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Role of aid, remittances and FDI in Fiji's growth

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Last week, we discussed the research findings of a study on the relative effectiveness of official development assistance (ODA) by advanced countries, popularly known as foreign aid, and foreign direct investment (FDI) by private sector. Aid and FDI have been a great support. They meet capital shortages of resource poor Pacific island countries (PICs).

The focus was on Vanuatu. The research paper presented at the last month's Pacific Update did not take into consideration the growing importance of rising inward remittances to PICs, since Vanuatu was handicapped by inadequate data series on remittances in terms of period coverage. Inward remittances, until very recently, were low and intermittent. Only after New Zealand's Recognized Seasonal Employer (RSE) program launched in 2007, which was followed later by Australia's Pacific Seasonal Worker Pilot Scheme, steady and substantial remittances began to flow from Vanuatu citizens, working on the farms as unskilled labour and fruit pickers in the orchards of New Zealand and Australia.

However, Vanuatu received large foreign aid consistently over a long period without any break since its independence in 1980. Further, Vanuatu has been a favoured destination for inflows of FDI because of no direct taxation of any kind and total absence of exchange controls. The Vanuatu study accordingly chose to consider only aid and FDI effectiveness.

Study on Fiji

On the other hand Fiji offered greater opportunity for research for studying the effectiveness of all the three supplements (aid, FDI and remittances) to domestic savings over a thirty-year period. Aside from traditional aid and FDI in natural resource-exploiting types of investments such as sugar and tourism, inward remittances from rugby players, teachers and nurses and other professionals of Fiji origin are well known.

A paper co-authored with Professor C.K. Choong of University of Tenku Abdul Rahman, Malaysia and Markand Bhatt of USP, which was presented at the 90th Annual Conference of Western Economic Association International held in Honolulu in early July evaluated the contributions of aid, remittances and FDI to Fiji's economic growth and development. The paper, which is published as Working Paper can be accessed on FNU website

Fiji among PICs has been receiving the least amount of aid in terms of percentage of its gross domestic product (GDP) amongst all PICs. Aid has been declining in importance over last 30 years. On an average, it was 5.4% of GDP during the ten year period (1980-89). In the next ten years (1990-99), aid was 3.6% of GDP. On the other hand remittances and FDI during the corresponding period were 1.4% and 2.1% of GDP and rose to 1.5% and 3.2% during 1990-99.

Thereafter, there has been a steady increase in remittances and FDI as against notable decline in aid. In 2010, aid was 2.8% of GDP. Remittances increased to 5.4% of GDP and FDI to 11.4%. Most recent data for all the three, enabling a comparison, reveal that aid is just 1.9% of GDP, whereas remittances and FDI were respectively 4.7% and 6.9% of GDP.

Findings

The study results show that remittances per capita have had the highest marginal impact on growth in per capita output, followed by per capita aid and FDI. The conclusions are not surprising. While bilateral aid to governments is well known for its boomerang effects, in that grants in aid are always tied to imports of goods and services from the benefactor country; and FDI in manufacturing or tourism sectors are heavily dependent on imports of machinery, building materials, transport equipment as well as for consumption goods ranging from toilet paper to food and beverages. The leakages are thus heavy, reducing the size of multiplier effects on GDP.

On the other hand, remittances received by families living mostly in rural areas seem to be spent more on consumption of domestic goods and services. These include local expenditures such as education and health services, minimizing the leakages. The multiplier effects of expenditures out of remittances by recipient families are expected to be much higher. Although there are no longitudinal surveys done on the use of remittances at a micro-level, anecdotal evidence has it that increasing number of families are now saving part of their additional incomes for investment in housing and other construction activities as well as starting small scale enterprises, as evidenced by a spurt in the number of informal business enterprises by rural households. Aside from increasing domestic demand, remittances do relax credit constraints of recipient families.

Policy implications

The government will do well to facilitate financial sector development for mobilizing savings by sector institutions in rural areas where a large number of recipient families live. Further, special incentive schemes towards linking the steady inflow of remittances with marketing and training potential entrepreneurs are worth implementing for encouraging small and medium enterprises.