Can Remittances Spur Economic Growth and Development?

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[1]The views in this discussion are those of the author and should not be attributed to the Atlanta Fed or the Federal Reserve System.

Capital Flows to Emerging Economies

- Remittances became a major source of foreign income in emerging economies: **$ 336 Billions. (2010)**
    - The equivalent to **48% of total net private capital flows to emerging economies (including middle income countries).**
    - In several countries, they represent more than **10% GDP** (Honduras 21%, Philippines 11.3%)
- First Question that comes to mind: **Do Remittances Spur/ Deter Economic Growth?**

Remittances and its effect on economic performance

- Data includes data for Latin American Countries for the period 1980-2005.
- **This paper regress GDP per capita on factors related to economic growth**.
  -Human Capital, Gross Capital Formation, Foreign Aid, Financial Flows, FDI, Openness, Economic Freedom, Exchange Rate Fluctuations.
- When including **remittances** in the regression, the coefficient is **positive**.
- **The paper concludes that remittances promotes economic growth**

Comments

- **What is the link behind this positive relationship between GDP and Remittances?**
- Do remittances promote financial development?
- Do they alleviate poverty, which allows households to spend more resources (schooling) on children?
- Do they relax financial constraints in potential entrepreneurs?

Comments-Spurious relationship?

- **Is that the only interpretation for the positive relationship between GDP and Remittances**? Among others...
- As economies develop, better institutions, **more remittances through formal channels**...
- Economic Crisis/War/Disasters results in emigration. **Later the economy recovers and remittances increase**..
- Economic booms trigger investment opportunities (e.g. housing), residents abroad send more money to invest there.
- If **US GDP grows, MEX grows** (e.g. more imports from MEX), but also **more remittances** (Spurious link)

Comments-Endogeneity

- Addressing these concerns, force the paper to deal with endogeneity.
- OLS with Fixed/Random Effects clearly not appropriate.
- The paper implements a **GMM differenced Arellano-Bond.**

GMM

System

- Persistence in data severely affect the small-sample properties of the GMM **differenced.** (Blundell and Bond, 1998)

- **Suggestion:** Combine this estimator with an estimator in levels and produce a **system** estimator.

- The additional moment conditions for the regression in levels are:

$$E\left[\left(y_{i,t-s} - y_{i,t-s-1}\right)\left(\eta_i + \varepsilon_{i,t}\right)\right] = 0 \text{ for } s = 1,$$
$$E\left[\left(x_{i,t-s} - x_{i,t-s-1}\right)\left(\eta_i + \varepsilon_{i,t}\right)\right] = 0 \text{ for } s = 1,$$

- Since the number of instruments would exploit. **Overfitting bias** would likely emerge: **use five years averages**.