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The decision to remit is a matter of interpersonal trust

Kamal Kasmaoui
ESC Pau Business School

Farid Makhlouf
ESC Pau Business School

Refk Selmi
ESC Pau Business School

Abstract

This article seeks to assess the role of the level of interpersonal trust in a country in the remittance landscape. Using historical data from the 2010-2014 wave of the World Value Survey (WVS) for interpersonal trust, our findings underline the substitution role played by interpersonal trust with remittances. More accurately, remittances tend to drop when the rate of interpersonal trust in the country of origin is high. Overall, a rise in trust is likely to underpin social cohesion, limiting therefore the need for remittances. These results are still fairly solid and unambiguous after controlling for confounding factors and possible reverse causality.

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Contact: Kamal Kasmaoui - kamal.kasmaoui@esc-pau.fr, Farid Makhlouf - farid.makhlouf@esc-pau.fr, Refk Selmi - refk.selmi@esc-pau.fr.
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1. Introduction

Social cohesion and trust among individuals have long been documented in the existing literature. In retrospect, Ibn Khaldun, the well-known 14th century historian, economist and the father of sociology, borrowed in his book Al Muqaddimah (1377) the concepts of social cohesion and solidarity among groups in society. He re-considered the original meaning of social cohesion (i.e., people related to each other by blood ties), and underscored that it rather implies solidarity, group feeling as well as awareness. He added that social cohesion is one of the crucial elements that influences the power and weakness of a group or tribe. It must be pointed out here that there is no common definition of social cohesion. A variety of indicators have been employed to investigate social cohesion but the most frequent indicators incorporate measures of trust and common social norms. Indeed, the trust can be perceived as "*the expectation that arises within a community from regular, honest and cooperative behaviour, based on commonly shared norms, on the part of other members of that community*" (Fukuyama, 1995, pp. 36).

The link between trust and economic outcomes have been largely studied. On the one hand, the trust's impact on economic development has been the subject of many economic researches (Guiso et al. 2006; Algan and Cahuc, 2010, among others). On the other hand, some empirical studies have tried to assess the extent to which the trust is linked to the income inequality (for example, Alesina and La Ferrara, 2000; Jordahl, 2007). Nevertheless, the effect of trust on remittances has not yet been well discussed and/or explored, although there was a wider policy concern regarding the effect of immigration on social cohesion. Given this consideration, this study attempts to address whether the level of interpersonal trust in a country has a significant impact on the remittances made by its diaspora. It must be stressed at this stage that interpersonal trust is hugely perceived as a key factor for development and social cohesion (see inter alia, Knack and Keefer, 1997; La Porta et al., 1997, Zak and Knack, 2001, Kasmaoui et al., 2018). Moreover, Fukuyama (1995) stated that trust can be also regarded as the basis of the virtuous circle of the economy. Building trust is not easier in any country, and it seems likely to be much more difficult in developing countries. Based on trust data from the latest World Value Survey (WVS, 2010-2014) covering 60 countries in the world, the average of trust in developed countries is 42.17%, while it is about 17.90% in developing countries. In some countries like Norway and Sweden, more than 60% of respondents deeply believe that people can be trusted. In other countries such as Brazil, only

10% of respondents agreed that people can be trusted. Overall, the level of trust is relatively low in developing countries (see Figure A1 in Appendix).

At the same time, the majority of developing countries are considered as emigration countries. Generally speaking, the lower the country's income, the more likely its citizens will tend to migrate, and in turn the greater will be its remittances flows. Owing to its size, its marked stability and its countercyclical behavior tending to rise during times of distress and heightened uncertainty, this issue has devoted a tremendous attention. Given the growing evidence on the huge role of remittance flows relative to other flows in developing countries, it is highly anticipated that the last decade was marked by increasing interest of policymakers and academics devoted to their developmental role. More particularly, the contribution of remittances to the overall development has been largely documented (for instance, Chami et al. 2005; Ratha, 2007; Ruiz et al. 2009; Fayissa and Nsiyah, 2008; 2010; Rao and Hassan, 2012; Makhlouf, 2013). In fact, migrant remittances are viewed as a source of foreign funds of paramount importance for several developing countries. Remittances continue to rise to over $500 billion in 2018 (World Bank). In some countries including Nepal, Tajikistan and Tonga, the share of remittances attained more than 30% of GDP, according to the World Bank. At the present, remittances are more than double the official aid received by these economies. According to Ratha (2007), "*remittances directly augment the income of recipient households. In addition to providing financial resources for poor households, they affect poverty and welfare through indirect multiplier effects and also macroeconomic effects*".

In addition to the remittances' contribution to the economic development, prior research tried to address what drives these inflows and what causes developing countries to receive different levels of remittances. Remittances are driven by social, economic and behavioral factors in receiving countries (for instance, Makhlouf, 2013; Edelbloude et al., 2017). Remittances are also determined by cultural and political situations in home countries (see, for example, Makhlouf et al. 2019). Since remittances are affected by the economic situation in countries of origin, one can expect that the level of remittances might be affected by the behavior of the people who receive them. In that case, trust is a major issue. In fact, remittances may be strengthened by ties between migrants and their families and friends in the country of origin.

The present research incorporates a reflection of the association between social capital and economic development by discussing the question whether interpersonal trust rise or lessen the need for remittances. More specifically, this study goes beyond the various usual determinants of remittances by seeking to test if the trust heterogeneity in developing countries exert a significant impact on remittance inflows. To this end, we use the WVS trust data for most emigration countries[1] and remittances from the World Bank. Our findings reveal that interpersonal trust has a negative effect on remittances. These results are still fairly solid and unambiguous after controlling for confounding factors and possible reverse causality.

The remainder of the article is organized as follows: Section 2 discusses the factors determining remittances dynamics. Section 3 presents the conducted methodology and the data. Section 4 reports and discusses the main findings. Section 5 concludes and provides some policy implications.

2. Methodology and data collection

We use cross sectional data to explore the relationship between trust and remittances. Data for the variable of interest "*trust*" comes from the World Value Survey (WVS). We obtain data for the dependent variable (i.e., remittances) and the rest of independent variables from the World Bank. We expect that a high interpersonal trust in home countries may counteract remittances in countries of origin. The relationship between remittances and trust may be substitutable: When trust is very high in countries of origin, people could easily access financial assistance and informal loans. Trust could encourage exchanges between individuals within countries. In contrast, if individuals do not trust each other, they will tend to be more likely to involve their relatives abroad. In this second case, remittances will undoubtedly increase.

2.1. Identification Strategy

As mentioned at the outset, the main objective of this study is to provide some fresh insights on the role of interpersonal trust in remittance dynamics. However, remittances as external income can also influence the level of trust. While trying to deal with possible endogeneity bias, we conduct an instrumental variable method. Inspired by Knack and Keefer (1997) and Zak and Knack (2001), we instrument trust with the proportion of Muslims and Christians in each country as also used in Kasmaoui et al., (2018). The latter may influence the level of trust in the country of origin but do not have a direct effect on remittances. A way to correct for the endogeneity problem is to perform a two-stage least squares (2SLS) or GMM

[1] The countries under study include Algeria, Armenia, Azerbaijan, Belarus, Brazil, Colombia, Cyprus, Ecuador, Egypt, Georgia, Ghana, Iraq, Jordan, Kazakhstan, Kuwait, Kyrgyzstan, Lebanon, Malaysia, Mexico, Morocco, Nigeri, Pakistan, Palestine, Peru, Romania, Russian Federation, Rwanda, Slovenia, South Africa, Philippines, Poland, Thailand, Trinidad and Tobago, Tunisia, Turkey, Ukraine, Uruguay, Uzbekistan and Yemen.

using lag of the explanatory variables as instruments. In the current study, we conduct a 2SLS model.

2.2. Baseline Model and variables definition

The model performed throughout the rest of our analysis can be denoted as

$$\log(Remit_{i,10-14}) = \beta_1 \log(Trust_{\,i,10-14}) + X_i\,\vartheta + \varepsilon_i \quad (1)$$

Where, ***Remit*** represents the Remittances variable or our dependent variable. Remittances comprise personal transfers and compensation of employees; it is the average annual remittances over the 2010-2014 period, where i represents the countries under study. Remittances inflows are in millions of U.S. dollars.

Trust corresponds to the percentage of people in each country giving the response “most people can be trusted” to the question "*Generally speaking, would you say that most people can be trusted, or that you can’t be too careful in dealing with people?".* Respondents not answering the question on trust were excluded from the dataset. The lowest trust value recorder in our sample is 3.2 % in the Philippines, and the highest rate is 60.3 % in China. The country-wise distribution of non-respondents is summarized in Table A1 (Appendix).

X refers to the matrix of control variables supposed to significantly influence remittances including per capita income, inflation and unemployment in the origin countries. Values of control variables are taken at the beginning of the period considered.

GDP per capita, PPP (lgdp) is the Gross Domestic Product converted into international dollars using purchasing power parity rates (PPP).

Inflation measured by the consumer price index, reflecting the annual percentage change in the cost to the average consumer of acquiring a basket of goods and services that may be fixed or changed at specified intervals (for our case, yearly). Data for this variable are collected from the World Bank.

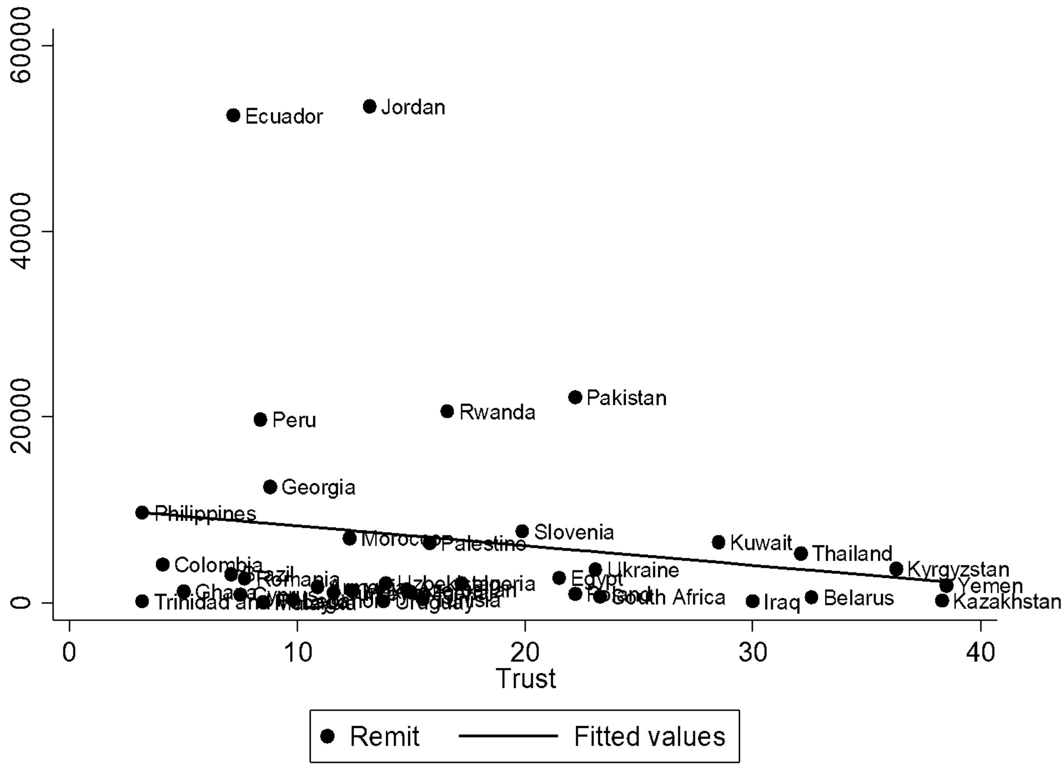
Unemployment refers to the share of the labor force that is without work but available for and seeking employment. Data is downloaded from the World Bank.

Proportion of Muslims and ***Proportion of Christians*** are respectively the proportion of Muslims and the proportion of Christians in each country. Data are collected from Pew Research Center.

Ethnic Fractionalization is an ethnic fractionalization index. Data for this variable are collected from the Historical Index of Ethnic Fractionalization Dataset (HIEF).

The variables consist of data on 41 developing countries taken from the 2010 – 2014 wave of the WVS. We have transformed the variables by taking natural logarithms to correct for heteroskedasticity and dimensional differences between the time series under consideration. Table A2 (in the Appendix) displays the descriptive statistics of the variables used in our analysis. Figure 1 relates the levels of remittances to trust; it shows that countries with high levels of trust also display lower levels of remittances.

Figure 1. Remittances and Interpersonal trust



Source: Authors' calculations.

3. Discussion of results

Table 1 reports the findings of the Baseline model (Column 1) and shows that interpersonal trust in home countries are likely to lower remittances. This outcome is still fairly robust to the incorporation of additional potential control variables (Column 2) and after controlling for possible endogeneity bias (2SLS results, Columns 3, 4, 5, 6, 7 and 8).

Columns 3, 4, 5 and 6 report the first and second-stage estimations of the 2SLS model. Instrumenting for trust with the proportion of Muslims and Christians in the population, the effect of trust on remittances remains significant at the 5% and 10% level respectively. Instrument validity tests show that the instruments are jointly significant in the first stage (as suggested by the value of F test (10.42 and 11.05) and the partial R2 Shea test (0.37 and 0.44). The first stage F-statistic for excluded instruments is greater than ten suggesting that our instruments satisfy the relevance condition. The instruments validate the Hansen J-test of over-identifying restrictions implying that the instruments are not correlated with the error term. Columns 7 and 8 report the first and second-stage estimations of the 2SLS model where using Ethnic Fractionalization as instrument for trust. In doing so, the effect of trust on remittances becomes insignificant. Validity tests of the instruments both the F-statistic, partial R2 Shea and the Hansen J-test show that the instrument (Ethnic Fractionalization) is not valid in the case of our study.

This deeply highlights that international interpersonal trust in countries of emigration is a significant determinant of remittances. Remittances could substitute (i.e., negative correlation) trust between individuals. More precisely, when trust among members of the same community is relatively high, they trust each other, help each other, and lend each other money. In this case, they will have less need of individuals living abroad. However, when trust is weak in countries of emigration, individuals will turn to their relatives or friends living abroad for more assistance. In this case, we may think that migration in general and remittances in particular are a response to the lack of trust among individuals and the trust in institutions. Knack and keefer (1997) assume that ethnic homogeneity is one of the key determinants of trust. They argue that ethnic homogeneity strengthens "social capital" or "trust", which are, in turn, associated with faster growth and high per capita income. Moreover, these authors suggest that Polarization[2] may increase rent-seeking activities that erode trust and undermine norms of cooperation.

[2] “Polarization is typically maximized when there are two groups of equal size, while fragmentation is high when there are several small groups”.

Table 1. The regression of remittances on trust and other potential control variables

Model	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	OLS	**OLS**	**2SLS Stage 1**	**2SLS Stage 2**	**2SLS Stage 1**	**2SLS Stage 2**	**2SLS Stage 1**	**2SLS Stage 2**
VARIABLES	Remit	Remit	Trust	Remit	Trust	Remit	Trust	Remit
ltrust	**-0.814****	**-0.842****		**-1,404****		**-1,176***		**-0,426**
	(0.332)	(0.336)		(0.704)		(0.642)		(2.532)
lgdp	-0.961***	-0.892***	1.02**	-1.007	0.815**	-0.912***	0.0159	-0.0503
	(0.237)	(0.268)	(0.403)	(0.789)	(0.342)	(0.221)	(0 .050)	(0.483)
Inflation		0.0456			0.5868	0.050	0.017	0.046
		(0.072)			(0.527)	(0 .069)	(0 .036)	(0.085)
Unemployment		0.0669			0.0981	0 .068	0.010	-0.0175
		(0.0448)			(0.3371)		(0 .024)	(0.059)
Percent Muslims			-0.152		-0.181			
			(0.090)		(0.901)			
Percent Christians			-0.230**		-0.264**			
			(0.097)		(0.103)			
Ethnic Fractionalization							-0.396	
							(0.528)	
Constant	10.94***	9.657***	8,125***	12.915***	12.215**	10.687***	3 .943***	12.822
	(2.295)	(2.731)	(1.899)	(3.100)	(5.296)	(3.106)	(1 .382)	(9.609)
Observations	41	39	39	41	39	39	39	39
R-squared	0.350	0.395	0.31	0.296	0.398	0.376	0,105	0.132
F-statistic			10.42		11.02		0,94	
p-value			0.000		0.000		0.654	
J-test Hansen				0.002		1.885		0.649
p-value				0.968		0.162		0.000
Shea R2				0.379		0.444		0,97

Note: (): Standard errors, *** p<0.01, ** p<0.05, * p<0.1

The effect of trust on remittances can be explained by several elements. These incorporate among others:

Inequality: Several studies have found an association between increased inequality and decreased interpersonal trust (Knack and Keefer, 1997; Zak and Knack, 2001; Rothstein and Uslaner, 2005; Bjørnskovk, 2007; Wilkinson and Pickett, 2010; Stiglitz, 2012). Hence, the remittances may pass through its effect on inequality.

Human capital and cultural factors: Another mechanism by which remittances could be indirectly influenced by interpersonal trust are human capital and cultural factors (Coleman, 1988; Knack and Keefer, 1997; Zak and Knack, 2001; Makhlouf et al. 2019). Coleman (1988) argued that social capital is a key factor in explaining educational outcomes. Furthermore, Whiteley (2000) stated that investment in education may not have a pronounced impact in a society with low trust level. Knack and Keefer (1997) added that interpersonal trust is most pronounced in countries with a well-educated population. Likewise, Zak and Knack (2001) concluded that interpersonal trust could be enhanced by improving education.

Institutions: The effect of trust on remittances can be achieved through the quality of institutions because the link between remittances and the quality of institutions is demonstrated in the existing literature (see for example, Putnam et al.1993; Fukuyam, 1995; Knack and Keefer, 1997; Zack and Kanck, 2001; Abdih et al., 2012; Berdiev, et al., 2013). Knack and Keefer (1997) pointed out that institutions have an influence on growth through trust. Zak and Kanck (2001) also concluded that trust depends on the social, economic and institutional environment in which the transaction is conducted. In addition, for Putnam (1993), institutional quality may exert a significant impact on the linkage between social capital and economic efficiency. Fukuyama (1995) argued that a high level of trust between citizens might affect the performances of all institutions in society, including businesses. Likewise, La Porta et al. (1997) provide evidence of the existence of a positive relationship between government effectiveness and trust. Remittances would facilitate cooperation and reduces the budgetary constraint of recipient families, and this could help to strengthen trust. An increase in interpersonal trust is likely to underpin social cohesion in the country of origin, thus limiting the need for remittances.

Informal vs formal remittances: The negative result between formal remittances and trust may be also explained by the fact that informal remittances are higher in low trust countries because migrants in countries where the quality of institutions is low bring money home directly or send money with family or friends visiting the country of origin. Another possibility that may explain why formal remittances are less important in countries with relatively low levels of trust is the fact that migrants bring with them durable goods such as refrigerators, TV and other consumer goods instead of sending money to buy them in their country of origin. Unfortunately, the lack of data on informal remittances makes it impossible to estimate its effect.

4. Conclusions and some policy implications

Nowadays, all societies are heavily concerned about collapsing trust. The present research goes beyond particularized trust which refers to trust in the family and close friends, and investigates the economic implications of the trust that people have in other members of society where uncertainty prevails–often referred to a generalized trust (Putnam, 1995; 2000).

In this context, Fukuyama (1995) claims that when trust does not extend beyond the family, the supply of capital and skilled managers will be limited, thus constraining the development of private enterprises. When trust among individuals within the same community is higher, it would be easier to carry out financial transactions as loans and financial aids; hence the need to migrate will be lowered. In the same way, when trust among individuals in a community is greater, mutual aid increases accordingly and people bear the cost of this mutual aid. This implies a low demand for money from members of the same community who work and live abroad as this operation could have a higher opportunity cost than it would from individuals who live in the same country.

Remittances are a complex phenomenon that respond to economic factors in both host and home countries. This evidence has been largely documented in the economic literature. Throughout the present study, *the drivers of remittances are extended to account for behavioral factors (in particular, the interpersonal trust).* Based on data from the World Value Survey and the World Bank, we show that interpersonal trust exerts a significant and negative impact on remittance inflows. Remittances can compensate for the lack of trust.

This article' outcomes provide robust evidence that remittances can be perceived as individuals' reactions to socio-economic conditions in countries of origin. An increase in interpersonal trust strengthens social cohesion in the country of origin, reducing therefore the need for remittances. *To our best knowledge, this is the first work that explores the interpersonal trust as a determining factor of remittances.* Other factors that may influence remittances, including among others the institutional trust, deserve to be meticulously studied. It may be also quite interesting to effectively address how policymakers could improve such a prominent type of social capital. If trust exerts a significant impact on economic and social outcomes, it seems of utmost importance to identify the institutions and public policies required for it to develop. A major driving force of interpersonal trust is the belief that others will act in equitable and communal way. The role of institutions is vital in this framework. This is an evident policy lever to boost trust by enhancing the integrity and transparency of institutions.

Last but not least, understanding and enhancing the economic implications of social cohesion necessitate robust and unambiguous evidence that can appropriately inform policymakers; hence the need to have proper and effective social measures. It must be mentioned at this stage that the statistical community has made noticeable progress in this matter. However, certain topics have not yet devoted a particular attention. Trust is one of these topics. Given the trust's role on the overall development, effective measures of trust at higher frequencies are highly required to be able to assess how trust respond to possible unforeseen shocks[3], how it can be safeguarded, and whether relevant policies can restore or strengthen it.

[3] The stock of trust can be promptly depleted after the occurrence of an unforseen shock (Algan et al. 2017).

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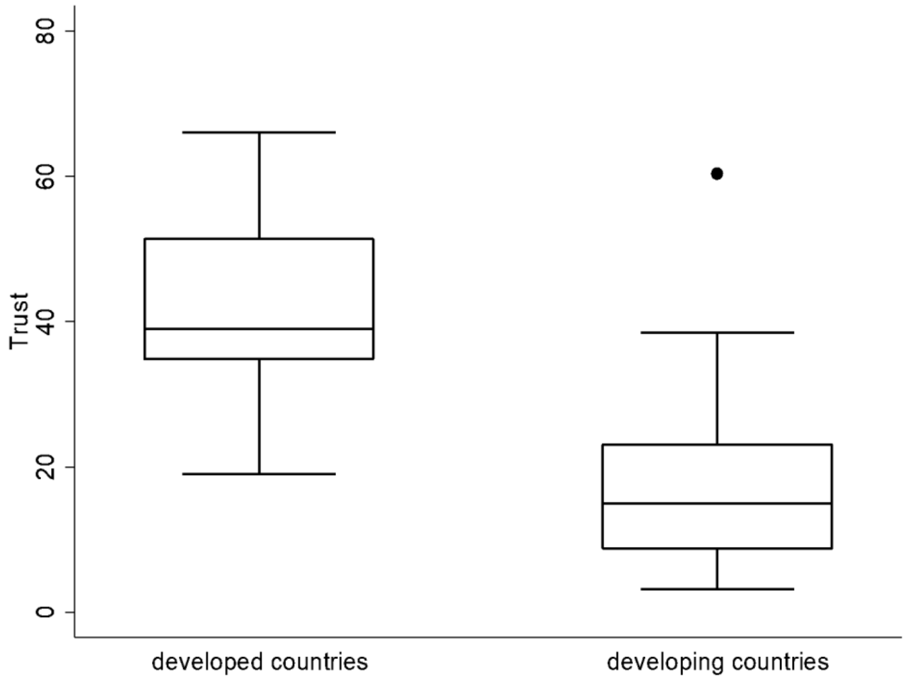
Appendix

Figure A1: Level of trust in developed and developing countries



Source: Authors' calculations using WVS.

Table A1: Non-Respondent Individuals

Country	no responding individuals	Country	no responding individuals	Country	no responding individuals
Algeria	4.2%	Jordan	_	Rwanda	_
Armenia	0.2%	Kazakhstan	_	Slovenia	0.3%
Azerbaijan	_	Kuwait	2.1%	South Africa	_
Belarus	0.9%	Kyrgyzstan	3.9%	Philippines	_
Brazil	_	Lebanon	_	Poland	_
Colombia	0.7%	Malaysia	_	Thailand	1.3%
Cyprus	0.4%	Mexico	_	Trinidad and Tobago	_
China	1.8%	Morocco	0.9%	Tunisia	_
Ecuador	0.1%	Nigeria	_	Turkey	2.1%
Egypt	_	Pakistan	_	Ukraine	1.6%
Georgia	_	Palestine	_	Uruguay	4.4%
Ghana	_	Peru	0.4%	Uzbekistan	0.4%
India	_	Romania	0.2%	Yemen	_
Iraq	_	Russian Federation	0.4%		

Table A2: Summary statistics

Variable	**Observations**	**Mean**	**Std. Dev.**	**Min**	**Max**
Trust	41	17.970	11.892	3.2	60.3
Remittances10_14	41	7580.507	13917.3	4.224	65031.71
GDP	41	7322.784	7792.609	553.597	37725.14
Inflation	41	8.2	5.68	0.62	24.69
Unemployment	39	5.96	3.543	0.987	13.881