Review of

Do transfer costs matter for foreign remittances? A gravity approach

Achievements

This paper uses data on remittances from 23 countries to Pakistan from 2001 to 2013 to analyze the effects of transaction costs of remittances. It argues that distance is a inadequate proxy for remittance costs and that the remittance costs are negatively correlated to remittances from a country. The paper presents new evidence on a generally underexplored phenomenon and is also well written.

Major Comments

Despite this I have a number of comments to the paper. These relate to the interpretation of the results of the paper, measurement issues, data and the presentation of result

1.) <u>Interpretation</u> – I am very concerned about the author's causal interpretation of the results. In particular my concern is that with respect to the central variable of interest (transaction costs) what the authors actually measure is self-selection. Immigrants that want to remit more (for unobserved reasons) are all else equal likely to self-select countries that offer low transaction costs. In addition given that the authors explain how important remittances are for Pakistan in section 2 I also have serious doubts as to the exogeneity of the bilateral exchange rate, GDP at home and credit to the private sector.

The authors therefore need to think much more carefully about their identification strategy, potential bias resulting from these assumptions needs to be discussed and to be more convincing the authors should also see whether they can improve their identification.

In this context I wonder whether the Pakistan Remittance Initiative in 2009, and the National Cash Remittance program in 2012 cannot be used to identify effects of reducing remittance costs.

2.) <u>Measurement</u> – I do not understand why remittances are measured in absolute value rather than per capita in equations (1) through (4). It seems to be clear to me that if remittances are measured in absolute values then they will be highly coreelated with the migrants residing in a certain country and this should be a very important variable in all specifications. Indeed the authors' results in tables 3 and 4 are very suggestive of this. The migrant stock is significantly positive with a coefficient that hardly ever differs statistically significantly from 1 (except for in the Hausmann Taylor estimates, which may however, be due to the weaknesses of these methods).

Also it is not really clear whether the Z variables in equation 1 are measured in absolute values or in logarithms (equation 1 suggests they should be in logs, the tables 3 through 5 suggest they are in levels, and the text does not clarify).

The authors need to justify better why they use the dependent variable or move to a measure of per capita remittances.

3.) <u>Data quality –</u> Given that a substantial part of the data is extra- and intrapolated the authors should make their assumptions for extrapolation much clearer and should also try to justify these (i.e. to state only the most obvious, why is Switzerland eith its huge banking sector like Norway in terms of transaction costs?)

It would also be important to see how the results are affected by the intra- and extrapolations, by an extra regression using only actually measured data.

- 4.) <u>Presentation of results</u> I really do not see why three tables of regression output are needed I would much rather the authors would
 - use only one (or at most two) panel estimators. Since there is little variance across different estimators it could be mentioned that the other estimators lead to similar results
 - reduce on the number of specifications. In particular here I do not understand why in the results for equation (4) presented in table 5 the migrant stock, which is highly significant in all other specifications as well as credit to prvate sector are dropped. This sort of non-nested design makes me very skeptical of the robustness of the results in table 5 to including the obvious missing variables in the specification.

The authors should therefore reduce the reported output and include the missing variables (migrant stock, credit to private sector). Also could the central point of the paper that distance is a bad proxy for transaction cost not be highlighted by simply regressing distance on transaction costs.

Minor comments

Between table 3 and 4 GDP(host) chnges too GDP (source) and GDP (home) to GDP recipient

In a number of cases the authors state that the sign of a variable may depend on the remittance motive, without explaining further how this is. As somebody who has not worked on remittances before I would need an explanation. This applies to

- P12: passage referring to GDP per capita at home
- P13: passage referring to exchange rates
- P18: passage on institutional variables