

IMPACT OF REMITTANCES ON BUSINESS CREATION AND SUSTAINABILITY IN  
RURAL COMMUNITIES: A CASE STUDY OF CIUDAD BARRIOS, EL SALVADOR

By

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To my parents, Remo and Lupita, who have been sources of support and inspiration.

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Remittances to El Salvador from the United States have increased considerably in the last decade. The Salvadoran government has implemented a series of macro economic policies aiming at capturing most of the benefits that come with remittances. Development scholars believe these flows can help in alleviating poverty, reducing inequality and increasing the life standards of recipients. On top of this, studies have shown that remittances can spur investment and self-employment activities among recipients. This research was conducted in Ciudad Barrios, a small agrarian community located in eastern El Salvador. Financial institutions in this area reported receiving more than US\$11 million during 2005 in remittance flows from the United States exceeding the predicted annual average of US\$3.7 million.

Our main objective was to examine the link between remittances and investment in rural areas. The examination centered on three research pathways: remittances and investment, remittances and household consumption (local demand), and remittances and the local labor market. Previous literature on these links used data collected through household surveys for their analysis. This study used data collected through interviews conducted with members of the business and financial sector of the selected community.

This study establishes that remittances play an important role in the creation and sustainability of businesses in the agricultural sector. Little evidence is found that shows that remittances have a direct impact on businesses in the construction or service sectors in Ciudad Barrios. However, there is evidence that shows that businesses in these sectors are indirectly impacted by remittances. Through increased consumption and the possibility to improve their life standards, remittance recipients have created the perfect opportunities for entrepreneurs to thrive in this community.

## CHAPTER 1 INTRODUCTION

The flow of remittances to developing countries, such as El Salvador, is of great importance for their macro and micro economic effects. In this thesis, I analyze the role that remittances play in the creation of businesses in a rural community of El Salvador. This is significant because development agencies and recipient countries are seeking to use these flows to promote local entrepreneurship.

### **Remittances**

International migration is one of the social and economic phenomena currently playing a crucial role in reshaping the socio-demographic panorama of many developing nations. Its effects go beyond that of a simple movement of people from one country to another. International migration affects, among other things, the supply and demand of labor in both the host and the sending countries and transforming economic relationships in the communities of origin. One particular effect of international migration is monetary remittances, the portion of money earned by international migrants that is sent back to their countries of origin. These flows are of special interest to policy makers and scholars because of the potential macro economic effects they have (Guarnizo, 2001, 4). Some potential effects include poverty alleviation and economic stimulation. This thesis analyzes information on the impact of remittances on businesses in a rural community setting. The central question of this study is to understand the role of remittances in the creation and sustainability of businesses in rural communities that depend heavily on these monetary flows. This chapter will introduce the topic by presenting a discussion of remittances and their significance, the state of the literature on this topic, and the research strategy designed to answer the research question.

## Definitions

Remittances are a flow of migrant earnings from the host country to the country of origin. The migrant can send the money by using either an informal channel or a formal channel. Remittances sent through the informal channels are transferences done outside the financial systems of both the sending and the host countries. This method is favored by people from areas that are not serviced by the formal financial system. This is particularly true for rural areas (IFAD, 2006, 6)<sup>1</sup>. Remittances from the informal channels are difficult to measure because they are done out of the scope of official documentation. Remittances through formal channels are done by using services provided by the financial institutions of both the host and recipient countries. These transactions are easier to track and report since they are recorded in the official records of the institution but total remittances are heavily underestimated<sup>2</sup>. The transactions are reported by central banks which do not take into consideration informal remittances.

Other forms of remittances, such as in-kind remittances, are also excluded from official counts. International migrants remit more than just money. They also send to their communities of origin consumer goods such as clothing and toys, and capital goods such as machinery, which are not accounted by the official channels. It is important to mention this because capital goods do play a role in the development and the productivity of businesses. Finally, social remittances are not included in official counts because technically they do not represent income earned by migrant workers per se. Social remittances are transferred by Home Town Associations (HTAs),

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<sup>1</sup> The most common method of transferring money through informal channels is by using the services of a human courier. Human couriers transport not just money but also other goods such as clothing and medicines from one country to another (Gammage, 2004, 1).

<sup>2</sup> Although there have been many efforts to improve the data collection methods in order to include informal transferences, most central banks are still relying heavily on the data recorded by the financial systems (IFAD, 2007, 6). International organizations interested in the topic of remittances use the information collected by the central banks in parallel to information collected through household surveys. By doing so, agencies try to take into account remittances done through informal channels. The assumption behind this is that central banks underestimate the quantity of money that actually enters their respective countries (IADB, 2006).

which are groups formed “among remittance senders to coordinate their support of their towns” (Orozco, 2002, 48). HTAs enhance the wellbeing of a given community because of the nature of their activities which range from charitable aid to enhancement of a communities’ infrastructure (Orozco, 2002, 48).

## **Magnitude**

Remittances have become essential to many developing countries. Even if we take into consideration the underestimation problem described above, the flows that are sent yearly by international migrants to the developing world represent extremely large sums. The flow of remittances has increased steadily over the past ten years. Data reported by the World Bank shows that in the period from 1996 to 2006 alone, remittance receipts worldwide increased from US\$106.3 billion to US\$276.2 billion. Figure 1.1 shows the historical pattern, from 1990 to the present, of worldwide remittances as reported by the World Bank. The figure shows not only that the amounts of remittances sent worldwide have increased in the past sixteen years, but also that this increase has accelerated since 2000. One conclusion, drawn by the World Bank is that, at least in the short-run, remittances will not disappear or decline sharply as feared by many critics of remittance dependence. The increase in remittance flows is attributable to two main causes: an increase in the transfer activity and better estimation techniques (World Bank, 2007, 85). It is important to note that the data published by the World Bank relies on figures reported by the central banks. These data are complemented by an internal estimation done by the World Bank to account for informal remittances. To determine the informal flows, the World Bank has developed an econometric equation based on a set of different variables assumed to have an impact on the sending choice of the migrant (informal or formal channels). The variables used are the total amount of remittances sent via formal channels, the fee that is charged to the remitter for sending the money and the exchange penalties. The assumption behind this equation

is that the total amount sent via informal channels depends on how accessible the formal channels are to the senders and the recipients, both in terms of cost of service and geographical distance. This equation still does not fully capture the total amount sent through informal means.

Although worldwide levels of remittance flows have attained higher levels than ever before, the flows are not distributed evenly among countries. Some regions, such as Asia and Latin America, receive a larger share of the flow than the rest of the developing world. Figure 1.2 shows the distribution of remittance flows by region. The graph shows the proportion and the actual values of remittances to each region. Latin America received an estimated 23% of total worldwide remittances, trailing significantly behind the Asian region which received an estimated 37% of total remittance flows. The Near East region, which encompasses Turkey, the Middle East<sup>3</sup> and some ex-USSR<sup>4</sup> territories, received a minimal 10% of the total pie, in 2006.

### **Remittance Flows to Latin America**

Latin America is the second largest recipient region in the world after Asia. The flow of remittances has increased consistently in the past twenty years, with annual growth rates higher than fifteen percent since 2000 (Acosta, 2006, 959). Remittances to the Latin American and Caribbean region have also shown an upward trend, growing as much as 50% in the course of one year. It is estimated that in 2005 the Latin American and Caribbean region received US\$44.5 billion which increased to US\$68 billion in 2006. According to many development agencies, such as the Inter-American Development Bank, the amount of remittances that the Latin American region receives annually surpasses both the foreign direct assistance and foreign direct investment (IADB, 2006). This flow has tended to be especially concentrated among Mexico, the

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<sup>3</sup> The report presents information on Iran, Iraq, Jordan, Lebanon, West Bank and Gaza, Syria and Yemen only.

<sup>4</sup> The countries are present day Armenia, Azerbaijan and Georgia.

Central American countries and some Caribbean nations. In order to further understand the puzzle of remittances it is important to look at them from two angles. The first perspective looks at remittances from a purely quantitative angle by looking at the absolute values. The second perspective tries to understand the importance of remittances by looking at what these flows represent to the countries' economies by comparing them to their national GDP and national exports figures.

The first perspective, which looks at remittances from a purely quantitative angle, shows that the largest recipients in the region are Mexico and Brazil. It is estimated that Mexico alone received US\$24 billion in 2006. Brazil followed with an estimated US\$7 billion that same year (IFAD, 2007, 14-15). The Central American region received an estimated US\$11 billion, of which El Salvador alone received US\$3 billion. The IFAD also reports that the South American region received an estimated \$24 billion in 2007. These flows would be much higher for all regions if informal remittances were accounted for.

The second perspective, which focuses on remittances in terms of proportion of the GDP, provides a better understating of how strong their economic impact on a given country. Generally, smaller countries (smaller economies) are more financially dependent on remittances than larger economies such as Mexico (See Table 1.1). It comes as no surprise then that countries such as Honduras, Haiti, El Salvador and the Dominican Republic are more impacted by remittances and they depend more on the remittance flows they receive. Larger economies, such as Brazil and Mexico, depend much less on remittances even if quantitatively they receive more (IFAD, 2007, 14-15). This thesis focuses on the impact that international remittances have on smaller economies by looking at the case of eastern El Salvador. This region has been identified as being the one which receives the most in the country (Gammage, 2004, 3-4).

## **The Literature**

As stated in the previous paragraphs, international remittances are large transfers of money from destination to origin countries of migrants. The literature on remittances has focused on understanding both the reasons why international migrants decide to remit a portion of their earnings and the potential socioeconomic impacts that these flows of money can have on the economies of the receiving countries.

Remittances represent an important influx of foreign capital into the local economy of the recipient country. Agencies such as the IADB and World Bank have determined that the amount of remittances sent to Latin America in recent year surpasses the amount sent to the region as foreign direct investment and as foreign aid (Acosta et al, 2006, 957). Many scholars argue thus that remittances represent a source of capital that could potentially change the socio economic panorama in the region (Acosta et al, 2007, 59-60). The literature on international migration and remittances can be divided into studies that focus on explaining migration decisions, studies that focus on the effects of remittances on poverty and inequality, on the relationship between remittances and entrepreneurship, on the link between local consumption (household demand) and remittances, and finally on studies that investigate the impact of remittances in the macro-economy.

### **Understanding Migration and Remittances**

When studying remittances it is necessary to do so by understanding the conditions that lead people to migrate in the first place. The Harris-Todaro model is one of the more popular models employed to explain out-migration from rural to urban areas (De Haan, 1999, 4). This model proposes that an individual's decision to migrate is influenced by two factors. First, the potential migrant foresees a wage differential between the origin and the destination and second, is the perceived probability of being employed at the place of destination (Todaro, 1969). This

model, although still influential, has its shortcomings. Scholars now argue that migration is caused by many reasons beyond the expected wage differential between origin and destination. De Haan reviews a list of studies that show that migration happens also as a response to poverty, lack of access to land, lack of labor opportunities, violence, and government insecurity. A model developed in the late 1980's by Stark and Lucas extends that of Harris-Todaro by looking at migration as a household level strategy. They argue that emigration, in general, is a decision taken at the household level in order to spread the risk and pool more resources, and as protection against market imperfections in the rural areas (especially in the credit markets). Stark and Lucas explain remittances in this model as returns from the households' investment on migration (Stark, 1988, 466-468).

Studies conducted in the specific case of Latin American migration patterns show that migration in general occurs as a response to various factors, including poverty and violence. Latin American nations have been characterized for their widespread poverty, high levels of wealth inequality, and a lack of labor opportunities (Orozco, 2003; Amuedo-Dorantes, 2006; Pastor, 1990). On top of this, there exists an income differential between the Latin American region and developed countries. In the case of El Salvador, massive emigration to developed nations started as a response to widespread violence due to the civil war. After the civil war, the country still experienced high out-migration. These high rates of emigration are related not only to the climate of insecurity but also to poverty, inequality, unemployment, social pressure and family reunification (UNDP, 2006, 34).

Despite the fact that many scholars explain migration as an escape from poverty and income inequality, several authors have established that, in developing countries, it is not the poorest of the poor who migrate (De Haas, 2005; De Haan, 1999; Skeldon, 2002). As De Haas

points out in order to emigrate, the household and/or the individual must possess a certain level of social capital, financial capital, skills and a sense of entrepreneurship. These attributes are significant because they imply that households receiving remittances do not live below the threshold of extreme poverty.

### **Remittances and Poverty**

Remittances are a by-product of international migration. They are considered one of the many tools which can help countries attain their economic development goals especially in regards to poverty alleviation. Despite this effect, the relationship between remittances and poverty is still elusive at the best and varies from region to region (De Haan, 1999, 26-27). On one hand there are studies which have demonstrated the benefits of remittances. Studies conducted by international organizations, such as the World Bank, conclude that remittances have a statistical impact on reducing poverty levels in the developing world (World Bank, 2007: 108). On the other hand, there are several studies that show that remittances have a negative impact on poverty alleviation. It is argued that remittances contribute little to decrease poverty levels, because they create dependence among recipients. In the long run, this dependence only fuels more migration because recipients are forced to keep up with the consumption levels. This dependence is referred to as “the migrant syndrome” (Brown, 1994, 348).

The supposed effectiveness of remittances as a tool to promote economic development is certainly reduced if one takes into consideration that international migrants, who are remittance senders, do not come from among the poorest of the poor households. It has been well established that international migration is only an option if the individual possesses a certain level of social, human and financial capital. Following this logic, it is thus arguable that remittance recipients are not necessarily living under the poverty lines, which limits the potential of remittances to help lower poverty headcounts and inequality. Acosta (et al in 2007) found that

in countries such as Nicaragua and Peru most remittances go towards people living in the top quintile of the income distribution. Countries such as Dominican Republic show a more equitable distribution with the lowest and the highest quintiles receiving most of the remittances. This same study showed that in the case of Mexico and El Salvador, remittances are, by far, destined for people in the lowest quintile of the income distribution. Furthermore, it has been argued that remittances can have the potential to reduce poverty but they alone will not resolve the structural causes that create it (IADB, 2006).

Despite all the concerns raised, there is large amount of research which has shown that remittances have a statistical impact on reducing poverty and income inequality. Furthermore, some scholars argue that by using remittances to cover basic needs, like nutritional or education needs, living standards in recipient countries are increased. This investment in life improvement has an impact on reducing poverty and inequality, if not in the short run at least in the long run.

One specific study published by Adams and Page concluded that remittances have a “strong statistical significant impact on reducing poverty in the developing world.” Their paper studied a data set that included measures of poverty, inequality and migration (among other things), collected from 71 developing countries. Other studies have examined the link between international migration, remittances and poverty reduction by looking at specific countries and/or communities of migrants in a specific country. For example, Adams analyzed data from Guatemala and found evidence that international remittances help reduce the severity of poverty by 19.8% (Adams, 2004, 19). Another study, undertaken by the United Nations Development Program in El Salvador concluded that remittances helped ease poverty and income inequality. Their data demonstrates that, at the national level, the Gini coefficient would increase from 0.50 to 0.54 if remittances were to suddenly stop (UNDP, 2006, 82).

But remittances do not simply alleviate poverty in the short term. By reducing budget constraints among recipient households, remittances allow people access to education, health care and ultimately improved living conditions. For example, in the case of El Salvador it has been found that remittances help reduce the dropout rates among elementary students, especially among students in rural areas (Cox, 2003, 456-457). This is important because spending money on human capital and physical wellbeing advances development in a country. This article also argued that remittances have a spillover effect and can make an impact on the wellbeing of non recipient households.

### **Remittances and the Business Sector**

The literature on remittances and the business sector is more limited than the literature on remittances and poverty. The business sector literature can be divided into studies that focus on the relationship between remittances and investments (entrepreneurship), and those which focus on remittances and business conditions. The analysis of business conditions literature will be included in the section on remittances and macro-economy.

There is evidence that remittances can help in areas other than poverty alleviation and income redistribution. Studies have established that remittances can help spur business investments in the communities of origin. Remittances have been thought of as an opportunity to create and expand business environments and markets throughout the region not only by the potential investment opportunities but also because of the demand for national products and services from the international migrants (Guarnizo, 2001, 12-14). They also help the business environment by spurring household consumption. The increase in household expenditures on items such as clothing, schooling, health care and improved living conditions is significant to the communities that receive remittances (Jennings et al., 2005, 688). Other scholars have reached similar conclusions. One such study, conducted among Mexican migrants in the United States

concludes that an increase in household consumption provides entrepreneurial opportunities for both migrants and non-migrants alike (Massey et al., 1998, 11-12). This same effect was found by Durand et al., who studied the effects of international migration in selected communities in Mexico. This study concluded that by increasing household consumption at the local level, remittances have a multiplier effect which spurs investment in the recipient community (Durand et al., 1996, 249).

Remittances, as outlined above, create demand for consumer goods by reducing constraints on household consumption. This in turn, creates entrepreneurial opportunities and also provides the required capital to finance such activities. There are some studies that have focused on the subject of the use of remittances as capital to finance new businesses and/or acquire new assets within an existing business. Studies based on household surveys show that remittances are sent not only to help cover daily expenses but also to invest in business opportunities in the migrant's home countries. In a study of remittance patterns in the South Pacific islands, Brown found that a portion of remittances received are invested and or saved (Brown, 1994). A similar conclusion is reached by Acosta et al. Their study focused on entrepreneurial activities and labor market participation among remittance recipient households in El Salvador. They concluded that "remittances increase entrepreneurial activities among recipients" (Acosta, 2007, 153-155). This study was based on data collected by the Encuesta de Hogares de Proposito Multiple<sup>5</sup> from 2000 conducted by the Salvadoran government. This same conclusion has been reached by studies conducted on different migrant groups, such as Mexican, Turkish and Pakistani international migrants (Woodruff, 2007). The study conducted by Woodruff et al differed from the previous published literature in that results were based on Mexico's National Survey of Micro-enterprises

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<sup>5</sup> This is a household survey undertaken at the national level.

conducted in 1998 rather than household surveys<sup>6</sup>. A study using data from the Dominican Republic found evidence that a portion of remittances are used to finance current operations. The authors argue that Dominican migrants remit money because they expect to collect future returns from these investments (Amuedo-Dorantes and Pozo, 2006, 950).

The potential benefits that remittances can have on the business sector in any given country are minimized if the business environment is not appropriate. Remittance scholars point that in order to fully take advantage of these money inflows (for business creation), developing nations should promote structural reforms in order to attract more investment to the countries. This policy recommendation is also shared by other social scientists, which see the lack of confidence in the government institutions as one of the major obstacles to investment from the part of international migrants (De Haas, 2005, 1275).

### **Other Economic Effects of Remittances**

Remittance flows to developing countries have been determined to impact the macro-economies of the countries receiving them. Research on this subject is more limited, as most research has focused on the impact of remittances on poverty reduction and household expenditure patterns. The surveyed literature examines the impact of remittances at the macro level by looking at the effect they have on the real exchange rate and on the labor market.

Remittances are believed to have a negative impact on national businesses by affecting the real exchange rate of the recipient countries. A review conducted by Amuedo-Dorantes published in 2006 found that remittances helped appreciating the currency of recipient countries (Amuedo-Dorantes, 2004). To national business, an appreciated currency translates into loss of

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<sup>6</sup> This survey collected information from a sample of Mexican micro-firms with less than 15 workers. The survey focused on areas such as startup capital, sales and employment. The case study conducted in Ciudad Barrios took a similar approach by focusing on the business side as opposed to focusing on household data.

competitiveness in the domestic and international market because national production becomes more expensive to consumers. If national production is more expensive, then consumption patterns, at the national level, would shift as dictated by the law of supply and demand as consumers would prefer to purchase imported goods available at cheaper prices than that of locally produced goods. A particular study focusing on the impact of remittances in El Salvador argues that the current inflation rate and the increase in imports can be correlated to the increase in remittances (Caceres, 2005). Remittances could then be compared to the so-called Dutch disease<sup>7</sup> because of the effects they have on local production which will affect the business environment in the country.

Remittances can also have an impact on the labor market of a country. Some studies have concluded that remittances tend to increase the reservation wage of recipients. This translates into a decreasing participation in the local labor market. A decrease on labor supply would, in principle, put an upward pressure on national salaries. Research on this subject has also found that remittance receipt is associated with an increase in self-employment activities. In the case of Nicaragua, for example, it has been shown that remittance recipients are more likely to drop from the labor market and are that self-employment rates increase. This finding however does not mean that remittance recipients will become self-employed (Funkhouser, 1992, 1214-1215). Research focusing on El Salvador has shown that remittance receipt is associated with a decrease in the participation in the labor market, especially among rural households. The decrease is expressed by either stop participation in the labor market or by decreasing the number of hours

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<sup>7</sup> Dutch disease is a concept that refers to the effects of large inflows of foreign exchange, stemming from the export of a single sector (usually based on a natural resource), that will cause the real exchange rate to appreciate and make exports falls. Some economists argue that Dutch Disease is not limited to the exploitation of one single sector but can also occur with other large transfers of foreign capital, such as in the case of Foreign Aid. (Barder, 2006)

worked. This study also found that remittances help recipients overcome weaknesses in the credit market, which allows an increase in self-employment activities (Acosta, 2006, 153-155).

Many development policies of recipient countries are now focusing on capturing the potentials benefits of remittances. The case of El Salvador is a good illustration of how a government can incorporate this element into its public policies. As remittances show that they can help the national economy, a set of new policies and institutions have been designed. These new institutions implicitly encourage and facilitate migration (Gammage, 2006, 89). The Salvadoran government hopes to attract investment from the large Salvadoran transnational community. It is estimated that as many as 2.7 million Salvadorans have migrated to developed countries since 1980. Salvadoran migration is not stopping or slowing down according to various reports and it is thought that around 6,000 people leave the country per month, most without visas or work permits (Vega, 2006). This emigration is specially affecting the rural areas, as pointed by the UNDP report on El Salvador for 2005. The preferred destination, especially for the current generation of international migrants, is the United States. On top of that, the Salvadoran Central Bank reported that in 2006 remittance flows reached a high point of approximately US\$3.3 billion, representing 17.9% of the national GDP (US\$18.5 billion). Remittances are distributed among a third of the population in El Salvador. According to data published by the Salvadoran government, an average of 22% of the total households in the country receive remittances periodically (UNDP, 2006; FISDL, 2004).

## **Approach**

### **Research Questions**

The subject of remittances has become increasingly important to development economists. The studies cited in the above section show that there is an interest in understanding what effect if any, remittances have on the economies of recipient countries. Most of these studies approach

the subject of remittances through an analysis of data collected by national household surveys. Of the studies cited in the above section, only one (Woodruff et al) tried to understand the relationship between remittances and investment by analyzing data collected from surveys of businesses. A similar focus is given in this thesis. The effect of remittances on investments is studied from the perspective of businesses in a community with heavy migration outflows and remittance inflows.

The central question that will be answered in this study is: What is the role played by remittances in the creation and maintenance of businesses in rural communities? The surveyed literature on remittances and entrepreneurship showed that remittances may create and increase entrepreneurial activities by expanding demand for consumer goods and by providing the required start-up capital.

The rural community chosen for this study is located in eastern El Salvador. This region receives the highest share of the remittances that go into El Salvador which in 2005 equaled an estimated US\$2.8 billion. Ciudad Barrios, the community of interest, received an estimated US\$11 million the same year (only counting formal remittances<sup>8</sup>). To answer the research question, the business sector of Ciudad Barrios will be studied in depth.

## **Research Design**

One of the most challenging decisions made was to select an appropriate research strategy. This section will provide information on the selected research strategy and the reasoning behind this choice. The study's research question, as pointed above, is to understand the effects that remittances have on businesses in a rural community from the local business sector's

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<sup>8</sup> This number is based on information provided by the financial institutions. These institutions are only able to account for remittances transferred through them. Informal remittances would not be counted by their official records.

perspective. To answer this question a qualitative approach was deemed more appropriate because it provides the investigator with more flexibility to expand on issues of interest. There are many different qualitative research approaches: literature reviews, analysis of official documents and archives, longitudinal studies and case studies just to cite a few<sup>9</sup>. To address the research question more appropriately, a case study approach was selected over other qualitative research strategies.

A case study is more useful than other research approaches if the purpose of the research is to describe a current phenomenon rather than to predict possible outcomes. In this particular study, the research question calls for an answer that provides a complete picture of the effects of remittances on a given community. A more quantitative oriented research strategy would have been more adequate if the purpose of the study was to predict different scenarios.

The second reason to select a case study approach has to do with the current state of the research on the topic of remittances. The surveyed literature proves that remittances have been analyzed by scholars of various disciplines and by policy makers. It is safe to assert that the exploratory phase of research on remittances has already been completed. The purpose of conducting this particular study was to expand on the links between remittances and the business sector. Selective case studies are more appropriate when there is an extensive record of research on the issue but the particular study adds to this record by refining the existing knowledge (Hakim, 2000, 60). Most of the research conducted that has directly or indirectly attempted to understand the impact of remittances base their analysis on information collected through household surveys. Only one study was found which used data from a non-household survey<sup>10</sup>.

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<sup>9</sup> In her book 'Research Designs', Hakim points to eight types of research strategies considered qualitative research.

<sup>10</sup> Woodruff and Zenteno, 2007

This study differs from other research in that it focuses on the business sector perspective and does not use information from household surveys.

The final reason behind the strategy selection has to do with the fact that the study focuses on certain 'operational links'. In his book, "Case Study Research", Robert Yin argues that case studies are more appropriate if the goal is not to understand incidences or frequencies but rather operational links (Yin, 1984,22-24). This study will focus on three links: remittances and investment, remittances and consumer demand (local consumption) and remittances and labor markets.

Although he does not give a precise technical definition of what is a case study, Robert Yin does provide a good overview of the main goals of a case study.

A case study is an empirical enquiry that: investigates a contemporary phenomenon within its real life context; when the boundaries between phenomenon and context are not clearly evident; and in which multiple sources of evidence are used

These goals apply to this case study in that it analyzes a current phenomenon, remittances, in a real life context: Ciudad Barrios. The research was conducted on site, as opposed to working with an already existing data set. In this sense, this study is not separating remittances from their context but rather trying to understand the effect that remittances have on the business sector of this community. Finally, the third objective, to rely on various sources of information, is also met in that the study draws its conclusion from an array of sources: interviews with members of the business sector, an analysis of official records and a survey of the literature on the topic.

As mentioned above, the data collection process was done in three ways. The most important research method used was that of in-depth interviews. This type of interviewing does not follow a particular structure, even though there are certain topics and/or areas which are required to be discussed. In her book, Hakim argues that structured interviews differ from unstructured interviews in that the former rely on pre-designed questionnaires like a survey.

Structured interviews rely on “close-ended” questions, whereas unstructured interviews rely on “open-ended” statements that give more room to discuss issues not contemplated in the original guide. The other two methods used in this case study are literature review and analysis of official records. The records reviewed for this study were obtained through some study participants. Such records included a report of all the businesses operating in the community, which was obtained through the local government’s office of Ciudad Barrios, and various fiscal year end reports obtained from some of the financial institutions present in the area. Records from the financial institutions provided information on the magnitude of remittances in Ciudad Barrios. Records from the local government’s office helped construct a clearer picture of the business sector composition in the municipality.

The in-depth interviews that build this case study were conducted among members of the business sector in a rural community of Eastern El Salvador. As mentioned earlier, this country has received large amounts of remittances in the last decade. In 2006, remittances to El Salvador amounted to US\$3.3 billion, representing 18% of the country’s GDP. Most money goes to households in the eastern departments of the country, especially the departments of La Union and San Miguel<sup>11</sup>. According to reports from the Salvadoran Government, an estimated 22% of households at the national level receive periodical remittances (DIGESTYC, 2004). The municipality selected for this research is located in the department of San Miguel. It is estimated that 32.5% of the households in the community receive periodical remittances (DYGESTIC, 2004).

Ciudad Barrios is a small municipality that has experienced much economic growth in the last decade. Its economy depends largely on the remittances that are sent by international

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<sup>11</sup> See Appendix A

migrants. Although the community has traditionally depended on agriculture, the business sector has grown considerably especially in the area of services. There were a total of twenty-one interviews conducted among members of the business sector in the area. The interviews were divided as follows: three interviews were conducted with members of the agricultural sector; nine interviews were conducted with commercial business owners, six interviews with managers of the financial sector and three interviews with members of the 'manufacturing' sector. On top of these interviews, one previous interview was conducted with the manager of a financial institution that works indirectly with Ciudad Barrios<sup>12</sup> and one interview was conducted with the mayor of the municipality.

Each interview conducted followed a general guide which indicated the topics that needed to be addressed during each interview. The guide was adapted to the type of activity that the business performs. The interviews in general were designed to obtain information on the three linkages discussed previously.

The first research pathway tries to understand the relationship between remittances and business investments. More specifically, this pathway tries to understand whether remittances are being used as startup capital and/or to finance current operations. To get this information, participants were asked about the source from where their startup capital came, credit opportunities present in the municipality and land prices in the vicinity. Businesses, in the agricultural sector were specifically asked about where they obtain financing for their crops and whether other activities had become more profitable (especially activities dealing with land and the sale of parcels). In the case of businesses participating in the manufacturing sector, their

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<sup>12</sup> FEDECACES is a cooperative of credit unions at the national level. This organization works closely with the largest credit union in Ciudad Barrios. The manager of FEDECACES pointed that their partner in Ciudad Barrios had experienced a 300% growth in a period of five years. This interview was essential in selecting the research site.

interview guides did not include any question relating to the link between remittances and investment. Businesses in the service sector (non-financial activities) were asked about who provided them with start-up capital and how do they finance current operations. The financial sector was, by far, the most important sector in understanding the link between remittances and investment in the community. Interviews focused on the credit products available to the business sector in Ciudad Barrios and the saving behavior among remittances receivers.

The second pathway analyzed in this case study centers on the link between remittances and consumption (seen from local demand). One conclusion reached by various studies is that remittances increase the consumption patterns of recipient households. From that it is easy to assume that this expanded local demand (due to remittances) will be an incentive for local entrepreneurs. These entrepreneurs will see the opportunity to do business and meet the increased demand. To analyze this pathway, each sector was asked about their input consumption and their client base. In the case of the agricultural sector, participants were asked about who provides their inputs in order to determine whether they buy from local sellers or not. All interviewees were asked to describe whether their client base received remittances (to the best of their knowledge). Businesses in the service sector were also asked to describe sales patterns and the origin of the goods that they sell.

The last pathway focused on the relationship between remittances, international migration and the local labor market. This relationship was examined from two perspectives. First, the expansion of the business sector in Ciudad Barrios should have, in principle, created more employment opportunities (demand of labor). To examine this, each of the interviewed business was asked about the number of employees currently working for them. Businesses were also asked to examine how international migration has affected their labor supply.

## Summary

The purpose of this thesis is to examine more closely the effects that remittances have on business investments in a rural community. The literature on this topic suggests that remittances increase the expenditure of households on consumption and consumer goods. Some scholars have also suggested that remittances are used by entrepreneurs to start-up small businesses. The goal of this study is to examine how remittances affect business creation and business sustainability in the longer run in rural communities. This study was conducted in the community of Ciudad Barrios in El Salvador. Members of the business sector of this community were interviewed and asked about the link between remittances and investment, remittances and local demand (consumption) and remittances and the local labor market. This case study has been organized in three chapters. The first chapter provides background information on the current situation of El Salvador and the community of Ciudad Barrios. The information presented in this chapter provides a framework to understand the profound effect that migration and remittances have had and continue to have in this country. Following this, the second chapter discusses the results from this study and presents an analysis of the data collected in Ciudad Barrios in terms of the three research pathways previously discussed. The third and final chapter serves as a conclusion to the study and a discussion of the implication of this research for future policy making and potential future research studies.

Table 1-1 Remittances for Selected Latin American Countries, 2006

Country	US\$ Million	% GDP
Honduras	\$2,286	24.80%
Haiti	\$1,049	21.10%
El Salvador	\$3,328	18.20%
Nicaragua	\$798	14.90%
Dominican Republic	\$2,739	9.00%
Ecuador	\$3,162	7.80%
Colombia	\$4,516	3.30%
Mexico	\$24,354	2.90%
Brazil	\$7,373	0.30%

Source: IFAD, 2007

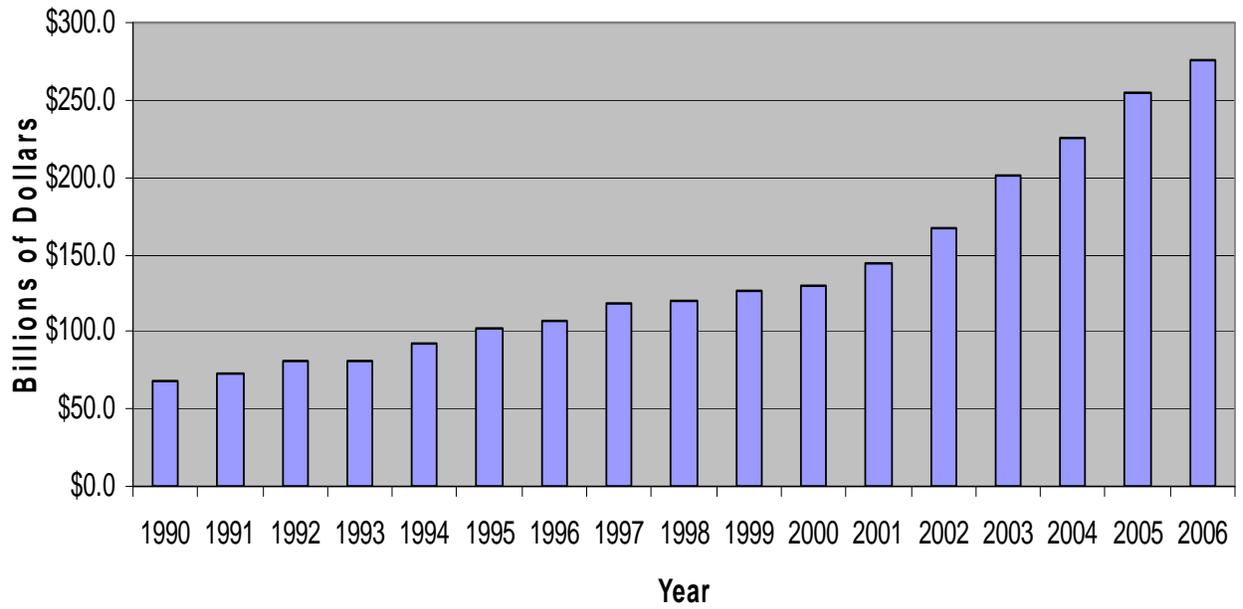


Figure 1-1 Workers' Remittances Worldwide. Source: *World Bank Database*  
<http://go.worldbank.org/6HAYAHG8H0>

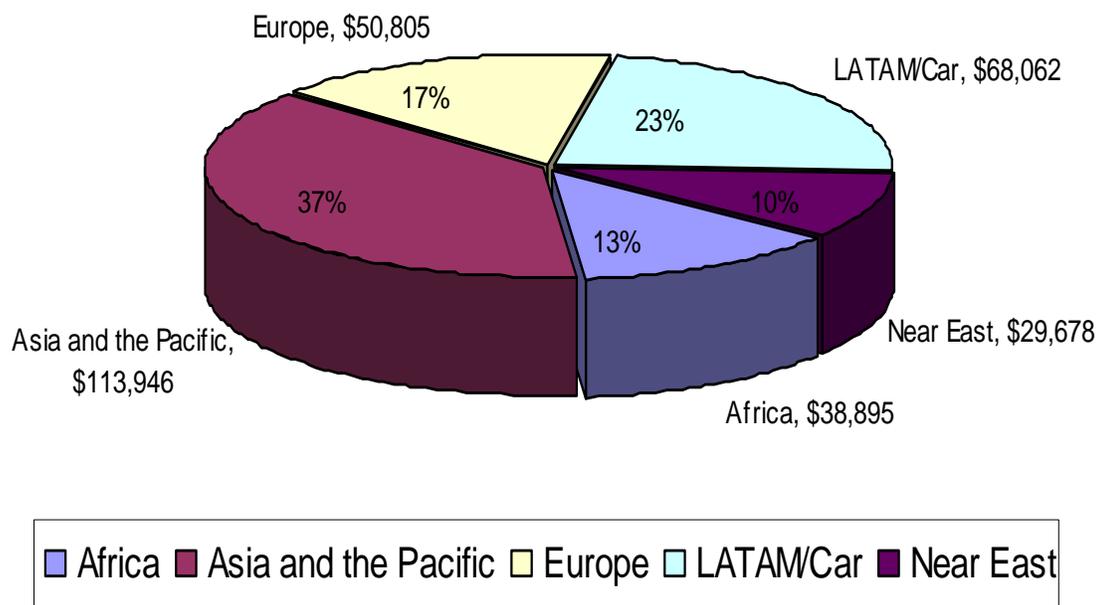


Figure 1-2 Remittances by Region in 2006: Amounts and Percentage of World Total (US\$ Millions). Source: IFAD, 2007.

## CHAPTER 2 THE CASE

Remittances have become an important source of revenue for El Salvador. In a country which received remittances that amounted to US\$3.3 billion in 2006, it is estimated that around 22% of the households at the national level receive remittances every month. Research has shown that in El Salvador remittances help reduce income inequality and poverty rates (UNDP, 2006). Understanding how remittances impact this country requires knowledge of the socio-economic and political-economy history since the 1980's. It is during this decade that international migration intensified as a consequence of the civil war. This chapter provides necessary background information on the country that will explain migration and remittance patterns.

The description of the research site will be divided into two sections. The first section provides an overview of El Salvador. This first section is introduced by a short discussion of recent historical events that have influenced the migration trend in the country and then focuses on the socio-demographic and socio-economic characteristics of El Salvador. This section is followed by a discussion on international migration and remittances that will introduce the case of Ciudad Barrios. The second section gives a complete description of the research site and its current socio-economic state.

### **El Salvador**

#### **The History of El Salvador**

Migration patterns in El Salvador have been heavily influenced by its recent history. This section will deal with the major historical events, which are relevant to migration, since 1980. That year marks the beginning of the civil war that ravaged the country for nearly twelve years.

Although political violence had started before 1980, that year is usually seen as the official beginning of the civil war.

International migration has always occurred in this country. There have been different waves of migration, the first one starting in the 1920s and the second one starting in the 1970s. As indicated, this section deals primarily with the historical events post 1980, which also happens to be the start of the third wave of emigration. There are different reasons for which this civil war erupted. Social unrest had been present as early as the 1930's in El Salvador. This unrest was due in part to the lack of democracy and the increasing levels of poverty and inequality. A series of violent political and social events triggered the war, the most notable being the assassination of Archbishop Oscar Arnulfo Romero by members of paramilitary groups in March 24, 1980 and ensuing massacre of mourners at his funeral by official forces (Boland, 2000,32-35).

The conflict involved different players, among which were the official forces, the guerrillas (FMLN), paramilitary groups and the rest of the Salvadoran society. Boland describes the FMLN as a revolutionary umbrella organization for several minor guerilla groups deriving its military and financial support from the former Soviet Union bloc (Boland, 2000,32-35). The majority of its members came from student organizations, unions, religious workers and collectives. Throughout the civil war, the FMLN was able to control most of the eastern region of the country. The result of this was felt at both the social and the economic level. Economically, the region was very hard hit because it relied heavily on agriculture. The increasing violence and the declining prices in the world market hurt the sector considerably. Socially, the violence intensified the process of out-migration among rural households. A report published by Salvadoran Foundation for Economic and Social Development (FUSADES) contends that about

34 percent of rural households report at least one member of the household leaving the country during the period of the civil war (Gammage, 2006, 77).

The civil war was costly in economic and also in psychological terms. The death toll of this 12-year conflict has been set to at least 70,000 people. On top of that the civil war displaced at least one million people from their communities of origin. The Salvadoran conflict ended in 1992 with the Chapultepec Peace Accords. This accords recognized the need to build a more democratic and equalitarian society. Since 1992, El Salvador has celebrated three elections which have demonstrated the improvements in the area of political democratization. The former guerrilla group, FMLN, have become an important political actor in present day El Salvador. However, they have yet to win a presidential election. At the end of the civil war many Salvadorans had fled and migrated to different regions of the world. The majority of the emigration went to the United States and a small minority to countries such as Australia and Sweden.

After the 1990s, the Salvadoran government changed several macro level policies to reduce the social problems that fueled the civil war. Emigration, however, continues to be a major trend among Salvadoran households especially in the rural areas. This is linked to the declining economic importance of the agricultural sector, the transition towards a fully liberalized service oriented economy and the underemployment levels being experienced in the country (Gammage, 2006).

In this last decade, the country has been involved in a series of profound changes in the macro-policy arena. Among other things, these changes have sought to strengthen the service sector (especially the financial sector) and to control interest and inflation rates. One of the most important decisions taken has been the dolarization of the Salvadoran economy. This process

was started under the mandate of President Francisco Flores in 2000. The goals of such decision were to eliminate exchange rate fluctuations, control inflation and influence the interest rates, and take more advantage of the flow of remittances that was coming in. These changes have also opened the Salvadoran economy to international trade. Among the most important events in this arena seems to be the signing of several trade treaties like CAFTA-DR<sup>1</sup> which took effect in March 2006. To comply with these treaties, the Salvadoran government engaged in the privatization of several important state owned enterprises.

### **Population**

El Salvador is the smallest country in Central America in terms of geographical area, yet it has the highest population density. With only 21,000 square kilometers, the country has an estimated 6.9 million population (2006). The population density for that same year was of 337 people per square kilometer. Population growth has been fairly constant in the last decade with an average growth of 1.8% per annum. On the other hand, the birth rate (per 1000 people) has shown a tendency to decline since the 1990s. In 2005, the birth rate was of 24 births per 1,000 people down from 30 births per 1,000 people in 1990<sup>2</sup>.

Another important feature of the Salvadoran population it is shifting from rural communities into the urban areas. In 2000, the share of rural population had decreased to 41.60% of the total population from 50.8% in 1990. This percentage had decreased even more by 2006, when the share of rural population hit a low 39%. Figure 2.1 shows the population distribution over a period of fifteen year by population total (in million).

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<sup>1</sup> CAFTA-DR is a trade agreement between the Central American countries and the Dominican Republic with the United States.

<sup>2</sup> Data obtained from the World Bank Database

International migration is also another important trend among the Salvadoran population. Although there is no consensual number on how many Salvadorans have emigrated, most experts agree that emigration has increased in recent years. The UNDP office determined that the migrant population represents at least a 20% of the total population in El Salvador.

## **Poverty**

According to data published by institutions such as the World Bank and the UNDP, El Salvador has significantly reduced poverty in the past ten years. The data from the World Bank (World Bank Database, 2008) estimate that in 2002, 37.2% of the Salvadoran population lived under the national poverty line. This number was down from the estimated 50.6% that the World Bank reports for 1995. This is also validated by data obtained from the UNDP which shows the poverty headcount declining from a 59.7% in 1992 to a 34.6% in 2004.

Looking at other measures of poverty, this trend is also confirmed. The poverty as measured by percentage of the population living under \$2 a day has decreased from a high 51.92% in 1996 to 40.55% in 2002. The poverty gap at \$2 a day has also decreased from 24.66% in 1996 to 17.73% in 2002 (World Bank Database, 2008). The poverty gap measure is calculated using a head count index and an income gap ratio. Although this measure does not give complete information on the severity of poverty, it provides with information on the depth of poverty. This measure introduces the concept of income inequality, which is a problem in El Salvador.

The inequality of income distribution for a given region is usually given by the GINI coefficient. A lower GINI coefficient indicates a more equal society, whereas a higher GINI coefficient indicates a more unequal society. The GINI coefficient for 2004 was 0.50 (based on income per capita). El Salvador is still a very unequal country. It has been suggested by the UNDP, that remittances have a positive effect on the GINI coefficient. Without remittances, El Salvador would be more unequal than it already is.

One drawback of these measures is that they limit their analysis to income. Other measures, such as the Human Development Index, draw from more angles through which the well being of a society can be measured. The measure of Human Development Index (HDI) looks at the life quality, access to education and income level. This index has a maximum value of 1, which indicates that all the three areas listed above have been met. The minimum value, which is 0, indicates a lack of progress on absolute levels towards achieving the three areas. For 2005, the UNDP reported El Salvador as having an HDI of 0.722. This index has remained stable since 2000.

## **Violence**

El Salvador is a country with a long history of violence. Although peace accords were signed in 1992, El Salvador still suffers from chronic violence. This violence, however, has shifted from being politic related to gang violence and general delinquency. In its 2005 country report, the UNDP office quoted violence and insecurity as some of the reasons, alongside economic reasons, for which people continue to emigrate.

In 1996, El Salvador was the most violent country in the developing world with a homicide rate estimated to be of 139 homicides per 100,000 inhabitants. There has been a steady decline in this rate, but El Salvador continues to have high homicide rate. In 2005 the homicide rate was of 55.5 per 100,000 inhabitants. Other forms of violence that are present in this country include kidnappings for ransoms, armed robberies and interfamilial violence. The most alarming trend in present day Salvadoran society has been youth violence which is closely linked to increasing gang activities in the country.

Violence and insecurity are very costly to the country. The UNDP field office in the country tried to quantify (economically) the cost of violence to the country. They determined that El Salvador pays a significant price for the high violence and crime rates. For 2003, the cost of

violence cost the country an estimated US\$1.7 billion, which represents around 11.5% of the national GDP for that year. This calculation is short in that intangible consequences of violence and insecurity cannot be quantified.

### **Economic Performance 2000-2006**

El Salvador has experienced slow but steady economic growth in the last five years. A series of macro economic reforms, including the dolarization of the economy, have been implemented to spur the economic development. Along with this, the country has shifted away from heavily depending on the agricultural sector into depending heavily on the service sector. In this context, international migration and remittances have become very important to the economic performance of the country. Understanding the present economic condition of the country is necessary in order to understand the reasons for which people continue to migrate to developed countries, in particular the United States. This brief analysis of the Salvadoran economy will focus on economic growth, inflation, sectoral performance and the present state of trade.

The Salvadoran economy has been experiencing low but constant economic growth since 2000. The 2006 GDP was estimated to be approximately US\$15.1 billion according to data from the World Bank. The GDP has been increasing at rates between 3.8% (maximum) and 1.7% (minimum). Figure 2.2 summarizes the GDP performance for El Salvador since 2000<sup>3</sup>.

According to data reported by the World Bank, inflation in El Salvador was around 24% in the early 1990s. By 2000, El Salvador had been able to bring inflation to fewer than 5% annually. Since then, inflation has been increasing but it is still under the 5% range. One of the targeted goals of the dolarization process was to tame the inflation rate. Figure 2.3 presents annual

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<sup>3</sup> It is assumed that the information presented has already been adjusted for inflation. Thus it is safe to infer from these numbers that the GDP growth is due to an increase in productivity rather than from inflationary pressures.

inflation rates since 1995 until 2005 as reported by the World Bank. As it is evident from figure 2.3, the inflation rate decreased dramatically in the years previous to the implementation of the dolarization process. Since 2000, the inflation rate has been increasing (except for 2001-2002) but has been controlled.

### **Sector Performance**

Scholars quote the declining importance of the agricultural sector as one of the main causes for the persistent emigration trend in El Salvador. For many years, the agricultural sector was of much importance to the national GDP, as well as to the Salvadoran labor market. Due to decreasing commodity prices in the world market, agriculture has lost much of its economic importance to other sectors. Data reported by the World Bank shows that in 1990, the agricultural sector represented 17% of the national GDP. By 2000, this percent had decreased to 10% of the GDP. The reduction of the agricultural sector has been felt especially by the agricultural labor force, which has seen not only a decrease in available jobs but also a decrease in their real wages (Gammage, 2006). The majority of the new labor opportunities are within the service sector. Unfortunately, most of the rural labor force does not possess the skills necessary to successfully compete in the service sector.

The service and the manufacturing sectors have experienced much growth in the past decade. The most benefited industry has been the financial sector which has grown by as much as 23% over a period of fifteen years (Gammage, 2006, 84). El Salvador has implemented a series of policies that have served to strengthen and stabilize its banking sector. This process started with the liberalization and deregulation of the financial sector in the 1990's. Figure 2.4

shows the importance of each sector in the Salvadoran economy. This trend stayed constant since 2000<sup>4</sup>.

### **International Trade**

The Salvadoran government has made efforts to open its economy to free trade. El Salvador's major trade partner for both exports and imports is, by far, the United States, followed by the countries of the Central American Common Market. El Salvador has been carrying a massive trade deficit for at least the past five years. The deficit in 2000 was of US\$2,007 million but had increased to US\$4,115 million by 2006. This trade deficit is in part financed by the high levels of remittances (The Economist, 2007). The principal good exported by El Salvador are manufactured goods (especially goods produced by the Maquila's sector) and labor. El Salvador's principal imports are consumer and intermediate goods.

### **International Migration and Remittances in El Salvador**

The UNDP reported in 2005 that there are more than 2.6 million Salvadoran living in another country. This section will start by discussing the four different waves of emigration and the principal reasons for which people decided to leave the country. Then, a discussion on remittances and their geographical distribution will ensue.

The history of international migration from El Salvador can be divided into four waves (UNDP, 2006). The first wave corresponded to the period from 1920 until 1969. This first wave emigrated looking for employment opportunities and access to land. The principal destinations were Honduras and Panama, although records indicate migration to the United States. The second wave took place from 1970 until 1979. The war that erupted in 1969 between Honduras and El Salvador shifted the destination of international migrants away from Honduras towards

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<sup>4</sup> For a comparison between 2000 and 2005 please see Annex B

the United States. The principal reasons for emigrating were no access to land for agricultural workers and rising political violence. The third wave took place during the civil war from 1980 until 1991. The principal motive for migrating to other countries was to escape the civil war. During this time, destinations were very diverse. There was a strong migratory pattern towards the United States (especially by undocumented workers from the rural areas) and to other Central American countries. Some European countries also became preferred destination as these countries offered asylum to many families escaping the violence.

With the end of the civil war it was assumed that international migration would decrease considerably. The fourth wave identified by the UNDP is from 1992 until 2005. In a study published by the Banco Central De Reserva de El Salvador, officials estimated that around 25,000 people minimum were leaving the country each year. The preferred destination is the United States, which receives at least 90% of the migration flow according to the UNDP. Migration is now due to a lack of employment opportunities, especially in the agricultural sector, and the persistence violence and insecurity in the country. Scholars, such as Sarah Gammage, argue that international migration has become a priority for the Salvadoran government because it relieves social pressures stemming from the lack of employment and the inequalities that still persist (Gammage, 2006).

Remittances to El Salvador have gained attention from different entities, such as the UNDP, due to the flow levels and their tendency to increase over time. At the beginning of the 1990's, remittance flows were under US\$500 million. By 2006, these flows had increased to US\$3,320 million. Figure 2.6 captures how much remittance flows have grown in the last fifteen years.

As stated in the first chapter, there are two ways in which remittances can be analyzed. The first one looks at remittances from a more quantitative angle. This perspective is illustrated in the above graph. The second perspective looks at remittances from what they represent in terms of the national GDP. The following graph offers this second perspective and shows the trend that remittances have followed in recent years. This graph shows that in the last decade, remittances to El Salvador have increased considerably, although this increase has slowed in since 2004. Remittances fuel much of the economic growth that the country has experienced. They also finance most of the trade deficit that El Salvador has with its trading partners.

Although remittances are received by households all over El Salvador, they tend to concentrate in certain regions. Investigators working for the Salvadoran government and the United Nations Development Program (UNDP) have concluded that remittances tend to go more towards the north central and eastern region of the country. These areas were heavily affected by the violence of the civil war (Andrade-Eekoff, 2003). According to a study published in 2005 by the Salvadoran government, an estimated 22% of the national households receive remittances periodically. More communities, or municipalities, from the eastern and the north central region of the country have more households receiving periodical remittances than the national average.

### **Ciudad Barrios**

Ciudad Barrios is a small municipality located in the north eastern region of El Salvador, in the department of San Miguel. As of 2006, this community had an estimated population of more than 37,000 inhabitants according to information published by the government of Ciudad Barrios<sup>5</sup>. The Salvadoran government estimated that in 2005 this community received approximately US\$ 3 million in remittances. It has been estimated that 32.5% of the households

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<sup>5</sup> <http://ciudadbarrios.isdem.gob.sv/informacion-municipal.html>

in this municipality receive remittances on a monthly basis. Another important fact regarding this community is that it is located in an area with high poverty rates (See table 2.1 below).

According to a report from the UNDP office in El Salvador, the municipality of Ciudad Barrios has approximately 37.7% of its population living under the national line of extreme poverty. This same report estimates that this municipality has a human development index of 0.630. Ciudad Barrios is surrounded by six other municipalities which also have high poverty tolls (UNDP, 2005)<sup>6</sup>.

The municipality of Ciudad Barrios has traditionally been an agrarian community. Coffee growing, processing and selling are still the principal economic activities in this community. Activities related to coffee production provide most of the current employment in the area, according to the city's local government. Despite the fact that agriculture remains important to the municipality, other activities have boomed in the past decade. Ciudad Barrios has been able to develop a strong service sector which serves not only this community but also serves other municipalities in the immediate surroundings. The booming service sector in Ciudad Barrios caters almost exclusively to households receiving remittances and to return migrants.

### **The Business Sector in Ciudad Barrios**

As mentioned above, despite the fact the agricultural sector is experiencing a declining face, it is still of much importance to the economic survival of this municipality. The reason for this is that the sector provides most of the employment opportunities in the area. The principal activity of this sector is coffee growing and processing. Other agricultural activities include aviculture and sugar cane plantation. The agricultural sector is heavily influenced by the local Coffee Grower Cooperative, which owns most of the productive land in the area. As in most of

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<sup>6</sup> See Appendix C for statistics on surrounding municipalities.

the country, coffee growing has started to become less vibrant primarily due to decreasing world prices in agricultural commodities. On top of this, farms land is disappearing in favor of housing development. Most of these new housing projects are sold to migrants and their families. The Salvadoran agricultural sector has been deeply transformed by international migration and remittances. One of the most noticeable changes, at the national level, is the apparent lack of labor supply to the sector. Members of the agricultural sector have linked this to a strong history of emigration and remittances receipt. Remittances have allowed many households to opt out of agricultural jobs.

The secondary sector, which includes manufacturing activities and industrial production, does not have a substantial presence in Ciudad Barrios. The only two activities which could be linked to this sector are construction and artisan production of traditional sweets. The construction industry has grown in the last decade, although by 2002 several companies went bankrupt leaving only ten companies operating in the area. This particular industry owes much of its growth to remittances and international migrants. One of the participants in this study, a local contractor, estimates that approximately 15% of their business is conducted directly in the United States<sup>7</sup>. Much of the projects being developed in the area are using lands which were once destined for agriculture.

The rise in construction can be tied to the fact that much of the farmland is currently being parceled and sold to individuals in the area. This trend intensified in 2000 once world coffee prices were decreasing and larger farmers opted out of this activity. Parceling farms has become much more profitable than producing to larger farmers. This has benefited smaller farmers who

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<sup>7</sup> The participant reported that a share of its business is negotiated and paid in the United States and not in El Salvador.

are now buying parcels in order to increase their holdings<sup>8</sup>. The final interview pertaining to this sector was that of a small producer of folkloric sweets. This is a small scale production which is sold only in the local market. The secondary sector, which has been thought as the sector which drives economic development, is limited to a few activities.

Ciudad Barrios has become a very commerce oriented community. This is due to the expansion of its service sector, which has been growing constantly in the past decade, fueled by increasing remittances and increased demand from those who receive them. This sector is composed of different types of businesses. Businesses dedicated to buying and reselling imported goods, such as appliances, furniture, clothing and miscellaneous goods are thriving. An official document obtained through the local government's<sup>9</sup> office reports that there are more than one hundred of micro-enterprises dedicated solely to commerce in Ciudad Barrios. The food service industry has also become very important in the area. There are many small restaurants (comedores), which are financed by the remittances received in the community. Transportation services have also experienced substantial growth, especially in the area of taximotos which were recently introduced to Ciudad Barrios.

There is also a strong presence of informal businesses in this community. According to official data, Ciudad Barrios counts with more than 150 informal sellers. Informal sellers do not pay taxes to the municipality, as opposed to formal businesses that are obliged to do so, and are only allowed to operate in the town's central square (or "Mercado"). These informal businesses offer a variety of products which range from clothing to DVDs and CDs. The formal service sector has also small businesses which offer telecommunication products, such as internet access

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<sup>8</sup> This information was obtained through an interview with the manager of a development company in Ciudad Barrios.

<sup>9</sup> CATASTRO 2005 Alcaldia Municipal de Ciudad Barrios

(cyber-café) or cell phone service. The final segment of the service sector, the financial institutions, has been the one segment which has experienced the most growth in the region.

The financial sector of Ciudad Barrios consists of branches of two large national banks and four small credit unions. All of the institutions are able to receive and distribute remittances and offer different financial products, like commercial loans and savings accounts. Although some of the institutions have been present since the 1960's, the financial sector in this municipality has experienced a boom since 2001, which is when the infrastructure to receive remittances in the area started to operate. Before 2001, remittance receivers had to travel to the department's capital (San Miguel) to be able to access their money or they would have to use the informal channels. The majority of the financial institutions in Ciudad Barrios operate through VIGO Money Transfer which offers low cost services to migrant workers in the US. The financial sector has been able to attract more members to use their services. One particular credit union, ACCACIBA, has reported a growth of more than 300% in its membership base over a period of five years. Credit unions are legally allowed to offer credit services to the community. Most of the credit products offered are for personal consumption, real estate and commercial activities. Interestingly none of the institutions present in the area offer credit products to finance agriculture related activities.

### **The Labor Market in Ciudad Barrios**

The unemployment rate in Ciudad Barrios has been estimated to be around 10.4%, according to the UNDP (UNDP, 2005). Table 2-2 presents information of the labor market in Ciudad Barrios. The data in this table shows that although there are more than 21,000 people old enough to participate in the labor market, only 9,540 people are active. One reason for this difference is that more people, old enough to participate in the labor market, are opting not to work. For example, the Salvadoran government includes children ages 10-15 in their count of

people old enough to work. Another discrepancy comes from the fact that people working for their households are not considered active in the labor market because they do not generate an income from such activities.

As mentioned previously, the agricultural sector provides the majority of the labor opportunities in this community. According to a household survey conducted by FISDL, 45% of the total employments in the area concentrate in agriculture. The service sector, more specifically services related to commerce and tourism, provides 17.3% of total employment in the area. The following table summarizes the distribution of employment by sector in Ciudad Barrios.

### **Summary**

International migration is still considered as the most viable option by many Salvadorans in light of the high levels of poverty, inequality, a lack of labor opportunities, and high levels of insecurity. Despite the many policy changes implemented by the Salvadoran government, the economy is not performing as expected which has exacerbated the migration flows and the dependence on remittances.

Remittances play an important role in the Salvadoran economy since they are considered an extra income for many households. Most of these flows are destined to households in the eastern and north central areas, which were heavily impacted by the civil war that ravaged the country in the 1980s. The research site, Ciudad Barrios, is located in the eastern region of the country. The business sector in this municipality has experienced tremendous economic growth in the last decade, primarily due to the remittance flows that its population receives. The following chapter will discuss the findings from this research.

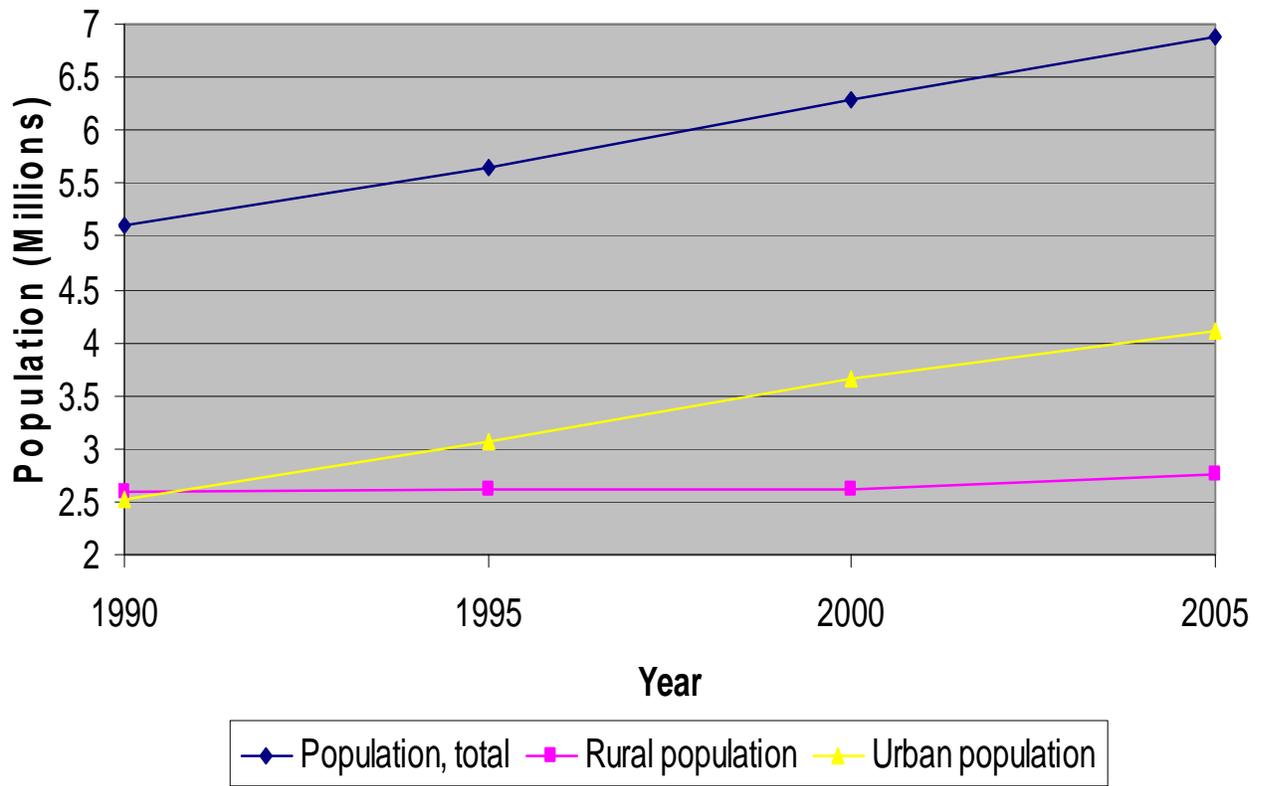


Figure 2-1. Population Trends in El Salvador. Source: World Bank Database  
<http://go.worldbank.org/6HAYAHG8H0>

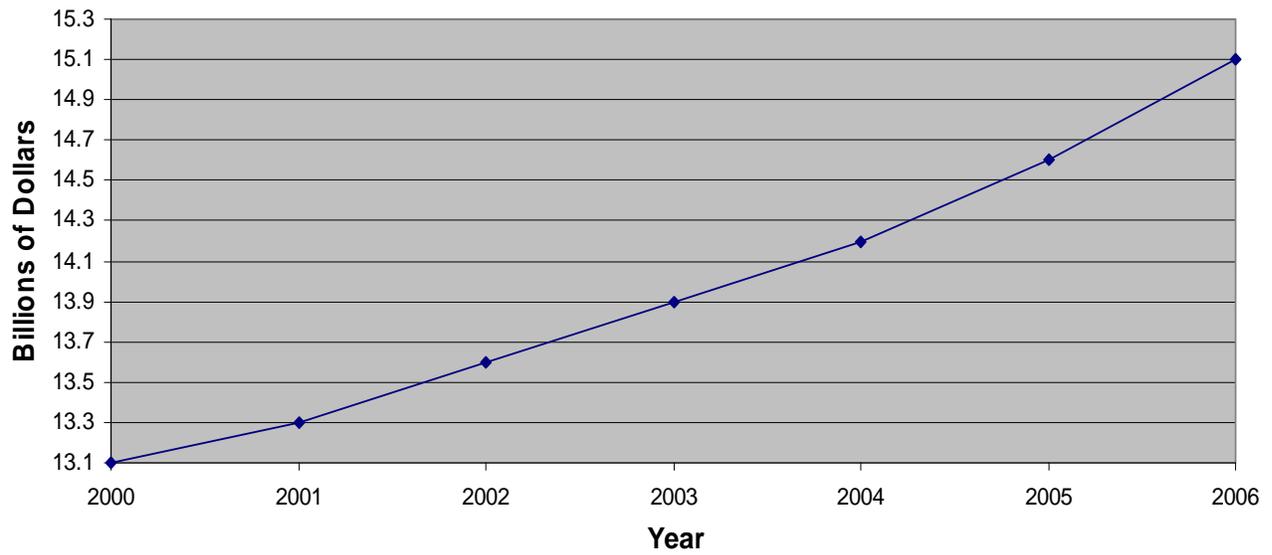


Figure 2-2 El Salvador's GDP (in US\$ Billion) Source: World Bank Database  
<http://go.worldbank.org/6HAYAHG8H0>

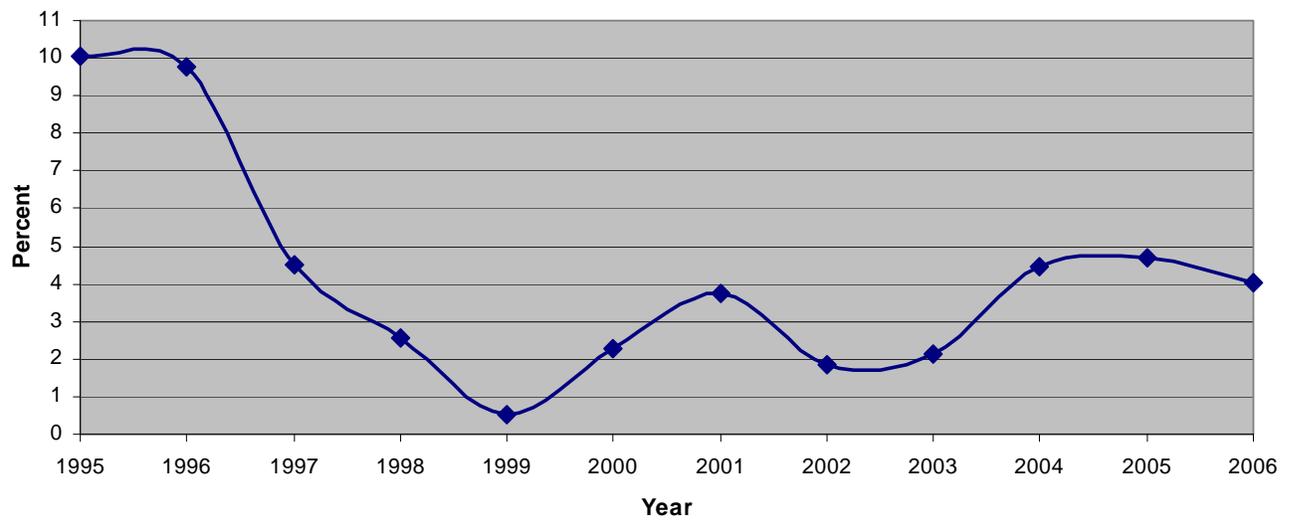


Figure 2-3 Inflation rate in El Salvador (% annual). Source: World Bank Database  
<http://go.worldbank.org/6HAYAHG8H0>

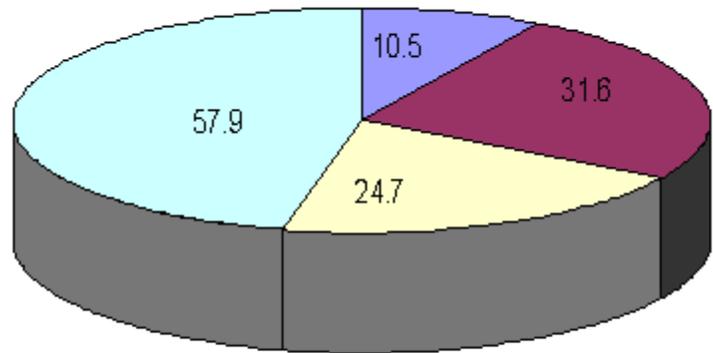


Figure 2-4 Sector Performance (% of GDP), 2000. Source: World Bank Database  
<http://go.worldbank.org/6HAYAHG8H0>

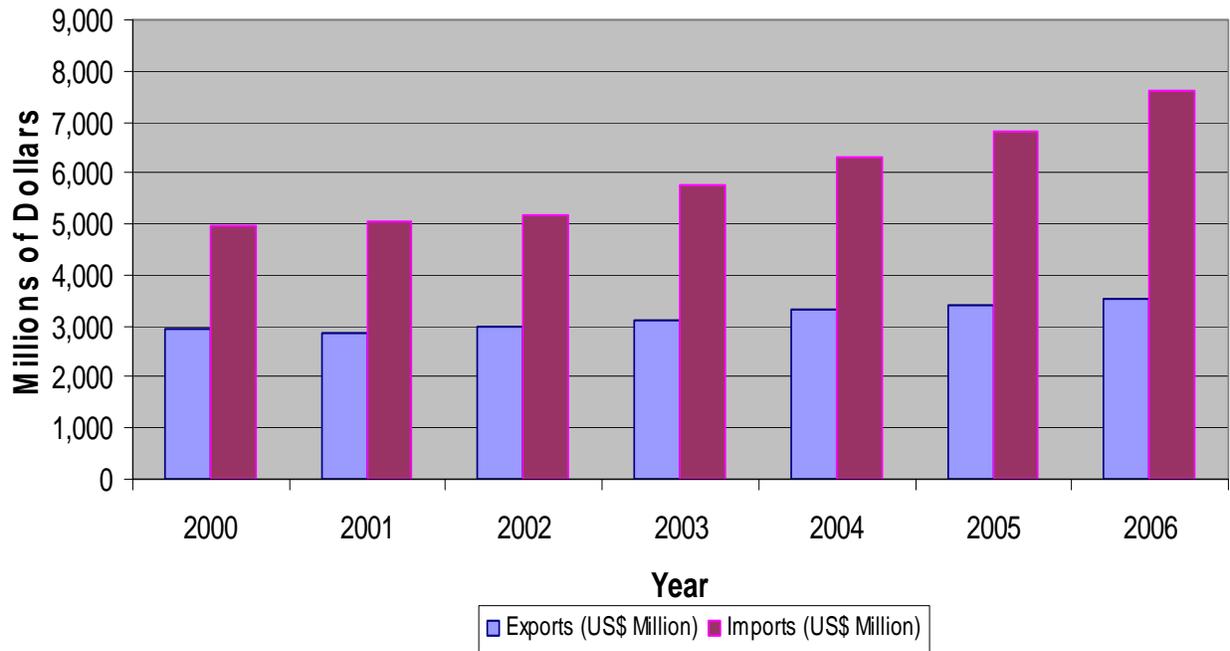


Figure 2-5 El Salvador's Trade Balance 2000-2006. Source: World Bank Database  
<http://go.worldbank.org/6HAYAHG8H0>

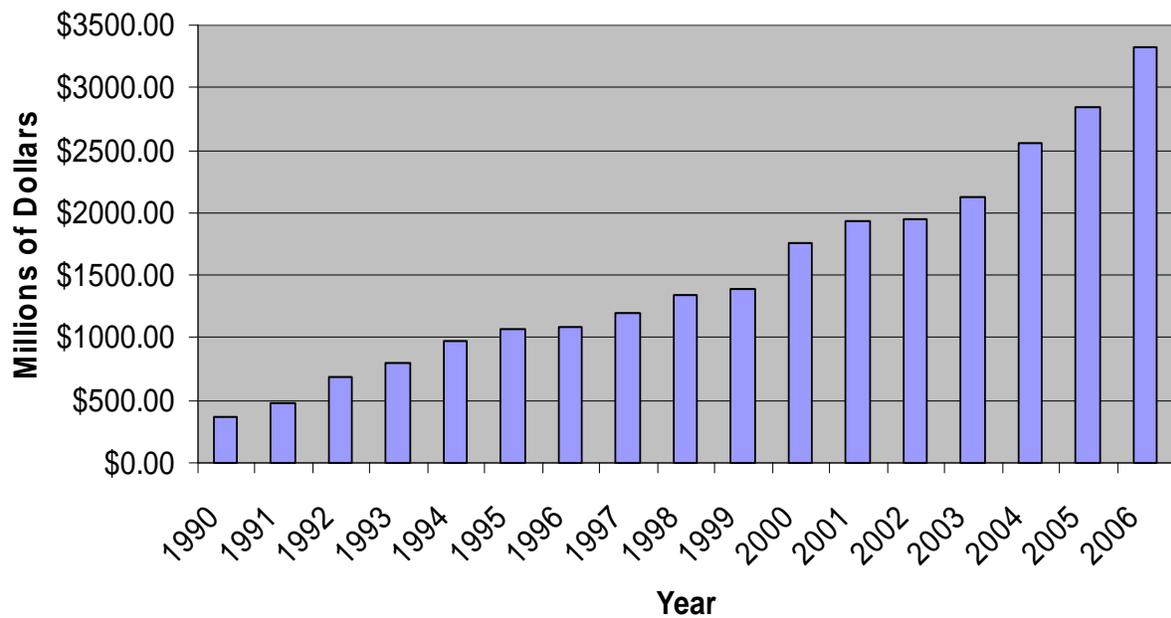


Figure 2-6 Total Remittances to El Salvador. Source: World Bank Data  
<http://go.worldbank.org/6HAYAHG8H0>

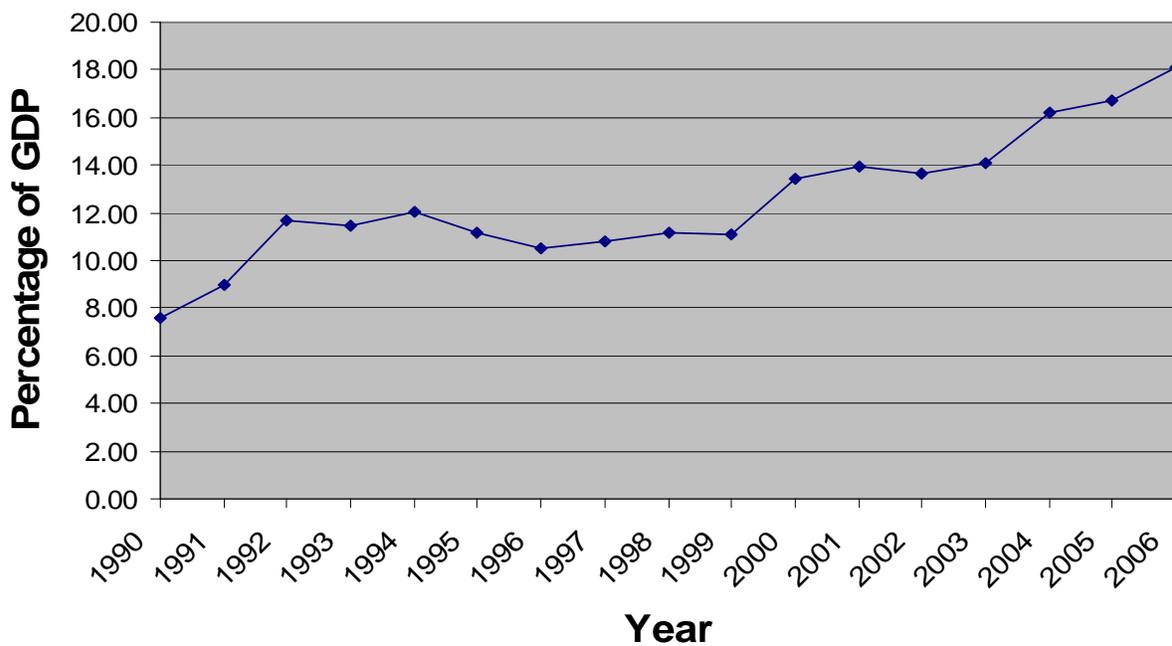


Figure 2-7 Total Remittances to El Salvador as % of GDP. Source: World Bank Data  
<http://go.worldbank.org/6HAYAHG8H0>

Table 2.1 Poverty Levels in Ciudad Barrios

Poverty Level	% of Households	% of People
Extreme Poverty	32.9%	37.7%
Relative Poverty	26.7%	27.6%
Not Poor	40.4%	34.7%

Source: UNDP El Salvador, 2005

Table 2-2. The Labor Market in Ciudad Barrios, 2004

Population of working age	21,203
Population active	9,540
Employed	8,545
Unemployed	995
Rate of global participation	45.0%
Unemployment rate	10.4%

Source: UNDP El Salvador, 2005

Table 2-3. Employment by Sector in Ciudad Barrios

Sector	Number of Jobs
Agriculture, cattle, hunting and forestry	3,907
Commerce, hotels and restaurants	1,484
Construction	811
Manufacturing	692
Community Service and Health	476
Private Households with domestic service	429
Public Administration	228
Education	188
Transportation and Storage	187
Finance	130
Electricity and Natural Gas providers	13
TOTAL	8,545

Source: UNDP El Salvador, 2005

## CHAPTER 3 DATA ANALYSIS

Much has been predicted on remittances and their impact on recipient economies. This study adds to the existing body of research by examining the impact of remittances on business creation and sustainability in a rural community.

In here, will examine and synthesize the findings from the data collection. The discussion will center on three research pathways that can help uncover the relationship between remittances and the business sector. The first pathway studied is the link between remittances and investments. The second pathway studied focuses on the link between remittances and local consumption (household demand). The third and final pathway explores the effect of migration and remittances in the local labor market (supply and demand of labor in the municipality).

The business sector in Ciudad Barrios has experienced tremendous growth in the last decade. In the 1980s, this community was very affected by the civil war as was much of the eastern region in El Salvador. The war not only isolated the community by destroying its infrastructure (roads and buildings) but also forced many to leave the community and the country, taking a heavy toll on the local private sector. The reconstruction process took a long time. For example, local leaders reported that the main road connecting this town with San Miguel (nearest major city) was not rebuilt until 1998. With the repair of the road and the increasing remittance flows, the town has been able to become the hub of commercial and financial services in the north eastern region of the San Miguel, servicing not only this municipality but neighboring municipalities as well.

As in the rest of the country, the business sector in Ciudad Barrios consists of service oriented activities, especially in commerce. Official records from 2006 show 113 registered

businesses solely dedicated to buying and reselling imported products in the municipality<sup>1</sup>. The business sector in this municipality consists of businesses operating in the agricultural, construction and service sectors. Businesses in the agricultural sector are mainly oriented towards coffee growing, processing and exporting. Most of these businesses are affiliated to a local cooperative. There is also a strong poultry farm which services not only Ciudad Barrios but also several neighboring municipalities. Businesses in the construction sector are either local contractors providing not only construction services but also selling hardware and inputs for agriculture, and “lotificadoras”, which are companies that parcel farms and develop housing projects. Finally, businesses in the service sector provide an array of products. The municipality counts with six financial institutions, which receive remittances, provide savings, loans and insurance products. There are also businesses specializing in telecommunication products, food services, general services (hair salons and travel agencies) and general commerce activities (bazaars, retailers and pharmacies).

### **The Study**

The selected research strategy was a case study approach, based on the analysis of business records obtained through the mayor’s office and a set of twenty-one in depth interviews conducted with local business owners and managers. The selected strategy is more advantageous than a quantitative approach in that it allows to collect information that might not be available otherwise. Case studies are designed to explore a given phenomenon within its context; surveys have more difficulty doing this because they have a limited number of variables (Yin, 1984: 22-23). In this case study, there are two specific examples that illustrate Yin’s arguments. The first example has to do with the level of remittances received by the community. Based on

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<sup>1</sup> This number is according to records obtained through the mayor’s office. For a list of business operating in Ciudad Barrios please refer to Annex.

information from a household survey conducted by the Salvadoran government, it was estimated that Ciudad Barrios receives an average of US\$312,359 monthly in remittances. Records from one credit union in Ciudad Barrios show that they distributed a total of US\$3.49 million in remittances during 2005. This same credit union distributed a total of US\$2.15 million in 2004. Another manager from a different credit union reports distributing an estimate of US\$11 million in 2005<sup>2</sup>. Why is there so much difference between the government estimates and the information from the financial institutions? This discrepancy can be attributed to the sample selected by the surveyors, underreporting by recipient households (lack of trust or misinformation) and/or due to one time lump sum remittances received by the financial institutions, which would have been difficult to account in a survey. Another example that reinforces Yin's argument is a finding regarding how businesses operate in Ciudad Barrios. Three business owners reported negotiating business transactions with clients in their place of destination, mainly in the USA. The literature on remittances and entrepreneurship, which is based on household surveys, doesn't account for such transactions.

The in-depth interviews were conducted during two field visits in Ciudad Barrios. The study participants were selected randomly (in the case of several businesses in the service sector) or through a key informant<sup>3</sup>. The interviews conducted focused on how remittances impact business activities in the area. Participants were specifically asked about their financing (start-up and operation capital), their client base (remittance recipient or not) and the origin of their products and/or inputs. Of the 20 participants interviewed, nine belonged to the service-non

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<sup>2</sup> This particular credit union services several municipalities in this region. The reported amount is the estimated flow that is distributed among households in Ciudad Barrios only.

<sup>3</sup> The key participant facilitated the majority of the interviews. Lack of trust seemed to be a major difficulty as some business owners seemed reluctant to provide sensitive information. The key participant was helpful to overcome this obstacle.

financial sector, six belonged to the financial sector, two belonged to the agricultural sector, and two to the construction sector. All the businesses in the service sector, excluding the financial institutions, had fewer than ten employees and eight of them had been established between 1998 and 2001.

### **Remittances and Investments**

The literature on the link between remittances and investments has focused on understanding whether or not recipient households invest in productive activities or in consumption (how they spend their money), and on understating the entrepreneurial drive of the migrants themselves (the likelihood of them becoming business owners). The literature that explores this particular link is based on household surveys conducted either in the recipient country or in the host country.

A review of the literature on the topic of remittances and business creation reveals the link between them is not very straight-forward. There are scholars who argue that remittances do not lead to a more productive business environment, but rather decrease the productivity of the communities as they give incentives to spend the money on consumption patterns which are unproductive and do not leave much aggregated value to the communities (De Haas, 2005). On the other hand, there are other studies which have shown that remittances have the capacity to spur business activities in the recipient communities. Such studies have shown that not only recipient households are actively accruing assets (De Haas, 2005; Adams, 1998) but they are also actively investing a portion of the remittances (rather small portion) they receive in productive activities (Adams, 1998).

In the specific case of research in Latin America, the results are also contradicting. A recent study on remittance and business ownership in the Dominican Republic concludes that remittances do not necessarily lead to the creation of more businesses among remittance

recipient households. Also, this same study finds that in the Dominican Republic, business ownership increases the likelihood of receiving more remittances because migrants are interested in collecting future returns (Amuedo-Dorantes and Pozo, 2006: 950). Other studies on the link between remittances and investment have focused on the case of Mexican migrant communities. One specific study is that of Woodruff and Zenteno who analyzed the impact migration has on micro-enterprises. This study is different from others conducted on the same topic in that its data come from a survey of micro-enterprises as opposed to other studies who rely on household surveys, like the Amuedo-Dorantes and Pozo in the Dominican Republic. The Woodruff-Zenteno study concludes that migration encourages investment by allowing the migrants and their households to access credit markets, which were not available to them pre-migration. Along this same line, Massey and Parrado concluded that remittances contribute to the overall business formation in Mexico and that the type of business formed depends on the national economic and investment climate (Massey, 1998). Finally, Funkhouser presents data for Nicaragua based on a household survey from the late eighties<sup>4</sup>. He concludes that remittance encourages self-employment amongst recipient households (Funkhouser, 1992: 1214-1215).

The literature analyzing the link between remittances and business investment/formation overall shows that remittances are being used to either create, expand or subsidize businesses in recipient communities. This case study tested this hypothesis by interviewing business owners and representatives from the financial agencies in Ciudad Barrios. The interviewees were asked about how they formed their business, more specifically whether their start-up capital came from remittances, private loans or a mix of both, and what role remittances played on the formation and/or expansion of their business activities. The goal of this approach was to understand where

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<sup>4</sup> The data that he uses in this study are limited to surveys of households located in Managua and was not extended to the whole country.

local businesses are finding their start-up capital from, whether remittances are being used as a way to finance operations (like buying machinery and/or inputs) and whether remittances are being saved in the formal banking sector<sup>5</sup>.

To test whether remittances are being invested in productive activities, business owners were asked on the origin of their start-up capital. The majority of the business owners operating in the local service sector asserted that their start-up capital came not from remittances but rather from loans from the financial institutions in the area or from personal savings. Of the nine interviews conducted amongst business owners in the service sector, only one reported having used family remittances to start operations. From this we can infer that in Ciudad Barrios, most of the remittances are not being directly used as start-up capital for most new businesses. To corroborate the information obtained from the service sector, the financial institutions were asked about their credit products and the saving patterns among their clients.

The financial sector in Ciudad Barrios has grown slowly but expanded quickly in the past ten years. This is especially the case of local credit unions as illustrated by the case of the credit union that has experienced a 350% growth over a period of four years. The data collected shows that local credit unions dominate the financial market in Ciudad Barrios. On one hand, credit unions have been servicing the municipality for a longer period of time. It was not until after the civil war was over that two national (larger) banks started operating in the municipality, one starting operations in 1993 and the other in 2005. Of the four credit unions in Ciudad Barrios, three started their operations before 1980. This is important because it allows us to assume that the credit market in Ciudad Barrios has been fairly limited and mostly inaccessible to the majority of the rural population. On the other hand local credit unions have experienced rapid

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<sup>5</sup> Savings in the formal banking sector might indirectly spur business formation amongst non-recipient households if banks use this money to actively lend it to local entrepreneurs.

expansion in terms of client base and adherence. This expansion is due partly to the fact that more remittance recipients are now using the formal service to receive their monies and to the fact that credit unions have engaged in a strategy of reaching out to clients<sup>6</sup>. With more remittances going through formal channels, the question that ensues is: how much of it is staying inside the financial sector? The answer to this question we must examine saving patterns among recipient households and the credit products available to the community. The data collected point that savings are not necessarily being loaned for productive activities, as evident from Table 3.1.

The saving rate among remittance recipients in this community is estimated to be between twenty to thirty percent of total remittances received per household, according to data collected from the interviewees<sup>7</sup> (please refer to Table 3.1). Of the six financial institutions only one, the smaller credit union, is not legally able to offer saving accounts to its members. The rest of the institutions reported that savings are used as capital to be loaned. The high rates of savings among remittance users were attributed by credit unions to their outreach programs which stress the importance of having saving accounts and insurance products.

The last two columns on Table 3.1 refer to the type of credit products offered by each financial institution. All the financial institutions offer loans for personal consumption (Personales Consumo), used to pay off debt or finance personal consumption needs, and for housing needs (Hipotecarios), used to finance purchase, construction or renovation of houses. On top of this, all financial institutions also offer loans for business needs (Prendarios, Personales and Comercio). These types of loans are used to finance start-up costs, purchase of inventory and machinery. There are no credit products available to the agricultural sector (finance crop or

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<sup>6</sup> Local credit unions reported that they would go from door to door to talk with people about the advantages of participating in the formal financial market. This outreach program promotes financial education among the population.

<sup>7</sup> This figure is based on the managers' perception and their available financial data.

expand land) and to the industrial sector (to build a manufacturing business). The agricultural sector is restrained from accessing the credit market because its activities are thought to be too risky. One of the credit unions used to offer a specific credit line to finance coffee related activities but had to close it due to the risk of crop damages, drought and the low prices of coffee at the national level. The manufacturing sector is not serviced because there is no demand for loans to finance this type of activities. All the interviewees from the financial sector reported that users mostly borrow money to finance commercial activities (buy goods for resale or expansion of current operations) and to finance personal consumption (especially to pay off previous debt and menial consumption needs)<sup>8</sup>.

Remittances can also have a financial impact on businesses by serving as capital to expand current activities and/or to improve the capital assets that make part of the business. For the purpose of this thesis, buying new machinery and/or upgrading the physical space of the business are classified as upgrades to capital. Furthermore, remittances can also have an impact on businesses if they finance purchases of inputs and/or merchandise. The literature on remittances and investments concludes that remittances are used to finance the purchase of capital assets such as farm land, machinery and tools for example (Woodruff et al, 2007:510). Given this information, the expected results from the data analysis are that remittances are an important element in the expansion and sustainability of a business. To test this relationship, the interviewees were asked about how they finance the purchase of inputs and/or merchandise. The results will be presented for each sector.

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<sup>8</sup> It is important to clarify and reiterate that the growth in the financial sector is mostly attributed to an increase in the usage of their remittance receipt services and not to more demand of their credit lines. In fact all the interviewees expressed difficulties meeting expected loan goals.

The first sector of interest in Ciudad Barrios is the agricultural sector. Overall, activities in this sector are largely related to coffee. The data collected include interviews with farmers that belong to the coffee cooperative in the area and also an interview with the manager of a small cooperative involved in the commercial production of egg and other avian products (ACOPACIBA). In the case of the agricultural sector, results from the interviews are consistent with what the literature has found in that remittances are being used to finance purchase better equipment, land and inputs and merchandise. On the case of the poultry farm, the manager reported having recently redesigned and purchased new equipment that would increase the capacity of the farm to produce more eggs. This purchase was financed through a loan obtained from a local bank and through remittances saved by the members of the cooperative. Remittances were also found to be financing crops and farm operations. In general, the decrease in coffee prices in national and international markets has negatively impacted coffee production. Many of the larger members of the coffee growers' cooperative have stopped their productions and some have even started to sell their lands for purposes other than agriculture. Despite this fact and the lack of capital to finance production, many farmers are still producing and processing coffee. The manager of the coffee growers association in Ciudad Barrios attributed this to members being able to obtain alternative funding and/or to members being culturally attached to this production. The manager reported that at least 60% of their members receive periodical remittances and use them to finance the purchase of inputs thus decreasing their dependence on the financial institutions. Receiving remittances doesn't only allow them to ensure production but also allows them to ensure the survival of their farms. The manager of the coffee growers' cooperative also reported that through remittances, small farmers have been able to purchase additional land from larger farms that used to produce coffee.

With remittances financing land purchases, the composition of the agricultural sector in this municipality has changed. According to the manager of the coffee growers association, larger farms are now disappearing in favor of smaller units. The association membership consists of 1,200 farms of which eighty-five percent are able to produce small quantities of coffee per harvest (between one to five quintals<sup>9</sup> of coffee). The manager of the association also shared that if remittances were not financing land purchases from smaller farmers, the sector would have been more affected by the coffee crisis. From the interviews with the agricultural sector it is clear that remittances are being used to finance purchases of capital assets, such as machinery and land, and are allowing farmers to cope with the credit constraints in the area.

The case of the service sector in Ciudad Barrios is much different than that of the agricultural sector. Most of the businesses in the area, related to the service sector, are micro-enterprises (less than ten employees). The majority of these businesses are involved in commercial activities, meaning that they are involved in buying and selling different merchandise. Business owners were asked about the source of their merchandise and the role that remittances play in their activities. The interviewees replied that most of their merchandise is purchased from providers outside the community and is financed by sales revenues. The only case again that claimed to use remittances to finance operations was the owner of a small internet café. The rest of the business owners that participated in this study did not report to have used remittances to finance operations and/or expansions.

According to the literature, remittances help businesses by financing businesses creation, expansion and operations. The results of the interviews indicate that in the case of the service sector, remittances are not being used directly as start-up capital or as capital to expand

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<sup>9</sup> A quintal is a measure used in European countries which represents one hundred pounds.

operations. The service sector relies more on personal savings and financing from the local financial institutions. In the case of the agriculture sector, remittances do finance start-up costs (purchase of land), operations (purchase of inputs) and expansions (purchase of land).

### **Remittances and Consumption**

The second link that was studied in this thesis is that of remittances and local consumption. The literature on remittances shows that recipient households spend most of their remittances on consumption of goods. Recipient households create a demand for consumer and human capital related goods that will increase their living standards such as: education, health, housing improvement and food and for leisure (Adams, 2004; Jennings and Clarke, 2005; Acosta, 2007).

This consumption, which has been described as unproductive by some scholars, does have an effect on the private sector of a given community. Even if remittances are not being invested in business ventures, by increasing the purchasing power of recipient households, they will still play an indirect role on creating business opportunities in a community. In a study of Mexican communities with strong out-migration, Durand et al argue that remittances have an important ‘multiplier effect’ (Durand et al, 1994). The presumption is that remittances have various effects on the local economies as they lead households to increase their expenditures. This in turn will give local entrepreneurs an incentive to create new sources of income in the community in order to meet the new demand (Adams, 1998). According to Adams, this effect has been largely neglected by the literature on remittances.

To capture the effect of remittances on local consumption, this study focused on two issues: understanding who the clients of businesses in the area are and on understanding if local businesses are purchasing from other local businesses (thus increasing demand). Both issues allow verifying the ‘multiplier effect’ that remittances are thought to have. The first issue deals with household consumption: are recipient households increasing local demand? The second

issue deals with businesses spurring local demand by becoming local consumers. The literature cited on this link has relied on data collected directly from households. One shortcoming of this type of data is that it doesn't really give any insight on whether the increase in consumption is helping the recipient community. The conclusions drawn by these studies are mostly applied at a macro level. To overcome this problem, a different approach was used by relying on data collected directly from businesses. To test the relationship between remittances and local consumption business owners were asked to describe their client base and describe the origin of their inputs and/or merchandise. The issue of sustainability of operations is also captured by the link between remittances and local consumption. If remittances were to suddenly stop, what effect would this have on local businesses in Ciudad Barrios? Interviewees were not asked about this as this question would be better addressed through a quantitative approach.

Local demand in Ciudad Barrios has increased through remittances. Many of the interviewees reported that through remittances, more households are not only able to increase their expenditure but also be able to afford better goods. One good example of this is the case of the poultry farm which has been able to expand operations from higher local demand. This farm started servicing the municipality of Ciudad Barrios in 1988. By 2005, the farm was able to service the whole department of San Miguel plus the neighboring state of Morazán, La Union and Usulután. The manager of the farm affirmed that this had been possible because of more families being able to consume eggs. Households in Ciudad Barrios are also spending more of their income on non-food products. The manager of the retail store in Ciudad Barrios said that in 1998, there was only one retail store servicing the municipality. In subsequent years more stores started operating in Ciudad Barrios, including this particular one which started operating in 2001.

By 2005, Ciudad Barrios had five retail stores carrying similar product lines which include furniture, appliances and electronic goods.

To understand the dependence of businesses on remittances, participants were asked to describe their client base (remittance recipient or not). The service and the construction sectors reported being more dependent on demand from recipient households than businesses in the agricultural sector. Surveyed businesses included a retail store which sells appliances (washers and dryers, cooking stoves and other white appliances), two stores that carry telecommunication products (a internet café and cell phone store) and a pharmacy which also carries book supplies (for school) and clothes<sup>10</sup>. Business owners in the service sector overwhelmingly reported that the majority of their client base is composed of rural households receiving remittances. For example, the pharmacy owner stated that over 60% of its clients receive remittances. This trend was also confirmed by two other participants (retail house and telecommunication store). In the case of the construction sector, two businesses were interviewed: a construction contractor, which also specializes in the sales of agro-chemicals and construction material, and a developer<sup>11</sup>. Both participants stated that their clients are international migrants and/or members of their households (remittance recipients). One interesting finding is that businesses reported that some of their operations are conducted directly with the migrants in the United States. These businesses are contacted directly by clients living in the United States and payment is made through a courier who then brings the money back to the owners. In the case of the agricultural sector, one participant mentioned that remittances have increased the demand for their product but could not assert that their client base was primarily remittance recipient households. The case

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<sup>10</sup> See Annex D for a complete description of the businesses interviewed.

<sup>11</sup> This company is mostly involved in selling plots of land from what used to be a major 'hacienda'. Their plots are being sold exclusively for housing projects which are managed by the same company.

of the coffee producers seems to be much different as they export most of their production (around 75%) to the European Union<sup>12</sup>. The rest of their production is sold locally at lower prices, which indicates that the quality of the product is lower than the product they export. However, the participant mentioned perceiving an increase in local demand which he attributed to remittances.

Businesses were also asked to identify whether or not they use local services and/or merchandise. Ciudad Barrios lacks a manufacturing industry and as such all its businesses have to buy their merchandise (inputs) from out of town providers. The only service that is provided locally is labor. This indicates that a large percent of sales revenues are not staying in the community.

According to the literature, remittances have a multiplier effect through the increase in local demand from the recipient households. The interviews conducted in Ciudad Barrios indicate a strong increase on business transactions; in other words, demand has increased as a result of remittances. The multiplier effect described in the literature is present in this community. Despite this positive finding, it is not possible to assert that the effect of remittances is very significant as much of the money leaves the community due to the lack of forward-backward linkages. The reason for this has to do to the lack of productive industries that will demand local raw material and labor. All the interviewed commercial businesses sell mostly imported goods from out of town providers. The multiplier effect might have a stronger impact if the national economy were to be analyzed, as they would finance businesses in other cities.

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<sup>12</sup> The cooperative has been able to access international markets by participating in technical programs sponsored by the USAID and by becoming a certified member of Rainforest Alliance, a fair trade organization.

## **International Migration, Remittances and Labor Market**

Some studies focusing on the link between remittances and the labor market have concluded that receipt of remittances has a negative effect on productivity as it gives an incentive to stop participating in the low wage labor markets (Amuedo-Dorantes and Pozo, 2006). There are several studies which have statistically shown that remittances do have a negative impact on participation in the labor market. One such study was conducted by Funkhouser among Nicaraguan remittance recipient households. His findings relate to labor force participation and self-employment activities. He found that an increase in remittance flows would decline the labor force participation, especially among urban women. He also found that a rise in remittances is statistically associated with a rise in self-employment, although not by much (Funkhouser, 1992: 1214-1215). Funkhouser's conclusions were also reached in a study conducted among Salvadoran remittance recipient households. This study concluded that labor force participation rates (as either no participation at all or reduction of hours worked) fall among remittance recipient household members, especially among women. The researchers also found that entrepreneurial activities tend to increase among recipient receiving households (Acosta, 2007). Such findings have made some scholars point that remittances have a negative effect in national productivity. Acosta warns against such conclusions saying that the decreasing participation in the labor market doesn't necessarily translate into a loss in productivity. He points to the fact that remittances might be giving incentives for people to become self-employed, invest in human capital or participate more in household activities (which might not be remunerated). This debate has also taken hold in the Salvadoran public arena, where remittances recipients are constantly being denounced for not wanting to participate in the labor market (Andrade-Eekoff, 2003). This argument is refuted by Andrade-Eekoff. In her book she states that remittances have helped reduce the incidence of child labor and have contributed to the retirement of older people.

For the purposes of this thesis, the literature offers two important conclusions. The first conclusion is that remittances cause a decrease in labor supply. This could become problematic for businesses in the area if the price of labor increases due to less supply and the cost of hiring and/or training people increase. The second conclusion reached from the literature is that remittances increase the probability that recipients engage in self-employment activities. For businesses this would translate as an increase in competition for workers but also as a potential increase in labor demand. The second conclusion was not covered in the interviews because it requires a more quantitative oriented approach. Interviewees were only asked about how migration has impacted their labor supply. The results of this study are much in accordance with the results presented by other authors only in the case of the agricultural sector only. The construction and the service sector did not report having as many problems in regards to labor supply. The interviewee from the construction sector reported that all his workers are hired locally. Interviewees from the service sector reported also that their employees are hired in Ciudad Barrios.

In the case of the agricultural sector, all interviewees agreed that they have difficulties with labor supply because many workers (and most skilled) have migrated to the United States. This finding is in accordance to data presented by Andrade-Eekoff on the impact of migration and remittances among rural households. Before migration, her data population was highly concentrated in the agricultural sector. It is as no surprise then that the agricultural sector is struggling with a declining available labor pool. The interviewed farmers expressed that as much as 40% of their labor supply is hired outside the community, which increases their expenditure

on labor (transportation and recruitment costs)<sup>13</sup>. However, the interviewees also expressed that a reduction in the available local labor is not due particularly to an income substitution effect of remittances. In fact, former workers who are now remittance recipients have been able to become self-sufficient by buying their own farms (hence increasing self-employment).

The literature on the link between migration, remittances and the local labor markets indicates that labor force participation declines as a result of increase in remittances. In Ciudad Barrios this argument holds only in the case of the agricultural sector. No other businesses reported a problem with labor shortage. A constricted labor market increases the amount that businesses spend on their labor supply. Study participants from the agricultural sector indicated that their labor related expenses have increased as their cost of hiring and transportation increase because they have to import their workers.

### **Summary**

This thesis focuses on how business owners perceive the impact of remittances in three research links: remittances and investment, remittances and consumption (local demand) and remittances and labor markets. The available literature on remittances has concluded that remittances have a strong potential to influence the economy of a country and help it develop. Much of the research relies on household surveys at the national level.

Each link was tested for a specific hypothesis in order to gain a better understanding of the impact of remittances on businesses in rural communities. The first hypothesis tested was in regards to remittances and local investments. The results show that in the case of Ciudad Barrios, remittances are not being used as start-up capital. However, in the case of the agricultural sector

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<sup>13</sup> The outside labor comes from the neighboring department of Morazán and/or from either Honduras or Nicaragua. In 2005, the Salvadoran government had to issue work permits to seasonal workers from Honduras and Nicaragua in order to meet the labor demand from the agricultural sector.

remittances are being used to finance the purchase of inputs and to buy more land. In the specific case of the agricultural sector, the findings indicate that remittances are financing further investment in the activity. This finding is in accordance to the results from a study conducted among remittance recipients in the Dominican Republic. The second hypothesis tested was in regards to remittances and local demand. The literature on this topic concludes that remittances help alleviate financial constraints among recipient households. This increase in consumption has a multiplier effect on the local economy. The results show that in the case of Ciudad Barrios, much of the businesses' client base is composed of remittance receivers. However, local businesses have to obtain their merchandise/inputs from non-local providers. The final hypothesis tested was in regards to remittances and local labor. The literature suggested that remittances have a negative impact on labor participation. This was particularly true for the agricultural sector in Ciudad Barrios, which has seen much of the former labor pool transform from employees into land owners.

Table 3-1 The Financial Sector in Ciudad Barrios

Type of Institution	Employees	Growth Rate	Remittances in 2005 (US\$)	% Savings <sup>1</sup>	Type of Credit Product <sup>2</sup>	Preferred Credit Product Usage
Credit Union	12	360% in 4 years	11,000,000 *	30%	-Personal Consumption -Mortgage -Popular	Construction
National Bank	N/A	22% annually	\$14,400,000*	30%	- Personal Consumption - Mortgage - Housing - Personal Consumption	- Commerce - Personal usage - Construction
Credit Union	7	N/A	\$50,000	25%	- Commerce - Asset**	Commercial activities
Credit Union	10	14.85% annually	\$3,498,577	25%	- Personal Consumption - Mortgage - Asset**	Construction Commercial activities
Credit Union	4	N/A	\$335,789***	Not offered	- Mortgage - Personal Consumption - Asset**	Commercial activities
National Bank	3	N/A	\$255,020****	N/A	- Personal Consumption - Mortgage	Small and Medium Enterprises

Source: Personal interviews with managers of the financial institutions conducted May-August 2006

\* These institutions had to estimate the amount of remittances distributed in Ciudad Barrios because they service more than one municipality.

\*\* Asset type of loans refers to loans made against the value of an asset presented by the client. The banks consider an array of assets for this type of loan such as jewelry, television sets, stereo equipment and cars among other things.

\*\*\*This amount is only for remittances distributed from April-December 2005 period

\*\*\*\* This amount is for remittances distributed between July –December 2005

<sup>1</sup> These saving percentages correspond to savings among remittance recipients who are clients of this specific institution. This information was collected from interviews with managers.

<sup>2</sup> The name of each credit line is a direct translation of the name of the product offered by each institution.

## CHAPTER 4 CONCLUSION

### **The Research**

Remittances have been shown to have a positive effect on self-employment and entrepreneurship amongst recipients. There is a consensus amongst researchers that remittances directly and indirectly provide incentives for business creations. On one hand, some researchers suggest that remittances are used as start-up and operating capital. On the other hand, some researchers suggest that remittances have a multiplier effect on local economies.

This thesis analyses the role that remittances play in business creation and sustainability in a rural community setting. The research site is located in northeastern El Salvador. The selection of this community has to do with the quantities received and the degree of dependence on these flows. For one, Ciudad Barrios receives a substantial amount of remittances estimated to be more than US\$3 million annually. On top of this, at least 32.5% of the households in this municipality depend on periodic remittances.

The study focused on three research pathways in order to answer the research question. The first pathway focused on remittances and investments. The second pathway analyzed the impact of remittances in local demand (household consumption). Finally, the third pathway focused on the impact that remittances and international migration have in the local labor market.

### **Major Findings**

The research conducted for this thesis begun with the analysis of the current literature on the issue of remittances and entrepreneurship. There are three major hypothesis which serve as a theoretical framework for this thesis. Remittances have been found to promote local investment. They serve as start-up capital, operating capital and to finance capital purchases. Remittances have also been found to have a multiplier effect through the increased demand of recipient

households. An increase in demand provides incentives to local entrepreneurs. Finally, remittances have been found to promote self-employment and business ownership amongst recipients.

Data collected from a total of twenty interviews conducted in Ciudad Barrios shows that the conclusions reached might not apply to all sectors. The agricultural sector seems to be the only sector in which all the hypothesis are confirmed. In the one hand, this particular sector in Ciudad Barrios is sustained by remittances. More than 60% of the farmers in this locality depend on remittances. These are used to finance crops allowing farmers to stay in business. On top of this, farmers are using their remittances to purchase capital assets like additional farming land and machinery. Remittances are also allowing more farm workers to become farm owners, thus encouraging self employment amongst farmers. This has a negative impact on the local labor market, as expected. Finally, increased consumption by recipient households impacts agricultural producers selling in the region.

The other two sectors interviewed did not show a link between remittances and business creation and sustainability as strong as that shown by the agricultural sector. Interviews with business owners and managers in the service sector show that remittances are not an important source of capital. This is also the case for the construction sector. Nevertheless, it is possible that remittances are helping these sectors in an indirect way. Through a multiplier effect from increases in demand, local businesses can benefit from remittance flows.

An interesting finding from this research study is that the financial institutions in the area have grown considerably in the last ten years. Remittances have played a crucial role in this. Managers of the institutions have used remittances as a way to promote participation in the banking system. Rural areas have traditionally been neglected by financial institutions. In Ciudad

Barrios, several institutions have aggressively promoted their services by not only talking to recipients when they collect their money but also by reaching out to households in the community. ACCACIBA is one success story. This local credit union has experienced a 300% rate of growth in the past five years. Not only do they have competitive fees for each remittance, they also engaged in these reaching out approach.

### **Significance of Study**

Most of the research conducted on the link between business investment and remittances relies on household surveys. These surveys, as shown in this study, are not very reliable. The principal problem with this is the underestimation of the impacts of remittances at the macro and micro levels. This study differs from previous research in that it does not rely on household data. The primary focus of analysis in this thesis is the business sector. In a period of four months, twenty interviews were conducted with members of the business sector in Ciudad Barrios.

This approach allows giving a new dimension to the study of remittances and investments. The focus is no longer how recipients spend their money (i.e. do they consume or do they save it) but rather to understand what happens to the remittance-investments. In this particular case study, the agricultural sector was more dependent on remittances than other sectors.

This study is also significant because of its policy making implications. The agricultural sector is going through a period of changes and adjustments to changing world prices and a more constrained local labor market. On top of this, the sector is capital-restrained by financial institutions who do not see these activities as profitable or as low-risk as commercial activities. Local governments should encourage financial institutions to provide financing to the sector. Existing farmers that prove to be successful could be entering partnership with international migrants in order to become more industrialized.

## **Future Research**

In this thesis I studied the impact of remittances in local consumption, investment and local labor market. All of these research pathways could give rise to potential quantitative studies since the findings of this study rely on anecdotal data. This would solidify the findings of this study and a comparison with similar studies in other communities would be possible.

One particular business practice, which seems to be happening in different business, is to negotiate with clients in the United States. These transactions occur outside the scope of the legal and financial institutions. There is direct negotiation between the involved parties and payment usually occurs through the informal channels. This type of practice, which is not mentioned in the literature surveyed for this thesis, should definitely be investigated more.

APPENDIX A:  
MAP OF EL SALVADOR AND AVERAGE REMITTANCES PER DEPARTMENT



Figure A-1 Map of El Salvador. Source: University of El Salvador

Table A-1 Average Remittances per Department and Poverty Headcount

Department	Average US\$ Remittances	Average Annual Remittances per capita	Poverty Headcount
Ahuachapán	\$15,283,288.80	\$53.40	51.56%
Santa Ana	\$54,313,387.20	\$100.44	45.40%
Sonsonate	\$25,756,827.60	\$57.45	43.65%
Chalatenango	\$23,363,121.60	\$117.84	48.30%
La Libertad	\$52,104,742.80	\$75.71	33.94%
San Salvador	\$151,335,360.00	\$76.46	29.64%
Cuscatlán	\$9,405,158.40	\$47.25	51.29%
La Paz	\$16,058,515.20	\$56.00	46.96%
Cabañas	\$15,314,653.20	\$98.04	62.03%
San Vicente	\$10,945,216.80	\$68.00	59.14%
Usulután	\$32,200,274.40	\$95.06	51.33%
San Miguel	\$64,623,183.60	\$134.84	45.61%
Morazán	\$20,326,519.20	\$120.03	65.23%
La Unión	\$57,000,438.00	\$210.06	40.37%
El Salvador	\$548,030,686.80	\$88.35	40.94%

Source: UNDP El Salvador, 2005

APPENDIX B:  
SECTOR PERFORMANCE 2000 AND 2005

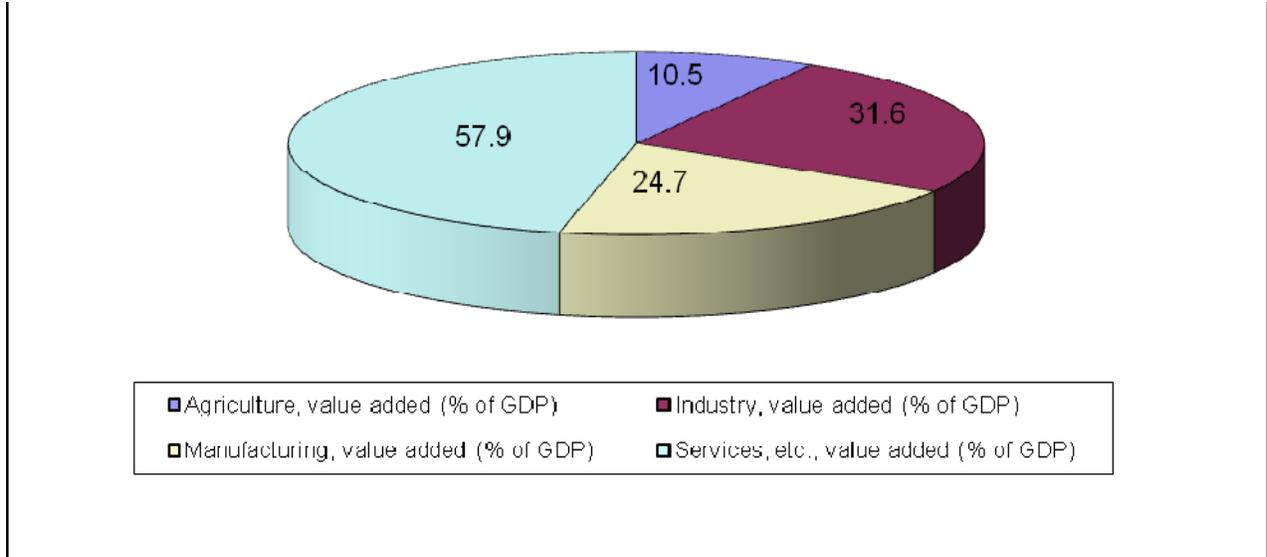


Figure B-1 Sector Performance El Salvador, 2000. Source: World Bank Data  
<http://go.worldbank.org/6HAYAHG8H0>

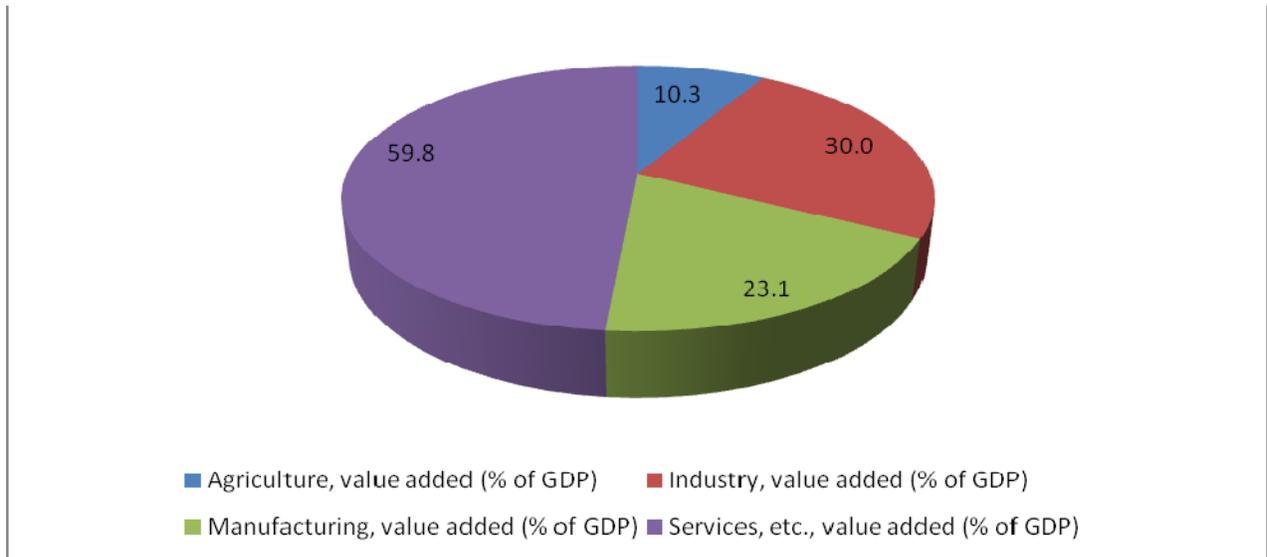


Figure B-2 Sector Performance El Salvador, 2005 Source: World Bank Data  
<http://go.worldbank.org/6HAYAHG8H0>

APPENDIX C:  
SOCIO-DEMOGRAPHIC CONDITIONS OF CIUDAD BARRIOS AND NEIGHBORING  
MUNICIPALITIES

Table C-1: Statistics for North-Eastern Municipalities

Municipality	Poverty Levels (% Households)	Poverty Levels (% of People)	Average Annual Remittances
Carolina	67.9	73.0	US\$1,603,140.00
San Luis de La Reina	52.7	61.1	US\$1,741,898.40
Sesori	54.8	62.4	US\$2,160,490.80
Chapeltique	40.3	47.0	US\$2,225,095.20
Guatajiagua	78.2	84.4	US\$703,443.60
San Simon	70.1	75.2	US\$234,346.80
Ciudad Barrios	59.6	65.3	US\$3,748,312.80

Source: UNDP Informe 262 (2005)

APPENDIX D:  
LIST OF INTERVIEWED BUSINESSES IN THE SERVICE AND CONSTRUCTION  
SECTOR IN CIUDAD BARRIOS

Table D-1 Types of Businesses Interviewed

Type of Business	Start Operation	Number Employees	Client Base	Origin Start Up Capital	Origin of goods
Commercial (Retailer)	2001	3	Remittance Recipient	Bank	USA, Mexico, El Salvador
Telecommunication Store	2001	3	Remittance Recipient	Bank	Telemovil El Salvador
Supplier of gas	1978	Self	Recipient and Non-recipient	Self	----
Pharmacy	1998	7	Recipient 60% Non recipient 40%	Self and private loan	United States, Guatemala and El Salvador (China)
Restaurant	2002	7	Recipient	Self	San Salvador
Informal sales	1999	4	Varied	Self	San Salvador
Food processor	1900	3	Varied	-----	Local
Transportation	2006	2	Varied	Self	India (taxi-motos)
Sale of machinery for Solar Energy	1990	4	Businesses	Providers of products	Japan and Germany
Telecommunication (Internet Café)	2005	2	Varied	Remittance and Self	United States (sent by family) and El Salvador
Developer	2003	1	Migrants and families	N/A	N/A
Hardware Store/ Contractor	1989	N/A	Migrants, recipient households	Provider of inputs	Germany, Guatemala, El Salvador and United States

Source: Interviews conducted during summer 2006

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## BIOGRAPHICAL SKETCH

Maria Francesca Bardi was born in Miami, FL, in 1981 but moved at an early age to El Salvador. She attended a French school and moved back to the United States soon after completing high school. Since early in her academic life, she developed a passion for social sciences and decided to major in anthropology at the University of Florida. During her undergraduate career, she became interested in issues of local economic development and trade. This interest is a reflection of what the inequalities she saw during her life in El Salvador. To further explore her interest, she became a graduate student in both Latin American studies, and food and resource economics.

In May 2006, Maria traveled to El Salvador to conduct a study on remittances and rural economic development. During her stay, she completed an internship with the UNDP office in El Salvador. This internship exposed her to the invaluable contribution that non-government organizations make in the field of development. This opportunity proved to be important in her life as she complemented her academic training with real life experience. She expects to enhance her training in economic development by completing her doctoral studies in the area.