

## **Remittances and development: The case of Bosnia**

**By Nermin Oruc, 2011**

### **Introduction**

One of the consequences of the 1992-95 war in Bosnia and the associated mass forced emigration of people is that Bosnia is one of the leading countries in terms of inflows of remittances as a share of country's GDP. After suffering severe destruction during the war and slow-post war recovery, it is of particular importance to this country to understand how the inflows of remittances can be utilized in order to bring best possible effects on Bosnia's economic development. This paper explores possible links and suggests optional solutions for optimized use of this important resource for the country's development.

### **Migration from Bosnia during the 1990s**

Before 1990s, Bosnia was one of the states within Yugoslavia; a country with exceptionally mixed ethnic structure, consisted of three main ethnic groups, which were considered as constitutive nationalities of the country (Bosnians, 43%; Bosnian Serbs, 33%; and Bosnian Croats, 18%), as well as a number of minorities. Conflict in Bosnia started in April 1992 and finished in December 1995, backed by US negotiations in Dayton, Ohio. This war has been characterized by severe destruction of physical capital and mass resettlement of people. During the period of war in Bosnia, about 5% of its population was killed, whereas more than a half was displaced. Half of them, or 25% of total population were displaced internally, while another 25% of the total population migrated to other countries (Ibreljic et al., 2006). This resulted in an almost total division of population along ethnic lines. It is estimated that today about 1.35 million Bosnians live abroad (BiH Migration Profile, 2010). During the war, more than 400.000 housing units (1/3 of total housing units in the country) were destroyed. The country's GDP fell to only 10% of its pre-war level. Moreover, the war has created new vulnerable groups in need of social transfers, such as disabled and/or unemployed war veterans and families of killed soldiers.

Bosnia today has a large diaspora, which is contributing significantly to its economic development, particularly through remittances. This country, with exports covering less than 50% of imports, and double-digit current account deficit, is highly dependent on remittances. They are particularly important in the situation of low inflows of FDI. Only inflows of remittances help the country to maintain the financial situation over a long period of time, otherwise the country would face bankruptcy. In such a situation, it is difficult to understand the lack of activities of Bosnian government towards its diaspora. It is well known that remittances are related to the extend to which emigrants are linked to their home country and that they decrease over time. Therefore, Bosnian government needs to establish a Ministry for Diaspora as soon as possible, in order to keep the level of remittance inflows at least at the same level. Moreover, the Government should improve possible other channels of supporting the diaspora, such as FDI, and it should support in exports from Bosnia, return migration as well as research and development.

## **Remittances to Bosnia**

As a consequence of large forced migration outflows during the war period in 1990s, Bosnia is the sixth leading country in terms of receiving remittances as a percentage of GDP (around 23%, World Bank Global Economic Prospects, 2006). Annual inflows of international remittances, through banking system only, are around 2.4 billion KM (BiH Central Bank, 2008). But the World Network of Bosnian Diaspora estimates these inflows to be at least 6 billion, as the majority of these remittances are sent as cash transfers through informal channels. These remittances inflows are a significant source of income for a large proportion of BiH population. Moreover, they are six times larger than FDI and three times than ODA to this country. There were no extensive analyses of the motives and use of remittances in Bosnia, but some evidence suggests that major part of them are spent on current consumption. The data from the Living in BiH 2004 survey shows, that approximately 11% of the households in Bosnia-Herzegovina receive remittances (Oruc, 2011). The average value of remittances received is about 95 KM per month. Although remittances already serve as an important source of income for a large number of families and have positive impact on economic stability and development of the country, channelling its use towards more productive activities, such as entrepreneurship, would have more positive impact on Bosnian economy, particularly in the long term.

## **Remittances and Development: Exploring the links**

As remittances are becoming an important source of foreign capital for developing countries, their impacts on home countries at both micro and macro levels have gained importance among scholars. The literature on remittances has recently redirected its traditional focus on the motivation for remitting to the analysis of their use. Several studies analyse the impact of remittances on different aspects of the recipient economies. Funkhouser (1992) provides one of the first studies on the impact of remittances on labour supply of remittance-receiving households. He found that remittances increased self-employment among men and reduced labour supply by women in Nicaragua. Chami *et al.* (2005) provide evidence of a negative effect of remittances on growth and productivity. However, a recent study by Rapoport and Docquier (2006) has figured out a positive impact of remittances on productivity and growth, through solving liquidity constraints and financing productive investments.

Within the pool of studies investigating the impact of remittances on home countries, there are an increasing number of those focussing on their impact on investments in human capital (Moser, 1996; Cox and Ureta, 2003; Hanson and Woodruff, 2003; Borraz, 2005; McKenzie and Rapoport, 2006; Dustmann, 2007; Leon *et al.*, 2007; Amuendo-Dorantes *et al.*, 2008). These studies point out several channels through which emigration impacts on children's schooling. The possibility that remittances positively influence households' educational investment decisions are based on the idea of a relaxed liquidity constraint and reduced children's labour participation in the remittances receiving household (e.g. Amuedo-Dorantes and Pozo, 2006: 4). This, in turn, induces investment in children's education leading to a positive relationship between remittances and children's educational attainment and a negative relationship between remittances and child labour supply.

The impact of remittances on poverty and inequality has been heavily investigated so far (Milanovic, 1987; Stark, Taylor and Yitzhaki, 1988; Prasad and Sardana, 1989; Adams, 1992; Russell, 1992; Taylor and Wyatt, 1996; Taylor 1999; Brown and Markova, 2006; Jimenez, 2007; Giannetti *et al.*, 2009), but the available empirical evidence does not provide clear-cut answers. There

are two totally different basic approaches: On one side, there is evidence supporting the idea that remittances are usually sent to richer families, who are more able to bear the costs of migration, thus increasing inequality. On the other side, several studies support the hypothesis that migrants are selected from lower tail of income distribution, thus remittances sent to these families decrease inequality.

In the following text, author's previous work on exploring the impact of remittances on education, poverty and inequality in Bosnia as well as possible other impacts briefly discussed are presented.

### **Remittances and education in Bosnia**

As explained above, remittances can have positive impact on educational investments, by solving liquidity constraints by receiving households. Using this channel is a particularly important opportunity for Bosnia, as it suffered considerable "brain drain" during the war. Increase in human capital, as the key factor of economic growth, is an imperative for a country aiming at improving the speed of post-war recovery.

There were no analyses of the use of remittances in Bosnia, but the sporadic evidence suggests that the vast majority of remittances are being used for consumption. In one of a few studies on remittances in Bosnia, using LSMS 2004 survey, Oruc (2011) found that the remittance flows have positive, albeit relatively small impact on the educational attainment of children from receiving households. Only when we control the income distribution of households, we find positive impact of remittance receipt on educational attainment of children from households in the third and fourth decile of income distribution. This is in line with the predictions of liquidity constraint hypothesis. Still, this impact is lower than we could have expected. Possible explanations for this are that education in Bosnia is already highly subsidized, thus liquidity constraint is not so binding, and that remittances are already being used primarily for current consumption without using any policies that would promote investment of this money.

### **Remittances and poverty in Bosnia**

Remittances are known for influencing poverty and inequality levels in a country. Different factors determine direction of this impact. Most of the previous studies have found that remittances have positive impact on reduction of poverty in a country, but not necessarily to the improvement of equality within a society. There have been several studies on the impact of social transfers on poverty and inequality in Bosnia-Herzegovina (for instance, World Bank, 2009), but only one analysis of the impact of remittances on poverty and inequality.

According to Oruc (2010), the remittances sent to Bosnia-Herzegovina are not pro-poor. Larger proportion of non-poor households receives remittances. Moreover, the average amount received is twice larger than the amount received by poor households. Households in rural areas receive more remittances (in terms of proportion of households that receive them and in terms of average amount) than households in urban areas. This suggests that remittances, although not contributing to poverty reduction overall, may be expected to have positive impact on reducing differences in poverty incidence between rural and urban areas. Finally, a significantly larger number of female headed households receive remittances, than male headed households.

Similar to the figures for poverty, remittances do not contribute to the decrease in inequality, as the average amount of remittances steadily increase from the poorest to the richest decile. Also, the proportion of household receiving remittances in each decile, with the exception of the richest quintile, increases as we move from poorer to richer decile.

## **Remittances and labour market in Bosnia**

Remittances can have two opposing effects on labour market in a receiving country. First, they are expected to reduce labour supply by receiving households, as their “reservation wage” increases with receipt of remittances (Killingworth, 1983). Second, they can relax liquidity constraint for investments by households and thus induce entrepreneurial activities, which would lead to increase in employment.

This impact of remittances was not investigated in the Bosnian context yet. Only what we can say about this relationship is that, in very unfavourable conditions for entrepreneurial activities, we should not expect any particular positive effect of remittances on employment. On the other hand, previous analysis of the impact of social transfers on labour supply suggests significant negative relationship. Findings about the relationship between social transfers and remittances in Oruc (2010) suggest that both types of transfers are not pro-poor and that a large proportion of households receive both social transfers and remittances. Moreover, findings suggest that social transfers “crowd-in” remittances. Consequently, we could expect a similar effect of remittances on labour market supply by receiving households in Bosnia, *i.e.* that they reduce employment in the country.

## **Conclusions**

Above figures, although only briefly presenting the situation of the remittances inflows to Bosnia, still relatively clearly reveal the importance and potential that remittances can have for economic development of the country. They are already one of the key factors contributing to economic stability and development of Bosnia. Still, detailed analysis of each possible channel through which they can be utilized, such as investments in education, employment and reduction of poverty, suggests that their current contribution still falls below its possible level of utilization. This is not surprising in a country like Bosnia, which is not having any remittances policies. This has to be changed, particularly knowing that inflows of remittances tend to decrease over time.

Besides remittances, there are many other channels through which diaspora can contribute to economic development of the country, such as export and FDI promotion, research and development, tourism, *etc.* Bosnian government needs to be aware of this potential and take an active role in designing policies and projects that will exploit this potential. This involves development of the institutions and creation of a set of strategies that will support such objective. It sounds unbelievable that Bosnia, as a country with one of the largest diaspora as a share of country’s population, does not have an institution such as a Ministry of Diaspora, that will take care of this population and their contribution to the country’s economic development.

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