

Vol. 10, 2016-4 | February 01, 2016 | <http://dx.doi.org/10.5018/economics-ejournal.ja.2016-4>

Do Transfer Costs Matter for Foreign Remittances? A Gravity Model Approach

Junaid Ahmed and Inmaculada Martínez-Zarzoso

Abstract

Using bilateral data on remittance flows to Pakistan for 23 major host countries, this is the first study that examines the effect of transaction costs on foreign remittances. The authors find that the effect of transaction costs on remittance flows is negative and significant; suggesting that a high cost will either refrain migrants from sending money back home or make them remit through informal channels. They also find that remittances are facilitated by the existence of migrant networks and improvements in home and host country financial services. Distance, which has been used in previous studies as an indicator of the cost of remitting, is found to be a poor proxy.

JEL F22 F30 O11

Keywords Remittances; geographical distance; transaction cost; financial services; Pakistan

Authors

Junaid Ahmed, ✉ Department of Economics, Georg August University Göttingen, Germany and Faculty of Management and Social Sciences, Capital University of Science and Technology Islamabad, Pakistan, junaid.ahmed@wiwi.uni-goettingen.de

Inmaculada Martínez-Zarzoso, Department of Economics, University of Göttingen, Germany, and Institute of International Economics, Universitat Jaume I, Castellón, Spain

Citation Junaid Ahmed and Inmaculada Martínez-Zarzoso (2016). Do Transfer Costs Matter for Foreign Remittances? A Gravity Model Approach. *Economics: The Open-Access, Open-Assessment E-Journal*, 10 (2016-4): 1–36. <http://dx.doi.org/10.5018/economics-ejournal.ja.2016-4>

Received January 30, 2015 Published as Economics Discussion Paper February 20, 2015

Revised December 31, 2015 Accepted January 7, 2016 Published February 1, 2016

© Author(s) 2016. Licensed under the [Creative Commons License - Attribution 3.0](https://creativecommons.org/licenses/by/3.0/)

1 Introduction

One of the principal factors that encourage migration across national boundaries is the difference in expected real earnings adjusted for migration cost (Borjas, 1999; Stark and Taylor, 1991). The costs incurred during the migration process are considered to increase with distance from the migrant sending to the migrant hosting country, and decrease as social networks in the hosting country grow (Ozden and Schiff, 2006). As migration is often thought to be a family decision (Borjas, 1999), the resulting remittances should be a central element of familial arrangements (Rapoport and Docquier, 2006). As a result, the physical distance between the migrant and the staying-behind household can affect remittance patterns (Rapoport and Docquier, 2006). There are different arguments related to the way in which distance influence remittances. Three of them indicate that remittances might decrease with distance. Firstly, remittances might be motivated by altruism, which could decrease if distance rises and associated contact falls. Secondly, migration to far-off countries might reinforce strategic behavior, since greater distance from the family may reduce the enforcement capability of any family arrangement agreed prior to migration. Thirdly, remittances may decrease with distance if the latter would be a good proxy for transfer costs (Lueth and Ruiz-Arranz, 2008; Frankel, 2011). At the other end of the spectrum, the loan repayment hypothesis supports the view that remittances may increase with distance (De Sousa and Duval, 2010). An increase in physical distance between migrant home and host countries can result in an increase in remittances in return for the high migration cost paid by the family (De Sousa and Duval, 2010). Clearly, these interpretations are conflicting. Some authors even argue that the cost of transferring money might be unrelated to geographic distance. Portes and Rey (2005) claim that financial assets are “weightless” and are therefore not subject to transportation costs. Remittances cost could also reflect technological developments and degree of competition in the financial-services industry. These factors reduce the cost of sending remittances through the formal financial sector (Freund and Spatafora, 2008) and are unrelated to distance. Furthermore, distance is time invariant and is therefore unable to pick up technological changes. Beck and Pería (2011) also illustrate that corridors with a larger number of migrants and higher competition exhibit consistently lower costs than others, indicating that migration networks could also influence the cost of remitting.

Remittances sent to developing countries via the official channel have increased more than tenfold over the last decade. The amount reached \$404 billion in 2013, growing by 3.5 percent compared with 2012 (World Bank, 2014a). This overwhelming growth in remittances is partly due to increase migrant stocks and rising remittances per immigrant. It may also be attributed to better recording of data as well as to a shift from informal to formal channels induced by falling cost of remitting money. However, the prevalence of informal transactions is still likely to be substantial. Freund and Spatafora (2008) argue that informal remittances amount to about 35–75 percent of recorded remittances to developing countries. This is due to lower transaction fees generally charged by informal channels.¹ Compliance with regulations to counter terrorism financing and anti-money laundering could be a major cost factor putting upward pressure on prices, thus leading sizeable flows to underground channels (World Bank, 2014a).

None of the abovementioned studies have investigated the cost of remitting as a factor influencing remittances flows. Hence, the effect of implementing policies in the receiving country to facilitate the transfers and lower the cost remains an empirical question. For this reason, the main aim of this paper is to provide an estimate of the effect of transaction costs on remittances and to evaluate the magnitude of this effect. At the conceptual level, the contribution is also the comparison of the effect of distance with the effect of remittance costs. At the empirical level, this is the first country-study of this kind for the South Asian region. Given that the region accounts for the highest share of world wide remittances, the results could be helpful in better understanding these remittance flows. More specifically, we estimate a gravity model using panel data for remittances from 23 sending countries² to Pakistan over the period from 2001 to 2013. The model is augmented with a new proxy for cost of remitting that, to the best of our knowledge, has never been used in previous studies. Moreover, we also include migration networks in the analysis as an important factor explaining the

¹ According to Sander (2004), in most cases the average cost of remitting is between 3 and 5 percent when using informal channel, whereas Orozco (2003) suggest that the costs is lower than 2 percent of the amount transferred when informal channels, such as *hawala* or *hundi*, are used.

² The countries considered include: Australia, Bahrain, Belgium, Canada, Denmark, France, Germany, Greece, Ireland, Italy, Japan, Kuwait, the Netherlands, Norway, Oman, Qatar, Saudi Arabia, Spain, Sweden, Switzerland, UAE, the UK, and the US.

variation of remittances over time. The cost of remitting has been constructed using the real cost of sending money for a number of countries (including a representative country in each regional area) for which the data are available for a period of 4 years. We have estimated a model of the determinants of the cost of remitting to extrapolate this information to our whole sample. The main variables used to predict the cost of remitting are proxies for the financial development in both home and host countries and migrant stocks. We focus on Pakistan because it is among the top ten remittance receiving countries in the world and relies heavily on international transfers. The development potential of these transfers is therefore of great importance.

The rest of the paper proceeds as follows. Section 2 presents Pakistan's migration and remittance main features. Section 3 discusses remittances cost. Section 4 reviews the literature, focusing particularly on bilateral remittance determinants. Section 5 employs a gravity model framework to examine the main determinants of remittance flows using bilateral data. Results are presented in Section 6. Section 7 concludes and outlines a number of policy implications.

2 Overview of bilateral migration and remittances to Pakistan

The first major wave of migration from Pakistan began in the 1970s when thousands of Pakistani workers left for the states of the Persian Gulf to participate in the development of the newly-rich oil economies. By 2013, about 5.7 million Pakistani immigrants were estimated to reside abroad, compared with 3.7 million in 2000 and 3.6 million in 1990³ (United Nations, 2014). This shows that 54 percent of this growth in migrants stock took place during the period 2000–2013. Factors driving this wave of migration include economic slowdown, increasing poverty, rapid population growth and substantial wage differentials (Ministry of Finance, 2013; Irfan, 1999).

Among the immigrants' destination countries, the Middle East is the most popular destination region accounting for more than half of Pakistani migrants,

³ This corresponds to around 2.2 percent of the country population in 2013 residing abroad compared to 2.9 percent in 2000 and 5.9 percent in 1990.

followed by North America, Europe, and Asia Pacific (UN, 2014). Saudi Arabia and the United Arab Emirates (UAE) host the largest Pakistani-migrant communities, possibly due to geographical proximity and cultural affinity. Moreover, the Gulf region also has attracted a large proportion of immigrants due to the availability of medium- and low-skilled jobs (Arif, 2009).

The United States (US), Canada, the United Kingdom (UK), Italy, and Spain are also countries with sizeable Pakistani overseas communities. At present, rapidly growing Southeast Asian economies, such as Malaysia and Singapore and also Australia, are attracting an increasing number of Pakistani workers (UN, 2014). The presence of such a significant number of immigrants has not only accelerated the integration of Pakistan into the world economy, but has also translated into a large flow of remittances back home. This flow plays an increasingly important role in easing difficulties facing the country's economy in terms of foreign exchange, balance of payments, and economic growth (State Bank of Pakistan, 2012).

For many developing countries facing a weak balance of payments situation such as Pakistan, remittances have emerged as a large source of foreign exchange earnings. The flows reached about \$14 billion in 2013, compared with \$1 billion in 2001 (see Table 1).

Similarly, this increase in remittances has outpaced that of net ODA and FDI, which accounted for only \$2.17 billion and \$1.31 billion in 2013 respectively (WDI, 2014). Likewise, compared to FDI and foreign aid, remittances tend to be resilient and increase during periods of economic turmoil (Ahmed and Martinez-Zarzoso, 2013; Mughal and Makhoulf, 2011).

Table 1 also indicates that Saudi Arabia, the USA, the UAE, and the UK represent Pakistan's main remittance sending countries. The Middle East region (Gulf Cooperation States) accounts for more than 60 percent of overall remittances, which are mainly sent from Saudi Arabia and the UAE. Overall, the share from major remittances corridors has increased over the period 2001–2013. Remittances per immigrant, however, portray a somewhat different picture, with higher amounts coming from developed nations such as the USA, Australia, and the UK.

Table 1. Remittance flows per immigrant by host country

Host Countries	Remittances by host country		Host' remittances over total remittances (percent)		Remittances per immigrant	
	<u>2001</u>	<u>2013</u>	<u>2001</u>	<u>2013</u>	<u>2001</u>	<u>2013</u>
GCC	693.22	8462.78	63.83	60.79	251.08	1354.61
-Bahrain	23.87	282.83	2.20	2.03	367.23	2405.61
-Kuwait	123.39	619.00	11.36	4.45	1142.50	3453.78
-Qatar	13.38	321.25	1.23	2.31	243.27	3209.20
-Saudi Arabia	304.43	4104.73	28.03	29.48	178.87	1214.14
-UAE	190.04	2750.17	17.50	19.75	307.01	1423.61
-Oman	38.11	384.80	3.51	2.76	179.76	715.39
North America	139.71	2363.59	12.86	16.98	474.70	4763.44
-Canada	4.90	177.19	0.45	1.27	61.78	1127.75
-USA	134.81	2186.40	12.41	15.70	627.02	6448.11
Europe	112.87	2371.59	10.39	17.04	235.02	3013.14
-Belgium	1.10	3.34	0.10	0.02	275.00	256.92
-Denmark	3.83	25.03	0.35	0.18	900.33	1973.04
-France	2.22	36.26	0.20	0.26	222.00	1842.85
-Germany	9.20	83.18	0.85	0.60	262.86	2122.59
-Greece	0.00	11.18	0.00	0.08	0.00	455.42
-Ireland	0.20	90.07	0.02	0.65	66.67	11982.17
-Italy	0.55	35.74	0.05	0.26	27.50	499.80
-Netherlands	3.60	5.45	0.33	0.04	327.27	459.22
-Norway	5.74	37.84	0.53	0.27	410.00	1861.84
-Spain	0.06	53.44	0.01	0.38	4.00	709.87
-Switzerland	4.24	30.37	0.39	0.22	1060.00	6927.46
-Sweden	0.74	13.68	0.07	0.10	246.67	1248.40
-UK	81.39	1946.01	7.49	13.98	229.92	4087.02

Table 1 continued

Table 1 continued

Host Countries	Remittances by host country		Host' remittances over total remittances (percent)		Remittances per immigrant	
	<u>2001</u>	<u>2013</u>	<u>2001</u>	<u>2013</u>	<u>2001</u>	<u>2013</u>
Asia Pacific	8.08	154.88	0.74	1.11	384.76	3511.22
-Japan	3.93	5.15	0.36	0.04	491.25	484.84
-Australia	4.15	149.73	0.38	1.08	319.23	4471.15
Other	132.69	568.88	12.22	4.09		
Total	1086.60	13921.70				

Notes: The figures in columns 1 and 2 are in current millions USD and in 5 and 6 in current USD. GCC denotes Gulf Cooperation Council states.

Source: State Bank of Pakistan and author's own calculations.

3 Cost of remitting to Pakistan

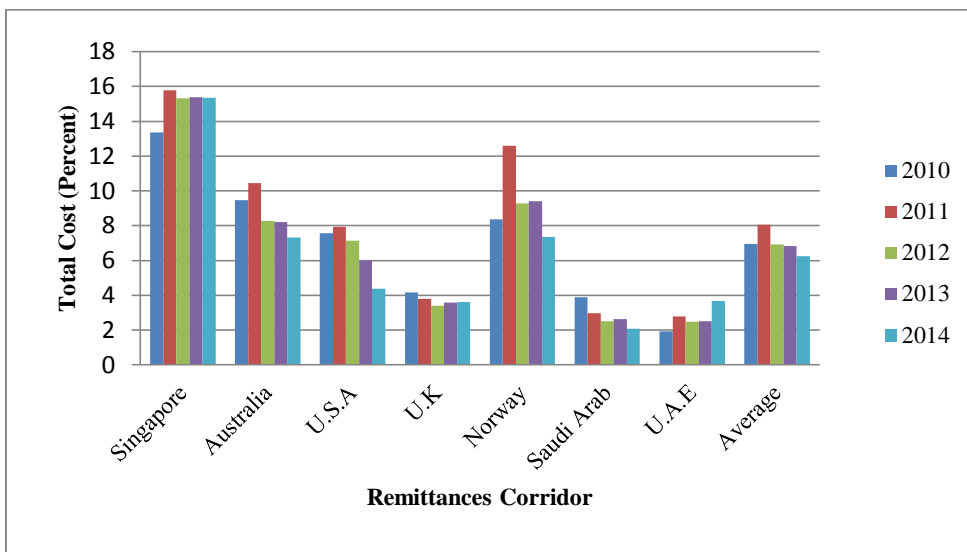
Pakistani migrants use various channels to send money from the host country to their families back home. These include banks, money transfer operators such as Western Union and Money Gram, family members, and friends as well as the so-called "hawala or hundi."⁴ Family, friends, and *hundi* are considered informal channels and are not recorded in the official statistics. In a study of remittances to Pakistan from Saudi Arabia, Arif (2009) points out that in 2009 about 38 percent of the remittances were transferred through the banking system, 28 percent through *hundi*, 17.9 through friends/relatives and 13.7 percent through migrants' home visits. There is no difference in the reported cost of transfer money either through bank or *hundi*. However, the distance from the closest bank and the amount of time required for each transaction are the main factors pushing migrants and their families to use the *hundi* system. In another study, Amjad et al. (2013) mentioned that the time required to withdraw money from the nearest bank and the

⁴ This is an informal method, which is comparatively cheaper than the formal transaction channel. The sender contacts a broker who acts as an intermediary and arranges the transfer. The sender remits a certain amount in Saudi Riyal and the broker contacts a counterpart in Pakistan, who makes the payment in Pakistani rupees to the family. Throughout the whole procedure, no money crosses the border, and no official records exist for this transaction.

high transaction costs are the main barriers to using the banking channel. Therefore, the transaction costs of sending remittances and in particular the fees paid to intermediaries continue to be a significant concern for immigrants, development agencies, and other actors involved in the process. The World Bank has constructed a database that contains the cost of sending remittances to families back in the home country. The average cost for sending remittances from the major remittances corridor was 8.0 percent in 2011 and has fallen to 6.2 percent of the amount remitted in 2014. Figure 1 shows the cost of sending remittances with a significant heterogeneity across major remittances corridors.

It reveals that it is significantly cheaper to send remittances to Pakistan from Saudi Arabia, UAE and the UK than from the other considered countries. Hence, the Middle East region was the least expensive corridor in 2013 with the cost being between 1.9 and 3.8 percent. Conversely, Singapore and Norway show the highest transfer costs. It is the most costly for a Pakistani resident to send money back home from Singapore with the cost being over 15 percent of the transfer.

Figure 1. Average cost for sending remittances (as a share of funds sent) to Pakistan from major remittances corridors.



Source: World Bank Remittances Prices Worldwide. All figures are percentages.

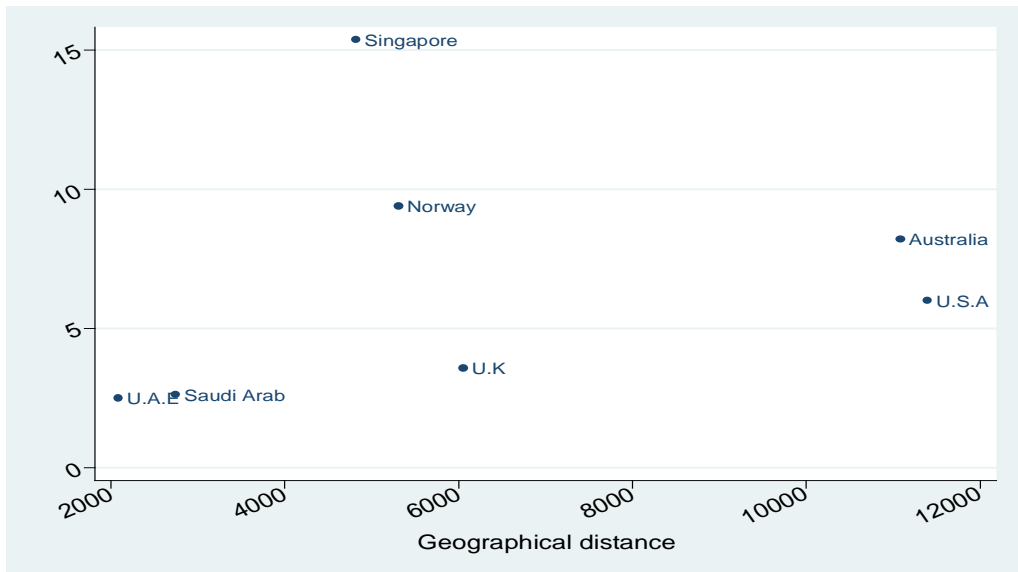
Sending money from Norway consistently costs more than twice, on average, than from the UK. This high transaction cost is probably one of the main obstacles that deters the use of remittances in the development process (Orozco, 2003, World Bank, 2014a). Some studies have shown that these flows are very sensitive to cost and are more likely to rise with a decrease in costs (Gibson et al., 2006). Therefore, high transaction costs, duration of the transfer, lower fees on informal transactions and lack of access to convenient remittance services encourage migrants to use informal channels. As an option to reduce these costs, the Pakistan Remittance Initiative (PRI) was launched in 2009 as a joint project of the Ministry of Overseas Pakistanis, the State Bank of Pakistan (SBP), and the Ministry of Finance (Ministry of Finance, 2013). Under this scheme neither the remitter nor the beneficiary is supposed to pay any fee to the transfer company. In 2012, the National Database and Registration Authority (NADRA) has launched the 'National Cash Remittance Program' to enable more than 117 NADRA centers to process inward home remittances from overseas for the general public using smart national identity cards. Similarly, the adoption of improved technology, such as cell-phone services help to enable remittances⁵ (World Bank, 2014a). The implementations of targeted government policies as well as the use of better technologies aimed at easing remittances are both putting downward pressure on the cost of remitting to the country.

A comparison between transaction costs and geographical distance could be illustrative of the important differences between both variables. The cost to transfer \$200 to Pakistan from the UK was 3.6 percent despite a capital-to-capital distance of 6049.92 kms, while the cost of transferring the same amount from Norway is 9.41 percent, with a distance of 5308.44 kms; and an even higher 15.37 percent from Singapore despite a smaller distance of 4819.49 kms. This shows that transaction costs are not exclusively determined by distance from the host country's to the home country (Figure 2).

⁵ In a short period of time branchless banking has become relevant in Pakistan with over one percent of the population holding branchless banking accounts with key services such as Easy paisa, UBL Omni and services from banks and the Pakistan Post office (Oak , 2014).

Figure 2. Geographical distance and transaction cost of remittances to Pakistan from selected host countries

Total cost (in percent)



Note: Information on transaction cost was collected in May 2013. The cost includes the fee and the exchange rate margin of transferring \$200.

Source: CEPII and World Bank Remittances Prices Worldwide. Geographical distance is measure in kilometers between countries' capital cities.

4 Factors behind bilateral remittances flow. A brief literature review

Recent literature has highlighted the importance of geographical distance and other bilateral variables in driving remittances. Empirical evidence in this regard is still scarce mainly due to limited data availability concerning bilateral remittances over time. We discuss in this section the related literature, starting by studies covering different countries and region and focusing next on existent studies for Pakistan. To the first group of studies belong Lueth and Ruiz-Arranz (2008). The authors model remittances for eleven countries in Asia and Europe for the period 1980–

2004 using a dataset of bilateral remittance flows for a set of 33 developing countries with remittances to 11 home countries: Bangladesh, Croatia, Indonesia, Kazakhstan, Macedonia, Moldova, Philippines, Serbia and Montenegro, Slovenia, Tajikistan and Thailand. They include several variables that appear frequently in the trade literature as determinants of remittances, namely the GDP of home and host countries, gravity variables (geographical distance, common language, colonial ties), stock of immigrants, political risk, etc. Their results indicate that economic activity in the host and home country and other gravity variables account for more than 50 percent of the variation in remittances. Similarly, Frankel (2011), using the same dataset, finds that distance is negatively associated with remittances while income per capita of the host country is positive and highly significant across all specifications. However, gravity variables such as common border and common language are not statistically significant.

The opposite result regarding the significance of geographical distance is found by Schiopu and Siegfried (2006) when using a panel dataset of bilateral remittances from 21 European sending countries to 9 European receiving countries over the period 2000–2005. They find that geographical distance plays no role in explaining remittances. However, the effect is positive if the countries have no common border. In a related study, De Sousa and Duval (2010) examine remittance flows to Romania originating from various sending countries during the period 2005–2009. The authors find that both home and host countries' economic size and geographical distance appear to positively impact bilateral flows. The positive relationship between remittances and distance is supported by the loan repayment hypothesis, according to which an increase in physical distance between migrant sending and receiving countries results in an increase in remittances in return for the high migration cost paid by the family.

Only two studies have analyzed the remittance motives in the Pakistani context. The first study by Bouhga-Hagbe (2006) points to the existence of altruistic motives for sending remittances. Those are proxied by “agriculture GDP” and are found to be a major driver of remittance flows to Egypt, Jordan, Morocco, Pakistan, and Tunisia. The second, by Kock and Sun (2011), suggests that skill level, investment return in both host and home countries, nominal and real exchange rates, and domestic economic conditions are the main factors explaining remittances to Pakistan.

The existing literature shows that whereas the role of home and host country economic conditions has often been explored and found to be an important determinant of migrants' remittances, the role of geographical distance used as a proxy for transferred cost needs further analysis. To date, few studies have examined the bilateral macroeconomic determinants of remittances and hence this study aims at closing this gap in the literature. Previous studies have merged different data to obtain bilateral remittances, which allows for more comprehensive conclusions. However, in the absence of international harmonization, remittances are documented in a different way in each country (De Sousa and Duval, 2010). In this study, the dataset used is constructed in a more homogenous way for a single home country (Pakistan), which implies using a smaller sample, but avoids the drawbacks of previous datasets concerning measurement differences.

Summarizing, we extend the literature in two important ways. Firstly, by focusing on a new factor, the cost of sending remittances, and emphasizing that distance cannot be used as a proxy for this factor, and secondly by using a homogenous dataset.

5 Empirical strategy

5.1 Gravity model of bilateral remittances

We estimate a gravity equation where the bilateral remittance flows are explained by the GDPs of both the host (i) and the home country (j), and by a set of transaction costs proxies including, in particular, the cost of remitting (Remcost_{ij}) and the geographical distance between a pair of countries (DIST_{ij}). The theoretical justification of the gravity equation for bilateral remittances is not as well established as for trade flows (see Anderson, 1979; Bergstrand, 1989; Feenstra et al., 2001 and Anderson and van Wincoop, 2003). However, the model has been further extended for the analysis of international capital flows as well as for international migration (Mayda, 2010; Karemera et al. 2000; Lewer and Van den Berg, 2008) and has been applied to explain remittances (De Sousa and Duval, 2010; Lueth and Ruiz-Arranz, 2008) and, more extensively, FDI flows (Hattari and Rajan, 2008; Bénassy-Quéré et al., 2007; Demekas et al., 2005).

In this study, we employ a parsimonious model which includes commonly-used determinants while focusing on specific bilateral variables. Similar to the gravity model used in the trade literature, the starting point of the gravity model of migration is the hypothesis that immigration is driven by differences in economic size and impeded by migration costs (Borjas, 1999).

We start by specifying the baseline gravity model, in which bilateral remittances are directly proportional to the economic size of the host and home country measure by GDP, and inversely proportional to the distance between the two countries (Lueth and Ruiz-Arranz, 2008). The greater the distance between two countries, the higher the cost of remitting, thereby reducing the amount of remittances to the country.

The gravity model of remittances is given by,

$$REM_{ijt} = A \frac{(GDP_{it} * GDP_{jt})^{\alpha_1}}{(Dist_{ij})^{\alpha_2}} Z_{ijt} \quad (1)$$

Where, *GDP* denotes income in host (*i*) and home (*j*) country and *t* denote years. Pakistan is considered the “home country” and the rest of the 23 source countries are used as “host countries”. *Dist* denotes geographical distance between capitals of countries *i* and *j*, and *Z* represents a number of control variables.

By taking natural logs of equation (1), we adopt a similar empirical specification as in Lueth and Arranz (2008) and De Sousa and Duval (2011). The linearized gravity model of remittance flows from host (*i*) to home country (*j*) in year (*t*) is expressed as,

$$\begin{aligned} \ln(REM_{ijt}) &= \alpha_0 + \alpha_1 \ln(GDP_{it}) + \alpha_2 \ln(GDP_{jt}) \\ &+ \alpha_3 \ln(DIST_{ij}) + \alpha_4 \ln(MigStock_{ijt}) + \alpha_5 (BilExc_{ijt}) + \mu_i \\ &+ \varepsilon_{ijt} \end{aligned} \quad (2)$$

In our baseline specification, bilateral remittances (in natural logarithms) between the host country *i* and the home country *j* at time *t* (REM_{ijt}) are related to *GDPs* in the host and home countries, geographical distance, migrants stock, and bilateral exchange rate. REM_{ijt} comprises funds classified as workers’ remittances, compensation of employees, and migrant transfers.

The explanatory variables GDP_{it} and GDP_{jt} stand for the real gross domestic products for the host country (i) and home country (j) in period t , and $DIST_{ij}$ is the physical distance between the capitals of the home and the host country. $BilExc_{ijt}$ is the bilateral exchange rate denominated in home country currency and $MigStock_{ijt}$ denotes the stock of migrants from j that live in country i at time t . Finally, μ_i denotes the host-country specific fixed (random) effects that control for unobservable heterogeneity. The last term, ε_{ijt} , denotes the idiosyncratic error term.

The baseline model is augmented with additional host and home country characteristics that could influence remittances.

$$\begin{aligned}
 & \ln(REM_{ijt}) \\
 & = \alpha_0 + \alpha_1 \ln(GDP_{it}) + \alpha_2 \ln(GDP_{jt}) + \alpha_3 \ln(DIST_{ij}) \\
 & + \alpha_4 \ln(BilExc_{ijt}) + \alpha_5 \ln(MigStock_{ijt}) + \sum_{k=1}^K \alpha_k Z_{ijkt} + \mu_i \\
 & + \varepsilon_{ijt}
 \end{aligned} \tag{3}$$

In the first extension of the model other controls are introduced as additional regressors, Z_{ij} , referring to the vector of all control variables that relate to either the host or home country or both. This includes domestic credit to the private sector (as a percent of GDP) in country i and j . Similarly, the political stability in country $j(i)$ is included to measure political uncertainty prevailing in the home (host) country. Moreover, proxies for common official language and common religion are also included in the model in order to measure cultural similarity between i and j .

In the next specification, the log of transaction costs is introduced and physical distance is excluded,⁶ in order to estimate the impact of the cost on remittances to the home country.

⁶ Distance was initially included also in model (4), since it could be argued that it proxies for other type of remittance costs different to transfer costs, however it was statistically significant and for this reason it was excluded from the model.

$$\begin{aligned}
 & \ln(REM_{ijt}) \\
 &= \alpha_0 + \alpha_1 \ln(GDP_{it}) + \alpha_2 \ln(GDP_{jt}) + \alpha_3 \ln(Remcost_{ijt}) \\
 &+ \alpha_4 \ln(BilExc_{ijt}) + \alpha_5 \ln(MigStock_{ijt}) + \sum_{k=1}^K \alpha_k Z_{ijkt} + \mu_i \\
 &+ \varepsilon_{ijt} \tag{4}
 \end{aligned}$$

$Remcost_{ijt}$ is the transaction cost of sending remittances from the host country to the home country. Since some variables are in natural logs (except dummies, exchange rate, financial development and exchange rate variable), μ_i the estimated coefficients can be interpreted as elasticities.

5.2 Data and variable definitions

We collected data on remittances from 23 host countries to Pakistan. These countries account for about 90 percent of remittance flows to Pakistan during the examined period (see Table 1). The selection of countries depends on the availability of bilateral remittances data. As factors explaining bilateral flows, we use both country-specific and bilateral variables taken from different sources. In particular, bilateral remittances in USD millions come from the SBP. The limitation of the reported data is that they most likely underestimate the volume of remittances sent through informal channels (*hawala or hundi*). Data on informal remittance flows are indeed patchy and do not permit the construction of time series with any degree of reliability. A few estimates of informal flows exist for specific points in time and for specific remittance corridors. For example, Arif (2009) points out that more than half of the remittances sent to Pakistan from the Persian Gulf come through informal channels. This notwithstanding, the study is concerned with the effect of transaction costs on the amount of formal remittances received, for which officially available data of acceptable quality are used.

In what follows, we describe the variables that are considered important factors in influencing remittance flows. The GDP for the host country in billions of USD comes from WDI and is the most obvious factor that influences higher remittances to home countries (Vargas-Silva and Huang, 2006). The second explaining factor is the income level (measured in term of GDP) in the home

country, which has an ambiguous effect on remittances depending on the prevailing motive to remit. The migrants stock in the destination country is also considered a crucial factor in determining remittance volumes (Freund and Spatafora, 2005). The data of Pakistani migrants stock in the host countries are taken from the Bureau of Immigration and Overseas Employment (BIOE, 2013) and from the Organisation for Economic Cooperation and Development (OECD, 2013). For North America, Europe, and the Asia-Pacific region, where labor receiving countries are located, we use the OECD database for two main reasons. Firstly, the BIOE dataset only contains legal outflow per year of workers looking for employment, thus excluding migratory movements for education, family union as well as illegal migrants (Amjad et al., 2012). Secondly, it does not track returning workers, which makes it impossible to accurately estimate the country's migrant stock. We estimate the stock of migrants for Middle Eastern countries using the BIOE dataset assuming that the returning workers represent around 4 percent of the total migrant stock. This figure is based on Iqbal and Khan (1981), who computed the share of returning migrants to be 3.4 percent of the Pakistani migrants stock in the Middle East. Geographical distance is measured as the distance from Islamabad, Pakistan's capital, to the corresponding capital of the remittances-sending country. The variable comes from the CEPII database. The transaction cost variable is estimated using data from the World Bank Remittances Prices Worldwide for major sending corridors to Pakistan (World Bank, 2014b). To obtain data for each destination and time period, we formulate two assumptions. First, we assume that transaction costs of sending remittances from the UAE to Pakistan are similar to that of the neighboring countries Oman, Kuwait and Qatar. Similarly, the remittances cost from the US is also used for Canada. Moreover, the cost of remittances from Norway to Pakistan has been used to proxy for the cost from Germany, France, Italy, Sweden, Denmark, Greece and Switzerland. Secondly, we assume that the costs of remittances are determined by migrants stock in the remittance-host country as well as the financial development in both the home and host countries. Data for cost of remitting are available only for the years 2010 to 2013. We use data from these four year to estimate the transaction cost for each sending country by regressing the cost of remitting on migrants stock in the remittance-host country and financial development in both

home and host countries as well as extrapolating the resulting predicted values for the missing time period (2001–2009).⁷

The study uses real exchange rate computed as the nominal exchange rate times the relative price of the respective countries, which is also an important determinant of remittances (Dakila and Claveria, 2007). The bilateral exchange rate of the PKR is obtained from DataStream. The relationship between remittances and the exchange rate is a priori ambiguous. Remittances could decrease or increase with home country currency depreciation depending on the motive to remit.

With respect to the financial sector development for home and host countries, we use domestic credit to the private sector as a percent of GDP. The data come from the WDI. Financial development is another important factor that makes remittances easier and cheaper, hence stimulating the flows via official channels (Freund and Spatafora, 2008; Singh et al., 2011). We therefore expect that the overall financial-sector development might lead to greater availability and lower costs for remittance services.

As a proxy for institutional quality, we use a political stability indicator from the World Governance Indicators from the World Bank. The improved political situation may encourage remittances, since such an environment favors investment in the home country (Singh, et al., 2011). On the other hand, weak institution may also encourage remittances to compensate for the loss of purchasing power of the family back home. Fragile institutions in the home country are among the main reasons behind the decision to emigrate (Collier et al., 2011).

It has also been argued that common language and religious ties tend to affect the choice of destination countries. For instance, larger shares of Pakistan's migrants reside in the Middle East and in the countries with a similar official language. We expect a positive sign for these two variables. The variables bilateral remittances, GDP (host), GDP (home) and bilateral exchange rate are at constant 2005 prices. Table2 provides descriptive statistics for the above-mentioned variables.

⁷The predictions were estimated with OLS regression with a linear trend.

Table 2. Descriptive statistics

Variables and definitions	Source	Mean	S.D	Min	Max
Dependent variable					
Bilateral remittances million (USD)	State Bank of Pakistan	177.17	342.34	.024	1717.62
Gravity variables					
Host GDP in billion (USD)	WDI	1.40e+14	2.77e+14	1.27e+07	1.45e+15
Home GDP in millions (USD)	WDI	1.17e+11	1.83e+10	8.75e+10	1.47e+11
Geographical distance	CEPII	5436.47	2639.01	1801.39	11392.8
Common language	CEPII	0.21	0.41	0	1
Transaction costs (percent)	World Bank Remittances Prices Worldwide and author's calculations	15.37	2.37	9.77	19.70
Other control variables					
Exchange rate	DataStream	0.14	0.59	.002	4.45
Domestic credit to private sector as percent of GDP (home)	WDI	23.30	4.46	15.65	28.74
Domestic credit to private sector as percent of GDP (host)	WDI	104.65	51.44	27.26	232.10
Migrants stock	BIOE, OECD, UN-DESA	0.2	0.54	.003	3.38
Institutional variables					
Political stability (home)	World Wide Governance Indicator, World Bank	0.16	0.07	0.10	0.40

Note: All the variables are in levels. Period 2001–2013.

5.3 Estimation issues

A variety of empirical techniques are employed in the study. The model is first estimated using a pooled OLS as a benchmark with standard errors corrected for heteroskedasticity. However, given the panel nature of the dataset, the pooled OLS is only consistent when unobserved fixed effect and explanatory variables are uncorrelated (Wooldridge, 2002). In order to take into account the resulting unobserved heterogeneity, we also use a panel data approach, using fixed and random effects models. Restricted F-statistics, Breusch and Pagan (1980) LM and Hausman (1978) specification tests are used in order to choose between pooled OLS versus fixed effects, pooled OLS versus random effects, and fixed versus random effects models. To choose between fixed and random effects, the Hausman test was used, which indicates that the country fixed effects are correlated with the regressors, and therefore, both OLS and random effects yield biased results. The inclusion of country fixed effects in this panel study controls for sources of endogeneity related to unobservable heterogeneity that are country specific and time-invariant. The fixed effect estimator, however, does not provide a direct estimation of the coefficients of time invariant variables. One solution for this is to use the Mundlak approach (Mundlak, 1978) who proposed approximating the country specific effects as a function of the mean of time-variant variables. This is an alternative procedure to the fixed effects model, which includes averages of time-varying explanatory variables (Wooldridge, 2002), instead of using dummy variables or the within transformation and will be used in order to obtain estimates for the distance variable, which is time invariant. Finally, given that some explanatory variables might be endogenous (GDPs, the cost of remitting as well as the migrants stock) we use a procedure proposed by Hausman and Taylor (1981) and also suggested by Baltagi et al. (2003) to tackle endogeneity issues in a panel data framework. This Hausman-Taylor approach uses the means of the exogenous time-variant variables as instruments for the endogenous variables (Baum, 2006, p.229).

Finally, in order to check for the quality of our estimations, we carry out several post estimation tests. The calculation of bivariate correlations between the explanatory variables helps us to identify collinearity between the explanatory variables. Variables that are highly correlated are used separately or are dropped from the regression. To test for autocorrelation, the Wooldridge test is used (the

null hypothesis is that there is no first order autocorrelation while the alternative hypothesis is that there is a presence of autocorrelation) the Breusch-Pagan test is used to test for heteroskedasticity.

6 Empirical Findings

In this section, we discuss our main empirical results. The benchmark estimates presented in Table 3 provide results for the baseline model using several estimation methods. The first column provides fixed effects estimates, the second column presents results using the Mundlak approach, and finally the third column presents Hausman and Taylor estimates. In the first specification, the log of remittances is regressed on the GDPs of host and home countries, geographical distance, the bilateral exchange rates, and migrants stock. Concerning the effect of economic activity in the home country on remittances, we find that the GDP of the home country has a positive and statistically significant effect on remittances (Columns 1–3 in Table 3). This shows that Pakistani migrants send more remittances when the economic conditions improve at home, which supports the portfolio investment motive. This result is consistent with the findings in Kock and Sun (2011), Lueth and Arranz (2008), and Docquier et al. (2012).

However, remittance flows to Pakistan do not seem to respond to the host country's economic conditions. This is in contrast to the findings of Schiopu and Siegfried, (2006), Vargas-Silva and Huang (2006) and Kemegue et al. (2011) who argue that remittances are more responsive to the host country's economic conditions than to the economic conditions of the home country. The results can be explained by considering the extent to which the migrant is integrated into the formal sector of the host economy. It could also be explained by the loan repayment hypothesis stating that remittances are fixed loan payments made by the emigrants to the households (Vargas-Silva and Huang, 2006). These reasons could also explain why the recent economic crunch has not adversely affected remittance flows to the country.

Table 3. Baseline panel gravity model estimates

VARIABLES	(1) Fixed Effects	(2) Mundlak Approach	(3) Hausman and Taylor Approach
GDP (host)	-0.014 (0.015)	-0.014 (0.015)	-0.015 (0.026)
GDP (home)	1.205** (0.527)	1.205** (0.532)	1.184*** (0.340)
Migrants stock	1.534*** (0.367)	1.534*** (0.370)	1.542*** (0.167)
Geographical distance		-0.384 (1.017)	1.090 (0.813)
Common official language		1.006 (0.745)	-0.450 (0.904)
Bilateral exchange rate	0.472*** (0.056)	0.472*** (0.057)	0.451*** (0.120)
Number of observation	299	299	299
R-squared	0.547	0.547	
Hausman test (Fixed Vs Random effects)	Prob>chi2 = 0.0404		

Notes: *** p<0.01, ** p<0.05, * p<0.1. Robust standard errors in parenthesis. All the variables except dummies and the exchange rate are in natural logs. The endogenous variables in the Hausman and Taylor approach are GDP (host country), GDP (home country) and migrants stock.

The geographical distance is not statistically significant in any of the estimated models (see Table 3 and Table 4). The mixed results in the previous literature for geographical distance indicates that distance is not always an important driver of remittance flows. The estimated results corroborate the graphical illustration in Figure indicating that the cost of transferring money to Pakistan is unrelated with geographical distance. Another possible interpretation of why distance is a poor proxy for remittance costs is that the cost of sending money from a developed to a developing country is significantly lower than the cost of remitting in the opposite

direction, whereas distance is the same. Evidence shows that remittance cost is high in the same bilateral corridor depending on the direction of the flow (Ratha and Shaw, 2007). As a result, the cost of remitting money is more related to technological developments and increased competition in the financial-services than to geographical distance. In regard to the effects of migrants stock on remittances, our results expectedly show that remittances depend positively and significantly on migrants stock. This means that countries with an increasing size of migrants stock attract a higher volume of remittances (Freund and Spatafora, 2008). The results are robust and consistent with our expectations. Concerning the exchange rate variable, our findings indicate that it has a positive effect on remittances. This suggests that in case of appreciation of the home currency, migrants tend to send more money in foreign currency to insure the same amount of income in the domestic currency. Another possibility could be that migrants send more remittances in order to keep the same utility level of their family compared with their own personal utility level.

Now, we turn to the extended estimated model that includes other important control variables that are likely to have an impact on remittance flows, namely, domestic credit to the private sector as a percent of GDP for host and home countries and political stability.⁸ The results for the augmented model are presented in Table 4. The inclusion of additional control variables does alter the magnitude and significance of GDP (home) in some of the estimated models. We also take into account the financial sector development (the driving factor of transfer cost) for both host and home country. As expected, remittances are positively and significantly related to financial sector development. The findings reveal that better financial development in the host and home countries turn into higher flows of remittances. In addition, financial improvement in the home country would enhance the availability of low cost remittance services that could then direct large amount of remittances through official channels (Freund and Spatafora, 2008; and Wahba, 1991).

⁸The correlation matrix of the variables indicates that common religion and geographical distance are highly correlated. We dropped common religion as this might affect the direction and significance of the effect of other variables on the dependent variable.

Table 4. Augmented gravity model

VARIABLES	(1) Fixed Effects	(2) Mundlak Approach	(3) Hausman and Taylor Approach
GDP (host)	0.013 (0.010)	0.013 (0.010)	0.012 (0.023)
GDP (home)	0.618 (0.623)	0.618 (0.629)	0.601* (0.341)
Migrants stock	1.377*** (0.321)	1.377*** (0.324)	1.466*** (0.144)
Geographical distance		-0.426 (0.950)	-0.091 (0.768)
Common official language		1.108 (0.776)	0.063 (0.838)
Bilateral exchange rate	0.356*** (0.058)	0.356*** (0.059)	0.348*** (0.108)
Credit to private sector (host)	0.013** (0.006)	0.013** (0.006)	0.012*** (0.002)
Credit to private sector (home)	0.040*** (0.010)	0.040*** (0.010)	0.041*** (0.012)
Political stability (home)	-1.293** (0.547)	-1.293** (0.553)	-1.251*** (0.484)
Observations	299	299	299
R-squared	0.647	0.647	
Hausman test (Fixed Vs Random effects)	Prob>chi2 =	0.0449	

Note: *** p<0.01, ** p<0.05, * p<0.1. Robust standard errors in parenthesis. All the variables except dummies and exchange rate are in natural logs. The endogenous variables in the Hausman and Taylor approach are GDP (host), GDP (home) and migrants stock.

Countries with improved financial markets thus have more opportunities to attract remittances through formal channels and are thereby more likely to channel it into more productive uses.

The coefficient of the political stability variable representing institutional quality in the home country is negative and significant, implying that an unstable political environment (associated with lower growth) may encourage larger amounts of remittances. This result supports the notion that the altruistic behavior of the migrant encourages sending more remittances when the earning prospects of the migrants home country income decreases, in order to assure the same level of satisfaction.⁹ Similarly, the money transfer could also increase by higher outflows of emigrants to other economically well-off destinations due to political turmoil at home. This stabilization role of remittances to compensate for the loss of purchasing power due to political instability indicates that remittances are used to hedge against political disorder. We also included initially political stability in the host countries as an additional regressor, however due to its high correlation with GPD it was dropped from the reported estimations.¹⁰

Finally, Table 5 reports the estimates of equation (4), which include transaction cost. Financial development is not included because it is highly correlated with the predicted transaction costs.

Results in column (1) of Table 5 indicate that high transaction costs significantly reduce remittances. For instance, a one percent decrease in the transaction cost would yield about 1.6 percent increase in remittances flows. This seems to suggest that higher transfer costs deter transferring money back home. As discussed, variation in transfer costs has a large impact on remittances. In particular, a 20 percent reduction in the average cost of remitting will increase the average bilateral remittances (slightly below 200 USD, according to Table 2) by 32 percent (taking the coefficient of column 1 in Table 5, $32=1,6*20$), which mean around 64 USD. This result is consistent with the two hypotheses stated in the paper, for instance, the notion that higher transfer costs discourages remitters or

⁹ In unpredictable political situations, the cost of capital would increase and consequently, investors will look for more stable investment destinations. Therefore, political instability deters economic growth (Aisen and Veiga, 2013).

¹⁰ When excluding GDP host from the regression, the coefficient of political stability in the host country was negative but only statistically significant at the 10 percent level, with a magnitude of (-0.84).

pushes them into the informal sector. In column (2) political stability in the host country is included and the result concerning transaction cost remains similar with a slightly higher magnitude.

Table 5. Remittances explained with transaction cost

VARIABLES	(1)	(2)	(3)
GDP (host)	-0.0145 (0.0238)		0.00561 (0.0234)
GDP (home)	0.661* (0.348)	0.853*** (0.328)	
Migrants stock	1.399*** (0.165)	1.190*** (0.136)	1.541*** (0.163)
Common language	0.266 (0.592)	0.297 (0.590)	0.080 (0.686)
Transaction cost	-1.597*** (0.615)	-1.798*** (0.601)	-1.516*** (0.613)
Bilateral exchange rate	0.467*** (0.078)	0.391*** (0.117)	0.467*** (0.078)
Political stability (home)	-1.885*** (0.503)	-1.908*** (0.499)	
Political stability (host)		-0.279 (0.521)	-0.279 (0.521)
Dummy year 2002			0.169
Dummy year 2003			0.752***
Dummy year 2004			0.731***
Dummy year 2005			0.896***
Dummy year 2006			0.936***
Dummy year 2007			0.852***
Dummy year 2008			0.796***
Dummy year 2009			0.726***

Table 5 continued

Table 5 continued

VARIABLES	(1)	(2)	(3)
Dummy year 2010			0.664***
Dummy year 2011			0.675***
Dummy year 2012			0.594***
Dummy year 2013			0.464**

Note: *** p<0.01, ** p<0.05, * p<0.1. Robust standard errors in parenthesis. All the variables except dummies and exchange rate are in natural logs. Hausman and Taylor approach used in all models. The endogenous variables are GDP (host) and GDP (home) and migrant stock. Column (3) include time dummies, hence the coefficients of GDP (home) and political stability (home) cannot be estimated. No. obs = 299.

Having found that migrants remit less in the presence of high transaction costs, we investigate whether the Pakistani initiatives to favor remittances sent through formal channels have had an effect on the amount of remittances sent to Pakistan. In column (3) of Table 5 we include time dummies to check whether there is a significant difference before and after the Pakistan Remittances Initiatives and the National Cash Remittance Program initiatives, in 2009 and 2011, on the amount of remittances sent through formal channels. The coefficients of the dummy variables after the starting of the programs are not significantly higher than the coefficients of the time dummies before 2009. This could be due to a number of reasons.

Firstly, a considerable proportion of immigrants from Pakistan (more than 60 percent) reside in the Middle East. Those are mainly low-wage workers, often illiterate or with a low level of education, who probably find the formal banking channel's documentary requirements daunting. Secondly, the effects of a new policy take time to become visible in the statistics. Thirdly, the presence of formal banking institutions in the rural areas is thin. And finally, evidence found in Ahmed and Mughal (2015) shows that most work-related migration from the country is that of working-age males, in whose absence social customs do not encourage unaccompanied long-distance travel of women in order to go to a financial institution. Hence, informal money transfer channels provide delivery services at the doorstep to cater for these households' requirements, in particular

for women living in remote areas that are unable to go to financial institutions absent nearby.

As robustness we use a variety of models to estimate the effect of transaction cost on remittances, and the main results are robust to changes in the specification and remain practically unchanged. We also run regression using the shorter series of original data on transaction costs and the results indicate a weaker relationship between transaction cost and remittances due to smaller variation in the data.¹¹ An important difference with respect to results in Table 5 is that the Pakistan remittances initiative dummy turns significant in 2011, indicating that remittances were higher in 2011 with respect to 2008.

7 Concluding remarks

This paper explores the relative importance of the determinants that drive the volume of remittance flows to Pakistan with a particular focus on transaction costs. With this aim, we estimate a gravity model using bilateral remittances data for 23 major remittance-sending countries during the period 2001–2013 and apply a variety of panel data estimation techniques to tackle several econometric issues.

According to our findings, recorded remittance flows rise with the country's stock of migrants residing abroad. Similarly, our findings indicate that differences in the financial system and variations in the bilateral exchange rate strongly influence the size of remittance flows to Pakistan. More importantly, decreases in transaction costs seems to foster remittances, suggesting that when the cost on remitting increases, migrants either refrain from sending money home or use informal channels to remit (*hundi or hawala*, by hand, through friends, etc). In contrast, no significant effect of geographical distance could be identified. This indicates that geographical distance is not a good proxy for the cost of remitting, which is more closely related to of the existence an importance of migrant networks and also to developments in home and host country financial services.

These empirical findings indicate that policies that aim to facilitate remittances should focus on reducing the transaction cost of sending money. Transaction costs can be lowered by increasing access to financial services in the remote areas

¹¹Results are shown in Table A.2 in the Appendix.

through innovations such as branchless banking. The reduction of costs will not only increase the volume of remittances but will enhance financial inclusion. The improved financial services will redirect these flows from informal to formal channels in the medium term that will eventually open new door for easing these flows as an important finance source for developing countries.

Acknowledgements The authors gratefully acknowledge the comments and suggestions made by Prof. Stephan Klasen. We also would like to thank the participants at the IS Academy: Migration and Development, the 16th Göttingen Workshop on International Economics, 12th Arnoldshain Seminar as well as the 2015 Annual Conference of the Research Group on Development Economics for their valuable inputs. I. Martinez-Zarzoso also acknowledges the support and collaboration of Project ECO2014-58991-C3-2-R funded by the Spanish MINECO and of Project “Production Networks and Economic Integration” funded by the University Jaume I (P1.B2013–06).

References

- Aisen, A. and Veiga, F.J. (2013). How does political instability affect economic growth? *European Journal of Political Economy*, 29, March: 151–167.
<http://www.sciencedirect.com/science/article/pii/S0176268012000675>
- Ahmed, J. and Martinez-Zarzoso, I. (2013). Blessing or curse: The stabilizing role of remittances, foreign aid and FDI to Pakistan. May 2013, discussion papers, Center for European Governance and Economic Development Research, No. 153.
<http://econpapers.repec.org/paper/zbwcegedp/153.htm>
- Ahmed, J. and Mughal, M.Y. (2015). Great expectations? Remittances and asset accumulation in Pakistan, Working Papers 2014–2015_6, CATT - UPPA - Université de Pauet des Pays de l'Adour, revised Jan 2015.
http://econpapers.repec.org/paper/tacwpaper/2014-2015_5f6.htm
- Al-Mashat, R. and Billmeier, A. (2012). Push or pull? The determinants of remittances to Egypt, *Review of Middle East Economics and Finance*, 8(2), 1–27.
<http://www.degruyter.com/view/j/rmeef.2012.8.issue-2/1475-3693.1429/1475-3693.1429.xml>
- Anderson, J.E. (1979). A theoretical foundation for the gravity equation. *American Economic Review*, 69(1), 106–116. <http://www.jstor.org/stable/1802501>
- Anderson, J.E. and van Wincoop, E. (2003). Gravity with gravitas: A solution to the border puzzle. *American Economic Review*, 93(1), 170–192.
<https://www.aeaweb.org/articles.php?doi=10.1257/000282803321455214>
- Amjad, R., Irfan, M. and Arif, G.M. (2013). How to increase formal inflows of remittances: An analysis of the remittance market in Pakistan, International Growth Center, WP, 2013. <http://www.theigc.org/project/how-to-increase-formal-inflows-of-remittances-to-pakistan/>
- Amjad, R., Arif, G. M. and Irfan, M. (2012). Preliminary study: Explaining the ten-fold increase in remittances to Pakistan 2001–2012. Working papers and research reports, 2012. <http://pide.org.pk/pdf/Working%20Paper/WorkingPaper-86.pdf>
- Arif, G.M. (2009). Economic and social impacts of remittances on households: The case of Pakistani migrants working in Saudi Arabia. Pakistan Institute of Development Economics.
<http://www.egypt.iom.int/Doc/IOM%20study%20on%20Economic%20and%20Social%20Impacts%20of%20Remittances%20on%20Households%20-%20the%20Case%20of%20Pakistani%20Migrant%20Workers%20in%20Saudi%20Arabia.pdf>

- Baltagi, B.H., Bresson, G. and Pirotte, A. (2003). Fixed effects, random effects or Hausman–Taylor?: A pretest estimator. *Economics Letters*, 79(3), 361–369. <http://www.sciencedirect.com/science/article/pii/S0165176503000077>
- Baum, C. F. (2006). An introduction to modern econometrics using Stata. Stata Press. <http://www.stata.com/bookstore/modern-econometrics-stata/>
- Beck, T. and Pería, M.S.M. (2011). What explains the price of remittances? An examination across 119 country corridors. *The World Bank Economic Review*, 25 (1), 105–131. <http://elibrary.worldbank.org/doi/abs/10.1596/1813-9450-5072>
- Bénassy-Quéré, A., Coupet, M. and Mayer, T. (2007). Institutional determinants of foreign direct investment. *The World Economy*, 30(5), 764–782. <http://onlinelibrary.wiley.com/doi/10.1111/j.1467-9701.2007.01022.x/full>
- Bergstrand, J.H. (1989). The generalized gravity equation, monopolistic competition, and the factor-proportions theory in international trade. *Review of Economics and statistics*, 71(1), 143–153. <http://www.jstor.org/stable/1928061>
- Borjas, G.J. (1999). The economic analysis of immigration. *Handbook of Labor Economics*, 3, 1697–1760. <http://www.hks.harvard.edu/fs/gborjas/publications/journal/Handbook1999.pdf>
- Bouhga-Hagbe, J. (2006). Altruism and workers’ remittances: Evidence from selected countries in the Middle East and central Asia (No. 06/130). International Monetary Fund. <https://www.imf.org/external/pubs/cat/longres.aspx?sk=19178.0>
- Bureau of Emigration and Overseas Employment (BEOE) (2013). Labor and manpower division, Government of Pakistan, Islamabad.
- Breusch, T.S. and Pagan, A.R. (1980). The Lagrange multiplier test and its applications to model specification in econometrics. *The Review of Economic Studies*, 47(1), 239–253. <http://www.jstor.org/stable/2297111>
- Collier, W., Piracha, M. and Randazzo, T. (2011). Remittances and return migration. Discussion Paper No. 6091, IZA. <http://ftp.iza.org/dp6091.pdf>
- Dakila, F. and Claveria, R. (2007). Identifying the determinants of overseas Filipinos’ remittances: Which exchange rate measure is most relevant? Center for Monetary and Financial Policy. Bangko Sentral ng Pilipinas, Working Paper No. 2007–02. <http://www.bsp.gov.ph/downloads/publications/2007/wps200702.pdf>
- De Sousa, J. and Duval, L. (2010). Geographic distance and remittances in Romania: Out of sight, out of mind? *International Economics*, 121, January, 81–97. <http://www.sciencedirect.com/science/article/pii/S2110701713600098>

- Demekas, D.G., Horváth, B., Ribakova, E. and Wu, Y. (2005). Foreign direct investment in Southeastern Europe: How (and how much) can policies help? IMF Working Paper No. 05/110. <https://www.imf.org/external/pubs/cat/longres.aspx?sk=18247.0>
- Docquier, F., Rapoport, H. and Salomone, S. (2012). Remittances, migrants education and immigration policy: Theory and evidence from bilateral data. *Regional Science and Urban Economics*, 42(5), 817–828.
<http://www.sciencedirect.com/science/article/pii/S0166046211001219>
- Frankel, J. (2011). Are bilateral remittances countercyclical? *Open Economies Review*, 22(1), 1–16. <http://link.springer.com/article/10.1007%2Fs11079-010-9184-y>
- Feenstra, R. C., Markusen, J.R. and Rose, A.K. (2001). Using the gravity equation to differentiate among alternative theories of trade. *Canadian Journal of Economics*, 34(2), 430–447. <http://onlinelibrary.wiley.com/doi/10.1111/0008-4085.00082/abstract>
- Freund, C. and Spatafora, N. (2008). Remittances, transaction costs, and informality. *Journal of Development Economics*, 86(2), 356–366.
<http://www.sciencedirect.com/science/article/pii/S0304387807000818>
- Gibson, J., McKenzie, D. and Rohorua, H. (2006). How cost elastic are remittances? Estimates from Tongan migrants in New Zealand. University of Waikato, Department of Economics, Working Paper No. 20/6.
<http://researchcommons.waikato.ac.nz/handle/10289/1639>
- Hattari, R. and Rajan, R.S. (2008). Sources of FDI flows to developing Asia: The roles of distance and time zones. ADBI working paper series, No. 117.
<http://www.econstor.eu/bitstream/10419/53582/1/604626827.pdf>
- Hausman, J.A. (1978). Specification tests in econometrics. *Econometrica*, 46(6), 1251–1271. <http://www.jstor.org/stable/1913827>
- Hausman, J.A. and Taylor, W.E. (1981). Panel data and unobservable individual effects. *Econometrica* 49(6), 1377–1398. <http://www.jstor.org/stable/1911406>
- Iqbal, M. and Khan, M.F. (1981). Economic implications of the return flow of immigrants from the Middle East: A preliminary study. Pakistan Institute of Development Economics, Research Reports No. 132.
<http://opendocs.ids.ac.uk/opendocs/handle/123456789/2543#.VqCUg0bCoaA>
- Irfan, M. (1999). Emigration from Pakistan – 1947–97. MPRA Paper No. 38623, University Library of Munich, Germany. <https://mpra.ub.uni-muenchen.de/38623/>
- Karemera, D., Oguledo, V.I., and Davis, B. (2000). A gravity model analysis of international migration to North America. *Applied Economics*, 32(13), 1745–1755.
<http://www.tandfonline.com/doi/abs/10.1080/000368400421093>

- Kemegue, F., Owusu-Sekyere, E., and van Eyden, R. (2011). What drives remittance inflows to Sub-Saharan Africa? A dynamic panel approach. *Ersa – economic research southern africa*, Working Paper No. 262.
<http://www.econrsa.org/publications/working-papers/what-drives-remittance-inflows-sub-saharan-africa-dynamic-panel-approach>
- Kock, U. and Sun, Y. (2011). Remittances in Pakistan: Why have they gone up, and why aren't they coming down? International Monetary Fund, Working Paper No. 11/200.
<https://www.imf.org/external/pubs/ft/wp/2011/wp11200.pdf>
- Lewer, J.J. and Van den Berg, H. (2008). A gravity model of immigration. *Economics Letters*, 99(1), 164–167.
<http://digitalcommons.unl.edu/cgi/viewcontent.cgi?article=1023&context=managementfacpub>
- Lueth, E. and Ruiz-Arranz, M. (2008). Determinants of bilateral remittance flows. *The BE Journal of Macroeconomics*, 8(1).
<http://www.degruyter.com/view/j/bejm.2008.8.1/bejm.2008.8.1.1568/bejm.2008.8.1.1568.xml>
- Mayda, A. M. (2010). International migration: A panel data analysis of the determinants of bilateral flows. *Journal of Population Economics*, 23(4), 1249–1274.
<http://www.jstor.org/stable/40925859>
- Ministry of Finance, (2013). Pakistan Economic Survey 2012–13. Government of Pakistan, Islamabad. http://www.finance.gov.pk/survey_1213.html
- Mundlak, Y. (1978). On the pooling of time series and cross section data. *Econometrica*, 46(1), 69–85.
<https://www.econometricsociety.org/publications/econometrica/1978/01/01/pooling-time-series-and-cross-section-data>
- Mughal, M.Y. and Makhlof, F. (2011). Volatility of remittances to Pakistan: What do the data tell? *Economics Bulletin*, 31 (1), 605–612.
<http://www.accessecon.com/Pubs/EB/2011/Volume31/EB-11-V31-I1-P58.pdf>
- OECD (2013). International migration database. OECD Publishing.
<https://stats.oecd.org/Index.aspx?DataSetCode=MIG>
- Oak, C (2014). Country Viewport: Digital Money in Pakistan 2014, Shift Thought Ltd.
http://digitalmoney.shiftthought.co.uk/sage/View_Viewports/Viewport_Pakistan_2014/
- Orozco, M. (2003) Worker remittances in the international scope. Inter-American Dialogue, Inter-American Development Bank Working Paper, commissioned by the Multilateral Investment Fund.
<http://www.iadb.org/wmsfiles/products/publications/documents/35076501.pdf>

- Ozden, C., and Schiff, M.W. (Eds.). (2006). International migration, remittances, and the brain drain. World Bank Publications, Report No. 33988.
<http://documents.worldbank.org/curated/en/2006/01/6360661/international-migration-remittances-brain-drain>
- Portes, R., and Rey, H. (2005). The determinants of cross-border equity flows. *Journal of International Economics*, 65(2), 269–296.
<http://www.sciencedirect.com/science/article/pii/S0022199604000716>
- Rapoport, H., and Docquier, F. (2006). The economics of migrants' remittances. *Handbook of the Economics of Giving, Altruism and Reciprocity*, 2, 1135–1198.
- Ratha, D. and Shaw, W. (2007). *South-South migration and remittances*, World Bank, Washington DC.
- Schiopu, I. and Siegfried, N. (2006). Determinants of workers' remittances: Evidence from the European neighbouring region. European Central Bank, Working Paper No. 688.
<https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp688.pdf?f31c4dfff2b68deec59ef90384bc8e4f>
- Singh, R.J., Haacker, M., Lee, K.W. and Le Goff, M. (2011). Determinants and macroeconomic impact of remittances in Sub-Saharan Africa. *Journal of African Economies*, 20(2), 312–340.
<http://mh.devgro.com/papers/singhaackerleelegoff2011.pdf>
- Sander, C. (2004). Capturing a market share? Migrant remittances and money transfers as a microfinance service in Sub-Saharan Africa. *Small Enterprise Development*, 15(1), 20–34.
- Stark, O., and Taylor, J.E. (1991). Migration incentives, migration types: The role of relative deprivation. *The Economic Journal*, 101(408), 1163–1178.
<http://www.jstor.org/stable/2234433>
- State Bank of Pakistan (2012). Annual performance review, 2011–12.
<http://www.sbp.org.pk/reports/annual/arFY13/Vol2/anul-index-eng.htm>
- State Bank of Pakistan (2014). Country-wise workers' remittances.
<http://www.sbp.org.pk/stats/survey/index.asp>
- Vargas-Silva, C., and Huang, P. (2006). Macroeconomic determinants of workers' remittances: Host versus home country's economic conditions. *Journal of International Trade and Economic Development*, 15(1), 81–99.
<http://www.tandfonline.com/doi/pdf/10.1080/09638190500525779>
- United Nations (2014). Trends in international migrants stock, Department of Economic and Social Affairs.
- UNCTAD (2013). UNCTA Dstat. New York: United Nations.

- Wahba, S. (1991). What determines workers' remittances?. *Finance and Development* 28 (4), 41–44.
- Wooldridge, J.M. (2002). *Econometric analysis of cross section and panel data*. MIT press. <https://mitpress.mit.edu/books/econometric-analysis-cross-section-and-panel-data>
- WDI (2013). World Development Indicators. Online Database, World Bank.
- World Bank. (2014a). Migration and remittance: Recent developments and outlook. Migration and Development Brief 22. Migration and Remittances Unit, Development Prospects Group. Washington DC. <https://siteresources.worldbank.org/INTPROSPECTS/Resources/334934-1288990760745/MigrationandDevelopmentBrief22.pdf>
- World Bank. (2014b). Remittance prices worldwide: Making markets more transparent. Washington DC.

Appendix

Table A.1. Correlations matrix

	1	2	3	4	5	6	7	8	9	10
1	1									
2	0.05	1								
3	-0.23	0.13	1							
4	0.73	0.00	-0.41	1						
5	0.28	0.00	0.13	0.62	1					
6	0.15	-0.12	-0.16	0.07	-0.10	1				
7	0.45	0.24	-0.48	0.53	0.22	-0.03	1			
8	-0.05	-0.41	-0.07	-0.00	-0.00	0.07	-0.08	1		
9	-0.01	-0.32	-0.05	0.00	0.00	0.03	-0.07	-0.11	1	
10	-0.76	0.00	0.65	-0.88	-0.31	-0.10	-0.73	0.00	0.00	1

Note: Number of observations: 299. 1. GDP (host). 2. GDP (home). 3. Migrants Stock. 4. Geographical distance. 5. Common language (official) 6. Bilateral exchange rate 7.Domestic credit to private sector (host) 8.Domestic credit to private sector (home) 9.Political stability (home) 10. Common religion.

Table A.2. Gravity model for 2008-2013 with actual transaction cost

VARIABLES	(1)
GDP (host)	-0.0282 (0.0202)
GDP (home)	- -
Migrants stock	0.752*** (0.205)
Common language	1.159 (0.724)
Transaction cost	-0.199 (0.158)
PRI_dummy_2011	0.186** (0.078)
Bilateral exchange rate	0.443*** (0.132)
Political stability (home)	- -
Observations	116

Note: *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$. Robust standard errors in parenthesis. All the variables except dummies and exchange rate are in natural logs. Hausman and Taylor approach used. The endogenous variables are GDP (host) and GDP (home) and migrant stock.

Please note:

You are most sincerely encouraged to participate in the open assessment of this article. You can do so by either recommending the article or by posting your comments.

Please go to:

<http://dx.doi.org/10.5018/economics-ejournal.ja.2016-4>

The Editor