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# **Remittances and Poverty in El Salvador**

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## **Abstract**

With larger income gaps and opportunities between rich and poor countries, world labour migration has increased, and so have remittances from international labour migrants. Since remittances are an important source of income for many developing countries of the world, there is a need for studies that address effects of remittances on the receiving economy. The objective of this thesis is to study the impacts of remittances on poverty in El Salvador, one of the major remittance receiving countries of the world. The study is mainly based on data from the national household surveys 1996-2003. It is found that remittances contribute significantly to lower the poverty levels in El Salvador. The benefits from remittances do not reach all poor households and do not seem to contribute to an equalized income distribution in the country. Therefore, encouraging the inflows of remittances need to be part of a broader long-term poverty reduction strategy since remittances alone will not be enough to eliminate poverty.

Keywords: Remittances, Poverty, Income inequality, Rural, Urban, Migration, El Salvador

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## **List of Abbreviations**

ASIPES	Association for Economic and Social Investigation and Promotion in El Salvador
BCR	Central Reserve Bank of El Salvador
DIGESTYC	Directorate General of Statistics in El Salvador
EHPM	The National Household Surveys for Multiple Purposes in El Salvador
FDI	Foreign Direct Investment
FUSADES	Salvadoran Foundation for Economic and Social Development
GDP	Gross Domestic Product
IADB	Inter American Development Bank
IMF	International Monetary Fund
IOM	International Organization for Migration
IPEA	Institute for Applied Economic Research
LAC	Latin America and the Caribbean
MIF	Multilateral Investment Fund
NELM	New Economics of Labour Migration
ODA	Official Development Aid
UNDP	United Nations Development Program

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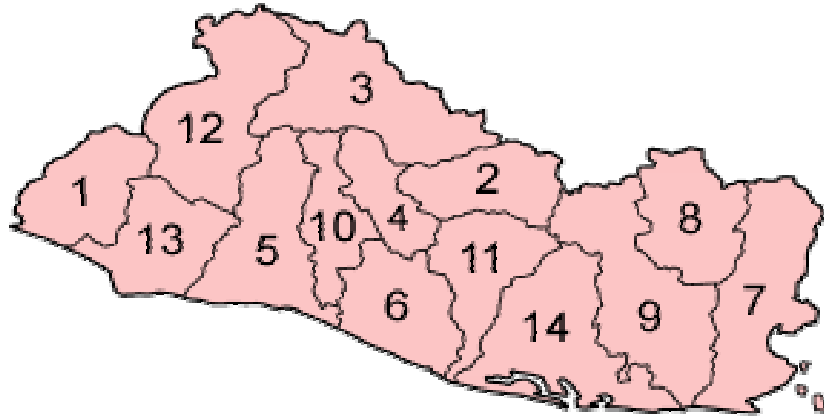
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## Political Map of El Salvador



### Departments:

- |                 |                  |
|-----------------|------------------|
| 1. Ahuachapán   | 8. Morazán       |
| 2. Cabañas      | 9. San Miguel    |
| 3. Chalatenango | 10. San Salvador |
| 4. Cuscatlán    | 11. San Vicente  |
| 5. La Libertad  | 12. Santa Ana    |
| 6. La Paz       | 13. Sonsonate    |
| 7. La Unión     | 14. Usulután     |

Source: Wikipedia, [http://en.wikipedia.org/wiki/El\\_Salvador](http://en.wikipedia.org/wiki/El_Salvador) (2005-09-20)

# 1. Introduction

## 1.1 Background

As a result of increasing labour migration, remittances have come more and more into focus as a contributor to development of the migrant sending countries. Remittances can be defined as the share of international migrants' earnings that are sent back to the country of origin from the host country.<sup>1</sup> The volume of remittances to developing countries has augmented rapidly over the past decades. IMF estimates that remittance inflows have grown five-fold between 1980 and 2003 to reach US\$ 91 billion in total. The sum is larger than all other private capital inflows, and represents 1.6 percent of developing countries' GDP.<sup>2</sup> Latin America and the Caribbean are both the fastest growing and highest volume remittance markets in the world and remittances now constitute an important flow of foreign currency to the majority of the countries.<sup>3</sup>

El Salvador is one of the major beneficiaries of remittances. Entering the capital, San Salvador, from the road leading to the international airport, there is a great monument<sup>4</sup> representing all Salvadorans living abroad. It gives an indication of the importance of migration to the Salvadoran society. Around 2.7 million Salvadorans live outside El Salvador, which is a large number considering that the country has about 6.7 million inhabitants. The large inflows of money to El Salvador from the Salvadorans who live and work abroad, mainly in the United States, have made remittances an important part of the Salvadorian economy. Almost one of four households in El Salvador has remittance income, which makes El Salvador more dependent on remittances than any other Latin American country.<sup>5</sup>

The impact of remittances on developing countries is a relatively new area of research. Until relatively recently, economic researchers emphasized the negative aspects of remittances. Common arguments were that remittances mainly were spent on consumer goods, and that they seldom were invested in productive activities that would benefit the

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<sup>1</sup> See for example IOM, 2003, p.226

<sup>2</sup> IMF, 2005, p. 71

<sup>3</sup> IADB, 2003

<sup>4</sup> Los hermanos lejanos (The far away siblings)

<sup>5</sup> DIGESTYC, 2004

economies of the developing countries. Another argument was that the receivers would become dependent on the extra source of income. More recent studies show that remittances have a far more positive impact on communities in developing countries than previously acknowledged.<sup>6</sup> Different studies can show contradicting results depending on what factors are considered and what country or region is investigated. The majority of the country and region studies have focused on South Asia, the Middle East and Mexico. Few studies have been conducted in El Salvador, and very few results are based on information from the yearly national household surveys that are coordinated by the Ministry of Economy. This motivates a case study of the impacts of remittances, using the household surveys.

## **1.2 Objective**

The objective of this thesis is to assess the impact of remittances on poverty in El Salvador.

In order to reach my objective I will address following questions:

- What determines remittances?
- What are the potential impacts of remittances on the receiving economy?
- What are the characteristics and use of remittances in the case of El Salvador?
- What are the characteristics and patterns of poverty in El Salvador?
- What are the impacts of remittances on poverty in El Salvador?

## **1.3 Methodology and limitations**

The scarce time frame has limited me from conducting own primary research. Nevertheless, there is a need for studies based on information from the national household surveys as well. The main source for this study is the Multi Purpose Household Surveys (EHPM) that is carried out every year by the Directorate General of Statistics in El Salvador, DIGESTYC. Another main source of data is the Central Bank of El Salvador (BCR), from where I have collected economic indicators. Other important sources are a theoretical framework on remittances and poverty, earlier published studies, and general information on El Salvador.

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<sup>6</sup> Martin, 2001

The choice of 1996-2003 as the primary time period for my analysis is 1) because remittances were more profoundly examined in the surveys from the year of 1996, and 2) because the surveys from 2003 are the most recent available. For some data there has not been information for the chosen time period. This is why data for shorter periods are shown in some cases. El Salvador is divided into 15 regions, so called departments. Information on remittances and poverty for each department will be examined. Department specific information is not available for the years 1996-97.

Since there are many different ways in which remittances can affect poverty, this study is limited to mainly focus on the direct impacts of remittances on poverty. However, to understand the relation between remittances and poverty, the indirect effects of remittances will also be discussed.

## **1.4 Outline**

*Chapter 2*, will present migration and remittance theories where the main theoretical framework of motives and determinants of remittances will be introduced. The theoretical approaches to the impacts of remittances will also be discussed. *Chapter 3* will highlight the case of El Salvador. Brief information of the country's economical structure will be followed by the migration and remittance trends, patterns and characteristics in El Salvador. In *Chapter 4*, I will discuss poverty measurements, theories and characteristics and patterns of poverty in El Salvador. Finally, in *Chapter 5*, the relations between remittances and poverty will be analysed. The conclusions will be presented in *Chapter 6*.

## **2. Remittances: Motives, and Impact on Poverty**

The purpose of this chapter is to give a general picture of the theories that are of importance for an analysis of the findings in this study. Empirical evidence on the impacts of remittances on poverty will also be considered. Remittances as a focus for theoretical studies have only existed for a few decades. As remittance is a relatively new area of research, the theoretical framework in this area is scarce. Since the 1980s, the microeconomics of remittances have in large been focused on familial and strategic motives as determinants of remittances. In the macro economic area, the research has shifted towards more consideration for the long-term economic effects of remittances. In the 1970s and 1980s, static trade models were often used to explain short run effects of international transfers. With the New Economics of Labour Migration (NELM), focus has changed to long-run considerations, notably the role of remittances in the dynamics of poverty, inequality and economic development.<sup>7</sup>

The theories that most frequently are being quoted in the literature are presented in the following pages. They illustrate the motives for remitting and what determines the size of remittances. They also give a picture of the potential impacts of remittances.

### **2.1 Determinants of remittances**

Russell (1986) argues that factors can have an impact on decisions, such as whether to remit or not, how to remit, and what amount to remit. Thereby, these factors can increase or decrease the actual flow of remittances. The determinants of remittances that are expected to have a definite positive correlation to remittances are: number of workers abroad; economic activity in host and labour source country; facility of transferring funds; and the marital status of the migrants (married migrants tend to remit more money to their families).

The factors that are expected to have a definite negative correlation to remittances are: political risk factors in source countries (the greater the risk, the smaller the possibility of remitting); the ratio of females in the migrated population in host country (the greater

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<sup>7</sup> Rapoport and Docquier, 2003, p.3

the ratio of females, the lesser the amount of remittances, possibly because female migrants more often bring the children when migrating and therefore there is less need to remit money home); the number of employed people in the household; the level of education; and the occupational level of migrants (it is assumed that poorer families tend to send migrants with lower education and skill levels abroad).<sup>8</sup>

There are also factors that may have a positive or negative impact on remittances depending on the individual country/household situation: wage rates; exchange rates; relative interest rates, and years since out-migration.<sup>9</sup> The outcome of the remitting decisions will depend on the motives for remitting.

## **2.2 Remittance motives: altruism and self interest**

Motivations to remit influence how remittances are used, and therefore it is important to consider the motives for remitting in order to understand the economic effects of remittances on the receiving economy. Oded Stark (1991) has studied motives for remitting in rural-urban migration. Theoretical considerations by Stark of the determinants of remittances present two extreme motives for remitting; altruism, i.e. the care the emigrated worker has for the family left behind, and self-interest motives, i.e. a form of investment as insurance for future returns.

The motives for remitting can be a mix of altruism and self-interest. This theory is called tempered altruism or enlightened self-interest and explains the motives for remitting as an agreement between the migrant and the rest of the family, aimed to benefit both parties. The agreement considers investment and risk. Remittances can be seen as a means of spreading the risk when the insurance and the capital markets are imperfect. A positive correlation between the amount of remittances and the migrant's education level has been interpreted in the tempered altruism theory as repayment to the family for education investments. This does not mean that an educated migrant will send a higher fraction of the wage than a non-educated migrant, but rather that in order for the family to be repaid for investments in education for the migrant, remittances will have to rise with higher education. Since higher education often correlates with a higher

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<sup>8</sup> Russell, 1986

<sup>9</sup> Ramamurthy, 2003, pp. 65-66

wage level it can be seen as an altruistic motive by the educated to remit, and not a return of investment for the family.<sup>10</sup> Hence, in comparison, the motives for remitting should rather be seen in the context of the fraction of wage remitted than the amount remitted.

The altruism model also shows a positive relation between remittances and wage, and therefore education. Whatever motive is behind remittances, the income of the migrant affects the amount remitted. What mainly separates pure altruism from tempered altruism is that the pure altruistic motives for remitting are, in addition, affected by the income and the size of the receiving household, where lower household income is compensated by higher remittance income. The self interest motives to remit are, on the other hand, determined by potential inheritance, future possibility of returning home and business opportunities and other investments in the home region that can be secured by family members left behind.<sup>11</sup>

In summary, according to the altruistic theory, the amount of money remitted rises with higher wage levels, household income and the size of the household. In tempered altruism, remittances increase with higher education (and thereby wage level) and are affected by changes in the insurance and capital markets. If the motives are self-interest, remittances will increase with higher household income, future possibility of returning home and return of investments.

### **2.3 The impacts of remittances**

Remittances can have an impact upon the receiving economy in different ways. Glytsos (2001) describes the channels through which remittances can affect the receiving country. There is no consensus in the literature as to whether the remittance inflows give a positive or negative effect on poverty. In the current thinking on migration and development, two opposing perspectives can be seen: the *Migrant syndrome* perspective, and the *Developmentalist* perspective. The reality will probably lie in between the two extremes, and depend on the characteristics of the studied region. These issues will be further explained in this chapter.

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<sup>10</sup> Stark, 1991, pp. 237-239

<sup>11</sup> Ibid

### 2.3.1 Remittance channels

Generally there are two major channels through which remittances can have an impact on the receiving economy on a macro economic level, as described by Glytsos, 2002. Firstly, as foreign exchange through the balance of payments, and secondly, as income that is either saved or consumed.

1. Foreign exchange influences economic development and growth through demand and supply factors. The financial inflows result in short- or long-term implications for the economy. In the literature of development economics the lack of foreign exchange is described as an impediment for development.<sup>12</sup> The extra inflow of foreign exchange from remittances would imply that the balance of payments improves. There would be an increase of the total amount of money available without affecting the inflation rate, and as a result the national currency would become stronger.<sup>13</sup> However, the appreciation of the national currency may diminish the competitive power of national tradable goods and thereby cause a deficit in the external current account, e.g. Dutch disease.<sup>14</sup>
2. If remittances are saved they can lead to higher investment and economic growth, according to traditional economic models. If remittances are consumed, they can affect the receiving economy differently depending on the consumer behaviour. If remittances are used for purchase of imported goods, it can result in trade deficit and higher inflation.<sup>15</sup> The effects of remittances hence depend on how the receiving households use the money.

Due to the risk of moral hazard and the loss of skilled workers, investment and consumption can be partly offset by production reduction.<sup>16</sup> Remittances can also make households dependent on the extra source of income. This is a risk for the households, particularly if the remittance flows are unpredictable. The implications concern the households involved, but can also affect the economy in total, considering that

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<sup>12</sup> Glytsos, 2002, pp. 5-6

<sup>13</sup> Ramamurthy, 2003, p.64

<sup>14</sup> Dutch disease occurs when an inflow of foreign currency raises the value of that nation's currency, making domestic goods less competitive with other nations, leading to increasing imports and decreasing exports (see for example Bourdet and Falck, 2005)

<sup>15</sup> Ramamurthy, 2003, p.65

<sup>16</sup> Ratha, 2003, p.164

remittances often constitute more than 50 percent of household income used for consumption. Therefore, a decline in remittances implies that consumption would decrease drastically.<sup>17</sup>

Since the major part of remittance inflows is often used for current consumption, it has been argued that remittances are an unproductive source of income. Remittance-receiving households spend more money on consumption than non-remittance-receiving households. However, since remittance-receiving households often have a larger income in total it should be expected that their consumption would be higher. Accordingly, it is important to compare the difference in proportions of the spending patterns between remittance-receiving and non-remittance-receiving households when studying the impacts of remittances.

The use of remittances for consumption may not only be seen as unproductive. Even if the main part of the remittance income is allocated to consumption, it can stimulate the national industry through higher demand for domestic goods. Through the multiplier effect, other households than the receiving ones can benefit from remittances. That is, on the assumption that the consumption of domestic goods increases, and the increased consumption is not entirely the purchase of imported goods.

### **2.3.2 Migration, remittances and poverty: opposing theories**

The impacts of migration and remittances on poverty are explained by two opposing theories: the “Migrant syndrome” perspective and the “developmentalist” perspective. The “Migrant syndrome” perspective, views migration as a drain on labour and capital resources of the migrant-sending area. According to this perspective, migration may reduce income in migrant-sending areas if the marginal product of a migrant’s labour is large prior to migration and/or if migrants take productive capital (including human capital) with them when they leave. Migrants’ remittances may only partially compensate for the loss of labour and capital effects, and remittances may also lead to inflation and Dutch disease.<sup>18</sup>

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<sup>17</sup> IOM, 2003, p. 230

<sup>18</sup> Taylor and Fletcher, 2001

From this pessimistic perspective, poverty may increase if migrants originate from poor households, or if the labour of poor farmers becomes less productive as a result of the lost labour and capital due to migration. For the migrant's source country, migration can be viewed as labour export and remittances are the payment for that export. In this way local production activities compete with migration for limited labour. The Dutch disease's effect on the economy can be noticed as production of tradable goods decreases.

The households with migrants will benefit (otherwise they would not migrate) but the rural poor households may not be among the beneficiaries. If migration is costly and risky, migrants may come from the middle or upper segments of the income distribution, and not from the poorest households. If migration adversely affects local production, the income of the poor may fall, and poverty increases. Further, as production and income decrease, this may create negative multipliers and a downward spiral in local economic activity. The remittance-receiving households may not spend their income on locally produced goods and services, which would limit migrations' potential to alleviate poverty through a higher demand for local production.<sup>19</sup> Families that receive remittances would in this case be able to buy imported goods, while the poor become poorer and income gaps increase.

The developmentalist perspective, which is associated with the New Economics of Labour Migration (NELM), presents a more optimistic view. It views migration decisions as part of a household strategy to raise income, obtain funds for investment, and insure against risk. Remittances, or even the potential for remittances, can offset production and investment constraints, and start a development process in poor, rural areas.

This perspective sees the potential for migration and remittances to reduce poverty, provided that the benefits of migration reach the poor. Remittances may contribute directly or indirectly to the income levels of the poor households that participate in migration. If migrants originate from poor households, remittances may directly reduce poverty by raising the income of the poor.<sup>20</sup> Additionally, if remittances are used to buy

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<sup>19</sup> Taylor and Fletcher, 2001

<sup>20</sup> Ibid

local products and services, they can contribute to development through higher demand. In this case, other households in the economy can increase their income through a higher productivity (the multiplier effect) and income gaps can thereby decrease.<sup>21</sup>

### **2.3.3 Impacts of remittances on poverty: empirical evidence**

A limited number of studies have investigated the impacts of remittances on poverty-related factors and there is no uniform theoretical framework. To sum up the impacts remittances may have on poverty, the following has been observed in the literature:

- i. Remittances have a direct effect on poverty by raising household incomes or extending the opportunities to increase incomes. Adams and Page (2003) found, in a cross-country study<sup>22</sup>, that an increase of remittance income of 10 percent in average led to a 1.6 percent decrease in the share of people living on less than \$US 1 a day. A recent cross-country study by IMF (2005)<sup>23</sup> also found a strong link between remittances and poverty, where a 2.5 percentage point increase in the remittances per GDP ratio was associated with a decrease in the share of people living in poverty by 0.5 percentage points.
- ii. Remittances may have an equalising effect on income distribution by reaching the poor. This is confirmed in South Korea (Kim 1983, 1986; Ro and So, 1988), Sri Lanka (Rodrigo and Jaytissa, 1989), Pakistan (Burney, 1989), and Mexico (Adelman and Taylor, 1990).<sup>24</sup> However, other researchers have found that because of the cost of migrating, mainly better-off households can afford to migrate, and thereby migrants' remittances may increase income inequality (Stahl 1982; Lipton, 1980 in India).<sup>25</sup>
- iii. Remittances allow receiving households to increase their consumption of local goods and services, which can have a multiplying effect, by which other households than the receiving households can benefit. Several studies have

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<sup>21</sup> IOM, 2003, p. 230

<sup>22</sup> A sample of 74 countries

<sup>23</sup> A sample of up to 101 countries over the period 1970-2003

<sup>24</sup> Quoted by Taylor, 1999

<sup>25</sup> Adams and Page, 2005, p. 279

found significant multiplier effects: Adelman and Taylor in Mexico (1990)<sup>26</sup>, and Glytsos in Greece (1993).

- iv. However, if remittances are used to buy imported goods, the result can be lower incomes for local producers, and larger income gaps between remittance receiving and non-receiving households. Unequalising income distribution has been found in Egypt (Adams 1991), and Central Africa (Russell et al. 1990)<sup>27</sup>.
- v. At a national level, remittances may provide valuable foreign exchange, and contribute significantly to GDP and employment, which may reduce poverty in the longer run. Indications supporting this are found in South Korea (Hyun 1989)<sup>28</sup>, Sri Lanka (Rodrigo and Jaytissa, 1989)<sup>29</sup>, and in Mexico (Meyers, 1998)<sup>30</sup>. However, the cross-country study by IMF (2005), found no statistically significant link between remittances and real per capita output growth.
- vi. There is important evidence of moral hazard in the form of lower labour participation, which in turn can have a negative impact on GDP. This phenomenon has been observed in Pakistan (Kozel and Alderman, 1990)<sup>31</sup>, El Salvador (Funkhouser, 1992)<sup>32</sup>, The Caribbean (Izigsohn, 1995)<sup>33</sup>, and in a cross-country study with data from 113 countries (Chami, Fullenkamp, and Jahjah, 2003). However, Andrade-Eekhoff (2003) found that remittances do not decrease the incentive to work in El Salvador, and thereby do not decrease labour supply. This study, as well as a study by Lungo and Kandel (1999), indicate that a higher income from remittances creates opportunities for the household members to seek other employment. Some of the younger generation seem to leave the agricultural sector for other employment or to start small businesses.

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<sup>26</sup> Taylor, 1999

<sup>27</sup> Quoted by Ramamurthy, 2003

<sup>28</sup> Quoted by Asch, 1994

<sup>29</sup> Quoted by Taylor, 1999

<sup>30</sup> Quoted by Ramamurthy, 2003

<sup>31</sup> Quoted by Asch, 1994

<sup>32</sup> Ibid

<sup>33</sup> Quoted by Chami, Jahjah and Fullenkamp, 2003

The empirical evidence presents support for both positive and negative impacts of remittances on poverty in different countries. The impacts depend on how strong the positive effects are in relation to the negative effects of remittances. This suggests that the country characteristics are important for the impact of remittances, and that the impact varies from country to country. It also means that the impact may change over time.

## 3. Economy, Migration and Remittances in El Salvador

### 3.1 Economic structure

El Salvador is a low-middle income country with an economy based on services, agriculture, and manufacturing. The population of working age is estimated to be over 2.5 million. Although agriculture accounts for only 8.7 percent of GDP, it is the largest source of employment, engaging 20 percent of the country's total work force. The manufacturing sector employs 18 percent of the work force and contributes 24 percent of GDP. The unemployment rate has been quite stable in recent years. It decreased slightly between 1996 and 2003 from 7.7 to 6.9 percent.<sup>34</sup> At the same time the informal sector has grown considerably.<sup>35</sup> The working population in the urban areas increased by 100 000 between 1999 and 2002, of which 94 000 were working in the informal sector. In total, 728 278 people (49.7 percent of the working population) were working in the informal sector in urban areas 2002, according to the EHPM.<sup>36</sup>

El Salvador experienced a trade liberalisation process during the last decade. However, this process has not been accompanied by policies to make Salvadoran exports more competitive on the international market. The result has been large trade deficits that could have generated an economic crisis in the absence of the inflow of foreign exchange through migrants' remittances.<sup>37</sup>

As a consequence of the structural changes resulting from the liberalization of the economy, traditional agricultural exports have been replaced by industry, manufacturing, service, and migrants' remittances. In 1990, the traditional export goods, principally coffee, represented approximately 45 percent of total exports. The sustained decline in coffee prices has decreased the activity in this sector. Real prices of most agricultural tradables experienced large declines during the first half of the 1990s.<sup>38</sup> The World Bank's Rural Development Study (1998) concludes that the most important

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<sup>34</sup> DIGESTYC, 2002 and 2003

<sup>35</sup> Defined by UNDP, 2004, p. 136, as employment in family activities of less than five workers, working on their own account, or employers of businesses with less than five employees in professions that are not technical or administrative.

<sup>36</sup> UNDP, 2004, p. 136-137

<sup>37</sup> Ibid, pp. 134-135

<sup>38</sup> Ibid, pp. 109-121

factor explaining the decline in domestic product prices was real exchange rate appreciation. Between 1990 and 1995, the exchange rate appreciated (in real effective terms) by 30 percent, which was partly due to the inflow of remittances.<sup>39</sup>

At present, non-traditional exports, service, and industry, have passed traditional exports by far. As seen in table 3.1, the largest sources of foreign exchange are now remittances and manufacturing exports.

Table 3.1: Changes in the principal sources of foreign exchange (1978 and 2002)<sup>1</sup>

Source of foreign currency	Millions of US\$		Percentual structure	
	1978	2002	1978	2002
<b>Traditional agricultural exports<sup>2</sup></b>	514	161	80	6
<b>Non-traditional exports</b>	54	335	8	12
<b>Manufacturing (net income)</b>	21	475	3	16
<b>Remittances</b>	51	1,935	8	67
<b>Total</b>	640	2,906	100	100

Notes: 1) Does not include exports to Central America, 2) Coffee, cotton, sugar, and shrimp  
Source: UNDP, 2004, table 6.1. Based on data from BCR

The change in the composition of output has not been accompanied by an increase in the overall productivity of the economy.<sup>40</sup> The major part of the income generated by GDP goes to consumption. In poor households the propensity to consume is higher than in non-poor, where more than 80 percent of the income goes to consumption.<sup>41</sup> The Central Bank estimates that 82 percent of the consumption goods are categorized as non-durable (for example groceries and clothing). The external current account deficit doubled from 2000 to 2004, and during this time period the country experienced a slow economic growth (on average 2 percent per year).<sup>42</sup> This may reflect a Dutch disease effect, created by migrants' remittances.

### 3.2 Migration

Since remittances are a result of migration it is important to understand the history, characteristics and trends of migration in El Salvador to understand the nature of remittances. Migration can be a way for the people to escape poverty and to seek better

<sup>39</sup> Silvério Marques, 2004, p. 42

<sup>40</sup> Segovia and Larde, 2002

<sup>41</sup> UCA, 2004, pp. 767-768

<sup>42</sup> BCR, [http://www.bcr.gob.sv/publicaciones/revista\\_trimestral/rev\\_trim\\_4\\_2004.pdf](http://www.bcr.gob.sv/publicaciones/revista_trimestral/rev_trim_4_2004.pdf) (2005-03-20)

work opportunities. Earlier migration in the country was closely related to the history of the country, where basically two factors determined the migration flows; armed conflicts and natural disasters. The conflicts of the 70s and 80s in Guatemala, Nicaragua and El Salvador made many people leave their homes, which caused migration flows throughout Central America. The internal migration in El Salvador was significant during the civil war and remained constant after the Peace Agreements of 1992. It was characterized by rural to urban areas migration, mainly to the capital, San Salvador.<sup>43</sup> In 1970, 60 percent of the population lived in rural areas.<sup>44</sup> By the year 2003 the rural population had declined to 41 percent.<sup>45</sup>

In recent years, international migration has become more frequent. A significant emigration from El Salvador was initiated in the 70s with a yearly net migration of 18 000 emigrants. This number increased exponentially to 57 000 persons during the 80s. After the peace agreements the international migration slowed down, but from 1996 this trend was reversed and the negative net migration passed over 35 000 a year.<sup>46</sup>

At present, nearly 2.7 million Salvadorians live outside El Salvador. This means that one out of four Salvadorians resident in another country. The vast majority have migrated to the United States, where around 2.3 million Salvadorians are living. Other popular host countries for Salvadoran migrants are Canada, Australia, Belize, Costa Rica, Mexico, and Western European countries.<sup>47</sup> Many Salvadorians leave the country illegally. With stricter border controls it is becoming more difficult to cross the borders of El Salvador.<sup>48</sup> This may reduce the migration flows in the future.

### **3.2.1 Migrant profile**

Of the international migrants in the most recent years, 53 percent are men and 47 percent women. Around 60 percent of the emigrants are between 15 and 30 years, whereof many leave before having children of their own. However, the percentage of emigrants with established families before migrating is growing. International migration used to be principally an urban phenomenon, but now, according to recent statistics

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<sup>43</sup> ASIPES, 2002, p. 19-24

<sup>44</sup> UNDP, 2004, p. 68

<sup>45</sup> DIGESTYC, 2004

<sup>46</sup> UNDP, 2004, p. 68

<sup>47</sup> Ministerio de Relaciones Exteriores, <http://www.rree.gob.sv/website/comunidades1.html> (2005-01-25)

<sup>48</sup> ASIPES, 2002, p.44

from the EHPM, two out of three international emigrants depart from urban areas and one from rural areas.<sup>49</sup> The reason for the former urban dominance may be that emigrants first migrated to the city for better opportunities to finance the international migration, but now, with increasing migration, it has become easier to migrate directly from rural areas.

### **3.2.2 Migrant motives**

What are the motives for Salvadorians to migrate? Historically, migration in El Salvador has been determined by social, economical and political reasons. It is evident that because of armed conflicts and natural disasters many people have felt unsafe and/or lost their homes, which has forced them to migrate.

According to a recent survey of 101 representative households, made by ASIPES in 2002, the main motives for Salvadorians to emigrate are basically economical. Unemployment is the main motive to emigrate for 52 percent of the migrants. Improvement in the standard of living is the second most common motive (24 percent), and poverty (11 percent). Less common motives are violence, earthquakes, and other factors.

## **3.3 Remittances**

### **3.3.1 Trends**

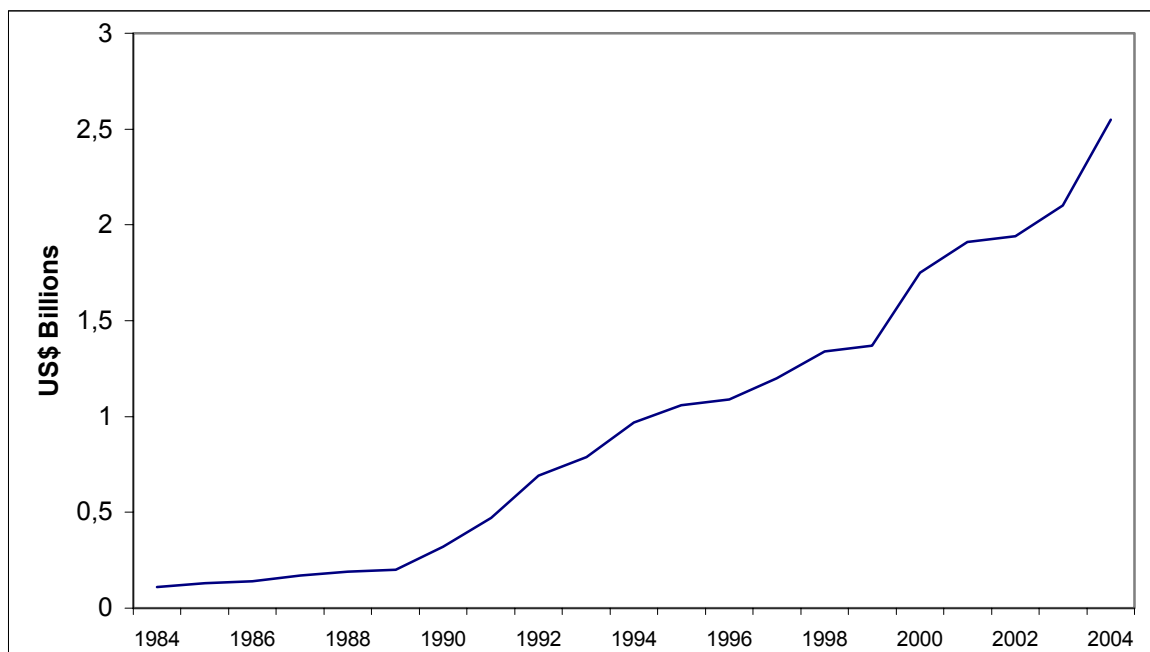
Estimations of the trends and patterns of remittance flows are complicated by the extended use of informal transfer channels. Since most of the remittances are sent through unofficial channels, they are not included in official statistics, and the actual amount of remittances is probably considerably higher than recorded estimations.<sup>50</sup>

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<sup>49</sup> UNDP, 2004, p. 68

<sup>50</sup> IOM, 2003, p 310

Figure 3.1: Remittances to El Salvador (1984-2004)



Source of data: BCR

Data from the Central Bank (figure 3.1) shows that the remittance inflows have steadily increased over time. The increase has been much faster since the 1990s, and in 2004 the remittance inflows amounted to over US\$ 2 500 millions<sup>51</sup>, which means that they have more than doubled in the last seven years. The main share of remittances is sent by migrants working in the United States (90 percent of the emigrated Salvadorans in 2002 resided in the United States)<sup>52</sup>.

Data from the national household surveys by DIGESTYC on remittances trends for each department (see table 3.2) indicate that remittances in the last six years have increased for all departments. In general, remittances increased faster in the initial years and slowed down in the latter years of the time period. Between 2002 and 2003 five departments experienced a decrease in the money received per capita: San Salvador, Cuscatlán, La Paz, San Vicente, and La Unión (see Appendix 2). This indicates that a continuous increase in the amounts of remittances received should not be taken for granted, and there is a possibility that remittances may even decrease in the future. However, it is too early to make reliable estimations of the trends of remittances and they can generally still be seen as a relatively stable source of income. Additionally, as

<sup>51</sup> BCR, [http://www.bcr.gob.sv/estadisticas/se\\_remesas.html](http://www.bcr.gob.sv/estadisticas/se_remesas.html) (05-05-21)

<sup>52</sup> UNDP, 2004, p. 104

seen in the data from the Central Bank, the increase in remittances in the following year, 2004, was among the largest ever. In conclusion, there are no real indications that the increase in the long-term remittance inflows is decreasing, or that future inflows of remittances will decrease.

Table 3.2: Remittance income per capita in US\$ (1998-2003)

	1998-2000	2001-2003
<b>Ahuachapán</b>	16.1	25.1
<b>Santa Ana</b>	23.3	40.0
<b>Sonsonate</b>	16.1	22.4
<b>Chalatenango</b>	21.8	38.3
<b>La Libertad</b>	17.4	24.4
<b>San Salvador</b>	18.7	25.6
<b>Cuscatlán</b>	17.5	25.1
<b>LaPaz</b>	21.1	25.1
<b>Cabañas</b>	28.4	43.5
<b>San Vicente</b>	18.7	26.0
<b>Usulután</b>	25.1	37.5
<b>San Miguel</b>	30.4	43.6
<b>Morazán</b>	31.9	47.5
<b>La Unión</b>	48.0	71.7

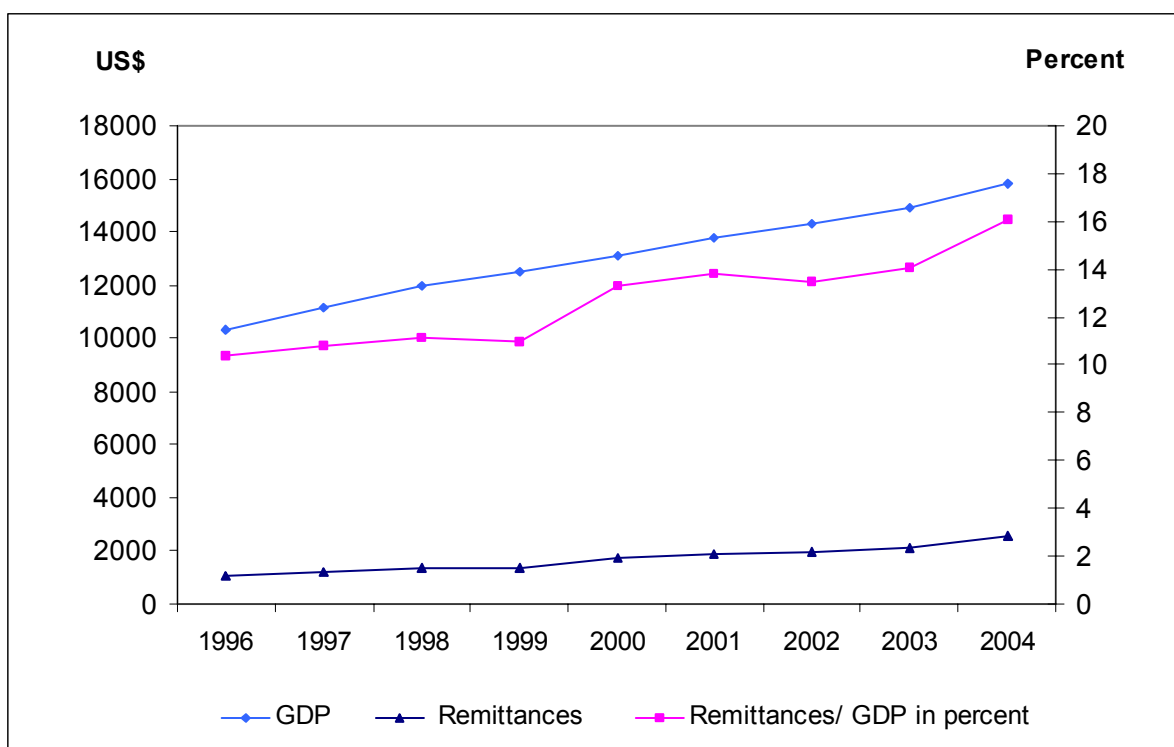
Source of data: DIGESTYC

Remittance inflows exceeded ODA, FDI, and tourism incomes by far, and had a more stable trend for the second half of the 1990s.<sup>53</sup> Additionally, the percentage of remittances per GDP and total imports increased significantly. As seen in figure 3.2, the percentage of remittances per GDP steadily increased from 10.4 percent of GDP in 1996 to 16.1 percent of GDP in 2004.<sup>54</sup>

<sup>53</sup> IADB/ MIF, 2001

<sup>54</sup> BCR, [http://www.bcr.gob.sv/publicaciones/revista\\_trimestral/rev\\_trim\\_4\\_2004.pdf](http://www.bcr.gob.sv/publicaciones/revista_trimestral/rev_trim_4_2004.pdf) (2005-04-20)

Figure 3.2: Remittances and GDP (1996-2004)



Source of data: BCR

### 3.3.2 Remittance receiving households

The national household survey of 2003 shows that 21.4 percent of the households in El Salvador receive remittances. Of the rural households 22.2 percent receive remittances, which is slightly higher than among the urban households where 21.0 percent receive remittances. The average amount received is US\$ 36 every month per person, or US\$ 152 per household.<sup>55</sup> The rural households receive a lower amount of US\$ 139 a month in comparison to urban households, where the average amount received is US\$ 161 a month. This is probably because the urban migrants have a higher average education and thus have managed to get better-paid employment, or because some of the rural migrants have moved to urban areas within the country and not abroad where the salary often is higher. A survey by ASIPES, 2002, showed that 70 per cent of the remittance recipients earn less than US\$ 400 per month and that the median recipient receives remittances 10 times a year.<sup>56</sup>

<sup>55</sup> DIGESTYC, 2004

<sup>56</sup> Pew Hispanic Center and Bendixen and Associates, 2003

### **3.3.3 Determinants**

A survey by BASIS/FUSADES (2000) on rural households with migrated family members in the United States showed that the most important factors determining the size of remittances are associated with the years since out-migration, and the relations between the migrant and the remittance receiving household. More time since the out-migration is associated with an increase in remittances until a point in time when they start to decrease.<sup>57</sup> This implies that in the first years after the migration, the migrant has fewer possibilities of generating a large income. The possibility of sending money home improves with time, with more and better job opportunities and fewer constraints, such as the obligation to pay off a debt for the fare ticket. However, after a longer period, time has a negative impact on remittances, possibly because of less contact with the family in the home country, or because other household members have migrated as well.

As expected, married migrants tend to remit larger amounts of money in comparison to unmarried migrants. Children also tend to remit a larger quantity of money, although the amount is less than married migrants send to their spouses. Migrants with under aged children in the United States remit less money home, while migrants with under aged children in El Salvador remit larger amounts of money.<sup>58</sup> Migrants may bring their children to the host country after some time, and then remit less to the household that is still left in the home country, which also may be a reason why remittances increase until a point and then start to decrease.

The results give support to the altruistic theory of the determinants of remittances, where the amount of money remitted is expected to rise with higher wage levels, household income, and the size of the household.

### **3.3.4 Use of remittances**

The effect of remittances on economic development is dependent on the way in which the receivers use the money. Researchers have found that, in El Salvador, most of the remittances are spent on basic household expenses and the remainder are used for improving the standard of living through better housing, education, additional

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<sup>57</sup> Andrade-Eekhoff, 2003, p. 59

<sup>58</sup> Ibid pp. 59-60

consumption, and loan payment.<sup>59</sup> The household survey of 2003 showed that 84 percent of the money is used for current consumption, 7 percent is invested in education and 3 percent in health. Only 0.5 percent is invested in business and 4 percent is used for savings.<sup>60</sup> Hence, the receivers have a high propensity to consume, and most of the remittance income is spent rather than saved. However, there is nothing that indicates that remittance-receiving households spend a larger share of their total income on current consumption than do non remittance-receiving households. Hence, even if the share of income that goes to investment and savings is not higher among the remittance-receiving households, the total amount is likely higher, presuming that they have a higher total income as a result of remittances. The survey also shows that women are more likely than men to use the money for education, health or savings.<sup>61</sup> The gender difference in income allocation may indicate that increased female bargaining power in the household could generate a more effective resource allocation.

### **3.3.5 Impacts on a national level**

#### *Foreign exchange*

It is not difficult to see why remittances are important for the macro-economy in El Salvador. In the last decade the trade deficit has reached the highest level ever, but has been compensated for this by the remittances. Even if there still is a large trade deficit, the estimated gap was smaller in 2004 than in 2003, which, according to the Central Bank, is partly associated with the large increase in remittance inflows.<sup>62</sup> Studies show that the inflow of dollars through migrants' remittances has not only covered the trade deficit gap, but also contributed to it through the appreciated exchange rate and thereby less export competition power because of the cheaper imports.<sup>63</sup> In other words, remittances have contributed to a Dutch disease effect on the economy. The result has been negative for the productive sectors of the economy: manufacturing and agriculture, because the higher prices have made them less competitive on the international market.

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<sup>59</sup> Ramamurthy, 2003, p. 78

<sup>60</sup> DIGESTYC, 2003

<sup>61</sup> DIGESTYC, 2004

<sup>62</sup> Banco Central de Reserva de El Salvador, p.21

<sup>63</sup> Wilma de Calderón, 1996, FUSADES, 1995

### *Savings and Consumption*

An important part of El Salvador's economic growth is achieved by higher aggregated demand, created by the inflow of remittances.<sup>64</sup> This is because remittances increase the output equilibrium by increased saving and consumption, which generate growth, at least in the short run. Since the major part of remittances goes to consumption, it can be argued that remittances do not contribute to a sustainable economic growth. Keeping in mind that the economic growth has been low in El Salvador since the turn of the century, it could be that the economy is slowing down because of remittances. On the other hand, many other factors influence economic growth, and remittances may give opportunities for employment in sectors that benefit from the increased consumption through remittance income.

Even if remittances are used for current consumption, they can have a positive effect on the economy through the multiplier effect, as in the case of Mexico (Adelman and Taylor, 1990) and Greece (Glytsos, 1993). This is if remittances are spent on locally produced goods or services, as explained in the previous chapter. This can benefit small farmers and owners of small businesses, generate new jobs, and lower income inequality and poverty. However, in El Salvador, the increase in remittances has not been accompanied by a significant change in unemployment rates and income inequality, which gives limited support for the multiplier effect in this case. It is probable that increased income through remittances will mean that households are able to afford to buy imported goods, and that these replace domestic goods. There is no evidence of this from earlier studies, but an indication of this can be that imports largely increased throughout the 1990s.

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<sup>64</sup> UCA, 2004, p. 763

## **4. Poverty in El Salvador- Measures, Development and Patterns**

### **4.1 Defining and measuring poverty**

Different uses of the term poverty and different methods of measuring poverty have led to a vague perception of what is actually meant by poverty. In order to discuss how poverty can be reduced there is thus a need for an understanding of what poverty is, and to address the problems involved when estimating poverty.

#### **4.1.1 Income and non-income poverty**

A first distinction, when defining poverty, can be made between income poverty and non-income poverty. Income poverty is the classical definition, in which a certain level of income or consumption is set and the people below this limit are considered poor. This is the easiest way to define and estimate poverty. However, poverty does not need to be money based. A person can also be poor in the sense of lack of opportunities and capabilities, such as education, health care and gender discrimination. In order to get a completely accurate estimation, the perception of each individual's own situation must be considered, but this would make it impossible to measure poverty. Therefore, income poverty is often preferred as a measure of poverty.<sup>65</sup>

#### **4.1.2 Absolute and relative poverty**

The definition of poverty also needs a distinction between absolute poverty and relative poverty. The relative definition of poverty establishes a poverty line as a fixed proportion of an income standard in the population, for example the mean or median income. The relative poverty measurement is useful when measuring inequality within a country, but does not show how the standard for the poor has developed; it may show rising poverty even though the standard of living of the poor has actually increased. Absolute poverty is more frequently used. It refers to a fixed poverty line where purchasing power is determined so that it covers basic needs.<sup>66</sup>

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<sup>65</sup> Maxwell, 1999

<sup>66</sup> See for example Bourguignon, 2004, pp.1-2

### 4.1.3 Poverty measures

Measurements of poverty in countries are generally based on national poverty lines. A poverty line is derived by the purchasing power parity (PPP) estimation of an income level, below which people are considered poor. However, because of the problems with different methods for estimating uniform poverty lines across countries, multilateral organisations, such as the World Bank, often make their own estimations using a 1 US\$ a day poverty line for estimating poverty.<sup>67</sup>

To measure income poverty we can use Headcount Index or Poverty Gap Index. These measurements are frequently used in the literature and show different aspects of poverty.

- **Headcount index:** The number of poor (people below the poverty line) divided by the total population.
- **Poverty gap index:** The mean difference between income of the poor and the poverty line.

The problems with the Headcount Index are that it does not consider how far from the poverty line the poor are situated. The implications are that although improvement in income poverty may have occurred it does not show in the Headcount Index if they have not climbed above the poverty line. The Poverty Gap, on the other hand, measures how much money needs to be transferred to the poor in order for them to meet the poverty line, and thereby also measures the depth of poverty.<sup>68</sup>

### 4.1.4 Data on poverty

Data on household income and consumption are generally collected through household budget surveys or other surveys covering income and consumption. Income data have the advantage that people often remember their income, which is not always the case with consumption. It is easier to get a clearer picture of the standard of living when using consumption data, because income may vary over time and seasons when living

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<sup>67</sup> UNDP, 2004, p.55

<sup>68</sup> World Bank, [http://povlibrary.worldbank.org/files/5467\\_chap1.pdf](http://povlibrary.worldbank.org/files/5467_chap1.pdf) (2005-07-08)

standards may not. More countries are now turning to consumption data and, when available, it is often preferred to income data.<sup>69</sup>

There is also a problem of how to compare surveys: household survey questionnaires often differ widely, and even similar surveys may not be fully comparable due to differences in quality. Even if household surveys are entirely accurate, they ignore the inequalities in income distribution within the household.<sup>70</sup> For more accurate results the surveys should therefore be conducted on an individual basis.

#### **4.1.5 Income inequality**

When analysing poverty it is common to include indicators of equity because the link is very strong. Recent studies have shown that it is easier to reduce poverty in a country that is relatively egalitarian.<sup>71</sup> However, the definition of inequality is also controversial. In economic terms, inequality can be described as disparities in relative income. Many of the problems with inequality measurements are similar to the problems of measuring poverty, namely data collection and inconsistent surveys.<sup>72</sup> Generally income inequality is measured by the Gini Coefficient, which ranges income inequality from 0 (perfect equality) to 1 (perfect inequality). It is measured graphically in a Lorenz diagram by dividing the area between the perfect equality line and the Lorenz curve by the total area to the right of the equality line.<sup>73</sup>

## **4.2 Poverty reduction**

There is no simple outline on how to reduce absolute poverty. Factors and policies that are expected to reduce poverty differ across countries. Economic growth has traditionally been central in poverty reduction strategies. More recently it has been evident that they need to be broadened to include economic opportunities, political participation and power, and reduce poor people's vulnerability to for example economic shocks, ill health and natural disasters. Also, research has shown the importance of inequality, not only in income, but also in gender and ethnic as causes of

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<sup>69</sup> UNDP, 2003, p.42

<sup>70</sup> Ibid

<sup>71</sup> Lok-Dessallien, 2003, p.5

[http://www.undp.org/poverty/publications/pov\\_red/Review\\_of\\_Poverty\\_Concepts.pdf](http://www.undp.org/poverty/publications/pov_red/Review_of_Poverty_Concepts.pdf) (2005-05-25)

<sup>72</sup> See for example Goldberg and Pavcnik, 2004, pp. 5-6

<sup>73</sup> See for example Ray, 1998, pp. 188-191

poverty, as presented in the World Development Report 2000/2001.<sup>74</sup> Growth is still seen as important for poverty reduction, but needs to be considered as a part of a broad poverty reduction strategy.

Economic growth itself does not necessarily reduce poverty, but studies have shown that it is a prerequisite for income poverty reduction. Non-income poverty may be reduced by economic growth, if the poor people have gained as a result of growth, through additional resources for schooling, health care etc.

Most economists agree that growth is essential for poverty reduction under the assumption that the income distribution remains more or less constant. Bourguignon (2004) describes this phenomenon in a “Poverty-Growth-Inequality Triangle”, where a development strategy is fully determined by the rate of growth of the mean income of the population and the change in income distribution.<sup>75</sup> Poverty reduction can then be determined by the rate of growth of the mean income of the population and the change in income distribution over time.

To achieve poverty alleviation, growth needs to be stimulated in a way that is beneficial to the poor, so called pro-poor growth. The pro-poor growth concept involves the connection between growth, income distribution and poverty. A simple way to define pro-poor growth is a situation in which economic growth favours the poor.<sup>76</sup> If the distributional shifts caused by economic growth favour the poor, then the rate of pro-poor growth exceeds the ordinary growth rate. Thus, the rate of pro-poor growth equals the ordinary growth rate times distributional correction.<sup>77</sup>

The results of a recent World Bank cross-country study (Kraay, 2004) emphasize importance of growth in average incomes for poverty reduction. It suggests that pro-poor strategies should focus on policies that affect growth in average incomes, such as the protection of property rights, stable macro economic policies and openness to international trade.<sup>78</sup> In another recent World Bank study (Silvério Marques, 2004),

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<sup>74</sup> World Bank, 2001, pp. 31-35

<sup>75</sup> Bourguignon, 2004, p.2

<sup>76</sup> Ravallion, 2004, p.2

<sup>77</sup> Ibid, p.6

<sup>78</sup> Kraay, 2004, p.1-2

remittances are noted as one of the key factors that influence pro-poor growth. Other important factors influencing pro-poor growth are macro instability, public spending policies, rural development, labour market conditions, and gender policies. It also states that insecurity about future employment and income affects development negatively, because most households and workers care not only about the level of their standard of living, but also about its security.<sup>79</sup>

Since the poverty impact of growth differs between countries, case studies can give better indications of proper strategies for pro-poor growth, and thus poverty reduction. With this in mind, I will study whether remittances as a source of income benefit the poor in El Salvador and should therefore be encouraged in a strategy to reduce poverty.

### **4.3 Poverty and income inequality in El Salvador**

Most of the data on poverty in El Salvador are collected in the national household surveys (EHPM) by DIGESTYC. The EHPM have a national coverage and represent both rural and urban areas. Poverty is defined as income-poverty, and the estimates are based on national poverty lines for extremely and moderately poor. Household income data have been used as the basis for estimations, and not expenditure data. A problem with DIGESTYC's income estimates is that they do not include in-kind income and other components of non-monetary income that are important, especially for agricultural households.<sup>80</sup>

The poverty lines are calculated by estimating the costs of the most commonly consumed food in the urban and rural areas, updated with new prices every year. The extreme poverty line corresponds to the monthly cost of a basic food basket, set to US\$ 126 per month for urban households and US\$ 90 per month for rural households, that provides a minimum requirement of about 2 200 Kcal a day for a family of four members. Households that cannot afford one food basket are defined as extremely poor, and households that cannot afford two food baskets are defined as moderately poor. According to the household surveys of 2003<sup>81</sup>, 36.1 percent of the households in El Salvador are poor, of which 14.4 percent are classified as extremely poor and 21.7

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<sup>79</sup> Silvério Marques, 2004

<sup>80</sup> e.g. purchase items that are produced in homes or are received as a donation for education health, food or utilities.

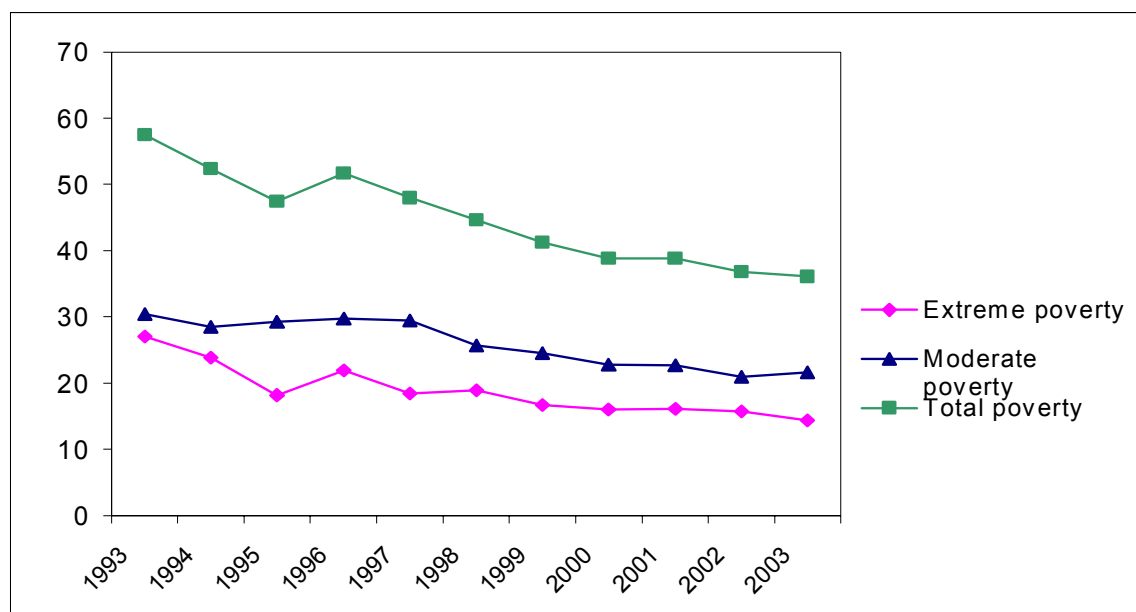
<sup>81</sup> DIGESTYC, 2004

percent as moderately poor. The actual numbers are, according to the UNDP, probably even higher. UNDP also states that absolute poverty could be alleviated if 1.1 percent of El Salvador's annual GDP were transferred to the poorest sector of the population.<sup>82</sup> That at least a third of the population in El Salvador live in conditions of poverty, and that income inequality is actually increasing in the country, makes poverty and inequality crucial issues in the development process of this country.

#### 4.3.1 Poverty trends

Absolute poverty declined rapidly in El Salvador between 1993 and 2003 (see figure 4.1). According to the EHPM, poverty affected nearly 60 percent of the population in 1993; 27 percent of the population was in extreme poverty and another 31 percent was in moderate poverty. By 2003, poverty had declined to 46 percent, or by 11 percentage points. The severity of poverty also declined during the period. In 1993, 60 percent of the total poor were classified as extremely poor, compared to 46 percent in 2003.

Figure 4.1: Households in poverty in percent (1993-2003)



Source of data: DIGESTYC

Due to some shortcomings in DIGESTYC's income estimates<sup>83</sup>, World Bank staff have re-estimated DIGESTYC's income series and re-calculated the poverty rates using the

<sup>82</sup> UNDP, 2004, pp. 9-11

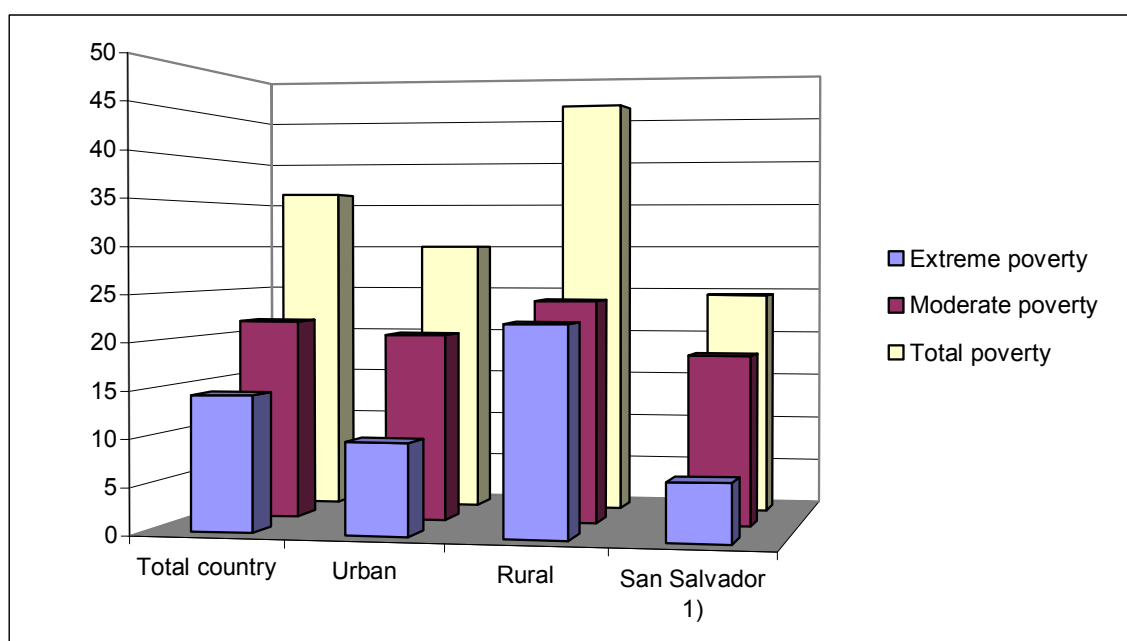
<sup>83</sup> The two major problems with DIGESTYC's incomes estimates are: (i) they do not include in-kind income and other components of non-monetary income that are of particular importance for agricultural

national poverty lines. World Bank's estimates for 1991-2002 show a similar trend in the decline in poverty, although they show a larger decline in poverty than DIGESTYC (27 versus 23 percentage points).<sup>84</sup>

### 4.3.2 Rural and urban poverty

There are considerable differences in poverty rates between urban and rural areas, and the capital, San Salvador. The total poverty rate (extreme + moderate) for rural areas was 65 percent in 1993, compared to 50 percent for urban areas. In 2003, the poverty rates were 46 percent for rural areas, and 30 percent for urban areas (see figure 4.2). The decline in poverty was slightly larger in the urban areas (20 percentage points) than in rural areas (19 percentage points), but the rural areas experienced a larger decline in extreme poverty (12 percentage points) than the urban areas (7 percentage points). Nonetheless, as seen in figure 4.2, extreme poverty is still much more frequent in rural areas than in urban areas. It can also be noted that the lowest poverty rates are found in San Salvador.

Figure 4.2: Rural and urban poverty in percent (2003)



Note: 1) The Metropolis Area of El Salvador  
Source: DIGESTYC 2003

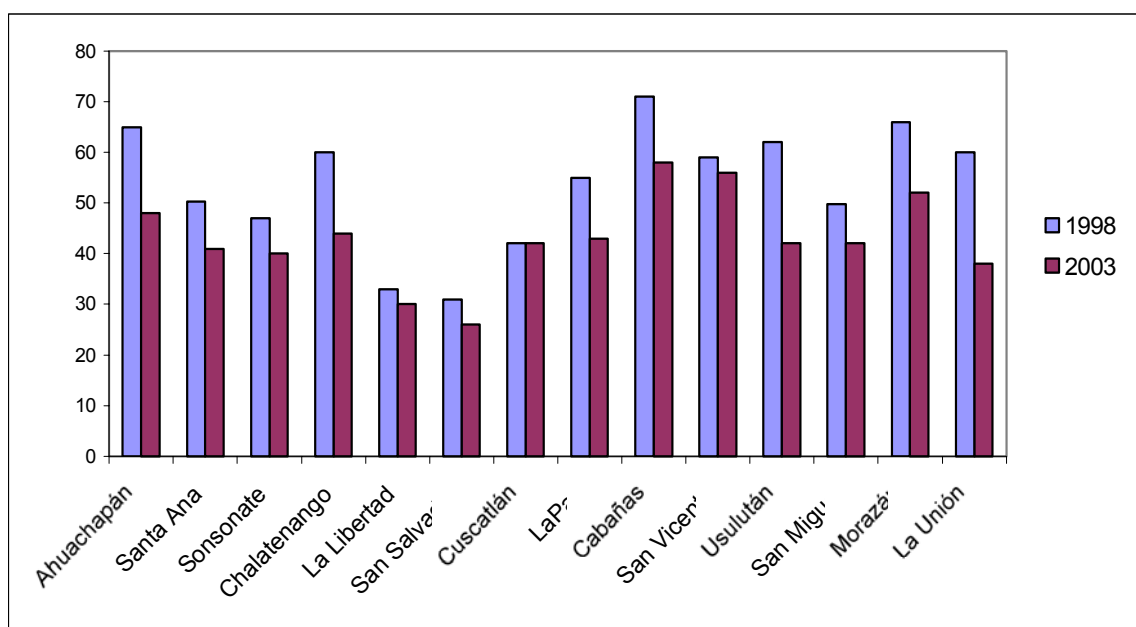
households (e.g., purchase items that are home-produced or that are received as a donation for education, health, food or utilities); and (ii) in the early years they did not include the implicit rental value for homeowners. (Silvério Marques, 2004, p. 11)

<sup>84</sup> Silvério Marques, 2004, p. 10-11

### 4.3.3 Regional poverty

Figure 4.3 shows the changes in total poverty (e.g. extreme + moderate poverty) per department from 1998 to 2003. La Unión experienced the largest decline in poverty (22 percentage points), followed by Usulután (20 percentage points), and Ahuachapán (17 percentage points). These are coastal departments in the western and eastern regions of El Salvador (see Annex 1). The departments that experienced the smallest decline in poverty are Cuscatlán (which was on the same poverty level in 2003 as in 1998), La Libertad and San Vicente (both with a decline of 3 percentage points). Geographically, these are located in the central region of El Salvador (see Annex 1).

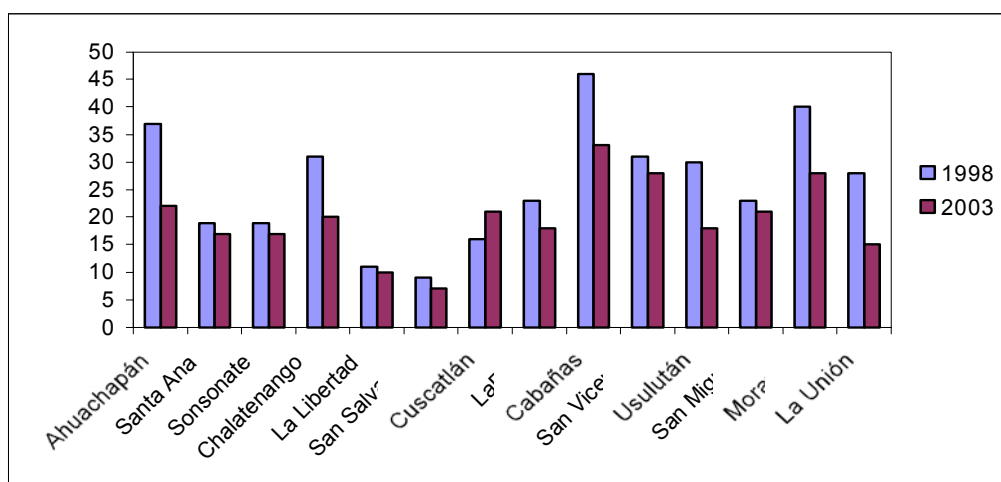
Figure 4.3: Poverty per department in percent (1998 and 2003)



Source of data: DIGESTYC 1998 and 2003

As seen in figure 4.4, Ahuachapán is the department that experienced the largest decline in extreme poverty for the period of 1998-2003 (by 15 percentage points), followed by Cabañas and La Unión (13 percentage points each). Cuscatlán is the only department that has had a net increase in extreme poverty for the period (5 percentage points). The increase in poverty from 11 percent to 21 percent occurred in the two last years of the period.

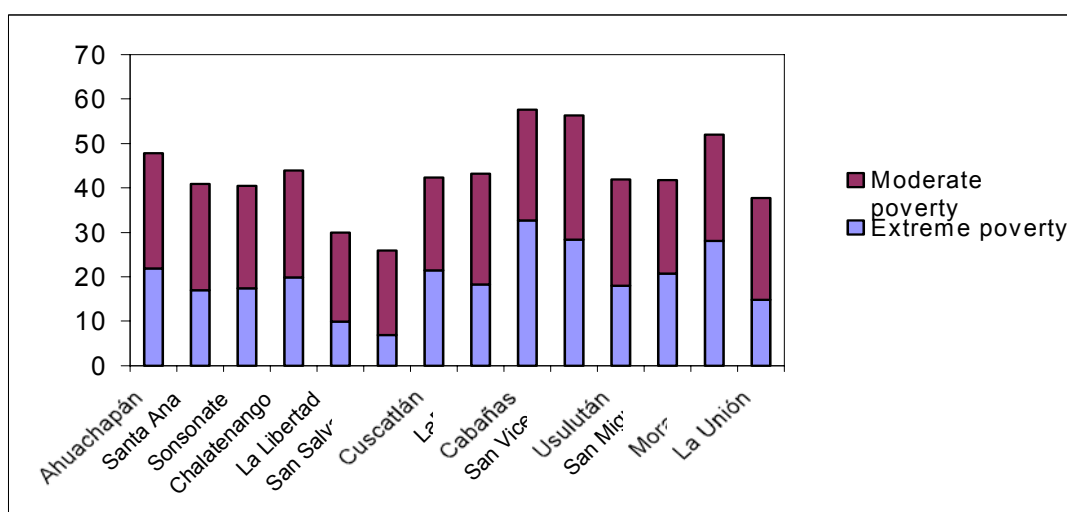
Figure 4.4: Extreme poverty in percent per department (1998 and 2003)



Source of data: DIGESTYC

Figure 4.5 shows the extreme and moderate poverty for the departments in 2003, which is also a way to illustrate the poverty gap. Cabañas had the highest total poverty rate (58 percent) followed by San Vicente (56 percent) and Morazán (52 percent). These were also the departments with the highest rates of extreme poverty (Cabañas 33 percent, Morazán 28 percent, and San Vicente 28 percent). San Salvador was the department with the lowest poverty rates, in total (26 percent) as well as in extreme poverty (7 percent). Geographically, the departments with highest poverty rates were not concentrated to a specific region (see Annex 1). Nevertheless considerably lower poverty rates were found in San Salvador, and a tendency for lower poverty rates could be found in the costal departments.

Figure 4.5: Poverty in percent per department (2003)



Source of data: DIGESTYC 2003

#### 4.2.2 Income inequality

El Salvador has one of the highest rates of inequality in the world in terms of income distribution. The richest 20 percent of the population have, on average, incomes 18 times higher than the lowest 20 percent. Higher income equality is one of most important issues in the poverty reduction strategy of the country.<sup>85</sup> Unfortunately, no regional data on income inequality is available.

Income inequality was close to being unchanged during the 1990s (see table 4.1). Estimates of the Gini coefficient indicate higher income equality (Gini dropped) during 1991-96 but then a more uneven distributed income (Gini increased) during 1996-2002, with a slight increase in income inequality for the complete period.

Table 4.1: Distribution of (Unadjusted) Income: 1991, 1996, 2002 (Percentage)

Quintile, Gini	1 (poorest)	2	3	4	5 (richest)	Gini
1991	3.1	7.8	12.7	20.5	56.0	0.527
1996	3.3	7.9	13.1	21.1	54.7	0.517
2002	2.8	7.5	12.8	21.2	55.7	0.534
Δ 1991-96	0.2	0.1	0.4	0.6	-1.3	-0.01
Δ 1996-02	-0.5	-0.4	-0.3	0.1	1	0.017
Δ 1991-02	-0.3	-0.3	0.1	0.7	-0.3	0.007

Source: Silvério Marques, 2004, p. 14

From 1991 to 2002 the 4<sup>th</sup> income quintile had the largest increase in their share of total income. The two poorest quintiles were the income groups that benefited the least from changes in relative incomes during the period 1991-2002. The decrease of their share of total income was larger in the period 1996-2002 than the period before. In the latter period, the share of total income for the poorest quintile decreased by 0.5 percentage points, from 3.3 to 2.8 percentage.

As mentioned earlier in this chapter, lower income inequality and higher growth are important in a poverty reduction strategy. Silvério Marquez (2004) found that the elasticities of poverty to growth and inequality for El Salvador are relatively high.<sup>86</sup> This means that an increase in growth and a decrease in income inequality will lead to a

<sup>85</sup> UNDP, 2004, p.64

<sup>86</sup> Silvério Marques, 2004, p. 23-28

larger decrease in poverty. A recent study by IPEA/UNDP (2003) indicated that a 30 percent increase in income per capita would only lead to a 10 percent decrease in poverty. However, if inequality decreased by 30 percent, it would lead to a corresponding decrease in poverty of 23 percent.<sup>87</sup> The studies show the importance of growth and improved income distribution for poverty reduction in El Salvador, and thus support the theory of pro-poor growth.

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<sup>87</sup> UNDP, 2004, p.64

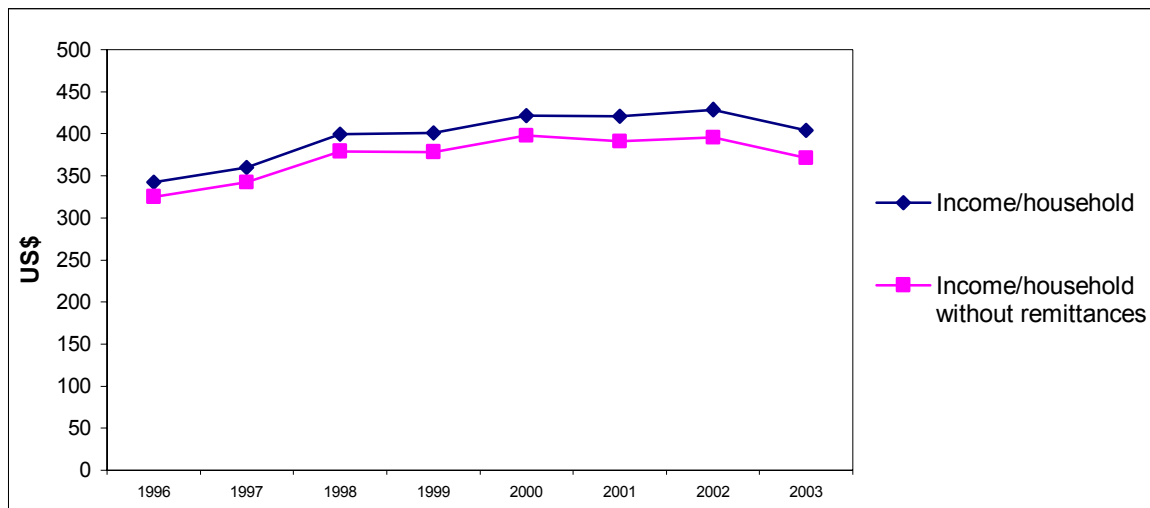
## 5. Remittances and Poverty

The correlation between remittances and poverty-related factors in El Salvador will be examined in this chapter, to better understand the relationship between remittances and poverty. Firstly, remittances as a source of income will be investigated, both for the receiving households, and for the Salvadoran economy in total. Secondly, I will examine the distribution of remittances among different income groups. Thirdly, I will study the patterns of remittances and poverty over time and for different regions.

### 5.1 Remittances and Household Income

As described in chapter 2, remittances have a direct effect on income poverty by raising household incomes. How important are remittances for the incomes of the Salvadoran households? Without remittance incomes the average household income in El Salvador will be significantly lower (see figure 5.1).

Figure 5.1: Household income without remittances (1996-2003)



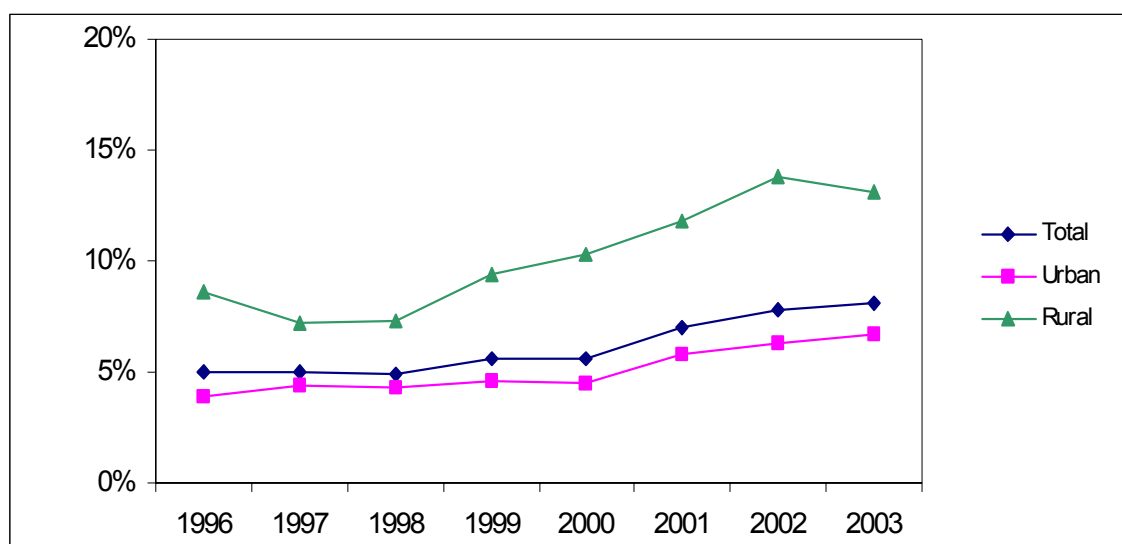
Source of data: DIGESTYC

The average income would have been 6.1 percent lower between 1996 and 2003, if remittances as a source of income did not exist in El Salvador. The gap between total income and income without remittances increased over the period, from 5.0 percent in 1996 to 8.1 percent in 2003.

### 5.1.1 Rural areas: remittances and income

Since rural areas generally are poorer than urban areas, it can be expected that rural areas are more dependent on remittance income than urban areas. The share of remittances out of total income for all households (remittance receiving and non-remittance receiving households) in rural areas increased every year except for 1997, from 8 percent in 1996 to 13 percent in 2003 (see figure 5.2). Since rural areas are poorer than urban areas, it can be expected that remittances constitute a larger share of income in rural areas, and this is also shown in figure 5.2. The increase of the share of remittances of total income has been larger in rural areas than in urban areas. This shows that rural areas are becoming more dependent on the remittance income.

Figure 5.2: Remittances as a share of total income: All households

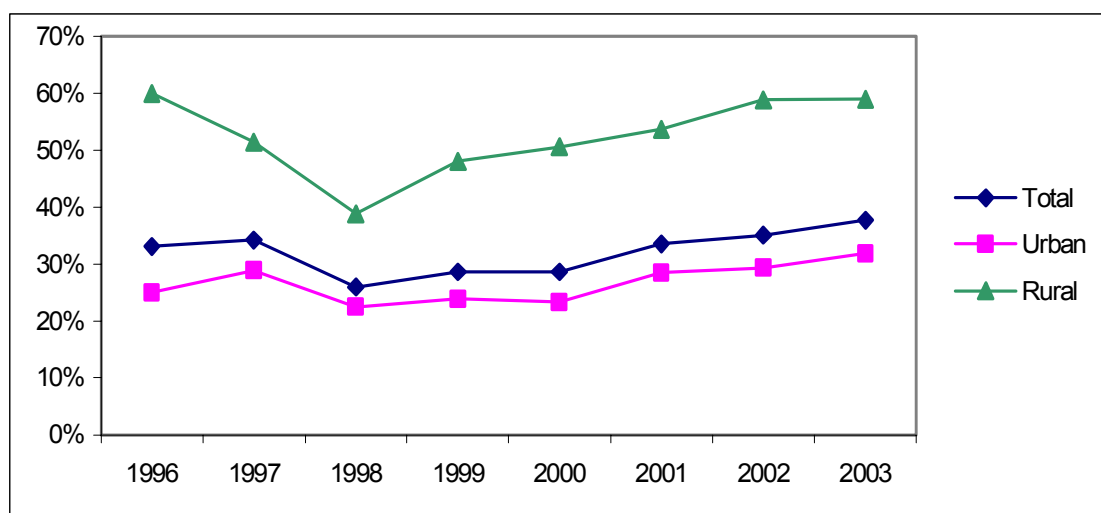


Source of data: DIGESTYC

In the former case (figure 5.1), all households were included, even households that did not have any remittance income. It is probable that remittances as a share of income will be considerably higher if only the recipient households are considered. Figure 5.3 shows that remittances constitute nearly 40 percent of the income for an average remittance receiving household. For rural households the amount is almost 60. It is hence likely that many of the households depend entirely on the income from remittances. The share of remittances out of income for rural remittance-receiving households, decreased from 1996 (60 percent) to 1998 (40 percent), but increased after that steadily over the years and amounted to an average of 60 percent of the household income in 2003. Note that in the average total income non-remittance receiving households are also included. Thus

the actual share of remittances out of total income may be lower, presuming that remittance-receiving households have a larger average income in total. Still, the figure shows that remittance-receiving households depend largely on remittance income, particularly in the rural areas, and that the trend is towards more dependency.

Figure 5.3: Remittances as a share of total income: Remittance-receiving households

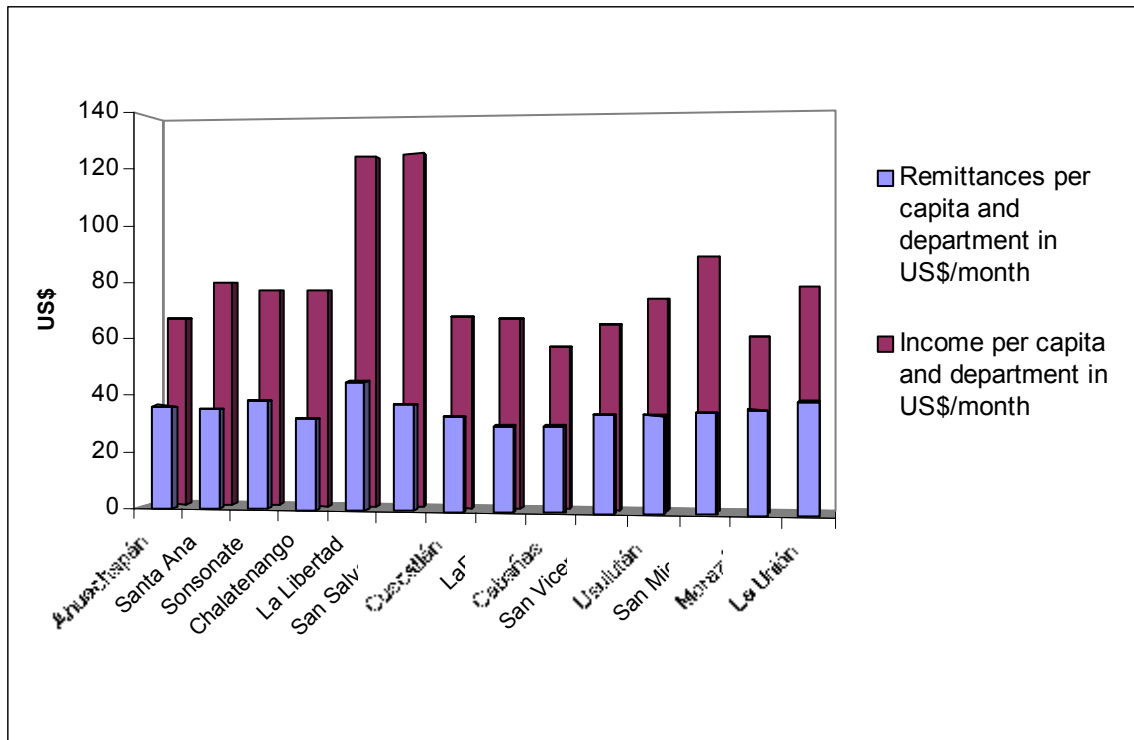


Source: DIGESTYC

### 5.1.2 Remittances and income in departments

In the previous sector it was shown that the rural areas, which have a lower average income, are more dependent on remittance income than urban areas. The patterns may be similar for geographical regions where lower income departments can be expected to have a higher share of remittances in total income. This assumption is confirmed by figure 5.4, which shows that Cabañas, Morazán, and Ahuachapán are the departments with the highest share of remittances in total income, and these departments are also the departments with the lowest average income (with the exception of Ahuachapán which has the fourth lowest average income). It may be noted that remittances are an important source of income for all departments, and that remittances constitute more than half of the income per capita in several departments.

Figure 5.4: Remittances and income per capita and department (2003)



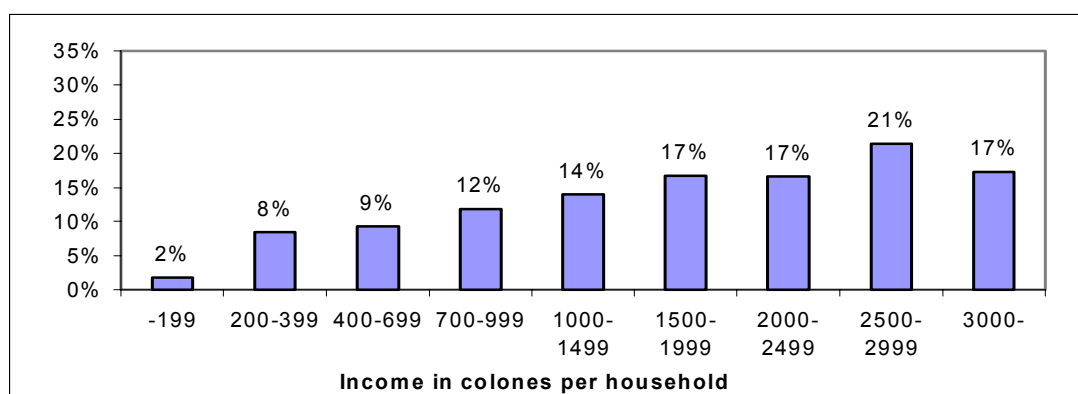
Source of data: DIGESTYC

## 5.2 Distribution of remittances

If remittances reach low-income households, they can lower poverty and have an equalising effect on income distribution. How are the receivers of remittances distributed among income groups? By examining this question it will be possible to get indications of the income and poverty status of the receiving households.

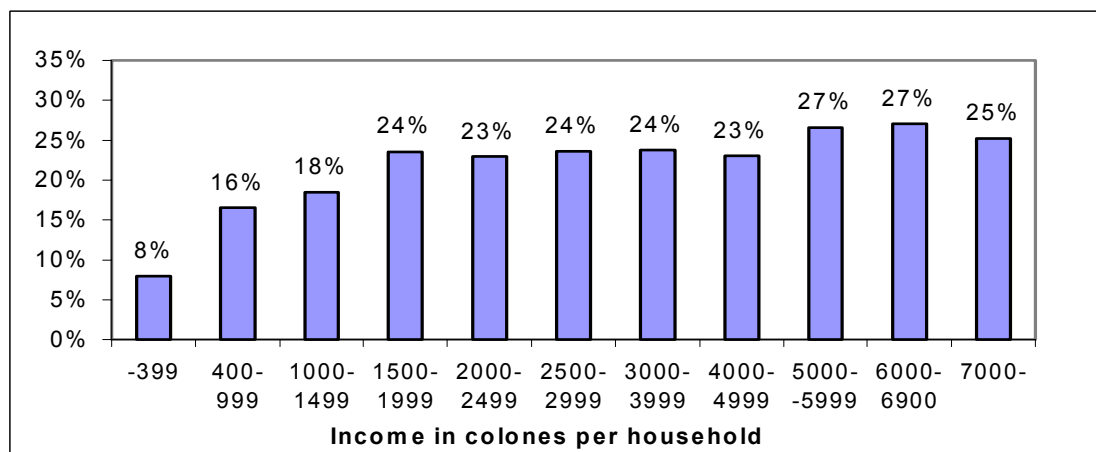
Figures 5.5 and 5.6 show how many percent of the households in different income groups that received remittances in 1996 and 2003. This may give important indications of the changes in income levels of the remittance-receiving households. If the low- (middle-, high-) income groups of 1996 are compared to the low- (middle-, high-) income groups of 2003, it can be noted that the percentage of remittance-receiving households increased for all income groups for the period.

Figure 5.5: Percent of households that receive remittances per income group (1996)



Source of data: DIGESTYC  
 Note: 8.75 colones equals 1 US\$.

Figure 5.6: Percent of households that receive remittances per income group (2003)



Source of data: DIGESTYC  
 Note: 8.75 colones equals 1 US\$

### *High-income groups*

For the higher income groups it may be noted that a substantial share of the households receive remittances. For example, 25 percent of the households in the highest income group received remittances in 2003. This may indicate that migration among families in the highest income groups is common and that poverty is not the only reason for migrating. However, it may also be that the amounts of money remitted to the households are large, and that families from lower or middle-income groups in 1996, as a result of the remittance income, had transferred to the higher income groups in 2003.

### *Middle- income groups*

Many people from the middle-income groups must have migrated, since the share of households with remittances increased in this segment, but also because the share of households with remittances in the higher income groups increased. A part of the households that were situated in the middle income group in 1996 may have transferred to the higher income groups in 2003 when they started to receive money from a migrated family member, or as the remittances from earlier migrated family members increased, for example from higher salaries in the migrants' host country.

### *Low- income groups*

There is no evidence showing that remittances have an equalising effect on income distribution by reaching poor households, since the lower income groups tend to have fewer remittance recipients. The lowest income group has had the smallest increase of remittance receiving households, and there is still a relatively small share of remittance receiving households. The reason for this can be that the cost of migrating is too high for the poorest families to be able to finance. It can also be that families that originated from this section advanced to a higher income group when a family member migrated and they received migrant's remittances. As a result they may have moved out of extreme poverty.

### *Dependency on remittance income*

An interesting finding, when looking at the amount of remittances that every income group receives, is that many households are in the same income group as the remittance income group (see Appendix 3). For example, 32 percent of the households that receive between 1500 and 1999 Colones<sup>88</sup> monthly also have a remittance income of 1500-1999 Colones a month. Many of these households probably have such a low ordinary income that remittances constitute almost their total income. It is also probable that for some households, remittances constitute their total income, and that the family members instead of working, rely on the remittance income. The percentage of the households that are in the same income group as the remittance income group increased significantly for all income groups between 1996 and 2003, except for the ones with an income of less than 1000 Colones a month. For the latter, it is probably because their

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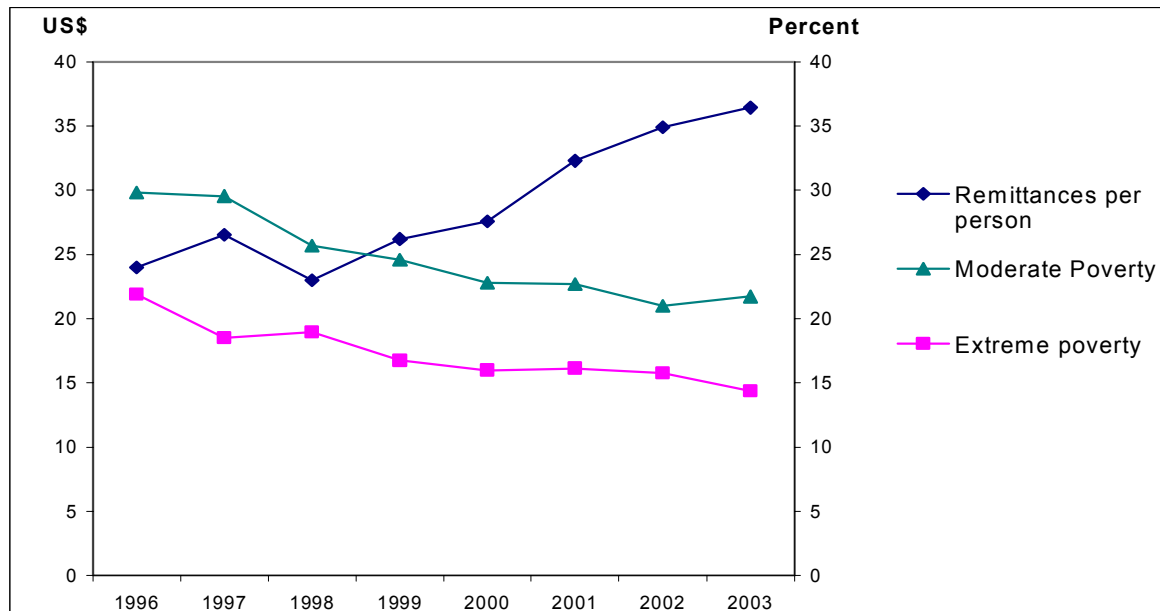
<sup>88</sup> One US\$ equals 8.75 Salvadoran Colones

total income is relatively low and the remittance income is not sufficient. An explanation for the first case can be that the remittance income has increased while the ordinary income has not. It can also mean that we have a case of moral hazard where family members have quit working and instead rely on the remittance income. This indicates that, for many households, remittances are the main, or even the only source of income. The average amount of remittances that a rural household receives every month is 139 US\$. This can be a large amount of money for a rural agricultural household, and it possibly encourages remittance-receiving household members to leave the agricultural sector when the remittance income gives them the opportunity to do so.

### 5.3 Remittances and poverty patterns

As expected, there is a strong inverse relation between remittances and the absolute poverty rate (see Figure 5.7). The link between the two variables is particularly clear when the absolute poverty rate is determined by the extreme poverty line.

Figure 5.7: Remittances and poverty in El Salvador (1996-2003)



Source of data: DIGESTYC

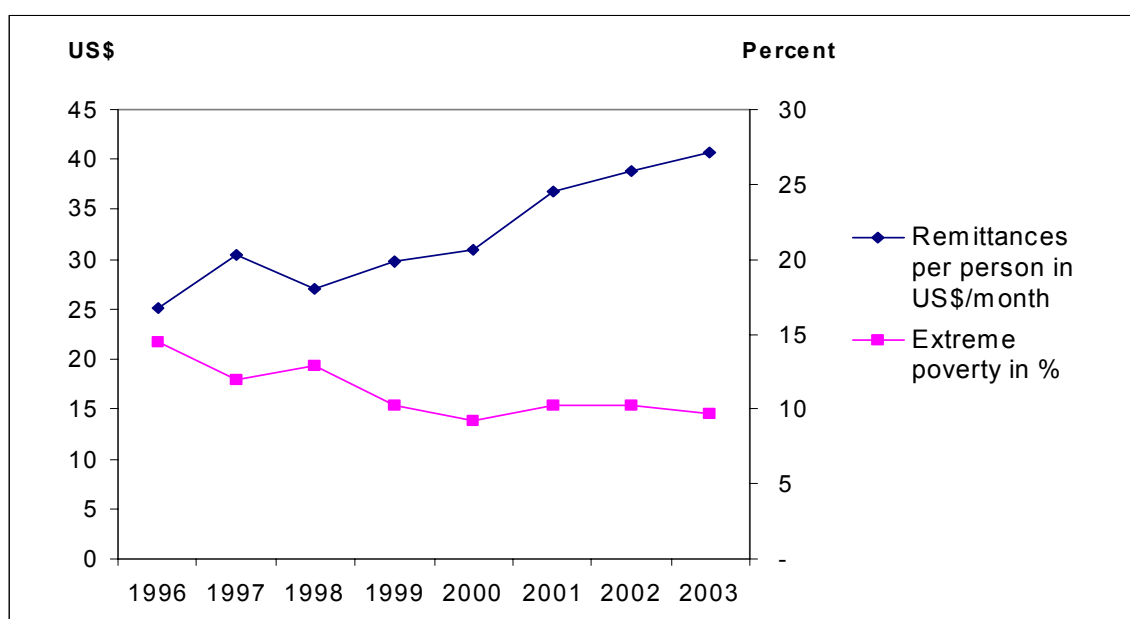
UNDP has estimated the part of the population that was lifted out of poverty as a result of received remittances, by calculating the gap between poverty levels and poverty levels without the effect of remittances. The percentage of the population, that was able to leave extreme poverty through remittance income, increased from 4 percent in 1992

to more than 6 percent in 2002. The increase for rural households was larger and was estimated to be almost 8 percent for 2002.<sup>89</sup>

### 5.3.1 Urban patterns

For the urban and rural areas, the pattern is similar to the country estimates, but there are some exceptions. In 2001, the poverty level increased slightly in the urban areas despite a large increase in remittances (see Figure 5.8). This can have various explanations and one is that major earthquakes, which left many people below the poverty line, hit El Salvador. Another can be the dollarisation<sup>90</sup>, which resulted in higher inflation. This specifically concern households without remittances since their loss in purchase power cannot directly be compensated with increased remittances.

Figure 5.8: Remittances and poverty in urban areas (1996-2003)



Source of data: DIGESTYC

### 5.3.2 Rural patterns

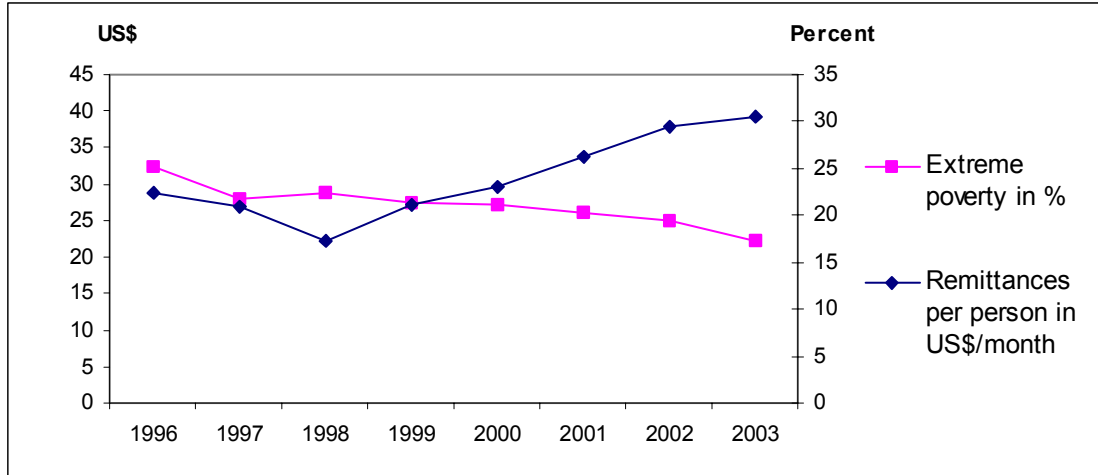
Except in 1996, poverty had an inverse correlation to remittances in the rural areas, meaning that an increase in family remittances lead to a decrease in the extreme poverty rates, and vice versa (see figure 5.9). It is not very surprising that an increase in remittances led to fewer households living in absolute poverty. However, what is more

<sup>89</sup> UNDP, 2004, p. 67

<sup>90</sup> In 2001 the US\$ replaced Colones as the national currency in El Salvador

interesting is that the relation is very apparent. When the household remittances dropped, in 1998, there was a significant rise in households living in extreme poverty.

Figure 5.9: Remittances and poverty in rural areas (1996-2003)

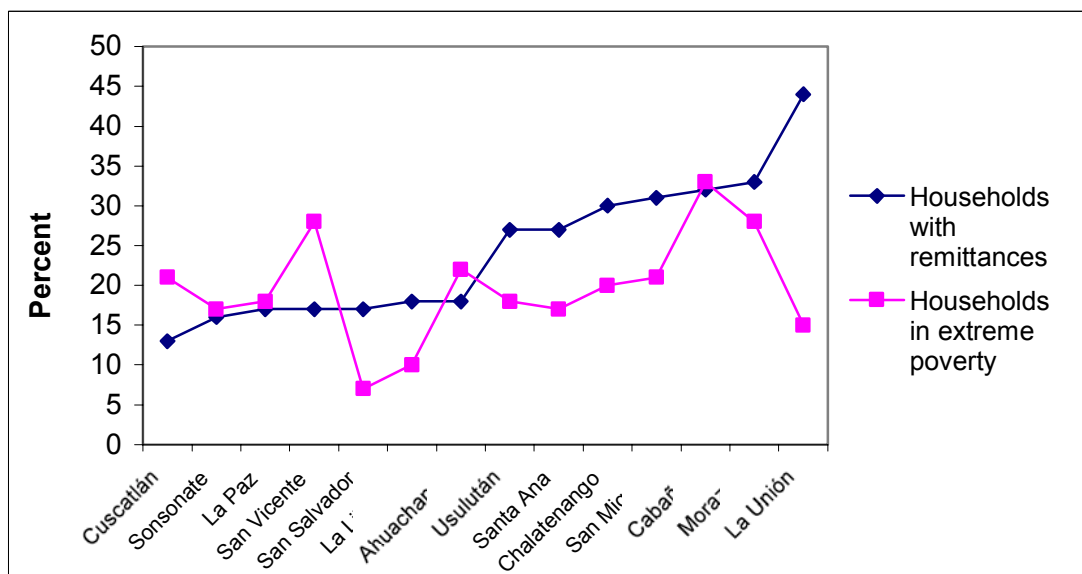


Source of data: DIGESTYC

### 5.3.3 Department patterns

As shown in figure 5.10, there is no apparent correlation between the departments in terms of the number of remittance receiving-households and households in extreme poverty.

Figure 5.10: Remittances and poverty, departments (2003)

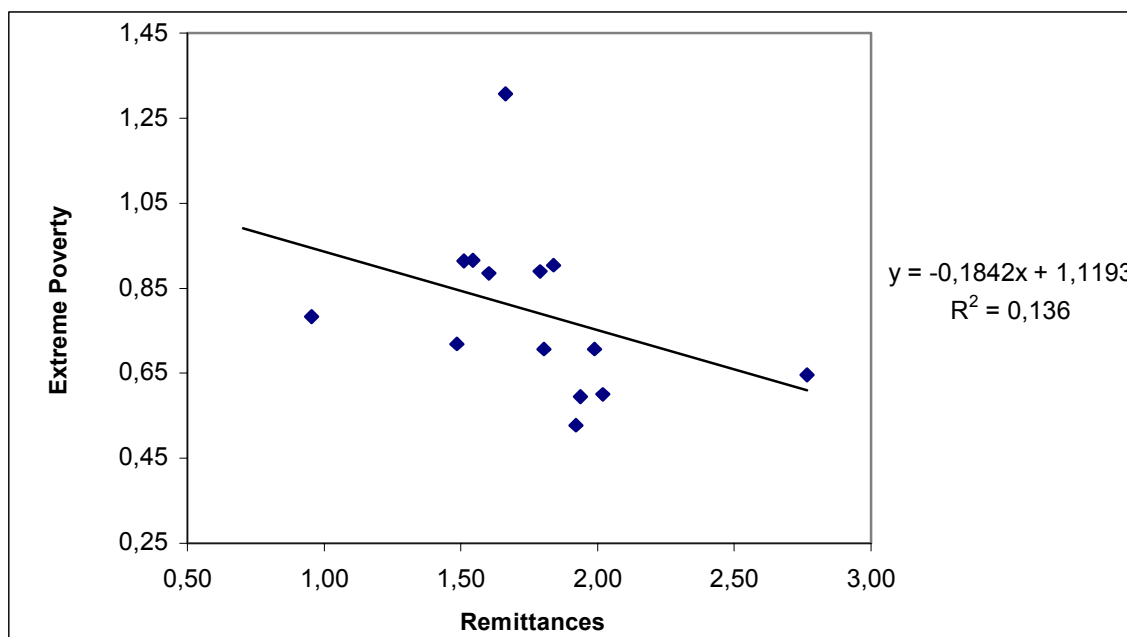


Source of data: DIGESTYC

This does not mean that remittances do not have an impact on poverty. If remittances more often go to poorer departments, they may have higher poverty rates than departments with less remittance income, but remittances still may have reduced poverty to lower levels than would have been the case without remittances.

By testing if the departments with a large increase in remittances per household also experienced a large reduction in poverty rates, and the reverse, the impact of remittances on poverty can be shown. In figure 5.11 I have plotted the changes in remittances and extreme poverty between 1998 and 2003 for the fifteen departments. An inverse correlation between remittances and absolute poverty is confirmed in the model. This means that remittances are important when explaining the changes in poverty, and remittances have a significant impact on poverty. Only one department showed an increase in extreme poverty in combination with an increase in remittances for the period: Cuscatlán. It deviated significantly from the other departments and can thereby not be seen as significantly representative. On the other hand, this still may give important indications of the effect of remittances on poverty, since Cuscatlán was the only department that experienced a drop in remittances during the period (see figure 5.12).

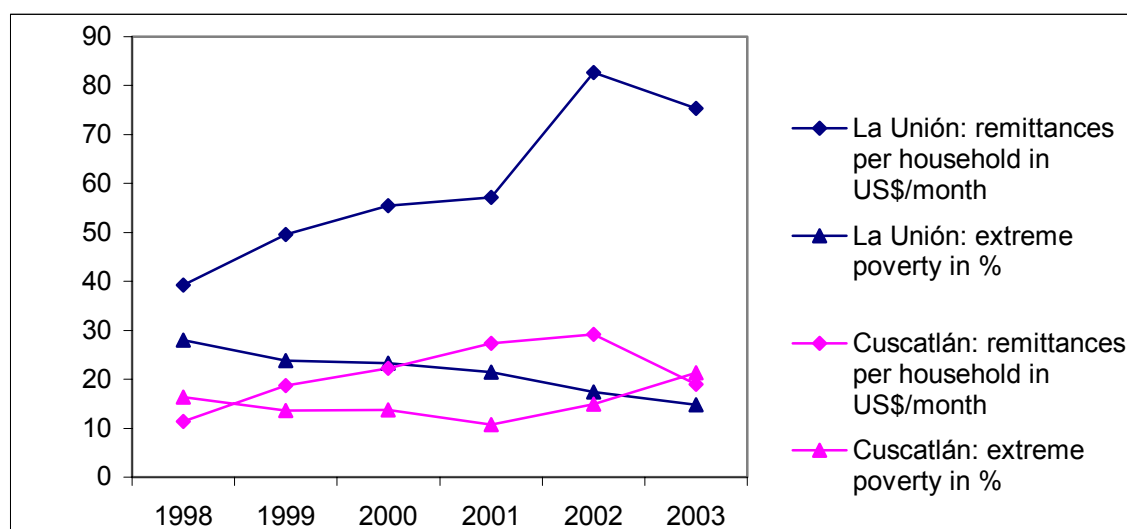
Figure 5.11: Remittances and extreme poverty: Departments (Average change 1998-2003)



Source of data: DIGESTYC

Figure 5.12 shows the department that is most dependent on remittances in comparison with the department with least remittances per capita. This figure is interesting because it confirms not only what is expected; that absolute poverty decreases with increased remittances, but also that, when remittances decrease, the number of households in poverty increase. In Cuscatlán, poverty increased about as simultaneously as remittances decreased. Such an evident pattern cannot be noted in any of the other departments, but none of them experienced a similar drop in remittances per capita. However, La Unión had a significant drop in remittances that is not correlated with increased poverty. This can be because this department receives much more remittances and requires a larger drop in remittances for a notable increase in poverty. If it is a general pattern that poverty will increase with a significant drop in remittances, many households can be expected to return to poverty when they no longer receive remittances. This means that remittances are generally not invested for a secure economic future and therefore should not be seen as a sustainable development tool. That is to say, unless remittances will continue to increase or stabilize.

Figure 5.12: Remittances and Poverty in La Unión and Cuscatlán (1998-2003)



Source of data: DIGESTYC

#### 5.4.2 Remittances and inequality

For a sustainable poverty reduction, it is not enough to achieve lower poverty rates through higher average incomes. Income inequality should also decrease, according to the Poverty-Growth- Inequality Triangle. This has not been the case for El Salvador. Despite higher incomes and lower poverty rates, income inequality has remained close

to unchanged. Remittances are not sufficient in a strategy to reduce poverty, since they do not reach all the poor households. For the poorer households it is more difficult to send migrants because of the cost involved, and as a result there are probably fewer migrants originating from the poorest segment of the society. The multiplier has not been sufficient to make it possible for other households, apart from the receiving ones, to indirectly benefit from the increase in remittance incomes. In addition, inflation, which is partly a result of remittance inflows, is more costly for the non-remittance-receiving poor households, and may thus make the poorest people poorer and increase the income gaps.

## 6. Conclusions

Remittances to El Salvador have grown considerably over the years, and even though it may be too early to determine the long-term effects of remittances, considering that remittances are a relatively recent phenomenon, important indications of the impact of remittances on poverty can be noted. For the receiving households, remittances as a source of income are very important. They contribute directly to raising household incomes in El Salvador, and also broaden the opportunities to increase incomes. Lower remittance incomes are directly associated with an increase in the absolute poverty rates in El Salvador, which is in line with the cross-country studies by Adam and Page (2003) and IMF (2005).

Since remittances have a direct impact on recipient household incomes, a decrease in remittance incomes will leave many receiving households in a difficult economical situation. So far, remittances have been a relatively stable source of income. Data from the Central Bank shows that remittance income in El Salvador increased considerably over the last decade, and the trend does not show any indication of a change in direction. Nevertheless, the national household surveys on remittance trends for the different departments reveal that, although there was a total increase in remittances, five of the departments in El Salvador experienced a decline in remittance income in the last year of the period examined. The declines in remittances on a regional level may well be only temporary, but can also indicate a trend that will become noticeable in other departments as well in the future. If additional regions start to experience a decline in remittance incomes, El Salvador might experience a national slow-down in the increase of remittance incomes in coming years. Although the upward trend of remittance inflows on a national level is still relatively stable, the possibility of a decrease in remittance inflows should not be overlooked. It has been showed in El Salvador that a longer time since emigration has a negative impact on the amount of money remitted. Thus, unless the emigration continues, remittances will probably decrease over time, which possibly will make many households return to poverty.

Some earlier studies have found that remittances have a positive effect on GDP, while others have not found a connection between remittances and an increase in GDP. In El

Salvador economic growth has been low in recent years, but this is not necessarily a result of increased remittances since many factors influence growth. There are studies, including a study of El Salvador by Funkhouser (1992), showing that remittances decrease labour supply (which can have a negative impact on economic growth and poverty in the longer run). Nevertheless, this is not shared by other studies of El Salvador (Andrade-Eekhoff, 2003; Lungo and Kandel, 1999). The latter studies found that, as a result of remittances, some of the recipients have left the agricultural sector for work in other sectors, which has rather led to a shift in labour supply between different work sectors than to a decrease in the labour supply. My results, on the other hand, indicate that moral hazard possibly exists, since many households rely on the income from remittances, and that the labour supply may thus have decreased as a result of remittances.

Earlier studies on remittances and income inequality show support for both higher and lower income inequality as a result of remittances, depending on the country examined. In El Salvador there is no indication on a change in income inequality from remittances. Since indications do not show that remittances have a substantial impact on inequality and growth, they will have a limited effect on the long-term poverty reduction. It has been concluded in the “Poverty-Growth-Inequality Triangle” that sustainable poverty reduction can be reached by a higher mean income of the population and more evenly distributed income. El Salvador has had a large increase in average income in recent years, which, as concluded in the analysis above, is largely a result of increased remittance income. This confirms the positive impact of remittances on poverty, since a higher average income will reduce poverty. Nevertheless, since the increase of remittances has not led to more evenly distributed incomes, remittances alone cannot generate a sustainable poverty reduction.

Finally, it can be concluded that remittances do contribute to a decrease of the absolute poverty rates in El Salvador, and they are an important factor in poverty reduction. However, since they do not reach all poor households, and may affect the non-remittance-receiving households adversely, other factors must support remittances in a poverty reduction strategy, especially policies to reduce income inequality. Without a more equally distributed income, it will be difficult to achieve a sustainable poverty reduction in El Salvador.

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## Appendix

Appendix 1: Map of El Salvador



Source: Wikipedia, [http://en.wikipedia.org/wiki/El\\_Salvador](http://en.wikipedia.org/wiki/El_Salvador) (2005-09-20)

Appendix 2: Per capita remittance income/month in US\$ (1998-2003)

	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
<b>Ahuachapán</b>	15	16	18	20	27	29
<b>Santa Ana</b>	22	26	23	36	36	39
<b>Sonsonate</b>	17	16	16	20	22	25
<b>Chalatenango</b>	15	21	29	35	39	41
<b>La Libertad</b>	18	18	17	22	29	32
<b>San Salvador</b>	16	19	20	25	27	24
<b>Cuscatlán</b>	11	19	22	27	29	19
<b>LaPaz</b>	23	21	20	30	24	22
<b>Cabañas</b>	25	33	28	37	45	49
<b>San Vicente</b>	17	17	23	24	29	26
<b>Usulután</b>	20	25	31	34	38	40
<b>San Miguel</b>	28	29	34	41	44	45
<b>Morazán</b>	27	31	38	45	49	49
<b>La Unión</b>	39	50	55	57	83	75

Source of data: DIGESTYC

Appendix 3: Remittances per Income Group

(Year 2003)

Total Income

	-399	400-999	1000-1499	1500-1999	2000-2499	2500-2999	3000-3999	4000-4999	5000-5999	6000-6900	7000-
<b>Remittance income</b>											
<b>-399</b>	100%										
<b>400-999</b>	33%	67%									
<b>1000-1499</b>	33%	44%	23%								
<b>1500-1999</b>	24%	33%	11%	32%							
<b>2000-2499</b>	31%	34%	9%	14%	13%						
<b>2500-2999</b>	17%	33%	9%	12%	3%	25%					
<b>3000-3999</b>	20%	26%	10%	15%	3%	11%	15%				
<b>4000-4999</b>	16%	30%	8%	14%	3%	9%	12%	8%			
<b>5000--5999</b>	17%	30%	5%	15%	2%	8%	7%	6%	10%		
<b>6000-6900</b>	18%	22%	12%	12%	4%	15%	6%	3%	7%	2%	
<b>7000-</b>	16%	24%	7%	10%	4%	8%	8%	7%	4%	1%	10%

(Year 1996)

Total income

	-399	400-999	1000-1499	1500-1999	2000-2499	2500-2999	3000-
<b>Remittance Income</b>							
<b>-399</b>	100%						
<b>400-999</b>	32%	68%					
<b>1000-1499</b>	32%	54%	15%				
<b>1500-1999</b>	22%	42%	8%	28%			
<b>2000-2499</b>	22%	45%	10%	16%	6%		
<b>2500-2999</b>	19%	37%	5%	16%	4%	19%	
<b>3000-</b>	21%	35%	7%	16%	4%	9%	8%

Source: DIGESTYC