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Economics
Discussion Paper Series
EDP-1125

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November 2011

Economics
School of Social Sciences
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Edited on 8th November, 2011

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Abstract

The present study re-examines the effects of remittances on growth of GDP per capita using annual panel data for 24 Asia and Pacific countries. The results generally confirm that remittance flows have been beneficial to economic growth. However, our analysis also shows that the volatility of capital inflows such as remittances and FDI is harmful to economic growth. This means that, while remittances contribute to better economic performance, they are also a source of output shocks. Finally, remittances contribute to poverty reduction – especially through their *direct* effects. Migration and remittances are thus potentially a valuable complement to broad-based development efforts. Yet migration and remittances should not be seen as a substitute for aid, as private money cannot be expected to contribute towards public projects. Also, not all poor households receive remittances, and public funds are meant to alleviate poverty.

JEL Classification codes:

Keywords: remittance, economic growth, volatility, poverty.

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Acknowledgement

This study is funded by IFAD (International Fund for Agricultural Development). We are grateful to Thomas Elhaut and Ganesh Thapa, Asia and the Pacific Division, IFAD, for their support and guidance throughout this study. The views expressed are our personal views and not necessarily of the organisations to which we are affiliated.

Remittances, Growth and Poverty: New Evidence from Asian Countries

1. Introduction

In 2010, migrants from developing countries sent over \$325 billion to their origin countries, far exceeding the official development assistance (ODA) received. This does not include the unrecorded flows. The increase in remittances to developing countries has been due to (i) more number of people settling abroad, and (ii) easier, faster and cheaper modes of transmitting money to another country are now available which also facilitate recording by the Central Banks.

The impacts of migration on growth and poverty levels of a country are mixed. While the resulting remittances increase the income of the recipient country and consequently decrease poverty, there are social costs not accounted for in these higher incomes¹. On the one hand, remittances reduce work efforts and dampen long term growth, and on the other, they improve financial sector development and thus stimulate growth. Remittances have a positive impact on the credit rating of a country, provide a large and stable source of foreign currency that can curtail investor panic, help deal with balance of payments crisis, and can be used for development projects (Ratha et. al., 2011).

Remittances reduce poverty through increased incomes, allow for higher investments in physical assets and education and health, and also enable access to a larger pool of knowledge. Inflow of workers' remittances results in physical capital accumulation through increased access to finance, although this depends on the recipients' marginal propensity to consume. For instance, in Nepal, one third to one half of the reduction in the poverty headcount ratio from 42 per cent in 1995-96 to 31 per cent in 2003-04 is attributed to the increases in remittances (World Bank, 2006). In rural Pakistan, temporary migration is associated with higher female and total school enrolment (Mansuri, 2006). On the other hand, migration of high skilled workers can result in a brain drain (Adams, 2003; Docquier et al. 2007) that could have a negative impact on the growth of the country in the long run².

¹ These (remittances) also come at the risk of psychological stress and adverse emotional impact, both for the migrant as well as his family.

² However, the effect of the brain drain could be positive if migration prospects foster investments in education because of higher expected returns abroad (Beine et al., 2001).

Many of Asia and the Pacific countries recently enjoyed a surge of remittances until the beginning of the global financial crisis and experienced economic growth as well as poverty reduction at the same time, but no studies, to our knowledge, have assessed the impacts of remittances on economic growth and poverty in these countries. The present study attempts to fill this gap.

The objectives of the present study are (i) to assess the relationship between remittances and growth of GDP; (ii) whether volatility of remittances is harmful to growth; and (iii) whether remittances reduce poverty. The econometric methods used correct for endogeneity of remittances and other variables, and robust results are obtained, based on a cross-country panel of a large number of countries in Asia and the Pacific region.

The remainder of the paper is structured as follows. Section 2 discusses the impact of the recent financial crisis of 2008-09 on remittances. Section 3 reviews the recent literature on the relationship between remittances, economic growth and poverty. Both results of cross-country and country-specific analyses are reviewed. Section 4 is devoted to a review of the data and discussion of the econometric specifications used. The results are discussed in Section 5. Section 6 concludes with observations from a broad policy perspective.

2. Financial Crisis and Remittances

The global financial crisis has had a dampening effect on the remittances received by developing countries. A recent ADB (2011) study shows that since the onset of the financial crisis, remittance flows to Asian countries have declined, primarily due to rising unemployment. Analysis of household surveys shows that, during the crisis, the number of migrant workers declined by 7 per cent for Bangladesh, 2 per cent for Indonesia and remained unchanged for Philippines. There was a decline in incomes as a result of the crisis. 97% of households in Bangladesh, 82% in Indonesia, and 64% in the Philippines reported lower incomes. The reasons include, apart from falling remittances, job losses, wage cuts and depreciation of the peso (in the Philippines). Both savings and investments (in physical and human capital) declined. As a coping mechanism, households in Bangladesh and Indonesia worked more, and in the

Philippines, borrowed more. Evidence from the Philippines shows that children were removed from school as a result of the shock.

Although, in most cases, there has been a decline in remittances received by developing nations (eg: remittances to Tajikistan decreased by 29 per cent in 2009), in some cases, remittances have increased due to workers coming back to their home country and bringing back all their savings. This, however, may be just a temporary increase (e.g: Pakistan witnessed a 23 per cent growth in remittances in the first half of 2009). The Philippines received USD 11.34 billion in remittances between January and August 2009, as compared to USD 10.94 billion for the same period in the previous year. In Bangladesh, remittances increased from USD 471 million in August 2007 to USD 935 in August 2009. That there has not been a steep decline in remittances in some countries may be attributed to (i) permanent overseas migrants not suffering from the financial crisis, (ii) many migrants are settled in developing nations which were not severely affected by the financial crisis, and (iii) migrants are engaged in those jobs or industries which are relatively untouched by the financial crisis (Jha, Sugiyarto, & Vargas-Silva, 2009).

More recent evidence from IFAD³ points to a rise in remittances. Migrant workers around the world began 2011 by sending home significantly more money than they did in 2010. While Pakistan showed a 34 per cent increase, Bangladesh reported a two per cent increase. This may be attributed to the rate of recovery in the United States, the largest remitting economy. While short-term migrant labourers tend to be the first to lose their jobs during an economic downturn, they are often the first to be rehired during a recovery, so there is hope for continued improvement in global remittances as the U.S. economy continues to emerge from the crisis. Since the outbreak of the financial crisis, exchange rates have been highly volatile. Accordingly, over the course of 2010, while 70 per cent of the countries showed an increase in the dollars remitted, recipients in 60 per cent of the countries experienced an actual decrease in the purchasing power of the money they received. The rise of the dollar against developing country currencies at the outset of the global recession initially had a positive effect for families receiving remittances, effectively delaying the effect of the crisis in those countries with a flexible exchange rate. In 2010, however, that trend began reversing as developing country

³ <http://www.ifad.org/media/press/2011/18.htm>

currencies rebounded, leaving many recipient families to face the same financial pressures that have been experienced by migrant workers in more developed economies.

3. Remittances, Growth and Poverty

Remittances impact growth in the following three ways: (i) By affecting the rate of capital accumulation. Remittances not only increase the rate of accumulation of both physical and human capital, but also lower the cost of capital in the recipient country. Thus, additional borrowing may increase and lead to greater indebtedness. These may also have a role in stabilizing the economy, or reducing volatility, and hence, reducing the risk premia that investors demand. (ii) By affecting the labour force growth: remittance receipts have a negative impact on labour force participation, by substituting remittance income for labour income, and by consuming more leisure and doing less work. (iii) By affecting TFP growth: remittances impact the efficiency of investment, depending on who is making the investment decision (Barajas, et al. 2009). If the recipient makes the decision on behalf of the remitter, it is likely that his decision is not as efficient as the one made by a skilled domestic financial intermediary in case of a formal capital inflow. Remittances may result in greater financial development. It can also result in exchange rate changes – inflow of funds can result in currency appreciation (or the Dutch disease) and lower exports.

Barajas et. al (2009) examine the impact of remittances on growth in 84 recipient countries based on annual observations during 1970–2004. They use the following instrument: the ratio of remittances to GDP of all other recipient countries that captures the effects of global reductions in transactions costs and other systematic changes in the microeconomic determinants of remittances. The control variables used are: the trade-weighted average growth rate of real per capita GDP of the remittance-receiving country's top 20 trading partners, initial GDP-per-capita, trade-to-GDP ratio, money supply to GDP ratio, inflation rate and investment to GDP ratio. In most cases, remittances have a negative sign and, in others, there is no robust relationship between remittances and economic growth.

Adams (2010), based on a data set of 76 low income and middle income countries over the period 1995-2001, examines the determinants of international remittances in developing countries. Log of remittances per capita is regressed on a set of demographic, economic and political/financial characteristics plus unobservable country fixed effects. Although IV estimation is used, some of the instruments employed appear weak. The poverty headcount, for example, uses share of urban population in a labour-sending country as an instrument. More problematic is that the same instrument is also used for the poverty gap. Why cost of sending remittances is not considered as an instrument is intriguing.

The main findings are, however, interesting. The skill composition of migrants matters in determining remittances. Countries which export a larger share of high-skilled (educated) migrants receive lower remittances 9 per capita). A 10 per cent increase in their share reduces the remittances by about 9 per cent. One reason is that they bring their families with them and their ties with their home country weaken.

For high-skilled migrants, the level of poverty has a negative effect on remittances. A likely explanation could be the use of a weak instrument for poverty. The author's explanation that this reflects propensity of high-skilled migrants to remit for investment purposes is far-fetched.

Remittances increase with per capita GDP up to the value \$2200 per year, and fall thereafter. Or, middle-income countries receive more remittances than low or high-income countries.

Chami et. al (2003), in analysing the impact of remittances on growth, construct an optimal remittance function. This shows that remittances are compensatory in nature, rising with the level of altruism, and falling as the recipient's wage in the high output stage rises. Thus there should be a negative relationship between the recipient's income and the level of remittances. This is the opposite of what would happen if remittances functioned as investment flows. The model also implies a negative externality on both the immigrant and the recipient. Given the moral hazard issue-workers slackening with remittances-there is a negative effect on aggregate output. This again differs from what would happen if remittances were an investment flow.

The empirical analysis in Chami et al. (2003) is based on data for 113 countries over a 29 year (1970-98) period. Two stage regressions are employed. In the first stage, growth rate of remittances ($\Delta \log$ workers' remittances) as a function of income gap between the recipient country and US (lagged by one year) and interest rate gap between the recipient and US (real deposit or money market interest rate) is estimated. In the second stage, instrumented values of $\Delta \log$ workers' remittances are used as an explanatory variable in a regression with growth rate of income in the recipient country as the dependent variable. Other explanatory variables include log of investment to GDP ratio, and ratio of net private capital flows to GDP. Specifications with fixed and random effects were also estimated. The estimated coefficient on income gap in the first regression is negative, confirming compensatory nature of remittances. This implies that the larger the income gap, the larger are the remittances. In the second stage regression, the coefficient on instrumented change in workers' remittances is negative and highly significant. This finding supports the second important implication of the model that remittances have a negative effect on growth. As suggested above, this is consistent with the moral hazard issue of workers' slackening efforts with higher remittances. Further confirmation of the authors' view that remittances are not equivalent to capital flows is found in the contrasting negative effects of remittances and positive effects of FDI.

Vargas-Silva et al. (2009) examine the impact of remittances on poverty and economic growth in Asia (using annual data). In their specification, growth (GDP growth rate) and poverty (poverty gap ratio) are expressed as a function of remittances (log of remittances as per cent of GDP), logarithm of initial GDP per capita, primary school completion rate, natural logarithm of gross capital formation, openness of trade, and GDP deflator. While the impact of remittances on growth is positive, the impact on poverty is negative. A 10 per cent increase in remittances as a share of GDP in a given year leads to about a 0.9–1.2 per cent increase in annual growth. A 10 per cent increase in remittances (as a percentage of GDP) decreases the poverty gap by about 0.7–1.4 per cent. Pradhan et al. (2008) examined the effect of workers' remittances on economic growth using panel data from 1980–2004 for 39 developing countries and confirmed a positive impact on growth.

Adams and Page (2010) study the effect of international migration on poverty in the developing world. Attention is given to endogeneity of migration and remittances by using instrument variables. The instruments include: distance between remittance-sending and receiving countries, level of education, and government stability. There are a few difficulties. (i) Use of the same set of instruments for both migration and remittances renders identification difficult. Specifically, remittances are likely to be affected by cost of transfers, and exchange rate fluctuations, among others. Also, the degree of altruism is key to remittances and not necessarily to migration. (ii) Another difficulty is separate use of migration and remittances in the poverty equation. Other studies (Semyonov and Gorodzeisky, 2005, for example) have demonstrated that both matter.

A merit of this study (compared with the extant literature) is that the econometric analysis is based on a large data set (71 low income and middle income developing countries, covering migration, remittances, inequality and poverty). Both OLS and IV estimation results are reported. The FGT class of poverty indices are regressed on per capita GDP, the Gini coefficient of income distribution, share of migrants in the population, and (alternatively) per capita official remittances. All these variables are in logs. In addition, regional dummies are used.

Our comments are confined to the IV estimates of impacts on poverty. After instrumenting for the possible endogeneity of international migration and remittances, these two variables have a significant negative impact on poverty. Migration has a significant negative impact on two of the three poverty measures (the headcount and poverty gap), while remittances impact negatively on all three poverty measures (including the distributionally sensitive poverty gap or squared poverty gap).

Aggarwal et al. (2010) assess the impact of remittances on financial sector development (measured as share of bank deposits or the ratio of bank credit to the private sector expressed as a percentage of GDP) using data for 109 countries over the period 1975-2007. The study uses a dynamic GMM framework using lagged values of regressors to tackle the problem of reverse causality. The findings show that remittances are positively related to the measures of financial development. The coefficient is larger for the bank deposit to GDP ratio than that of bank credit to GDP ratio. The results hold true even for a smaller sample (42) of countries for which

remittances also include those received using informal or non-bank sources. After instrumenting, using economic conditions in remittances sending countries, and policies and views on immigration in these countries, the second stage results show a positive association between remittances and deposit and credit ratios.

Remittances help in reducing consumption instability in developing countries. Remittances act both as ex-ante risk avoidance tool (e.g. ex-ante investments that smoothen incomes and increase resilience to shocks) as well as ex-post risk management mechanism (e.g.: remittances increase after natural disasters affect a region). Combes and Ebeke (2010) uses a System-GMM-IV model for a cross-sectional panel of 87 developing countries over the period 1975-2004 (non-overlapping 5 year periods) to estimate the impact of remittance on consumption instability. They find that remittances significantly reduce consumption instability, the impact being stronger in financially less developed countries. However, the stabilizing impact of remittances decreases at higher levels of remittance. Remittances also increase resilience to shocks (such as natural disasters and macroeconomic shocks).

Country Specific Case Studies

A brief distillation of findings for a few Asian countries supplements the results obtained from cross-country data. Some combine a computable general equilibrium model with a micro-econometric analysis of reduction in probability of being poor with remittances. Yet another distinguishing feature is that urban and rural effects of remittances are distinguished.

Consider, for example, Bangladesh first. Raihan et al. (2009) show that a reduction in remittances lowers GDP, wage rates-especially for agricultural labour-and returns to capital in agriculture. Alongside, real consumption declines in both rural and urban areas, and poverty worsens. The impact of an increase in remittances, at the household level, based on micro econometric analysis, is to increase expenditure on food and housing, and lower poverty.

In Pakistan, Ahmed et al. (2010) report reduction in remittances reduces GDP, and consumption in both rural and urban areas, and worsens both the headcount of poor and poverty gap. These

poverty impacts are larger in the urban areas. Micro-econometric analysis confirms a reduction in poverty with remittances

There is a reverse migration as a result of laying off of workers abroad which has resulted in Pakistani workers returning home with their accumulated savings. This led to a temporary increase in remittances in 2008-09.

In an insightful study, Rozelle et al. (1999) study the factors that trigger migration and how large scale migration affects agricultural productivity in China. Their main finding is that maize yields fall sharply as a member leaves the farm, implying significant lost-labour effects. However, the negative effects from less family labour is in part compensated by access to capital through higher remittances. Remittances, it is reported, are a positive function of migration. The former help loosen credit and risk constraints and thus raise yields. Given imperfections in land and capital markets in rural China, households with more land are likely to be more capital-constrained in crop production. However, the proxy variable for wealth, the value of all non-productive assets, has a negative effect on migration. Evidence also suggests that higher wealth increases maize yields. Migrants from households facing uncertainty about land allocation remit less, consistent with the expectation that these households are not inclined to invest in their land.

In another important contribution, Atamanov and Van den Berg (2011) examine with data for Kyrgyzstan whether the impact of remittances on crop income differs across farmers with varying amounts of land owned, as they may encounter different constraints to invest in crop production and different incentives and capacity to migrate. Another interesting hypothesis examined is whether permanent migrants have a stronger negative lost-labour impact on crop income than seasonal migrants.

Migration of labour has a relatively large effect on crop income. Distinguishing between seasonal and permanent migrants, it is found that the lost-labour effect is only significant for permanent migrants. That the lost-labour effect of seasonal migrants was not significant could be because they return home regularly and contribute to crop income.

Remittances partly compensate for the lost-labour effect. However, the positive effect is weaker for higher land groups. This suggests that small farmers were more liquidity constrained than those better endowed. The positive effect of remittances on small farms' productivity indicates the importance of establishing supporting financial institutions, which may also slow down permanent labour migration and, as a result, its negative impact on local crop production.

4. Data and empirical strategy

Data

Our sample is dictated by data availability and consists of 24 Asia and Pacific economies over the period 1980 to 2009. A list of the countries as well as the definition and sources of all the variables are given in Appendices 1 and 2. Unless stated otherwise, the data are drawn from World Development Indicators 2011 (World Bank, 2011). Based on the existing literature on remittances and growth, such as Chami et al. (2003), our baseline specification takes the following form:

$$\Delta y_{it} = \gamma LREM_{it} + \beta X_{it} + \eta_i + \varepsilon_{it} \quad (1)$$

where for country i at time (denoting year) t , Δy denotes rate of growth of real per capita GDP, $LREM$ is logarithm of workers' remittances expressed as a percentage of GDP, η_i is unobserved country-specific effect and ε_{it} is the idiosyncratic error term. The vector X contains a standard set of determinants of economic growth, such as lag of real per capita GDP⁴, financial sector development, inflation, civil war, resource abundance, capital account openness, and investment.

Following the empirical literature of economic growth, we include lagged real per capita GDP to allow for convergence. Here a negative coefficient is expected given the predictions of the standard neoclassical model. In line with Levine et al. (2000), we use deposit money bank assets as a share of deposit money and central bank assets (defined by Beck et. al., 2009) as a measure of financial sector development. To capture the macroeconomic and political environments, we account for inflation and civil conflicts measured by internal armed conflicts from UCDP/PRIO

⁴ 2 year lag has been taken in the present study, but use of 1 year lag or a longer lag will not change the results significantly.

Conflict Database (2009)⁵. In addition, we consider the role of resource abundance captured by fuel exports as a percentage of merchandise exports sourced from the Quality of Government dataset (2011)⁶. We also use the capital account openness measure, first introduced by Chinn and Ito (2006), which measures a country's degree of openness based on restrictions on cross-border transactions. Following Barajas et al. (2009), we check the sensitivity of the remittances-growth nexus to the inclusion of investment as a conditioning variable recognising that it may be one of the most important channels through which remittances influence economic growth.

To further check the robustness of the baseline regressions, we also utilise an extended set of control variables, including trade, foreign direct investment (FDI), foreign aid, government expenditure and regime durability - measured by the number of years since the most recent regime change (from Quality of Government dataset, 2011). Finally, we control for property rights protection which is captured by 'constraint on the executive' from the Polity IV dataset. This follows Acemoglu and Johnson (2005) who make a strong case for the appropriateness of this indicator as a measure of property rights protection. According to them, because this variable captures procedural rules which constrain political leaders and other powerful elites, it is closely linked with the security of private property rights.

Model of Remittances and Economic Growth

To explore the effects of remittances on growth, we first use static panel data methods, such as fixed or random effects model. However, as some of the explanatory variables, including remittances, are likely to be endogenous, we also use the panel two-stage least squares (2SLS). Here, lagged per capita GDP, financial development, and investment are instrumented by their own lags since these are orthogonal to the error term. Our main variable of interest – remittances – is also instrumented by its own lag. In line with Chami et al. (2003), we use the income gap between each remittance receiving country and the US as an additional instrument.⁷

⁵ It is available from <http://www.prio.no/CSCW/Datasets/Armed-Conflict/UCDP-PRIO/> (accessed on 5th November 2011).

⁶ It is available from <http://www.nsd.uib.no/macrodatabase/set.html?id=37&sub=1> (accessed on 5th November 2011).

⁷ To test the appropriateness of the instruments, we report three sets of specification tests. First, we evaluate the cluster-robust Kleibergen-Paap Wald F-statistic which tests the relevance of the instruments. Second, we examine the validity of the instruments using Hansen's *J* statistic. Finally, we report the Kleibergen-Paap rk LM statistic

Volatility of capital inflows and growth

It is generally accepted that most sources of foreign exchange for poorer countries tend to follow global economic trends, increasing in good times and decreasing in bad times. Here, we empirically test whether the volatility of two types of inflows – namely, FDI and remittances, is harmful, or beneficial to economic growth. To measure volatility, we have used the standard deviation of each variable measured over a non-overlapping 5-year period as we are interested in the steady state link between the volatility of capital inflows and growth.

For this purpose, following Love and Zicchino (2006), we estimate a trivariate panel vector autoregression (PVAR) in the following form:

$$Y_{it} = \beta_0 + \sum_{j=1}^k \beta_j Y_{it-j} + \eta_i + \varepsilon_{it} \quad (2)$$

where for country i at time t , Y_{it} is a vector of three endogenous variables (i.e., the logarithm of real per capita income and the standard deviations of FDI and remittances), η_i denote a country-specific fixed effect and ε_{it} is the error term. Since by construction the lagged dependent variables are correlated with the unobserved country-level fixed effect, η_i , we use forward mean-differencing which validates the use of lagged right hand side variables as instruments for the endogenous variables via system generalised method of moments (GMM) procedure.

Our interest lies in generating impulse response functions which depict the reaction of one variable in the system to innovations in another variable while keeping all other shocks at zero. To make the variance-covariance matrix of the errors orthogonal, Cholesky decomposition is used where variables that come early in the ordering of the VAR system are assumed to affect the other variables contemporaneously and those that come last in the ordering are assumed to influence those listed earlier only with a lag. In our estimations, we assume that innovations in the volatility of remittances influence the other variables contemporaneously and hence the standard deviation of remittance appears first in the ordering. On the other hand, we assume that the performance of real per capita GDP in resource receiving countries does not influence the

which examines whether the excluded instruments are uncorrelated with the endogenous variables, i.e., whether the equations are underidentified.

volatility of inflows within the same year. Hence, it comes last in the ordering. The matrix of the impulse response functions is based on the estimated VAR estimates and their standard errors and the confidence intervals are produced with Monte Carlo simulations.

5. Empirical results

Remittances and Growth

The baseline results are reported in Table 1. In columns [1] – [4], we exclude investment from the regressions. The results show that the coefficient on lagged GDP carries the expected negative sign and it is significant at the 1% level. Financial development is found to be positively related to growth, but it is not statistically significant once investment is included in the specification in columns [5] – [8].

The results show that macroeconomic instability in the form of high inflation is detrimental to economic growth as found in all the columns. This is in line with the conventional wisdom that a stable macroeconomic environment reduces the risks and uncertainties associated with investment projects and thus results in economic growth. Similarly, we find that civil wars are negatively related to growth presumably because of their disruptive effects on economic activity. The coefficient estimate is negative and significant except in the columns [5] and [7].

It is consistently found across different specifications and estimation methods that remittances are positively associated with better economic performance. The results are important because the coefficient estimate of remittances is positive and significant even if it is instrumented by its own lag and the income gap between each remittance-receiving country and the US (in columns [3], [4], [7] and [8]). The existing literature (for example, Barajas et al. 2009) identifies various channels through which remittances enhance growth including the boosting of capital accumulation, labor force growth, and total factor productivity. While we are not exploring these channels empirically, our results are in sharp contrast with Barajas et al. (2009), which finds no relation between remittances and growth, or Chami et al. (2003) claiming that remittances negatively affect growth. The reason why we have obtained different results remains unclear, but it is surmised that focusing only on Asian countries and more recent periods (1980-2009) may have overturned the sign of the coefficient estimate.

The results indicate that, on average, countries with open capital account regimes register higher rates of growth. This is in line with the new evidence which indicates that financial openness is likely to be associated with higher factor productivity and greater efficiency, and hence better economic performance (Bekaert et al. 2010). The estimated coefficients also suggest that both investment and natural resources are positively related to growth.

The results in Table 2 check the sensitivity of the baseline results by considering the effects of an extended set of control variables using panel-2SLS. In columns [1] and [2], we augment the baseline specification with trade openness (proxied by the share of imports and exports in GDP) which enters with the expected positive sign. Columns [3] and [4] incorporate property rights protection which is found to boost growth. This is in line with the results of a broader research agenda showing the positive effects of institutions on economic performance (see e.g., Acemoglu and Johnson, 2005).

The impact of regime durability on growth is generally found to be positive (in columns [5] and [6]), suggesting that countries with stable governments tend to enjoy a higher level of economic growth. This variable has previously been used as an indicator of political stability (e.g., Collier et al. (2004)). The main results remain unchanged when we include additional variables such as FDI, government expenditure and foreign aid. The results suggest that both aid and government expenditure are inversely related to growth, for example, because aid may encourage corruption (as found by Knack, 2001), while increased government expenditures may crowd out the private sector. Finally, FDI generally carries the expected positive sign even though it is mostly non-significant at the 10% level.

The positive and statistically significant coefficient estimate of remittances is unchanged in Table 2 after adding various control variables. The results are robust as they are either significant at the 1% level or 5% level. The magnitude of coefficient estimates varies from 0.667 to 3.248 depending on which model or specification is applied. In all cases, remittances are instrumented by their own lag and the income gap between each country and the US.

Throughout the estimations, the Hansen J statistic fails to reject the validity of the over-identifying restrictions assumed for the estimation, suggesting that the instruments are valid. The Kleibergen-Paap rk Wald F statistic is almost always above 10, the critical value proposed by Stock and Yogo (2005), indicating that the instruments are indeed relevant. Finally, the Kleibergen-Paap rk LM statistic indicates that the regressions are not underidentified, suggesting that the excluded instruments are correlated with the endogenous variables. The details of specification test results are given in Appendix 3.

Table 1: Remittances and growth – baseline models

	FE	RE	FE-2SLS	RE-2SLS	FE	RE	FE-2SLS	RE-2SLS
	Without investment				With investment			
	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]
Lagged GDP ¹	-3.014 [1.046]***	-1.531 [0.697]**	-6.232 [1.601]***	-2.597 [0.851]***	-4.379 [1.454]***	-2.503 [0.870]***	-8.145 [1.791]***	-3.447 [0.940]***
Inflation ¹	-0.801 [0.524]	-0.926 [0.501]*	-0.812 [0.325]**	-0.988 [0.312]***	-1.069 [0.517]*	-1.143 [0.496]**	-1.044 [0.322]***	-1.137 [0.310]***
Fin dev / GDP ¹	4.184 [2.287]*	4.435 [1.730]**	6.353 [2.967]**	5.180 [2.044]**	2.159 [2.355]	2.508 [1.774]	4.243 [2.969]	3.619 [2.157]*
Remittance / GDP ¹	1.220 [0.529]**	0.841 [0.447]*	2.011 [0.488]***	1.304 [0.397]***	1.078 [0.548]*	0.805 [0.464]*	1.702 [0.475]***	1.196 [0.392]***
Resource abundance	0.096 [0.024]***	0.082 [0.020]***	0.091 [0.035]***	0.095 [0.022]***	0.084 [0.026]***	0.071 [0.026]***	0.077 [0.034]**	0.087 [0.022]***
Cap acc openness	0.964 [0.505]*	0.770 [0.292]***	0.905 [0.428]**	0.823 [0.318]***	0.746 [0.469]	0.652 [0.292]**	0.767 [0.411]*	0.760 [0.313]**
Civil war	-0.534 [0.276]*	-0.657 [0.301]**	-0.644 [0.336]*	-0.756 [0.305]**	-0.421 [0.272]	-0.534 [0.285]*	-0.434 [0.324]	-0.629 [0.299]**
Investment / GDP					0.219 [0.078]**	0.204 [0.071]***	0.166 [0.069]**	0.127 [0.061]**
Observations	303	303	299	299	303	303	298	298
Specification tests ²								
Hausman test (chi-squared)	1.69				3.72			
Overidentification			0.25				0.87	
Underidentification			0.00				0.00	
F-statistic (weak inst.)			24.27				19.82	

Notes: Dependent variable is GDP per capita growth. Robust standard errors in brackets. ***, ** and * indicate significance at the 1, 5 and 10% levels, respectively. ¹ Variables are in log form. Lagged GDP, financial development and investment are instrumented with their own lags. Remittance is instrumented with its 1st lag and the income gap between each country and the US. ²The specification tests are (i) the overidentification test which displays the p-values for the Hansen J-statistic for the null that instruments are uncorrelated with the error term and thus valid; (ii) the underidentification test shows the p-values of the Kleibergen–Paap rk LM-statistic for the null that the excluded instruments are uncorrelated with the endogenous variables; (iii) the weak identification test is the Kleibergen–Paap rk Wald *F* statistic for the null of weak correlation between the endogenous variables and the instruments.

Table 2: Remittances and growth – extended models

	FE-2SLS	RE-2SLS	FE-2SLS	RE-2SLS	FE-2SLS	RE-2SLS	FE-2SLS	RE-2SLS	FE-2SLS	RE-2SLS	FE-2SLS	RE-2SLS
	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]	[9]	[10]	[11]	[12]
Lagged GDP ¹	-9.412 [1.945]***	-3.131 [0.923]***	-10.757 [2.072]***	-3.143 [0.914]***	-11.066 [2.137]***	-1.037 [0.634]	-9.426 [2.041]***	-1.081 [0.651]*	-9.937 [2.090]***	0.009 [0.510]	-14.657 [2.999]***	-2.920 [0.953]***
Investment/GDP	0.191 [0.071]***	0.129 [0.060]**	0.220 [0.072]***	0.137 [0.060]**	0.220 [0.072]***	0.112 [0.053]**	0.191 [0.071]***	0.116 [0.053]**	0.177 [0.071]**	0.109 [0.048]**	0.232 [0.080]***	0.117 [0.049]**
Fin dev / GDP ¹	4.036 [2.970]	3.513 [2.054]*	4.977 [3.133]	3.318 [2.063]	4.265 [3.254]	2.042 [1.625]	5.913 [3.280]*	2.690 [1.709]	6.858 [3.319]**	1.568 [1.531]	10.719 [3.868]***	1.144 [1.519]
Remittance/GDP ¹	1.518 [0.488]***	1.085 [0.377]***	1.406 [0.493]***	1.000 [0.374]***	1.467 [0.491]***	0.867 [0.305]***	2.123 [0.481]***	0.899 [0.304]***	2.212 [0.489]***	0.667 [0.272]**	3.284 [0.636]***	1.065 [0.299]***
Inflation ¹	-1.064 [0.321]***	-1.150 [0.311]***	-1.065 [0.335]***	-1.176 [0.322]***	-0.998 [0.336]***	-1.238 [0.323]***	-0.750 [0.333]**	-1.033 [0.323]***	-0.813 [0.337]**	-1.141 [0.322]***	-0.527 [0.375]	-0.607 [0.340]*
Resource abundance	0.057 [0.036]	0.083 [0.021]***	0.049 [0.036]	0.080 [0.021]***	0.040 [0.037]	0.061 [0.017]***	0.046 [0.036]	0.058 [0.018]***	0.037 [0.037]	0.042 [0.015]***	0.030 [0.040]	0.053 [0.016]***
Cap acc openness	0.908 [0.416]**	0.723 [0.299]**	0.791 [0.427]*	0.711 [0.298]**	0.649 [0.437]	0.603 [0.241]**	0.450 [0.430]	0.481 [0.251]*	0.635 [0.445]	0.463 [0.211]**	0.355 [0.498]	0.729 [0.217]***
Civil war	-0.251 [0.335]	-0.630 [0.302]**	-0.163 [0.339]	-0.621 [0.302]**	-0.193 [0.338]	-0.984 [0.284]***	0.076 [0.341]	-0.718 [0.298]**	0.171 [0.348]	-0.810 [0.273]***	0.061 [0.364]	-1.089 [0.276]***
Trade	0.042 [0.019]**	0.006 [0.012]	0.045 [0.019]**	0.007 [0.012]	0.039 [0.019]**	-0.013 [0.009]	0.045 [0.018]**	-0.014 [0.010]	0.045 [0.019]**	-0.028 [0.008]***	0.034 [0.020]*	-0.011 [0.010]
Property rights			0.313 [0.171]*	0.019 [0.149]	0.377 [0.179]**	-0.111 [0.143]	0.365 [0.184]**	-0.141 [0.145]	0.512 [0.205]**	-0.200 [0.142]	0.676 [0.234]***	-0.242 [0.141]*
Regime durability					0.069 [0.049]	0.056 [0.022]***	-0.019 [0.053]	0.040 [0.022]*	-0.005 [0.054]	0.055 [0.018]***	-0.006 [0.057]	0.039 [0.018]**
FDI ¹							0.238 [0.250]	0.317 [0.205]	0.233 [0.252]	0.388 [0.214]*	-0.008 [0.289]	0.604 [0.220]***
Gov exp / GDP ¹									-3.329 [1.901]*	-0.743 [0.888]	-4.857 [2.145]**	0.460 [0.946]
ODA / GNP ¹											-0.982 [0.512]*	-1.221 [0.281]***
Observations	298	298	295	295	295	295	283	283	283	283	265	265
Specification tests ²												
Overidentification	0.66		0.29		0.57		0.88		0.78		0.67	
Underidentification	0.00		0.00		0.00		0.00		0.00		0.00	
F-statistic (weak inst)	25.60		29.85		29.46		22.52		25.74		7.93	

Notes: Dependent variable is GDP per capita growth. Robust standard errors in brackets. ***, ** and * indicate significance at the 1, 5 and 10% levels, respectively. ¹ Variables are in log form. Lagged real GDP, financial development and investment are instrumented with their own lags. Remittance is instrumented with its 1st lag and the income gap between each country and the US. ²The specification tests are (i) the overidentification test which displays the p-values for the Hansen J-statistic for the null that instruments are uncorrelated with the error term and thus valid; (ii) the underidentification test shows the p-values of the Kleibergen–Paap rk LM-statistic for the null that the excluded instruments are uncorrelated with the endogenous variables; (iii) the weak identification test is the Kleibergen–Paap rk Wald *F* statistic for the null of weak correlation between the endogenous variables and the instruments.

To sum up, our findings from Table 1 and Table 2 indicate that remittances (as a share of GDP) have promoted economic growth in our sample countries. This result is robust to endogeneity issues and omitted variable bias. In what follows, we investigate the related issue of how the volatility of remittances inflows influences economic growth relative to other types of capital inflows, such as FDI.

The volatility of capital inflows and growth

An attractive feature of the PVAR is that it sidesteps endogeneity concerns by treating all the variables in the system as endogenous. Table 3 summarises the results⁸. As can be seen from Table 3, the volatility of both remittances and FDI are inversely related to economic performance. The coefficient estimates indicate that the negative effects of volatility are little larger with FDI than with remittances. It is postulated based on this finding and our previous results that, while remittance flows may alleviate financial constraints and thus stimulate economic development, they may also be a source of output shocks, e.g. arising from the situations where countries are unable to buffer against sudden swings in inflows.

Table 3: PVAR results

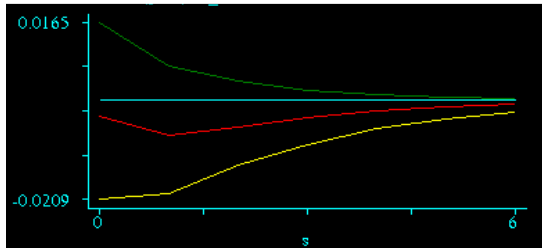
	Income	FDI volatility	Rem volatility
Rem volatility ($t-1$)	-0.027 [2.010]**	0.130 [1.822]	0.002 [0.010]
FDI volatility ($t-1$)	-0.049 [-2.882]**	0.196 [2.194]**	-0.001 [-0.014]
Income ($t-1$)	0.591 [21.872]**	0.027 [0.211]	-0.090 [-0.998]
<i>Notes:</i> the trivariate panel VAR model is generated via GMM. Robust t -statistics are in parentheses and ** indicates significance at the 5% level.			

To get a better feel of the response of income to changes in the volatility of capital inflows, we also show the impulse response functions for our variables of interest – namely, the volatility of remittances and FDI, as illustrated in Figures 1a and 1b. The confidence intervals of the impulse response functions are obtained using Monte Carlo simulations with 1000 repetitions. Impulse response functions show that an exogenous shock to the volatility of both types of capital inflows

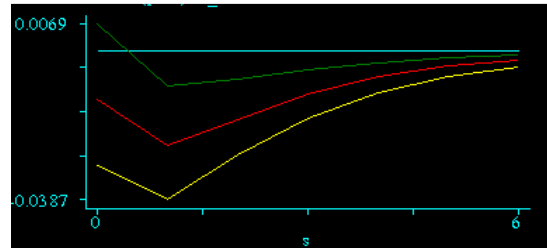
⁸ An important caveat to our results is that the sample size is reduced significantly with 5-year averages when calculating the volatility measures. So we have also estimated models with 4 and 3-year averages and the results remain largely unchanged. These alternative results are available on request from the corresponding author.

contracts economic growth- especially in the short run (i.e. in 2 to 3 years after the shock), where countries may find it harder to adjust to unexpected changes in capital inflows.

**Figure 1a: Impulse response function:
Response of income to remittance volatility
shock**



**Figure 1b: Impulse response function:
Response of income to FDI volatility shock**



Remittance and Poverty in Asia

In this sub-section, we examine how remittances would affect poverty in Asian countries as an extension of the growth regressions in the previous sections along the lines of Imai et al. (2010). Among various poverty measures including both income and non-income indicators, we will use international poverty headcount measures based on US\$1.25 or US\$2 a day, estimated by the World Bank (Ravallion et al. 2008), as they cover a wide range of countries and years.. However, as these poverty data are usually based on household surveys which take place once in few years, the corresponding panel is highly unbalanced. Constrained by limited data, we have used a parsimonious specification in which log of growth rate of GDP per capita is estimated by a smaller number of explanatory variables, that is, (2 periods) lagged *growth* of agricultural value added per worker (or lagged (level of) agricultural value added per worker, or lagged (level of) GDP per capita as an instrument), investment, financial development, remittances, trade in the first stage of Fixed-effects 2SLS. In the second stage, the poverty head- count ratio (based on either US\$1.25 or US\$2 a day poverty line) is estimated by the same set of variables except the instrument (i.e. GDP growth rate from the first stage). The growth of two- year lagged agricultural value added per worker is used as an instrument for economic growth rate to capture the long-run effect of agricultural productivity on growth in our sample countries in Asia.

Table 4a: Remittances, growth and poverty (with lagged growth of agricultural value added per worker)

Dep Var	FE-2SLS		FE-2SLS	
	1st Stage	2nd Stage	1st Stage	2nd Stage
	Growth Rate (GDP pc)	Poverty Headcount (US\$1.25)	Growth Rate (GDP pc)	Poverty Headcount (US\$2.00)
Growth Rate ¹	-	-0.140	-	-0.100
Lagged growth of Ag VA per worker ¹	19.25 [6.224]***	-	17.71 [7.015]**	-
Investment/GDP	0.255 [0.069]***	-0.006 [0.026]	0.326 [0.074]***	-0.0021 [0.023]
Fin dev / GDP ¹	2.891 [2.350]	-0.645 [0.619]	2.491 [2.649]	-0.110 [0.442]
Remittance/GDP¹	1.169 [0.499]**	-0.010 [0.166]	1.026 [0.562]*	-0.008 [0.117]
Trade	0.017 [0.026]	-0.013 [0.006]**	0.0126 [0.028]	-0.006 [0.004]
Observations	101	101	103	103
Specification tests				
Overidentification	0.000		0.000	
Underidentification	0.0026		0.0123	
<i>F</i> -statistic (weak identification test)	9.561		6.375	

Notes: Robust standard errors in brackets. ***, ** and * indicate significance at 1, 5 and 10% levels, respectively.

¹ Variables are in log form.

Table 4b: Remittances, Growth and Poverty (with lagged agricultural value added per worker (level))

	FE-2SLS		FE-2SLS	
	1st Stage	2nd Stage	1st Stage	2nd Stage
Dep Var	Growth Rate (GDP pc)	Poverty Headcount (US\$1.25)	Growth Rate (GDP pc)	Poverty Headcount (US\$2.00)
Growth Rate ¹	-	0.198	-	0.110
Lagged Ag VA per worker (level) ¹	-9.86 [2.935]***	-	-11.09 [3.058]***	-
Investment/GDP	0.309 [0.069]***	-0.094 [0.033]***	0.361 [0.072]***	-0.067 [0.021]***
Fin dev / GDP ¹	5.434 [2.440]**	-1.64 [0.785]**	5.431 [2.671]**	-0.648 [0.495]
Remittance/GDP¹	1.878 [0.502]***	-0.5005 [0.205]***	1.796 [0.549]***	-0.2804 [0.120]**
Trade	0.031 [0.026]	-0.0174 [0.008]**	0.0355 [0.028]	-0.009 [0.005]*
Observations	101	101	103	103
Specification tests				
Overidentification	0.000		0.000	
Underidentification	0.0012		0.0005	
<i>F</i> -statistic (weak identification test)	11.298		13.165	

Notes: Robust standard errors in brackets. ***, ** and * indicate significance at 1, 5 and 10% levels, respectively.

¹ Variables are in log form.

Table 4c: Remittances, Growth and Poverty (with lagged GDP per capita (level))

Dep Var	FE-2SLS		FE-2SLS	
	1st Stage	2nd Stage	1st Stage	2nd Stage
	Growth	Poverty	Growth	Poverty
	Rate	Headcount	Rate	Headcount
	(GDP pc)	(US\$1.25)	(GDP pc)	(US\$2.00)
Growth	-	0.103	-	0.054
Rate ¹	-	[0.051]**	-	[0.029]*
Lagged GDP per capita (level)¹	-8.479	-	-9.534	-
	[1.548]***	-	[1.657]***	-
Investment/GDP	0.312	-0.069	0.364	-0.048
	[0.063]***	[0.022]***	[0.065]***	[0.014]***
Fin dev / GDP ¹	5.654	-1.361	5.699	-0.504
	[2.170]**	[0.608]**	[2.376]**	[0.394]
Remittance/GDP¹	2.511	-0.362	2.519	-0.207
	[0.481]***	[0.143]**	[0.527]***	[0.089]**
Trade	0.048	-0.0162	0.0537	-0.008
	[0.023]**	[0.006]**	[0.026]	[0.004]**
Observations	101	101	103	103
Specification tests				
Overidentification	0.000		0.000	
Underidentification	0.000		0.000	
<i>F</i> -statistic (weak identification test)	30.010		33.111	

Notes: Robust standard errors in brackets. ***, ** and * indicate significance at 1, 5 and 10% levels, respectively.

¹ Variables are in log form.

Tables 4a, 4b and 4c give the FE-2SLS results for poverty (Table 4a is for lagged agricultural growth per worker, 4b for lagged agricultural value added (in level) per worker and 4c for lagged GDP per capita). The first two columns of each table show the results for poverty headcount based on US\$1.25 and the second two columns on US\$2. Both cases, however, yield broadly similar results. The results of the first stage equation for growth rate are largely the same as those in Table 1. There is a striking difference in the effect of agricultural production on growth depending on whether we use the level or growth. In Table 4a, we observe a strong and statistically highly significant effect of lagged agricultural growth on economic growth

(consistent with a key role of agricultural sector as an engine of economic growth). However, in Table 4b, the coefficient estimate of the level of agricultural value added per worker becomes negative and statistically significant. This presumably reflects the convergence effect of agricultural production, that is, a country with *low* initial agricultural production tends to have a higher growth than those with high initial production. If we replace lagged agricultural value added per worker by lagged GDP per capita in Table 4c, another and more conventional specification to check for growth convergence, we find a similar pattern of results. The results of other variables are the same as before – investment, financial development, and remittances have positive and significant coefficients. However, trade openness is positive but non-significant.

In the second stage, the share of remittances in GDP is negatively associated with poverty in Tables 4b and 4c. It follows that remittances not only promote economic growth, as evidenced by the results in Tables 1, 2, 4a, and 4b, but also reduce poverty (on the two criteria of US\$1.25 and US\$2). The underidentification test suggests that the equations are not underidentified, i.e., the instruments are relevant and correlated with the endogenous variable. However, in Table 4a, the coefficient estimate of remittances is negative and not significant in the second stage of poverty equation. Simulation requires significant coefficient estimates and thus we will use Table 4b for poverty simulations.

Table 5: Magnitude of the effect of remittances on poverty

Case (1) Headcount Ratio based on US\$1.25\$												
	$\frac{\partial \log \text{gdp pc}}{\partial \log \text{remittances}}$	$\frac{\partial \log \text{poverty}}{\partial \log \text{gdp pc growth}}$	indirect effect	+	direct effect	=	$\frac{\partial \log \text{gdp pc}}{\partial \log \text{remittances}}$					
	0.309 *	0.198	0.061		(-0.500)		-0.439					
10.0	% increase in remittance ratio		→	4.4	% reduction of poverty head count ratio (\$1.25 a day)							
20.0	% increase in remittance ratio		→	8.8	% reduction of poverty head count ratio (\$1.25 a day)							
50.0	% increase in remittance ratio		→	22.0	% reduction of poverty head count ratio (\$1.25 a day)							
Case (2) Headcount Ratio based on US\$2												
	$\frac{\partial \log \text{gdp pc}}{\partial \log \text{remittances}}$	$\frac{\partial \log \text{poverty}}{\partial \log \text{gdp pc growth}}$	indirect effect	+	direct effect	=	$\frac{\partial \log \text{gdp pc}}{\partial \log \text{remittances}}$					
	0.361 *	0.110	0.040		(-0.280)		-0.240					
10.0	% increase in remittance ratio		→	2.4	% reduction of poverty head count ratio (\$2 a day)							
20.0	% increase in remittance ratio		→	4.8	% reduction of poverty head count ratio (\$2 a day)							
50.0	% increase in remittance ratio		→	12.0	% reduction of poverty head count ratio (\$2 a day)							
Summary of Remittance and Growth Effects												
	% Change in Remittance Ratio (% in GDP)			% Change in Growth Rate per capita			% Change in Poverty Headcount Ratio US\$1.25 a day		% Change in Poverty Headcount Ratio US\$1.25 a day			
	Remittance Ratio (% in GDP)	Growth Rate		Poverty Headcount Ratio	Poverty Headcount Ratio							
Bangladesh	2009	11.78	%	2009	4.30	%	2005	49.60	%	2005	81.30	%
	10% increase	12.96	%	10% increase	4.43	%	10% increase	47.42	%	10% increase	79.35	%
	20% increase	14.14	%	20% increase	4.57	%	20% increase	45.24	%	20% increase	77.40	%
	50% increase	17.67	%	50% increase	4.97	%	50% increase	38.69	%	50% increase	71.54	%
China	2009	0.98	%	2009	8.54	%	2005	15.90	%	2005	36.30	%
	10% increase	1.08	%	10% increase	8.80	%	10% increase	15.20	%	10% increase	35.43	%
	20% increase	1.18	%	20% increase	9.07	%	20% increase	14.50	%	20% increase	34.56	%
	50% increase	1.47	%	50% increase	9.86	%	50% increase	12.40	%	50% increase	31.94	%
India	2009	3.59	%	2009	7.65	%	2005	41.60	%	2005	75.60	%
	10% increase	3.95	%	10% increase	7.89	%	10% increase	39.77	%	10% increase	73.79	%
	20% increase	4.31	%	20% increase	8.12	%	20% increase	37.94	%	20% increase	71.97	%
	50% increase	5.39	%	50% increase	8.84	%	50% increase	32.45	%	50% increase	66.53	%
Indonesia	2009	1.26	%	2009	3.35	%	2005	18.70	%	2005	50.60	%
	10% increase	1.39	%	10% increase	3.45	%	10% increase	17.88	%	10% increase	49.39	%
	20% increase	1.51	%	20% increase	3.56	%	20% increase	17.05	%	20% increase	48.17	%

		50% increase	1.89	%	50% increase	3.87	%	50% increase	14.59	%	50% increase	44.53	%
Kazakhstan	2008	2.05		%	2008	0.14	%	2007	0.17	%	2005	1.48	%
	10% increase	2.26		%	10% increase	0.14	%	10% increase	0.16	%	10% increase	1.44	%
	20% increase	2.46		%	20% increase	0.15	%	20% increase	0.16	%	20% increase	1.41	%
	50% increase	3.08		%	50% increase	0.16	%	50% increase	0.13	%	50% increase	1.30	%
Lao PDR	2009	0.63		%	2009	4.49	%	2005	33.90	%	2005	66.00	%
	10% increase	0.69		%	10% increase	4.63	%	10% increase	32.41	%	10% increase	64.42	%
	20% increase	0.76		%	20% increase	4.77	%	20% increase	30.92	%	20% increase	62.83	%
	50% increase	0.95		%	50% increase	5.19	%	50% increase	26.44	%	50% increase	58.08	%
Nepal	2009	23.83		%	2009	2.80	%	2004	55.10	%	2005	77.60	%
	10% increase	26.21		%	10% increase	2.89	%	10% increase	52.68	%	10% increase	75.74	%
	20% increase	28.60		%	20% increase	2.97	%	20% increase	50.25	%	20% increase	73.88	%
	50% increase	35.75		%	50% increase	3.23	%	50% increase	42.98	%	50% increase	68.29	%
Philippines	2008	11.19		%	2008	1.86	%	2006	22.60	%	2006	45.00	%
	10% increase	12.31		%	10% increase	1.92	%	10% increase	21.61	%	10% increase	43.92	%
	20% increase	13.43		%	20% increase	1.98	%	20% increase	20.61	%	20% increase	42.84	%
	50% increase	16.79		%	50% increase	2.15	%	50% increase	17.63	%	50% increase	39.60	%
Sri Lanka	2009	8.01		%	2009	2.79	%	2007	7.04	%	2005	29.10	%
	10% increase	8.81		%	10% increase	2.88	%	10% increase	6.73	%	10% increase	28.40	%
	20% increase	9.61		%	20% increase	2.96	%	20% increase	6.42	%	20% increase	27.70	%
	50% increase	12.02		%	50% increase	3.22	%	50% increase	5.49	%	50% increase	25.61	%

As both dependent and explanatory variables are in logarithms, the coefficient estimates in Table 4b are the elasticities. Table 5 discusses in detail the magnitude of the effects of remittances on poverty. In the case of headcount ratio (US\$1.25), the indirect effect of remittances on poverty (0.061) is obtained by multiplying 0.309 (the elasticity of economic growth with respect to remittances) and 0.198 (the elasticity of poverty with respect to economic growth) assuming that other factors are unchanged. With regard to the direct effect, the elasticity of poverty with respect to remittances is -0.500. This is much larger than the indirect effect in absolute term and the total effect is -0.439. This implies that a 1% increase in the share of remittances in GDP (e.g. 10% to 10.1%) leads to a 0.439% decrease in the headcount ratio (from 10% to 9.956%) *ceteris paribus*. Likewise, in the case of the US\$2 poverty, the indirect effect of remittance is obtained as 0.040 and the direct effect is -0.280, leading to the total effect of -0.240 *ceteris paribus*.

We have estimated the change in the poverty headcount ratio for 10 selected countries using these elasticity estimates. Three cases have illustrative value – a 10%, 20%, or 50% increase in the current remittance ratio and their poverty effects. For example, in Bangladesh, a 50% increase of the share of remittances in GDP (from 11.78% to 17.67%) would increase GDP per capita growth rate from 4.30% to 4.97% and reduce the poverty headcount (on US\$1.25 a day) from 49.60% to 38.69% and that on the higher cut-off (US\$2.00 a day) from 81.30% to 71.54%. These results imply that remittances reduce poverty significantly, especially extreme poverty.

A few other cases further corroborate these results. In India, a 50% increase in the share of remittances in GDP (3.59% to 5.39%) accelerates economic growth (from 7.65% to 8.84%) and reduces the US\$1.25 poverty from 41.6% to 32.45%, and the US\$2 poverty from 75.60% to 66.53%. Again, a potential reduction in poverty arising from increased remittances is substantial. Similar results are obtained for Nepal, the Philippines and Sri Lanka. In Nepal, where the remittance share has increased significantly in recent years (Appendix 5⁹), a 50% increase in it-a rise in the share from 23.83% to 35.75%- leads to a substantial poverty reduction from 55.10% to 42.98% (US\$1.25 a day) and from 77.60% to 68.29% (US\$2.00 a day). If Sri Lanka sees a rise in the share of remittance from 8.01% to 12.02% (i.e by 50%), the headcount ratio (on US\$2.00) will reduce from 29.1% to 25.61%. These results will have to be interpreted with caution as the same elasticity estimates are applied to all countries in the sample. However, it would be safe to conclude that increase in remittances not only promote economic growth but also reduce poverty.

6. Conclusions and policy implications

The present study re-examined the effects of remittances on growth of GDP per capita using annual panel data for 24 Asia and Pacific countries. The results generally confirm that remittances flows have been beneficial to economic growth. This is important as remittances are instrumented by their own lag and the income gap between each country and the US. However, the paper also presents some new evidence that the volatility of some capital inflows such as remittance and FDI is harmful to economic growth. This means that, while remittances

⁹ Appendices 4, 5 and 6 plot time trends of key variables, namely, remittances, poverty headcount ratio and GDP per capita growth for each country.

contribute to better economic performance, they are also a source of output shocks. Finally, remittances contribute to poverty reduction – especially through their direct effects. This result is robust for both measures of poverty, estimated using the cut-off points of \$1.25 per capita/day and \$2 per capita/day.

A few developing countries-including India- have raised substantial amounts of development financing by issuing diaspora bonds. These bonds represent a stable and cheap source of external finance, especially in times of financial stress. They have several advantages, both for the issuer and the emigrant buyers: though retailing at small denominations, issuers can tap into the wealth of relatively poor migrants (though not limited to migrants). Migrants tend to be more loyal than the average investor in times of stress.

Migration and remittances are thus potentially a valuable complement to broad-based development efforts. Yet migration and remittances should not be seen as a substitute for aid, as private money cannot be expected to contribute towards public projects. Also, not all poor households receive remittances, and public funds are meant to alleviate poverty. So policy priorities include: harnessing of development potential of migration and remittances by increasing awareness of decision-makers and through better data on remittances; facilitating labour mobility and recruitment across borders while allowing for safe and efficient means of transferring money; measures encouraging use of remittances in physical and human capital investments; and combating xenophobic responses to migration towards greater benefits to both sending and receiving countries.

In conclusion, while there are valid reasons why migration and remittances may not have the desired impact on poverty and development- lowering of work effort and growth, brain drain and the Dutch disease of exchange rate appreciation, lowering of exports and consequently lowering of growth-.our analysis points to their substantial potential for enhancing welfare.

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Appendices

Appendix 1. List of countries

1. Armenia	2. Iran	3. Nepal
4. Azerbaijan	5. Kazakhstan	6. Pakistan
7. Bangladesh	8. Korea, Rep.	9. Papua New Guinea
10. Cambodia	11. Kyrgyz Republic	12. Philippines
13. China	14. Lao PDR	15. Sri Lanka
16. Fiji	17. Malaysia	18. Thailand
19. India	20. Maldives	21. Tonga
22. Indonesia	23. Mongolia	24. Vanuatu

Appendix 2. List of Variables

Variable	Source
Growth	Real per capita growth (WDI, 2010)
Lagged GDP	Lagged real per capita income (WDI, 2011 April) expressed in log form
Remittance	Workers' remittances and compensation of employees, received (% of GDP) [WDI, 2011 April] expressed in log-form.
Financial development	Captured by deposit money bank assets / (deposit money + central) bank assets [Beck and Demirgüç-Kunt, 2009] expressed in log-form
Investment	Gross capital formation (% of GDP) [WDI, 2011 April] expressed in log-form.
Inflation	Measured by CPI (annual %) [WDI, 2011 April]
Resource abundance	Proxied by fuel exports (% of Merchandise Exports) [Quality of government dataset, 2011 April]
Capital account openness	A measure of a country's degree of capital account openness based on the existence of multiple exchange rates, current account and capital account transaction restrictions [Chinn and Ito, 2008]
Civil war	Internal armed conflicts [UCDP/PRIO Conflict Database, 2009]
Trade	Exports plus imports (% of GDP) [WDI, 2011 April] expressed in log-form
Property rights protection	A measure of property rights protection or institutional quality: measured by 'constraint on the executive' from the Polity IV dataset. A 7-point scale where higher values imply strong property rights (Marshall et al., 2009).
Regime durability	The number of years since the most recent regime change [Quality of Government dataset, 2011]
FDI	Foreign direct investment (% of GDP) [WDI, 2011 April]
Government size	General government final consumption expenditure (% of GDP) [WDI, 2011 April]
Aid	Oversees development aid (% of GNP) [WDI, 2011 April]

Appendix 3. Details of Specification Tests used in Tables 1 and 2.

*Table 1 column 3-4

Underidentification test (Kleibergen-Paap rk LM statistic):	53.209
Chi-sq(2) P-val =	0.0000

Weak identification test (Cragg-Donald Wald F statistic):	49.110
(Kleibergen-Paap rk Wald F statistic):	24.270
Stock-Yogo weak ID test critical values:	<not available>

Hansen J statistic (overidentification test of all instruments):	1.302
Chi-sq(1) P-val =	0.2539

*Table 1 column 7-8

Underidentification test (Kleibergen-Paap rk LM statistic):	62.460
Chi-sq(2) P-val =	0.0000

Weak identification test (Cragg-Donald Wald F statistic):	36.565
(Kleibergen-Paap rk Wald F statistic):	19.820
Stock-Yogo weak ID test critical values:	<not available>

Hansen J statistic (overidentification test of all instruments):	0.029
Chi-sq(1) P-val =	0.8656

*Table 2 column 1-2

Underidentification test (Kleibergen-Paap rk LM statistic):	57.994
Chi-sq(2) P-val =	0.0000

Weak identification test (Cragg-Donald Wald F statistic):	31.705
(Kleibergen-Paap rk Wald F statistic):	25.600
Stock-Yogo weak ID test critical values:	<not available>

Hansen J statistic (overidentification test of all instruments):	0.194
Chi-sq(1) P-val =	0.6597

*Table 2 column 3-4

Underidentification test (Kleibergen-Paap rk LM statistic):	54.165
Chi-sq(2) P-val =	0.0000

Weak identification test (Cragg-Donald Wald F statistic):	29.889
(Kleibergen-Paap rk Wald F statistic):	29.847
Stock-Yogo weak ID test critical values:	<not available>

Hansen J statistic (overidentification test of all instruments):	0.290
Chi-sq(1) P-val =	0.5905

***Table 2 column 5-6**

Underidentification test (Kleibergen-Paap rk LM statistic): 52.331
Chi-sq(2) P-val = 0.0000

Weak identification test (Cragg-Donald Wald F statistic): 29.980
(Kleibergen-Paap rk Wald F statistic): 29.460
Stock-Yogo weak ID test critical values: <not available>

Hansen J statistic (overidentification test of all instruments): 0.326
Chi-sq(1) P-val = 0.5680

***Table 2 column 7-8**

Underidentification test (Kleibergen-Paap rk LM statistic): 59.028
Chi-sq(2) P-val = 0.0000

Weak identification test (Cragg-Donald Wald F statistic): 30.864
(Kleibergen-Paap rk Wald F statistic): 22.521
Stock-Yogo weak ID test critical values: <not available>

Hansen J statistic (overidentification test of all instruments): 0.022
Chi-sq(1) P-val = 0.8817

***Table 2 column 9-10**

Underidentification test (Kleibergen-Paap rk LM statistic): 55.918
Chi-sq(2) P-val = 0.0000

Weak identification test (Cragg-Donald Wald F statistic): 30.855
(Kleibergen-Paap rk Wald F statistic): 25.743
Stock-Yogo weak ID test critical values: <not available>

Hansen J statistic (overidentification test of all instruments): 0.079
Chi-sq(1) P-val = 0.7788

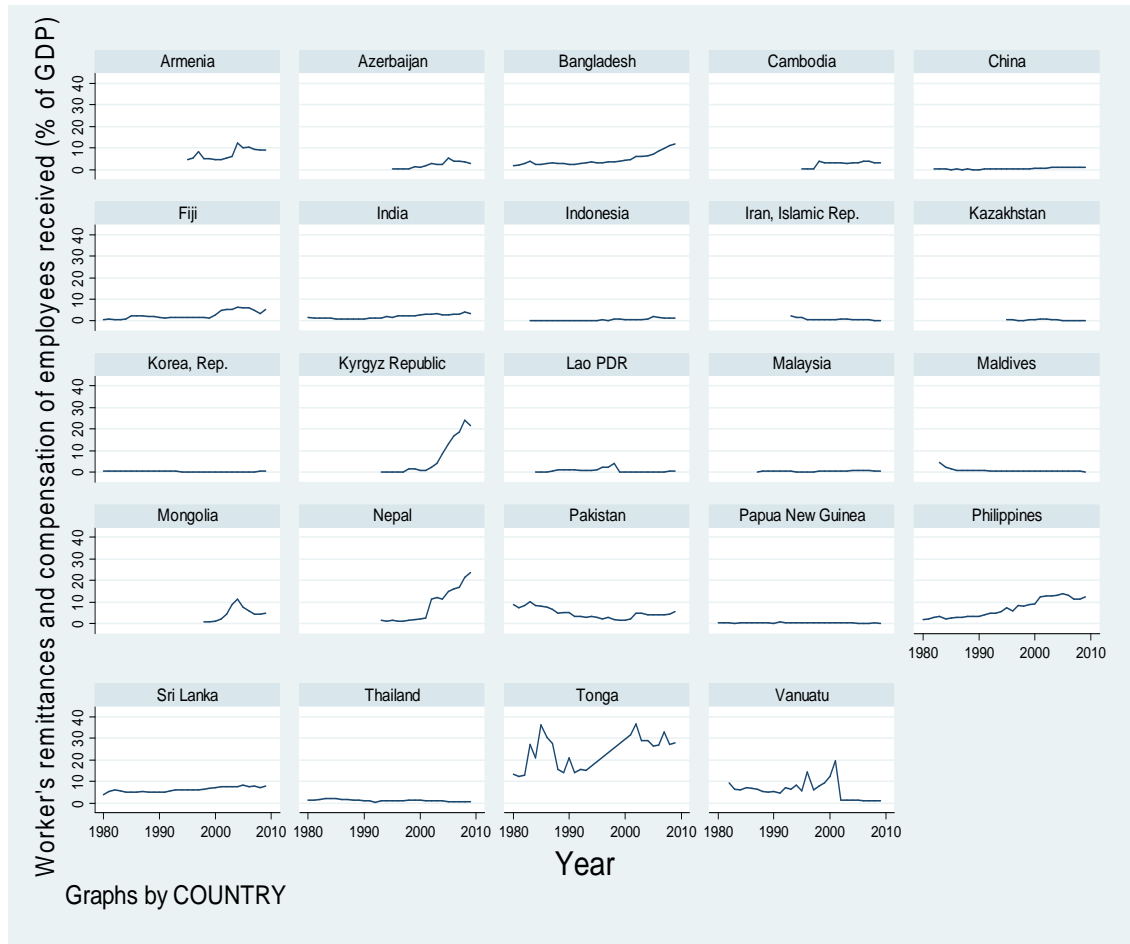
***Table 2 column 11-12**

Underidentification test (Kleibergen-Paap rk LM statistic): 28.074
Chi-sq(2) P-val = 0.0000

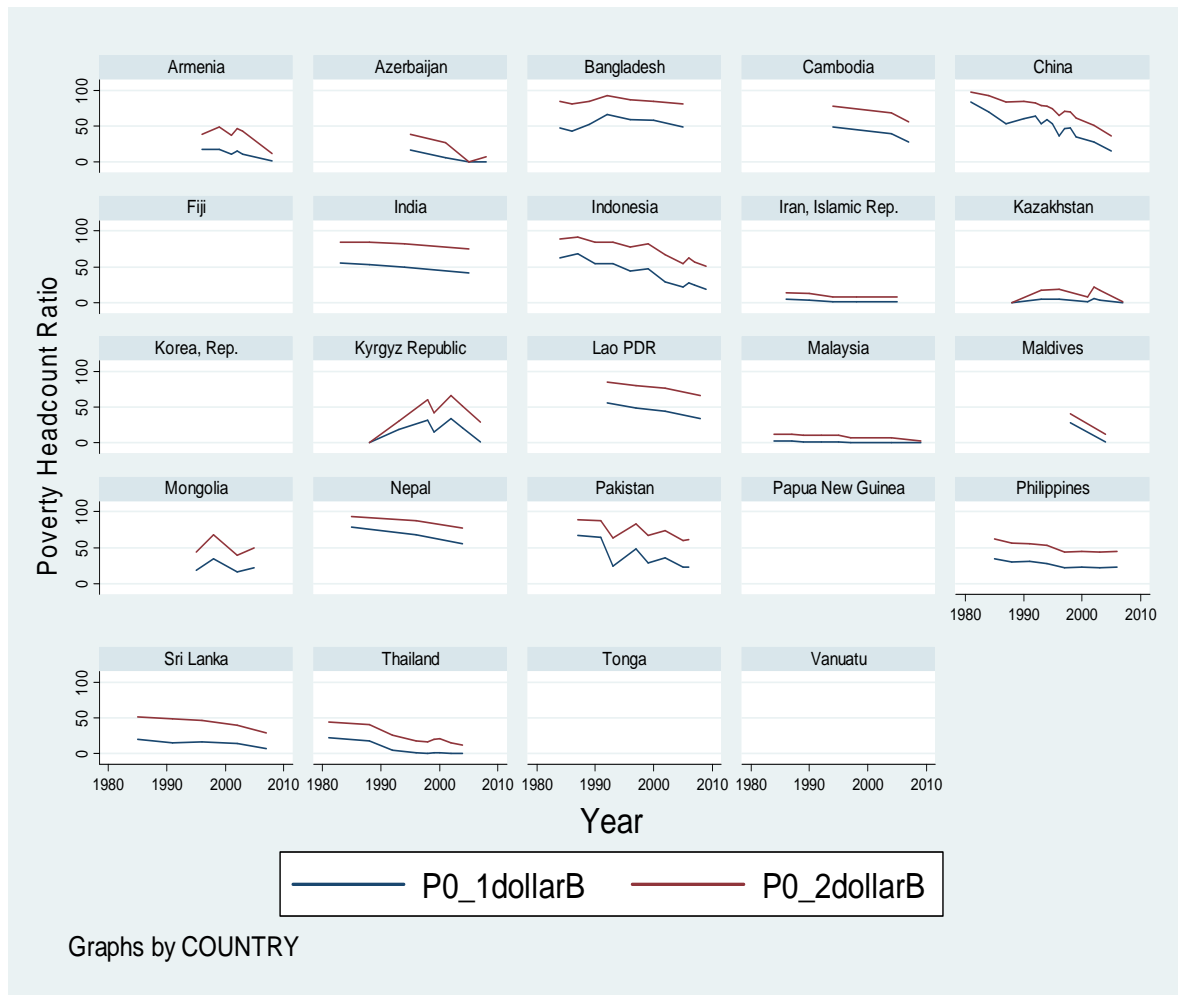
Weak identification test (Cragg-Donald Wald F statistic): 15.271
(Kleibergen-Paap rk Wald F statistic): 7.927
Stock-Yogo weak ID test critical values: <not available>

Hansen J statistic (overidentification test of all instruments): 0.181
Chi-sq(1) P-val = 0.6707

Appendix 4. Trends of share of remittances in GDP, by country



Appendix 5. Trends of share of poverty headcount ratios, by country



Appendix 6. Trends of GDP per capita growth, by country

