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Voting With The Wallet: The Response of Remittances to Political Systems

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Abstract

Existing economic literature has clearly established that remittances represent a significant source of international capital flows for financing the development of countries of emigration. This paper investigates the empirical relationship between political systems and remittances. In a panel data study of 83 of developing countries from 2007 to 2016, 61 countries were classified as having a relatively advanced democratization process and 22 countries have as having a relatively weak democratization process. By using Generalized Method of Moments (GMM), the results show that countries with advanced democratic processes and economic freedom are more likely to benefit from remittances. Countries still in the process of democratization should accelerate the process in order to incorporate migration into their economic development.

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1 Introduction

The most obvious link between international migration and countries of origin has been and will continue to be remittances. Remittances are considered as a major channel through which wealth is transferred across countries (Buyukkarabacak et al., 2016). In fact, according to World Bank data, remittances reached more than \$500 billion in 2017 with a more pronounced increase since the turn of the century. Remittances may be significant in not only raising the consumption for recipient families but also in increasing productivity, especially when the weight of remittances in the general economy is relatively high (Makhlouf, 2018). The positive role played by remittances in terms of development has been demonstrated in several studies (Mjaku and Mjaku, 2017; Frankel, 2010; Bouhga-Hagbe, 2006, and others). This increasing importance of remittances has motivated economists to investigate the macroeconomic determinants implied. Indeed, the impact of economic conditions in the home country on international remittances and their fluctuations has become a central issue in economics (Makhlouf, 2013; Mughal and Makhlouf, 2010). As previously stated and demonstrated in economic literature, the economic conditions in both origin and host country impact remittances, for example, see the literature review of (Hagen-Zanker and Siegel, 2007) on macro-economic determinants of remittances. By empirically testing the impact of political conditions in home countries, this paper goes further and presents this as a new determining and decisive factor for remittances. A significant number of previous studies have focused on the macroeconomic determinants of remittances. These studies however, focus more on the impact of economic conditions in host countries than in countries of origin, namely GDP, exchange rate, inflation, financial development (Hagen-Zanker and Siegel, 2007). Conversely, few studies consider the impact on remittances of political conditions in countries of origin. For example, cultural and political factors in the country of origin could also influence remittance volumes (Elbadawi et al., 1992). Recently, using an example of Tunisia, in the context of Arab Spring, remittances increased as a result of the fall of the old regime (Edelbloude et al., 2017).

This paper will try to extend the findings of (Edelbloude et al., 2017) (that remittances have increased in Tunisia as a result of the introduction of democracy) by investigating a panel of emigration countries and also by using several democracy-related variables. Furthermore, this paper brings new insights to the debates which have largely concentrated on migrant reaction to changes in the political systems in their home countries and the subsequent reaction of remittances. Remittances may react to changes in the political system in countries of origin for two main reasons:

- First, migrants send money to finance the democratic process. In this case a negative link between remittances and democracy is expected. Again, once the democratic process is completed, migrants will send less. In others words, migrants sent money only to help their families and to alleviate the budgetary constraints of their families they left behind in their country of origin. The democracy could have direct impact on remittances through the channel of

political economy. With an advanced political system the redistribution and the fiscal policy may be efficient and adequate and migrants have no need to send money to compensate for an insufficient distribution policy.

- Second, migrants who are disappointed with political systems in their countries of origin will limit their remittances to altruistic purposes. In this case, an improvement in political systems will encourage migrants to send more, for example to buy houses or co-finance investment projects. Similarly, [Funkhouser \(1992\)](#) thinks that the difference in the behavior of remittances between Salvadoran and Nicaraguan migrants can be explained, in part, by political hostility or family detachment among those best able to remit. Democracy can provide migrants with a perception of participation in the political orientations of their countries of origin. For this reason, we expect democracy to have a positive effect on remittances.

The literature exploring links between the political situation of a home country and remittances raises the following questions: Can remittances be considered as a form of political participation? Do emigrants vote with their wallet in the same way as others vote with their feet? In his article about the fall of the German Democratic Republic, [Hirschman \(1978\)](#) established a link between migration and democracy based on the idea of a political safety-valve. He considered « the cost of exit may rival the cost of voice ». With this in mind, having been considered as an act of loyalty towards the home country, could remittances also be considered as a form of voice after an exit? An empirical study is needed to clarify the link between remittances and the political system in the country of origin. By using panel data for 83 developing countries from 2007 to 2016 and controlling endogeneity with GMM technique, results show that countries with advanced democratic processes and economic freedom are more likely to benefit from remittances.

Naturally, with the emergence of internet communication technologies (ICTs), migrants are more connected to their country of origin. Consequently, this generates a quick-reaction from migrants depending on the nature of the information received. In terms of remittances, the response of migrants with a democratic system in their country of origin will differ from those with an autocratic system. As an illustration, the Kurdish diaspora has played an important role in providing vital assistance in the reconstruction of the Kurdistan region of Iraq ([Baser, 2018](#)). As [Stiglitz \(2002, P.166\)](#) notes, people have a legitimate right to know what the government is doing and why. In this case, migrants may join the development process of their countries of origin, particularly through their remittances.

This paper contributes to existing literature by: Firstly attempting to understand the role of political systems in the participation of migrants in their countries of origin through remittances. Secondly, the paper distinguishes between countries with a relatively advanced democratic process and countries with low scores on their democracy level. A distinction is made between what is considered in the literature review as a temporary political shock, (namely the study by [Edelbloude et al. \(2017\)](#) on the impact of the Arab Spring on remittances) and a permanent political situation. The results complement previous

studies on the impact of the political situation in the migrant-sending countries on remittances.

Section 2 of this paper reviews earlier studies, mainly on the macroeconomic determinant of remittances and the relationship between democratization and remittances. Section 3 provides the context of this study, describes data and econometric strategy and comments on the results. Section 4 concludes this study.

2 Literature Review

Since the pioneering work of [Lucas and Stark \(1985\)](#) at the micro-economic level and [Swamy \(1981\)](#) at the macroeconomic level, the number of empirical studies on determinants of remittances has significantly increased. Several researchers into macro-economic determinants have tried to study the interlinkages between economic conditions in home and host countries and remittances, namely the links between GDP per capita, exchange rates, interest rates and financial development. [Hagen-Zanker and Siegel \(2007\)](#) establish a review of macroeconomic determinants of remittances. Only few papers incorporate variables related to political systems into the explanation of remittances; all the more relevant since the political context can certainly influence remittances ([Arestoff and Kuhn, 2010](#)). [Funkhouser \(1992\)](#) states that the difference in remittance amounts between El Salvador and Nicaragua can be explained by behavioral coefficients. Recently, in the case of Pakistan, by using GMM technique, [Abbas et al. \(2017\)](#) find that democracy induces remittances. In the same way [Edelbloude et al. \(2017\)](#) find strong evidence that remittances associated with Arab Spring increased in the case of Tunisia. They concluded that migrants remain connected with their home countries and their remittances reflect their reactions. In this case remittances can be viewed as a fuel for political revolutions and migrants can participate and go along with political transition. [Konan \(2017\)](#), by analyzing the determinants of international remittances received during the post electoral crisis in Côte d'Ivoire, finds that the crisis has been a means for mobilizing social capital and increasing remittances. In the Middle East and North Africa (MENA) region [Docquier et al. \(2017\)](#) by using empirical investigations find that individuals who intend to emigrate to high-income countries share more gender-egalitarian views.

In the case of Mozambique, [Batista et al. \(2017\)](#) show that inhabitants of a village will intensify their demand for political accountability from a fellow voter according to the number of migrants in close contact with him/her. Why do some immigrants send more money to their country of origin than others? Studying this question [Carling \(2008\)](#) emphasizes the fact that some migrants send more than others. [Sinning \(2011\)](#) reveals that return intentions positively affect remittances in the case of migrants living in Germany. In this particular case institutions may play an important role in the decision to return home.

The economic literature exploring links between the political situation of a country of origin and remittances raises the question of the indirect participation

of Diaspora to political issues in their home country, mainly through the votes cast. For example, [Lafleur and Sánchez-Domínguez \(2015\)](#) examine the variables which influence the electoral behavior of emigrants voting in their home country. Analyzing the participation from Bolivian emigrants in the 2009 Bolivian presidential election from abroad, they tested empirically a voter-typology model based on scientific literature. They identified the drivers of immigrant transnational political participation. [Burgess \(2012\)](#) takes the example of Mexican emigrants living in the USA. He examines the influence exerted by migrants from new democracies on the politics of their home countries, especially in electoral politics and civic engagement. For the purposes of this paper the question is whether remittances should be considered as a more implicit form of political mobilization, with no correlation to the electoral calendar. By studying the case of Thailand, [Osaki \(2003\)](#) suggests that sending remittances is a practice rooted in altruism. It enables migrants to maintain and cultivate personal contact over time with relatives left behind. The idea of this paper is to test, on developing countries, the idea put forward by [Edelbloude et al. \(2017\)](#) in the case of Tunisia where migrants have reacted positively through their remittances to changes in the political system and to complete studies on the impact of non-economic variables on remittances.

3 Empirical investigations

3.1 Data

We construct panel data to include 83 developing countries from 2007 to 2016¹. In order to assess the impact of variables on remittances linked to democracy we use remittances as a percentage of GDP in receiving countries as the dependent variable. Democracy variables are obtained from POLITY IV PROJECT data. The two principal variables considered are “DEMO” and “POLITY”. Definitions are given below.

DEMOC: Democracy is conceived by three essential interdependent elements. The first is the presence of institutions and procedures through which citizens can express effective preferences about alternative policies and leaders. Second is the existence of institutionalized constraints on the exercise of power by the executive. Third is the guarantee of civil liberties to all citizens in their daily lives and in acts of political participation. The Democracy indicator is an additive eleven-point scale (0-10 with 0: lack of democracy and 10: strong democracy). The operational indicator of democracy is derived from outcomes of the competitiveness of political participation, the openness and competitiveness of executive recruitment and constraints on the chief executive. Figure 1 in the annex shows that in all countries the trend is towards democratization.

POLITY: The POLITY scale ranges from +10 (strongly democratic) to -10 (strongly autocratic). Data on remittances have been obtained from World

¹List of countries given in table 3 in appendix

Bank (WDI, 2017). In our sample, 61 countries have a democracy indicator that ranges from 5 to 10 and 22 countries with an indicator distinctly below².

3.2 Empirical specification

Causality may go in both directions - remittances to democracy and vice versa - so Generalized Method of Moments (GMM) was used to deal with the issue of endogeneity between remittances and democracy indicators. The empirical analysis examines the dynamic linear panel model for the remittances (model 1). In this approach we estimate the effect of democracy on remittances to GDP:

$$\log(\text{Remit}_{it}) = \beta_1 \text{DEMOC}_{it} + X'_{it}\theta + \varepsilon_{it} \quad (1)$$

where Remit_{it} is the remittances per GDP in country i at time t , democ_{it} is the measure of democracy in country i at time t , X is the matrix of explanatory variables. ε_{it} error term including time-varying unobservable variables. The model is estimated by system GMM technique proposed by Blundell and Bond (1998). We control the classical determinants of remittances such as exchange rate, inflation and GDP per capita and inflation, we add two variables that could have an effect on remittances that are economic freedom and local culture³.

Explanatory variables used in model (1) allow us to control the economic environment in the countries of origin. The GDP per capita can capture the altruism effect. Under the altruism effect, remittances increase after a negative shock in income in the home country (Sayan, 2006). The exchange rate can also affect remittances (Farid, 2014; Makhoul and Mughal, 2013). There is no consensus in economic literature on the nature of the relationship between exchange rate and remittances, for example Sayan (2006) finds a positive relationship while Singh et al. (2010); Batista et al. (2017) find a negative relationship. Changes in exchange rate cause substitution effect of revenue. We use the real effective exchange rate from the World Bank (WDI, 2010). Labor-exporting countries with relatively high economic freedom could increase the incentive for migrants to invest. As stated by Gershman (2015) the evil eye belief⁴ leads people to adopt the “right kind” of behavior. As a corollary, migrants from countries that have a belief related to evil eye may apply that belief

²Countries with relatively high level of democracy are: Albania; Argentina; Armenia; Benin; Bolivia; Botswana; Brazil; Burundi; Bulgaria; Colombia; Comoros; Costa Rica; Croatia; Cyprus; Czech Republic; Dominican Republic; Ecuador; Estonia; Ghana; Guinea-Bissau; Georgia; Guatemala; Guyana; Honduras; Hungary; India; Indonesia; Jamaica; Kenya; Latvia; Lesotho; Lithuania; Madagascar; Mauritius; Malawi; Mexico; Moldova; Mongolia; Mozambique; Namibia; Nepal; Nicaragua; Niger; Panama; Paraguay; Peru; Philippines; Poland; Romania; El Salvador; Senegal; Sierra Leone; Slovak Republic; Slovenia; Solomon Islands; Sri Lanka; Trinidad and Tobago; Turkey; Ukraine; Uruguay; Zambia.

Countries with low level of democracy are: Algeria; Azerbaijan; Burkina Faso; Bangladesh; Cameroon; China; Ethiopia; Fiji; Jordan; Kazakhstan; Malaysia; Morocco; Nigeria; Pakistan; Rwanda; Tanzania; Thailand; Turkmenistan; Togo; Uganda; Uzbekistan; Vietnam.

Table 1 in appendix reports summary statistics on the data employed in empirical investigations.

³We thank the anonymous reviewer for suggesting these two variables.

⁴<http://pewforum.org>.

to their remittances. Data on the evil eye⁵ belief are obtained from Standard Cross-Cultural Sample (SCCS).

3.3 Results

Results (reported on table 2) show that, when the process of democracy is well established it has a significant and positive impact on remittances. We replace democracy by POLITY. Results indicate that the efficiency of democracy enhances the level of remittances. However, the level of remittances drops when the political system is an autocracy. The coefficients on GDP per capita, exchange rate are found to be significant. These results show that remittances are higher when GDP per capita is weak, which support the altruism assumption (Agarwal and Horowitz, 2002), and when currency is depreciated or devalued. The lagged variable of remittances is significantly positive. In order to check if the effect of democracy or autocracy is greater in countries with a high level of GDP per capita, we introduce an interaction term into our model, between democracy indicators and GDP per capita. Table 2 reports the results of the joint effect of GDP per capita and democracy on remittances and shows a negative and significant interaction between GDP per capita and democracy on remittances.

The economic freedom of the world index has also been included in the model. We found that countries with lower economic freedom are more likely to receive less from remittances. Migrants who are fearful of their entourage do not display their assets and personal property to their own community; they prefer to invest in their countries of origin where people do not know them they no longer have personal, daily contacts.

3.4 Comments / Discussion

Our corpus brings together countries at different levels of democracy, corresponding with several waves of democratic transition. The first one began in the middle of the 20th Century with massive decolonization, which allowed many countries to become independent. The following waves occurred in the seventies and eighties in the South American and Latin American dictatorships. Then, in the early nineties, in post-socialist Europe, so that the meaning of concept of « Arab authoritarian exception » made its first appearance, describing the persistence of authoritarian regimes in Arab countries from the 1990s until the Arab Spring in 2010-2011. The present political instability and pseudo-democracy that reigns in Africa is the results directly in poor governance, subsequent discontent among the population, which can lead to mass migration. In contrast, concerning the consequences of remittances on the political system in home countries, some papers question these assumptions (stabilization of autocracies

⁵Variables used for evil eye belief are: eye1 with two values 0 (absent) and 1(present) and eye2 is coded as following: absent (1), almost certainly absent (2), probably absent (3), possibly absent (4), possibly present (5), probably present (6), almost certainly present (7), incontrovertibly present (8).

vs. democratic transition). As [Escribà-Folch et al. \(2015\)](#) showed, thanks to remittances, voters are less dependent on state transfers. As a consequence of the diminishing support for autocratic regimes, the likelihood of democratization increases in party-based dictatorships. Contrary to this, in dominant-party-regimes remittances may be used to finance patronage instead of increasing private consumption. Even if he does not focus on remittances in particular, but treats the migration movements as a whole, [Pfütze \(2012\)](#) shows that international migration does impact the functioning of democratic institutions in home countries. Migrants' democratic dissatisfaction may lead them to limit their transfers to those intended only to ease the budgetary constraints of their families left behind, limiting or putting a stop to any further investment, house purchases for example. To explain one of these consequences of migration, he cites Mexico's remittances as one means of making citizens from the sending countries less dependent on local governments and practices such as clientelism. In an authoritarian regime, remittances are high and could be limited to aid and purely altruistic reasons. Generally, in these highly autocratic countries migrants leave because they are dissatisfied (push factor) and do not benefit from redistribution policies with a feeling of exclusion. In a regime where the process of democracy is well advanced, the level remittances can be explained by the desire for investment and participation in development. In fact, migrants do not feel excluded from economic policy decisions. In this case, migrants leave for pull factors. Migrants who believe in the 'evil eye' will not accumulate capital and demonstrate wealth in host countries because they fear the reactions of other members of their community. Instead of investing or purchasing goods in the host country, they will endeavor to transfer money to their country of origin. Migrants living in communities with a shared culture behave and react as they would in the country of origin; they will try to transfer their property to a city or village where very few people know them, in order to protect themselves from the evil eye. Consequently, their remittances will be higher than those from migrants who do not believe in the evil eye.

4 Conclusion

The aim of this study was to examine the role that democracy plays in attracting remittances to the home country. Our main findings suggest that democracy in their home country boosts migrants to send home more remittances. An advanced process of democracy generates a desire among migrants to send more. In addition, classical determinants of remittances - GDP per capita, exchange rate - show results in line with our expected results. Depreciated or devalued currency stimulates migrants to send even more toward home country increase the amount they send back home. A negative income shock will generate more remittances regardless of the political situation. Economic freedom and local culture have a significant effect on remittances. Countries in political transition will not benefit more from international migration, especially through remittances, than do highly democratic countries. Countries with a weak de-

mocratization process should reform their institutions in order to accelerate the democratization process and integrate migration as an important component of development.

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Appendix

Table 1: Summary Statistics

Statistic	N	Mean	St. Dev.	Min	Pctl(25)	Pctl(75)	Max
Remit	830	5.196	6.276	0.005	0.961	7.367	35.052
GDPcapita	830	5,414.146	5,537.089	218.284	1,174.230	8,173.388	25,447.430
Exchange.rate	430	100.784	10.936	67.067	96.639	104.775	150.361
Inflation	830	6.346	7.763	-27.633	1.993	8.416	103.823
DEMOC	830	6.364	3.278	0	5	9	10
P_OLITY	830	5.183	5.247	-9	4	9	10
Eco_freedom_rank	830	81.887	38.027	5	52	114	160
eye	830	0.482	0.500	0	0	1	1
eye2	830	3.422	3.653	0	0	8	8

Table 2: The Effect of Democracy on Remittances
GMM Blundell and Bond

	Remittances to GDP			
	(1)	(2)	(3)	
lag(log(Remit), 1)	0.937*** (0.008)	0.938*** (0.007)	0.932*** (0.008)	0.851*** (0.015)
log(GDPcapita)	-0.061*** (0.01)	-0.061*** (0.009)	-0.067*** (0.010)	-0.103*** 0.0178
log(Eco_freedom_rank)	-0.0268*** (0.009)	-0.027*** (0.009)	-0.025*** (0.009)	-0.090*** (0.013)
DEMOC	0.006*** (0.002)		0.007*** (0.005)	0.054*** (0.0151)
POLITY		0.004*** (0.001)		
eye1	0.049*** (0.017)	0.051*** (0.016)	0.188 0.021***	
eye2			0.009*** (0.005)	
Inflation	-0.0044*** (0.0007)	-0.0042** (0.0006)	-0.0043*** (0.005)	-0.006*** (0.0007)
Echange rate				-0.004*** (0.0005)
DEMOC × GDPcapita				-0.005*** (0.001)
Balanced Panel n	83	83	83	83
T	10	10	10	10
Number of Observations Used:	830	830	830	731
Sargan test: chisq(48)	46.35052 (0.540)	46.38125 (0.539)	45.823 (0.562)	chisq(50) = 40.143 (0.8392)
p-value	-3.220 (0.504)	-3.150 (0.0016)	-3.233 (0.0012)	-2.3411 (0.019)
Autocorrelation test (1)	0.667 ($\leq e^{-16}$)	0.661 (0.508)	0.660 (0.509)	0.1616 0.871
Wald test for coefficients	chisq(6) = 34746.51 ($\leq e^{-16}$)	38324.73 ($\leq e^{-16}$)	33648.07 ($\leq e^{-16}$)	9656.9 ($\leq e^{-16}$)
p-value	chisq(8) = 36.6 (0.00001)	37.833 (0.000008)	34.220 (0.00003)	31.405 (0.0001)

Notes: ***Significant at the 1 percent level.
**Significant at the 5 percent level.
*Significant at the 10 percent level.

Table 3: List of Countries

Albania Algeria Argentina Armenia Azerbaijan Benin Burkina Faso Bangladesh Bolivia Botswana Brazil
Burundi Bulgaria Cameroon China Colombia Comoros Costa Rica Croatia Cyprus Czech Republic Dominican Republic
Ecuador Estonia Ethiopia Fiji Ghana Guinea-Bissau Georgia Guatemala Guyana Honduras Hungary India
Indonesia Jamaica Jordan Kenya Kazakhstan Latvia Lesotho Lithuania Madagascar Malaysia Mauritius
Malawi Mexico Moldova Mongolia Morocco Mozambique Namibia Nepal Nicaragua Nigeria Niger Pakistan Panama
Paraguay Peru Philippines Poland Romania Rwanda El Salvador Senegal Sierra Leone Slovak Republic Slovenia
Solomon Islands Sri Lanka Tanzania Thailand Turkmenistan Togo Trinidad and Tobago Turkey Uganda Ukraine
Uruguay Uzbekistan Vietnam Zambia

Figure 1: Plot Mean (Democracy)

