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On the Use of Remittance Income in Mexico

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Immigration affects sending countries through receipt of remittance income. These cash transfers impact households and communities in a variety of ways and have attracted the attention of remittances as a development mechanism. This study attempts to understand to what degree consumption patterns are affected by the receipt of remittances, thus the ways in which the broader communities may be impacted. Using household income and expenditure data for Mexico, expenditure patterns of remittance receiving households are analyzed. Regression analysis indicates that remittance-receiving households spend a greater share of total income on durable goods, healthcare, and housing.
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Abstract
Abstract: Immigration affects sending countries through receipt of remittance income. These cash transfers impact households and communities in a variety of ways and have attracted the attention of remittances as a development mechanism. This study attempts to understand to what degree consumption patterns are affected by the receipt of remittances, thus the ways in which the broader communities may be impacted. Using household income and expenditure data for Mexico, expenditure patterns of remittance receiving households are analyzed. Regression analysis indicates that remittance-receiving households spend a greater share of total income on durable goods, healthcare, and housing.

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Introduction

The effect of immigration on host countries has been very well studied, particularly with regards to labor market outcomes. Much research has also investigated to what extent the loss of workers in a country from which many workers emigrate affects economic outcomes in the sending country. However, one factor of seeming consequence within the debate over immigration is the effect of funds that are sent by immigrants to friends or family members in their home countries. These funds, or remittances, have become very large in recent years, and represent a potentially important part of the debate surrounding the topic of immigration.

Although difficult to measure, recent studies estimate that official international remittances exceed US$100 billion per year, approximately twice the amount of official aid-related income to developing countries. Remittance income represents a transfer often from developed countries to less developed countries. These transfers are highly efficient; they require no bureaucracies, contain very low transaction costs, and typically go to those households with the greatest need. Although cash transfers may be a poor proxy for the services that would be provided to the household were the emigrant present, it seems possible to assume that households that receive remittance income are made better off. In any case, clearly the remittance receiving households would be party to large welfare effects from any changes in immigration policy under consideration.

The efficacy of remittance transfers are not without critics, however. Much of the criticism is concerned with problems of moral hazard or suboptimal consumption.

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1 IMF World Economic Outlook, Globalization and External Imbalances (2005)
patterns, for example increased consumption of alcohol or increased leisure. It is possible
to theorize that households are worse off due to these cash transfers through some sort of
dependency or reduced incentives to work or invest. It then becomes largely an empirical
question as to whether or not this form of direct aid increases, or decreases, welfare.
One way to examine the effects of remittance transfers is to observe the economy in
aggregate and infer any changes in measures such as output per capita as a result of
changes in aggregate receipt of remittance income. This may indicate whether the
average household spends remittance income on productive, such as investment, or non-
productive, such as leisure, activities. The main problem with this approach is the
relatively small number of observations (country/year) compared to the large number of
confounding country-specific variables. There are potentially hundreds of other factors
that affect output growth such as foreign direct investment, domestic policies, natural
disasters, etc. Controlling for all of these factors is difficult even with the largest datasets.
Other studies used to evaluate the expenditures of remittances have relied upon
recipients’ explicit reporting of how remittance income was spent. To the extent that
income received in the form of remittances is fungible, offsetting increases or decreases
in expenditures of other funds could bias expenditure levels reported by family members.
The difficulty of determining the effect of remittance income on expenditures lies in the
fungibility of income at the household level. While households may have records of both
incomes and expenditures, the direct observation of the allocation of marginal income is
impossible.
Possibly a better approach is to utilize household data to infer differences in consumption
behavior across households as a result of the receipt of remittance income. While
household data may seem ideal for investigating effects of remittance income on the welfare of households, it is fraught with difficulties. First, even though remittance flows are large, it remains that very few households actually receive remittances, even in the largest of household datasets. Second, within the small sample of households that receive remittances, it is not possible to observe how the actual remittance receipts are expended separately from other forms of income, nor is it possible to observe the household’s counterfactual consumption patterns, or how they would have spent their income in the case that they did not receive remittances. Finally, and most problematic, we cannot think of the household as being randomly selected to receive remittances. The receipt of remittances to the household is the outcome of some agreement or negotiation between the remitter and the household and is therefore endogenous to the household’s consumption decisions.

Nevertheless, household expenditure data can be used to make at least some inferences regarding the ways in which remittance receiving households allocate remittance income. In this article, I utilize household expenditure data from Mexico. While the survey is not large enough to find households which are identical in every respect except for the receipt of remittances, I utilize regression analysis to statistically control for variations across households. I find that households receiving remittance income differ from their counterparts in important ways. In particular, these households are more likely to spend money on durable goods, healthcare, and education than are households that do not receive remittance income. These results appear to question theories of dependency or induced moral hazard since they indicate that remittance income is used in productive ways.
The paper proceeds as follows. I begin with a discussion of the evidence presented within the literature regarding possible effects, both at the aggregate and household levels, of remittances on economic outcomes. Next, I describe the data and the empirical method utilized. The final section summarizes the results.

**Previous literature**

Much of the early literature regarding remittance flows was notably pessimistic concerning the effects these types of cash receipts have on the household. In particular, ethnographic studies in Mexico often claimed that remittances were disproportionately used for conspicuous consumption and increased leisure. In fact. Durand and Massey(1992) review thirty-seven community studies finding that investigators were “remarkably unanimous in condemning international migration as a palliative that improves the well-being of particular families but does not lead to sustained economic growth within sending communities.” Broader studies relating to Mexico at the community level by Dinerman(1982), Lopez(1986) and others find the vast majority of remittance income spent on consumption. To the extent that households use remittance income only for consumption, the growth in remittances could lead to a culture of dependency and possibly idleness (Kapur, 2003). This has led many investigators to conclude that migration perpetuates a culture of economic dependency that undermines the prospects for development.

An opposing argument is that remittance income is used by households to insure against negative income shocks, particularly at the macro level, or as a mechanism to mitigate credit constraints at home. Thus, remittances may play an important role in gaining access to capital, especially among lower-income households. It remains an empirical
question whether or not the remittance income is spent in ways that increase the productive capacity of remittance-receiving communities.

A number of studies have analyzed the use of remittance income and the impact of remittances on national income. One example is Adams and Page(2005), which uses aggregate income and remittance data for 71 countries, finding evidence that remittance income reduces poverty in developing countries. However, aggregate data used by Chami, et al(2003) finds that remittances are negatively associated with economic growth, an artifact they claim is created by the disincentives to work caused by the remittance income.

Using firm level data is a study by Woodruff and Zenteno(2001). In looking for evidence that remittances are used for productive uses, the authors analyze whether remittances are relied on for small firms to access capital. They find that remittances are responsible for almost 20% of the capital invested in microenterprises in urban Mexico. However, Amuedo-Durantes and Pozo(2004), in the case of the Dominican Republic, where remittance income accounts for an even larger share of GDP than in Mexico, find no evidence that remittances promote small business ownership.

Few analyses have investigated the use of remittances using household expenditure data. One exception is Cox-Edwards and Ureta(2003) who examine the effect of remittance income on schooling choices. Assuming remittances to be exogenous to the household, the authors argue that remittances, playing the role of a randomly assigned transfer, provide a clean estimate of the impact of income on school retention rates. They find that children of remittance receiving households are more likely to stay in school. While more
a study of the effect of additional income on schooling decisions, the study does shed
some light on the expenditure patterns of households receiving remittance income.
While studied less frequently than other forms of capital flows such as foreign direct
investment or foreign aid, remittance income provides an important role of social
insurance and has a significant impact on both poverty and equity. While the sum of the
effects of remittances on household decisions is not well understood, the growth in
remittance flows appears to have large long-term implications for development.

The Data

In this paper I use a large household expenditure survey and relate expenditure on various
goods to household characteristics and then test whether there exists differences in
expenditure patterns depending on the receipt of remittances as a type of income
I use data from the Household Income and Expenditure Survey (ENIGH) of Mexico. The
ENIGH is a nationally representative household survey based on a stratified random
sample and conducted by the Instituto Nacional de Estadística, Geografía e
Informática(INEGI) in Mexico. While there exist alternative data sources to analyze
income, the ENIGH is the only nationally representative survey and contains
observations across a relatively long time span. The income and demographics
supplements of ENIGH contain individual level information on demographic
characteristics, employment, and earnings. The expenditure supplement contains detailed
expenditure data for the household for the three months prior to the survey date. All
income and expenditure data are self-reported. The ENIGH is the only household level
nationally representative expenditure survey in Mexico, and surveys have been conducted
approximately biannually going back to 1984. Depending on the year, the survey details
as many as thirty-six various categories of income for the individual including regular earnings, overtime, bonus, transfers, sale of durables goods, etc. Included in income is money received from abroad in the form of remittances.

Table 1 presents remittance income as a share of household income for the years 1984 through 2000. The first column indicates that the incidence of remittance income at the household level has risen dramatically, from 1.34% of households reporting the receipt of some remittance income in 1984 to 4.27% of households in 2000. The largest change occurred in response to the macroeconomic crisis, between survey years 1994 and 1996, when the number of households receiving remittance income increased by almost 50%. However, as the second column illustrates, the importance of remittances within those households receiving remittances has remained relatively stable from 1994 through the end of the decade. In Mexico, as in most countries, remittances are typically reported by the national bank estimated from the balance of payments accounts. The final two columns of Table 1 compare the estimated level of remittances, measured in current U.S. dollars, with the total remittances claimed by the households in the ENIGH survey, using the sample weights to represent the entire nation. In each year, the Bank of Mexico’s estimate is larger than that calculated using the ENIGH survey, suggesting that the Bank’s estimates may slightly overstate the actual amount of remittances received by households.

Table 2 combines years 1992 to 2000 to demonstrate the differences in observable characteristics between households that receive remittance income and households that do not. All years combine to include observations on 58,440 households, 2,377 of which report positive remittance income. As can be seen from the table, the average monthly
income in 1994 pesos is 2,198 pesos for all households and only 881 pesos for households that receive some remittance income during the month. However, including the remittance income increases the total mean household income to 1,912 pesos, or 87% of the average income for all households. Households receiving remittances are also somewhat more likely to have young children. Table 2 also highlights the differences in characteristics of the household head between all households and only those households that report positive remittance income in the month of the survey. The typical head of a household receiving remittance income is more likely to be female, older, less educated, works fewer hours, and has a lower average wage than the typical household head within Mexico as a whole. It remains the case however, that the majority of remittance-receiving households are headed by working-age males, suggesting that remitters are likely to be adult children or relatives of the head rather than the household head himself.

**Methodology**

I begin with a general expression that relates household expenditure on good category $i$ to the household’s total expenditures

$$p_{ij} = f(x, n, z, u)$$

where $p_{ij}$ is expenditure on good category $i$, $x$ represents total household expenditure in household $i$, $n$ is a vector of demographic characteristics taken to be a list of the number of people in the household within defined age and gender categories, $z$ includes other household characteristics including whether or not the household received positive remittance income during the survey month. As usual, $u$ represents unobservable taste variation of the household. In order to viably ignore price variation, I limit the analysis to
one year of data, the year 2000. This year is especially convenient because many of the characteristics may be cross-checked using the Mexican decennial census of 2000.

The question of concern in this analysis is whether households that receive remittances exhibit expenditure patterns which are different from households that do not. In order to evaluate the differential consumption patterns of remittance receiving households, the procedure will be to make a list of goods, or goods categories, and test whether receiving households exhibit consumption patterns different from their comparable non-remittance receiving counterparts. The simplest way to do this is to estimate an Engel\(^2\) curve of the following form:

\[
w_i = \frac{p_i q_i}{x} = \alpha_i + \beta_i \ln \left( \frac{x}{n} \right) + v_i \ln(n) + dz + u_i \tag{2}
\]

where \(x\) is total household expenditures, \(p\) and \(q\) are price and quantity of good of type \(i\), \(n\) represents the household size, and \(z\) contains a number of dummy variables to allow for possible effects of household characteristics and includes the dummy variable of interest, whether or not the household received remittance income in the period of the survey.

The econometric procedure used here is straightforward. Using the household survey with households as the unit of observation, equation 2 is estimated using ordinary (weighted) least squares, and all households are included. The test concerns whether or not the estimated coefficient associated with the dummy variable contains statistical content. We can use these coefficients to help understand the average effects of

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\(^2\) This type of Engel curve is an extension of the Leser-Working specification, see Deaton and Muellbauer(1980)
remittances on spending patterns at the household level after controlling for numerous characteristics of the household.

Results are presented in Table 3. The estimated coefficients for the dummy variable are presented by type of good. Coefficients found to be statistically significant at the 95% level are shown in bold type and include expenditures on food, durables, healthcare and housing. The estimates indicate that households that receive remittances purchase more durables, healthcare and housing and spend a lower share of the household budget on food. These estimates may be interpreted as the expenditure of the remittance peso, or the marginal peso, on various types of goods. The results indicate that after controlling for the size, location, and demographic characteristics of the household, remittance income is associated with a 56% rise in the share of durables, a 44% rise in the share of healthcare, a 17% rise in the share of housing, and a 8% decline in the share of food. Since at the mean level of income, remittances play a large role in the household budget (close to half), the expenditure levels of all goods purchased rises. But this is evidence that the consumption patterns of remittance-receiving households is distinct from other households and favors goods which could be viewed as investments rather than consumption.

Summary

Remittances are one of the important ways in which immigrants affect the people and communities within their respective sending countries. Unlike foreign aid, remittance flows impose no burden on taxpayers. Remittances require no bureaucracy, simply going directly to households as cash transfers. As immigration, both legal and illegal, continues to be an important policy issue in the U.S., little is known about the effects of remittances
sent by those immigrants to households in their country of origin. Fundamental to our understanding of migration policies is our understanding of how sending communities are affected. This analysis presents evidence that households that receive remittances expend a higher share of their household budget on durable goods, healthcare, and housing, and less on food than their observationally equivalent counterparts that receive no remittance income. This suggests a number of things. First, that anecdotal evidence of remittance receiving households engaging in conspicuous consumption or non-productivity enhancing activities does not withstand the wider scrutiny of a large nationally representative dataset. Second, remittance income can be thought of as welfare improving to households in Mexico, on average, and these welfare effects accrue to lower than average income households. Finally, to the extent that remittances play an important role in the provision of healthcare, housing, or investment goods, it is possible that remittances may play a role in the development of the economy in aggregate, and may be growth enhancing.

**Appendix**


Kapur, Devesh (2003) Mimeo, Center for Global Development


Woodruff Christopher and Zenteno, Rene(2001) “Remittances and Microenterprises in Mexico”, working pape
<table>
<thead>
<tr>
<th>Year</th>
<th>Share of households receiving positive remittances</th>
<th>Remittances as a share of total household income conditional upon receiving positive remittances</th>
<th>Total estimated international remittances to Mexico (ENIGH) billions US dollars</th>
<th>Total estimated international remittances to Mexico (Banco de Mexico) billions US dollars</th>
</tr>
</thead>
<tbody>
<tr>
<td>1984</td>
<td>1.34%</td>
<td>51.48%</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>1989</td>
<td>2.98%</td>
<td>60.66%</td>
<td>1.67</td>
<td>2.43</td>
</tr>
<tr>
<td>1992</td>
<td>2.81%</td>
<td>38.95%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1994</td>
<td>2.70%</td>
<td>59.63%</td>
<td>2.78</td>
<td>3.72</td>
</tr>
<tr>
<td>1996</td>
<td>4.01%</td>
<td>59.40%</td>
<td>3.65</td>
<td>4.22</td>
</tr>
<tr>
<td>1998</td>
<td>4.15%</td>
<td>56.59%</td>
<td>4.26</td>
<td>5.63</td>
</tr>
<tr>
<td>2000</td>
<td>4.27%</td>
<td>54.35%</td>
<td>5.85</td>
<td>6.57</td>
</tr>
</tbody>
</table>

*Source: Author's calculations based on ENIGH (INEGI), Banco de Mexico*
Table 2


<table>
<thead>
<tr>
<th>Characteristic, household</th>
<th>All Households mean(sd)</th>
<th>Households receiving positive remittances mean(sd)</th>
</tr>
</thead>
<tbody>
<tr>
<td>total monthly household income excluding remittance (1994 pesos)</td>
<td>2198 (6824)</td>
<td>881 (1705)</td>
</tr>
<tr>
<td>total monthly household income including remittance (1994 pesos)</td>
<td>2198 (6824)</td>
<td>1912 (2328)</td>
</tr>
<tr>
<td>number of children under age of 5</td>
<td>0.61</td>
<td>0.67</td>
</tr>
<tr>
<td>children between ages of 6 and 10</td>
<td>0.56</td>
<td>0.57</td>
</tr>
</tbody>
</table>

Characteristic, head of household

| Age | 45.1 (15.4) | 49.6 (16.1) |
| % female | 16.30% | 24.50% |
| years of education | 5.75 (4.8) | 2.4 (3.4) |
| hourly wage (1994 pesos) | 6.75 (12.5) | 2.92 (4.6) |
| total hours worked per week | 41.2 (24.5) | 20.1 (26.1) |
| N | 58,440 | 2,377 |

Source: Author's calculations based on ENIGH (INEGI)
## Table 3

### Estimates of Remittance Income on Consumption Share

<table>
<thead>
<tr>
<th>Category of Expenditure</th>
<th>estimate</th>
<th>s.e.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food</td>
<td>-0.0334</td>
<td>0.0082</td>
</tr>
<tr>
<td>Rent</td>
<td>-0.0067</td>
<td>0.0053</td>
</tr>
<tr>
<td>Durables</td>
<td>0.0192</td>
<td>0.0053</td>
</tr>
<tr>
<td>Health</td>
<td>0.0221</td>
<td>0.0066</td>
</tr>
<tr>
<td>Clothing</td>
<td>0.0009</td>
<td>0.0335</td>
</tr>
<tr>
<td>Recreation</td>
<td>-0.0012</td>
<td>0.0057</td>
</tr>
<tr>
<td>Transportation</td>
<td>-0.0012</td>
<td>0.0038</td>
</tr>
<tr>
<td>Personal</td>
<td>0.0046</td>
<td>0.0026</td>
</tr>
<tr>
<td>Housing</td>
<td>0.0102</td>
<td>0.0049</td>
</tr>
</tbody>
</table>

N = 10,075

Notes: results from weighted ordinary least squares estimation of equation (2). Household characteristics include education of head, rural/urban designation, age of head, and marital status. Estimated coefficients relate to dummy variable which assumes the value of 1 if the household received international remittance income in the survey month. Coefficients which are significant at the 95% level indicated in bold.

Source: ENIGH 2000 (INEGI)