Box 1

EFFECTS OF THE TAX ON REMITTANCES FROM THE UNITED STATES TO CENTRAL AMERICA AND THE DOMINICAN REPUBLIC

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Introduction

Remittances are particularly significant for most economies in Central America and the Dominican Republic (CADR), where they are one of the main sources of revenue in the current account balance. In several cases, they exceed earnings from exports and foreign direct investment. Aside from their macroeconomic weight, remittances play an essential role in household spending by invigorating sectors such as trade and construction[2] and by acting as a subsistence mechanism.[3] In addition, their stability, even in the setting of a global crisis (such as the COVID-19 pandemic), has helped to cushion external imbalances and to support the exchange rate.

Most remittances sent to the CADR region are from the United States,[4] which makes the recent change to US legislation on remittances, due to come into effect on 1 January 2026,[5] especially important. According to this change, a tax of 1% will be levied on certain types of remittances sent abroad. This measure will only affect cash remittances transferred via money orders or cashiers' cheques and will not include transfers from bank accounts or funded with a credit or debit card issued in the United States. The tax will be paid by the sender when the money is transferred and could particularly impact migrants who have limited access to formal banking systems and usually send cash.[6]

The effect of the tax on remittances

Different studies have identified factors influencing remittance flows such as the size of the diaspora,[7] the exchange rate[8] and the income level in the source country.[9] However, the effect of remittance costs has received less attention despite its potential importance. Orozco[10] indicates that lower costs may spur the sending of remittances, although elasticity to remittance costs is low.

Although a downward trend has generally been observed in the cost of sending remittances from the United States to countries in the CADR region in the last decade,[11] these costs remain very high (above 4%) and there are significant cross-country differences (Chart 1). For instance, the average cost of sending remittances to EL Salvador and Honduras is lower than the consistently higher costs of sending them to the Dominican Republic. This is because there are fewer formal operators, such as authorised banks and firms, which drives down competition and raises costs.

To analyse the effect of changes in these costs on remittances, Badilla and Izaguirre[12] use a panel of quarterly data from 2011 Q1 to 2025 Q1 for five countries in the CADR region (El Salvador, Guatemala, Honduras, Nicaragua and the

1 Evelyn C. Badilla and Juan F. Izaguirre are an economic statistics and database analyst and an economist, respectively, of the Executive Secretariat of the Central American Monetary Council (SECMCA).

2 Alina Carare, Alejandro Fiorito Baratas, Jessie Kilembe, Metodij Hadzi-Vaskov and Wenzhang Zhang. (2024). "The Joint Effect of Emigration and Remittances on Economic Growth and Labor Force Participation in Latin America and the Caribbean". IMF Working Papers, WP/24/175, International Monetary Fund.

3 According to the Banco Central de Reserva de El Salvador, 98.7% of remittances were used for household consumption in 2024. In Guatemala, the Encuesta sobre Migración Internacional de Personas Guatemaltecas y Remesas 2022 indicates that 58.4% were used for household spending and the remainder for investment, saving, health and education. In Honduras, 76.4% were spent on food, whereas a lower share was allocated to education, saving and investment.

4 Chart 2.a of Juan Carlos Berganza, María Pía Cobián González, María Teresa García Cid and Esther López Espinosa. (2025). "Remittances from Spain to Latin America: some key figures". *Economic Bulletin - Banco de España,* 2025/Q2, 01.

5 It is a provision of the One Big Beautiful Bill Act signed by the US President on 4 July 2025.

6 According to the nota de remesas published by CEMLA, the percentage of cash remittances sent from the United States ranges from 40% to 47% for Mexico and from 76% to 80% for Guatemala.

7 Richard H. Adams Jr. and John Page. (2005). "Do international migration and remittances reduce poverty in developing countries?". *World Development,* Vol. 33(10), pp. 1645-1669.

8 Dean Yang. (2008). "International migration, remittances and household investment: Evidence from Philippine migrants' exchange rate shocks". *The Economic Journal,* Vol. 118(528), pp. 591-630.

9 Dilip Ratha. (2003). "Chapter 7. Workers' remittances: An important and stable source of external development finance". In World Bank, *Global Development Finance 2003,* pp. 157-175.

10 Manuel Orozco. (2002). "Globalization and migration: The impact of family remittances in Latin America". *Latin American Politics and Society,* Vol. 44(2), pp. 41-66.

11 Thorsten Beck, Mathilde Janfils and Kangni R. Kpodar. (2022). "What Explains Remittance Fees? Panel Evidence". IMF Working Papers, WP/22/63, International Monetary Fund.

12 Evelyn C. Badilla Barrantes and Juan F. Izaguirre Silva. (2025). "Impacto del costo de envío en los flujos de remesas hacia Centroamérica y República Dominicana" Documento de Trabajo SECMCA-05-2025.

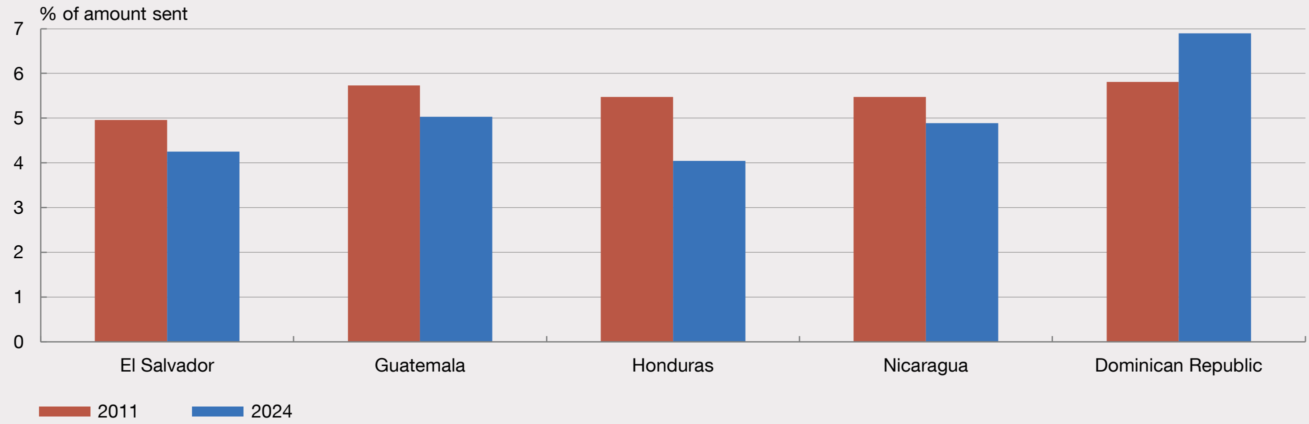
Box 1

EFFECTS OF THE TAX ON REMITTANCES FROM THE UNITED STATES TO CENTRAL AMERICA AND THE DOMINICAN REPUBLIC (cont'd)

Dominican Republic). The results show that a one percentage point (pp) increase in remittance costs (i.e. the same magnitude as the tax on certain remittance transfers approved in the United States) reduces the volume of remittances by 0.37% in the short term. If this increase in cost is persistent, the cumulative reduction may reach 1.21%.

Considering these results, cash remittances sent from the United States to the CADR region are not expected to be significantly affected by the new tax which will come into force on 1 January 2026. What is more, the effect will be mixed across countries and will be higher, the higher the share of cash remittances sent.

Chart 1
Average cost of sending US$200 from the United States



SOURCE: Authors' calculations drawing on World Bank data (Remittance Prices Worldwide).