Paying Their Share

Migrants' contribution to fiscal health in Mexico and El Salvador

Summary document[1]

[1] The complete texts of each case study are available on the NALACC website, *www.nalacc.org*. These documents contain more complete details on the methodological processes, findings, tables and graphs.

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I. Introduction and acknowledgements

In December 2000, the United Nations declared December 18 International Migrants Day. In keeping with the principles articulated in the Universal Declaration of Human Rights, this declaration was made in recognition of the considerable growth in the number of people that have emigrated in search of improved living conditions. International Migrants Day reminds us that, irrespective of the place we were born, as migrants, we ARE, above all, human beings fully deserving of being treated with dignity.

The struggle to achieve full recognition of migrants' humanity continues today. This struggle occurs in Latin American migrants' countries of residence, but is also happening in our countries of origin. The National Alliance of Latin American and Caribbean Communities (NALACC) was created in order to improve the quality of life in our home communities in the United States, as well as in our communities of origin in Latin America and the Caribbean. NALACC seeks to strengthen migrant organizations so that they can work together efficiently toward the political change needed to obtain conditions that are necessary for a life that is not only dignified, but also sustainable. By working for greater civic and democratic participation both in the United States and in our countries of origin, NALACC hopes to influence decision-making processes around the policies that impact the life of Latin American migrants as well as economic and migration policy.

The original hope behind finding a way to estimate the contribution that remittances make to the national budgets in Mexico and El Salvador came from many of the organizations that are members of NALACC. In interpreting this desire, Executive Director Oscar Chacón was able to articulate a broad research proposal focused on this particular angle of the link between migration and remittances. In addition to a well-designed and novel vision, the project's implementation also required an unusual design in order to translate the initial goal into a tangible product. Working toward that goal, the NALACC leadership invited two outstanding research institutions to join in an innovative collaboration model that would be directed by NALACC, a migrant organization. Specifically, the *Fundación Nacional para el Desarrollo* (FUNDE) of El Salvador and the C*entro Regional de Investigaciones Multidisciplinarias* (CRIM) of Mexico were asked to be partners.

The work at hand demanded a rigorous, multidisciplinary and reliable analysis from experts on fiscal policy and experts on remittances and migration. It also required developing a way to present the findings in order to reach diverse interest groups (leaders of migrant organizations, government representatives, multilateral organisms, academic institutions, the media, etc.). NALACC wisely chose Katharine Andrade-Eekhoff as the ideal person to coordinate the implementation of this innovative effort.

We involved a broad range of people to supervise the investigation, advise the teams and collaborate in the analysis and dissemination. In Mexico, Fernando Lozano Ascencio, Marcos Valdivia and Luis Huesca created a formidable team that was both dynamic and interdisciplinary. Carlos Pérez, Nelson Fuentes, and Rommel Rodríguez developed an excellent analysis for El Salvador. The discussions between the two research teams have been a vital part of this project.

Our Advisory Council included Sarah Gammage, an economist with the International Labor Organization in Chile, Denise Stanley, an economist at California State University, Fullerton, Manuel Orozco, a political scientist at the Interamerican Dialogue in Washington D.C., Dilip Ratha, an economist at the World Bank in Washington D.C., and Ricardo Estrada, director of Erie House in Chicago, Illinois. Their suggestions, comments and perspectives have guided us since the beginning of this project, but the content is completely the responsibility of the authors.

Upon obtaining the initial data, each research team presented their findings to a group of national experts. In Mexico, we received critical and constructive feedback from Juan Carlos Moreno Brid, Miguel Ángel Mendoza, Clara Jusidman, Pablo Cotler, Luciana Gandini, Indira Romero, Daniela Gutiérrez, and Randolf Gilbert. Miguel Ángel Mendoza spent many additional hours with the Mexico research team, helping them find the best path. In El Salvador, Álvaro Trigueros, Oscar Cabrera, and Giovani Berti gave substantive suggestions to improve the work.

Once the work was finished, Tara Mathur and Bernabé Pineda took over the translation, style revision and graphic design of the text. We are thankful for their ideas, suggestions, advise and time.

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Ángela Sanbrano, President, NALACC
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II. Executive Summary

"Like a towering lighthouse guiding sailors towards the coast, 'development' stood as the idea which oriented emerging nations in their journey through post-war history. No matter whether democracies or dictatorships, the countries of the South proclaimed development as their primary aspiration, after they had been freed from colonial subordination. Four decades later, governments and citizens alike still have their eyes fixed on this light flashing just as far away as ever: every effort and every sacrifice is justified in reaching the goal, but the light keeps on receding into the dark."

Wolfgang Sachs (2007: 1)

The debate on migration reform in the United States has begun again. Many people think that if a reform is successful, the country's migration "problem" will be resolved. It is essential that the current migration law, which is obsolete, wasteful, inhumane and unjust, be changed. But migration reform does not get at the causes of migration, which can be primarily linked to the lack of opportunities for development in the migrants' countries of origin. And, as Wolfgang Sachs describes, migrants have seen that the light coming from the development lighthouse has grown faint in the darkness of their countries of origin and, many times, in their new places of residence as well. Despite the millions of dollars that the migrants have sent to help develop their families and communities, young people continue to follow the same path toward what they perceive to be the promised land, because the development lighthouse continues to grow farther away and become more nebulous. Most of the analysis that has been done on the link between migration and development to date has focused on the contribution of family remittances in improving economic indicators. But the promise of well being has not come to fruition.

This study aims to shift the way we view the relationship between migration and development. The goal is to reposition the debate surrounding the link to government and its role in the investment and execution of the national budget, setting aside the discussion on how those that receive remittances invest the money sent by their family members who have had to migrate in search of better opportunities outside their home countries. The concrete objective of this project is to **estimate the contribution of remittances to public income in the migrants' countries of origin**, specifically as a payment of value-added tax (VAT) in Mexico and in El Salvador. By examining the relationship between migration and development, our focus is concentrated on fiscal health—and one of the most important instruments used to measure public policy plans, programs and actions is the national budget.

Our findings show that Mexican and Salvadoran migrants generate significant income for the national budgets in their home countries. In **Mexico**, remittance money that was spent in 2008 generated approximately $**1,500 million dollars** in VAT, which means that for each dollar that enters Mexico as a remittance, almost six cents on the dollar becomes VAT income. This **amount represents 4% of the total VAT income** reported by the *Secretaría de Hacienda y Crédito Público* (Secretary of Treasury and Public Credit) during that year. This contribution to the public treasury was equivalent to **50% of the resources designated in 2006 for the Mexican federal program to combat poverty known as *Oportunidades, or "Opportunities"*, and 40% of that which was designated in 2008**. When compared with other migrant-related programs such as the **Mexican 3 x 1 Program** (***Programa 3x1)*,** the VAT contributions associated with the flow of remittances is significantly higher—for **every dollar paid in VAT,** the federal government contributed the equivalent of one cent on the dollar in 2006 and **three cents on the dollar in 2008.** Given the probable restructuring of budget income in the near future (due to a drop in income from petroleum exports), the role that VAT contributions associated with remittance flows will play in the finances of the Mexican public sector could increase even further in coming years.

In **El Salvador**, VAT income generated by remittances totaled $**194.7 million dollars in 2007**, which means that for each dollar sent in remittances by Salvadorans living abroad, a little more than five cents on the dollar is directed to the *Ministerio de Hacienda* (Ministry of Treasury) as VAT income. This represents **6.8% of all tax income and 12.9% of all VAT income collected** by the Ministerio de Hacienda during that year. This amount is **6.5 times greater** than what the Salvadoran government spent on its primary program to alleviate poverty, **known as Red Solidaria or the "Solidarity Network".** It also represents **128% of the amount invested in the country's national hospital network and 34% of the investment in public education**. The almost $200 million dollars of VAT income generated by remittances represented **12.8% of the central government's social expenses** in 2007. El Salvador is a country in which one fourth of all homes receive remittances, representing 30% of their total income. But the data generated by this study reveals that El Salvador's fiscal health depends in large part on the circulation of remittances in the economy.

Table II.1: Summary of the primary findings

Indicators	Mexico 2008	El Salvador 2007
VAT income associated with remittances (millions of dollars)	$1,493.0	$194.7
VAT income associated with expenditure of remittances		
As a % of the VAT income collected	4%	13%
As a % of the primary anti-poverty program	40%	656%
As a % of the 3x1 Program (Mexico only)	3393.2%	-
As a % of the GDP	0.14%	1.0%

Source: Authors, based on the results of this study.

With respect to the income sources for those households that receive them, remittances represent 20% and 31% of the total income (in these particular homes) in Mexico and El Salvador, respectively (Table II.2). The data from Mexico for 2006 indicates that remittances accounted for 30% of the total income for that year, but due to the financial crisis and a reduction in remittances, the indicator was reduced to 20% in 2008. Mexican households compensated for this loss of income by increasing the income from paid work within Mexico. In other words, the families that receive remittances also have other types of income and when remittances are reduced they are substituted with employment within the country. With regards to expenses, there are no significant differences between households with and without remittances. Rather, the differences in the expense structures of the household has more to do with social class: for poorer families, a greater percentage of expenses is dedicated to food while among the richer households of Mexican and Salvadoran society, a greater percentage is dedicated to housing or shoes and clothing. The findings of the study also show that the Salvadoran households that receive remittances suffer less poverty; in Mexico remittances contribute to reducing poverty, especially in rural areas.

Table II.2: Basic data on Mexican and Salvadoran homes, with and without remittances

	Mexican households 2008		Salvadoran households 2007	
Indicators	With remittances	Without remittances	With remittances	Without remittances
Number of households	1,583,292	25,149,302	238,458	1,048,798
Remittances as a % of total income	20.1%		30.9%	
Wages as a % of total income	28.0%	47.9%	51.3%	78.9%
Food as a % of total expenses	24.2%	22.1%	46.6%	49.4%
Health and education expenses as a % of total expenses	8.5%	8.3%	16.0%	14.9%
Poverty rate* (%)	18.1%	18.2%	26.8%	37.4%
Urban (%)	13.5%	12.3%	23.5%	32.0%
Rural (%)	25.7%	40.4%	32.3%	48.6%
Female head of household (%)	46.6%	23.6%	47.5%	29.8%
Age of head of household (average)	52.3	48.0	52.5	47.0
Number of family members (average)	4.1	4.0	4.1	4.0
Number of working family members (average)	1.5	1.7	1.2	1.3

*Source: Authors, based on results of a 2008 ENIGH study on Mexico and a 2007 EHPM study on El Salvador; *Nutritional poverty for Mexico and poverty headcount index for El Salvador. The different methodologies used to calculate poverty in the two countries means that the data between Mexico and El Salvador cannot be compared.*

Additionally, there are important differences between the composition of households that receive remittances and those that do not. In Mexico as well as in El Salvador, families that receive remittances are more likely to have female heads of household and older heads of households. In other words, in the homes that receive remittances there is a greater probability that an older woman is in charge of making the best use of resources and the well-being of family members.

This study proves that **migrants do pay taxes in their countries of origin** and that these taxes are vital to the development plans executed by the country's leaders. This is especially true in the case of El Salvador given the size of the economy as it relates to the flow of remittances, but it is also significant in the case of Mexico.

The implications of these results are diverse and we have summarized four of our primary recommendations.

• Migrants' participation in their country's decision-making should be broadened to include decisions around public issues of greater magnitude.

One of the primary tools used to express these decisions in the public sphere is the national budget. And despite the significant contribution of migrants, both in Mexico and in El Salvador, transparency is lacking with regards to budget information, how it is formulated, and the political and development priorities implicit in its construction and execution. The migrant population has been totally marginalized from the considerations around creating and executing the national budget to which they contribute. In the best case scenario, migrants are invited to participate *after* decisions have been made, priorities established, and the ways that programs will function and the rules of the game determined—in other words, when the most important decisions have already been made. What kind of society do we want to build? What are the best ways to build it? How should we allocate our human, natural and financial resources in order to reach this goal? These are the "development" decisions of greater magnitude.

• The debate on remittances and development should focus on the government's role in fostering the wellbeing of its citizens and the type of society that it wants to promote and not on the way in which migrant family members spend or invest their remittances.

While Latin American migrants in the United States demand the recognition of their basic rights in that country, it is important to guarantee that they have a place at the discussion table on transcendental decisions being made in their countries of origin. Migrants themselves should contribute ideas about how this can be achieved. Until this important aspect is included, both Mexico and El Salvador will encounter a situation that resembles one of the most well-known slogans of the U.S. revolution, "*no taxation without representation.*" In other words, by paying taxes and contributing to their country's budgets, migrants should have a say in and the opportunity to vote on the public decisions of greater import.

• We invite stakeholders (leaders of migrant organizations, public servants, and the staff of international organizations) involved with matching fund programs to reflect on the relative importance of initiatives such as Programa 3x1 in the local, national and international context.

Many public servants continue look to migrants to finance social investment or public infrastructure programs. The Mexican 3 x 1 Program is an important initiative that has served as an international model and has strengthened migrants' process of organization. But the amount that the government has allocated to this program is relatively small, especially when compared with other items on the national budget. Without a doubt, stakeholder organizations in matching fund initiatives such as the 3x1 program contribute to improving some aspects of life at a local level. But these programs are severely limited. Additionally, we have lost sight of the much more significant contribution migrants make via the generation of tax income which results from the circulation of remittances in the national and local economy.

• We recommend that similar studies be done in other countries with significant migratory flows in order to make visible the relationship between migration and development, based on the link between remittances and fiscal health.

This study was carried out based on two cases. However, it is clear that there are many countries in Latin America for which migration is a structural part of life. It follows, then, that migrants and their remittances contribute to the country's national budget in these societies. For that reason, we recommend that versions of the methodology applied here be applied in countries involved in the Central America Free Trade Agreement (CAFTA). Not only are Guatemala, Honduras, Nicaragua and the Dominican Republic part of the CAFTA agreement with the United States, they are also exporters of their population and recipients of millions of dollars in remittances. Migration is also a structural part of the economies and societies in Ecuador, Bolivia, Colombia, Guyana, Peru and Jamaica. In this study, we have prioritized the link between remittances and VAT income, but migrants also contribute to public income in their home countries by paying other taxes for tourism, airports, income, property, etc. Therefore, the invitation is not only to apply the methodological path outlined here, but also to improve upon it, broaden it, and go into greater depth in this field of analysis.

III. Shifting the debate on remittances and development: The contribution of remittances to public income

In 1948 and again in 1976, the United Nations proclaimed long lists of human rights, but the immense majority of humanity enjoys only the rights to see, hear and remain silent. Suppose we start by exercising the never-proclaimed right to dream? Suppose we rave a bit? Let's set our sights beyond the abominations of today to divine another possible world.
Eduardo Galeano (2007: 341).

Uruguayan author Eduardo Galeano invites us to dream that another world is possible, a world in which *"in the streets, cars shall be run over by dogs; people shall not be driven by cars, or programmed by computers, or bought by supermarkets, or watched by televisions; the TV set shall no longer be the most important member of the family and shall be treated like an iron or a washing machine; people shall work for a living instead of living for work"*. In that world, "*economists shall not measure **living standards** by consumption levels or the **quality of life** by the quantity of things"*. And *"the world shall wage war not on the poor but rather on poverty, and the arms industry shall have no alternative but to declare bankruptcy; food shall not be a commodity nor shall communications be a business, because food and communication are human rights; no-one shall die of hunger, because no-one shall die of overeating; street children shall not be treated like garbage, because there shall be no street children; rich kids shall not be treated like gold, because there shall be no rich kids; education shall not be the privilege of those who can pay; the police shall not be the curse of those who cannot pay; justice and liberty, Siamese twins condemned to live apart, shall meet again and be reunited, back to back"* (Galeano, 2007: 341-343). In workshops with NALACC migrant leaders, this passage of Galeano's "The Right to Rave" was read to conclude a discussion on the pillars of "development." His vision makes crystal clear the kind of development that these workshop participants long for, both in their current communities and their countries of origin.

Galeano resonates with migrants because they live the contradictions of development policies in their countries of origin and their new neighborhoods—where they deposit their sweat and tears. Migrant leaders have channeled thousands if not millions of dollars into their home countries to build schools, hospitals, roads, churches, soccer fields and countless other "development" projects; but despite their efforts, young people continue to leave the countryside, small towns, and cities of South and Central America in search of more and better opportunities in the North. Despite their efforts, development is not happening. Gustavo Esteva goes so far as to state "*there is nothing in modern mentality comparable* to [development] as a force *guiding thought and behavior. At the same time, very few words are as feeble, as fragile and as incapable of giving substance and meaning to thought and behavior as this one."*(2007: 8). However, the word development continues to figure prominently in national plans, community programs and multilateral priorities. And more and more frequently, migrants are sought out to "productively" contribute to development in their countries of origin. It appears that the $69.2 billion dollars that they send to their families in Latin America (IADB, 2009) and their work in the North is not considered "productive"—or at least not productive enough.

Despite the claims that governmental leaders and international agencies have trumpeted about their potential, evidence on the contribution of migrant remittances to sustainable local development is inconclusive. What is clear is that remittances have had a tremendous impact on the millions of homes that receive them, the majority of which are sent by family members who work in the globalized North (see for example, UNDP, 2005 and 2009; Fajnzlber and López, 2006; Gammage, 2006; IADB, 2006). At a minimum, remittances have increased the buying power of those who receive them in the home countries. At the same time, new evidence is emerging that remittances are fueling new sources of inequalities on a local level, when some families are able to dramatically improve living conditions while their neighbors without remittances feel left behind and are hard pressed to make ends meet due to inflationary processes that remittances also stimulate (Ortiz, 2009). One only has to look at the changes in housing in communities heavily impacted by migration to see evidence of the growing gaps in wealth.

A number of researchers have begun to try and understand the conditions under which remittances can have a positive, lasting impact for stimulating social and productive capacity at a local level (García Zamora and Orozco, 2009; Adams, de Haas, and Osilila, 2009). Clearly, more research is needed in this area, but there is another avenue of inquiry that has been largely ignored, and which could prove to be a powerful lever for engaging sending-country governments more seriously in designing more solid strategies for collaboration with migrants in local and national development.

One of the missing pieces of the puzzle is an analysis of **the contribution of remittances and migration as a source of public income in the countries of origin**, specifically concerning the taxes generated when remittances are spent for consumption and investment, and more specifically as Value Added Tax (VAT). In fact, there is hardly any research on the overall fiscal impacts of remittances on sending-countries governments. As a result, those governments (as well as multilateral institutions) may grossly underestimate the degree to which the fiscal health of the nation depend on remittances or the broader economy of migration. The lack of data on this issue also makes it difficult to press governments to invest more significantly and systematically in engaging emigrants in development efforts on more than an artisanal scale.

Our primary objective has been to estimate the degree to which the remittances sent by Mexican and Salvadoran migrants, who are living and working outside the country, impact the generation of public income by way of the value added tax charged by the national governments in both countries, and how this income is being put to the service of national economic development agendas. We chose these two countries given their high volumes of remittances and migration. The more than $25 billion dollars sent as remittances in 2008 by Mexican workers living outside the country represent the highest volume of remittance flow into Latin America and the third largest volume in the world (after China and India). Mexican migrants in the United States are the largest group of Latinos in the country and they make up a fundamental part of the NALACC membership. The almost $3.7 billion dollars in remittances that El Salvador received from its migrants in 2007 represent 18% of the country's Gross Domestic Product. Almost one fourth of Salvadoran homes receive remittances and in the United States this migrant group is the fourth largest group of Latinos. Their community organizations are an important part of the NALACC membership.

Additionally, we want to offer a methodology that can be replicated for similar analysis in other countries. According to NALACC members, this is particularly relevant to Honduras, Guatemala, and the Dominican Republic. But Ecuador, Peru, Guyana and Bolivia would also likely find this proposal useful, along with countries in other hemispheres, including Moldovia, the Philippines, Vietnam, Morocco and Pakistan.

Despite the financial crisis, the results of the study indicate that, in 2008, Mexican migrants through their remittances contributed $1,493 million dollars in Value Added Tax (VAT) to the Mexican federal government's public coffers. In Mexico, this represents 3.6% of all of the VAT income collected during that year, equivalent to 6.6% of Foreign Direct Investment and 3,393.2% of the migrant program 3x1. In El Salvador, the $194.7 million dollars that migrants contributed to VAT income by spending their remittances represent 12.9% of the total VAT income collected, 1% of the GDP and 12.8% of the central government's social investment. Without a doubt, we are talking about a significant amount of money.

This data demonstrates that remittances play a role that goes beyond the discussion of household income. It illustrates one of the multiplier effects that they have on other areas of the economy and moves the debate on the link between development and remittances toward the sphere of the role of the State and the national budget, rather than placing the burden on the shoulders of migrants and the way in which they spend their money.

Public budgets articulate the values and choices of a society, forming the backbone of policy making and development priorities for national, state and local governments. Many times, citizens' voices are marginalized from these crucial discussions. Migrants, who significantly contribute to the national income, have even less opportunity for participation. In the best case scenario, migrants' opinions are taken into account after key decisions about national budget priorities have been made. By making public a solid analysis of the impact that remittances and other sources of migration related activities play in the public sphere, migrant led organizations along with academics, and local civic groups in migrant-sending countries, can more effectively engage in the debates that determine the development priorities established through public expenditures. This type of effort forces the discussion into another arena of debate, specifically focusing on the State's role in promoting societal development and equality via budgetary instruments.

How did we arrive at the amounts of $1,493 million dollars and $194.7 million dollars in VAT income generated by the circulation of remittances in Mexico and El Salvador, respectively? The primary source for this information was national household surveys carried out in Mexico and in El Salvador. These are the only data sources that contain detailed information on household income and expenses—the starting point for analyzing the amount of remittances received and the products and services that are subject to the value added tax. In Mexico, we used the *Encuesta Nacional de Ingreso y Gasto de los Hogares*, ENIGH (the National Household Income and Expense Survey) from 2006 and 2008. In El Salvador, we used the *Encuesta de Hogares de Propósitos Múltiples* (Multiple-purpose Household Survey) from 2007. The research teams analyzed specific expenses made by homes that receive remittances, taking into account the products and services subject to value added taxes in each country. Proportional household expenses that could be specifically associated with remittances were isolated. We also took into account that the informal market in both countries plays an important and varying role, depending on the social strata or the place that products are purchased. These adjustments diminish the amount and percentage of VAT income that the governments may be receiving. Subsequently, household level data was expanded using information about remittances provided by the central banks in both countries. Each one of these steps has represented a series of methodological decisions, all of which have been reviewed along the way to ensure solid results. Parallel paths were used to reach the results, though each research team had to adopt distinct procedures based on the specificities of its country. The details of the methodology can be reviewed in the complete texts of each study, available on the NALACC website.

Following this introduction, we have included the most relevant findings from the two case studies: first a chapter on Mexico followed by a chapter on El Salvador and, finally, some reflections on the implications of this study for future investigations, the debate on remittances and development, and elements that impact public policy.

IV. A significant contribution: The case of Mexico[2]

Introduction

Although it is understood that Mexican migrants working in the United States pay taxes in the local Mexican economy via the purchases made with family remittances, specialized studies on migration and development have largely ignored the contribution of remittances to the country's public coffers. Based on the hypothesis that a significant part of the contribution to public revenues comes from indirect taxes, this section estimates remittances' contribution to Mexican public income by quantifying how much VAT income was collected as a result of remittances that were sent from the United States. We aim to respond to the following questions: How much Value Added Tax was collected from purchases made with remittance money and how has this contribution changed between 2006 and 2008? How important is this contribution when compared with other sources of public revenue such as petroleum exports or income tax? What is fiscal charge of Mexican households that receive remittances when compared with those that do not? Do poor families that receive remittances pay more in taxes than poor families that do not receive remittances? Is public spending received by households with remittances socially fair?

For many years, Mexico has demonstrated serious symptoms that its tax system is in crisis. These symptoms were recently accentuated by a drop in international petroleum prices and in Mexican petroleum production. The government's strategy for dealing with this crisis, as seen in President Felipe Calderón's 2010 fiscal reform proposal, which was approved with modifications by the Mexican congress, has been to obtain more resources by increasing , to a feasible extent, VAT. Given that remittances are the third largest source of external income, after manufacturing and petroleum exports, it is important to ask whether or not this source of external income is truly contributing to fiscal earnings. The results of this study answer the question by demonstrating that remittances do significantly contribute to the public revenues; this despite the fact that, since 2007, the flow of remittances has experienced a diminishing growth rate and even a reduction in absolute terms. This decline is not even close to that which was observed for other sources of income such as petroleum and we can therefore assume that, in the immediate future, remittances will continue to play an important role and may even have increased importance for the country's fiscal income, in comparison with what is expected from other sources.

The empirical results of this study are supported by an analysis of expenditures (for products and services that generate VAT) made by Mexican households that received remittances, based on information obtained from the *Encuesta Nacional de Ingreso y Gasto de los Hogares*, ENIGH (National Household Income and

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Expense Survey), for 2006 and 2008, along with information on family remittances reported by the Central Bank of Mexico. The current chapter is comprised of this introduction, followed by a general overview of Mexico's tax revenues. Part three examines the recent evolution of remittance flows and the general characteristics of the recipient households, based on an analysis of their socio-demographic characteristics, the composition and structure of income, and analysis of inequality and poverty in Mexico. Part four presents the estimated amount of VAT and an analysis of its redistributive impact over households with and without remittances. Part five analyzes what the VAT generated by purchases made by remittances means in terms of diverse economic indicators. The section concludes with a series of final reflections.

Tax revenue in Mexico

Mexico's public revenue can be divided into two large groups: petroleum and non-petroleum. During the past three decades, petroleum has held a predominant place in public revenues that in 2008 reached 36.9% (see Table IV.1). The country's public finances have depended heavily on this income, which is very susceptible to variations in international oil prices and the growth or reduction of national petroleum reserves. Tax revenues (which are considered non-petroleum revenue) represented slightly more than 40% of total revenues between 2006 and 2008, though it is important to consider the weight of its components: income tax represents approximately 20% of total revenues and value added tax represents almost 16%.

Likewise, Mexico is characterized by low fiscal revenues with respect to its overall economic activity. Mexico has one of the lowest tax burdens in Latin America, defined as a percentage of the fiscal revenue with respect to the GDP, 12% in 2007; the regional average is 18%. To give an example, El Salvador's tax burden was higher than Mexico's, 15% in 2007 (CEPAL, 2009). Thus not only does Mexico have a low tax base, but it is also weak, as reflected by its dependence on petroleum, a strong degree of informality and a high number of exemptions and special regimes for the payment of taxes.

Table IV.1: Revenue in the public sector, 2006-2008

Item	Billions of nominal pesos			Percentage distribution		
	2006	2007	2008	2006	2007	2008
Petroleum	861	881	1,055	38.0	35.4	36.9
Non petroleum	1,402	1,605	1,806	62.0	64.6	63.1
Tax revenues	931	1,047	1,208	41.1	42.1	42.2
Income tax	448	527	562	19.8	21.2	19.7
VAT	381	409	457	16.8	16.5	16.0
Other non-tax income	472	558	599	20.8	22.4	20.9
Total	2,264	2,486	2,861	100.0	100.0	100.0

Source: Secretaría de Hacienda y Crédito Público, Mexico.

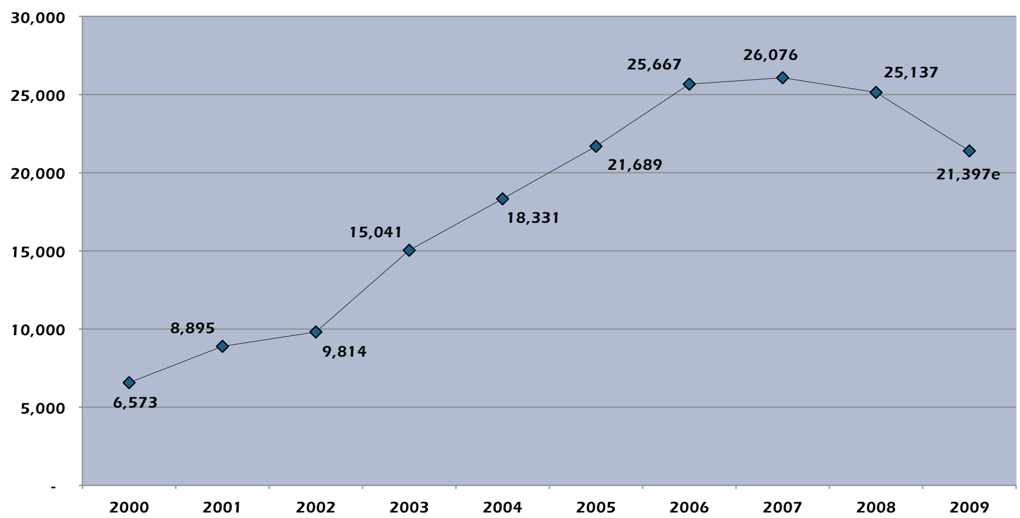
During recent decades, Latin America's tax revenue growth rate has been primarily based on the expansion of VAT (Jiménez, 2009:26 in CEPAL, 2009). For the year 2007, the percentage of tax revenues generated from the payment of VAT in Latin America oscillated between 30% and 50%. Specifically, El Salvador's percentage was 46% and Mexico's was 42%. This contrasts with averages registered for Organisation for Economic Co-operation and Development (OECD) countries—only 19%—which speaks to the importance of private consumption as a source of fiscal resources (via VAT income) in many

Latin American countries, including Mexico. This tendency is more profound in Mexico, as illustrated by the 2010 fiscal reform that approved an increase, from 15% to 16%, for products that are subject to VAT.

The current flow of remittances and the recipient households: changes between 2006 and 2008

According to information obtained from the Central Bank of Mexico, the flow of family remittances grew explosively during the current decade. Between 2000 and 2006, remittances grew from $6.6 billion dollars to $25.7 billion dollars, representing a 290% increase in this six-year period. Between 2006 and 2007, there was a slight degree of absolute growth (2%), but this figure reflected a clear downturn in the growth rate since 2000. Between 2007 and 2008, for the first time, the annual flow of remittances experienced a negative growth of -3.6%, which fell -14.9% between 2008 and 2009.[3] However, this drop is not comparable to other public income; for example, petroleum exports, which represented 50% or more than $40 billion dollars in the January-October 2008 period, and fell to $20 billion dollars for the same period in 2009.[4] This indicates that remittances continue to be an important source of external revenue for the country, even during this current period of crisis, and, given the eventual recovery of the U.S. market, it is likely that in the near future the amount generated will be similar to that generated by petroleum exports. As this document suggests, this has important implications for fiscal income.

Graph IV.1: Family remittances received in Mexico, 2000-2009 (Millions of dollars)



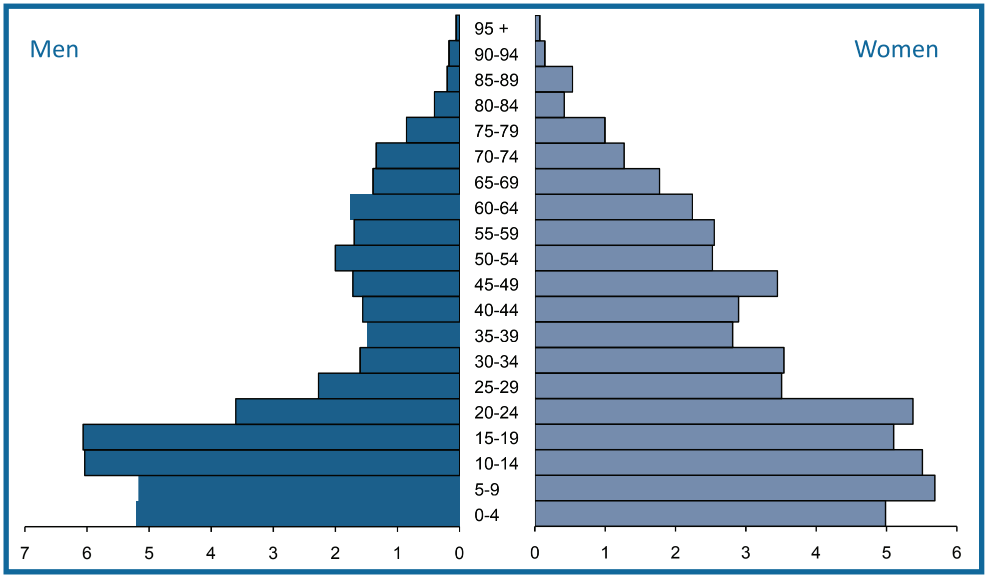
Source: Authors, based on information from the Central Bank of Mexico.

[3] The 2009 remittance data was estimated based on the amount reported by BANXICO between January and November of the same year, a total of $19,621 million dollars, plus the amount recorded in December 2008, which was $1,776 million dollars.

[4] Based on information obtained on the Petróleos Mexicanos (PEMEX) website, December 17, 2009: *http://www.ri.pemex.com/index.cfm?action=content&sectionID=16&catID=12155*

According to information supplied by ENIGH, the population of households in which at least one person receives income from abroad increased to 7.4 million people in 2006 and dropped to 6.5 million people in 2008.[5] The decrease between 2006 and 2008 reflects a drop in remittances sent by Mexican migrants from the United States. When looking at the gender and age of the recipient population, the presence of women in the households that receive remittances is notable: in 2006, 57.1% of recipients were women and, in 2008, 55.4% were women. Information on age groups demonstrates that the households that receive remittances include a greater percentage of children and the elderly, as compared to the population of those households that do not receive remittances. There is also a smaller percentage of household members that are considered to be of a productive age, 15-64 years of age.

Graph IV.2 Population by age group and gender in households that receive remittances, Mexico, 2008 (Percentage Distribution)



Source: Authors, based on ENIGH micro data, 2008.

Similarly, between 2006 and 2008, the number of households in which at least one person stated that they had received support from family members living abroad dropped by 15%, from 1.9 to 1.6 million households during this time period. However, the drop was more pronounced among the rural population, where the decrease in the number of households that receive remittances fell by as much as 25% between 2006 and 2008; among the urban population, the decrease was only 6%.

In looking at the quantity, dynamic and structure of Mexican household income, the results of ENIGH's survey illustrate that the average nominal income in all of the country's households decreased in real terms by 1.6% between 2006 and 2008, while for the households that receive remittances, this same indicator experienced a 6.1% increase. This means that the average nominal income in the households that receive remittances increased in real terms from 27,522 to 29,201 pesos quarterly (based on 2008 prices). This is a significant finding because it illustrates that households that receive

[5] It is worth mentioning that, according to ENIGH, between 2006 and 2008 the Mexican population increased by 1.8 million people, from 105.0 to 106.8 million individuals.

remittances did not suffer the fall in average income that was experienced by the rest of Mexican households; this despite the fact that the average remittance amount decreased from 9,235 pesos quarterly in 2006 to 6,203 pesos in 2008.[6] The decreased importance of remittances as a percentage of total household income was compensated by, among other things, an increase in salaried income, which increased by 24.3%, from 6,925 pesos quarterly in 2006 to 8,611 pesos in 2008.

With regards to the amount, dynamic and structure of Mexican household expenditures, average nominal monetary expenses diminished in real terms by 12.7% between 2006 and 2008. Nevertheless, this drop was not as severe for those households that receive remittances, in which the average quarterly nominal monetary expense decreased by 3%. In 2008, the highest percentage of expenses for households with remittances was designated for food, representing 24.2% of all expenses. This was followed by transport and communications, 13.1%; housing, 6%; education, 6%; clothing and shoes, 3.9%; and healthcare, 2.5%. In summary, households that receive remittances maintained an expense structure that has fiscal implications, considering the VAT generated through purchases made by recipient households did not diminish drastically despite the decrease in remittances between 2006 and 2008.

To conclude this section, we compare poverty rates between the households that do and do not receive remittances, based on methodology employed by the *Consejo Nacional de Evaluación de la Política de Desarrollo*, CONEVAL (National Council to Evaluate Development Policy) with information from ENIGH, 2006 and 2008. CONEVAL has established three terms for classifying poverty in Mexico. The first is *alimentary poverty,* which includes the population that does not have sufficient income to cover the cost of the basic food basket. The second is *capacity poverty*, which is the population that cannot cover the cost of the basic food basket and expenses related to healthcare and education. The third is *patrimonial poverty*, which includes the population that cannot satisfy its nutritional, health, educational, housing, clothing and public transportation needs. CONEVAL estimated that, between 2006 and 2008, the percentage of the Mexican population living in patrimonial poverty increased from 42.6% to 47.4%, the percentage of the population living in capacity poverty increased from 20.7% to 25.1% and the population living in alimentary poverty increased from 13.8% to 18.2% (CONEVAL, 2009). The information presented in Table IV.2 uses the CONEVAL methodology. It offers 2006 and 2008 estimates of poverty based on the population's income and whether or not they received remittances.

[6] Households that received remittances transformed their income structure between 2006 and 2008 given that transfers from the United States depreciated with regards to the *total income* (this includes monetary and non-monetary income, plus financial income), moving from 31.9% in 2006 to 20.1% in 2008, while the participation of remittances in the *nominal monetary income* fell from 43.1% to 27.1% between 2006 and 2008.

Table IV.2: Population living in poverty, by income, with and without remittances, urban and rural, 2006 and 2008

Location and type of poverty	Population and percentage distribution				Percent Change between 2006 and 2008	
	2006		2008			
	With remittances	Without remittances	With remittances	Without remittances	With remittances	Without remittances
National	7,382,954	97,440,341	6,542,255	100,177,093		
Alimentary	15.6	13.6	18.6	18.2	3.0	4.6
Capacity	21.5	20.6	25.6	25.0	4.1	4.5
Patrimonial	42.8	42.6	51.3	47.1	8.5	4.5
Urban	3,858,538	76,759,475	3,789,811	79,032,723		
Alimentary	13.4	9.5	13.5	12.3	0.1	2.8
Capacity	17.8	15.9	21.1	18.7	3.3	2.7
Patrimonial	38.9	37.9	42.2	41.1	3.3	3.2
Rural	3,789,811	79,032,723	2,752,444	21,144,370		
Alimentary	18.0	28.9	25.7	40.4	7.7	11.5
Capacity	25.7	37.9	31.8	48.9	6.2	11.0
Patrimonial	47.1	60.0	63.8	69.7	16.7	9.6

Source: Authors, based on micro data from ENIGH, 2006 and 2008.

Is the population that receives remittances poorer than the population that doesn't receive them? If we look exclusively at the **urban** population, there are not, generally speaking, any significant differences in the levels of poverty between those who receive remittances and those who do not. However, in looking at the **rural** population (those living in localities of less than 2,500 inhabitants) we do observe important discrepancies between those who do and do not receive remittances; the poverty level in both years is noticeably lower for the population that did receive remittances. For example, in Table IV.2, we observe that 28.9% and 40.4% of the rural households that did not receive remittances suffered alimentary poverty in 2006 and 2008, respectively. This data contrasts significantly with the 18% and 25.7% of this same population that did receive remittances during the same years. Similar tendencies are found for those suffering from capacity poverty and, to a lesser degree, those suffering patrimonial poverty. This allows us to draw a first conclusion from the analysis—the flow of remittances contributes to the reduction of poverty in rural Mexico. This, as we analyze in the document, allows poor families that receive remittances to play a more significant role in the payment of VAT.

Estimation of VAT revenue generated in Mexico by households that receive remittances

This section offers results garnered from the estimation of VAT payments in households with and without remittances, based on micro data from ENIGH, 2006 and 2008. It also includes an analysis of how VAT payments impact households, based on whether or not they receive remittances, their urban or rural location, and their percentiles of per capita household income; these factors allow us to determine the degree of regressivity of the VAT payment. Finally, we present an estimate of the amount of VAT revenues associated with remittance flows by using the results obtained from the ENIGH, 2006 and 2008 and scaling this information based on data on family remittances reported by the Bank of Mexico. The section begins with a description of the methodology that was employed to generate the estimates.

Description of the methodology used to estimate fiscal revenues

The methodology used to estimate VAT revenues associated with the flow of remittances was as follows. Using the *Encuesta Nacional de Ingreso y Gasto de los Hogares* (ENIGH), 2006 and 2008 editions, the first step was to do an imputation of VAT payments for each household included in the sample, according to the products and services that generate VAT revenues and were consumed by the households. The next step was to estimate an informal consumption rate per household based on where each of the products and services were purchased; if the products were acquired in municipal markets, in open air markets *(tianguis),* mobile markets, from street vendors, from establishments outside the country, consumption was considered informal and, thus, it did not generate VAT revenues. Estimation of informal consumption is central to determining the amount of money that does not enter the public treasury, especially purchases that should include VAT revenues but do not. Once these steps were taken, we obtained an estimate of the VAT generated by Mexican households, which was then analyzed according to the following typology: whether or not the households receive remittances, location of the household in an urban or rural area, and based on deciles of total per capita household income. Finally, using the ENIGH results from 2006 and 2008, we generated an estimated amount of VAT revenue associated with remittances, based on information reported by the Central Bank of Mexico.

VAT revenue generated by households that receive remittances

Households that receive remittances contributed $1,036 million dollars in VAT in 2006 and $975 million dollars in 2008, which, based on the ENIGH estimate, represented 4.6% of the total in both years. Calculations of the VAT revenue considered an average rate of informal consumption of 12.6% in 2006 and 13.3% in 2008. In Table IV.3 shows that, while the total amount of VAT collected, per the ENIGH estimate, decreased by 5.2% between 2006 and 2008, the most significant drop occurred in rural households (both those with and without remittances), a decrease of approximately 22%. Urban households with remittances are the only group in which there was positive growth in VAT payments, 3.3%. Even though the VAT estimate used a conservative calculation of informal consumption, a considerable amount of revenue was generated through value added taxes.[7]

[7] Table IV.3 also illustrates that, using the ENIGH micro data, it is possible to estimate a significant percentage of VAT reported by the *SHCP*, approximately 65% in 2006 ($22.475 billion dollars) and 52% in 2008 ($21.314 billion dollars).

Table IV.3: VAT estimate per type of household based on ENIGH, 2006 and 2008 (Data in millions of dollars, adjusted for expenditures in the informal sector[8])

Type of household	2006 VAT	%	2008 VAT	%	% Change
Rural with remittances	372	1.65	289	1.36	-22.3
Rural w/o remittances	2,138	9.51	1,660	7.79	-22.4
Urban with remittances	664	2.95	686	3.22	3.3
Urban w/o remittances	19,301	85.88	18,679	87.64	-3.2
Total (ENIGH)	22,475	100.00	21,314	100.00	-5.2
Subtotal with remittances	1,036	4.63	975	4.58	-5.9
Subtotal w/o remittances	21,439	95.36	20,339	95.42	-5.1
Total (ENIGH)	22,475	100.00	21,314	100.00	-5.2
SHCP	34,912		41,001		17.4
ENIGH proportion	%		%		
ENIGH (%)	64.37		51.98		
SHCP (%)	100.00		100.00		

Source: Authors, based on the ENIGH, 2006 and 2008 and its expansion factors.

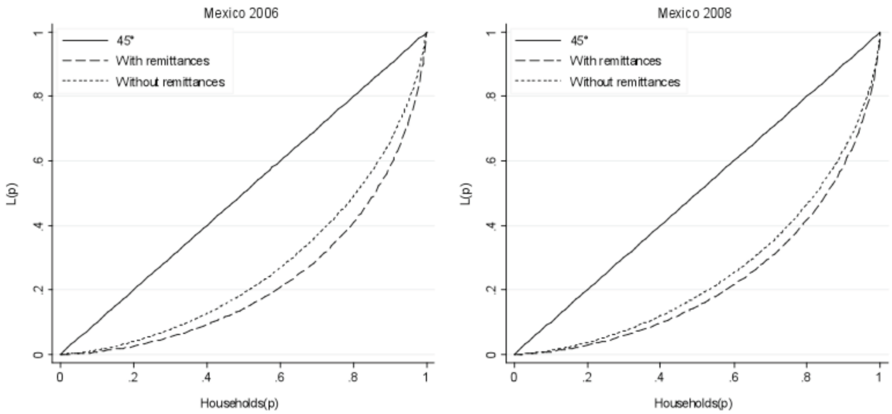
The data reflected here supports information presented in the previous section on the households that receive remittances (especially urban households). These families experienced an increase in their average nominal income, thus generating higher levels of VAT revenues as opposed to what occurred for the rest of the population that contributed less in value added taxes (see Table IV.3).

The redistributive impact of VAT revenues among households that receive remittances, 2006 and 2008

In order to measure the redistributive impact of VAT payments, we analyzed the data based on deciles of per capita income along with the Gini coefficients and the Lorenz curves (Yithzaki, 1983; Kakwani, 1984; and Lambert, 2001). This analysis permits us to compare the degree to which tax revenues are concentrated in households with or without remittances. This comparison is also carried out for the country as a whole and for rural and urban households. In the case of VAT revenues, the desired result is a high Gini coefficient and a Lorenz curve distanced far away from the line of perfect equality. The closer the curve is to the 45° straight line, the greater the regressivity; in other words, payment of taxes would be more concentrated in those households that have lower income, the opposite of what is sought in terms of equality. Graphs IV.3 and IV.4 illustrate the Lorenz curves corresponding to the 2006 and 2008 payment of VAT, for households that do and do not receive remittances. It shows that the distribution of VAT in households with remittances is closer to the equality curve than that of its counterpart, confirming that VAT payment is less concentrated in the higher deciles, while households with lower deciles showed a higher tax burden for VAT.

[8] To convert the ENIGH quarterly figures from pesos to dollars, an average exchange rate (foreign currency debt) from the third quarter of the year was used, which was 10.947 pesos for 1 dollar in 2006 and 10.323 pesos for 1 dollar in 2008. To obtain the annualized figure, the result was multiplied by four. All of the other figures in pesos that did not come from ENIGH, including those provided by the *Secretaría de Hacienda* (SHCP), were converted to dollars using the average exchange rate for each year, which was 10.901 pesos per 1 dollar in 2006 and 11.152 pesos per 1 dollar in 2008.

Graphs IV.3 and IV.4: Lorenz Curves for the VAT payments in Mexico, 2006 and 2008



Source: Authors, based on micro data from ENIGH, 2006 and 2008.

With regards to the Gini Coefficients for Mexico (Tables IV.4 and IV.5), we observe a less concentrated distribution of VAT payments among households that receive remittances, a sign of greater regressivity.[9] Not only do these families pay more VAT in relative terms, but, additionally, households with lower-income percentiles contribute at a higher tax burden. The Gini indexes for households receiving remittances were lower, 0.479 in 2006 and 0.495 in 2008, compared with those households that did not receive remittances with higher index values of 0.562 and 0.537, respectively.

Table IV.4: VAT revenue per decile of per capita income in Mexican households that receive remittances, 2006 and 2008 (Data in millions of dollars, adjusted for expenditures in the informal sector)

Decile	VAT 2006	% of VAT Revenue	VAT 2008	% of VAT Revenue	Proportional difference of Contribution
1	45	4.3	44	4.5	0.2
2	53	5.1	77	7.9	2.7
3	91	8.8	86	8.8	0.0
4	95	9.2	66	6.8	-2.4
5	121	11.7	86	8.8	-2.9
6	113	10.9	97	10.0	-0.9
7	82	7.9	129	13.2	5.3
8	114	11.0	115	11.8	0.8
9	178	17.2	133	13.6	-3.5
10	144	13.9	143	14.7	0.8
Total	1,036	100.00	975	100.00	
Gini Std. Error		0.4794 (0.013)		0.4949 (0.017)	

Source: Authors, based on ENIGH study and respective weighted factors.

[9] A tax system is **regressive** if it proportionally extracts greater resources from those who generate less income. A tax system is **progressive** when those who earn more, pay proportionally higher taxes.

Table IV.5: VAT revenue per decile of per capita income in Mexican households that do not receive remittances, 2006 and 2008 (Data in millions of dollars, adjusted for expenditures in the informal sector)

Decile	VAT 2006	% of VAT Revenue	VAT 2008	% of VAT Revenue	Proportional Difference of Contribution
1	454	2.1	576	2.8	0.7
2	743	3.5	802	3.9	0.5
3	924	4.3	969	4.8	0.5
4	1,078	5.0	1,150	5.7	0.7
5	1,270	5.9	1,330	6.5	0.6
6	1,530	7.1	1,610	7.9	0.8
7	1,910	8.9	1,800	8.8	-0.1
8	2,410	11.2	2,462	12.1	0.9
9	3,460	16.1	3,370	16.6	0.4
10	7,660	35.7	6,270	30.8	-4.9
Total	21,439	100.00	20,339	100.00	
Gini Std. Error		0.5621 (0.005)		0.5374 (0.003)	

Source: Authors, based on ENIGH study and respective weighted factors.

Remittances' contribution toward VAT revenues in Mexico

Thus far, we have estimated the amount of VAT generated by households that receive remittances, but we have not specified the exact amount of VAT income associated with remittances. To do so, it is first necessary to estimate the amount (in a hypothetical scenario) of VAT related exclusively to the expenditure of remittances, using information based on micro data provided by ENIGH, 2006 and 2008. Then, VAT revenues are estimated based on remittance data as reported by the Central Bank of Mexico for the same years. To do this, we created a counterfactual scenario, which tells what would happen if the state received only VAT income associated with the expenditure of remittances. The estimate calculated the proportion of VAT income corresponding only to the proportion of remittances as a percentage of the total income for each household. Similarly, using this hypothetical scenario, an adjustment was made for purchases made in the informal sector assuming that remittances would be spent in the same proportion as total income. The estimates are presented in Table IV.6 under *Hypothesis of VAT associated with the expenditure of remittances in ENIGH*—which totaled $342 million dollars in 2006 and $226 million dollars in 2008.[10] This information was used to calculate the proportion of the total remittances recorded by ENIGH, which reached 5.9% in both years (see *VAT from remittances as a % of the total amount of remittances in ENIGH,* Table IV.6). This means that for each dollar of remittances that enters Mexico, close to six cents on the dollar are translated into VAT revenues.

[10] In looking at these results, it is important to highlight the difficulty in determining the exact amount of remittances designated for specific expenditures or investment. For this reason the "VAT from remittances" is an approximation of the real number, which assumes that households will only contribute in a proportion equivalent to the purchases resulting from the remittances they receive.

The last step was to obtain an appropriate estimation of the total amount of remittances in order to correct ENIGH's sub-estimation. To do this, a common practice was employed for adjusting household income survey data with results of national accounts (SHCP, 2008; Vargas, 2006) in which ENIGH's estimate for remittances was rescaled using an expansion factor (Altimir Factor).[11] This was then validated with least squares linear regression model, taking into account regional data from ENIGH and the Central Bank of Mexico.[12] The amount of remittances reported by the Central Bank of Mexico is shown in Table IV.6; in 2006 it totaled $25,567 million dollars and in 2008 was $25,137 million dollars. The 5.9% calculated from these amounts resulted in an estimate of remittance-related VAT totaling $1,517 million dollars for 2006 and $1,493 million dollars for 2008. VAT revenues associated with the flow of remittances represent 4.3% of the total VAT collected in 2006 and 3.6% of that collected in 2008, as reported by the *Secretaría de Hacienda y Crédito Público*.

Table IV.6: Estimate of VAT associated with expenditures of remittances based on the ENIGH and adjusted with information from the Central Bank of Mexico, 2006 and 2008. (Millions of dollars)

	2006	2008
Hypothesis of VAT associated with remittance expenditures (ENIGH)	342	226
Estimated amount of remittances (ENIGH)	5,764	3,806
VAT from remittances as a % of the total amount of remittances in ENIGH	5.93	5.94
Estimated amount of remittances (BANXICO)	25,567	25,137
Estimated amount of VAT associated with remittances expenditures	1,517	1,493

Source: Authors, based on information from ENIGH, 2006 and 2008 and the Central Bank of Mexico.

Public spending, transfers and social programs in Mexico, and how they compare with remittances' contribution to VAT

During recent years, Mexico's public sector's programmable spending[13] (including nominal spending, investment spending, subsidies and transfers) was approximately 16% of the Gross Domestic Product (GDP), specifically 16.1% in 2006 and 18.4% in 2008. Non-programmable spending has remained steady at approximately 6% of the GDP. According to *Secretaría de Hacienda y Crédito Público* (SHCP) data, spending categorized as "social development" (including education, healthcare, social security, urbanization, housing, regional development, potable water, sewage systems and social assistance) represented 59% and 60% of programmable spending in 2006 and 2008, respectively. All other public spending was categorized as "economic development" (which represented 30% of the total programmable spending for the same years). A significant part of Mexico's overall public spending is directed to education and healthcare, which totaled as much as one third of programmable spending: healthcare and education expenses were 36% and 33% of the total programmable

[11] The expansion factor that has been used is $FA_t = BM_t/ENIGH_t$, in which BM is the amount of remittances reported by the Central Bank of Mexico in year "t" and ENIGH is the amount of remittances estimated by ENIGH in time period "t".

[12] Diverse regressions carried out using regional information from ENIGH and the Central Bank of Mexico suggests that the expansion of ENIGH's remittance amount toward the amount provided by the Central Bank of Mexico is an appropriate methodology. The expansion factor used for 2006 and 2008 was 4.4% and 6.6%, respectively, and the regression analysis of the entire body of regional data for both years results in an expansion factor of 5.5% with an R^2 of 0.88.

[13] Programmable Spending: Expenses that can be planned for in advance and are part of governmental programs directed to providing public goods and services to the population. Non-programmable spending: Expenses that are automatically adjusted to the fluctuations that arise during the fiscal year, including public debt, fiscal responsibility, debts for previous fiscal years, financial costs of semi-governmental entities (Pemex, CFE), and participation in and contribution to federal and municipal entities.

spending in 2006 and 2008, respectively. A figure worth noting is the difference between the VAT revenues from remittance expenditures and the public healthcare benefits to households that receive remittances. Based on information from ENIGH and other official sources, it was possible to estimate that, for 2008, the VAT revenues from remittances was 50% greater than the amount spent on healthcare for the population that receives remittances (Table IV.7).

Another important area of social spending are Conditional Cash Transfers, which, in Mexico are associated with programs such as *Oportunidades* and *Procampo.* In stark contrast to the amounts designated for healthcare and education, the total combined budget for *Oportunidades* and *Procampo* was less than 3% of the total programmable spending, 2.6% in 2006 and 2.5% in 2008. When compared with these programs, VAT revenues from remittances is not insignificant*;* VAT revenues from remittances were equivalent to 50% and 40% of the amount designated to *Oportunidades* for 2006 and 2008, respectively. For the *Procampo* program, VAT revenues from remittances represented more than 10% and 17% of the total in 2006 and 2008, respectively (Table IV.7).

Another social program that has received a significant amount of attention in recent years based on its direct link with remittances is the 3x1 Program for Migrants. This program aims to fight poverty and foment local development in migrants' communities of origin and is financed in the following way: for each dollar that migrant's contribute, federal, state and municipal governments each provide a dollar, thus the term 3x1. However, the State's contribution to the 3x1 Program represents a very small portion of public expenses: 0.01% and 0.02% of total programmable spending in 2006 and 2008, respectively. Further still, in evaluating whether or not the contribution to the 3x1 Program is significant in terms of the population to which it is directed, our own estimations based on information provided by ENIGH showed that these expenses represented 3% and 8.3% of all total direct transfers carried out by *Oportunidades* and *Procampo,* directed to households with remittances in the years 2006 and 2008, respectively. Furthermore, VAT revenues generated from the expenditure of remittances were 85 and 35 times greater than what the Mexican State contributed to the 3x1 Program in 2006 and 2008, respectively. This means that for each dollar generated in remittance associated VAT, the federal government contributed the equivalent of one cent on the dollar in 2006 and three cents on the dollar in 2008.

Finally, other economic and fiscal indicators show that the 2008 VAT revenues associated with the expenditure of remittances represented 0.14% of the GDP, 1.6% of the budgeted petroleum revenues, 3.0% of income tax, 3.6% of value added tax and 6.6% of direct foreign investment (see the last panel of Table IV.7).

Table IV.7: Estimate of VAT revenues generated from remittances and economic indicators, 2006 and 2008
(Millions of dollars)

Economic indicators	2006		2008	
	Millions of dollars	Remittance related VAT as a % of the indicators	Millions of dollars	Remittance related VAT as a % of the indicators
Estimate of remittance-generated VAT	1,517		1,493	
Social expense indicators				
Oportunidades	3,075	49.3	3,740	39.9
Seguro Popular	1,116	135.9	2,232	66.a
Procampo	1,378	110.1	1,273	117.3
3 x 1 Program for Migrants	18	8,427.8	44	3,393.2
Economic and fiscal indicators				
Gross Domestic Product	985,899	0.15	1,087,001	0.14
Budgeted petroleum revenues	78,984	1.9	94,602	1.6
Income tax	41,097	3.7	50,395	3.0
Value added tax	34,912	4.3	41,001	3.6
Direct foreign investment	25,618	5.9	22,516	6.6

Source: Authors, based on information from ENIGH, 2006 and 2008; Government Report, 2009; Secretaría de Hacienda y Crédito Público; and Central Bank of Mexico.

Final reflections

Mexican migrants in the United States contribute a significant amount of fiscal income in the Mexican internal market via purchases made with remittances sent to their families.

Historically, international migration and the remittances generated by migrants have had significant repercussions for Mexico's economic and social development. However, it is imperative that the government of Mexico and society as a whole recognize that migrants contribute a significant part of Mexico's fiscal revenues via the expenditure of their remittances in the national, internal market. According to the results of this study, purchases made with remittances generated Value Added Tax (VAT) revenues of approximately $1,500 million dollars in 2006 and 2008. This is no small amount, especially if we consider that in 2006 this was equivalent to half of the government's budget for the *Oportunidades* program and 40% of the same in 2008.

Households that receive remittances will continue to contribute to Value Added Tax (VAT) revenues and will likely contribute even more in the near future.

Given the reconfiguration of public revenues in the immediate future (especially due to a significant decline in petroleum income), VAT income associated with the flow of remittances will continue to be significant and may in fact increase. According to the calculations of this research, approximately 4% of VAT revenue in Mexico comes from remittance related expenditures. Our calculations, using fiscal projections provided by the SHCP, indicate that the budgetary revenues generated by taxes could increase from 42% to 50% in 2009, while petroleum income may drop from 37% to 25%. Additionally, the role of VAT revenues in the budget will increase from 16% in 2008 to 18.5% in 2009. Under this new scenario, remittances' participation in the generation of VAT could increase in the coming years; a decline in remittances will doubtlessly be less significant in comparison with the decline that will be observed in other important sources of budget income, especially petroleum.

A decrease in remittances does not translate into a proportional decrease in the VAT garnered from those households that receive remittances.

The population that receives remittances is not poorer than the rest of the population and this can be explained, in large part, precisely by the fact that these households receive remittances. In applying CONEVAL's methodology to measure poverty, we can conclude that for the more vulnerable sectors of the population—those who live in rural areas—poverty levels for those who receive remittances are considerably lower than those experienced by households that do not benefit from these resources. This is not the case in urban areas, in which there is no significant difference in the poverty levels between those that receive and those that do not receive remittances. The fact that levels of poverty in households that receive remittances did not exceed those experienced by those who did not receive remittances suggests that the former have successfully found strategies to compensate for the decrease in remittances (for example, a greater level of insertion in the job market). For the purpose of this study, this implies that households with remittances were able to maintain past levels of consumption, which explains why VAT revenues from these households did not shrink, as would have been expected.

Governmental programs such as Oportunidades provide greater benefits to the population associated with migration than those benefits offered under the 3 x 1 Program.

The government's contribution to the 3x1 Program is less than 10% of what remittance recipients receive from the *Oportunidades* and *Procampo* programs. The 3x1 Program for Migrants has been seen as an important initiative, almost paradigmatic, directed at promoting economic and social development in the regions with larger concentrations of families with migrants. Strictly speaking, it is difficult to question governmental policies of this kind, especially considering that the 3x1Program has stimulated an important social organization process within Mexican migrant communities abroad. Nevertheless, what can be criticized is the small amount of funds designated by the Mexican government for this program, especially when compared to the amount of VAT income generated by purchases made with remittances. For every dollar collected in VAT income as a result of the expenditure of remittances, the federal government contributed the equivalent of one cent on the dollar in 2006 and three cents on the dollar in 2008 to the 3x1Program.

V. Extreme dependence: The case of El Salvador[14]

Introduction

Most rational people continually search for better opportunities in order to achieve greater levels of well-being; this is an on-going quest that leads people to increase their human capital, look for new employment, etc. This search often leads people to migrate to other municipalities, to leave a rural area and move to an urban area, and to migrate to another country. This migration creates a transformation in the country's social and economic structure. Similar to other under developed countries, El Salvador has experienced this kind of migration and gradual transformation for more than 60 years. In the 1960s and 1970s, the once rural population moved to urban centers. In the 1970s, an agrarian society transformed to an industrial society, based on commerce and services, a process that was interrupted in the 1980s with the outbreak of the armed conflict and then further consolidated in the 1990s.

The political climate and the measures adopted by the government in the 1980s, together with a deepening armed conflict and an economic crisis provoked by the closure of businesses and the flight of foreign capital, forced large masses of the population to migrate to urban areas and to other countries, especially the United States and Canada. In the 1990s, migration continued, this time as a result of family reunification, lack of employment opportunities in El Salvador, and families' search for improved well-being.

The *Dirección General de Estadísticas y Censos*, DIGESTYC (the General Statistics and Census Administration) (2009) reports that between 1980 and 2005 the net five-year average for international migration was -11.04 migrants per 1,000 people. This information reflects a negative correlation to the behavior of the Salvadoran economy: as the economy grows, the flow of migration diminishes and when the economy experiences a slowdown or a drop, migration increases.

The increase in migration has resulted in an increase in the amount of remittances sent to El Salvador; in 1980, migrants sent $53 million dollars in remittances, a figure that had risen to $3,788 million dollars by 2008 (based on information from the BCR). These figures represent an average annual growth rate of 18.1% in which remittances represented an average of 7.6% of the GDP in the 1980s, 12% in the 1990s, and 15.7% in the period 2000 to 2007. In 2007, remittances totaled 18.1% of the GDP.

Many studies have addressed the macroeconomic effects of family remittances, the profile of the migrant and his or her household, ways and costs of sending remittances, the use of these funds, among other

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aspects. But there is one aspect that has not been studied, at least not for El Salvador, and this is the contribution that remittances make to public revenue, given that the recipients of remittances spend a large part of these funds on the acquisition of consumer goods, fixed assets, and services, which for the most part are currently subject to taxes in El Salvador.

This chapter explores the fiscal revenue generated by households that do and do not receive remittances, emphasizing the amount of value added taxes (VAT) generated in El Salvador. This amount is compared with the amount that the government spends on various social programs, evaluating to what extent the government is reinvesting in families as a result of their tax contributions. This study is based on information on household income and expenses provided by the *Encuesta de Hogares de Propósitos Múltiples,* EHPM (Multiple-purpose Household Survey) from 2007, making a distinction between household purchases for products and services that are taxable, those that are exempt, and those that are not subject to VAT, as well as the role that the informal sector plays in household consumption.

In addition to this introduction, the document is comprised of the following sections: The first section provides a summary of the tax revenue structure. This is followed by an analysis of available data on family remittances. The next section provides a profile of Salvadoran households based on socio-demographic characteristics, whether or not the households receive remittances, place of residence (urban/rural), expenditures, and poverty rates. The following section addresses remittances' contribution to fiscal revenue and includes an analysis by decile of per capita household income. We then look more closely at government spending programs and allocations for education, the national hospital system, local development programs and the monetary transfer program known as *Red Solidaria* (Solidarity Network). The chapter concludes with a series of final reflections on El Salvador's economic and social policy and the need for a development agenda that takes migrant communities into account, given the important contribution of taxes that are paid when families make purchases with their remittances and given that migrant remittances create economic development and stability in the country.

El Salvador's tax revenue system

Since 1990, El Salvador's fiscal policy has gone through a series of transformations, aimed at generating conditions that would improve the country's growth and productivity and resolve the fiscal deficit; government policy has in fact prioritized short term obligations.

In an attempt to achieve greater efficiency, the priority for fiscal revenue during the past 18 years has been to simplify the tax revenue system and administration. In the 1990s, and as part of a policy of reducing barriers to trade, El Salvador implemented an accelerated reduction in import taxes.

Currently, the Salvadoran tax system includes few taxes, which are simple and easy to administrate. The Non-Financial Public Sector revenue[15] is classified into three main categories: a) Nominal revenue which is subdivided into tax revenue, non-tax revenue, contributions to the health care system, public enterprise surplus and others; b) capital revenue; and c) donations from outside the country. El Salvador's tax revenue system has a simple structure that includes direct taxes (income tax and transfer of real estate) and indirect taxes (VAT, including a property transfer tax, tax on services, and selective consumption taxes: alcoholic beverages, carbonated beverages, cigarettes, weapons; import duties; and special contributions: FOVIAL, tourism, extracted sugar, etc.).

[15] The Public Sector is divided in two main categories: Financial Public Sector and Non-Financial Public Sector. The second group includes the General Government (the Central Government, decentralized institutions and other institutions) and Non-Financial Public Companies.

Direct imports, which represent slightly more than one-third of the total tax revenue, increased from 28.7% in 1990 to 34.7% in 2007. VAT is the most significant part of this revenue, representing 51.8% in 2007 (Table V.1).

Table V.1: Composition of Tax Revenue, 1990-2007
(% of Tax Revenue)

Item	1990	1995	2000	2005	2007
Direct taxes	28.6	28.5	31.9	32.1	34.7
Income tax	22.5	27.2	31.1	31.4	34.0
Property	3.9	0.1	0.0	0.0	0.0
Transfer of property	2.2	1.1	0.8	0.7	0.7
Indirect taxes	71.4	71.5	68.1	67.9	65.3
Import duties	22.4	17.6	9.7	8.1	7.3
Value Added Tax (VAT)	31.3	46.9	55.1	52.5	51.8
Selective consumption tax	15.4	5.3	3.4	4.3	3.4
Others (FOVIAL, tourism, sugar)	2.3	1.7	0.0	3.0	2.8
Tax revenue (%)	100.0	100.0	100.0	100.0	100.0
Tax revenue (millions of dollars)	438.2	1,062.5	1,344.1	2,131.7	2,720.4

Source: Authors, based on data from the BCR.

Table V.1 provides an overview of the proportions of tax revenue since 1990 demonstrating an increased participation of direct taxes and, as a result, a decreased participation of indirect taxes. Even though the participation of direct taxes has increased, the tax structure is a little less regressive but remains essentially the same and indirect taxes continue to play an important role in the total revenue.

Definition of family remittance income

The *Banco Central de Reserva,* BCR (Central Reserve Bank) is officially responsible for recording El Salvador's total remittances, part of the BCR's regular activities to register balance of payment transactions. External family support for individual households is documented by the *Dirección General de Estadísticas y Censos* (DIGESTYC).

According to the BCR, remittances are defined as: a) Nominal transfers from foreigners residing outside the country who have been or intend to be outside the country for a period of more than one year, which are sent to those residing in the worker's country of origin; b) funds earned by non-resident immigrants, defined as those who have been in the country for less than one year; and c) transfers from emigrants that earn compensation from the flow of goods and exchanges in financial areas arising from the migration of individuals from one economy to another, meaning the goods an emigrant takes from one country to another when he or she moves (CEMLA, 2009: 22).

DIGESTYC obtains remittance data from the EHPM. For this study, the value of remittances has been calculated as the amount reported by the selected households at the time that they were interviewed.

Table V.2: Comparison of annual income from family remittances, BCR and EHPM (Millions of dollars)

Description	2001	2002	2003	2004	2005	2006	2007
BCR Data	1,910.5	1,935.2	2,105.3	2,547.6	3,017.1	3,470.9	3,695.2
% of GDP	13.8%	13.5%	14.0%	16.1%	17.7%	18.6%	18.1%
EHPM Data	521.9	610.3	624.7	699.1	789.5	826.4	730.5
% of GDP	3.8%	4.3%	4.2%	4.4%	4.6%	4.4%	3.6%
Difference, BCR - EHPM	1,388.6	1,324.9	1,480.6	1,848.5	2,227.6	2,644.5	2,964.7
EHPM/BCR (%)	27.3%	31.5%	29.7%	27.4%	26.2%	23.8%	19.8%
BCR/EHPM	3.7	3.2	3.4	3.6	3.8	4.2	5.1

Source: Authors, based on data from the BCR; HDR, 2005; and the EHPM, 99-2007.

Historically, there has been a significant discrepancy between the amounts reported by each of these two institutions. In 2007, the difference totaled $2,964.7 million dollars (see Table V.2)—the amount reported by the EHPM in 2007 was only 19.8% of that which was reported by the BCR. *The Human Development Report, El Salvador, 2005* (HDR) explains that this difference may be understood by analyzing two factors: EHPM's systemic under-estimation of remittances or the BCR's over estimation of the same, which may be the result of capital deposits that are not part of family remittances, for example, money laundering (UNDP, 2005).

For the purposes of this study, given that the nature of this research requires direct input from households concerning the composition of income and expenses for each family unit, calculation of family remittances was based on information provided by the EHPM for the year 2007 ($730.5 million dollars). However, since we know that this amount and other information generated by EHPM studies is under estimated, we have rescaled the total VAT revenue based on the aggregate value of household expenditures according to national accounts. This enabled us to arrive at closer approximation of the actual value of remittances received in El Salvador in 2007 and the corresponding contribution to VAT.

Description of Salvadoran households

To provide a framework for the importance of remittances and in order to obtain a complete panorama of families that do and do not receive remittances, we have presented the socio-demographic characteristics of Salvadoran households (see Table V.3).

Table V.3: Description of Salvadoran households

Description	Households with remittances			Households without remittances		
	Urban	Rural	Total	Urban	Rural	Total
Total number of households	238,458	143,271	381,729	705,694	343,102	1,048,796
Female head of household						
No	49.9%	55.4%	52.5%	67.3%	73.6%	70.2%
Yes	50.1%	44.6%	47.5%	32.7%	26.4%	29.8%
Poverty classification						
Poverty:	23.5%	32.3%	26.8%	32.0%	48.6%	37.4%
Extreme poverty	4.2%	7.2%	5.3%	9.1%	20.1%	15.5%
Relative poverty	19.3%	25.1%	21.4%	22.9%	28.5%	21.9%
Not living in poverty	76.5%	67.7%	73.2%	68.0%	51.4%	62.6%
Averages						
Size of household	3.9	4.4	4.1	3.8	4.4	4.0
Age of head of household	52.2	52.8	52.5	47.7	46.1	47.0
Family members under the age of 12	0.9	1.2	1.0	0.9	1.3	1.0
Family members between ages 12 and 64	2.6	2.8	2.7	2.7	2.9	2.7
Family members ages 65 and older	0.4	0.4	0.4	0.3	0.3	0.3
Family members that receive remittances	3.9	4.4	4.1	0.0	0.0	0.0
Working family members	1.2	1.2	1.2	1.3	1.3	1.3

Source: Authors, based on EHPM, 2007.

The table shows that female heads of household are predominant in those homes that receive remittances (47.5%); this differs from households that do not receive remittances, in which only 29.8% are headed by a woman. This difference can be explained by the preference for a man to migrate to another country and for a woman to stay in the country of origin to take care of the house, the children and, in some cases, the migrant's parents. Along these same lines, 48.3% of the household population that does not receive remittances is male, differing from households that do receive remittances in which men represent only 43.9% of the population.

Another significant difference is seen in the overall well-being of the family: only 26.8% of households that receive remittances are living in conditions of poverty, 5.3% of which are living in extreme poverty. Conversely, 37.4% of the households that do not receive remittances are living in poverty and 15.5% in extreme poverty. These results speak to the importance of remittances in reducing poverty.

There are no significant differences between recipients and non-recipients when looking at the size of the household, the primary ages of family members, or the average number of family members who are employed within the country. What can be observed is that the heads of households in the families that receive remittances are slightly older than in the case of the non-recipient households.

When further breaking down the household age structure, the data demonstrates that there are other differences between those families that receive remittances and those that do not: 33.5% of family members in the first group are ages 20-49, while this same age group constitutes 41% of the families that do not receive remittances. 22% of the members of households that receive remittances are 50 years of age or older, while this figure is only 16% for non-recipients. The fundamental reason for this difference is that the population that migrates is between 20 and 49 years of age, while those who are 50 and older remain in the country or return to the country after having worked abroad for many years.

The importance of remittances for the family income

Migration to the United States has contributed to generating a new economy in El Salvador (UNDP, 2005). Families have changed in various ways including the feminization of the heads of household, a transnationalization of the family, a separation of parents and children, and other changes that impact consumption and living habits.

Remittances play a protagonistic role in all of these changes for investments to improve housing, purchase vehicles and household furnishings, or guarantee better education and healthcare. For the households that receive remittances, these resources have largely substituted salaried income, which has become a less-significant component in meeting expenses.

Table V.4: Composition of total household income, 2007 (% of total income)

Area	Households	Employment income	Remittances	Other	Total
Urban	Non recipient	80.5%	0.0%	19.5%	100%
	Recipient	58.3%	25.5%	16.2%	100%
	Total	73.4%	8.2%	18.4%	100%
Rural	Non recipient	72.8%	0.0%	27.2%	100%
	Recipient	28.9%	48.2%	22.9%	100%
	Total	57.0%	17.4%	25.6%	100%
Total	Non recipient	78.9%	0.0%	21.1%	100%
	Recipient	51.3%	30.9%	17.8%	100%
	Total	69.8%	10.2%	20.0%	100%

Source: Authors, based on the EHPM, 2007.

In 2007, employment income for households that received remittances made up 51.3% of the total income and remittances represented 30.9% of the total. In households that did not receive remittances, employment income represented 78.9% of total income 21.1% of this total came from non-salaried income, specifically retirement pension funds, support from family members living within El Salvador, and other income (Table V.4). Remittances are relatively more important for rural families and represented 48.2% of the total income, compared with 25.5% in urban households. On the other hand, employment income represents 80.5% of household income for urban families that do not receive remittances and 72.8% in rural households.

Migration varies from one province to another within the country. In the provinces of La Unión and Morazán, which experience the highest rates of migration (50.7% and 41.5% of households receive remittances, respectively), remittances are a greater proportion of total income, 52.9% and 44.7%, respectively, compared to income from employment at 26.1% and 30.3%, respectively.

In considering deciles of per capita income, as income increases, the importance of remittances in the total household income for recipient households becomes less significant—they represent 48.2% of income for decile 2 and 16.1% of the same for decile 10. Salaried income reflects an evolution that is inverse to that of remittances: it represents 1.1% of the first percentile's income and 68.2% of the tenth decile's income.[16] What is relevant for the distribution of remittances per decile is that decile 1 receives 1.8% of its income from remittances, which means that this group of households benefits very little from the possibility that remittances will help them to overcome poverty. This can be explained, in part, by the vicious cycle experienced by the poorest households: since they do not have enough money to finance a trip to the United States, they cannot migrate and therefore they do not have family members who can send remittances back to El Salvador.

Remittances and household expenses

In analyzing the composition of total household expenses (Table V.5), we can see that there are no significant differences between how households that do and do not receive remittances spend their money. For both groups, resources are distributed as follows: the largest percentage is designated for food purchases, 46% and 50% of total expenses; this is followed by the purchase of goods and services; and, thirdly by expenses related to education, 14.4% of the total. The same results are found in analyzing the information by deciles of per capita income: there are no significant differences between those households that do and do not receive remittances.

Table V.5: Composition of total household expenses, 2007 (% of total expenses)

Expense	Households with remittances	Households without remittances	Household total
Food	46.6	49.4	48.5
Basic goods and services	25.3	25.9	25.7
Complementary household items	10.6	8.0	8.8
Transfers to others	1.5	1.8	1.7
Healthcare	1.4	0.6	0.8
Education	14.6	14.3	14.4
Total	100.0	100.0	100.0

Source: Authors, based on EHPM, 2007.

The importance of remittances in reducing poverty

Remittances are essential to the well-being of the families that receive them. An analysis of the existing levels of poverty in the country[17] demonstrates that households that receive remittances experienced a lower incidence of poverty. In Table

[16] Detailed information can be found in the complete text of this study, available on line.

[17] The poverty analysis is done using the Foster-Greer-Thorbecke (FGT) index which include three components: **Headcount** (H), which calculates the proportion of people living below the poverty line; the **Poverty Gap** (PG), which measures the *deficit* relative to the income of the poor with respect to the value of the poverty line

V.6 we can see that the poverty level is 10% less for households that receive remittances than for those that do not. The difference is even more significant in rural areas, reaching as much as 16 points.

Table V.6: Household poverty indicators (Foster-Greer-Thorbecke Indicators (FGT))

Geographic area	Households with remittances			Households without remittances			Total		
	H	PG	FGT_2	H	PG	FGT_2	H	PG	FGT_2
Urban	23.5	5.3	2.5	32.0	9.7	5.4	29.8	8.6	4.7
Rural	32.3	18.4	9.4	48.6	30.0	18.4	43.8	26.6	15.8
Total	**26.8**	**10.2**	**5.1**	**37.4**	**16.3**	**9.7**	**29.8**	**14.7**	**8.5**

Source: Authors, based on EHPM, 2007.

The same trend occurs in analyzing the poverty gap. Rural households that receive remittances are only 18.4% from the poverty threshold while those that do not receive remittances are 30% from the line that separates those who are poor and those who are not. In urban households, the difference is less significant, but maintains the same tendency found in rural households. Finally, the FGT_2 Index demonstrates that poverty is twice as severe in households that do not receive remittances when compared with those that do.

Remittances' contribution to fiscal revenue

While remittances are essential for maintaining reasonable standards of living for the families that receive them, they are also of vital importance for fiscal revenue given that taxes are generated when these resources are spent on a number of items, including the direct consumption of goods and services, education related expenses, health costs, housing, and others.

Although household expenditures have an effect on all of the country's current tax revenue, this study focuses on the contribution of Value Added Tax (VAT) because it is a general tax on consumption and because it is the most important component of El Salvador's tax revenue.

To determine the importance of remittances for VAT revenue, a distinction was made between expenses that are taxable, those that are exempt, and those that are not subject to VAT. An assumption was created based on the estimated proportion of goods and services that are acquired from the informal market, which are not include in the estimate of VAT revenue. Finally, in order to calculate the VAT revenue generated by purchases made by both recipient and non-recipient households, a direct imputation of the general tax rate was made according to details from each expense category, which, in the case of El Salvador, is 13%.[18]

As mentioned above, the values determined by using EHPM micro data[19] have been rescaled to the level of national

and the **FGT Index$_2$**, which measures the degree of severity of poverty (CEPAL, 2005; Panorama Social de América Latina, 2004).

[18] El Salvador's VAT structure includes: a) A general rate, 13%, which is applied to the transfer of goods and services within the country and to the importing of goods and services and b) a 0% rate applied to the export of goods and services.

[19] The VAT revenue associated exclusively with remittances and based on the EHPM micro data is $54.3 million dollars. This represents 45.16% of VAT revenue generated by recipient households ($120.3 million dollars).

accounts, using the assumption that the amount of family remittances published by the BCR corresponds to the same scale used to express national accounts. In order to obtain rescaled values, "aggregate" household consumption was compared with total household expense data provided by EHPM and then the estimated percentage of VAT revenue was applied to each category according to the procedure explained above.

The rescaled results using aggregate household consumption (for households that do and do not receive remittances) indicate that both types of households contributed a total of $1,344.5 million dollars in 2007, equivalent to 46.7% of the gross tax revenue and 6.6% of the Gross Domestic Product (GDP). The specific contribution of remittance recipient households reached $431.1 million dollars, representing 15% of gross tax revenue in 2007 and an equivalent of 2.1% of the GDP. This contribution is also equivalent to 28.6% of the total VAT revenue, which in 2007 totaled $1,506.4 million dollars. Additionally, the contribution of recipient households was equivalent to 28% of the central government's spending on social programs for the entire program during the 2007 fiscal year. This information tells us that more than one-fourth of VAT revenue comes from households that receive family remittances.

Table V.7: VAT revenue per deciles of per capita income, 2007 (Millions of dollars and %)

Decil	Households with remittances		Households without remittances		Total	
	VAT	%	VAT	%	VAT	%
1	9.7	2.3%	55.8	6.1%	65.5	4.9%
2	13.6	3.2%	51.7	5.7%	65.3	4.9%
3	20.5	4.8%	56.1	6.1%	76.6	5.7%
4	28.1	6.5%	52.8	5.8%	80.9	6.0%
5	27.4	6.4%	61.6	6.7%	89.0	6.6%
6	46.5	10.8%	83.4	9.1%	129.8	9.7%
7	52.0	12.1%	87.9	9.6%	140.0	10.4%
8	63.7	14.8%	118.3	13.0%	182.0	13.5%
9	72.1	16.7%	133.6	14.6%	205.7	15.3%
10	97.4	22.6%	212.2	23.2%	309.6	23.0%
Totals	**431.1**	**100.0%**	**913.4**	**100.0%**	**1344.5**	**100.0%**

Source: Authors, based on EHPM, 2007 and BCR.

In looking at the per capita income by percentile, we see that wealthier households contribute a larger proportion and amount of taxes, given that income is concentrated in these sectors and they have a higher tendency to acquire goods and services in the formal market. On the other hand, low income families contribute less to the treasury since a larger percentage of their funds circulate in the informal economy.

Upon examining tax revenue by province, receipt of remittances contributed in some cases to a higher contribution of fiscal revenue. This is the case for most of the provinces, with the exception of Ahuachapán, La Libertad, San Salvador, Cuscatlán and La Paz. In La Unión province, given the concentration of remittances, the fiscal revenue generated by households that receive remittances is much more significant than for the other provinces—it is three times greater when remittances are present and represents 56.7% of all VAT revenue generated by households in that province.

Up to this point, this analysis has provided information on VAT revenue generated by households that receive remittances, but has not isolated the specific amount of their contribution. This information, based on the data available in the EHPM micro data, was calculated by assigning the percentages that VAT revenue represents in each expense category to the total value of remittances obtained ($730.5 million dollars). Then, as mentioned earlier, this amount was rescaled to the level of national accounts, applying the percentage that it represents for the VAT revenue generated by recipient households to the rescaled values.[20] The **VAT revenue associated exclusively with the total amount of remittances totaled $194.7 million dollars, equivalent to 14.5% of the total that household spending generated in VAT** (see Table V.8). This means that **for each dollar in remittances sent by Salvadorans living abroad, a little more than five cents on the dollar translates into VAT revenue** for the Ministry of Treasury. Additionally, it represented 6.8% of the gross tax revenue.

Table V.8: Hypothesis of VAT associated with purchases made using remittances in VAT revenue, 2007 (Millions of dollars and %)

VAT associated with households and remittances	Area of the country			Total
	West	Central	East	
VAT revenue from households without remittances	187.6	601.3	124.6	**913.4**
VAT revenue from households with remittances	97.3	227.5	106.3	**431.1**
VAT revenue from households with remittances, not including the value of the remittances in the expenses	*53.9*	*136.7*	*45.8*	***236.4***
VAT revenue from households with remittances associated with the expenditure of remittances	***43.4***	***90.8***	***60.5***	***194.7***
Total VAT revenue for all households	284.9	828.8	230.9	**1344.5**
VAT revenue associated with the expenditure of remittances as a % of the total VAT revenue from households with remittances	44.6%	39.9%	56.9%	**45.2%**
VAT revenue associated with the expenditure of remittances as a % of the total VAT revenue generated by all households	15.2%	11.0%	26.2%	**14.5%**

Source: Authors, based on EHPM, 2007 and BCR.

Geographically, in absolute terms the central part of the country generates higher amounts of VAT from remittances; yet the relative proportion is significantly higher in the eastern part of the country, followed by the western part of the country.

Public spending and its link to development

El Salvador's public spending is structured the following way: administrative governance, security and justice, social development, support for economic development, general governmental obligations, public debt and public business production. In the last five years, social spending has represented 42.1% of the budget while debt service averaged 20.1% of the budget, annually (Table V.9). The total central government spending represented 18.1% of the GDP.

[20] Greater detail of the steps in this procedure can be found in the methodological annex of the full Salvadoran case study, available on the web site of NALACC.

Public spending, which plays a more significant role at a local level, was concentrated in areas of social development, including education, healthcare, local development and *Red Solidaria,* the primary program to mitigate rural poverty. One of the objectives of this study was to establish a link between the contribution that each province made to VAT revenue and compare this figure with the specific amount spent by the government in the same department. The final step was to establish a link between the contribution to VAT revenue from households that receive remittances and the government spending at a local level, in order to evaluate the degree to which state resources are "redistributed" to these households.

Table V.9: Composition of central government spending, 2004-2008 (Millions of dollars and %)

Area	2004		2005		2006		2007		2008		AVERAGE	
	Value	%	Value	%	Value	%	Value	%	Value	%	Value	%
Administrative governance	269.3	9.6	299.6	9.6	344.2	9.5	359.2	10.0	396.1	10.3	333.7	9.8
Administration, justice and security	349.5	12.5	387.6	12.4	426.7	11.7	473.7	13.2	576.1	14.9	442.7	12.9
Social development	1,176.0	41.9	1,364.0	43.5	1,447.0	39.8	1,525.7	42.6	1,646.5	42.6	1,431.8	42.1
Support for economic development	281.2	10.0	388.0	12.4	451.7	12.4	411.8	11.5	454.8	11.8	397.5	11.6
Public debt	557.9	19.9	580.0	18.5	873.0	24.0	725.4	20.3	692.0	17.9	685.7	20.1
General governmental obligations	172.2	6.1	113.0	3.6	78.0	2.1	64.4	1.8	63.0	1.6	98.1	3.1
Public business production		0.0		0.0	13.7	0.4	17.5	0.5	34.2	0.9	21.8	0.4
Total	**2,806.1**	**100**	**3,132.2**	**100**	**3,634.3**	**100**	**3,577.7**	**100**	**3,862.7**	**100**	**3,402.6**	**100**

Source: Authors, based on financial management reports from the government, Ministerio de Hacienda.

Table V.10 allows us to draw conclusions about the way in which the government "reinvests" in the provinces by utilizing their contributions to VAT revenue. In general, the households' contributions to VAT revenue is considerably higher than the public spending that they receive in return; the latter represents 0.6 times the amount contributed by the households via their remittances. We can therefore deduce that there is a deficit in the redistribution of income—for each dollar that the recipient households contribute to the treasury in VAT revenue, the government returns to them only sixty cents on the dollar in programs that invest in community infrastructure and public services. Only in some of the provinces is the relationship between spending and revenue greater than one (Morazán, Chalatenango and Cabañas).

Cuadro V.10: Public spending related to the contribution towards VAT revenue by households that receive remittances, 2007 (Millions of dollars)

Province	Educational spending (Central government)	Hospital spending	FODES	FISDL	Red Solidaria	Total spending	Percentage of recipient households	Spending on recipient households	Contribution of recipient households to VAT revenue	Relationship between spending and revenue
Ahuachapán	33.1	4.2	7.8	3.8	2.4	51.3	18.8%	9.7	15.8	0.6
Santa Ana	49.6	14.6	9.2	1.6	1.2	76.2	31.1%	23.7	46.7	0.5
Sonsonate	45.9	5.3	10.5	3.2	2.8	67.7	25.4%	17.2	34.8	0.5
Chalatenango	24.0	4.8	10.2	6.5	5.5	51.0	35.5%	18.1	14.4	1.3
La Libertad	60.0	6.3	13.6	0.8	0.6	81.2	23.1%	18.7	52.1	0.4
San Salvador	118.3	73.7	15.8	0.6	0.0	208.4	19.6%	40.9	113.9	0.4
Cuscatlán	26.2	3.2	7.2	0.9	0.6	38.1	19.1%	7.3	10.1	0.7
La Paz	34.7	4.0	9.6	1.2	0.6	50.1	21.9%	11.0	16.1	0.7
Cabañas	19.2	3.4	5.0	2.0	1.8	31.4	40.6%	12.8	10.9	1.2
San Vicente	20.5	4.3	5.9	1.8	1.3	33.8	28.3%	9.5	10.2	0.9
Usulután	40.3	8.2	11.7	2.8	2.6	65.5	33.7%	22.0	28.3	0.8
San Miguel	45.5	13.5	10.7	3.9	2.5	76.1	35.9%	27.4	40.1	0.7
Morazán	20.6	2.1	9.0	5.6	6.9	44.2	41.5%	18.4	12.2	1.5
La Unión	26.7	3.8	10.1	1.0	0.8	42.4	50.7%	21.5	25.7	0.8
Total general	564.6	151.3	136.4	35.5	29.6	917.3	26.7%	258.1	431.1	0.6

Source: Authors, based on data from the statistical appendices of the government's general budget and special budgets; Fiscal year, 2007; MINED; MSPAS; FISDL; reports from Red Solidaria; EHPM.

The situation of family remittances in 2008 and 2009

With the outbreak of the financial crisis in the United States, in 2008 the economy began to perceive the effects of credit restrictions and the loss of confidence in financial markets. The closure of many companies in all productive sectors marked a rising tendency of unemployment, which reached historic figures in the U.S. One of the groups that has most suffered the impacts of this crisis is the Hispanic population, especially those employed in areas of low levels of specialization. According to the US Bureau of Labor Statistics (BLS), Hispanic unemployment increased from 6.3% to 9.4% during 2008 and to 13.0% by August of 2009; in recent months it improved slightly, but Hispanic unemployment remains high.[21]

As a direct result of the high levels of unemployment in the United States, the flow of family remittances to Latin America suffered a slow down in 2008 and a sharp fall in 2009. In El Salvador, the official data published by the Central Reserve Bank reported that remittances sent to El Salvador grew by only 2.5% in 2008, after average growth rates of 15% in previous years. They experienced a 10% drop in the period January-October, 2009.

Data from the EHPM in 2008 shows that remittances grew 8.2%, to a total of $790.1 million dollars. This discrepancy can be explained in part by the same factors previously mentioned. However, in looking at specific geographic areas, the situation varies. For urban households, remittances grew by 11.4%, while in rural households the growth was only 2.6%; this indicates that the latter group has been more heavily impacted by the U.S. financial crisis. Worth noting from the EHPM, 2008 is the 2.1% drop in the number of households that receive remittances when compared with the data provided by the EHPM for 2007. Rural households experienced a higher rate of variation (-4.1%) than urban households (-0.9%).

Even though remittances experienced a low growth rate in 2008, the well-being of households suffered only a small step backwards—0.5 points, especially when compared with the a 4.9 point increase in poverty rates experienced by households that do not receive remittances, , reaffirming the importance of family support from abroad.

In terms of the decreased remittances in 2009 and the impact on fiscal revenue in this same year, tax revenue fell approximately 9% in the January-October period, but the areas most affected were VAT revenue generated by imports (-27%) and customs revenue (-25.7%). The total VAT revenue, which is the subject of this study, is falling at rate of 13.8% as a result of the impact of imports on VAT.

Implications, conclusions and recommendations

Remittances make a significant contribution to public revenue in El Salvador. VAT revenue from remittance related spending totaled $194.7 million dollars in 2007 and represented 6.8% of the gross tax revenue, 1% of the GDP and 12.9% of the total VAT revenue, which in 2007 was $1,506.4 million dollars. This is roughly equivalent to 12.8% of the central government's spending on social development, which totaled to $1,525.7 million dollars. Table V.11 summarizes the most relevant remittance indicators, the contribution made by recipient households to fiscal revenue, and their impact on public finances.

[21] Data obtained from the web site: *http://www.bls.gov/webapps/legacy/cpsatab3.htm*

Table V.11: Summary of remittances' importance for public revenue, 2007 (millions of dollars)

Description	Value	% of GDP
Remittances according to EHMP	730.5	3.6%
Remittances according to BCR	3,695.2	18.1%
Total VAT revenue according to the Ministerio de Hacienda	1,506.8	7.4%
Central government's social spending	1,525.7	7.5%
VAT revenue associated with remittances	194.7	1.0%
VAT revenue associated with remittances as % of tax revenue	6.8%	-
VAT revenue associated with remittances as a % of total VAT revenue	12.9%	-
VAT revenue associated with remittances as a % of the central government's social spending	12.8%	-

Source: Authors, based on the results of this study.

Based on the results of this study, it is clear that migrants play an important role in their countries of origin, especially in El Salvador. Given that remittances are one-third of recipient families' income, they not only provide an important pillar of economic activity for the population, but also represent a significant source of income for the government.

It is important to highlight that some of the government's spending programs, such as FODES and FISDL, have wide-reaching effects in the country and affect all municipalities. These programs, together with the conditional cash transfers made in municipalities of extreme poverty and other *Red Solidaria* projects (now called *Comunidades Solidarias*, or Solidarity Communities) allow for a redistribution of public spending in these areas. The resources designated for spending on primary and middle-school education and on the national hospital network can be fully identified in order to determine the degree to which the government "returns" to the families their contributions to the national treasury. Nevertheless, this study concludes that there is a *deficit* in government spending at a local level, since the contribution made by families that receive remittances is greater than the social spending allocated in most of the country's provinces.

Furthermore, despite the important role that remittances play in the national economy and specifically for public revenue, migrant communities have very little influence in defining public policies that are directed at improving the well-being local communities in El Salvador. In 2004, the government created the Vice Ministry for Salvadorans living abroad, with the objective of attending to migrant needs. However, this has not resulted in institutionalizing participatory mechanism so that this population can take part in decision-making processes.

Finally, migrants play almost no role in decision making processes concerning the central government's public policies, despite their significant contribution to the country's economic and social development. We must remember that remittances have effectively contributed to reducing poverty for the households that receive them, and have a favorable impact on the country's overall poverty indicators.

In order to have a greater impact, the government must recognize the importance of migrants for the country's economic and social development and for funding public spending. Therefore, in order to generate a greater degree of social justice and equality, migrant communities should be guaranteed the right to participate in strategic decision-making in the country.

A first step would be to approve an absentee voting process such that migrants could participate in the election of their representatives in their countries of origin. This does not mean repeating the mechanism set up during the March 2009 presidential election, in which special separate voting booths were designated in El Salvador for people living outside the country. For a variety of reasons, travel to El Salvador in order to vote is not feasible, and this sort of mechanism did not nor will it ever have a positive added value.

Another mechanism for participation is the creation of spaces for debate and consultation around the government's planned political actions, in which migrant communities should be able to actively participate. Currently, policies are discussed among the country's primary economic sectors: private business, associations, non governmental organizations, and others, but there is no on-going space for the participation of Salvadorans living abroad. These debates and consultations could be held outside the country, as has been done in the past—the government could easily go to areas where Salvadorans are living and organize on-going consultations with the communities and their representatives.

The government should also strengthen support for wide-reaching economic development programs, especially programs that invest in local development in order to optimize benefits for the entire population. There should be transparency in the management of funds to make sure that they are used efficiently and to guarantee that there is a true rendering of accounts to society as a whole.

Finally, the government should focus economic policy on the search for an economic and development agenda that includes the participation of all sectors, including representation from migrant communities; these communities are an important part of Salvadoran society and, through their remittances, they contribute to maintaining the economy and public revenue afloat.

VI. Final Reflections

This study included three primary objectives: estimate migrants' contribution to public income in two countries, lay out a methodological path that would stimulate similar investigations in other countries, and emphasize that the debate surrounding the link between migration and development should focus on the role of government in generating dignified opportunities.

Without a doubt, migrant remittances are contributing to Mexico and El Salvador's public income. In both cases the contributions are significant, though each of them takes on a different form and amount. While the amount estimated for Mexico was only 4% of the total VAT collected in 2008, this amount represented half of what the federal government designated to its primary anti-poverty program. It also represents more than 3,000% of the amount designated to the program that is co-financed by Mexican migrant organizations and different levels of government to support initiatives in the migrants' communities of origin. The analysis included in this document indicates that the VAT associated with Mexican remittance flows could play a more significant role in coming years. In absolute terms, a lower amount of VAT revenue from remittances was calculated for El Salvador, but this amount carries greater weight and significance than the amount generated in Mexico. The public finances of this Central American country depend in large measure on remittances' contribution to VAT. The almost $200 million dollars in VAT associated with remittances represent 13% of the total VAT revenues in 2007 and this amount is greater than that which was designated for the national hospital network and 6.5 times more than the amount designated to the government's program to mitigate rural poverty. There has been a lot of emphasis on Salvadoran households' dependence on remittances, but the results highlighted in this study demonstrate that remittances are also significant for the national budget and shows the degree to which the fiscal well-being is dependent upon them.

Migrants' should play a much greater role than they have thus far in their countries of origin. Migrants should not merely be seen as a source of income to finance programs that are not covered by other means. Public functionaries continue to turn to migrants to pay for social investment and public infrastructure programs. In almost every case, migrants are asked to play a role *after* the way in which the programs will function and the rules of the game have been prioritized and determined. They are invited to invest in, contribute to and donate still more funds, but not until after the most important decisions have been made. The migrant population is totally marginalized from considerations around how to build and execute the national budget, a budget to which they contribute—as this has been clearly demonstrated in this study. A country's budget represents one of the most concrete ways of giving expression to governmental priorities and the kinds of development it will encourage for its citizens. In order to encourage transparency and democracy, it is essential that migrants play a role in the creation and execution of the national budget as well as overseeing its results.

The debate on remittances and development should be focused on the government's role in generating well-being for its citizenry and the kinds of societies that should be promoted, not on the way in which migrant family members spend or invest their remittances. While Latin American migrants living in the United States demand recognition of their basic rights in their country of residence, it is important to guarantee that they have a place at the discussion table with regards to transcendental decisions that are being made in their countries of origin. The migrants themselves can help develop ways in which to achieve this. If this does not occur in Mexico and El Salvador, migrants will find themselves in a situation reminiscent of the well-recognized slogan of the U.S. revolution, "*no taxation without representation."* If migrants pay taxes that contribute to their home country's national budget, they should also have a say and vote in public decision-making.

Those involved in the Mexican 3 x 1 Program and similar efforts in other countries are invited to reflect upon the relative importance of this kind of initiative in the broader local, national and international context. The Mexican 3 x 1 Program,[22] which is financed with money provided by Mexican migrants and money from the municipal, state and federal government, is the only one of its kind in the world and serves as an example for other countries. El Salvador imitated this idea when it initiated a similar program called "*Unidos por la Solidaridad*" (United for Solidarity), which ended in 2006. The 3 x 1 Program is an important example to follow. At the same time, those involved with the initiative should consider the broader context. There is no doubt that the 3 x 1 initiative is improving to the lives of Mexicans in the areas where the program operates and that the process has greatly contributed to strengthening Mexican migrant organizations. But the program represents a mere drop in the bucket. Mexican migrants contribute 3,393% more money via VAT generated from purchases made from their remittances than what the Mexican government has allocated to the 3 x 1 Program. This is **not** to suggest that the 3 x 1 Program should increase by 3,000%. While it should be strengthened, the more important point is that spaces must be opened to involve migrants and the traditionally-marginalized population in making fundamental decisions that affect society.

There is an open invitation to adapt the methodology that has been tested in this study in order to improve upon and broaden it and thereby make visible this new way of looking at the relationship between development and migration. This study has prioritized the link between remittances and the Value Added Tax (VAT), though it is clear that migrants contribute to public income in their countries of origin by way of other taxes, including tourism, airports, income tax, property tax, and others. Additionally, in El Salvador in 2007, a new tax was imposed on calls from the United States* generally regarded as a tax on migrants. We suggest a deeper analysis with other kinds of taxes in Mexico and El Salvador to understand the multiple ways in which migrants contribute to the budgets of their countries of origin. Additionally, we recommend applying this analysis to other countries that have a significant flow of migration and remittances. In the Americas, this should include countries that are part of the free trade agreement with Central America and the Dominican Republic (CAFTA). This kind of analysis could also be done in other places with a significant flow of migrants, including Ecuadorian migrants in the U.S. and Spain, Haitian migrants in the Dominican Republic, and Nicaraguan migrants in Costa Rica.

Galeano invites us to "exercise the never-proclaimed right to dream," in order to imagine that another world is possible. The envisioning of this other world should be our starting point and must include those that live both inside and outside of national territory.

[22] See information on the program and its functions on the website for Mexico's *Secretaría de Desarrollo Social*: *http://www.sedesol.gob.mx.*

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