International Political Economy (SOCS-SHU 222)

THE IPE OF REMITTANCES

Instructor: JING QIAN

Free Capital Flow

**"Trilemma":
a country can only have
2 out of 3 of these**

Fixed Exchange Rate   **Sovereign Monetary Policy**
Remittances

The IPE of Remittances

READING ASSIGNMENT:

Singer, David Andrew. 2010. Migrant Remittances and Exchange Rate Regimes in the Developing World. *American Political Science Review* 104 (2): 307-323.

Migrant Remittances and Exchange Rate Regimes in the Developing World

DAVID ANDREW SINGER   *Massachusetts Institute of Technology*

*T*his article argues that the international financial consequences of immigration exert a substantial influence on the choice of exchange rate regimes in the developing world. Over the past two decades, migrant remittances have emerged as a significant source of external finance for developing countries, often exceeding conventional sources of capital such as foreign direct investment and bank lending. Remittances are unlike nearly all other capital flows in that they are stable and move countercyclically relative to the recipient country's economy. As a result, they mitigate the costs of forgone domestic monetary policy autonomy and also serve as an international risk-sharing mechanism for developing countries. The observable implication of these arguments is that remittances increase the likelihood that policy makers adopt fixed exchange rates. An analysis of data on de facto exchange rate regimes and a newly available data set on remittances for up to 74 developing countries from 1982 to 2006 provides strong support for these arguments. The results are robust to instrumental variable analysis and the inclusion of multiple economic and political variables.*

Previously in class

- Who is against immigration?

- Answer:
  - People who face job competition from immigrants
  - The scarce factor of production
  - (Also: cultural values matter)
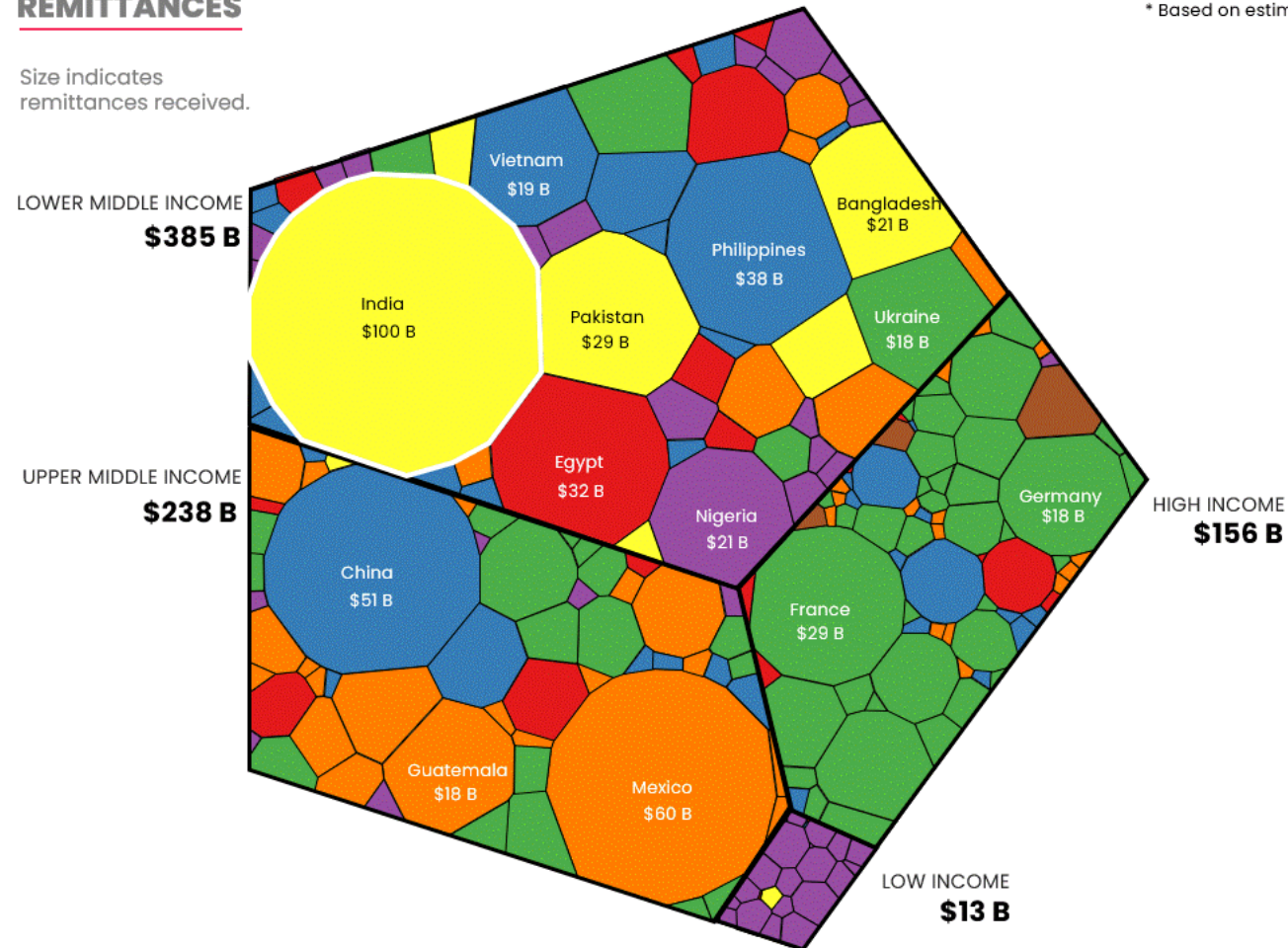- This class: Why are the immigrants here?

Remittances!

- A lifeline for poor countries
- A sizeable share of GDP

- >25% of GDP for:
  - Tonga, Tajikistan, Lebanon, Samoa, Nicaragua, Honduras, Nepal, etc.

- >5% of GDP for 60 countries in 2022.

- Global flows: $794 billion in 2022
- > other important external financial sources (ODA, bank lending, private investment)

Countries received transfers worth $794 Billion* in 2022 from citizens working abroad.

REMITTANCES

Size indicates remittances received.

LOWER MIDDLE INCOME
$385 B

UPPER MIDDLE INCOME
$238 B

HIGH INCOME
$156 B

LOW INCOME
$13 B

Vietnam $19 B

Bangladesh $21 B

Philippines $38 B

India $100 B

Pakistan $29 B

Ukraine $18 B

Egypt $32 B

Nigeria $21 B

Germany $18 B

China $51 B

France $29 B

Guatemala $18 B

Mexico $60 B

Legend:
- ● South Asia
- ● East Asia & Pacific
- ● Europe & Central Asia
- ● Sub-Saharan Africa
- ● Middle East & North Africa
- ● Latin America & Caribbean
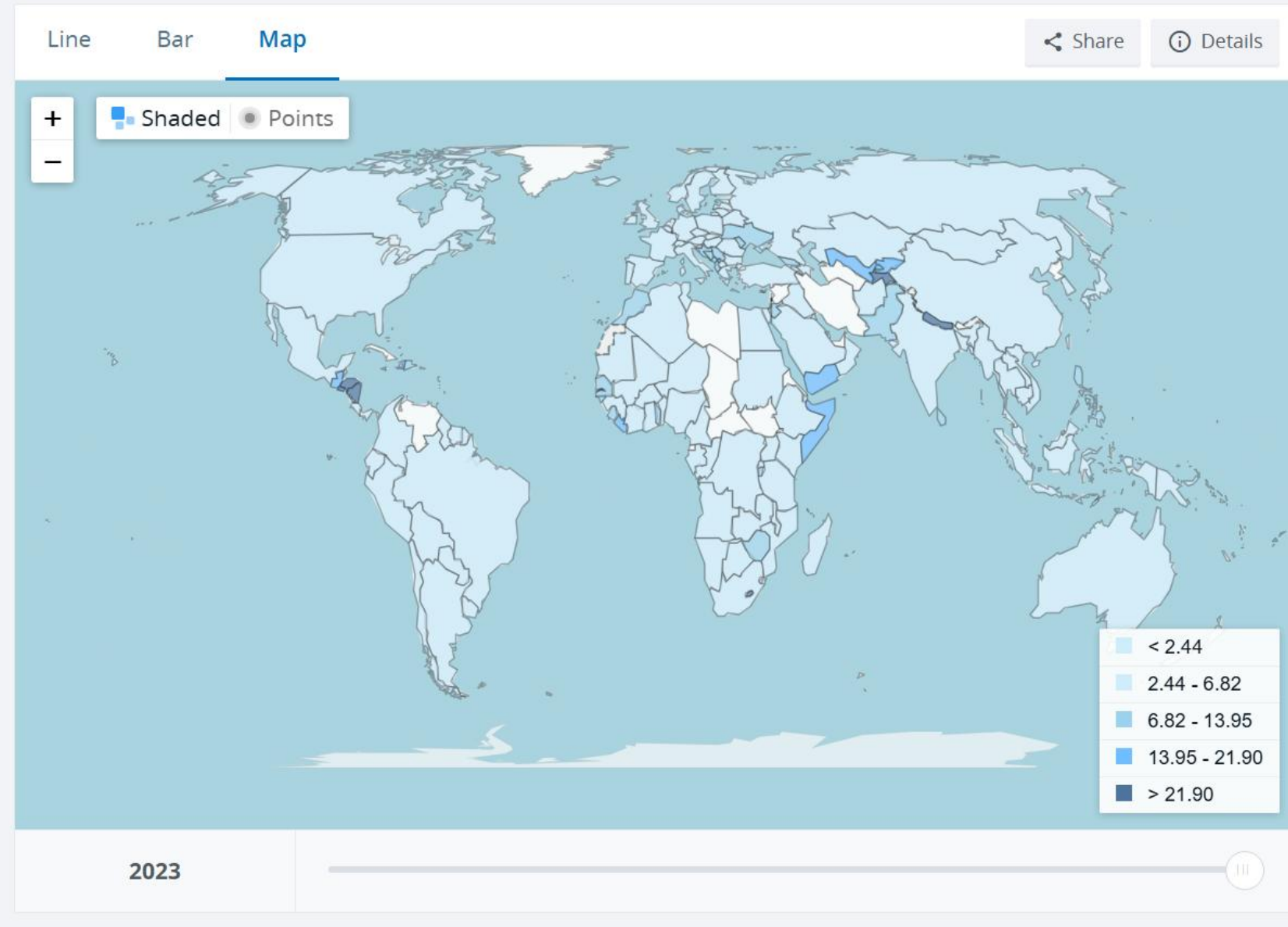- ● North America

https://www.weforum.org/stories/2023/01/chart-remittance-flows-impact-gdp-country/

Bezalel Data

Personal remittances, received (% of GDP)
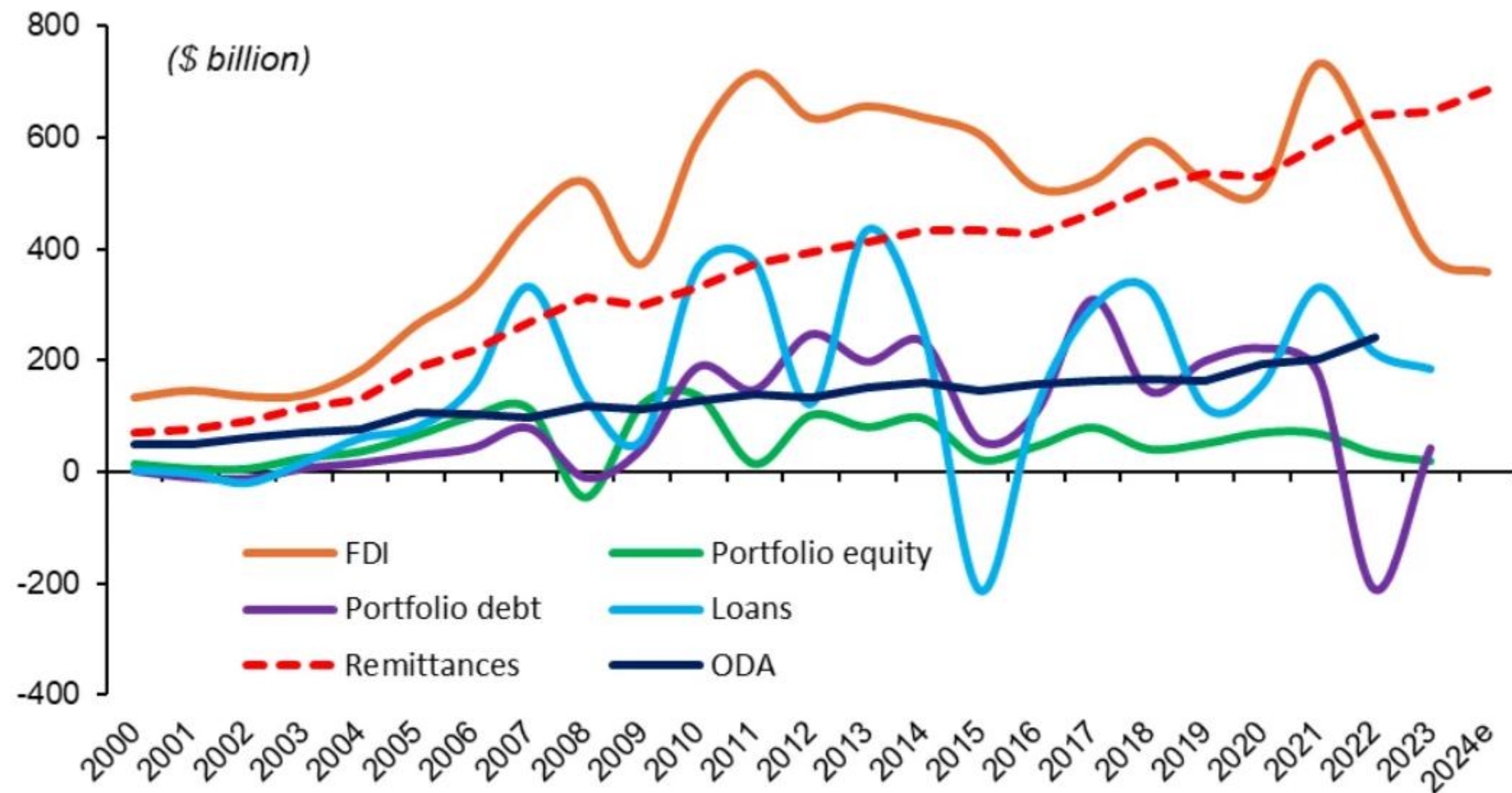
World Bank staff estimates based on IMF balance of payments data, and World Bank and OECD GDP estimates.

License : CC BY-4.0 ⓘ

| Line | Bar | **Map** | | ⟨ Share | ⓘ Details |

Shaded ● Points

Legend:
- < 2.44
- 2.44 - 6.82
- 6.82 - 13.95
- 13.95 - 21.90
- > 21.90

2023

Figure 5. Remittances continued to outpace FDI and ODA combined

Source: Authors' estimates, World Development Indicators, IMF Balance of Payments Statistics

Note: FDI = foreign direct investment; ODA = official development assistance

Why Remittances?

- Unrequited
  - Don't have to pay them back
  - No obligations

- Cannot be withdrawn
  - No capital flight

- Most importantly for this lesson…
- …
- ***COUNTERCYCLICAL!!!***

Countercyclical

- When times are good back home, migrants send less money

- But when times are hard, migrants send more money

- Example: If a natural disaster hits, migrants send more money home in a hurry!

- *BUT – what if the value of what you send home keeps varying?*
  - *➔ uncertainty*

- Maybe migrants send less $$$ under uncertainty
  - (Maybe the value of what they send drops)

- Solution:
  - **FIXED EXCHANGE RATES (XR)**

Singer's Argument about how remittances mitigate the problem of the trilemma

- In an open-economy, fixed XR takes away monetary policy autonomy

- Without monetary policy autonomy, governments cannot take countercyclical measures against (alternatively)
  - unemployment
  - inflation

- But remittances flow counter-cyclically!

- Fixed XR help bring in remittances***

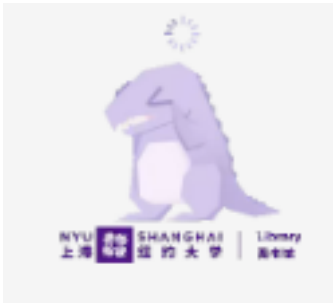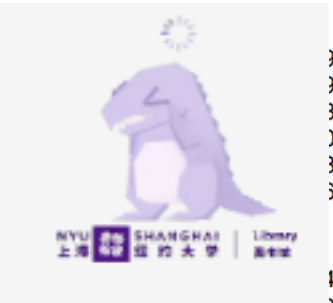- Remittances address cyclic problems of unemployment/inflation!

Test the Argument!

TABLE 2.   Ordered Probit Results (de facto and de jure Exchange Rate Regimes)

	Model 1 (de facto)	Model 2 (de facto)	Model 3 (de jure)
Lagged dependent variable	1.524***	1.415***	1.331***
	(0.149)	(0.151)	(0.106)
Remittances/GDP (lagged)	−0.025*	−0.034**	−0.040***
	(0.013)	(0.015)	(0.015)
GDP (log)	−0.017	0.054	−0.016
	(0.046)	(0.063)	(0.052)
GDP per capita (log)	0.047	0.094	−0.048
	(0.083)	(0.105)	(0.079)
Exports/GDP (lagged)	−0.005	−0.001	−0.011***
	(0.005)	(0.006)	(0.003)
Capital account	−0.063	−0.097*	0.002
	(0.045)	(0.052)	(0.042)
Reserves (in m...)	−0.020	−0.045**	−0.057**
	(0.021)	(0.019)	
Democracy (po...)	0.021**	0.028**	
	(0.010)	(0.012)	
Inflation (lagged)	−0.004***	−0.003***	
	(0.001)	(0.001)	
Current account	0.006	0.012	
	(0.011)	(0.014)	
EU (dummy)	0.361	0.253	
	(0.298)	(0.295)	
Terms of trade volatility	0.009	−0.007	
	(0.008)	(0.009)	
Political constraints		−0.369	0.152
		(0.309)	(0.392)
Political instability		1.232	0.671
		(1.040)	(0.751)
Manufacturing/GDP		−0.037***	−0.011
		(0.014)	(0.010)
Percent fix (de jure only)			−0.014***
			(0.005)
Cut 1		...3	0.134
		(...1)	(1.046)
Cut 2		...1	0.337
		(...4)	(1.051)
Cut 3		...1	2.622
		(...9)	(1.065)
Observations			899
Countries			74
Pseudo R^2		...1	0.500
Prob $> \chi^2$	0.00	0.00	0.00

Note: Ordered probit coefficients; standard errors (clustered on country) in parentheses.
*$p \leq .10$; **$p \leq .05$; ***$p \leq .01$.

A simple 5-step guide to
How to read basic "regression" results

1. What is the analysis "explaining"?
   Dependent variable, usually in the title of the table

2. What is the unit of analysis?
   How many observations… of what? ("country-years", "countries", "individuals", …)

3. What are the independent variables of interest?
   Main independent variable(s), Control variables

4. What is the effect of each independent (explanatory) variable?
   Just ask: Is the "coefficient" positive/negative?

5. Are the effects statistically significant?

   a. Star-gazing *, **, ***

   b. Is the standard error <1/2 the size of the coefficient?

   c. OR: is the t-stat/z-stat >1.96?

   d. OR: is the p-value<0.05?

Step 1: Dependent Variable

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	(0.083)	(0.105)	(0.079)
Exports/GDP (lagged)	−0.005	−0.001	−0.011***
	(0.005)	(0.006)	(0.003)
Capital account openness (KAOPEN)	−0.063	−0.097*	0.002
	(0.045)	(0.052)	(0.042)

P316: Recall that lower values of the dependent variable imply greater degrees of exchange rate fixity.

Step 2: Unit of Analysis

How many observations… of what? ("country-years", "countries", "individuals", …)

Observations	992	824	899
Countries	73	70	74
Pseudo R^2	0.452	0.441	0.500
Prob $> \chi^2$	0.00	0.00	0.00

Note: Ordered probit coefficients; standard errors (clustered on country) in parentheses.
$^*p \leq .10$; $^{**}p \leq .05$; $^{***}p \leq .01$.

P314: I assembled a timeseries cross-sectional data set with annual observations on up to 74 developing countries from 1982 to 2006.

Step 3: Independent Variable of Interest

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Step 4: Effect/Coefficient

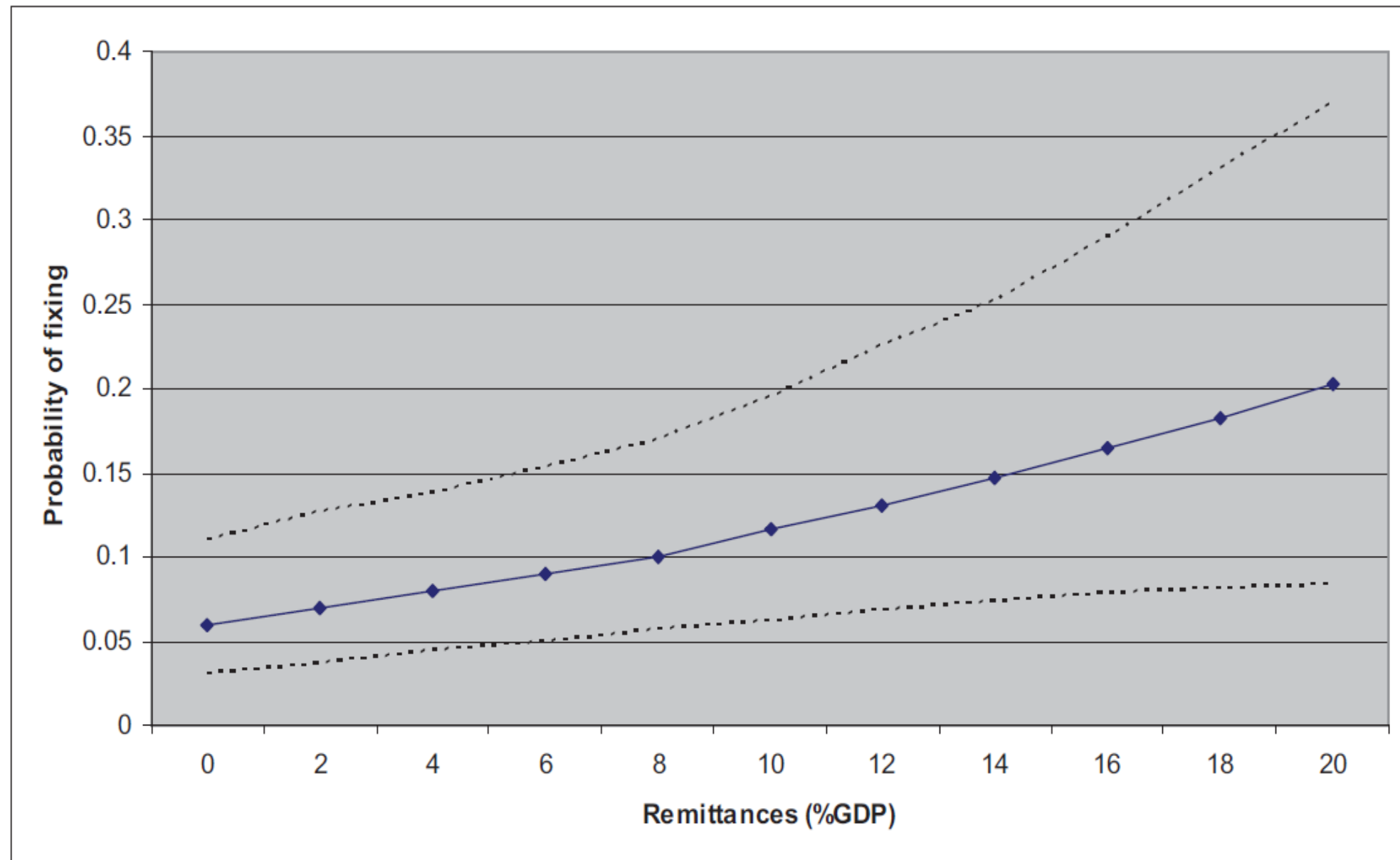**TABLE 2. Ordered Probit Results (de facto and de jure Exchange Rate Regimes)**

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Step 5: Statistical Significance

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FIGURE 4. Predicted Probability of Fixing the Exchange Rate by Level of Remittances

Note: Results based on Model 2. All other variables held at their means. Dotted lines represent 95 % confidence intervals. Simulations conducted using CLARIFY (Tomz, Wittenberg and King 2003).

Instrumental Variable Approach?

- What if people are more likely to send $$$ home if the XR is fixed?
- Argument is:
  - Remittances ➜ Fixed XR
- But it might really be:
  - Fixed XR ➜ Remittances
- Possible "endogeneity" !
- (Or mutual causation)
- To test this, we can perform a quasi-experiment
- Find something correlated with remittances, but not directly related with the XR
- E.g., Emigration rates
- Emigration ➜ Remittances
- But no direct relationship between emigration and XR
- (You could challenge this)
- So any relationship between emigration and XR captures the effect of remittances on XR, removing possible "endogeneity."

Take-away

- Why emigrate? Remittances

- Countercyclical

- Fixed Exchange Rate (Fixed XR) –vs- Floating XR

- How to read statistical results -- a cheat sheet

- *(Instrument / Instrumental Variable)*