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On the Role of Remittances in Microfinance

– Creating Transnational Financial Services in El Salvador

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“Volver visibles a los invisibles”¹

“To make the invisible ones become visible”

¹ This is the foundation of the work of the microfinance institution Apoyo Integral, El Salvador.

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ABSTRACT

More and more poor people regularly receive money transfers, remittances, from family members abroad as international migration increases. But since many poor and low-income people in developing countries lack access to financial services their opportunities to achieve investment goals, and thereby improve their living conditions, are limited. This study explores the possibility of channelling remittances into microfinance as a way to increase the development effects of these money transfers. In the specific case of El Salvador, examined in this study, a new innovative housing microfinance product, linked to remittance funds, is investigated.

The main contribution of this thesis is the exploration of how remittances can reduce market failures and solve problems on the credit market when channelled into microfinance products. In particular linking remittances with housing microfinance, and thereby adding to development, is examined. The study points out that a new client type, the transnational family, is emerging in countries with extensive migration. It is found that promoting the development of remittance services through microfinance institutions can contribute to increasing the banking of these transnational families, and hence facilitate their overall access to financial services. The so called *Transnational Credit*, investigated in this study, poses an answer to the lack of financial products that link the demand of the migrant with the demand of the family in the home country. Although the product needs to be improved, it forms an important contribution in the struggle to make financial services available for the poor.

KEYWORDS: Remittances, Microfinance, Housing, Migration, El Salvador.

LIST OF ABBREVIATIONS

Alante	Alante Financiam
ASOMI	Asociación de Organizaciones de Microfinanzas
BCR	Central Bank of El Salvador (<i>Banco Central de Reserva de El Salvador</i>)
CGAP	Consultative Group to Assist the Poor
DIGESTYC	General Directorate of Statistics in El Salvador (<i>Dirección General de Estadística y Censos</i>)
EHPM	The National Household Surveys in El Salvador (<i>Encuesta de Hogares de Propósitos Múltiples</i>)
FDI	Foreign Direct Investment
FUSAI	Fundación Salvadoreña de Apoyo Integral
GDP	Gross Domestic Product
IDB	Inter-American Development Bank
IMF	International Monetary Fund
Integral	Apoyo Integral
IOM	International Organization on Migration
IRCA	Immigration Reform and Control Act
LAC	Latin America and the Caribbean
MFI	Microfinance Institution
MFIC	Microfinance International Corporation
MIF	Multilateral Investment Fund
Sida	Swedish International Development Cooperation Agency
ODA	Official Development Assistance
UN	The United Nations
UNDP	United Nations Development Programme
UNFPA	United Nations Population Fund
US	The United States of America
USAID	United States Agency for International Development

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1. INTRODUCTION

Today, the number of people living outside their home country is larger than ever before. Estimations show that there are close to 200 million people living outside their country of birth, comprising approximately three per cent of the world's population.² If all of them lived in the same place it would constitute the world's fifth most populous country.³ Why people from the poorer regions of the globe wish to migrate to more prosperous countries is not difficult to understand. People have always moved within regions or from one region to another in order to improve their standards of living. Today, the globalization has made poor people both motivated – observing the wide disparities in the world – and able to move.⁴

International migration is the departure point of this thesis, since it is a precondition for international remittances to occur. These money transfers are perhaps one of the most tangible outcomes of migration for the receiving countries. Remittances are defined as the portion of the international migrant's earnings sent back from the host country to the country of origin.⁵ In the last decade, the flow of remittances has accelerated significantly and in a number of less developed countries they exceed foreign aid and constitute the largest source of foreign capital.⁶ Hence, remittances play an important economic role in many countries, not least since evidence suggests that they can reduce poverty. However, remittances have a potential of even greater economic impact if larger shares were channelled towards long-term investments.

Nevertheless, without access to financial products the potential large impact of remittances will be limited. Since many poor and low-income people in the developing world do not have access to formal financial services, such as credits, savings, insurances and money transfer services, microfinance can be a means to include this share of the population into the financial system.⁷ Combining remittances and microfinance is a way to take advantage of the great magnitude of today's remittance flows, and open up for greater development impacts. This thesis is about this combination.

² <http://www.iom.int/jahia/page3.html>, (2007-04-15)

³ UNFPA, 2006, p. 14

⁴ <http://www.iom.int/jahia/page3.html>, (2007-04-15)

⁵ IOM, 2003, p. 226

⁶ Özden, Ç. – Schiff, M. (ed.), 2006, p. 1

⁷ CGAP, 2006, p.1

In particular, I have chosen to study the combination of remittances and housing microfinance. Housing investment was brought to my attention due to its potential importance for development. Also since the housing sector is a rather neglected one I found it especially interesting to investigate. Housing has wide economic benefits for society and should not be viewed as a resource-absorbing, unproductive sector. Instead it is an investment good with positive impact on savings, employment, health and education.⁸ In less developed economies the demand for housing finance products is great, while the financial services for poor people are scarce. This phenomenon is to be explored within the framework of a case study in El Salvador, Central America.

The choice of El Salvador as my case is due to the country being one of the major beneficiaries of remittances per capita since approximately a third of the Salvadoran population is living abroad.⁹ Consequently, one out of four Salvadoran households receives remittances.¹⁰ The large inflows of money to the country from the migrants living and working abroad have made remittances an important part of the Salvadoran economy. Besides, El Salvador has a mature and competitive microfinance market, making it ideal for carrying out this field work.

1.1 Statement of purpose and thesis questions

The general objective of this study is to explore how the development effects of remittances can be enhanced. The specific aim is to investigate how to capture the great potential of remittance flows and channel them into long-term investments – such as housing – for poor people.

In order to reach my purpose I will address the following thesis questions:

- How can the development effects of remittances be enhanced?
- How can remittances be used to finance housing for poor and low-income households and hence solve problems on the credit market?

⁸ Arku, G., 2006, p. 391

⁹ UNDP, 2005, p. 8

¹⁰ Based on EHPM, 2005.

To be able to answer my overall thesis questions I will consider the following sub questions:

- What economic role do remittances play in general – and in particular in El Salvador?
- Why is microfinance needed?
- Why is housing important for development?
- Through which mechanism can remittances be channeled into housing microfinance, and what are the restrictions for this product to work properly?

1.2 Motivation of thesis questions

This thesis stresses the importance of enhancing the development effects of remittances. Most studies show that remittances mainly are used for consumption. From the perspective of development economics I found it more interesting to explore the use of remittances for long-term investment purposes since it may have significant influence on poverty levels. Therefore, the thesis explores how remittances can play a significant role in meeting the housing needs of poor and low-income households, thus adding to development. The underlying argument of this study is that financial products aimed at improving housing conditions can have substantial effects on economic development and poverty reduction in the long term.

1.3 Methodology and material

This thesis is the result of a field study carried out in El Salvador in 2007. The choice of El Salvador as the case for the study was due to the great importance remittances play in the Salvadoran economy along with the existence of a mature and competitive microfinance market, including the presence of innovative financial products. Therefore El Salvador serves as an excellent case study for the aim of this thesis.

This is a qualitative study, which is most preferable when dealing with questions such as *how* and *why*. Then one has to go beyond quantifiable factors.¹¹ My primary research in the field includes interviews with employees at, and clients of, the microfinance institution *Apoyo Integral* in El Salvador and its corresponding partner in the US, *Alante Financial*. Another

¹¹ Merriam, S., 2003, p.22-23

main source has been the yearly national household surveys (EHPM) carried out by the General Directorate of Statistics in El Salvador, under the supervision of the Ministry of Economics. Further, economic data has also been collected from the Central Bank of El Salvador (BCR). The theoretical framework on migration, remittances and microfinance builds on earlier published studies and surveys.

1.4 Limitations

Migration takes place across countries, as well as within territories. Consequently, remittances can be sent from abroad or from within a country. Although internal migration and urban-rural remittances also play a considerable role in households' economy, this study exclusively considers international migration and internationally sent money transfers only. Moreover, this thesis solely explores the possible development impact that remittances may have in relation to microfinance products and services linked to housing. Remittances used for other purposes than home improvements or acquisition of a home are not explored in this study, due to resource constraints. In addition, this thesis has been carried out in a developing country and is therefore primarily focused on the impact of remittances for the receiving country. For this reason, the preferences of the sending market have not been considered in depth, although they play a key role in the features of the remittance market. Further research also in this field is needed for a comprehensive understanding of the phenomenon.

1.5 Outline of the thesis

The first part of this thesis introduces theories on migration and remittances. Migration, however, is not explored in detail, since it is beyond the scope of this study. Yet a brief overview is motivated since migration is the precondition for remittances to occur. In the same section an overview of the regional remittance market in Latin America and the Caribbean is given. This section is followed by a comprehensive explanation of microfinance and housing microfinance as well as an exploration of the role of housing for economic development. In the following part, the empirical data from El Salvador are presented. This section investigates in further detail the combination of remittances and housing microfinance. The last part contains the summary, conclusions and policy implications of this study.

2. MIGRATION AND REMITTANCES

International migration has great economic, social, and cultural implications in both origin and destination countries. More and more people are on the move today than at any other point in human history. At present, one of every thirty-five persons in the world is counted a migrant. Simultaneously, the remittance flows from migrants to their relatives in their country of birth has showed a fast and accelerating rate of growth in the last decade. Following this, the economic importance of remittances has increased significantly in many developing countries.

2.1 Understanding migration

This part aims to introduce the reader to the phenomenon of migration and to present a few models, attempting to explain why international migration takes place. This is crucial in order to understand the occurrence of remittances – perhaps one of the most tangible results of migration.

The International Organization on Migration (IOM) estimates that there are now about 192 million people living outside their country of birth, which is about three per cent of the world's population or one of every thirty-five persons. Between 1965 and 1990, the number of international migrants increased by 45 million, an annual growth rate of about 2.1 per cent. The current annual growth rate is about 2.9 per cent.¹²

It is likely that over the next two decades the migration of people from developing to high-income countries will continue to rise. The aging population in developed countries shrinks the workforce and increases the demand for services that immigrants are willing and able to supply. As income standards rise it is also likely that the demand for other services that employ immigrants (such as household help) will grow.¹³

2.1.1 Determinants of international migration

There is no single well-developed theory on international migration – the movement of people across international boundaries. Rather a variety of different approaches exist. According to Stanton Russell the five most quoted approaches refer to migration as a result of one or more

¹² <http://www.iom.int/jahia/page3.html>, (2007-04-15)

¹³ The World Bank, 2006a, p. 27-29

of the following reasons: differences in supply and demand for labour; individuals' cost-benefit calculations; families' decision to diversify income and minimize risks; the demand for low-skilled workers in more developed economies; and the globalization, including multinational companies penetrating peripheral markets (box 2.1).¹⁴

Box 2.1: Theories on migration

- **Neoclassical economics – macro theory:** This model views differences in the supply and demand for labour in origin and destination countries as the major factors driving individual migration decisions. Consequently, this model assumes labour markets to be the primary mechanisms inducing movements. Among the assumptions of this model is that international migration will not occur in the absence of the above-mentioned differentials, and that the elimination of them will bring an end to international movements.
- **Neoclassical economics – micro theory:** This model focuses on the individual level considering the individual as a rational actor who makes decisions to migrate based upon a cost-benefit calculation. If that calculation indicates a positive net return to movement the individual will choose to migrate. In this approach, human capital characteristics that raise the potential benefits of migration, and individual, social, or technological factors that lower costs, will lead to increased migration.
- **The new economics of migration:** This model views migration as a family strategy to diversify sources of income, minimize risks to the household, and overcome barriers to credit and capital. In this model, international migration is a means to compensate for the absence, or failure, of certain types of markets in developing countries, for example crop insurance markets, unemployment insurance, or capital markets.
- **Dual labour market theory:** This model holds that demand for low-skilled workers in more developed economies is the critical factor shaping international migration. To avoid the structural inflation that would result from raising entry wages of native workers, and to maintain labour as a variable factor of production, employers seek low-wage migrant workers. In this model, international migration is demand based and initiated by recruitment policies of employers or governments in destination areas.
- **World systems theory:** This model focuses not on labour markets in national economies, but on the structure of the world market and the ongoing globalization. According to this theory international migration is generated as land, raw materials, and labour in areas of origin are drawn into the world market economy and traditional systems are disrupted. The transports, communications, cultural and ideological links that accompany globalization further facilitate international migration. In this model, international migration is primarily determined by policies toward investments and the international flow of capital and goods.

Source: Stanton Russell, S., 1995, p. 4-5

Other studies emphasise that migration should be thought of as a combination of the neoclassical micro theory and the dual labour market theory (box 2.1). Various studies find that migration is explained primarily by the presence of wage inequalities between sending and receiving regions. Hence, the principal cause of south-north migration is, in most cases, the difference in expected real wages, adjusted for migration costs.¹⁵

Furthermore, social networks are shown to affect migration, according to studies. Since the 1980s there has been an increase in immigration, creating large groups of migrants in high-

¹⁴ Stanton Russell, S., 1995, p. 4-5

¹⁵ The World Bank, 2006a, p. 27-29

income countries that reduce the costs and risks of migration.¹⁶ The networks can be based on family, community, ethnicity, or nationality and appear to play an important role for migration decisions. They are likely to help with legal barriers, lower search costs regarding jobs and housing and provide additional insurance in case of unanticipated events. The presence of a social network in the destination country has been shown to significantly lower the costs of migrating. In addition, migrant networks raise the probability that other community members migrate internationally, especially when a larger share of the community migrates. Then migration costs fall and relatively poorer members migrate and benefit from the larger network as well.¹⁷

Moreover, the distance seems to have considerable importance in migration decisions and in particular for unskilled migrants who face financial constraints. Since most migrants have extensive economic and social links with their home countries, this is more difficult to maintain with more distant countries.¹⁸ The World Bank asserts that migration destination mainly is determined by geographic proximity, but that colonial ties also play a crucial role in the choice of destination country. Hence, it is found that migration costs increase with the distance between source and destination countries, but decline with social networks in the destination country.¹⁹

Mora and Taylor assert that migration is a selective process. Not only individual but also family and community characteristics are significant in shaping migration. The characteristics of the migrants are different from those who stay behind. Their study on Mexico shows, inter alia, that schooling has no effect on international migration, even though it is often assumed that educated people have a higher propensity to migrate internationally than less educated people. This is not necessarily the case for unauthorized migration to low-skill labour markets abroad where the returns to schooling are likely to be small (as for the case of this study; migration of Salvadorans to the US). Further, their work confirms the findings from other studies that family contacts in the destination country significantly affect international migration. Also household wealth and work experience have a significant positive effect on international migration. Moreover, they found evidence that males, in most cases, are more

¹⁶ The World Bank, 2006a, p. 27-29

¹⁷ McKenzie, D., 2006, p. 142f

¹⁸ Özden, Ç. – Schiff, M. (ed.), 2006, p. 4f

¹⁹ The World Bank, 2006a, p. 27-29

likely to migrate than are females. In addition, and not surprisingly, the immigration policies of the destination countries affect the selectivity of migration.²⁰

Box 2.2: Statistics on migration and remittances

- The IOM estimates that there are now about *192 million people* living outside their country of birth. Migrants hence comprise *3.0 per cent of the global population* and if they all lived in the same place they would constitute the fifth most populous country in the world.
- The stock of international migrants remains concentrated in relatively few countries. *75 per cent of all international migrants reside in 12 per cent of all countries.*
- *Women* accounted for *49.6 percent* of global migrants in 2005.
- There are roughly *30 to 40 million unauthorized migrants worldwide*, comprising around 15 to 20 percent of the world's immigrant stock. According to 2005 estimates, the US hosts 10.3 million undocumented migrants and approximately 500,000 arrive each year. This makes the US the recipient of the largest absolute number of irregular immigrants, making up about 30 percent of its total foreign-born population.
- In 2005, remittance flows were estimated to have exceeded US\$ 233 billion worldwide, of which US \$ 167 billion went to developing countries.

Source: <http://www.iom.int/jahia/page3.html>, (2007-04-15)

For many households in developing countries remittances are probably the most tangible consequence of international migration. Remittances have demonstrated a rapid growth over the past decade and consequently increased in importance for the receiving countries. The next section will explore the occurrence of remittances in further detail.

2.2 Understanding remittances

Remittances can be defined as the share of the international migrant's earnings sent back from the host country to the country of origin.²¹ Remittance flows to developing countries have grown steadily over the past 30 years, and in 2005 the World Bank estimated the value worldwide to be over US \$ 230 billion (box 2.2).²² This rising trend is likely to persist as population aging continues, and pressures for migration from developing to advanced economies increase. For many developing economies, remittances constitute the single largest source of foreign exchange, exceeding export revenues, foreign direct investments, and other

²⁰ Mora, J. – Taylor, E., 2006, p. 21 and 46-47

²¹ IOM, 2003, p. 226

²² <http://www.iom.int/jahia/page3.html>, (2007-04-15)

private capital inflows. For some individual recipient countries, remittances amount to half of the Gross Domestic Product (GDP).²³

Remittances play an important economic role in many countries. Evidence suggests, inter alia, that remittances can reduce poverty and help smooth household consumption, by responding positively to external shocks and ease capital constraints. Moreover, remittances are shown not to be sensitive to market cycles, as for instance international capital flows are. Remittances have proved surprisingly resilient in economic downturns and crises, and are therefore viewed as an attractive source of external finance that can help foster development and smooth crises. Instead, they have even increased during economic recessions.²⁴ In addition, and unlike foreign aid, migrant remittances go directly to families in places that are often difficult to reach with Official Development Assistance (ODA).²⁵ Yet, at the same time there are concerns, among them that remittances can be abused to launder money and finance terrorism.²⁶

2.2.1 Determinants of remittances

The existing literature on the determinants of remittances is largely based on microeconomic analyses. Pioneers in the area were Lucas and Stark, and their theory still remains among the most quoted ones. In their study on Botswana they considered several hypotheses for motivations to remit. Most previous work on remittances had been characterized by the idea that migrants remit only because they care for those left behind. Even though it might be true, Lucas and Stark found it an unsatisfying view as it does not answer why some migrants remit more, why some remit for longer or why some do not remit at all. Accurately, their study found that altruism alone does not appear to be a sufficient explanation of the motivations to remit.²⁷

Lucas and Stark stress that the migrants' motivations to remit range from *pure altruism* to *pure self-interest*. In the case of pure altruism, remittances are driven by migrant workers' concern for the income and consumption needs of family members left in the home country. The altruism approach is based on the economics of the family; migrants send part of their

²³ The World Bank, 2006c, p. 17

²⁴ The World Bank, 2006a, p. 117

²⁵ <http://www.iadb.org/mif/remittances/markets/index.cfm?language=En&parid=1> (2007-04-15)

²⁶ IMF, 2005, p. 69f

²⁷ Lucas, R. – Stark, O., 1985, p. 913f

income to their home countries to increase the well-being of family members. In the case of pure self-interest, remittances are fundamentally driven by an investment motive. Then migrants remit in order to purchase long-lasting goods and invest in housing, land, or a business at home.²⁸

However, Lucas and Stark found that evidence from their study rather supported a third model, called *tempered altruism* or *enlightened self-interest*. This alternative is based on a combination of pure altruism and pure self-interest, meaning that the migrant and the rest of the family make an arrangement aimed to be of mutual benefit for both parties. The combination of the two approaches is also supported by more recent studies.²⁹ The family invests by reallocating certain members as migrants, and the remittances are the mechanism for redistributing the gains from that investment. In other words, the migration decision can be viewed as a livelihood strategy for the families. Besides an investment, remittances can be seen as a means of spreading risk when the insurance markets and the capital markets are imperfect.³⁰

Less established is the macro-level analysis of remittances. Merely a few studies have been conducted in the field, and there is little consensus about the key macroeconomic determinants of remittance flows. Conflicting evidence shows that, on the one hand, remittance flows are not affected by exchange rate variations or by changes in the real rate of return on investment.³¹ Other studies show that both exchange rate and interest rate differentials are important in attracting remittances through official channels.³² It has also been found that money transfer fees and the presence of dual exchange rates reduce remittances. Moreover, the host country's economic activity is supposed to have a positive effect while the home country's economic activity is assumed to have a negative effect on the size of remittances.³³ Generalizing on these findings therefore seems to have limited value.

²⁸ Lucas, R. – Stark, O., 1985, p. 913f

²⁹ See for example IMF, 2005, p. 78

³⁰ Lucas, R. – Stark, O., 1985, p. 913f

³¹ IMF, 2005, p. 81

³² El-Sakka, M. – McNabb, R., 1999, p. 1493

³³ Freund, C. – Spatafora, N., 2005, p. 1

2.2.2 Destination of remittances

Households are usually asked to identify what remittances are spent on or for what purpose they are intended. However, the results need to be analyzed with care. Even if the remittance itself is used for one purpose, it may free up other sources of income that can be used for other means.³⁴ However, the major part of the remittances received is used for current consumption according to most studies.³⁵ Surveys conducted among remittance receivers by The Multilateral Investment Fund (MIF) of the Inter-American Development Bank (IDB) confirm this pattern, showing that clear majorities use the funds to pay for basic living expenses, such as rent, utilities and food, rather than for savings and business endeavours.³⁶ A regional study by the IDB shows that in Central America the household expenditures account for 77 percent of the use of remittances. Around seven percent is used for educational expenses; six percent is used for investments and another six percent for savings.³⁷

Nevertheless, studies show that remittance receivers, in comparison with households not receiving remittances, still spend a smaller share of their total household income on food and a proportionately larger share on housing, education, and health.³⁸ For instance, a study conducted in Guatemala shows that receiving remittances actually increases the family's investments in housing and education expenditures rather than spending on basic consumption. In other words, at the margin households receiving remittances actually spend less on consumption than do households without remittances. The study also shows that households receiving remittances tend to view their remittance earnings as a temporary (and possibly uncertain) stream of income, and preferably spend more on investments than on consumption goods.³⁹ Another study confirms that remittances have positive effects on investment goods such as schooling. In El Salvador it is found that remittances have a larger effect than other types of income on school retention, regardless of parents' levels of schooling.⁴⁰

³⁴ McKenzie, D. 2006, p. 125

³⁵ Zarate-Hoyos, G., 2004, p. 563

³⁶ Terry, D. – Wilson, S. (ed.), 2005, p. 24

³⁷ MIF, 2004, p. 23

³⁸ The World Bank, 2006b, p. 34

³⁹ Adams, R., 2006, p. 77f

⁴⁰ Cox Edwards, A. – Ureta, M., 2003, p. 456-457

2.2.3 Remittances in Latin America – regional features

There are currently an estimated 25 million adults born in Latin America and the Caribbean (LAC) living outside their country of origin. The LAC region is both the fastest growing and highest volume remittance market in the world. For the year 2006 the remittance flows to the region reached over US \$ 60 billion from all parts of the world.⁴¹ This amount exceeds the combined flows of all Foreign Direct Investments (FDI) and net ODA to the region. Remittances to the region will continue to grow in coming years and surpass US \$100 billion a year by 2010, predicts the IDB.⁴² However, it is important to have in mind that these great amounts reflect, besides substantially increased actual volumes, also much improved mechanisms to accurately report the full dimensions of these flows.⁴³

The majority of the remittances are sent from the US and from Western Europe, where the great bulk of LAC migrants reside. Almost 75 percent of LAC remittances are sent from the US but in recent years Western Europe has become the fastest growing destination for LAC migrants, resulting in 12 percent of the market. Other large flows come from Japan to Brazil and Peru, and from Canada to Jamaica and Haiti. Intraregional flows account for most of the rest.⁴⁴

The country in the region with the highest volume of remittances, in absolute terms, is Mexico. It received US \$23 billion in 2006 and is hence one of the countries that receive the most remittances in the world.⁴⁵ Between 2002 and 2005 remittances to the Latin American region were estimated to have grown at a rate of 18.7 percent per year. While this rapid growth has been largely driven by Mexico's 25 percent annual growth in remittances flows, annual rates close to or above 20 percent have also been observed in Guatemala, Honduras, Nicaragua, Costa Rica, Trinidad and Tobago and Peru. Counting remittances as a proportion of the GDP puts Haiti first in the ranking; remittances accounted for close to 53 percent of the country's GDP in 2004. Other countries where the remittances are significantly important for the economy are Jamaica (17.1 percent of the GDP in 2004), Honduras (15.6 percent), El Salvador (15.3 percent), the Dominican Republic (12.1 percent) and Guatemala (10.1 percent). On a per capita basis the country with the highest level of remittances is Jamaica

⁴¹ Calculations based on statistics from <http://www.iadb.org/mif/remittances> (2007-06-07)

⁴² <http://www.iadb.org/news/articledetail.cfm?artid=3692&language=English> (2007-06-07)

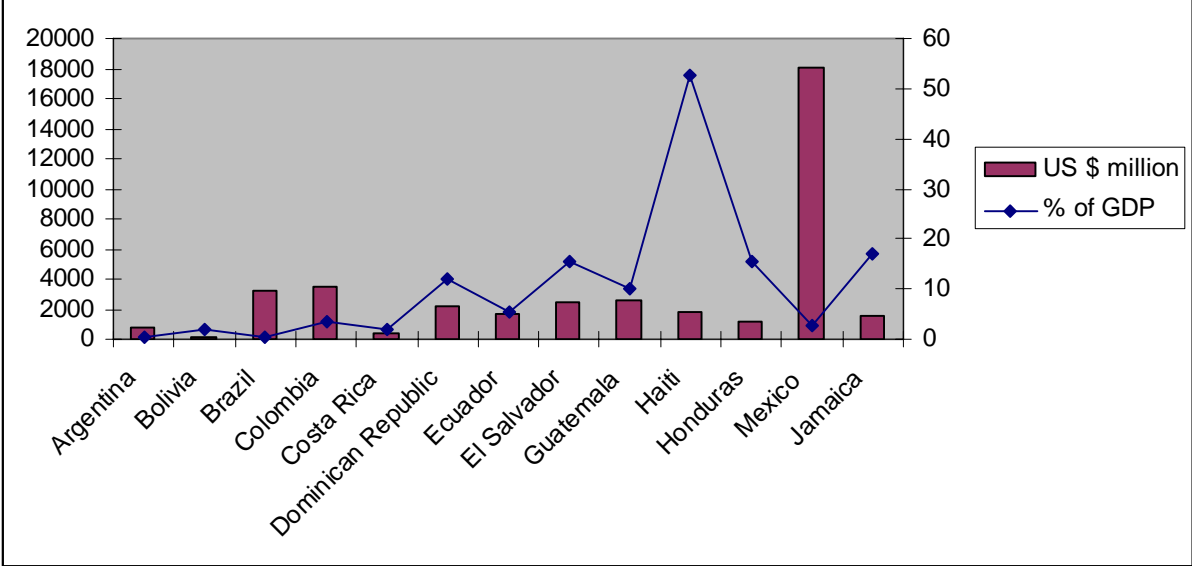
⁴³ <http://www.iadb.org/mif/remittances/markets/index.cfm?language=En&parid=1> (2007-04-15)

⁴⁴ Ibid.

⁴⁵ http://www.iadb.org/mif/remesas_map.cfm?language=English&parid=5&item1d=2 (2007-06-07)

with approximately US \$ 550 per capita, followed by Barbados with about US \$ 400 per capita and El Salvador with flows of approximately US \$ 350.⁴⁶

Figure 2.1: Remittances to Latin America and the Caribbean 2004 (selected countries)



Source: The World Bank, 2006c, p. 17
 Note: The calculations are based on official statistics of remittance flows.

Next the characteristics of the Latino remittance senders and receivers will be explored. A word of caution is, however, motivated with regard to the upcoming surveys, as reporting problems may occur. This can be, for example, lack of trust, leading to the person interviewed not furnishing the correct information. Another problem is that the population interviewed can be biased since it might not truly reflect the immigrant population (it might, for example, exclude undocumented workers).

2.2.3.1 The Latino sender

Since the major part of the Latino remittances are sent from the US this study will focus on the characteristics of this specific segment of the market. Approximately 62 percent of the adult, foreign-born Latinos in the US (some ten million people) send money home on a regular basis, typically between US \$100-300 a month.⁴⁷ Two-thirds of remittance senders report that they dispatch money at least once a month. However, remittance senders are not evenly distributed across the migrant population; they are instead concentrated among more recently arrived immigrants. The migrants that have resided in the foreign country less than five years are the most frequent remitters. Three-quarters of these send money home at least

⁴⁶ The World Bank, 2006c, p. 17
⁴⁷ MIF et.al., 2003, p. 3

once a month.⁴⁸ Several surveys conducted by IDB among remittance receivers confirm this pattern. In Mexico, for example, respondents whose family members have been abroad for five years or less were nearly twice as likely to report that they received remittances regularly, as those whose relatives had been away longer. Nevertheless, studies on Latino immigrants in the United States show that about half of all who have been there for more than ten years still send remittances to their families on a regular basis. Even though the money flow drops off among those with longer tenure, a substantial proportion of immigrants who have been away from home for 20 to 30 years still send money back to their relatives.⁴⁹

2.2.3.2 The Latino receiver

Studies on remittance receivers in the Latin America and Caribbean region show that the characteristics of the receivers differ widely. For example, a significant variety in the proportion of households receiving remittances can be found across the region. In Haiti more than a fourth of the households report having received remittances (2001), as also is the case for El Salvador where close to 25 percent of the households say that they receive remittances (2005).⁵⁰ Between 10 and 25 percent of the households in the Dominican Republic, Nicaragua and Honduras are benefiting from remittances, and so are between 5 and 10 percent in Mexico and Guatemala, but only between 3 and 5 percent in Bolivia, Ecuador and Paraguay. At the bottom end Peru is found, where only 3 percent of the households benefit from these money flows.⁵¹

When investigating the income distribution by non-remittances income, 61 percent of the receiving households in Mexico belong to the poorest fifth of the population, and only 4 percent belong to the richest fifth. A similar pattern is found in Paraguay where 42 percent of the remittances are directed to the poorest 20 percent of the population and merely 8 percent to the wealthiest 20 percent. In El Salvador, Guatemala and Ecuador, at least 30 percent of the recipients belong to the poorest fifth of the population. In contrast, in Peru and Nicaragua the distribution of remittances across households is completely different. Less than 6 percent of the households in Peru that receive remittances belong to the poorest fifth while 40 percent belong to the richest fifth of the population. Likewise in Nicaragua; the remittances seem to be flowing towards the richest. Only in four countries, Bolivia, Honduras, the Dominican

⁴⁸ <http://www.iadb.org/mif/remittances/markets/index.cfm?language=En&parid=1> (2007-04-15)

⁴⁹ <http://www.iadb.org/mif/remittances/markets/senders.cfm?language=En&parid=2> (2007-04-15)

⁵⁰ Based on the EHPM, 2005.

⁵¹ The World Bank, 2006b, p. 17

Republic and Haiti do remittances appear to be homogeneously distributed across population according to the distribution of income.⁵²

Nevertheless, the situation changes dramatically when the economic status of recipients on the basis of total income (including the value of remittances) is analyzed. Then, the share of recipients that belong to the poorest share of the population falls dramatically in all the countries with the exceptions of Mexico, Paraguay and El Salvador where 50, 40, and 34 percent of recipients, respectively, continue to be among the poorest 40 percent of the population. In the rest of the countries more than half of recipients now belong to the richest 40 percent of the population. Not surprisingly, this concentration is particularly marked in those countries where migrants seem to come from richer classes. For example, in Peru more than 75 percent of recipients are now among the richest 40 percent of the population.⁵³ These results demonstrate that wide differences exist when it comes to the distribution of remittances, and they consequently dismiss any ideas that remittances are only limited to the very poor.

Clear majorities of Latino remittance receivers report that they use the funds to pay for everyday expenses such as food, housing expenses and utilities. However, this should not be interpreted as if it were pure consumption. The share that is destined for everyday expenses might include important investment components such as consumer durables, housing, education and health. A World Bank household survey shows that Latino remittance recipients direct a smaller share of their total expenditures towards food. At the same time as the share of food expenditures is decreasing among remittances recipients, expenditures on durable goods, housing, education and health are increasing. Similarly, as earlier mentioned, data from Mexico and Guatemala indicates that remittances are likely to be spent less on food and more on housing, education, and health. According to the World Bank study, such changes in spending are shown in the case of El Salvador, where the share of durable goods is increasing significantly among remittances recipients. Housing improvements are more frequent among remittance recipients in El Salvador as well.⁵⁴

⁵² The World Bank, 2006b, p. 17

⁵³ Ibid.

⁵⁴ Ibid, p. 34

2.2.3.3 The importance of informal transfer mechanisms

Wire transfer companies such as Western Union or Money Gram are the most common means by which Latinos residing in the US transfer remittances. Around 70 percent of the senders report that they use such firms. Eleven percent of senders report that they use banks, since several major US banks have entered the market with remittance transfer products in the past few years. But a considerable share, 17 percent of the senders, say that they use informal means such as regular mail or individuals who carry the funds by hand.

The remittances transferred without involving any type of money transfer services are unlikely to be captured in official statistics, although they may represent a substantial addition to remittances sent through official channels. Firstly, the large share of people reporting that they send their remittances through informal channels indicates that the flows of remittances are significantly greater than shown in official data. Estimates of the importance of the informal sector vary widely, ranging from 35 percent to 250 percent of total remittances. Secondly, the recorded increase in remittances after the year 2001 may suggest that a part of the increase actually reflects a shift from informal to formal channels in response to the stricter regulations that have come into force since September 11, 2001.⁵⁵ Thirdly, and most important for the aim of this thesis, the large informal sector indicates that remittance senders and/or receivers either are not familiar with the financial system – and consequently have no access to financial services such as money transfer products – or have chosen not to use financial institutions, inter alia for reasons like lack of trust. Next, the role that remittances can play in banking the unbanked will be explored.

2.2.4 The role of remittances in banking the unbanked

Financial systems throughout Latin America and the Caribbean – like in all developing regions – traditionally, do not reach the majority of their populations. Most financial institutions are not interested in serving the poor part of the “remittance population”. On the other hand, most financial institutions are not trusted by those poor families. This results in shallow financial markets which contribute to perpetuate inequality, particularly in rural areas.⁵⁶ To promote a broader inclusion into the financial system for this population segment, microfinance, being explored in the upcoming section, usually proves to be a good option.

⁵⁵ Freund, C. – Spatafora, N., 2005, p. 1

⁵⁶ <http://www.iadb.org/mif/remittances/markets/intermediation.cfm?language=En&parid=3&itemlid=3>
(2007-04-15)

According to a survey conducted by MIF in 2006, 51 percent of the Latino remittance senders in the US state that they do not have a bank account, demonstrating this population segment's need for banking. Regular Latino remittance senders that have a bank account in the US are likely to be South American, over 35 years of age, and have annual household incomes of more than US \$ 20,000 a year according to recent surveys.⁵⁷ Investigations in Latin America show a similar pattern. In Mexico, for instance, only 33 percent of remittance receivers report that they have bank accounts. However, in comparison to 22 percent of the Mexican population in general having bank accounts, this indicates the importance that remittances can play in including people in the financial system.⁵⁸

The above indicates that the scale and scope of remittances may serve as a powerful force to open up financial systems, mobilize savings, generate small business loans, and thereby enhance the development effects. Remittances could have a greater impact for individuals, households and societies if better access to banking and financial services were provided. According to the IDB, that is one of the most important development objectives of remittances; to deepen the financial markets and promote financial intermediation throughout the developing world.⁵⁹

Microfinance institutions are one type of actor that can leverage the economic impact of remittances and serve to include poor people in the financial system. In recent years microfinance organizations have started to appear in the Latin American region. These institutions can link up with financial institutions in developed countries in order to increase the development effect of remittances.⁶⁰ But the IMF stresses that also formal financial intermediaries, such as banks, need to enter the remittance market more actively in order to enhance the development impact of remittances.⁶¹ The IDB asserts that remittances can make an important difference when it comes to one of the greatest challenges of today; the struggle to achieve financial democracy – inclusion for all in the financial system.⁶²

⁵⁷ MIF, 2006, p. 42f

⁵⁸ <http://www.iadb.org/mif/remittances/markets/receivers.cfm?language=En&parid=2&itemlid=3> (2007-04-15)

⁵⁹ Ibid.

⁶⁰ Ibid.

⁶¹ IMF, 2005, p. 84

⁶² <http://www.iadb.org/mif/remittances/markets/receivers.cfm?language=En&parid=2&itemlid=3> (2007-04-15)

2.3 The emerging role of the transnational family

Remittance flows are a sign of the emerging role of the transnational family, which is a term aiming to encompass the type of family that has members residing in different countries, and where the family members living abroad maintain an active role in the family. New market research shows that immigration no longer is only a one-way process. Rather it is a new transnational way of life that immigrants create for themselves.⁶³ The large share of household income that remittances constitute for poor families is a reflection of the transnational family. Also the migration decision can be such a reflection. For instance, when migration is viewed as an investment for the family and a way to spread the economic risks, the migrant is expected to maintain an active economic role in the household, although living abroad. The decision to send a family member abroad is often a livelihood strategy for the whole family.

The migrants of today are, to an increasing extent, living in two worlds. The emergence of the transnational family is a growing phenomenon not yet sufficiently addressed. The implications for the financial market will be further explored within the framework of this study. However, it is true that the appearance of this new type of client makes it key to adapt financial products in accordance with their preferences. To put it simply, transnational financial ties demand transnational financial services.⁶⁴

The financial products to be adapted to this niche market are, inter alia, mortgages (the object of this study), products for home improvements, savings and insurances. If this is successfully done, it will lead to transnational families having more money available for their own purposes, while empowering them with more options in using those resources. It is therefore of critical importance to increase the banking and access to financial services for transnational families. Promoting the development of remittances services through microfinance institutions aims to increase the banking of recipient families and facilitate their access to financial services. This is thought to enhance the economic impact of remittance transfers and improve the lives of the families.

⁶³ Terry, D. – Wilson, S. (ed.), 2005, p. 153f

⁶⁴ Ibid.

An attempt to link remittances with microfinance products will be presented later in this study. In the upcoming section the reader will be introduced to the world of microfinance.

2.4 Concluding remarks

This section has explored the magnitude of international migration and remittances, and their determinants. There are many theories on migration. In brief; the wage differences between high-income and low-income countries, individuals' cost-benefit calculations, migration as a livelihood strategy for whole families and the growth of networks of immigrants in high-income countries comprise the main causes of the latest decade's increase in migration flows. As a consequence of increased migration, remittance flows have augmented significantly in the last decade. In many developing countries remittances are playing an important economic role constituting large shares of the GDP. This section has illustrated that the reasons for sending remittances seem to range from pure altruism to pure self-interest. Evidence shows that a combination of both, meaning that the migrant and the rest of the family make an arrangement aimed to be of benefit for both parties, is the motivation supported by most studies.

Latin America is the region in the world where the remittance flows are the largest and the fastest growing. Remittances to the region are predicted to continue to grow notably in coming years. The case study for this thesis, El Salvador, is one of the countries in the region where the out-migration is significant and where remittances account for at least a tenth of the country's GDP.

However, as in other developing regions the financial markets in the Latin American region are shallow and the traditional financial intermediaries show only a modest interest in serving the poor. In this context, remittances are thought to be a powerful tool to open up the financial systems and make more financial intermediaries interested in providing services for the poor. Already, a large number of microfinance institutions operate successfully in the region, and some of them have also entered the remittance market. Why it is important to provide access to financial services for poor people will be further explored in the upcoming section on microfinance.

3. MICROFINANCE

In most developing countries only a minority of the population have access to financial services that most of us take for granted. Usually the poor and low-income families have no access at all to credits, savings, insurances and money transfer services. Since the financial sector makes an important contribution to economic development this is a major concern in the overall struggle for poverty eradication. Microfinance is about serving clients that are unserved by the formal banking sector. Thereby microfinance can form a way for people to escape poverty.

3.1 The role of the financial sector for development

The financial system is widely recognized as playing a critical role in economic development. The World Bank, for instance, considers finance key to investment and therefore also for growth. The crucial role of the financial sector is due to its ability to enhance efficient use of the resources in an economy. In brief, financial systems offer payment services, mobilize savings and allocate credit. They limit, price, pool and trade the risks resulting from these activities. Households, businesses and governments are all using these services provided through a range of instruments and institutions. With financial services it is made cheaper and less risky to borrow and lend, and to trade goods and services.⁶⁵ For example, saved resources can be provided to someone with a more productive use for them, raising the income for both the saver and the borrower. This in turn can build companies and create employment. Furthermore, security can be provided, for instance, through insurance against economic shocks, and savings for retirement or for investments. Moreover, effective money transfer services make the reception of remittances quick and cost-efficient.

Box 3.1: The role of the financial sector

- Provides payment services
- Matches savers and investors
- Generates and distributes information
- Allocates credit efficiently
- Prices, pools and trades risks
- Increases asset liquidity

Source: Todaro, M. – Smith S., 2003, p. 733-734

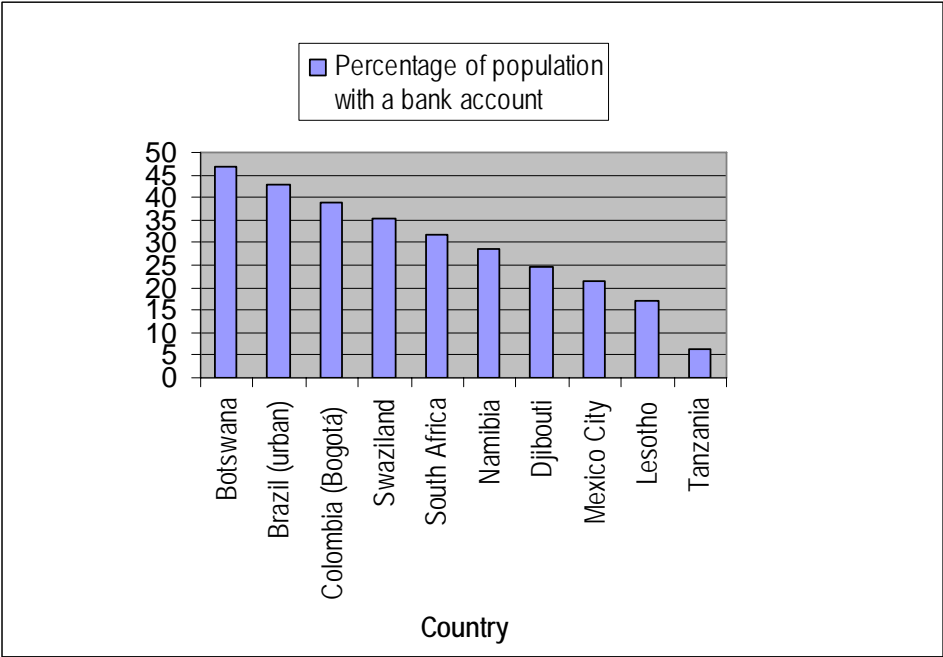
The quantity and quality of the financial services determine the financial system's contribution to the economy, which mainly lies in its ability to increase the efficiency of the economy. This is the principal difference between economies with mature and economies

⁶⁵ The World Bank, 1989, p. 25

with immature financial markets. Lending, for example, can be both costly and risky without efficient financial markets.⁶⁶

Nevertheless, most people in the developing world – constituting the majority of the world’s population – do not have access to formal financial services. Very few benefit from a savings account, loan, or a convenient way to transfer money.⁶⁷ The United Nations (UN) finds a considerable amount of “bankable” people “unbanked”. The “bankable” are people and firms who are creditworthy and able to generate income to repay what they borrow, but who have no access to credit and who are excluded from full participation in the financial sector. Estimations of access to financial services show dramatic differences between industrialized and developing countries. National surveys on access to savings show that in the 15 initial members of the European Union, on average, 89.6 per cent of the population state that they have a bank account. Country variations range from 99.1 per cent in Denmark to 70.4 per cent in Italy. The comparable figure for the United States is 91.0 per cent.⁶⁸

Figure 3.1: Access to savings in developing countries



Source: The United Nations, 2006, p. 1-2

Note: In Botswana, Lesotho, Namibia and Swaziland, this is the percentage who says that they have a savings/transaction account from a bank.

⁶⁶ The World Bank, 1989, p. 26

⁶⁷ CGAP, 2006, p. 1

⁶⁸ The United Nations, 2006, p. 1

The corresponding data on access to a bank account in some developing economies is found in figure 3.1. Microfinance has therefore emerged as an answer to the lack of financial services for the poor.

3.2 Understanding microfinance

When the regular financial systems do not manage to provide financial services for the majority of its people a gap emerges between the demand and supply of such services and products. This gap has to be filled for the economy to work properly and prosper. However, market failures such as asymmetric information, high transaction costs and borrower's lack of collateral constitute too high risks for commercial lenders, who therefore are reluctant to enter less developed markets. To combat these problems microfinance institutions have emerged in the last decades and grown into powerful tools for poor people.

Box 3.2: The pioneer in microfinance – Grameen Bank in Bangladesh

The Grameen Bank started out as an experimental project in 1976 by the Bangladeshi professor Dr. Muhammad Yunus, who was awarded the Nobel Peace Prize in 2006 for his achievements in the microfinance area. Yunus reasoned that if financial resources could be made available to the poor people on terms and conditions that are appropriate and reasonable, poor people would generate self-employment without external help. In 1983 the project was turned into the Grameen Bank, with the government holding almost all of the shares. Today the bank is owned by the rural poor whom it serves. Borrowers own 94 percent of its shares, while the remaining 6 percent is owned by the government. The Grameen Bank has not received any donor funds since 1998, the existing growing deposits are enough to both expand its credit programs and repay current loans. The bank provides services in almost 80,000 rural communities, covering more than 91 percent of the total villages in Bangladesh. As of March 2007, it had more than 7 million borrowers, 97 percent of whom were women. The loan repayment rate is an exceptional 98.28 per cent. Ever since the bank came into being, it has made a profit every year except for three years.

The Grameen Bank offers four different interest rates, 20 percent for income generating loans, 8 percent for housing loans, 5 percent for student loans and 0 percent for struggling members (beggars). In comparison, the government of Bangladesh has a fixed interest rate for government-run microcredit programmes that amounts to about 22 percent. Hence, the Grameen Bank's interest rates are lower. Housing loans were introduced by the bank in 1984, and became very attractive. The maximum amount given for a housing loan is approximately US \$ 217, to be repaid over a period of 5 years in weekly instalments. Until today around 650,000 houses have been constructed with the housing loans amounting to roughly US \$ 200 million. These housing loans account for the largest single asset in the portfolio of Grameen Bank, the largest and most successful of microfinance institutions.

Source: <http://www.grameen-info.org/bank/> (2007-06-04) and Buckley, R. – Kalarickal, J., 2005, p. 247

Microfinance is most commonly known as small credits for poor and low-income people, but includes a wide range of financial services to the poor such as the provision of savings, insurances and money transfer services. The need for poor people to borrow and save is actually greater than for better-off people, although their capacity may be lower. Just because their incomes are tight, and many times also volatile, financial services can help them to fill in

mismatches between income and consumption needs. Hence, there is a market for microfinance.⁶⁹

The first microfinance institution, the Grameen Bank, was originated in Bangladesh in the mid 1970s, and turned out to be a success story (box 3.2). Today, different types of replications of the Grameen Bank are found in almost every corner of the developing world. Next, why microfinance is needed will be discussed in further detail.

3.2.1 Problems of the financial markets

In an ideal and simplified economy, without the existence of market failures, capital would move from rich to poor countries. Since technology and capital would be transferable, the productivity would potentially be the same, and since no transfer costs would exist, capital would move towards markets where capital is scarce and where the marginal returns are higher on each additional unit. This in accordance with the principle of diminishing returns which assumes that when an enterprise invests more, each additional unit of capital will bring smaller and smaller marginal gains. Consequently, a borrower in a poor country would be willing to pay more for capital than a borrower in capital intense markets, which in turn would attract investors. In this simplified economy the implication would be that capital moves from North to South. However, in reality there are market imperfections implying that capital will not move in those directions. The main obstacles to the markets working perfectly is a combination of market failures such as incomplete information, high transaction costs (meaning it is costly to obtain information and to make and implement contracts) and poor people's lack of collateral.⁷⁰ As will be shown, microfinance is an innovative way to compensate for these imperfections in the market.

3.2.1.1 Agency problems – adverse selection and moral hazard

The main reason why lenders are unwilling to enter the capital markets of developing countries is the risk. For several reasons the risk is higher in less developed markets than in industrialized countries. This section will explain the most common features of less mature markets and why they entail risk.

⁶⁹ Roodman, D. – Qureshi, U., 2006, p. i

⁷⁰ Armendáriz de Aghion, B. – Morduch, J., 2005, p. 5.

Limited liability

When discussing lending to poor people in developing countries it is reasonable to assume *limited liability*, defined as the situation when borrowers cannot repay more than from their current income.⁷¹ This means that borrowers have no collateral to offer the bank as security for their loans.⁷² Since the poor borrowers have nothing to lose – in case of default – the contract is risky only from the lender's point of view. In addition, the weak legal enforcement mechanisms in developing economies create another difficulty. Even if the borrower was in possession of some assets, those would be difficult for lenders to seize due to legal reasons. Thus, for a lender, if a repayment cannot be legally enforced, there is no point in making a loan to a customer without collateral, since borrowers after the default can move and change identity.⁷³

Adverse selection

When lenders and borrowers have asymmetric information about a market transaction the transaction completed may be biased in favour of the actor with better information.⁷⁴ This is called *adverse selection* and is a common problem in lending to poor people. In this case it means that lenders are unable to distinguish between safe and risky borrowers due to the lenders' poor information. This problem arises before the contractual agreement takes place. The borrower has better information about his or her creditworthiness and risk taking than the bank. This in turn has implications for how the interest rate is set. In order to compensate for the greater probability of default, banks would like to charge riskier customers more than the safer ones. But since the bank is unable to determine who is who, this is impossible and at the same time charging a common (and higher) interest rate for all would drive safer customers out of the credit market. Charging everyone the same interest rate creates market inefficiencies since the safer borrowers would then cross-subsidize the riskier ones. The consequences might be that the safer borrowers leave the bank, which will be left with a riskier-than-average pool of customers. To be able to have an efficient and well-functioning market, safe borrowers would also have to participate, and in that case everyone could be

⁷¹ Armendáriz de Aghion, B. – Morduch, J., 2005, p. 37

⁷² Initially the problem of lack of collateral can be found in the lack of clear property rights and formal titles that are common in many developing countries. However, this discussion goes beyond the scope of this thesis.

⁷³ Armendáriz de Aghion, B. – Morduch, J., 2005, p. 36f

⁷⁴ Nicholson, W., 2002, p. 233 + 729

charged the same, lower interest rate.⁷⁵ But, of course, normally safe borrowers cannot be forced to participate.⁷⁶

Moral hazard

Another well-known information asymmetry is *moral hazard*, defined as the effect of insurance coverage on an individual's decisions to undertake activities that may change the likelihood of incurring losses.⁷⁷ Moral hazard occurs when the lender cannot observe the effort that the borrower makes to realize his or her project, or the profit that he or she makes. These two situations are referred to as *ex ante* moral hazard and *ex post* moral hazard. The *ex ante* moral hazards are the actions that affect the probability of a good realization of returns to the project, e.g. the actions taken place before the project returns are realized. The information asymmetries make banks unable to deter borrowers from taking excessive risks in their projects, which raises the probability of default. The *ex post* type of moral hazard occurs when the lender is not able to observe the profits that the borrower makes. The borrower can falsely claim a loss or a default and take the money and run after profits are realized. Because no collateral is given the lender bears the risk. Inefficiencies arise in the market since the defaulting borrowers will avoid facing the full consequences of their actions.⁷⁸ Moreover, both adverse selection and moral hazard are worsened by the difficulty of enforcing contracts in economies with weak judicial systems.⁷⁹

Summing up, the agency problems refer to the lender's inability to observe the borrower's characteristics, effort and profits. Due to these problems, in combination with the borrowers' lack of collateral, commercial lenders are reluctant to enter the markets of developing countries. Microfinance can be seen as an attempt to overcome the market inefficiencies created by incomplete information, high transaction costs and poor people's lack of collateral.

How to mitigate agency problems?

The main problem in low-income markets is the limited liability, e.g. the borrowers' lack of collateral. Both adverse selection and moral hazard could be solved if the borrowers could offer collateral to secure their loans. Then the risk would be taken by the borrower and not by

⁷⁵ Armendáriz de Aghion, B. – Morduch, J., 2005, p. 51

⁷⁶ As individuals can, for example, in social insurance schemes.

⁷⁷ Nicholson, W., 2002, p. 230 + 732

⁷⁸ Armendáriz de Aghion, B. – Morduch, J., 2005, p. 43f

⁷⁹ *Ibid*, p. 7

the bank. However, when collateral is scarce the commercial lenders need to acquire more information which is costly in less mature markets.⁸⁰ Next the reader will be introduced to the most common forms of microfinance, all of them attempting to mitigate the agency problems.

3.3 Microfinance in practice

The innovative idea of microfinance was to introduce group lending. To avoid the high transaction costs the client selecting and monitoring is shifted from the lenders to the borrowers themselves, by group formation implicating joint responsibility. But, microfinance also offers individual lending which is built around more traditional lending relationships between the bank and the client. Below, these two most common forms of microfinance will be explored.

Group lending

The most typical and well-known microfinance products of today are the ones based on group lending mechanisms. Since smaller loans are relatively more costly to provide, the client selecting and monitoring is therefore shifted from the lenders on to the borrowers themselves. Since joint liability is assumed, group lending will make the borrowers reveal what type they are. The lender might not get to know anything new, but the group members themselves have good information about fellow members, and this information is used to the bank's advantage. The lender in this way transfers onto the customers the responsibility for functions usually undertaken by banks. This mechanism mitigates the problems of adverse selection and moral hazard as well as enforcement difficulties.⁸¹

It works as follows; borrowers – individuals without collateral – are asked to form a group where all members jointly are liable for all loans taken out. The loans are individual to group members, but if any member fails to repay, all members of the group will face the consequences. Thus, the group relies on group responsibility, which is composed of joint liability and regular group meetings. Weekly repayments usually start immediately and when the loan is repaid the borrower becomes eligible for a larger loan as long as the group approves it. Group lending has a few crucial characteristics. All members in the group share a common bond (such as living in the same village); the loan business is supervised through

⁸⁰ Armendáriz de Aghion, B. – Morduch, J., 2005, p. 51

⁸¹ Ibid, p. 37f

peer monitoring; and social sanctions help to ensure that members of the group repay their loan.⁸² This type of loan is common, for instance, in Asia and in rural Latin America.⁸³

Individual lending

Individual lending is more similar to traditional lending. These loans are larger than the ones in group lending and therefore cheaper for the lender to administer and less burdensome for the client. However, in contrast to conventional lending the amounts are smaller and the reliance on sources of security, collateral, is less. However, collateral sometimes is used, although the market value of most assets offered is low. Even though the collateral presented might not be able to cover losses in the event of default, it serves to motivate timely repayment. Instead, individual lending relies heavily on character assessment, where the loan officer needs to screen the potential borrower by interviewing friends, neighbours and business associates. This form of individual micro-lending is especially common in dense urban areas, notably in Latin America, where the social bonds are not strong enough to support the former type of lending based on group self-selection mechanisms.⁸⁴

3.3.1 Successful microfinance

How come some microfinance institutions are successful and some fail? To develop a competitive microfinance sector it is of utmost importance that the market conditions are not distorted through subsidies or grants. Interest rates need to reflect the true costs of the lending operation and the microfinance institutions need to be financially sound and operate on a commercial basis to work properly.⁸⁵ Further, four key challenges for microfinance business, in order to operate on a sustainable basis and grow, are identified by Roodman and Qureshi; building volume; keeping loan repayment rates high; retaining customers and minimizing the scope for fraud. Thus, commercial success depends on three factors; design of products, management techniques, and environmental factors.⁸⁶

⁸² Armendáriz de Aghion, B. – Morduch, J., 2005, p. 68

⁸³ Roodman, D. – Qureshi, U., 2006, p. 3

⁸⁴ Roodman, D. – Qureshi, U., 2006, p. 6

⁸⁵ Tannerfeldt, G. – Ljung, P., 2006, p. 126

⁸⁶ Roodman, D. – Qureshi, U., 2006, p. 37

Box 3.3: Products: Key features for product design

- Credits rather than savings; credits have advantages as they allow new microfinance institutions (MFIs) to build volume and grow.
- Progressive lending; the so called “loan ladder” effectively eliminates risky customers.
- Group lending to women; in the absence of collateral the joint liability of the group screens out risky projects and enforces repayment. Around 90 percent of group lenders are women.
- Frequent transactions and short loan terms; through frequent meetings and steady repayments the lender gets to know the customer, which protects against default.
- Charging high interest rates; to reach self-sufficiency and avoid external dependence all large MFIs should aim to cover their costs.
- Limited product offering; due to the mass production the limitation of product diversity has proved to be successful.

Source: Roodman, D. – Qureshi, U., 2006, p. ii

Box 3.4: Management: To build effective organizations

- Hiring, training and firing; many MFIs hire young people as more idealistic, and tend to hire them from the same communities as they are aimed to serve.
- Going to the customer; since poor people cannot afford to travel long distances, the MFIs must go to the client.
- Leadership; the vision, the mission, the commitment to continuous improvement, must come from the top.
- Monitoring and incentives; close monitoring of performance of branches and incentives to reward good performance.
- Organizational capacity for learning; many successful MFI managers have developed a culture of letting them learn from staff and spending time in the field.

Source: Roodman, D. – Qureshi, U., 2006, p. iii

Box 3.5: Environment: The setting matters

- Competition from actors with subsidized credit makes it hard for MFIs to enter the market, and should be avoided.
- It is crucial to avoid settings with legal impediments, such as rules preventing NGOs from lending, unfavourable tax policies, impediments to foreign investment etc.
- Macroeconomic stability is essential for microfinance.

Source: Roodman, D. – Qureshi, U., 2006, p. iv

However, Roodman and Qureshi distinguish between financial and social success. They stress that the true success lies in social gain and contribution to development and that microfinance should be thought of in that broader sense.⁸⁷

3.3.2 The limitations of microfinance

Murdoch is somewhat critical of the current enthusiasm about microfinance. By providing financial services to low-income households the hope is that much poverty can be alleviated and that economic and social structures can be transformed fundamentally. But, although MFIs have prospered in densely populated areas such as Bolivia, Bangladesh, and Indonesia, they have shown limited success in regions with highly seasonal income patterns and low population densities. Murdoch asserts that even in the best of circumstances, credit from microfinance programs helps fund *self-employment activities*, adding to income for borrowers, rather than drive fundamental shifts in employment patterns. In other words,

⁸⁷ Roodman, D. – Qureshi, U., 2006, p. 37

microfinance rarely generates new jobs for others. Evidence shows that reducing overall poverty rates requires increasing overall levels of economic growth and employment generation. Most important, Murdoch stresses, it still remains far more costly to lend small amounts of money to many people than to lend large amounts to a few. As a result, the microfinance programs are highly cost-sensitive, and too many rely on subsidies. Therefore, management structures and mechanism design must be looked over in order to lower costs while maintaining outreach, he suggests. It is hard to imagine substantial progress without more innovation, although it will not be simple.⁸⁸

Although microfinance is no panacea, microfinance is still, for millions of households, a promising help in the struggle to escape poverty. The success has impressed even critics and the microfinance movement has forced economists to rethink the nature of poverty, markets, and institutional innovation. This is probably the most important wisdom that the microfinance movement has brought about.⁸⁹

3.4 Housing Microfinance

The lack of adequate housing has a significant impact on poor people's livelihoods, affecting their health and their social, political and economic outcomes. Traditional housing finance systems fail to serve poor families in many ways. Mortgage lenders in most developing countries are scarce and focus on the middle and upper classes and traditional mortgages are unaffordable and inaccessible for households with informal and low incomes. Government programs, where available, reach only a fraction of those in need. Hence, many microfinance institutions have added housing finance products to their loan portfolio in recent years. These types of products are intended for the construction of new houses and/or home improvement. This section will, apart from explaining the functioning of such financial products, also address the importance of housing for economic development.

Important to have in mind is that there are several critical areas that need to be improved to enable decent housing for the poor. Facilitating access to financial products for purchasing or progressively improving a home is only one important component. Other key ingredients include land use rules, efficient registration of property titles, legal frameworks for long term

⁸⁸ Morduch, J., 1999, p. 1569-1614

⁸⁹ Ibid.

mortgage markets, credit insurance systems for lenders, and effective subsidy systems that reach the very poor.⁹⁰ Crucial to point out is the role of the government as an enabler instead of a provider of low-income housing. However, due to resource limitations this thesis will exclusively investigate the role of finance and access to financial products for low-income housing.

3.4.1 The importance of housing for development

Housing is one of the most important sectors of the economy, in developing countries as well as in richer ones. This is due to the fact that adequate housing creates large positive externalities in terms of economic growth, public health and societal stability.⁹¹ According to the World Bank, housing is considered a key store of household wealth, savings, and security in retirement. If housing finance is out of reach for the world's poor it will bring widening inequalities, more extensive slums, and worsen the already existing constraints on economic, social, and labour mobility.⁹² In this sense adequate housing is thought of as holding back an escalation in violence, crime and insecurity. The Swedish International Development Cooperation Agency (Sida) also considers land and housing as major assets that give people access to public services, a relatively more secure existence and a sense of inclusion in society. Moreover, secure housing also brings opportunities for creating home-based small scale production, making housing constitute also a productive asset.⁹³

Following this, housing can contribute substantially to economic development. But housing is still being addressed as if it were a passive element in economic development. For instance, housing systems in developing countries are dominated by badly designed, poorly targeted, and inefficient government subsidies, market failures in land markets, informality, and a growing slum population.⁹⁴ Instead, housing must be viewed as a part, rather than a by-product, of the economic development process. As will be shown below, housing has important linkages to, and effects on, other sectors of the economy, such as employment, health and productivity, and savings.⁹⁵

⁹⁰ <http://rru.worldbank.org/PapersLinks/ReadingList.aspx?topicid=100#id7807> (2007-06-05)

⁹¹ Jha, Abhas K., 2007, p.1

⁹² <http://rru.worldbank.org/PapersLinks/ReadingList.aspx?topicid=100#id7807> (2007-06-05)

⁹³ Sida Policy, 2006, p. 9

⁹⁴ Jha, Abhas K., 2007, p.1

⁹⁵ Arku, G., 2006, p. 391

The effect of housing on employment

Evidence worldwide shows that housing construction plays an important role in developing countries by creating employment, especially for unskilled labour. The construction and house building industries have high potential for employment generation since they also create additional jobs through linkages to related sectors, like land surveying, production of building materials and distribution of construction materials and equipment.⁹⁶

The effect of housing on savings and domestic financial mobilization

In low- and middle-income settlements in developing countries, the home is used not only for shelter but also as a source of income through home-based businesses. Those enterprises serve as vital sources of income-generating activity for low-income people. Moreover, they contribute to national income and, hence, to the economic development process.⁹⁷ The role of housing assumes an even greater economic significance when savings are considered. Due to low incomes and the lack of well-organized financial institutions the rate of bank savings in most developing countries is low. Those households that actually possess savings tend to hold them in unproductive assets such as gold and jewellery. However, most people attach a high priority to home-ownership and would prefer having their savings in a home. Many people are therefore prepared to make sacrifices in other areas in order to purchase a house. If these resources can be mobilized and properly channelled, the housing finance system could serve as a tool for the development of both the financial system and the domestic economy.⁹⁸ Nevertheless, it is important to point out that this potential correlation does not mean that one can say for sure that adequate housing would lead to a higher domestic financial mobilization. Other variables, influencing both housing and domestic savings, may be present and thus cause this relationship.

The effect of housing on health

Increased productivity is essential for economic growth, and population health has a crucial influence on productivity. Health, in turn, depends on living conditions, including housing. This implies that housing and related services are not just social or welfare issues but also economic issues. Studies on housing and health have singled out characteristics of the housing environment that pose serious threats to the health of people. The most important of these are

⁹⁶ Arku, G., 2006, p. 387

⁹⁷ Ibid, p. 388f

⁹⁸ Ibid.

overcrowding, location, tenure and housing conditions. For instance, findings show that those who rent their houses have poorer health than those who own their houses. Poor housing conditions, for instance poor sanitation and poor or non-existent water pipes, low state of repair, and poor location is related to illness to a larger extent than for people living in a decent house equipped with basic services such as electricity, water and sanitation.⁹⁹ According to these studies it is shown that there is a correlation between housing conditions and health. A word of caution is however motivated in this context. This correlation does not prove causation or, to put it simply, a cause-and-effect relationship per se between these variables. Other factors, such as education for example, might affect both health and housing, leading to this relationship.

Box 3.6: Housing in Latin America

Latin America has a higher urbanization level and a higher level of home ownership than most other regions of the world. In the past two decades urbanization, democratization, decentralization and globalization have led to greater depth of financial systems, a wider range of housing financial instruments, and a transformation in the role of governments from a housing provider to an enabler. Following this, the availability of housing finance has increased dramatically in the region over the past decade.

Despite these positive trends, a large housing deficit remains within the region. Still, an estimated 26 million housing units are currently inadequate and an additional 28 million units are needed to relieve crowding and unsatisfactory conditions. The rise in urban populations in combination with the failure of formal housing markets has led to the fact that 128 million people are living in slums in Latin America. In the major cities most housing is self-made, a percentage that has risen steadily. For instance, in 1952 an estimated 14 percent of the population in Mexico City lived in self-constructed homes compared to 60 percent in 1990. Less than a quarter of all housing in Latin America is financed through formal mechanisms, and mortgages still account for a small fraction of total credit. In addition, the price of land in Latin America is amongst the highest in the world, relative to income. Therefore informal tenure is common, accounting for about one third of home ownership.

Source: Jha, Abhas K., 2007, p. 1-4

3.4.2 Understanding housing microfinance

In advanced industrialized countries, equity in homes represents the largest single asset of the middle-class, and most of a nation's wealth. In addition, the housing industry generates a significant share of employment in richer countries, typically around 9 percent worldwide. Also in developing countries housing is considered the primary form of asset for people. Often it represents no less than 50 percent of the assets of poor households. Whereas in the developed world, mortgages constitute a large part of the financial system (about one-third of all financial assets in the US for example), in developing countries mortgage markets are typically small or non-existent, and housing is but a minor industry. The great bulk of families in developing countries cannot build wealth through equity in their homes due to lack of financial services. This makes the majority of poor families build their own homes

⁹⁹ Arku, G., 2006, p. 390

progressively over several years, largely unassisted by formal institutions. Low household incomes together with high costs in key markets that affect housing (such as land, building materials and financial services) contribute to this development. In addition, rental markets usually function poorly or not at all.¹⁰⁰

Housing microfinance, an innovative housing finance product, has been developed to serve poor households since traditional housing finance does not reach the poor adequately. Housing microfinance refers to small loans to low- and moderate-income households typically for self-help home improvement and expansion, but also for new construction of houses.¹⁰¹ Best practice in housing microfinance involves loans at unsubsidized interest rates and on short terms.¹⁰²

Housing microfinance can be thought of as a combination of microcredits and traditional mortgage finance. While conventional housing finance is generally intended for the purchase of a complete housing unit or construction of such a housing unit (with a repayment period of 10-30 years), housing microfinance is rather intended for progressive construction, where borrowers complete the construction of their homes through a series of loans. The typical amount (US \$300-5,000) and the duration (2-10 years) of housing microfinance loans are usually much smaller and shorter than that of mortgage finance, but greater than that of microcredits. Just as in microfinance, many housing microfinance programs work with semi-legal titles and informal incomes – usually from self-employment – which is the typical security that low- and moderate-income households can offer. In contrast, mortgage finance normally requires a formal-sector employment with a minimum and regular income, tangible assets and a registered title deed as collateral.¹⁰³

As is known, formal private housing finance agencies are reluctant to deal with the poorer sections of society due to the high administrative costs of small loans and the high-risk borrower type that poor people are considered to constitute. Furthermore, formal financial institutions lack experience and are unfamiliar with serving the poor. Microfinance institutions instead attempt to work with the poor by developing methods that do not

¹⁰⁰ Ferguson, B. – Navarrete, J., 2003, p. 309f

¹⁰¹ Ibid, p. 316f

¹⁰² Smets, Peer, 2006, p. 595

¹⁰³ Ferguson, B. – Navarrete, J., 2003, p. 316f

discriminate against those working in the informal sector and those living in informal settlements.¹⁰⁴

3.5 Concluding remarks

The departure point of this section is that most of the world's population is excluded from financial services. The reasons why the market does not deal with this problem are market failures arising from lack of collateral, poor information, high transaction costs and difficulties in enforcing contracts. Microfinance institutions offer financial products to the clientele deemed too poor, too risky and too costly for commercial banks to serve. This section has described the need for microfinance, especially for long-term investments such as housing, where housing has implications for the whole economic sector through its effects on employment, health and savings. An improvement in overall housing conditions can therefore have a notable impact on economic development and hence on poverty levels.

Housing microfinance is contributing to improve housing standards in developing countries. It is usually characterized by an individual loan with small loans on short terms. Lenders typically do not require a title to guarantee the loan and are willing to accept less formal types of collateral, making the financing more accessible to low income borrowers.

The next section will take a closer look at housing microfinance in El Salvador, an example of a country exhibiting a mature microfinance market along with receiving large sums of remittances. A new housing microfinance product has recently been launched for Salvadoran remittance senders and receivers. The following part will explore this product and how remittances can be channelled into microfinance and thereby lead to a larger development impact.

¹⁰⁴ Smets, Peer, 2006, p. 595-613

4. THE CASE OF EL SALVADOR

Since the early 1980s migration of large dimensions has dominated El Salvador, due to civil war and natural disasters. With a large share of its population living abroad, the country is today one of the largest recipients of remittances in Latin America. The challenge is to capture the great potential of the remittance flows so that these money transfers lead to enhanced development effects. Channelling remittances into microfinance is one way, and in 2006 a new transnational financial product of this type was introduced in El Salvador.

4.1 Historical background

El Salvador has a long history of international migration (box 4.1). Since the civil war, which erupted in 1980, the flow of out-migration has been large. About 75,000 Salvadorans were killed during the twelve year war. Social and economic instability along with armed conflict and violation of human rights triggered the departure of a large number of refugees to Costa Rica, Mexico, Belize and the US. After the peace agreements were signed in 1992 the political and economic situation slowly stabilized. However, no significant social programs were put in place to deal with the consequences of a decade of conflict and impoverishment. The hurricane Mitch in 1998 and the 7.6 degree earthquake in 2001 spread new devastation in the country. Housing, basic infrastructure and services, as well as agriculture and fisheries were severely affected. Another wave of out-migration from El Salvador took place, principally to the US.¹⁰⁵

According to official statistics the Salvadoran population amounts to 7.0 million people.¹⁰⁶ This can be compared with an estimated 2.5 to 3.3 million Salvadorans living abroad, according to the UNDP.¹⁰⁷ However, the actual figures are difficult to be precise about due to the large number of undocumented workers. Almost 9 out of 10 Salvadoran migrants are residing in the US¹⁰⁸ and Salvadorans account for no less than half of all Central American migrants in the US and Canada today.¹⁰⁹ With such a considerable part of the population living abroad El Salvador has become one of the largest recipients of remittances in Latin America. The typical features of the remittance market in El Salvador are explored in the next part.

¹⁰⁵ Serageldin, M. et. al., 2005, p. 16

¹⁰⁶ <http://www.digestyc.gob.sv/> (2007-08-09)

¹⁰⁷ UNDP, 2005, p. 8

¹⁰⁸ Ibid.

¹⁰⁹ Serageldin, M. et. al., 2005, p. 16

Box 4.1: The history of migration in El Salvador

According to the United Nations Development Programme the international migration from El Salvador during the last century has taken place in four main stages:

First stage (1920-1969)

During the first half of the last century many Salvadorans left their country mainly due to lack of access to land and, especially in the rural areas, lack of job opportunities. Many of the migrants at that time were found at the banana plantations in the north of the neighbouring country Honduras. Later, at the time of the Second World War, the migration flows towards Honduras changed and the main destinations for migrating Salvadorans now became Panama and the United States of America. In the US Central American non-skilled labour became attractive in the North American industries because of the war.

Second stage (1970-1979)

The Hundred Hour War¹¹⁰ with Honduras in 1969 forced many Salvadorans, who lived and worked in the neighbouring country, to move back to their country of birth. The armed conflict with Honduras worsened the socioeconomic situation of El Salvador. Thousands of refugees demanded work, housing, health and educational services, leading to political instability. At this time large numbers of migrants headed once again towards the US. The lack of land and job opportunities together with social insecurity, political violence and repression were the main incentives for migrating.

During the 1970s migration grew by 73 percent.

Third stage (1980-1991)

This epoch corresponds to the time of the civil war in El Salvador. The armed conflict between the army and the rebels created social instability, kidnappings and killings of politicians, terror and a critical economic situation for the country. The majority of the Salvadoran migrants headed towards the US, where migratory reforms in 1986 had legalized many of the immigrants due to a new law¹¹¹ intended to support family reunification. However, the great majority entered the US illegally, risking their lives.

During the 1980s migration grew by 307 percent.

Fourth stage (1992 – present)

This epoch starts with the ending of the civil war and the signing of the peace agreements in El Salvador. Political refugees and other people that had lived outside of the country during the war started to return, the economy grew and a process of national reconciliation began. However, soon the problems of the past returned; such as a lack of attractive jobs, increasing levels of inequality and political confrontation. During the period starting with the hurricane Mitch in 1998 and ending with the severe earthquake in 2001, the international prices of the main export product coffee dropped and the crime rates increased. This influenced many people to migrate once again. Another contributing factor to the increased migration was the success stories of the people that had decided to leave the country some decades earlier.

On average 1070 Salvadorans left the country each day in 2004 and of these 146 persons were deported and had to return.

According to the UNDP between 5 and 7 out of every 10 Salvadorans would migrate if possible. Among remittance receivers this share is even greater (see section 4.2.4).

Source: UNDP, 2005, p. 2-5.

4.2 Remittances

This section explores the features of the remittance market in El Salvador. The remittance flows and the destination of remittances are examined along with the characteristics of the remittances senders and receivers, as well as the transfer mechanisms used.

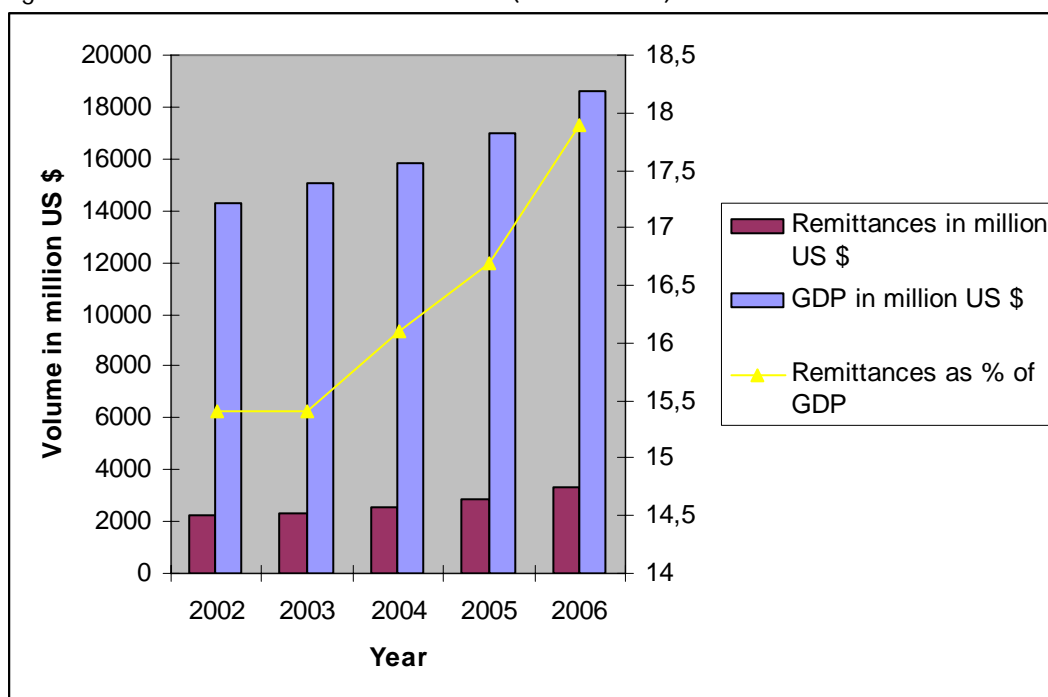
¹¹⁰ In Spanish: *La Guerra de las Cien Horas*

¹¹¹ Immigration Reform and Control Act (IRCA)

4.2.1 Macro level – remittance flows

In 2006, the official remittance flows reached US \$ 3,316 millions and El Salvador was, together with Guatemala, the largest recipient of remittances among Central American countries. There has been a steady increase in the remittance flows during recent years. On average, remittances to El Salvador have been growing at a rate of about 12 percent since the mid-1990s. However, between 2005 and 2006 the remittance flow grew at a rate of 17.2 percent.¹¹² The steady increase from the year of 2002 is shown in figure 4.1 below. In 2006, remittances constituted close to 18 percent of El Salvador's GDP¹¹³ and benefited a quarter of the households.¹¹⁴ In some locations, predominantly rural areas, the share of households receiving remittances reaches 40 percent. These areas also include some of the poorest households in the country.

Figure 4.1: Remittance flows to El Salvador (2002 – 2006)



Source: Banco Central de Reserva de El Salvador, 2006, p. 10

Note: The figure is based on official data. A considerable amount of remittances also enters the country through informal channels (see discussion in sections 2.2.3.3 and 4.2.5).

¹¹² Banco Central de Reserva de El Salvador, 2006, p. 1

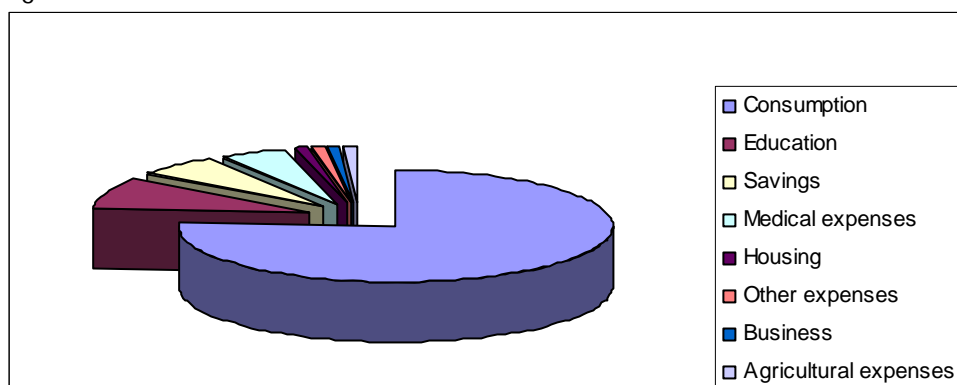
¹¹³ Remittances 2006: 3,316 millions of US \$, GDP 2006: 18,574 millions of US \$. Based on data from Banco Central de Reserva de El Salvador, 2007, p. 5

¹¹⁴ According to EHPM 2005; 24.8 percent of the population receives remittances.

4.2.2 Micro level – destination of remittances

According to the national household surveys (EHPM) in El Salvador, the remittance receivers report that they use 76 percent of their remittances for consumption. Nine percent is used for educational expenses, five percent for medical expenses and six percent is saved. Only one percent is used for housing expenses according to the latest survey (figure 4.2).¹¹⁵ As earlier stated, studies show that remittance receivers, compared to households not receiving remittances, spend a smaller share of total household income on food and a larger share on housing, education, and health. Those changes in spending are noteworthy also in El Salvador. A significant effect is further found for spending on housing improvements among remittance recipients in El Salvador.¹¹⁶

Figure 4.2: Destination of remittances in El Salvador



Source: Based on data from the EHPM, 2005.

4.2.3 The remittance sender

According to a survey on Salvadoran remittance senders in the US, published by the Bank of El Salvador, the typical sender transfers money on average 12 times a year, and approximately US \$ 300 monthly. Only ten percent report that they remit more than US \$ 400 each time. The majority of Salvadoran remittance senders are men, 56.4 percent, and on average they are 37 years old. They moved to the US at the age of 25 years and have 9.2 years of schooling on average.¹¹⁷ According to the survey, 23 percent of the remittance senders are residing in the US illegally, without documents. The rest have some sort of legal status, such as citizenship, permanent resident status, temporary protection status (TPS) or political asylum. A little surprising is that as many as 10 percent of the illegal population entered the

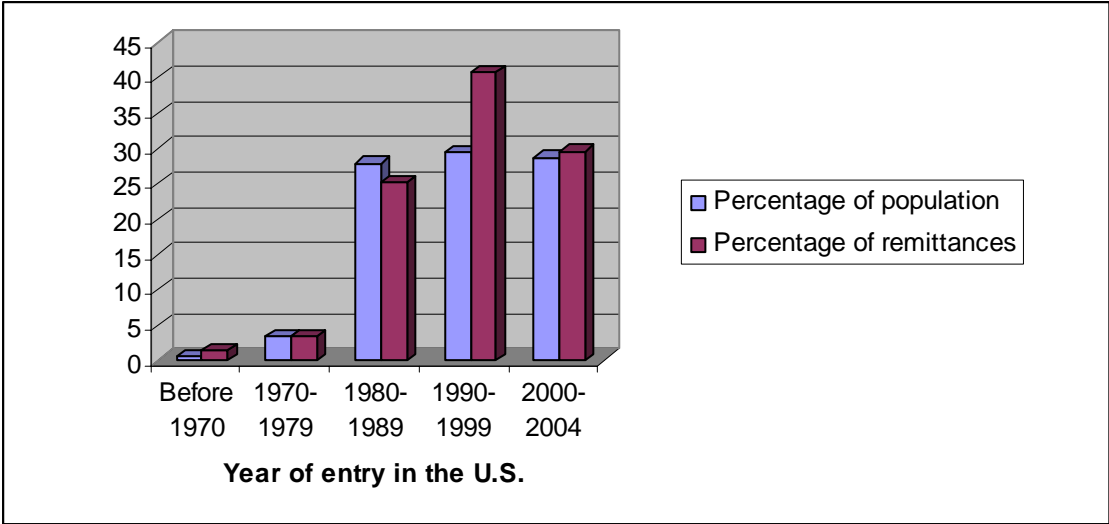
¹¹⁵ Based on data from the EHPM, 2005.

¹¹⁶ The World Bank, 2006b, p. 34

¹¹⁷ Banco Central de Reserva de El Salvador, 2005b, p. 22f

US before 1990.¹¹⁸ As stated previously, the recent migrants are those who remit the most (see section 2.2.3.1). According to figure 4.3, Salvadorans who have resided in the US for between 5-15 years are the ones remitting the most, proportionately more than their share of the Salvadoran immigrant population.

Figure 4.3: Salvadorans in the US: Relation between years in the US and share of remittances sent



Source: Banco Central de Reserva de El Salvador, 2005b, p. 25

4.2.4 The remittance receiver

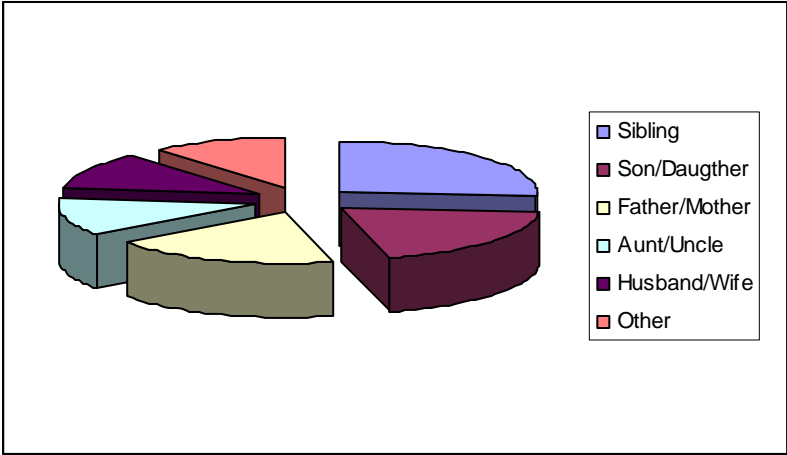
As mentioned earlier, the latest statistics show that close to 25 percent of the households in El Salvador receive remittances from a family member abroad.¹¹⁹ A survey reveals that the majority of the remittance receivers are women aged between 26 and 45. The great majority of the remittance receivers in El Salvador report that their family member is living in the United States of America (86 percent). Ten percent say their family member lives in Canada. The rest report that the family member is living in Australia, Mexico, Europe, other countries in Central- and South America or in other countries.¹²⁰

The remitter is most commonly a very close family member. One of every four persons reports that the remitter is a sibling, a fifth that the remitter is their child, another fifth that it is their parent sending money, 12 percent that it is their aunt or uncle and another 12 percent report that the remitter is their husband or wife (figure 4.4). Further, as many as 80 percent report that they have, in addition to the remitter, two or more family members living abroad.

¹¹⁸ Banco Central de Reserva de El Salvador, 2005b, p. 24
¹¹⁹ Based on data from the EHPM, 2005.
¹²⁰ Centro de Opinión Pública et. al., 2005, p. 11f

65 percent of the receivers report that their household's income is below US \$ 450 a month.¹²¹ Due to the low income levels remittances contribute to a large extent to the household economy; on average they comprise 60 percent of it. Higher percentages are reported in rural areas than in urban ones. Close to 75 percent of the households receiving remittances report that the remittances are the second most important source of income for the household, following income from some kind of work. As many as 17 percent count the remittances as their major source of income.¹²² According to the World Bank at least 30 percent of the remittance recipients in El Salvador belong to the poorest fifth of the population.¹²³ According to a survey, 77 percent of the remittance receivers in El Salvador have considered migrating, in comparison to 50-70 percent of the population in general (see box 4.1). 83 percent of those would like to move to the US.¹²⁴

Figure 4.4: Who is remitting to El Salvador?



Source: Centro de Opinión Pública et. al., 2005, p. 11f

4.2.5 Transfer mechanisms

There is a variety of companies offering remittance transfer services for migrants in the United States. Among the most commonly used by Salvadorans, besides Western Union, are the agencies to the Salvadoran banks in the US, Money Gram, Dolex, VIGO, Vía América among others. But great quantities are remitted through informal channels such as visiting family and friends in the US, Salvadorans visiting El Salvador or through persons who transfer, in person, cash money and goods to El Salvador for payment. These people are

¹²¹ The minimum wage is US \$158.4 per person and month according to the Ministry for Housing and Urban Development in El Salvador.

¹²² Centro de Opinión Pública et. al., 2005, p. 11f

¹²³ The World Bank, 2006b, p. 17

¹²⁴ Centro de Opinión Pública et. al., 2005, p. 11f

called *encomenderos*. Approximately six percent of the remittance senders regularly use *encomenderos* for their money transfers, while more than 15 percent have used such services at least once. However, the most frequently used informal way to transfer remittances is through visitors.¹²⁵ Important reasons for the rather large share using informal ways to transfer money are the legal status of the migrant (who is more restricted if illegal) and, as earlier stated, the unfamiliarity with financial products – at the sending and/or the receiving end.

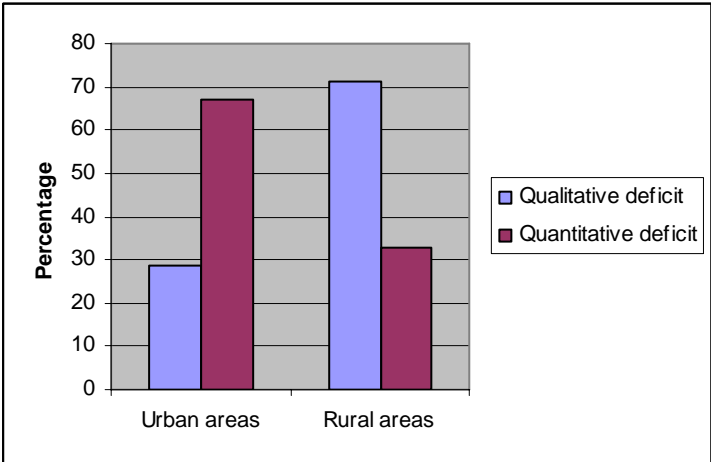
4.3 Housing standards

This thesis aims to explore how a combination of remittances and microfinance can enhance the development impact of remittances. One area that is important for long-term investment is housing. This section will further explore the housing standards in El Salvador.

4.3.1 Deficits in housing quantity and quality

The lack of adequate housing in El Salvador is approximately 545,000 units (2004), of which 94 percent is counted as a so called qualitative deficit, to be explored in this section.¹²⁶

Figure 4.5: Housing deficits in El Salvador



Source: Ministry for Housing and Urban Development, El Salvador, 2004 (based on EHPM).
 Note: Qualitative deficit refers to inadequate housing (deficits in basic services and/or building materials) and quantitative deficit refers to an actual lack of a place to live.

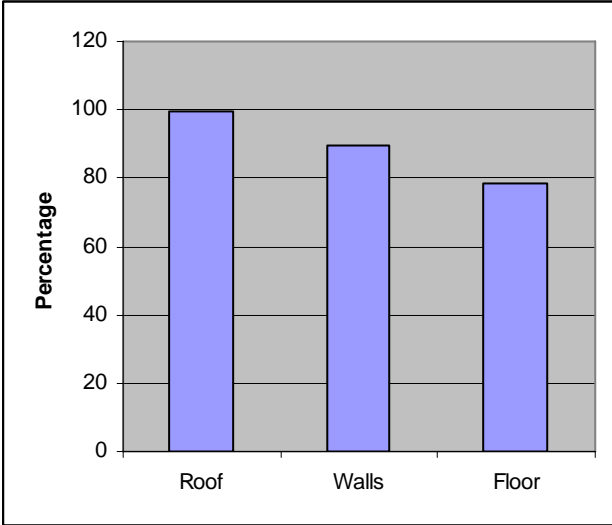
¹²⁵ Banco Central de Reserva de El Salvador, 2005a, p. 20f
¹²⁶ In 2004 the housing deficit in El Salvador was estimated to be 544,820 units, according to the Ministry for Housing and Urban Development.

Qualitative deficit refers to inadequate housing – such as lack of adequate building materials and/or lack of basic services – whereas quantitative deficit refers to lack of a house. The qualitative deficit is concentrated to rural areas while the quantitative deficit is most common in urban areas (figure 4.5). The most of the deficits, both qualitative and quantitative, are concentrated in the poorer sections of the population, among the households with an income below two minimum salaries.¹²⁷

4.3.2 Coverage of basic services and use of adequate building materials

The qualitative housing deficit in El Salvador is measured in relation to the coverage of basic services, such as electricity, water and sanitation, and the use of adequate building materials for the roof, walls and the floor. As the upcoming figures will show, the coverage of basic services is proportionately lower than the use of adequate building materials. This seems natural, since one usually first must have a roof, walls and a floor to be able to install electricity, water pipes and sanitary services.

Figure 4.6: Use of adequate materials – total population



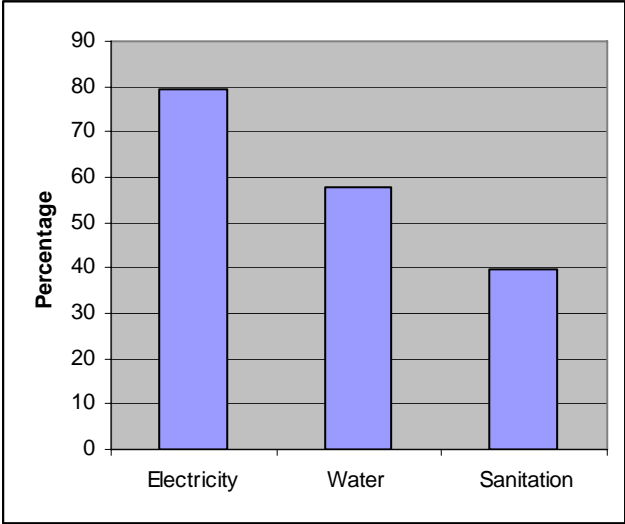
Source: Ministry for Housing and Urban Development, El Salvador (based on EHPM, 2004).
 Note: Materials; roof refers to aluminium sheet or roofing tiles of clay and cement, walls refer to different mixes of clay and cement, and floor refers to bricks of cement and clay or only cement.

When it comes to the use of adequate materials in building a house, almost all houses have a roof made of adequate material (figure 4.6). A rather large share of the population also has access to adequate materials when building the walls. However, as the figure also shows, around a fifth of the Salvadoran population lack an adequate floor in their home.

¹²⁷ The minimum salary is US \$158.4 per person according to the Ministry for Housing and Urban Development.

As shown in figure 4.7 a rather large share of the population have access to electricity, while only slightly more than half of the population have access to water inside, or outside, their home. Less than half of the population have the use of a private, or common, WC in, or near, their house.

Figure 4.7: Coverage of basic services – total population



Source: Ministry for Housing and Urban Development, El Salvador (based on EHPM, 2004).
Note: Electricity refers to private connection of electricity, water refers to access to water pipes inside or outside the home, and sanitation refers to access to a private or common WC.

Next, the impact of remittances on the housing standards will be explored. Could the reception of remittances improve the housing standards in El Salvador in a significant way?

4.4 The Relation between Remittances and Housing

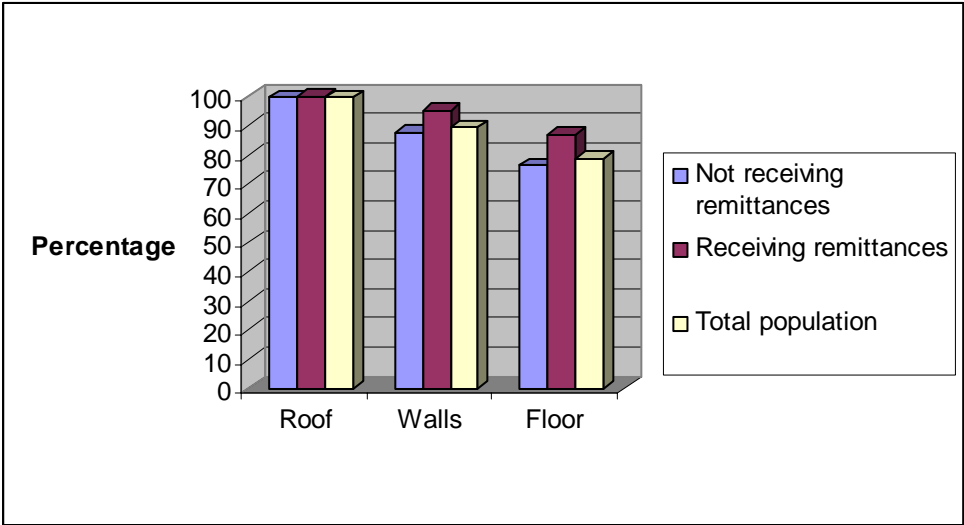
This part explores the potential impact of remittances on housing standards and on tenure. Moreover, the preferences regarding credit for housing are further examined.

4.4.1 Housing standards among remittance receivers

As the upcoming figures show, receiving remittances seems to have a significant impact on housing standards. Especially the impact of remittances on the use of adequate materials for building walls and floor can be noted (figure 4.8). Among the remittance population approximately an additional ten percent benefit from a satisfactory standard of walls and floors in comparison to the population not receiving remittances. But, little or no impact on the roofs is distinguished, barely surprising since almost all households already enjoy an

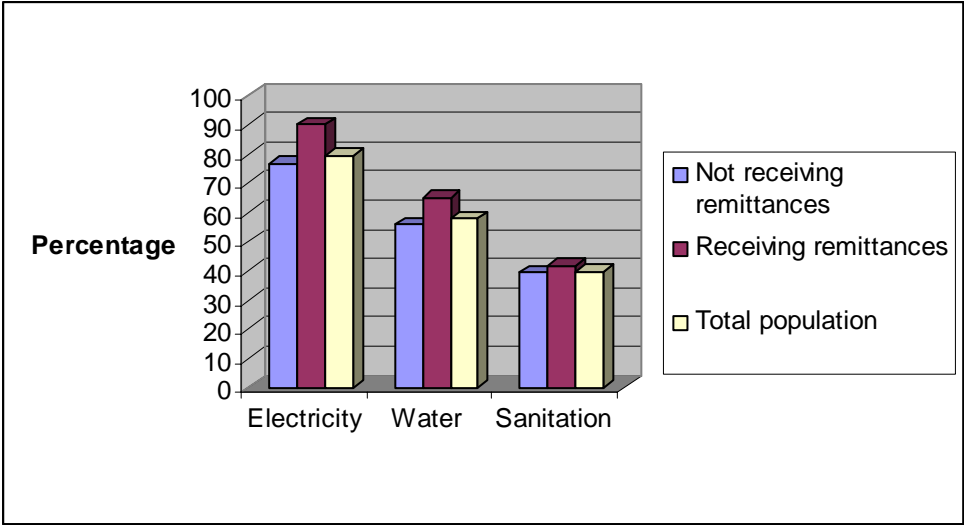
adequate roof. Furthermore, receiving remittances is demonstrated to have a considerable impact also on the coverage of basic services (figure 4.9). Noteworthy is the impact of remittances on the access to electricity, an increase in the coverage of about 14 percentage points, when comparing households receiving remittances with households that do not. Receiving remittances also seems to improve access to water significantly. Remittances show less impact on access to sanitary services, although a slight improvement is noted there as well.

Figure 4.8: Impact of remittances on housing – use of adequate materials



Source: Ministry for Housing and Urban Development, El Salvador (based on EHPM, 2004).
 Note: Materials; roof refers to aluminium sheet or roofing tiles of clay and cement, walls refer to different mixes of clay and cement and floor refers to bricks of cement and clay or only cement.

Figure 4.9: Impact of remittances on housing – coverage of basic services

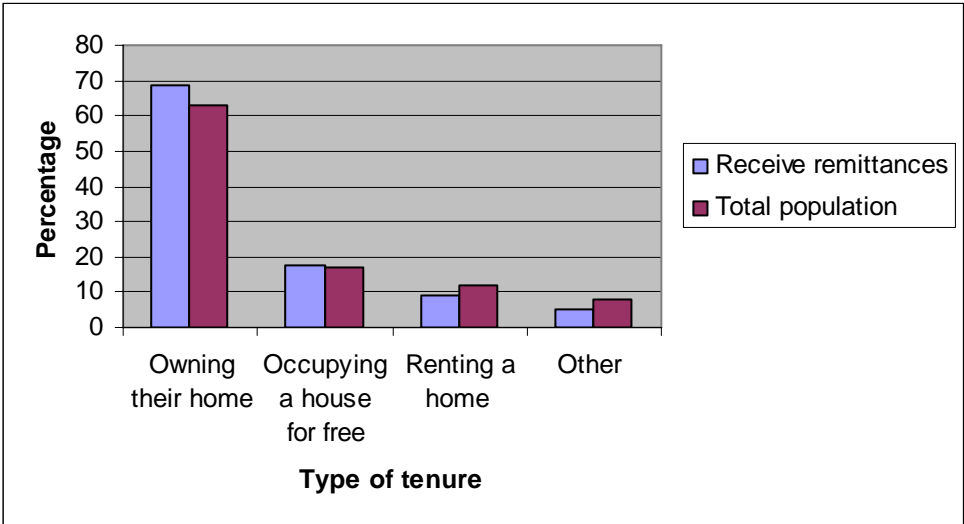


Source: Ministry for Housing and Urban Development, El Salvador (based on EHPM, 2004).
 Note: Electricity refers to private connection of electricity, water refers to access to water pipes inside or outside the home, and sanitation refers to access to a private or common WC.

4.4.2 The impact of remittances on tenure

Receiving remittances seems to have a positive effect also on tenure. Among the remittance receivers proportionately more people own their house and fewer people rent. A higher share of the households receiving remittances report that they own their home compared to the total population. Also a smaller fraction among the remittance receivers report that they are renting their home. Due to lack of data on households that do not receive remittances the comparison is done on the value for the total population. Since the value for the total population includes the population receiving remittances, it follows that the actual differences are greater than shown in figure 4.10.

Figure 4.10: Impact of remittances on housing – type of tenure



Source: EHPM, 2005 and the Ministry for Housing and Urban Development, El Salvador.

The results show that receiving remittances has a positive impact both on housing standards and on tenure. This may imply two things, either that remittances actually increase the housing standard, or that households that are better off have a higher propensity to invest in sending a family member abroad in the first place. However, as pointed out earlier, at least 30 percent of the remittance receivers in El Salvador belong the poorest fifth of the population, indicating that remittances loosen the budget constraint faced by those households, making resources available for housing investments. Moreover, I have already referred to studies showing that remittance receivers, compared to households not receiving remittances, spend a smaller share of the total household income on food and a larger share on housing, education and health. According to those studies the changes in spending patterns are true also for El Salvador. A significant effect has been found for spending remittances on housing

improvements in El Salvador. Combined with the results presented, I find it likely that receiving remittances positively affect the housing standard.

However, without access to financial products the potentially great impact of remittances on housing will be limited. The next section explores how remittances can be captured into microfinance products with the aim of improving housing.

4.4.3 Preferences of credits for housing

There is still little market research done regarding preferences for new, or potential, microfinance products related to remittances. This is true for both the sending and the receiving end of the remittance flows. Linking remittances with microfinance products is a new innovation and, consequently, rather unexplored. Nevertheless, the increasing interest in this market's potential makes it important to undertake such studies. Both the IDB, in cooperation with universities in the US, and the microfinance institution Apoyo Integral are at the moment carrying out such market research (not yet concluded), in the US as well as in El Salvador. However, this section will highlight a couple of existing surveys in the field. Note that those studies are not comprehensive and therefore only serve as an indication of the potential for this market.

According to a survey among Latino remittance senders and receivers, undertaken by the microfinance institution ACCIÓN¹²⁸ and supported by USAID,¹²⁹ credit products that enable the remittance senders to earmark funds for purchasing a home have solid market potential. However, the senders pointed out several obstacles that prevented them from purchasing a house in their home country. The main barriers identified were lack of credibility of home-country institutions, high interest rates, burdensome procedures and complicated legal issues.¹³⁰ Another survey, among remittance receivers in El Salvador, shows that 37 percent of the remittance senders have bought a property (a house or a piece of land) in their home country after moving abroad. The value of the property ranges from 24,000 to 31,000 US \$ on average. According to the remittance receivers 55 percent of the buyers paid for the property in cash, 22 percent used credit from a bank, and 23 percent of the receivers were not familiar

¹²⁸ For more information on ACCIÓN, visit www.accion.org

¹²⁹ United States Agency for International Development (USAID)

¹³⁰ Terry, D. – Wilson, S. (ed.), 2005, p. 144f

with the payment type used.¹³¹ The above surveys illustrate that there is a potentially great demand for investing in property in the home country. The latter survey further indicates that the majority of the people buying a property in their home country have the capacity to save up for this investment. Nevertheless, the fact that the major share of the buyers choose to pay in cash illustrates the existing lack of adequate financial products for this purpose. In addition, it can be an indication of the lack of trust in financial institutions. Thus, the many migrants that lack the capacity to save up for this kind of investment are consequently prevented from buying a property in their home country.

Creating financial products in accordance with the preferences of the transnational family in order to capture the great remittance flows is today's challenge. As earlier stated, transnational financial ties demand transnational financial services. The emergence of a rather new type of client, the migrant and his/her family, creates potential gains for those institutions managing to adapt their products in correspondence with this new market. An attempt to create such a product, linking remittances with microfinance products, will be presented next.

4.5 The use of remittances in housing microfinance: Evidence from El Salvador

This section will present one attempt to increase the development impact of remittances in El Salvador. The creation of a housing finance market for transnational families is underway, with the aim of enhancing the development effects of remittance flows. For this purpose a new financial product, a combination of remittances and microfinance, has entered the market.

4.5.1 A new product – The Transnational Credit¹³²

In late 2006 a new product was launched jointly by the microfinance institutions Apoyo Integral and Alante Financial (box 4.12). The product is called the *Transnational Credit* (Crédito Transnacional) and is a transnational financial product aimed at linking banking services between immigrants and their families, benefiting both the remittance sender and the receiver. The product has been introduced only in El Salvador (as of March 2007). The Transnational Credit is a loan given to the migrant in the US for the purchase of a home in El

¹³¹ Centro de Opinión Pública et. al., 2005, p. 3

¹³² When nothing else is stated; the information in this section is the result of repeated interviews with employees at the offices of Apoyo Integral and Alante Financial in San Salvador, El Salvador between Feb 5, 2007 and March 21, 2007.

Salvador benefiting the migrant's family. The purpose of introducing the credit is to create a housing finance market for transnational families – where the purchase of homes in El Salvador can take place from abroad – and to enhance the development impact of remittance flows.

Box 4.2: The link between Apoyo Integral and Alante Financial

Apoyo Integral is a microfinance institution in El Salvador, founded in 2002, serving 15,000 clients with a portfolio of credits amounting to 9 US \$ millions. The great majority, 73 percent of the clients, are women. Integral offers a wide range of microfinance products of which individual microenterprise credit (36 percent of the portfolio) and individual housing credit (29 percent) are the most requested ones. Apart from specialization in housing credits, Integral offers their clients financial services linked to remittances. This is done in cooperation with Alante Financial in the US.

Alante Financial is a network of microfinance service centers in the US owned and operated by Microfinance International Corporation. The head quarters of Alante are located in Washington DC and several offices are found along the North American east coast.¹³³ The aim of Alante is to offer financial services in communities which banks typically do not reach, and their special niche is to serve the Latino immigrant in the US. Alante provides services in Spanish, extensive knowledge about Latin America and the Caribbean and 22 partner institutions in ten countries across the region.¹³⁴ Alante works extensively with remittances, offering money transfer services, and cooperates with banks, microfinance institutions and credit unions in the receiving countries. Apoyo Integral, located in El Salvador, is one of their partners.

Source: <http://www.integral.com.sv/>, <http://www.asomi.org.sv/83.0.html> (Apoyo Integral), <http://www.alantefinancial.com/> and <http://www.mfi-corp.com/> (Alante Financial) (2007-06-18).

How does the Transnational Credit work?

The remittance sender in the US – client of Alante Financial – is the one applying for the credit, and will be the owner of the house. At the moment (March 2007) no credits are given for improvements of houses. Alante investigates the risk, that is the borrower's capacity and willingness to pay, in accordance with microfinance practice. The house to be purchased is located in the home country, El Salvador, where the remittance receiver – client of Apoyo Integral – is living. The risk, in case of default, is assumed jointly by Integral (50 percent) and by Alante (50 percent). The amount approved for the credit is a minimum of US \$ 8,000, where the loan at maximum covers 80 percent of the total costs. Hence, the client him/herself is obligated to pay the remaining 20 percent.

4.5.1.1 The typical client

The heading of this part is somewhat misleading. Up to the date of the study (March 2007) only two transnational credits had been approved, while ten applications had been dismissed. Therefore it is not possible to generalize on the results, nor discuss *typical* clients. However, to get a picture of what a typical client in the US (remittance sender) may look like I

¹³³ Eight agencies are located in Washington D.C, in Maryland, in Delaware and in Virginia.

¹³⁴ Alante Financial has partner institutions in Mexico, Guatemala, El Salvador, Nicaragua, Honduras, Dominican Republic, Colombia, Ecuador, Peru and Bolivia.

interviewed Alante Financial. According to them, there are some characteristics in common for remittance senders approved for, or interested in, this new loan.

The great majority of the applicants are men while the main beneficiaries in El Salvador are, or would be, women. The approved client in the US has a stable job and a stable income (at least US \$ 4,500 a month), and some sort of credit history with Alante or other microfinance institutions. The approved clients are residing legally in the US and have been living there for about 5-10 years. Moreover, they have at least 6-9 years of schooling and speak English well. The objective of the loan is to help the family, or a combination of help and own investment. Regarding the future the clients are not interested in moving back yet, but they feel sentimentality and as a result they maintain strong family links.

These characteristics make the clients approved for the credit not quite representative for Salvadoran remittance senders in the US. For example, almost a quarter of the migrants are residing in the US illegally, making them not at all eligible for the credit (see section 4.2.3). One can further question whether people having a high monthly income should obtain credit from a microfinance institution. But, using a MFI for financial services is not exclusively connected to income levels and poverty. One has to bear in mind that reasons like lack of inclusion in the financial system, lack of collateral when applying for a credit and lack of trust in commercial banks are also determining factors.

The clients who have applied for a credit but have been dismissed, or not yet been approved, also share some characteristics in common. Three features constitute the most important obstacles to being qualified for the credit. Firstly, many applicants do not have adequate permits for their residence in the US, preventing them from obtaining the credit. There is a large interest among undocumented workers to buy a house in the home country.¹³⁵ But to be eligible the migrant must be legally residing in the US. Secondly, among the applications dismissed a majority have shown interest in buying a specific house in the neighbourhood where they grew up. To buy specific houses is a very costly procedure and sometimes it is even impossible to acquire the requested house. Thirdly, the immigrants lack confidence in institutions and therefore do not easily furnish the information required. Consequently, it is a time consuming and costly procedure to get to know the customer in order to evaluate credit

¹³⁵ According to interviews with the commercial bank *Banco Salvadoreño*, also interested in penetrating the housing market for the poor, a great demand for housing credits comes from undocumented workers in the US.

worthiness (capacity and willingness to pay). Complicating it even more, the immigrants usually have more than one job and thus long work days and therefore – especially in large cities like Washington DC – the client might only be able to visit the office once or twice a month.

Of the two transnational credits that have been approved, I had the opportunity to visit only one of the beneficiaries in El Salvador. Although this single case has limited value, it serves as an illustration of what the client on the receiving end may look like. The beneficiary interviewed in El Salvador is a single mother with the son in the US for several years. According to the mother the son plans to move back to the home country in the future, but not yet. The idea of buying a house in El Salvador came from the son, who was being informed in the US. The housing credit amounts to US \$ 352 to be paid every month by the son. This means that the mother today receives approximately 50 percent less in remittances than she used to receive and that she consequently has had to abstain from certain consumption. However, both the mother and the son prefer to invest in a house rather than to consume, as is also showed by applying for the credit. The mother especially points out security as an important reason for buying the house. Now she feels much safer than before.

4.5.1.2 Problems with the product

Only a short time has passed since the transnational credit was introduced. However, there were great expectations of the demand for this product even in the short term. Instead it has started out on a smaller scale than anticipated. Due to the limited access to data it is not possible to generalize on the results. Nevertheless, both Alante and Integral have ideas about why the credit has not turned into a success as yet.

According to Apoyo Integral the disqualification of the undocumented immigrants in the US poses a major problem since these potential clients constitute a significant part of the market that is not being captured. Another main problem with the Transnational Credit is the lack of promotion of the product, both in El Salvador and in the US. The potential clients still lack information about the existence of the product. Moreover, according to Integral, products that cross the borders like the Transnational Credit encounter legal difficulties due to different regulations in the countries involved. In addition, due to existing Salvadoran law, time consuming and costly judicial problems can arise in case of default. Then seizing the house is

a complicated and costly procedure due to legal reasons. This makes the initial evaluation of the customers' credit worthiness even more important.

Institutional problems are, according to Alante Financial, the reasons why the start-up of the Transnational Credit has been slow. The principal objective of Alante is not to promote and sell the Transnational Credit. The aim of the business is to capture the resources of the Latino immigrants in the US and offer them services, where the Transnational Credit is but one of the products of the portfolio. Moreover, Alante reports lack of personnel resources to promote the product and to capture clients. At the moment only one person at the company works on remittances. Apart from this, since the product is new, reconfiguration of the product is needed before promoting it on a larger scale.

4.5.1.3 Possible solutions and discussion

According to Integral the solutions are information based. They include the building of alliances with North American companies and universities to promote the product and capture the clients in the US as part of the solution. There has to be publicity in Salvadoran newspapers in the US but also in newspapers, radio and television in El Salvador. Moreover, Integral stresses that the laws involved in this product need to be looked over and facilitated.

According to Alante, the validation of the product is of crucial importance before initiating a big promotion campaign. Focus groups have been set up by Alante with the aim of evaluating and improving the product. When the reconfiguration of the product is concluded efforts will be devoted to gaining new customers.

To sum up, I find the main obstacles to be due to a combination of external and internal factors. The critical problems appear to be the legal issues that arise when creating a product that is aimed to cross the borders; the disqualification of many potential customers that are undocumented workers; and that the product is not yet fully developed and adequately promoted.

According to me the legal problems are crucial to solve, such as simplifying the costly and time consuming paper work and making the undocumented workers eligible for the credit, in order for this type of product to grow and prosper. Then it would be more promising to further promote the product on a broader scale. In this context the key role of the government cannot

be understated. The role of the government must be to enable the market to function in a proper manner. Its role is therefore to facilitate laws and regulations so that innovative products, corresponding to the demands of the clients, can be developed.

Nevertheless, the Transnational Credit provides an answer to the lack of financial products of this kind, linking the demand of the migrant with the demand of the family in the home country. Although the product needs to be developed and improved, it forms an important contribution in the struggle to make financial services available also for the poor.

4.6 Concluding remarks

El Salvador is a country with great out-migration, having more than a third of its population living abroad. This results in a large amount of remittances entering the country, amounting to almost a fifth of the country's GDP. The major part of the remittances is used for consumption and to pay for daily expenses. Only small shares of the remittances are directed to investment goods of some kind, such as housing, education and savings. Housing is important due to its long-term development effects. In El Salvador the housing standard is poor, especially in rural areas, which affects the possibilities for individuals and households to escape poverty.

My exploration of housing and remittances in El Salvador shows that receiving remittances is likely to have a positive effect both on tenure and on housing standards. Several studies further indicate that the households receiving remittances are able to spend more on housing improvement than households without remittances.

Nevertheless, without access to financial products the potentially great impact of remittances on housing will be limited. Therefore, remittances need to be captured into microfinance products in order to maximize the development impact for the poor population. Surveys among remittance receivers indicate that there is a demand for using remittances for housing microfinance. This demand is thought to be met by the recently introduced Transnational Credit. A comprehensive study on the credit is yet too early, but the problems seem to be due to legal issues; the disqualification of undocumented workers; and the lack of full development, and adequate promotion, of the product.

5. SUMMARY AND CONCLUSIONS

5.1 Summing up

This thesis is an exploration of a new innovative area of microfinance. It shows that there are opportunities to link microfinance and remittance services in order to facilitate the channelling of remittance money flows into important investments. The thesis examines how to capture the great potential of both remittances and microfinance in order to achieve increased development effects. The case study of El Salvador investigates the impact of remittances on housing and shows that an innovative transnational product, introduced among Salvadoran remittance senders and receivers, creates an option for potentially solving problems on the housing credit market.

My thesis questions to be answered by this study are;

- *How can the development effects of remittances be enhanced?* This study investigates one method that can lead to enhanced development effects; through capturing the great potential of remittance flows and channelling them into long-term investments, such as housing.
- *How can remittances be used to finance housing for poor and low-income households and hence solve problems on the credit market?* This study examines the Transnational Credit as a way to channel remittances into housing microfinance and, at the same time, solve problems on the credit market.

This study leads to the following conclusions:

Receiving remittances improves housing standards

My study on housing and remittances in El Salvador shows that receiving remittances is likely to have a positive impact both on tenure and on housing standards. In particular, receiving remittances has a positive effect on basic services such as electricity, water and sanitation services. My results indicate that the population receiving remittances is able to spend more on housing improvement than households without remittances. Remittances appear to loosen the budget constraint that poor households are facing and make resources available for housing investments, which is also confirmed by other recent studies. These show that

households receiving remittances, compared to households without remittances, spend a smaller share of the total household income on food and a larger share on investment goods such as housing, education, and health. These results challenge the idea that remittances are mainly used for consumption. Even though this might be true in absolute terms; at the margin remittances are increasingly used for investment purposes. Consequently, this may indicate that remittance receivers would invest more in their housing if they were not lacking adequate financial products.

The development effects of remittances can be enhanced by a combination with microfinance products

The thesis explores how remittance flows can be channelled into microfinance by use of a case study of a new transnational housing microfinance product in El Salvador. The recently introduced Transnational Credit is a housing finance product for migrants and their families. The product is helping to solve problems on the credit market. The model is to link the transmitted funds directly to microfinance products, creating transnational financial products that can help immigrants and their families to achieve investment goals. Its combination with microfinance practice makes the product reduce market failures such as lack of collateral, poor information and high transaction costs. Promoting the development of remittances services through microfinance institutions aims to increase the banking of recipient families and facilitate their access to financial services. In the end this is thought to enhance the economic impact of remittances.

A comprehensive study on the outcomes of the Transnational Credit is yet too early. However, there seems to be a demand for housing microfinance products. The problems encountered so far appear to be due to difficulties with laws and regulations; the disqualification of undocumented workers; and the lack of full development, and adequate promotion, of the product. It is therefore of crucial importance to facilitate the burdensome paper work required and to include the undocumented workers now excluded. Then the product can be further promoted in a more successful manner. Against this background it is of key importance that the government recognizes its role as an enabler, instead of as provider, of services. Creating laws and regulations that facilitate the development of products, corresponding to the demands of the clients, is a central task for the government.

Transnational financial products and services are needed as migration increases

Migration is no longer a one-way process, instead migrants continue to stay active in their families' lives and they participate simultaneously in two communities. The thesis points out that the emergence of transnational families is a growing phenomenon not yet sufficiently addressed. As migration increases and remittances augment, the need for transnational financial products and services rises too, as shown by this study. The emergence of this new type of clients makes it crucial to meet their demands and to adapt financial products in accordance with their needs. If this is successfully done, it will increase the banking and access to financial services for transnational families and it will lead to those families having more money available for their own purposes. Promoting the development of remittances services through microfinance institutions can therefore be one way to increase the banking of recipient families and facilitate their access to financial services.

5.2 Policy implications and future research

This study emphasises the powerful force that remittances can constitute in order to open up financial systems. Remittances could make a greater impact for individuals, households and societies if better access to banking and financial services were provided. To that end formal financial intermediaries need to enter the remittance market more actively. In this context, governments can play an important role as an enabler, by reducing entry barriers and facilitating the rules and regulations. Also of utmost importance are the microfinance institutions that need to adopt new techniques to meet the demands of the communities of today.

Financial services will have to respond to the dynamics of the transnational family, as migration increases, in order to generate significant development effects. As stated earlier, transnational financial ties demand transnational financial services. Financial products that cross the borders, responding to the needs of the migrants and their families, must therefore be developed and the corresponding laws and regulations adapted accordingly. Migrants live in two worlds and their needs must be reflected in the market for financial products.

To link remittances with microfinance products is a new innovation and as a result rather unexplored. Too little research still exists on the potential demand for this type of financial products, both at the sending and the receiving end of the remittance flows. Better information

is needed about the magnitudes and sources of remittances, including both inflows and outflows. It is important that further studies do not forget that the client base consists of *both* remittance senders and receivers, making it key to consider the migrants' preferences as well. Without comprehensive information the development of new financial products, serving the needs of both remittance senders and recipients, will remain extremely difficult.

If the efforts to improve the access to financial products for the remittance population turn out successful, transnational families will have more money available for their own purposes. In the end they will be empowered by more options in using their resources and find more ways to improve their living conditions.

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6.2 Electronic sources

ACCIÓN INTERNATIONAL

<http://www.accion.org/>

ALANTE FINANCIAL

<http://www.alantefinancial.com/>

APOYO INTEGRAL

<http://www.integral.com.sv/>

ASOCIACIÓN DE ORGANIZACIONES DE MICROFINANZAS

<http://www.asomi.org.sv/>

DIGESTYC

<http://www.digestyc.gob.sv/>

THE GRAMEEN BANK

<http://www.grameen-info.org/>

THE INTER-AMERICAN DEVELOPMENT BANK

www.iadb.org/

THE INTERNATIONAL ORGANIZATION ON MIGRATION

<http://www.iom.int/>

MICROFINANCE INTERNATIONAL CORPORATION

<http://www.mfi-corp.com/>

WIKIPEDIA

<http://www.wikipedia.org/>

THE WORLD BANK

<http://www.worldbank.org/>

6.3 Interviews

A number of interviews were conducted in El Salvador between February 5 and March 21 2007. A complete list of persons interviewed can be obtained from the author upon request.

Appendix EL SALVADOR



El Salvador is located in Central America and shares borders with Guatemala and Honduras. It is the smallest country in continental America and has a total area of 21,040 km² of which only 1.4 percent is covered by water. The population of El Salvador is, according to official data, 7.0 million inhabitants (2006) and the population density is 332 persons per km².¹³⁶ The capital is San Salvador and the official language is Spanish. The country got its independence from Spain on September 15 1821. El Salvador is a republic, presently governed by the right-wing party *Arena* and the president, elected in 2004, is Antonio Saca. The inequality in the country is high, the Gini coefficient¹³⁷ amounts to 52.4 (2002). The Human Development Index (HDI)¹³⁸ is medium; 0.722 (2006).¹³⁹

¹³⁶ <http://www.digestyc.gob.sv/> (2007-08-09)

¹³⁷ The Gini coefficient is a measure of the inequality of an income distribution. It is defined as a ratio with values between 0 and 1. 0 corresponds to perfect income equality (i.e. everyone has the same income) and 1 corresponds to perfect income inequality (i.e. one person has all the income, while everyone else has zero income).

¹³⁸ The Human Development Index is a comparative measure of life expectancy, literacy, education, and standard of living for countries worldwide. It ranges from 0 to 1.

¹³⁹ http://en.wikipedia.org/wiki/El_Salvador (2007-07-09)