Remittances, Institutions and Development in Bosnia and Herzegovina

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Background: Remittances and development

- BiH among topp receivers of remittances
- Remittances obviously useful for individual receivers, but do they have positive effect on economic development of the country?
- More general question: Importance of foreign money for economic development
- Usually, 3 main sources of foreign capital are discussed

1. Development aid
2. Foreign direct investment (FDI)
3. Remittances

Sources of foreign capital

- Development aid
  - Not particularly impressive record since 1945 (With some exceptions, e.g. Marshall plan)
  - Perhaps few who believe that DA plays a major role today
- Foreign Direct Investment
  - Remarkable growth (to developing countries)
  - Has positive sides (boosts export revenue, increases employment opportunities, positive spillover effects on local suppliers, etc.)
  - Has also negative sides (FDI flows often strongly reduced in times of economic crisis, deepening the recession in receiving countries; sensitive to even minor political shocks, etc)

Sources of foreign capital cont'd.

- Remittances
  - Seen by some as perhaps *the* primary tool of development in the 21st century As Kapur 2004: 7) states:

    "*Remittances [...] fit in with a communitarian, "third way" approach and exemplify the principle of self-help. People from poor countries can just migrate and send back money that not only helps their families, but [also helps] their countries as well. [...] this "private" foreign aid is much more likely to go to people who really need it. On the sending side it does not require a costly government bureaucracy, and on the receiving side far less of it is likely to be siphoned off into the pockets of corrupt government officials. [...] What could be better?*"
  - Nevertheless, Kapur himself actually questions whether migrant transfers of money have much effects on long-term, structural poverty.

Remittances, good or bad?

- Possible to argue for both views
- On the positive side:
  - Large flows of remittances, lagging only behind FDI as the single largest source of external finance, and having long exceeded stagnating flows of aid
  - Consumer spending of remittances increases domestic demand, with possible multiplier and spillover effects in the national economy
  - Might increase savings, investment in education, etc.
- On the negative side
  - Negative arguments might be divided into two groups that we may call “moderate critique” and “radical critique” → Next slide

Possible negative effects of remittances

- “Moderate” argument: Remittances do not significantly improve macroeconomic conditions (but they do not harm either)
  - Remittances mainly used to finance ordinary consumption, therefore have little effect on investment (example: pre-war Herzegovina with fancy cars and houses as well as bad roads and high unemployment)
- “Radical” argument: Remittances hurt economic development
  - Used as a substitute for labor income – discourage labor participation by increasing reservation wage
  - Raise wage levels, causing loss of export competitiveness of the country
  - Make possible postponing of the necessary reforms of the economy

Importance of institutional framework

- Large FDI inflows – often presuppose fairly sound institutional framework
- In BiH – institutional framework weak (from complicated overarching political system to more mundane institutions like local bureaucracies and courts)
- Reasons to believe that effects of remittances might vary, depending on institutional context
  - Within sound institutional framework, FDI might be main vehicle of growth; negative effects of remittances on necessary econom. reforms might be more pronounced
  - When weak institutions – remittances particularly helpful for growth (alternative source of finance, help overcoming liquidity constraints, etc.) Remittances – robust and stable source of financing

Empirical analyses

- Dependent variable: annual percentage growth rate of GDP per capita (GROWTH)
- Main independent variable of interest: remittances / GDP
- Main control / contrast variable: FDI (as a share of GDP)
- Data: World bank – 103 developing and emerging economies
  - Time-series cross-section (TSCS) data. Period covered1997-2006
- “Standard” set of control variables also included (int’l trade, current account balance, price changes, foreign aid, etc.)
- Estimated models for whole sample (Table 1) and separated by institutional quality (Table 2)
- Three different estimation methods
  - OLS, robust regr. (iteratively reweighted least squares??) and fixed effects

Results

- **Whole sample**

	(1) OLS	(2) Reg. cluster	(3) Fixed effects
Independent variables	GROWTH	GROWTH	GROWTH
REMITTANCES	**0.128**	**0.040**	**0.642*** **
	(1.44)	**(0.49)**	**(2.68)**
FDI	**0.216*** **	**0.220** **	**0.084**
	(2.84)	**(2.28)**	**(0.89)**

Results II

- Split by institutional quality

Independent variables	(1) Reg. cluster **WBGI>=0** GROWTH	(2) Reg. cluster **WBGI<0** GROWTH	(3) Fixed effects **WBGI>=0** GROWTH	(4) Fixed effects **WBGI<0** GROWTH
REMITTANCES	**0.155**	**-0.005**	**0.459**	**0.774*** **
	(0.325)	**(-0.05)**	**(0.91)**	**(2.72)**
FDI	**0.322***	**0.178***	**0.539** **	**0.007**
	(1.72)	**(1.67)**	**(2.00)**	**(0.07)**

Note: WBGI = World Bank Governance Index

Implications and conclusions

- “Export strategy”
  - Should BiH focus more on its most successful export “product”?
  - Complex picture, loss of skill and abilities, but “pro et contra” arguments
- Importance of remittances under assumption of long-term existence of the current macro-political situation
  - Changes of the status quo might be desirable, but “threat” of changes (one way or another) useful for ethno-political purposes
  - Remittances might serve to alleviate economic dificulties