Remittances and Inequality in El Salvador

By

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December 5, 2006
Introduction

For more than the last 20 years there has been increasing migration of people of Latin American origin to the United States, and Latinos are now the largest minority in the U.S. Many of these immigrants send money home to their families each year in Mexico, South and Central America. These funds are used for a variety of purposes, including basic needs, home improvement, education and less often, investment. In addition, groups of immigrants organized into Hometown Associations send money home for yearly celebrations, community improvement projects and investments. Strikingly, the growth in these flows, known as remittances, has outpaced the growth in the U.S. Latino population. However, scholars disagree on how remittances impact income inequality in migrant’s home countries.

This paper will examine the extent to which migrant remittances reduce or increase inequality in El Salvador. I will focus on remittances from cross-border migration between El Salvador and the United States.

El Salvador is interesting for several reasons. First, Salvadorans have migrated to the United States consistently since the beginning of the civil war in the 1980s, and have sent a high level of remittances in recent years. According to most estimates they are the largest group of Central Americans living in the U.S.

In El Salvador as in other countries in Central America, globalization through trade and investment has been slower than elsewhere in Latin America. However, labor migration and remittances might be considered the principal means by which El Salvador
participates in globalization, with an estimated 958 thousand Salvadorans or 15.2 percent of the Salvadoran population lives the U.S.

Remittance monies have become influential in the Salvadoran economy. In 2005 Salvadorans sent home between $2.55 and $2.83 billion, or between 16 percent and 17 percent of GDP. These funds have remained steady in difficult economic times, becoming an important source of foreign exchange. This contrasts with the volatility of other capital flows from investment and trade, which contribute to the region’s unsteady economic performance. However, they also have some negative impacts on the Salvadoran economy. For instance, the flow of remittances causes an increase in the exchange rate. In combination with trade liberalization, this can lead to a boost in imports in the agricultural and industrial sectors, displacing local production. The outcome is slower economic growth and high unemployment and under-employment in the country. The unemployment rate in El Salvador is 6.5 percent for 2005 and there is a high rate of underemployment. As remittances have increased, savings rate as a percent of GDP has fallen.

In this paper I will examine several different aspects of remittances and the way in which they impact inequality in El Salvador. I will try to ascertain which segments of Salvadoran society are receiving remittances and how this impacts income inequality. I will also analyze the differences in volume and impact of individual remittances versus collective remittances sent by Hometown Associations (HTAs). HTAs are groups of migrants from a city or region in El Salvador living in the U.S. who send funds home as a group for specific purposes. Next I will examine Salvadoran government policies regarding remittances and evaluate how they influence remittance use.
Salvadoran Migration to the United States

While Salvadoran international migration started in the 1920s, the majority of migrants during the first 50 years were destined principally for other Central American countries, particularly Honduras. This began to change in 1969 after the “Guerra de Cien Horas” between El Salvador and Honduras forced many Salvadorans to return to their home country. This removal of a historical migration destination along with increasing military repression brought about a shift in migration to the U.S.

With the beginning of the civil war in El Salvador in the 1980s migration to the U.S. increased due to violence and a difficult economic situation. While the majority of this flow was of undocumented immigrants, the 1986 Immigration Reform and Control Act also strongly influenced immigration patterns. The law provided amnesty for many undocumented immigrants and allowed them to bring their families to the U.S. The signing of the peace accords in 1992 facilitated the return of many migrants who had left during the war. However, a weak economy, natural disasters such as Hurricane Mitch, and the social networks that developed to facilitate migration during the conflict have helped to ensure that migration from El Salvador to the U.S. has continued to grow.

It is difficult to determine how many Salvadorans reside in the United States because a substantial proportion are undocumented, and estimates range broadly. Estimates using data from the 2000 U.S. Census range from 655 thousand to 1.27 million, or 10 to 19 percent of the population of El Salvador, live in the U.S. The Salvadoran Ministry of External Relations estimates that 2.5 million, or 40 percent of all Salvadorans, reside in the U.S.

Remittances and Inequality Theory
There are a variety of factors that influence the impact of remittances on inequality. These include who migrates and the sectors of society to which they belong, the distance and difficulty of the trip, and the ways in which funds are used in the home country. Within the literature there is little agreement on the overall impact of remittances on inequality. In this section I will provide a summary of different arguments regarding the impact of remittances on inequality.

The sector of society that receives the majority of remittances in a country impacts the extent to which remittances increase or reduce income inequality. If a large number of very poor people receive remittances, then we might expect that overall income inequality in a country to decrease. However, if a larger proportion middle income or wealthy and highly educated people are migrating, we would expect this to have a negative effect on income inequality. It is also likely that better-off migrants will do better in the destination countries, due to higher levels of skills and education.

The distance and difficulty of the trip impacts cost of migration, and as costs rise, only people with higher levels of income will be able to absorb the risk of migration. In general, the trip from El Salvador to the U.S. is risky for illegal migrants and it costs approximately $5,000 to hire a ‘coyote’ (smuggler) to make the trip. Recent changes in U.S. immigration law and policy recently might have increased the cost of migration, perhaps shifting the types of Salvadorans that can afford to migrate.

Finally, the ways in which the remittances are used can impact inequality in the recipient community and country. If remittances are used for basic consumption by families, they will likely increase inequality between families that receive remittances and those that do not. On the other hand remittances that are invested in productive
projects might decrease inequality by providing employment and income to additional citizens in the community. Investment in health and education may also decrease inequality over the long run by increasing the human capital in a community or region.

The impact of remittances on inequality is influenced by ‘stage of migration’ and the ‘geographic scale’. According to Jones these two factors help to explain divergent findings regarding the impact of remittances on inequality. He hypothesizes that in the early stage, migrants come from higher-status families that are more prepared to take risks entailed in migration, thereby increasing inequality. In the second stage, information about routes, destinations and employment opportunities becomes more available. During this stage inequality decreases as the benefits of remittances reach a broader proportion of the public, especially lower-income families. Finally, an international migrant class emerges that is better off than the group of families that do not have access to remittances.xvi

The geographical unit of analysis can also influence the findings of the impact of remittances on inequality. For instance, within a village, migration might increase inequality between families. At the same time inequality may decrease between poorer migrant sending regions and richer regions elsewhere in the country.xvii

Within the literature there are what is commonly termed as ‘pessimistic’ and ‘optimistic’ analyses of remittances’ impact on development. The more pessimistic holds that individual remittances do not contribute much to economic development because a majority of them are spent on consumption instead of investment. It also holds that it engenders dependence upon remittances and reduces incentives to work.xviii Indeed,
remittances tend to increase the opportunity cost of working, increasing the salary for
which remittance beneficiaries are willing to work.\textsuperscript{xix}

The more optimistic analysis asserts that the additional consumption stimulated
by remittances creates a multiplier effect to the extent that household receiving
remittances increase their demand for locally produced goods and services.\textsuperscript{xx} This may in
turn depend upon which segments of society are sending migrants. Wealthier families
receiving remittances might increase their demand for imported goods rather than locally
produced goods.

\textbf{Remittance Receiving Households}

In El Salvador, it is estimated that up to 28 percent of the adult population
received remittances in 2003, a very large proportion of the population. This might mean,
as Suro asserts, that migration and sending remittances is not an activity that is limited to
the very poor in El Salvador.\textsuperscript{xxi}

According to the 2005 human development report for El Salvador, remittances do
not go to the very poorest sectors of society, rather they are destined for medium-low and
low income families.\textsuperscript{xxii} Most recently there has been an increase in migration from rural
areas in the country. The percentage of households receiving remittances in urban areas
was slightly higher than in rural areas in 2004, but the percentage that remittances
contributed to household incomes in urban areas (7.4 percent) was much lower than in
rural areas (12.5 percent). Since the incidence of poverty is much higher in rural migrant
sending areas than urban migrant sending areas, this might help reduce inequality
between rural and urban areas. However, it also might increase inequality between rural
households, as those households who receive remittances will have a higher household income than those that do not. xxiii

The departments of El Salvador with highest percentage of households receiving remittances are in the east and north of the country, particularly in La Union, Cabanas, Morazan, San Miguel, and Chalatenango. xxiv There are strong regional disparities; 14 percent of municipalities in the central and western parts of the country have less than 10 percent of households receiving remittances, while in five percent of municipalities more than half of the households receive remittances. xxv

Those departments that have the highest levels of remittance receiving households (Morazán, Cabañas and La Unión) also have the lowest Human Development Indicator scores. This is due at least in part to the fact that these departments were most affected by the armed conflict in the 1980s, putting them at an historical disadvantage. In addition, while their incomes have increased their youngest and most educated citizens tend to migrate to the U.S. xxvi Indeed, the majority of Salvadoran migrants living in the United States are younger than 44 years old. xxvii This means that migrant sending areas are losing their most productive citizens and can hamper the growth in those areas.

**Individual Remittances**

An overwhelming majority of remittances are individual remittances sent by a migrant directly to their family for friends in their country of origin. Of these funds, a majority are used to pay for common expenses such as food, housing and utilities. xxviii This holds true for El Salvador, where 69.1 percent of remittances are destined for food or other basic consumption. In addition, 6.2 percent are used for health purposes, and 4.8 percent are used for education. Overall, 3.0 percent are used for ‘family investment,’
which includes building or improving a home, buying land, starting or expanding a business, buying a vehicle or buying farm animals. Finally, very small percentages are spent on family leisure and contingencies such as repaying loans. Only 0.3 percent is used for savings.\textsuperscript{xxix}

Not surprisingly, the lower the migrant’s income, the greater their propensity to use remittances for family maintenance purposes, especially food consumption. As migrant incomes increase, spending on health and education also increases as a proportion of funds spent on family maintenance. Migrants with less education are more likely to spend money for family maintenance, and spending on education increases as the education of the migrant increases.\textsuperscript{xxx}

Receipt of remittances not only impacts income inequality but also access to quality housing, services and education. For instance, families receiving remittances are more likely to have concrete walls and floors of cement block instead of dirt. Households receiving remittances also were more likely to have electricity and running water.\textsuperscript{xxxi} Increases in real estate prices in remittance receiving areas has made it difficult for those not receiving remittances to purchase property.

Remittances have a divergent impact on education. Remittance sending areas in El Salvador have higher illiteracy rates and lower levels of schooling on average than those that do not send remittances. This may be in part because of a historical disadvantage and in part because younger and more educated people tend to migrate to where the returns on education are higher. On the other hand, children in remittance-receiving families tend to have higher enrollment rates at every level of the education system.\textsuperscript{xxxii}
However, it is likely that remittances increase inequality among households. Not only do they have higher incomes than those not receiving remittances, but it also leads to inequality in housing, access to services and education, which can have a long-term impact on inequality in El Salvador.

**Collective Remittances**

Hometown Associations (HTAs) are organizations formed of migrants who are from the same community in the sending country living in the same area in the United States. They can be formally or informally organized and have a variety of purposes, including social, philanthropic, political and economic goals.\(^{xxxiii}\) One report suggests that there are now approximately 200 of these organizations in the U.S.\(^{xxxiv}\) On average, membership reaches 20 people, but most organizations receive donations from over 100 people. Most organizations raise approximately $15,000 a year for projects.

These organizations often raise money in the U.S. through raffles, meals, and celebrations to provide support a variety of projects in their home communities. This section will concentrate on the economic and philanthropic activities of these organizations.

Many Salvadoran HTAs were formed by migrants who were displaced during the Civil war, but a new group of organizations emerged that have been formed since the signing of the Peace Accords in 1992. Studies suggest that about one percent of all remittances sent to Latin America are collective remittances. While this may seem small, in the case of El Salvador it totals to approximately $15 million invested in poor communities.\(^{xxxv}\) A study of Mexican and Salvadoran migrants found that 69 percent did not send money home for community projects. Only 7.8 percent of Salvadorans living in
the U.S. are members of HTAs, which helps explain why a majority (74.3 percent) of migrants sending money home for community projects did so through their families, while only 24.8 percent did so through HTAs.\textsuperscript{xxxvi}

According to a survey of Salvadoran immigrants to the U.S., collective remittances for community development (defined as public works, social services, economic development and employment generation through construction) make up 35.5 percent of collective remittances, while the remainder is destined for recreation and other purposes. However, disaster relief and funds sent to the local parishes are included in the recreation and other category and make up 51.9 percent of the total. It seems that at least part of these funds were likely used for community development or rebuilding purposes, but the data is not disaggregated further, making it difficult to draw concrete conclusions.\textsuperscript{xxxvii}

Within the community development category, Salvadorans sent 15.2 percent toward public works such as water, roads and electricity, 16.5 percent for social services such as schools, homes for the elderly and health-care purposes, 2.5 percent on economic development, and 1.3 percent on employment generating construction projects.\textsuperscript{xxxviii} Only a small proportion of these remittances are directed toward direct investments in economic development projects and job creation. However, I would argue that all of these activities have the potential to reduce inequality in a community.

However small, if targeted properly and fairly these activities are likely to reduce inequality by providing income generating opportunities in poor communities. Increasing business activity, especially locally owned businesses, can provide employment multiplier effects and linkages through inputs of local products and outputs.
that could be used in other businesses. While no calculation of this multiplier exists for El Salvador, it was calculated at $1.78 for a Mexican village in 1988. While this is clearly outdated, it is interesting to note that in some cases remittances do spur growth in the receiving community.

Investments in social services such as health and education are likely to improve the earning potential of the population. Healthy people are able to work more and take less time off for sickness. Educational opportunities are likely to have a longer-term effect of improving the human capital of the next generation. Unlike the impact of family remittances, improvements to school-houses and education technology are a public good for all school age children.

Finally, improving access to public goods such as quality roads, water and electricity in addition to improving the quality of life in these communities, helps to build the their economic base. Often these are a prerequisite for improving trade with nearby communities or cities, agricultural production and manufacturing potential. So long as all community members have access, these services should reduce inequality in beneficiary communities.

However, some evaluations have shown that HTAs are enmeshed in the political situation in the home country. For instance, positions of power within HTAs can be used as a form of clientelism in which leaders of HTAs can gain benefits through their connections to both communities. They can also lead to opportunities for leadership positions in their home communities, which can be lucrative. If these activities reproduce existing structures of inequality within a community it have a negative impact on inequality.
**Productive investment**

Substantial and sustainable investment at a community level is more likely to reduce inequality by increasing economic activity, the availability of jobs and income levels. However, it is important to consider the macro-economic situation of a country when analyzing the incentives for migrants to direct their remittances toward investment instead of personal consumption. As we mentioned, remittances themselves can both encourage macroeconomic stability and cause slow growth and unemployment. El Salvador’s GDP grew at only 2.8 percent in 2005. Thus while the Salvadoran government and real estate companies are encouraging migrants to invest, it is likely that their money will find higher returns elsewhere.

As we saw earlier, only 3 percent of individual remittances and 2.5 percent of collective remittances were invested in productive projects. According to a credit union working in the town of Ciudad Barrios, just one percent of its customers that receive remittances take out loans for businesses. One important aspect of the investment climate in El Salvador is the increase in gang activity in recent years. Indeed, many migrants do not invest in their home communities for fear that their families will be targets of gang violence, and credit managers are afraid to travel to areas where gang activity is prevalent.

Much has been written about the importance of reducing the costs of sending remittances as a way to increase flows and improve development. Remittance costs to El Salvador are among the lowest in Latin America, but banks have provided few incentives for recipients to open savings accounts. However, the fact that few remittances are channeled through banks can hinder overall investment and development in the
Salvadoran economy and thus hinder the inequality-reducing potential of remittances.

Banks and credit unions help grow capital and could provide stability for remittance receiving families through offering savings and checking services. Increased capitalization of banks through remittances could also provide increase the availability of credit in general, creating more incentives for investment.

**Salvadoran Government Policy**

El Salvador’s government has followed in the footsteps of the Mexican government in using Embassies in the U.S. to reach out to Salvadoran migrants communities and maintain friendly relations. It created a Directorate within the Ministry of Foreign Affairs to address the needs of the Salvadoran community living abroad in 2000. The Central Bank does not place restrictions on the transfer of remittances, and Salvadorans are allowed to bring up to $1,500 in merchandise duty-free, facilitating in-kind transfers.

The government has also created a program called ‘Unidos por la Solidaridad’, a program of the Social Investment and Local Development Fund (FISDL). The aim is to support the efforts Salvadoran HTAs in their home communities by running a competition for matching funds from the Salvadoran government for social infrastructure projects. Thus far it has co-funded 45 projects, with $2.1 million of HTA funds and $6.9 million of funding from FISDL. In line with our earlier conclusions regarding the work of HTAs, it is likely that such efforts will reduce inequality, though the proportion of remittances that they represent is fairly small.

In 2000 the Ministry of the Economy launched a program aimed at cultivating migrants as potential investors and created a ‘trading cluster’ in an attempt to link
Salvadoran businesses with migrant partners. While it showed some early successes, this program seemed to lose momentum within a year. If it is able to revive and increase migrant investment in productive projects, it has a chance of reducing inequality. However, considering the less-than-ideal investment climate in the country, it might be a struggle to attract investors.

**Conclusion**

Certainly, poverty in El Salvador would be worse without remittances. While remittances do not go to the very poorest sectors of society, they do impact poverty levels. Among remittance receiving households in El Salvador the extreme poverty rate is 5.7 percent, while among households not receiving remittance it is 14.5 percent.\(^1\)

The recent UN Human Development report for El Salvador found that the Gini coefficient for household receiving remittances is .44, while the Gini coefficient for households not receiving remittances is .52, a fairly large difference. However, it is difficult to tell whether this is the impact of remittances or some pre-existing characteristic of remittance receiving households. At the national level, the Gini coefficient would increase from .50 to .54 without the inflow of remittances. Thus the UN Human Development Report concludes “if it were not for remittances, El Salvador would not only be a poorer country, it would also be a much less equal country” (author’s translation).\(^\text{li}\)

However, the true picture is likely much more nuanced than the above quote would indicate. Remittances likely increase inequalities between families in remittance receiving regions. While it is difficult to tell exactly where El Salvador stands in Jones’ stages of migration, the level of migration and data on inequality of quality of housing,
access to services and education indicate that an elite migrant class might be emerging in some regions of El Salvador. However, because the regions with the weakest Human Development Indicators are those that are receiving remittances, it is possible that inequality is being reduced among regions.

On the other hand, HTA remittance funded projects are likely to decrease inequality in the communities they target. Because much of their work focuses on providing access to public goods that benefit the community as a whole and strengthen its economic base they can be a tool for growth and reducing inequality. Government programs that encourage social investment by HTAs and economic investment by migrants can also reduce inequality.

Thus remittances reduce inequalities and improve development by some measures, while they increase inequality and hinder development in other cases. Clearly, remittances are not the silver bullet to solve all of a countries problems, and they cannot substitute for political will and wise government policy targeting structural causes of inequality.

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Ibid., Ch. 1, p. 4.


Davis, “Imperfect Cure,” sec. A.


Ibid., 13.


Ibid., Ch. 2, p. 22-23.

Ibid., Ch. 2, p. 25.

Ibid., Overview, p. 15.

Ibid., Overview, p. 20.

Suro, “Remittance Senders and Receivers”


“Inmigrant Remitting Behavior,” p. 10-12.


Ibid., Overview, p. 20.


Ibid., p. 16.
Ibid., p. 16.


Black, Natali and Skinner, “Migration and Inequality.”


Davis, “Imperfect Cure,” sec. A.


Ibid., p. 142.

Ibid., p. 138.


Ibid., Ch. 2, p. 27.

Ibid., Ch. 2, p. 28-29