

## REMITTANCE LEVELS AND ENTREPRENEURIAL ACTIVITY IN POST-SOVIET COUNTRIES

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**ABSTRACT** Each individual entrepreneurial action has a more than proportional impact on economic growth, however less works are dedicated to investigate the impact of the remittance on entrepreneurial activity. This paper examines the impact of remittance level on entrepreneurial activity in 14 post-soviet countries over the period of 2006-2016. Panel data is employed to analyze the impact of remittance on entrepreneurial activity. Study found statistically significant impact of remittance on entrepreneurial activity for the post-Soviet countries in the sample.

Key words: remittance, entrepreneurial activity, panel data, Fixed Effect model, financial flows, electronic money,

### INTRODUCTION

Remittances from abroad have become one of the significant contributors to GDP for several developing countries. This source, however, is highly volatile and remains beyond the macro policy control of the recipient nation. At best, this is a temporary solution; and nations that can build up their domestic economies will have a greater capacity to shield themselves from external sources of revenue volatility. Remittances may become helpful, however, in shoring up such local capacities. One way that remittances have been noted to help developing economies is to serve as a cash flow source for financing entrepreneurial activities. In examining the impact of international remittances on entrepreneurial activity, the fundamental question is simple: How are the remittance cash flows used? Do households receiving remittances invest it in entrepreneurial activity, or do they merely use these monies to purchase new “status-oriented” consumer goods?

As indicated by the World Bank, gauges demonstrate that formally recorded settlements to low- and center salary nations came to \$466 billion of every 2017, an expansion of 8.5 percent over \$429 billion out of 2016. Settlements are required to keep on expanding in 2018, by 4.1 percent to reach \$485 billion. Worldwide settlements, which incorporate streams to high-pay nations also, grew 7 percent to \$613 billion of every 2017, from \$573 billion out of 2016. Worldwide settlements are required to develop 4.6 percent to \$642 billion of every 2018 (World Bank Report, 2017).

Even though experimental proof on the effect of remittance on financial development has all the earmarks of being blended, it is regardless perceived that, since remittance flows are utilized either to build utilization or venture, they can turn into an essential device for monetary improvement.

In developing countries, due to high-interest rate environments, remittance flows can be used as an alternative source of financing for entrepreneurial activity. In some developing countries, remittances have facilitated the development of the financial sector, by promoting the development of sophisticated money transfer operators; however, the extent of their impact on entrepreneurial activity is still unclear. Despite the ever-increasing size of official international remittances, relatively little attention has been paid to examining the effect of these transfers on entrepreneurial activity in countries with varying levels of economic development. The idea that remittance flows can be an alternative source of income in low-income countries is widely accepted. It is not always clear how remittances are used in low-income level countries in

comparison with high-income level countries. In light of the audits and studies that take a gander at innovative movement as a cutting edge marvel, one notification an absence of research on the effect of settlement streams on pioneering action.

This paper aims to analyze the impact of remittances on entrepreneurial activity in 14 post-Soviet countries. The panel sample contains data for 10 years, covering the period from 2006 to 2016. Annual data for the indicators considered in the analyses are obtained from the World Bank database. The key independent variable is remittance (REM), which is an aggregate level of personal remittances, received (in current US\$) annually by 14 countries. For measuring the level of entrepreneurial activity (ENT), the dependent variable of interest, we use a fraction of registered businesses per economically active inhabitant at the country level.

## LITERATURE REVIEW

The literature on Remittances. Earlier studies on the impact of remittances portrayed a relatively negative role they exerted on national economies in developing countries (Ratha, 2003), an appreciation of the national currency (Amuedo-Dorantes and Pozo, 2006), a decrease of a marginal spending behavior of households in consumption, a decrease of potential multiplier effect (Puri and Rizema, 2004; Adams, 2005b), and a lack of influence of remittances on farm output or agriculture in China (Zhu, Wu, Wang, Du and Cai, 2009). Despite the ever-increasing size of official international remittances, relatively little attention has been paid to examining the economic impact of these transfers on entrepreneurial activity, however.

Recent studies on remittances generally display more optimism with regards to their developmental impacts. The authors highlight a definite increase in welfare (Gustafsson and Makonnen, 1993), a decrease in poverty (Adams and Page, 2005), an improved health status (Hildebrandt and McKenzie, 2004), and an increase in the propensity to start a new business (Lianos and Pseiridis, 2009).

The impact of remittances can be characterized by either an individual (micro-) or a country (macro-) level of analysis. Papers at an individual level primarily focus on the elimination of credit constraints in households, a level of enhancement of investment opportunities, and an accumulation of savings. The impact of remittances at the individual level varies amongst developing and developed countries. The fundamental factor that influences the behavior of entrepreneurs that will use the remittance is the level of development of the financial infrastructure at the origin, which will vary from country to country. Remittance transfer processes and systems are other factors of growing policy concern. In states with a weak financial system, the positive impact of remittances is primarily offset by the charges of transferring organizations or agents. According to Ratha (2003), a reduction of fees by 5 percent would increase the remittance flow to developing countries by 4 to 5 million USD. The cost of remittance transfer services is also one of the main concerns in numerous other studies (Orozco, 2006; Ratha, 2008; Ebeke and Combes, 2010).

Moreover, the majority of papers at the individual level are country-specific studies. The authors mainly focus on savings and consumption behavior of households (Hoyos, 2004; Parinduri and Thangavelu, 2008; Zhu, Wu, Wang, Du and Cai, 2009), household welfare (Quartey, 2006), labor supply and school attendance (Acosta, 2006, Binzel and Assaad, 2009), savings and asset accumulation (Adams, 1996 and 2002), agricultural expenditure and insurance (Azam and Gubert, 2006). The characteristic finding of these papers is the positive impact of remittance flows on households' welfare and the variations of the effect between the different countries. For example, in a case study of Pakistan, Adams (2002) finds that the marginal propensity to save (MPS) given remittance income was more than other sources such as rental income. However, Zhu, Wu, Wang, Du, and Cai (2009) in a study of China, found that (MPS) from remittance income is lower compared to other sources of revenue.

At the macro-level of analysis, it has been found that remittances have a positive impact on a country's economic performance by not only financing trade deficits in specific countries but also increasing their foreign exchange reserves (Rapoport and Docquier, 2005). According to Newland (2007), remittances increase the credit ratings of a country. Taylor (1999), found that the developmental impact of remittances lies between two extremes. On the one extreme, where remittances result in the reduction of production constraints of the poor in developing countries, while on the other extreme, it opens migration opportunities and causes labor depletion in areas at the origin by resulting in 'brain drain.' Some authors stressed the fact that remittances are countercyclical in times of economic downturns in migrants' home countries (Córdova, 2004; Gupta, 2005; Ratha, 2007; Chami, 2008). However, most of these studies were conducted when the host countries were unaffected by an economic or financial crisis.

The literature on Entrepreneurial Activity. Most policy scholars today agree that entrepreneurship is a necessary ingredient for stimulating economic growth and employment opportunities in all societies. Acknowledgment of the significance of enterprising action has been missing for some time in standard (hypothetical) financial matters, be that as it may. Baumol (1968) griped that business enterprise, being difficult to catch in numerical conditions, vanished from the standard (neo-old style) financial aspects. Kirzner (1973) saw that the neo-old style model compelled the dynamic of the business person, as far as item quality and value, innovation, inside cutoff points completely strange to the setting in which true business visionaries distinctively work.

Contemporary reviews of the literature identify a large number of theoretical and empirical studies that sought to define the factors with a potential impact on entrepreneurial activity, either in single or multi-country studies. Wennekers, S.van Stel, A. Thurik, R. Reynolds, P. (2005) define the level of economic development, technology, demography, culture, and institutions as determinants of entrepreneurship. In comparison, Giannetti and Simonov (2004) focus on three types of variables which would affect entrepreneurial activity, namely--the economic characteristics of the area where the individual lives (e.g., income per capita, unemployment rate, etc.), individual characteristics (e.g., salary, wealth, age, and some demographic characteristic); and, the aspects of the social environment (religion, social status of entrepreneurs, education). Grilo and Thurik (2017) examine, using a sample of countries of 15 (EU) member states how social and demographic factors affect entrepreneurial activity.

Other authors have claimed that entrepreneurial activity is vital to economic progress. They allude, for instance, to the end of socialist economies where entrepreneurial activity was practically missing and to studies by Schumpeter (1934) and (neo-)Austrian economists (e.g., Kirzner, 1973). Klapper, L., Laeven, L., & Rajan, R. (2006) indicate that entrepreneurship (measured by business entry and density rates) is positively related to the level of economic development, the quality of the legal and regulatory environment, the ease of access to finance and the importance of the informal sector. Shane (2008) identifies that, in poor countries, many individuals are turning into entrepreneurs due to a lack of employment opportunities. However, in rich countries, individuals consider options other than starting their own business.

Besides, Bosma and Schutjens (2011) empirically studied the impact of regional and national conditions on entrepreneurial activity and attitudes during 2001-2006 in 17 EU countries. They found that institutional, demographic, and individual economic factors have a significant impact on variations of entrepreneurial activity and attitudes toward entrepreneurship. Albuлесcu and Tămăs (2014) indicate, based on an empirical investigation, that the most critical factors affecting entrepreneurial activity are--the level of economic development, population growth, financial development, and macroeconomic stability.

According to another study that analyzed the link between macroeconomic factors and aggregate entrepreneurship, GDP per capita, unemployment rates, marginal tax rates and volatility of inflation were the only macroeconomic variables that correlated significantly and consistently with aggregate entrepreneurship, despite having 32 macroeconomic indicators that were included in the empirical analysis (Arin, K.P.; Huang, V.Z.; Minniti, M.; Nandialath, A.M.; Reich, O.F, 2015). Finally, the impacts of financial capital, access to finance, and impact of remittances on entrepreneurship and entrepreneurial activity have been analyzed by several authors (Black and Strahan, 2002; Hurst and Lusardi, 2004; Mueller.P, 2006; Musso and Schiavo, 2008; Paniagua and Sapena, 2015). The general end demonstrates that the accessibility of financial capital and straightforward entry to finance can prompt an expansion in the number of entrepreneurs, and furthermore, to the improvement of enterprise at the national or territorial levels.

## DATA

This study presents evidence with regards to remittance flows and entrepreneurial activity in 14 post-Soviet countries during 2000–2016.<sup>1</sup> The data for country-level measures were collected from the World Bank database<sup>2</sup>.

Table 1.

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<sup>1</sup> Turkmenistan is excluded due to missing data.

<sup>2</sup> Data sources are last accessed on May 16, 2019 and are available at:

<https://data.worldbank.org/indicator/BX.TRF.PWKR.CD.DT>;

<https://data.worldbank.org/indicator/IC.BUS.NREG?view=chart>; <https://data.worldbank.org/indicator/SL.TLF.TOTL.IN/>.

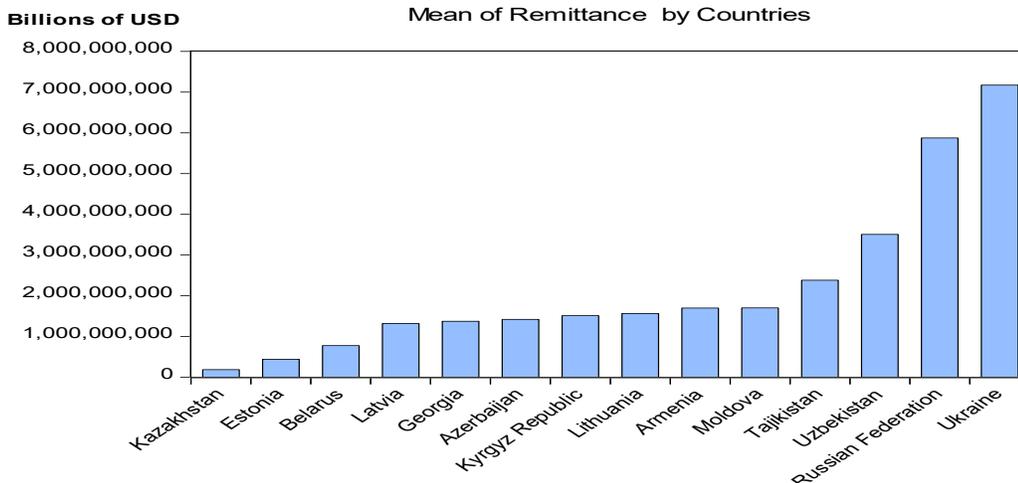


Table 2.

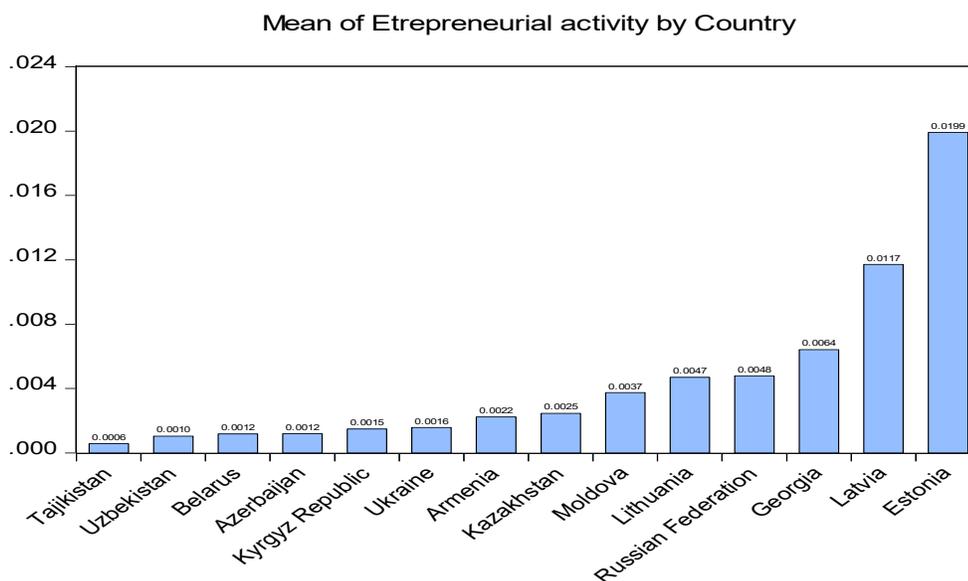


Table 3.

Correlation

	REM	TBUS	GDPP	INF	CONS	LNENT
REM	1					
TBUS	0.014	1				
GDPP	-0.154	-0.176	1			
INF	0.165	0.159	-0.181	1		
CONS	0.530*	0.031	0.288	0.051	1	
LNENT	0.513*	-0.417	0.715*	-0.337	0.129	1

\*Significance: 5% level.

Based on the correlation matrix, it is viable to conclude that there is a reasonable advantageous relationship between remittance (REM) and entrepreneurial endeavor (LNENT), which is consistent with our work; remittance additionally positively correlates with consumption (CONS). The strongest compelling correlation additionally between GDPP and entrepreneurial activity (LNENT)

**MODEL SPECIFICATION**

This section presents the econometric model that is specified to measure the relationship between Remittance flows and Entrepreneurial Activity:

$$\text{Ln}(\text{ENT})_{it} + \beta_0 + \beta_1(\text{REM})_{it} + \beta_2(\text{TBUS})_{it} + \beta_3(\text{INF})_{it} + \beta_4(\text{GDPP})_{it} + \beta_5(\text{CONS})_{it} + U_{it}$$

Where the subscript *i* denotes post-Soviet countries in the sample, and subscript *t* denotes times. The dependent variable represents Entrepreneurial Activity *i* in year *t*. Ln(ENT) represents the natural logarithm for the outcome measure, which is a count of registered businesses per economically active inhabitant representing an aggregated country level of entrepreneurial activity (Dvoulety, 2016). The independent variables are remittance (REM), Time to start Business (TBUS), Inflation rate (INF), Gross Domestic Product per Capita (GDPP), Consumption (CONS). Personal remittances are expressed as personal transfers and compensation of employees from abroad.

**METHODOLOGY**

A balanced panel data was used as an econometric model in the study. A panel data regression has the form:

$$y_{it} = \alpha_i + x_{it}\beta + \varepsilon_{it}, \text{ for } t=1,\dots,T \text{ and } i=1,\dots,N$$

Where the *i* subscript denotes the cross-section dimension, and *t* denotes the time-series dimension. When working with panel data, the first step is to define whether the data can be estimated through a pooled OLS model or a panel data model. The primary rationale behind pooling a period arrangement of cross-areas is to extend the database to show signs of improvement and increasingly dependable assessments of the parameters of the model. As indicated by (Baltagi 2008), the easiest likelihood test is the place the invalid theory is the OLS model,

$$y_{it} = \alpha + \beta X_{it} + v_{it}$$

and the FE model as its alternative,

$$y_{it} = \alpha + \beta X_{it} + \mu_i + v_{it}.$$

Since this initial step shows that a panel model specification should be preferred, the second step in panel data analysis is to define which method is more appropriate to use--Random Effect Model (RE) or Fixed Effect Model (FE).<sup>3</sup> A formal statistical test can guide the choice between Fixed Effects (FE) model and Random Effects (RE) model. Hausman (1978) proposed a specification test; "Under the invalid theory of no misspecification, there exists a predictable, asymptotically ordinary and asymptotically effective estimator. Under the elective speculation of misspecification, in any case, this estimator will be one-sided and conflicting."

Hausman’s insight means that if the individual effects are uncorrelated with one or more of the explanatory variables, both Fixed Effects (FE) and Random Effects (RE) estimators are consistent and it does not matter which one is used, or the sampling variation in the Fixed Effects (FE) is too large to conclude whether the difference is statistically significant. However, if the individual effects are correlated with one or more of the explanatory variables (misspecification), the assumption of the Random Effects (RE) estimators is false and Fixed Effects (FE) estimators should be used. Therefore, a rejection of the null hypothesis of Hausman (1978) specification test implies that the individual effects are correlated with the explanatory variables, and Fixed Effects (FE) estimates should be used. The unobserved heterogeneity of the post-Soviet countries may lead to country-specific unobserved characteristics to be correlated with the explanatory variables in the model. One of the possible options for handling the unobserved heterogeneity is to use Fixed Effects (FE) to control for the unobserved effects. So, the second method of the regression equation assumes constant but not homogenous country-specific effects, which leads to a Fixed Effects (FE) model. “Fixed Effects (FE) model is the best fit if we assume that the unobserved heterogeneity among the countries only results in parametric shifts of the regression function and that it is corresponded with

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<sup>3</sup> The error  $\varepsilon_{it}$  is very important in this analysis. Assumptions about the error term determine whether we speak of fixed effects or random effects. In a fixed effects model,  $\varepsilon_{it}$  is assumed to vary non-stochastically over *i* or *t* making the fixed effects model analogous to a dummy variable model in one dimension. In a random effects model,  $\varepsilon_{it}$  is assumed to vary stochastically over *i* or *t* requiring special treatment of the error variance matrix.

at least one of the logical factors (Wooldridge, 2002)". As indicated by Hausman (1978) test results, the invalid speculation is dismissed, which implies that Fixed Effect models are the better particular and must be favored over Random Effect Models.

**EMPIRICAL RESULTS**

Different panel data estimators test the equation in order to find a model that yields the best fit data and robust results. Based on the probability test result, the null hypothesis was rejected, which means that Pooled OLS estimator is biased and inconsistent, and we should use panel data estimation instead of OLS. In the second step, panel models were evaluated for Random Effects vs. Fixed Effects assumptions for whether the country-specific effects are uncorrelated with the regressors in the regression equation. The model estimation results table below summarizes the Random Effect (RE) and Fixed Effect (FE) results. Column (1) represents Random Effects estimation, and column (2) represents Fixed Effects estimation results. The discussions of the results are based on the findings of Fixed Effects model, which is reported in column (2) of the table. White cross-section correction is carried out in order to avoid autocorrelation, heteroscedasticity, and cross-section dependence problems in the estimated equation.

Table 4. Regression Results for the Association between Remittance Flows and Entrepreneurial Activity, 14 post-Soviet countries, 2000-2016.

<b>Model Estimation Results</b>		
<b>Dependent Variable: Entrepreneurial Activity</b>		
Independent Variables	Model 1 Random Effect	Model 2 Fixed Effect
REM	4.27** (1.76)	6.75** (2.22)
INF	-0.002 (-0.20)	0.0002 (0.069)
CONS	-7.33*** (-3.60)	-6.74*** (-3.44)
GDPP	6.32*** (3.12)	2.89** (1.81)
TBUS	-0.007** (-2.21)	-0.007** (-2.1)
C	-6.247*** (-25.3)	-6.008*** (-46.95)
N	154	154
No of Countries	14	14
R <sup>2</sup>	0.23	0.94
F-statistics	9.249***	124.9***
Hausman ( $\chi^2$ )	35.974701***	
Notes: Figure in parentheses are t statistics* p < 0.1, ** p < 0.05, *** p < 0.01 White cross-section standard errors & covariance (d.f. corrected)		

R-squared model fit statistics show that the Fixed Effects (FE) model explains 94 percent of the variation in the dependent variable (Entrepreneurial Activity). After re-estimating the model with the White cross-section standard errors & covariance, the variable inflation was removed from the model. The final estimation results are presented in the following expression:

$$\text{Ln (ENT)} = - 6.08815530451 + 6.75*\text{REM} - 0.007*\text{TBUS} + 2.89*\text{GDPP} - 6.74*\text{CONS} + e_i$$

All the coefficients in the final equation are statistically significant at 5% level. The remittance flows have a positive effect on entrepreneurial activity--when remittance flows increase by 1%, entrepreneurial activity appears to increase by

6.75%. The result offers evidence in support of our expectation that remittances have a positive association with entrepreneurial activity in post-Soviet countries.

The period it takes to begin another business inversely affects innovative movement, which fits existing proof on enterprise exercises (Audretsch, Keilbach, and Lehmann 2006). The higher are the transaction costs of starting a new business, such as time costs, the lower is the likelihood of new business activity. If this aspect of business regulation were to improve by 1 %, the entrepreneurial activity would increase by 0.007%, all else equal. Furthermore, according to empirical results, an increase in Gross Domestic Product per Capita by 1% increases entrepreneurial activity by 2.89%. This result fits the general theory of economics and illustrates that wealthier economies sustain greater levels of entrepreneurial activity. Finally, levels of consumption have a negative impact on entrepreneurial activity. A 1% increase in consumption is found to result in a 6.74% decrease in entrepreneurial activity. The finding that consumption negatively relates to entrepreneurial activity is reasonable, as consumption would absorb the resources needed for starting and maintaining entrepreneurial activity.

## **CONCLUSION**

Each individual entrepreneurial action has a more than a proportional impact on economic growth; however, limited research is dedicated to investigating the relationship of remittances with entrepreneurial activity. This study has cast light on this gap in the literature by examining the impact of remittances on entrepreneurial activity in post-Soviet countries in 2006-2016. The study presents evidence that the coefficient for remittance flows is statistically significant, suggesting that there is a positive relationship between remittance levels and entrepreneurial activity across the countries in the sample. It was further established that a 1 percent increase in remittances increases entrepreneurial activity by 6.75 percent. The result suggests that, in the post-Soviet countries, remittance flow encourages entrepreneurial activity. The findings are in accordance with the positive results found in single-country studies for the association between remittance and entrepreneurial activity. Our results confirm the evidence found in Central and Southeast Asia, Northern and Sub-Saharan Africa, and Latin America. The contribution of remittance is significant and most important in entrepreneurial activity. Its productive use can help the economy of these countries to maintain and improve the entrepreneurial activity by investing this money into investments and entrepreneurship, which ultimately can contribute positively to economic stability and a country's creditworthiness. However, the large amount of remittance flow can potentially lead to reduction in labor supply, the development of conspicuous consumption patterns and the powerlessness to build up a culture of sparing that can empower future speculations and development. Another adverse effect of remittance streams at a total level is their impact on trade rates through increments in the costs of locally created merchandise. Remittances transfers can expand the utilization of nontradable merchandise and the costs of locally delivered products, lessen fares, and harm the nation's intensity in world markets. The paper has some limitations: The articles studying the remittance focus on a specific country or region at a particular point in time. Because of cultural differences and country traits, some of the empirical evidence based on a particular country might not generalize to other economies. Another limitation is that remittance impacts might vary over time within a given country depending, among other things, on its policies and the characteristics. This study has been focusing only on the relationship between remittance flow and entrepreneurial activity, and the upcoming studies must investigate the relationship of remittances with other macroeconomic indicators that have a significant impact on economic growth.

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