

Review of manuscript:

"Do transfer costs matter for foreign remittances? A gravity model approach" by Ahmed and Martinez-Zarzoso

The paper addresses a potentially interesting question: how sensitive is the magnitude of foreign remittances to the costs of remitting from abroad. The authors analyse this question for the case of remittance flows to Pakistan.

They use data on bilateral flows for a panel of 23 host countries of migrants from Pakistan. Their measure of transaction costs is an original prediction based on regressing the available price of remittances on the stock of migrants and the financial development in the respective host country. The assumptions made for this imputation are strong but rather plausible.

The estimated panel models are decently justified. The results are mostly as predicted. The host country GDP and its geographical distance from Pakistan are insignificant under all specifications. The models reported in table 5 hardly illuminate the effects of the proxy for transaction costs on remittances. Their estimated coefficients are statistically significant and have a negative sign under all specifications. But this opens more questions than it provides answers.

Apart from potential sources of bias due to the constructed measure of costs, we cannot distinguish between the effect on overall flows and the switch to informal, unrecorded channels. As the authors indicate in section 3, less than 40 per cent of remittances to Pakistan were transferred via the banking system. They give somewhat contradicting statements on the differences between the costs of using the formal and the informal methods (in particular *huwala* and *hundi* - which are presumed cheaper in footnote 4 but not in the first paragraph on page 6). The only way to address such issues and to properly engage with the question of the paper would be to use micro data - like Gibson, McKenzie and Rohorua (2006) do for Pacific islands and Anwar and Mughal (2012) for Pakistan. Section 3 also includes some details on the Pakistan Remittance Initiative (PRI) was launched in 2009 and on the National Cash Remittance Program to enable NADRA centres to process remittances using smart national ID cards. The impacts of these programs are not discussed in the empirical part. But particularly the latter would provide an almost experimental setting to address the question of the paper.

I recommend major revisions of the current draft. These should consider the points above and:

- restructure and simplify sections 1 to 4 formulating explicit predictions for the models and stating the preferred theoretical justification;
- consider the use of micro-data or include more countries - all variables used are easily available for a cross-country analysis;
- could some of the host country variables be used as instruments to correct for biases arising from measurement errors (e.g. if informal remittances decline as a result of lower costs)? Are remittances endogenous to the macro controls used?
- provide a better intuition on the average cost-elasticity of remittances and calculate the expected per cent increase in formal remittances from lowering the cost of sending money through banks or operators to levels found in competitive markets.