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Remittances, Entrepreneurship, and Employment Dynamics over the Business Cycle*

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Abstract

We incorporate remittances and micro-entrepreneurship (self-employment) into a small open economy business cycle model with capital and labor market frictions. Countercyclical remittances moderate the decline of households' consumption during recessions. These remittances also are used to finance the start-up costs of microenterprises that bolster households' income during economic downturns. We show that the positive income effect from countercyclical remittances also leads to a decrease in salaried labor supply, which generates offsetting upward pressure on wages during recessions and adversely affects the recovery of the economy. Consistent with the microeconomic evidence, the behavior of remittances decisively affects labor force participation and the composition of employment between non-salaried and salaried employment over the business cycle. The model delivers labor market and aggregate cyclical dynamics that are consistent with the Mexican data, including a highly volatile and countercyclical unemployment rate.

JEL Classification: E24, E32, F24, J21, J64

Keywords: Business cycles, search and matching frictions, unemployment, self-employment, microenterprise development, remittances

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