-level. As the macro-economic discussion of remittances will demonstrate, even with accurate national poverty data it is still challenging to establish a causal relationship. Ultimately, since remittances are private transfers within families, it is reasonable to assume that the higher levels of income associated with migrant sending households do have some overall impact on poverty, but these benefits are not accrued evenly across communities. Furthermore, in countries like El Salvador where migrants are not principally from the lowest income quintiles, it is difficult for the benefits of remittance income to reach the poorest of the poor.

As the body of literature expands, specific themes are emerging related to the role of remittances and poverty at the community level. One such theme is the role of community organizations and specifically hometown associations (HTAs) in formalizing the connections between remitters and their families to maximize the benefits of remittances for community development. Another theme

focuses on the incentives offered by the public and private sectors to encourage remittances for community development. While these themes may not be generalizable across the LAC region, they are important elements of the remittance story at the community and family-levels in Mexico and El Salvador.

Hometown Associations (HTAs)

Integral to the transnational relationship between remitters and their home countries, hometown associations (HTAs) have emerged as an important contributor to economic development and poverty reduction, particularly in Mexican and El Salvadoran ex-patriate populations in the United States. HTAs are defined as “organizations that are formed among remittance senders to coordinate their support not only of relatives but also of their towns, as well as retain a sense of community as they adjust to life in the U.S.,” (Orozco, 2002, p. 42). HTAs have evolved from serving a purely social function to also satisfying an economic role by raising funds (via remittances) for the betterment of their places of origin. As the name implies, HTAs are sustained by personal relationships with members of the community; HTA members are motivated to remit not only for the benefit of individual family members, but also out of an interest in the overall community welfare and the needs of the lowest income earners (Alarcon, 2000). This altruistic focus on the poorest of the poor is one of the reasons that HTAs appear so promising to policy makers as a vehicle for poverty reduction (Orozco, 2005b).

HTAs are comprised primarily of first generation migrants from rural backgrounds and their activities range from charitable aid directed at specific

families to the building of ceremonial or recreational facilities or public infrastructure for the benefit of the community. While these activities do not necessarily lead to sustained economic growth in and of themselves, most researchers agree that they generate wealth for the community and generally improve quality of life. In Mexico there are some 600 HTAs based in over 30 U.S. cities and representing communities throughout the country (Orozco, 2002b). The impact of Mexican HTAs is particularly impressive when considering that in communities with less than 3,000 people, HTA donations can equal more than 50 percent of the community public works budget (Orozco, 2005b). In El Salvador HTAs are also growing in numbers and there are now estimated to be more than 70 in Los Angeles and 15 in Washington, D.C. (Paul and Gammage, 2004). Accurately quantifying the number of HTAs is complicated by the fact that not all organized groups of remitters identify themselves as HTAs. In Washington, for example, Salvadorans are organized in more than 20 groups building support and raising money specifically for the province of San Miguel in eastern El Salvador, but not all of these groups are identified as HTAs (Orozco, 2005b).

With the increase in HTAs comes new opportunities to reduce poverty and respond to the specific needs of communities, not only by increasing the funds for community projects, but also via non-economic measures such as training and technology transfer between migrants and home communities. While further research is required to explore the potential of HTAs as key actors in economic development, care must be taken to reflect the diversity of each HTA and its unique set of complex hometown relationships (Paul and Gammage, 2004).

Expectations for the potential of HTAs to reduce poverty must also be realistic given that fewer than 5% of Mexicans, and an even smaller percentage of Salvadorans, who actively send remittances are HTA members (Orozco, 2002a).

Government and Private Sector Incentives

The Federal Government of Mexico encourages the formation of formal migrant associations through programs such as the Program for Mexican Communities Living Abroad (PCMLA), providing services to migrants such as health care and education and offering ways to channel remittances toward hometown development projects (Orozco, 2002). In El Salvador, the government program Unidos por la Solidaridad (United by Solidarity) offers funds to migrant organizations to engage in local development through small infrastructure projects such as building schools, roads, setting up water systems, and installing public spigots (Paul and Gammage, 2004).

In addition to these programs, the governments of Mexico and El Salvador are increasingly aware that the growth of HTAs in the United States offers great potential to harness private remittances for poverty reduction and economic development. In order to encourage more participation of HTAs in funding community development activities, government has stepped in with initiatives such as the Three-For-One Program in Mexico that will match HTA donations with equal contributions from the municipal, state and federal levels of government. The Three-For-One Program began in 2002 and by 2003 it had led to a total of US\$36 million in new projects (one quarter financed through HTAs), with two-thirds of these projects established in the leading migrant-sending states

of Zacatecas, Guanajuato, Jalisco, and Michoacán. While these incentive programs have led to initial successes for community development, the long-term role of HTAs in poverty reduction requires more research. In particular, it will be important to assess the extent to which HTA funding represents new remittances in the recipient economy, as opposed to a replacement of existing direct-to-family transfers.

Another area that requires more analysis is the role of the private sector in encouraging the use of remittances for poverty reduction. The private banking sector is increasingly involved in offering incentives such as lower remittance transfer costs in order to encourage remitters to transfer funds through formal banking channels via bank accounts, thereby creating new customers for their deposit and loan services. These services, along with increased competition of in transfer service-providers resulting in lower costs, are already showing positive results in Mexico. While Mexico is a country with the lowest banking penetration in the region, remittance recipients are now demonstrating a higher rate of holding a bank account than the population as a whole (Hernandez-Coss, 2005).

The lure of lower transfer costs to entice new customers can be a win-win proposition for both banks and community development advocates as it encourages remittance recipients to save portions of their transfers in bank accounts for future productive uses. As summarized by Dilip Ratha of the World Bank, “for any poor households and migrants, remittances are the only point of contact with the formal financial sector” (Ratha, 2007). Yet another tool to maximize the impact of remittances on community development is the investment

bond, which is offered through both the government and private sectors in El Salvador and Mexico to raise external financing (Orozco, 2002; Maimbo and Ratha, 2005). These investment bonds are backed by future workers' remittances from the United States and while not specifically directed at community development, they do represent an innovative and market-driven approach to increasing the impact of remittances in the local economy, with potential for poverty reduction.

Inequality

The nuances between country case studies are more pronounced when assessing the impact of remittances on income inequality. On a micro-level, if it is assumed that the amount of remittances sent home to families is largely based on the earnings of the migrants in the United States, then it is logical that the median remittance amount tends to be uniform among rural and urban recipients. Despite this uniformity, the impact of remittances is higher on rural households, which survive on much less income than in urban areas and where remittances make up a larger proportion of income in relation to other sources (Edwards and Cox, 2003). For this reason, the rural-urban split of remittance recipients plays an important role in the overall impact on income inequality at the community level.

In Mexico, national-level statistics indicate that migrants are derived disproportionately from the lower income quintiles (61% in the year 2000), as shown in Table 1. While it is difficult to isolate the reasons for the difference in income distribution between Mexico and El Salvador, one explanation previously mentioned points to the geographical contiguousness between Mexico and the

United States, which decreases the travel costs of migration. Another explanation relates to the maturity of the migration network in Mexico compared with El Salvador. According to Taylor, who began studying the impact of remittances on income inequality at the village level in Mexico in 1986, the first Mexican migrants likely came from the upper end of the village income distribution because they were better equipped to sustain the high costs and risks associated with the journey (Taylor, 1986). Gradually, as migration information diffused through the village population and support networks formed with the number of migrants from the same village increasing, households at the lower end of the income distribution began to participate in both the investment in, and the economic benefits of, migration. While Taylor demonstrated this connection in his research comparing two different villages near the Mexico-Arizona border, his work also revealed that the impact of remittances on income inequality could not be easily generalized across communities and was critically dependent on the migration history and opportunities across different village households (Ibid.)

For El Salvador, similar community-specific migration stages exist. While national-level data points to more migrants originating from the higher levels of the income spectrum (32% in quintiles 4 and 5 according to the data from 2000), there are also many migrants (34% in 2000) from the lowest income quintile, and these numbers are likely higher when considering those undocumented migrants who could not afford to participate in the formal migration process.

Many researchers suggest that depending on the stage of migration, international migrants come from different parts of the income distribution of a

town or region. (Jones, 1998; Cohen, 2001) According to household survey data from across the LAC region, remittances are more likely to have an equalizing effect on income when they are directed to a larger proportion of households in the lower quintiles of the income distribution spectrum. (Acosta, *et al.*, 2008). As with the assessments of economic growth and poverty, the impact of remittances on income inequality is also linked to the ways in which remittances are used by recipients and diffused through the community.

CHAPTER 3: MACRO-IMPACTS

Quantitative data on remittances and development trends for each country has been compiled from peer-reviewed academic journals, while statistical data have been included from official sources such as the World Bank Development Indicators, Inter-American Development Bank (IADB) and the Central Banks of the each country government. In order to address the relationship between remittances and economic development, key macroeconomic indicators such as Gross Domestic Product (GDP), current account balance, exchange rate, inflation, and income distribution have been compiled in a time series from 1985 – 2005 alongside remittance data from the IMF's *Balance of Payments Statistics Yearbook*⁷. The following section summarizes some of the data trends and highlights key correlations between remittances and economic development, including poverty and income inequality in each country, drawing parallels between countries where possible. Complete sets of time series data for both Mexico and El Salvador are included in Appendices A and B respectively.

Economic Growth

Between 1985 and 2005 remittances to the LAC region grew an average of 14% per year (Acosta, *et.al*, 2006). Correspondingly, GDP growth averaged approximately 3.2% per year and only 1.1% according to per capita GDP. Table

⁷ For complete information on the remittance data included in the IMF's Balance of Payments Yearbook, see: <http://www.imf.org/external/np/sta/bop/bop.htm>

3 shows that for Mexico and El Salvador remittances have sustained a higher growth rate than the region, whereas GDP figures closely mirror the regional averages. As a supplement to this table, Figures 4 and 5 on the following page demonstrate that for both Mexico and El Salvador, as in most of the LAC region, remittances are now larger than Official Development Assistance and Foreign Direct Investment combined as a percentage of GDP. The following section seeks to explain the specific pattern of remittances and GDP growth for each country and identify common trends.

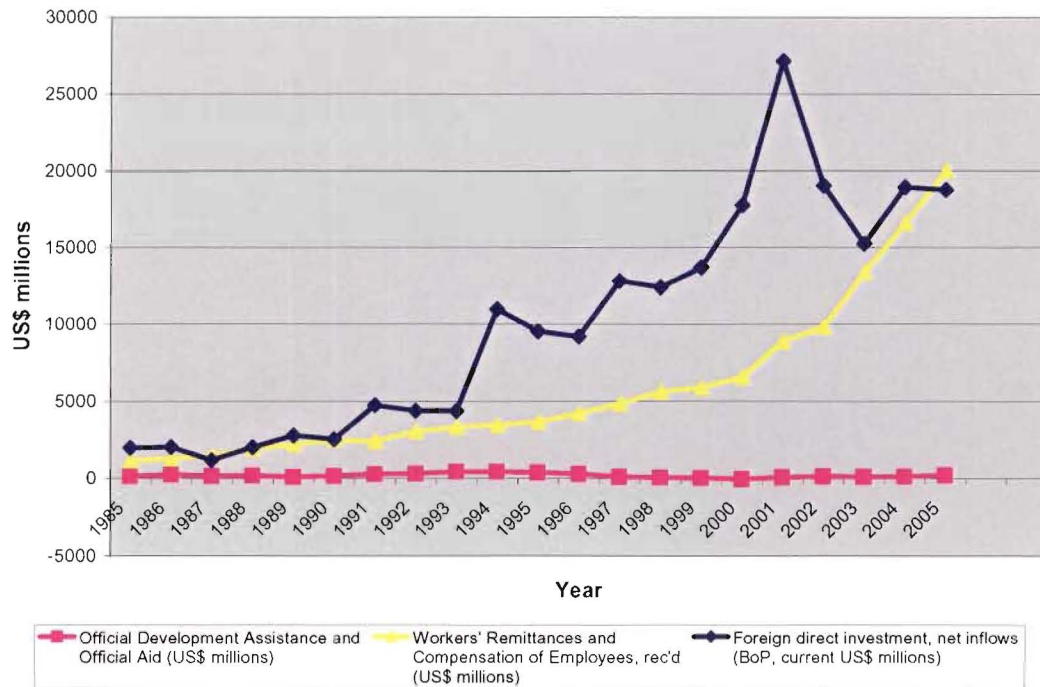
Table 3 Average Annual Growth: Remittances and GDP 1985 – 2005

	Mexico	El Salvador	LAC Region*
Average % GDP growth 1985 - 2005	2.6	3.2	3.2
Average % GDP growth per capita 1985 - 1995	1.0	1.4	1.1
Average % Remittance growth 1985 - 1995	14.3	16.3	14.0

SOURCE: Own calculations using World Bank Development Indicators 2005

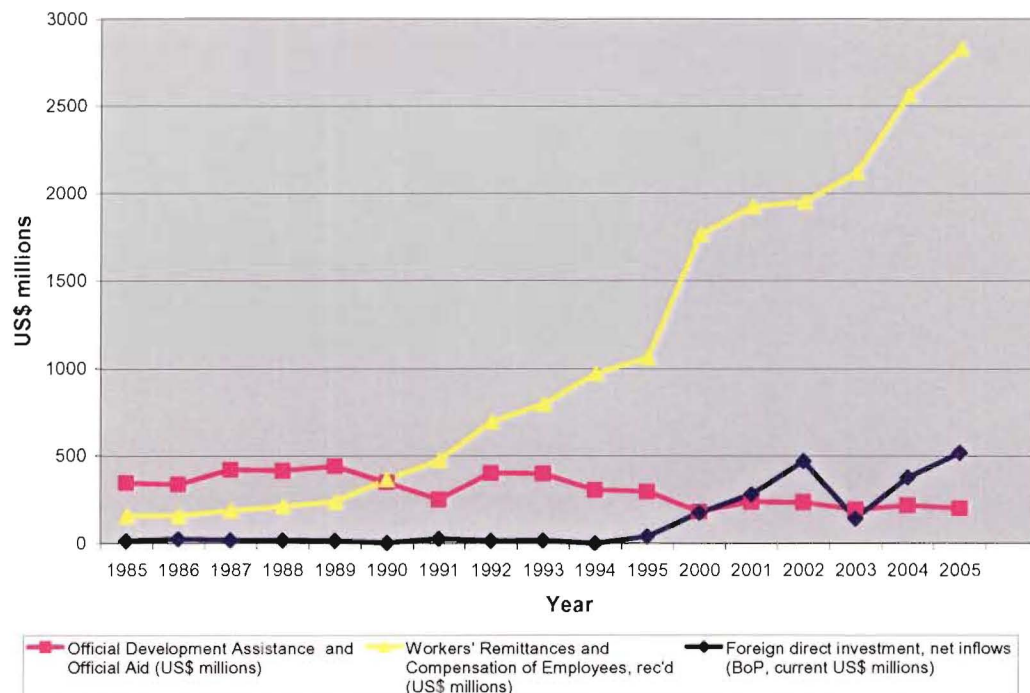
*IMF data for 10 Latin American countries 1990 - 2004 from Acosta, *et. al*, 2006

Figure 4 Mexico: Remittances, FDI and ODA 1985 – 2005



SOURCE: World Bank Development Indicators 2005

Figure 5 El Salvador: Remittances, FDI and ODA 1985 – 2005



SOURCE: World Bank Development Indicators 2005

Mexico

In the 1980s with the collapse of the Mexican economy and again with the currency crises of 1994 and 1998, there was a strong push factor motivating migrants in search of opportunity. Combined with a strong pull influence arising from the strength of the U.S. economy, the transnational movement of migrants is now a central feature of the Mexican economic development strategy. In 2005, the last year of the data time series, Mexico's population reached slightly more than 103 million, from which 644,361 people or less than 1% of the population officially made the decision to leave Mexico, primarily for the United States, in search of a better future (World Bank, 2007). From 1990 to 2002, it is estimated that the Mexican-born population living in the United States grew from 14 million to 25 million (Hernandez-Cross, 2005).

As evidenced by Table 4, Mexico's overall economic performance can be characterized as tumultuous from 1985 - 2005, but has improved consistently in the last ten years. The exchange rate has remained steady since the last currency crisis of 1998 and the GDP per capita (PPP) increased almost 50% during the study period, with inflation decreasing 93% since 1985.

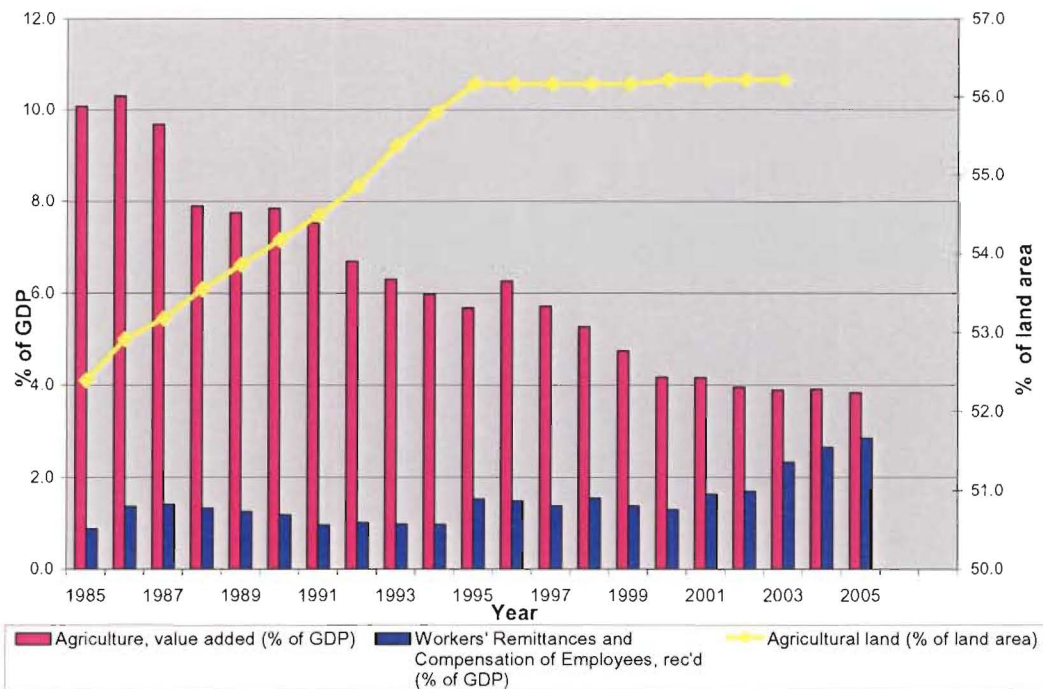
Table 4 Mexico: Macro-Economic Indicators 1985, 1995, 2005

	1985	1995	2005
Real GDP growth (% yoy)	2.6	-6.2	2.8
GDP per capita, PPP (current international \$)	5,480	7,030	10,811
Current Account Balance (% of GDP)	0.4	-0.5	-0.6
Foreign direct investment, net inflows (% of GDP)	1.1	3.3	2.4

SOURCE: World Bank Development Indicators 1985 - 2005

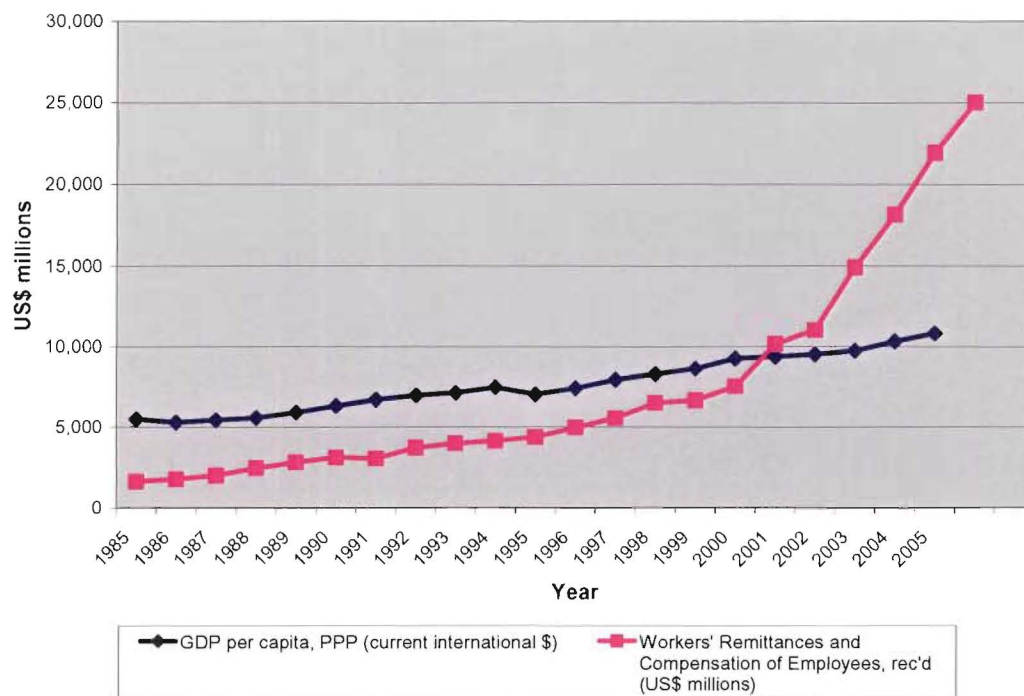
While significant GDP growth remains elusive, remittances are playing an increasingly key role in the composition of GDP. As a percentage of GDP, remittance receipts have grown 225% from 1985, yet still represent only 2.9% of the overall picture. Of note is the role that remittances play as a replacement for agriculture in the GDP, demonstrated by Figure 6. While the percentage of agricultural land increased and then remained steady since 1985, value-added agriculture as a percentage of GDP has dropped to 3.8% in 2005 down from 10.1% in 1985, a change of -165%. For the same period, remittances as a percentage of GDP have increased 70%. The overall growth of remittance receipts by millions of US dollars is compared with GDP per capita growth in Figure 7.

Figure 6 Mexico: Remittances vs. Agriculture as % of GDP 1985 – 2005



SOURCE: World Bank Development Indicators 1985 – 2005

Figure 7 Mexico: Remittances and GDP per capita 1985 – 2005



SOURCE: World Bank Development Indicators 1985 – 2005

El Salvador

El Salvador has a population of about 6.8 million and an additional 2 million El Salvadorans are estimated to be living abroad. The country is the fifth largest recipient of remittances in the region and the third largest per capita recipient, following Haiti and Honduras (World Bank, 2007). The Central Bank of El Salvador publishes monthly remittance statistics dating back to 1998. Beginning in 2005 remittance data was adjusted to include information from money transfer organizations and other remittance transfer businesses, which serves as a partial explanation for the impressive growth of reported remittances in recent years. The central bank statistics also incorporate the results of the biennial remittance survey (supported by the MIF/IADB) completed for El Salvadorans living in the U.S. The 2005 figure for total remittances as submitted for the IMF Balance of Payments is \$2,830 million and includes compensation of employees residing abroad only temporarily.

As with many Latin American countries, the 1980s in El Salvador represented a “lost decade” filled with violent civil war and economic decline as Salvadorans fled to the U.S. primarily for political and security reasons. Peace accords were signed in 1992 following 12 years of civil war and migration has since been motivated largely by economic factors. Despite efforts to liberalize trade, El Salvador struggles to diversify its economy, suffering from low prices for key exports such as coffee and cotton and a loss of competitiveness in the manufacturing sector, partly attributable to rising competitiveness of Asian countries. Table 5 provides a snapshot of key macro-economic indicators and trends in El Salvador at different points in the last twenty years.

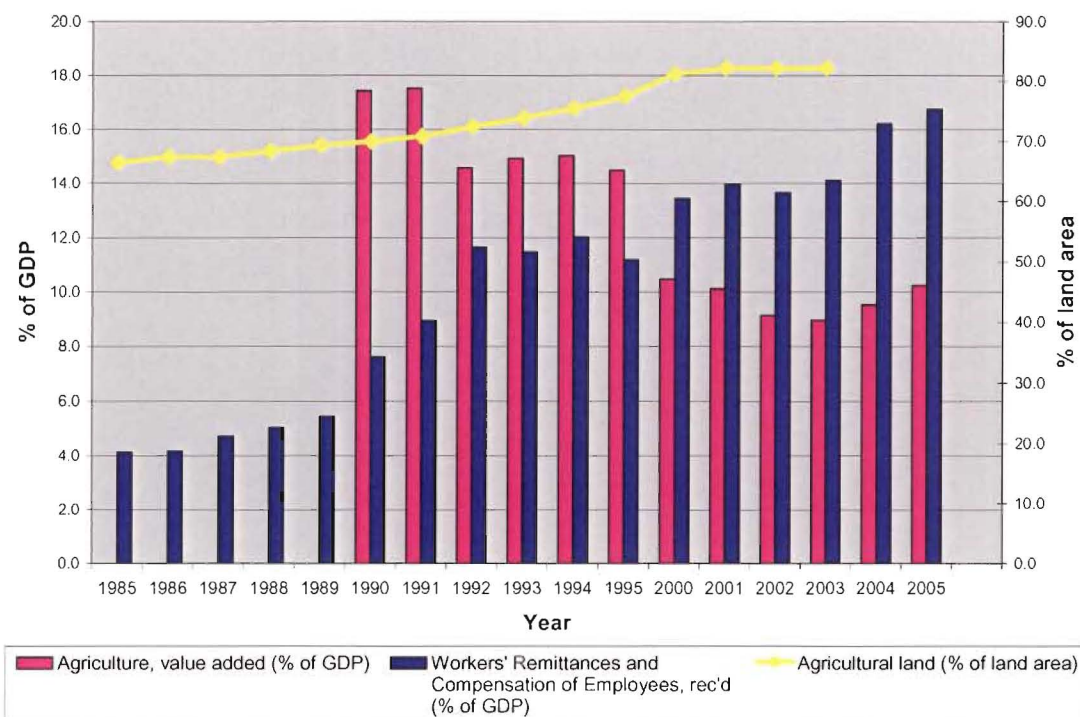
Table 5 El Salvador: Macro-Economic Indicators 1985, 1995, 2005

	1985	1995	2005
Real GDP growth (% yoy)	0.6	6.4	2.8
GDP per capita, PPP (current international \$)	\$2,427	\$4,035	\$5,255
Current Account Balance (% of GDP)	-0.8	-2.8	-4.6
Foreign direct investment, net inflows (% of GDP)	0.33	0.40	3.05

SOURCE: World Bank Development Indicators 1985 - 2005

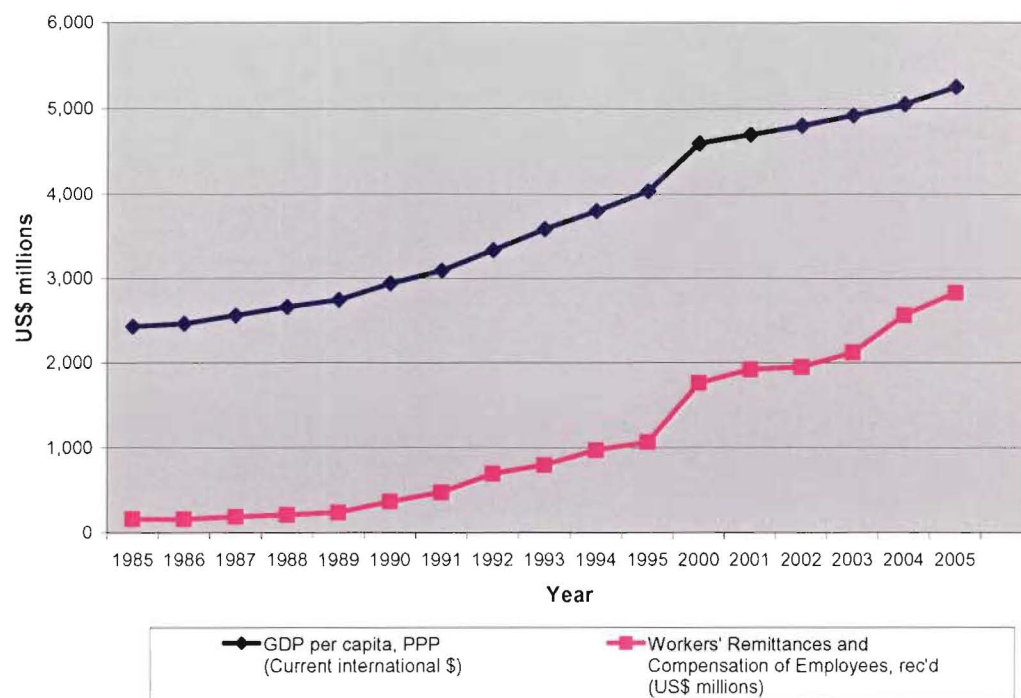
The rise of remittance income relative to other sources of economic productivity reveals that people have become El Salvador's most important export. Particularly as a counterbalance to the declining current account, remittances have been critical to macro-economic stability and as of 2005 comprised 16.7% of GDP. As demonstrated by Figure 8, remittances comprise an increasingly significant share of GDP, particularly when juxtaposed with sectors such as agriculture, which formerly comprised almost 20% of GDP in the early 1980s, and is down to 10% in 2005. Figure 9 demonstrates the consistent growth curve of remittances relative to GDP per capita (PPP).

Figure 8 El Salvador: Remittances vs. Agriculture as % GDP 1990 - 2005



SOURCE: World Bank Development Indicators 1985 – 2005 (Agriculture available from 1990)

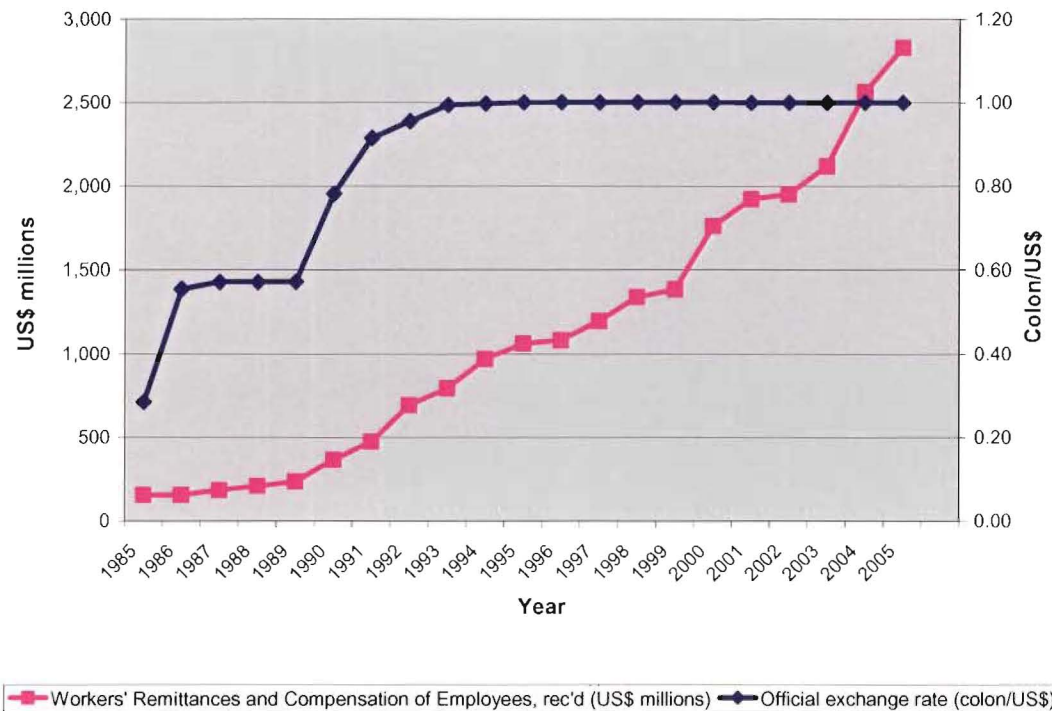
Figure 9 El Salvador: Remittances and GDP per capita 1985 – 2005



SOURCE: World Bank Development Indicators 1985 – 2005

While remittances may have a positive effect on GDP and may partly compensate for negative trade balances, country-specific research for El Salvador reveals a correlation between remittances and exchange rate appreciation in the last twenty years. Figure 10 on the following page demonstrates the connection between remittances and exchange rate during the study period. In Mexico, where remittances comprise less than 3% of GDP, their impact on the exchange rate has not been significant. In contrast, the Salvadoran remittance receipts, while providing much needed capital for domestic consumption, have wreaked havoc on the exchange rate. As a result, the country has experienced the phenomenon known by economists as “Dutch disease” where an influx of foreign currency, usually due to an export boom, can create an inflationary environment that leads to a currency appreciation and results in less-competitive exports. In the case of El Salvador, the currency appreciation was an unintended economic cost resulting from the influx of remittances, spent mostly on non-tradeables such as basic consumer goods, as well as housing and land (Amuedo-Dorantes and Pozo, 2004).

Figure 10 El Salvador: Remittances and the Exchange Rate 1985 - 2005



SOURCE: World Bank Development Indicators 1985 - 2005

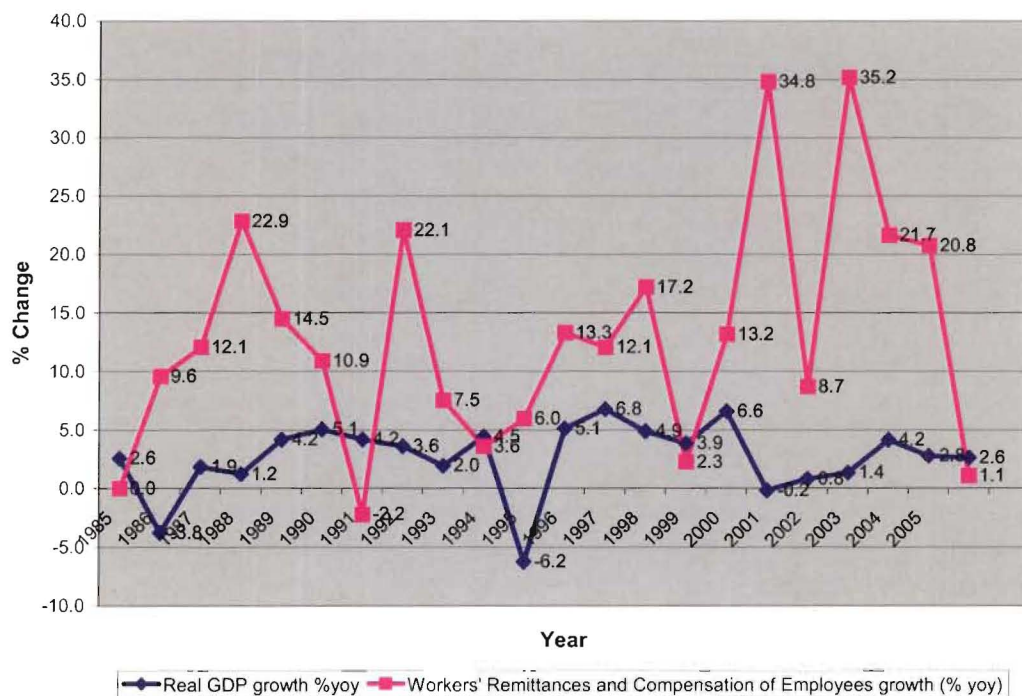
For a country such as El Salvador that relied mainly on exports of coffee and cotton for foreign exchange, the challenge of absorbing such enormous foreign exchange inflows immediately affected competitiveness (Acosta, 2006). As the volume of US dollars increased, the Central Bank intervened to manipulate both the exchange rate and the money supply. Not only did these policies fail to stem the appreciating currency, they also contributed to rising domestic interest rates (Cáceres and Saca, 2006). Thus, in January 2001, partly as a response to the flow of U.S. dollars ushered in by the remittance phenomenon, but primarily as an overall strategy to improve competitiveness, the government began the process of dollarization, allowing the U.S. dollar to circulate alongside the colon as an equivalent currency. As Gammage has noted

in her recent remittance research, "...dollarization would not have been so easily shepherded through the legislature had it not been for the abundant source of dollars entering the economy in the form of remittances" (2006, p. 85).

Remittances as Insurance

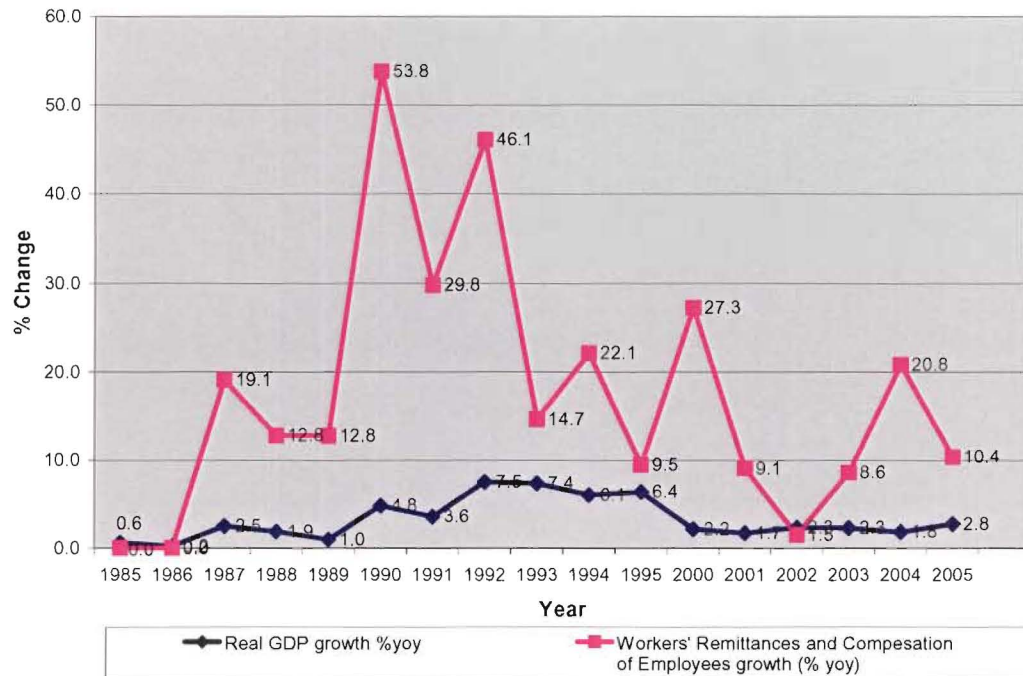
In addition to providing significant capital for these slow-growing economies, remittances may provide insurance and stability during times of crisis or economic decline. Figures 11 and 12 compare the pattern of remittance flows with annual GDP growth. While the chapter on micro-impacts emphasizes that it is largely the level of migrant earnings from the host country that determine remittances, it is possible that remittance transfer patterns also correlate with periods of political, economic or social decline.

Figure 11 Mexico: Remittance Growth vs. GDP Growth 1985 – 2005



SOURCE: World Bank Development Indicators 2005

Figure 12 El Salvador: Remittance Growth vs. GDP Growth 1985 – 2005



SOURCE: World Bank Development Indicators 2005

While further investigation into this correlation is required, it is clear from the figures that in each country remittances increase following minimal or negative GDP growth. In Mexico, for example, real GDP contracted significantly in 1986 (-3.8%) following the debt crisis and the 1985 earthquake that devastated much of Mexico City, but remittances grew 12.1% in 1987. Again, in 1995, when GDP declined -6.2% as a result of the currency crisis, by 1996 recorded remittances had grown 13.3%. While El Salvador has a steadier history of GDP growth, remittances grew 53.8% in 1990 following slow GDP growth of 1% in 1989. In the years following two powerful earthquakes in 2001 remittances continued to increase, but slower growth of only 1.5% in 2002 may be attributable to a reduction in migration. As one researcher noted, “the effects of

the earthquakes had more to do with households retaining labour at home to cope with the effects of the disaster than with the earthquakes disrupting migration financing” (Halliday, 2006, p.922).

Poverty

While country-by-country poverty data is derived from household surveys and is not reported annually for either Mexico or El Salvador, from a regional perspective the World Bank data demonstrates that 21% of the 500 million Latin Americans were earning less than \$2 per day in 2004, compared with 32% in 1989. In the case of extreme poverty, 13.87% were earning less than \$1 per day in 1989 versus 8.64% in 2004 (World Bank, 2006). Table 6 provides an overview of the changes in poverty rates for Mexico and El Salvador during the study period. When reviewing the table it is important to consider that while poverty headcount rates are a good measure of aggregate poverty at certain income points, they do nothing to explain the severity or depth of poverty or, “the amount by which the average expenditures (income) of the poor fall short of the poverty line.” (Adams & Page, 2005, p.1647)

Table 6 Mexico and El Salvador: Poverty Reduction 1989 - 2005

	Mexico			El Salvador		
	1992	2005	% Change	1989	2002	% Change
Poverty headcount ratio at \$1 a day (PPP) (% of population)	5.2	3.0	-41.8	21.4	19.0	-10.8
Poverty headcount ratio at \$2 a day (PPP) (% of population)	22.5	11.6	-48.1	43.0	40.6	-5.7

SOURCE: World Bank Development Indicators 2005

Using data available for Mexico, the number of those living in absolute poverty has declined 41.8%, but increases in poverty levels were experienced during the mid-late 1990s and periods of economic crisis. In El Salvador, the absolute poverty figures have only decreased 5.7% as of 2002, the last year for which data is available. From the Table it is clear that in Mexico there has been important progress in poverty reduction, but unfortunately in El Salvador the numbers are less encouraging. While there is no formal framework to assess the impact of remittances on poverty, Adams and Page used regression analyses against this same poverty headcount measure to isolate the impact of remittances on poverty reduction across developing countries. Their research suggests that a 10% increase in international remittances will lead to a 1.8% decline in the share of people living in poverty, and when using a poverty gap measurement (depth of poverty), remittances will have a slight larger impact (Adams and Page 2005).

Using an econometric methodology incorporating household survey data, researchers Fajnzylber and Lopez isolated the impact of remittances on poverty headcount as well as inequality measures. They concluded that remittances did not have an impact on poverty reduction in Mexico, but did contribute somewhat in El Salvador, (poverty headcount was reduced 0.9% more for those receiving remittances versus those without remittance income) and did help to reduce the poverty gap measurement for both countries (2005). While the research highlights the fact that remittances are generally pro-poor, there is caution from others that their direct effects on the poorest groups may be limited (Kapur,

2004). This caution may be particularly salient for El Salvador, where migrants are not selected from the poorest households.

Inequality

As established in the previous section, there is growing evidence that both international migration and remittances can reduce poverty and that "...dollar for dollar the income remitted by migrants from abroad reduces poverty much more than income generated by domestic activity," (Adams and Page, 2005). However, this poverty reduction may be mitigated by the fact that the impact of remittances on inequality remains inconclusive. Research suggests that the connection between remittances and inequality varies depending on factors such as whether or not the remittances flow to rural or urban areas. For example, research dating back to the 1980s suggests that there is a greater potential for "negative externalities" as a result of migrants' absence from rural areas which may be responsible for a worsening income distribution (Stark, *et al.* 1986; Jones, 1998).

The history of remittance sending within a community or region can also affect the impact of remittances on inequality. According to researchers inequality decreases over time because migration and remittances take on the pattern of an inverted "U" shape. Initially, migration is only available for those from higher income quintiles who can sustain the high costs and risks associated with starting a new life abroad. As the network of migrants grows and strengthens, assistance and information are offered to other community members, decreasing the costs and risks of migration over time. With diminishing costs and risks because of the support abroad, migration then becomes an attractive option for

those from the lower income quintiles (Koechlin and Leon, 2007; McKenzie and Rapoport, 2004). In Mexico, as evidenced in the chapter on micro-impacts, remittances have been observed to affect both poverty and inequality because migrants are typically from the lower income quintiles. Table 7 provides a snapshot of the improvements in income inequality as conveyed by the Gini coefficient⁸ for each country during the study period.

Table 7 Mexico and El Salvador: Income inequality 1989 - 2004

	Mexico			El Salvador		
	1989	2003	% Change	1991	2004	% Change
Income inequality (Gini coefficient)	0.526	0.508	-3.5%	0.527	0.484	-8.9

SOURCE: World Bank Development Indicators 2005

As demonstrated by the table, there have been only small improvements in income inequality during the study period. According to Edward Taylor these improvements may be attributable to positive impacts resulting from rural out-migration, including diversification of risk, alleviation of credit constraints and the trickle-down effects that come into play when remittances are spent locally within the receiving community (1991). Taylor also observes that remittances have a positive effect on the accumulation of income-producing assets (i.e. livestock, farm equipment), especially for household farms. "The distribution of these assets influences the distribution of total income over time" (Ibid, p. 205). As with poverty reduction, the research shows that the impact of remittances on income

⁸ Gini coefficient is a ratio with values between 0 and 1 used to levels of income inequality. A low Gini coefficient indicates more equal income or wealth distribution, while a high Gini coefficient indicates more unequal distribution.

inequality is strongest when the monies are applied to productive uses, particularly in rural areas.

Ultimately, the positive impacts on income distribution are limited by the minimal spread of benefits from migrant to non-migrant households. Most researchers agree that migrant households capture the impacts of migration almost entirely and there is evidence that non-migrant households may be negatively affected by the impacts of migration on local labour markets in the short-term. (Acosta, *et.al* 2006; Taylor, Eckhoff 1999). If local labour costs increase because of out-migration, for example, then non-migrant households may be even more handicapped to take advantage of market opportunities. As summarized by Fajnzylber and Lopez, “there is substantial heterogeneity in the effects of remittances on poverty and inequality depending upon the country’s initial conditions, as given by the ratio of per capita income to the poverty line and the Gini coefficient” (2005).

CHAPTER 4: SUMMARY AND CONCLUSIONS

This project compares the impact of remittances on the variables of economic growth, poverty and inequality from both a micro- and macro-perspective across Mexico and El Salvador. Although the research focuses on remittances as the single independent variable, it is understood that migration patterns also play a crucial role in remittance research. While remittances were once viewed as a consequence of migration, the economic benefits they bring are now regarded as a principal motivator.

At the micro-economic level, this research shows that the impact of remittances on the three dependent variables changes according to factors such as the personal circumstances of the sending family member, the income level of the recipient family, and the community environment (i.e. the history of migration, or the existing support network of community members in the destination country). From an economic growth perspective, remittances can strongly impact physical and human capital, whether by driving up labour costs in a community because of the absence of workers who have migrated, as witnessed in Mexico, or by increasing the education opportunities for the children of recipient families, as noted in El Salvador. In all case studies from the micro-level, the way in which remittance recipients allocate their funds significantly affects their impact on economic growth. When remittances are utilized not only for basic needs and

personal consumption, but also for mid- to long-term priorities such as education and enterprise development, the multiplier effects on growth are more significant.

Central to the role of remittances in poverty reduction at the micro-level is the degree to which the private family-to-family transfers are leveraged for shared projects to benefit communities and regions. Hometown Associations (HTAs) are prime examples of ways that remittances are being mobilized for more productive and long-term uses in both Mexico and El Salvador. Not only are HTAs playing a role in connecting migrants with the social development of their home towns, in some cases, such as in the Mexican state of Zacatecas, they are funding new physical infrastructure with matching funds from the municipal, state and federal governments. In each country the public and private sectors are also introducing services in an attempt to increase the impact of remittances on poverty reduction, including incentives from the banking sector to encourage recipients to retain their remittances in savings accounts.

Researchers agree that while remittances are generally viewed to be positive for poverty in these two countries, more effort is required to ensure that the funds are directed at savings or other medium- to long-term priorities.

Of the three dependent variables, inequality is the one most shaped by individual circumstances. As remittances are largely private transfers retained by the recipient families, they have the most influence on inequality when directed at rural families from the lowest income levels. For this reason, remittances have been found to have more effect on inequality in Mexico, where over 60% of migrants are sourced from the lowest income quintile. In El Salvador, research

shows that because the distance to migrate is longer and the Salvadoran migration support networks in the U.S. are less established when compared with the Mexican networks, the costs and risks to migrate are higher, which helps to explain why only about 34% of migrants come from the lowest income level.

At the macro-economic level, the research reveals a strong relationship between remittances and economic growth while the impact of remittances on poverty and inequality is less conclusive. In each country, the export of people has become a central element of the overall economic strategy and the subsequent rise of remittance income has compensated for declines in other areas of the economy such as agriculture production. In Mexico, remittances represent only a small portion of total GDP (2.9% in 2005), but have provided important income for some of the relatively poor, rural states such as Michoacán and Zacatecas. In El Salvador, remittances totalled 16.7% of GDP in 2005 and are offsetting macro-economic pressures such as a rising current account balance and declining exports, but they have also contributed to inflation and “Dutch disease”. For each country, the challenge is how best to direct remittances to productive uses and mitigate any adverse macroeconomic effects.

Poverty levels have been declining in each country according to the national head count measures, but the impact of remittances on the severity and depth of poverty is unknown. Attempts to isolate the impact of remittances on poverty reduction have demonstrated varying results. Research for the LAC region demonstrates a positive correlation between the two variables, but other country-specific data shows a positive relationship between remittances and

poverty in El Salvador, but not in Mexico. With regard to income inequality, research suggests that remittances may increase inequality in the short-term, but that in the longer-term as migrant networks develop and migrants are sourced from lower income levels, remittances can have an equalizing effect. As concluded with the micro-level analysis, the impact of remittances on both the poverty and inequality variables at the national level is linked inextricably to the migration history of the region, the income levels of the recipients, and the degree to which the remittances are leveraged for priorities other than immediate consumption.

Based on these findings, the challenge for policy makers is to create an environment that will enable remittance receivers to direct their income to more productive ends for long-term economic development, or as the title of this project suggests, to channel what are essentially private funds for public benefits. Ultimately, the extent to which remittances are successfully harnessed for productive uses will be a function of the political, social and economic context of each sending and receiving country. In addition to improving standards for remittance data collection and reducing remittance transfer costs, individual country governments and international institutions must pursue a comprehensive remittance and migration policy as an integral part of their broader economic development strategy. Since remittances are not a panacea for development, these strategies must also be balanced with alternative methods for addressing acute poverty in these countries, which may require long-term efforts and funding to increase domestic production.

APPENDIX A: MEXICO ECONOMIC INDICATORS 1985 – 2005

Mexico: Remittance and Macroeconomic Statistics (from World Bank Development Indicators unless otherwise noted)	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Population	75,465,000	77,016,416	78,565,768	80,115,632	81,668,344	83,226,000	84,793,155	86,369,232	87,953,642	89,545,773	91,145,000
Real GDP growth %yoy	2.6	-3.8	1.9	1.2	4.2	5.1	4.2	3.6	2.0	4.5	-6.2
GDP per capita, PPP (current international \$)	5,480	5,283	5,421	5,567	5,906	6,325	6,696	6,969	7,138	7,478	7,030
Current Account Balance (% of GDP)	0.4	-1.1	3.0	-1.3	-2.6	-2.8	-4.7	-6.7	-5.8	-7.0	-0.5
Foreign direct investment, net inflows (% of GDP)	1.1	1.6	0.8	1.1	1.2	1.0	1.5	1.2	1.1	2.6	3.3
Foreign direct investment, net inflows (BoP, current US\$ millions)	1,984	2,036	1,184	2,011	2,785	2,549	4,742	4,393	4,389	10,973	9,526
Total Reserves in Months of Imports	1.9	2.6	5.0	1.7	1.5	1.9	3.0	2.7	3.3	0.7	2.1
Real Interest Rate	..	..	..	..	..	..	..	..	7.5	10.0	15.6
Agricultural land (% of land area)	52.4	52.9	53.2	53.5	53.9	54.2	54.5	54.9	55.4	55.8	56.2
Agriculture, value added (% of GDP)	10.1	10.3	9.7	7.9	7.8	7.8	7.5	6.7	6.3	6.0	5.7
Official Development Assistance and Official Aid (US\$ millions)	144	251	155	172	97	156	274	314	421	424	384
Official Development Assistance and Official Aid (% of GDP)	0.08	0.19	0.11	0.09	0.04	0.06	0.09	0.09	0.10	0.10	0.13
Official exchange rate (peso/US\$)	0.26	0.61	1.38	2.27	2.46	2.81	3.02	3.09	3.12	3.38	6.42
Inflation, consumer prices (annual %)	57.7	86.2	131.8	114.2	20.0	26.7	22.7	15.5	9.8	7.0	35.0
Gross domestic savings (% of GDP)	26.3	22.4	25.4	24.0	22.9	22.0	20.4	18.3	17.1	17.1	22.6
Income inequality (Gini coefficient) ²	..	..	..	..	0.526	..	..	0.546	..	..	..
Poverty headcount ratio at \$1 a day (PPP) (% of population)	..	..	..	..	..	..	..	5.2	..	..	..
Poverty headcount ratio at \$2 a day (PPP) (% of population)	..	..	..	..	..	..	..	22.5	..	..	..
Workers' Remittances BoP (US\$ millions) ³	1,157	1,290	1,478	1,897	2,213	2,492	2,414	3,070	3,332	3,474	3,673
Workers' Remittances and Compensation of Employees, rec'd (US\$ millions)	1,616	1,771	1,985	2,439	2,793	3,098	3,030	3,700	3,979	4,122	4,368
Workers' Remittances and Compensation of Employees, rec'd (% of GDP)	0.9	1.4	1.4	1.3	1.3	1.2	1.0	1.0	1.0	1.0	1.5
Workers' Remittances and Compensation of Employees growth (% yoy)	0.0	9.6	12.1	22.9	14.5	10.9	-2.2	22.1	7.5	3.6	6.0
Workers' Remittances and Compensation of Employees per capita (US\$)	21.41	23.00	25.27	30.44	34.20	37.22	35.73	42.84	45.24	46.03	47.92

Mexico Remittance and Macroeconomic Statistics (From World Bank Development Indicators unless otherwise noted)										
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Population	92,570,752	93,926,296	95,251,064	96,584,488	97,966,000	98,994,087	100,002,340	101,020,862	102,049,758	103,089,133
Real GDP growth %yoy	5.1	6.8	4.9	3.9	6.6	-0.2	0.8	1.4	4.2	2.8
GDP per capita, PPP (current international \$)	7,416	7,935	8,300	8,625	9,262	9,372	9,518	9,744	10,312	10,811
Current Account Balance (% of GDP)	-0.8	-1.9	-3.8	-2.9	-3.2	-2.8	-2.2	-1.4	-1.0	-0.6
Foreign direct investment, net inflows (% of GDP)	2.8	3.2	2.9	2.8	3.1	4.4	2.9	2.4	2.8	2.4
Foreign direct investment, net inflows (BoP, current US\$ millions)	9,186	12,830	12,413	13,696	17,773	27,142	19,044	15,256	18,941	18,772
Total Reserves in Months of Imports	2.0	2.5	2.4	2.2	2.0	2.6	3.0	3.5	3.3	3.4
Real Interest Rate	4.3	3.8	9.5	7.5	4.3	6.5	1.2	-1.4	0.1	4.0
Agricultural land (% of land area)	56.2	56.2	56.2	56.2	56.2	56.2	56.2	56.2	..	..
Agriculture, value added (% of GDP)	6.3	5.7	5.3	4.7	4.2	4.2	3.9	3.9	3.9	3.8
Official Development Assistance and Official Aid (US\$ millions)	285	105	44	36	-56	73	133	99	116	189
Official Development Assistance and Official Aid (% of GDP)	0.09	0.03	0.01	0.01	-0.01	0.01	0.02	0.02	0.02	0.02
Official exchange rate (peso/US\$)	7.60	7.92	9.14	9.56	9.46	9.34	9.66	10.79	11.29	10.90
Inflation, consumer prices (annual %)	34.4	20.6	15.9	16.6	9.5	6.4	5.0	4.5	4.7	4.0
Gross domestic savings (% of GDP)	25.3	25.9	22.2	22.0	21.9	18.6	18.8	18.9	20.0	20.3
Income inequality (Gini coefficient) ²	0.542	..	0.536	..	0.529	..	0.510	0.508	..	..
Poverty headcount ratio at \$1 a day (PPP) (% of population)	7.8	..	8.8	..	5.9	..	4.3	..	3.0	..
Poverty headcount ratio at \$2 a day (PPP) (% of population)	27.8	..	27.5	..	22.6	..	21.2	..	11.6	..
Workers' Remittances BoP (US\$ millions) ³	4,224	4,865	5,627	5,910	6,573	8,895	9,814	13,396	16,613	20,035
Workers' Remittances and Compensation of Employees, rec'd (US\$ millions)	4,949	5,546	6,501	6,649	7,525	10,146	11,030	14,911	18,143	21,917
Workers' Remittances and Compensation of Employees, rec'd (% of GDP)	1.5	1.4	1.5	1.4	1.3	1.6	1.7	2.3	2.7	2.9
Workers' Remittances and Compensation of Employees growth (% yoy)	13.3	12.1	17.2	2.3	13.2	34.8	8.7	35.2	21.7	20.8
Workers' Remittances and Compensation of Employees per capita (US\$)	53.46	59.05	68.25	68.84	76.81	102.49	110.29	147.60	177.79	212.60

¹UNDP Human Development Index

²United Nations World Income Inequality Database V 2.0b May 2007. Gini coefficient is a ratio with values between 0 and 1 used to levels of income inequality. A low Gini coefficient indicates more equal income or wealth distribution, while a high Gini coefficient indicates more unequal distribution.

³IMF Balance of Payments. These figures represent goods and financial instruments transferred by migrants living and working in a new economy for more than one year.

APPENDIX B: EL SALVADOR ECONOMIC INDICATORS 1985 – 2005

El Salvador Remittance and Macroeconomic Statistics (from World Bank Development Indicators unless otherwise noted)	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Population	4,769,072	4,817,686	4,876,060	4,944,599	5,022,826	5,110,176	5,207,376	5,314,449	5,429,057	5,547,956	5,688,606
Real GDP growth %/yoy	0.6	0.2	2.5	1.9	1.0	4.8	3.6	7.5	7.4	6.1	6.4
GDP per capita, PPP (current international \$)	2,427	2,461	2,562	2,662	2,746	2,939	3,092	3,333	3,583	3,797	4,035
Current Account Balance (% of GDP)	-0.8	3.1	3.4	0.6	-4.4	-3.2	-3.2	-1.8	-1.2	-0.2	-2.8
Foreign direct investment, net inflows	0.33	0.64	0.46	0.40	0.33	0.04	0.47	0.26	0.24	0.00	0.40
(BoP, current US\$ millions)	12.4	24.1	18.3	17.0	14.4	1.9	25.2	15.3	16.4	0.0	38.0
Total Reserves in Months of Imports	3.0	3.2	3.7	3.0	3.1	3.0	3.1	3.1	3.4	3.3	3.0
Real Interest Rate	10.5	18.1	14.3	12.6	14.7	15.7	12.0	11.7	10.0	8.3	7.8
Agricultural land (% of land area)	66.5	67.4	67.4	68.4	69.4	70.0	70.8	72.4	73.9	75.5	77.5
Agriculture, value added (% of GDP)	..	..	..	..	..	17.4	17.5	14.6	14.9	15.0	14.5
Official Development Assistance and Official Aid (US\$ millions)	345	336	421	415	440	347	250	403	399	305	296
Official Aid (% of GDP)	9.08	8.91	10.63	9.91	10.07	7.23	5.55	6.78	5.76	3.77	3.12
Official exchange rate (colon/US\$)*	0.29	0.55	0.57	0.57	0.57	0.78	0.92	0.96	0.99	1.00	1.00
Inflation, consumer prices (annual %)	22.3	31.9	24.9	19.8	17.6	24.0	14.4	11.2	18.5	10.6	10.0
Gross domestic savings (% of GDP)	3.3	8.9	5.3	6.3	4.9	1.2	2.1	2.2	3.8	4.5	3.9
Income inequality (Gini coefficient) ¹	..	..	..	..	..	..	0.527	..	..	..	..
Poverty headcount ratio at \$1 a day (PPP) (% of population)	..	..	..	..	21.4	..	..	..	..	..	20.8
Poverty headcount ratio at \$2 a day (PPP) (% of population)	..	..	..	..	43.0	..	..	..	..	..	47.1
Workers' Remittances BoP (US\$ millions) ³	126	139	167	194	228	357	467	687	790	967	1,060
Workers' Remittances and Compensation of Employees, rec'd (US\$ millions)	157	157	187	211	238	366	475	694	796	972	1,064
Workers' Remittances and Compensation of Employees, rec'd (% of GDP)	4.1	4.2	4.7	5.0	5.4	7.6	8.9	11.7	11.5	12.0	11.2
Workers' Remittances and Compensation of Employees growth (% yoy)	0.0	0.0	19.1	12.8	12.8	53.8	29.8	46.1	14.7	22.1	9.5
Workers' Remittances and Compensation of Employees per capita (US\$)	33	32.59	38.35	42.67	47.38	71.62	91.22	130.59	146.62	175.20	187.70

El Salvador Remittance and Macroeconomic Statistics (from World Bank Development Indicators unless otherwise noted)	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Population	5,790,090	5,912,415	6,035,093	6,157,863	6,280,482	6,402,452	6,523,374	6,643,296	6,762,439	6,880,951
Real GDP growth %/yoy	1.7	4.2	3.7	3.4	2.2	1.7	2.3	2.3	1.8	2.8
GDP per capita, PPP (current international \$)	4,094	4,249	4,367	4,492	4,597	4,697	4,800	4,920	5,051	5,255
Current Account Balance (% of GDP)	-1.6	-0.9	-0.8	-1.9	-3.3	-1.1	-2.8	-4.7	-4.0	-4.6
Foreign direct investment, net inflows	-0.05	0.53	9.19	1.73	1.32	2.02	3.29	0.94	2.38	3.05
Foreign direct investment, net inflows (BoP, current US\$ millions)	-4.8	59.0	1103.7	215.9	173.4	278.9	470.0	141.2	376.3	517.5
Total Reserves in Months of Imports	3.6	3.9	4.4	4.6	3.8	3.3	3.1	3.4	3.0	2.7
Real Interest Rate	11.1	12.1	10.6	15.1	10.5	..	..	..	..	..
Agricultural land (% of land area)	77.7	77.7	79.3	80.8	81.3	82.2	82.2	82.2	..	..
Agriculture, value added (% of GDP)	14.0	14.4	12.9	11.2	10.5	10.1	9.1	9.0	9.5	10.3
Official Development Assistance and Official Aid (US\$ millions)	301	279	181	183	180	237	233	192	216	199
Official Aid (% of GDP)	2.92	2.50	1.51	1.47	1.37	1.72	1.63	1.28	1.37	1.17
Official exchange rate (colon/US\$)*	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Inflation, consumer prices (annual %)	9.8	4.5	2.5	0.5	2.3	3.8	1.9	2.1	4.5	4.7
Gross domestic savings (% of GDP)	2.3	3.5	5.3	4.1	1.9	0.9	1.7	1.1	-1.3	-2.7
Income inequality (Gini coefficient) ¹	..	..	0.534	0.512	0.519	0.525	0.523	0.498	0.484	..
Poverty headcount ratio at \$1 a day (PPP) (% of population)	25.3	..	21.4	..	18.9	..	19.0	..	..	..
Poverty headcount ratio at \$2 a day (PPP) (% of population)	51.9	..	45.0	..	39.2	..	40.6	..	..	..
Workers' Remittances BoP (US\$ millions) ³	1,084	1,199	1,338	1,373	1,751	1,911	1,935	2,105	2,548	2,830
Workers' Remittances and Compensation of Employees, rec'd (US\$ millions)	1,084	1,199	1,338	1,386	1,764	1,924	1,953	2,121	2,563	2,830
Workers' Remittances and Compensation of Employees, rec'd (% of GDP)	10.5	10.8	11.2	11.1	13.4	13.9	13.7	14.1	16.2	16.7
Workers' Remittances and Compensation of Employees growth (% yoy)	1.9	10.6	11.6	3.6	27.3	9.1	1.5	8.6	20.8	10.4
Workers' Remittances and Compensation of Employees per capita (US\$)	187.22	202.79	222.03	225.24	281.03	300.82	299.38	319.42	379.15	413.02

¹UNDP Human Development Index

²United Nations World Income Inequality Database V 2.0b May 2007. Gini coefficient is a ratio with values between 0 and 1 used to levels of income inequality. A low Gini coefficient indicates more equal income or wealth distribution, while a high Gini coefficient indicates more unequal distribution.

³IMF Balance of Payments. These figures represent goods and financial instruments transferred by migrants living and working in a new economy for more than one year.

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