

# Financial Development, Remittances and Growth in Jamaica

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# Background

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- ▶ There is discussion on whether the level of financial depth can determine the role that remittances may have for development.
- ▶ Substitution argument:
  - ▶ Remittances may play the role of financial intermediation in countries with low financial development, leading to growth.
  - ▶ In economies with more developed financial sectors, remittances are less likely to be used for this purpose.
- ▶ Complements argument:
  - ▶ Where there is high financial development, this system works in tandem with remittance inflows, directing these funds to productive uses.
  - ▶ This effect is not observed where there is low financial depth since the sector is not capable of being a strong facilitator for these funds.

# Relevance

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- ▶ The role of finance for the remittance-growth relationship (cross-country evidence):
  - ▶ Giuliano and Ruiz-Arranz (2009); Mundaca (2009); Nyamongo et al. (2012); Ramirez (2013).
- ▶ Studies are lacking at the country level, and there are important implications from findings.
  - ▶ An interaction between remittances and financial development gives insight into how remittances can be taken advantage of for growth.
  - ▶ Is financial sector reform needed? Is moral hazard affecting the potential of remittance dollars? Substitution and complementary scenarios carry different considerations.
  - ▶ This relationship is likely to differ across countries, based on their characteristics and environment.

# Motivation

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- ▶ Why Jamaica?
- ▶ High remittances inflows.
  - ▶ >10% of GDP since 2000.
  - ▶ Almost as large as tourism receipts.
- ▶ Context of migration in a small island developing state.
  - ▶ Net migration rates.
  - ▶ Brain drain, transfer of skills, etc.
  - ▶ Implications for planning where remittances/migration/Diaspora is concerned (NDP).
- ▶ Financial sector developments in Jamaica.
  - ▶ Liberalization.
  - ▶ Need for regulatory framework.
  - ▶ Value added by sector.

# Contributions

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- ▶ Adding to the discussion coming out of panel studies (complements vs. substitutes).
- ▶ Adding literature for a country-specific study (necessary for policy).
- ▶ Providing the analysis for the first time in Jamaica.
- ▶ Methodological contribution in this framework (interaction).
- ▶ Causality testing, for the remittance-growth-finance nexus, including an interaction.

# Brief Methodological Overview

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▶ Study takes a broader view of financial development/depth.

▶ PCA used to construct an index from 4 correlated measures.

$$\text{▶ } ED_t = \alpha_1 + \beta_1 R_t + \beta_2 F_t + \beta_3 (RxF)_t + \varepsilon_t \quad \text{Eq. (1)}$$

▶ ED – economic development, R – remittances, F – financial development, e – error term, t – time subscript.

▶ For endogeneity and structural concerns, we utilize a VAR structure, testing for co-integration with more than one approach and looking for causality under the appropriate form.

# Results

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▶ One long-run equation:

$$\begin{aligned} \text{ED} = & 0.85R + 0.9F - 0.18(R \times F) + 4.31 \\ & \quad (**) \quad \quad (*) \end{aligned}$$

▶ Causal links (long run):

▶  $R \rightarrow ED$

▶  $R \times F \rightarrow ED$

▶  $F \rightarrow ED$

▶  $R \rightarrow F$

# Discussion

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- ▶ Evidence adds to the literature on the substitution hypothesis.
  - ▶ What are the implications for Jamaica?
  - ▶ Remittances help to overcome constraints at lower levels of FD and allow for productive activity, but increasing levels of FD suggest that remittances are less likely to be taken advantage of. Are remittances being used more for consumption at this point? Is there a moral hazard problem?
- ▶ Given the context in Jamaica, and the potential of available remittances, these resources need to be taken advantage of for development. In the environment of remittances substituting for financial development, one must determine how to keep remittances productive in the face of improving the financial sector (e.g. new financial products). It is also noted that FD may not be the only contingent factor in the remittance-growth relationship. As FD increases, perhaps other links need to be strengthened (e.g. institutional quality, human capital). It provides a starting point for future analysis.



# Thank You!

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Additional questions or comments?

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