ARE REMITTANCES IMPORTANT FOR THE ROMANIAN ECONOMY?

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During the last three decades the developing world began to benefit from their initial high migration rates, through the remittances sent home by the nationals living and working abroad.The article resumes the main definitions given to the concept, reviewing few factors influencing the motivation to remit, the main tranfer channnels and the effects of such a decision at both micro and macroeconomic level. Then we study these elements in the case of Romanian economy, in search of an effective contribution of remittances to the improvement of current account deficit and household standard of living.

Keywords: remittances, emigrants, transfers, balance of payments, deficit, current account

The Role Remittances Play in Developing Countries. Literature Review

International migration raises challenges related to human capital loss or accumulation, social security problems, even balance of payments deficits. During the last three decades the developing nations were affected mostly by the negative spillovers of this process. Yet benefits are to come through the transfers migrants make to their home country. Remittances are thus seen as compensations for the brain-drain and capital outflows, associated to the departure of nationals to work and live abroad.

In World Bank's view, the concept includes: *workers' remittances*, reflected in the balance of payments as transfers made by persons who work abroad for a short period of time; *compensations received by employees*, in the form of wages and salaries paid by non-residents on behalf of the work of residents employed in other countries; and *migrants' transfers*, having a financial character and caused by the change of residence from one country to another [10, p.87]. Other major economic organizations, such as I.M.F. and O.E.C.D., provide similar definitions, finding the delimitations necessary for the correct identification of income sources for a national economy [8, p.10].

Hence the three elements are differently used to estimate the remittances' levels. Some financial institutions resume it to migrants' private capital transfers (such as National Bank of Romania in its annual reports on the balance of payments), other studies use workers' remittances as the only proxy for the inflows of income provided by migrants [9] or all of them combined [1]. Yet, Reinke (2007) emphasizes that each term gives a specific meaning to the "remittances" concept. At their core, the compensations for employees are remunerations for the work performed abroad; migrants' transfers are related to current account changes, while workers' remittances involve short-term money transfers to the home country.

The motivations behind the remitting process have a double character. First, they come from the remittent himself. The altruistic attitude the migrant has for the family and relatives left behind [6, p. 145]. If the migrant's intent is to return back home or to finance his children's education, then the remittances would be high. But once the family is reunited abroad, the amounts remitted to the home country get significantly lower [4, p.51]. Therefore, the social distance or the close attachment of the migrant to his original community marks the amount of remitted sums. Or, migrants may remit just out of self-interest, for "exchange purposes". In such cases remittances are meant to remunerate services such as taking care of migrants' assets at home or to ensure the transmission of his family possessions and property onto him. And last, but not least, the remittances increase with the skill – level the migrant possesses. Thus tertiary educated ones have access to better paid jobs, remitting higher sums at home [2, pp.18-19].

Then, the external environment affects the migrant's decision to remit through public measures. The increased security and the severe financial controls practiced by authorities, gave the Pakistani emigrants an incentive to increase their remittances between 2001 and 2003. Also, the tax exemptions for remittances decided by the Vietnamese government in 1995 favored the entrance of such flows economy through official channels [10, p.92]. Another factor determining remittances' frequency is the geographical distribution of the emigrants. Harrison (2004), for example, shows that remittance flows are more intensified if the nationals migrate in the same region, noticing the substantial amount of sums transferred in the South – South economic relationships [3]. Schiopu and Siegfried (2006) reach just the opposite conclusion, after analyzing the remittances send by workers in 19 West European countries to 9 nations geographically placed in the European Neighboring Region, during 2003 – 2005. They found that long distance is a positive factor for remittances. When the migrant's country of origin is "sufficiently far apart" the host one, their flow increases [9, p.22].

But maybe the most important determinant of remittances is the difference in GDP between the sending and the receiving countries. As O.E.C.D. analysts point out, the low and middle-income countries register significantly higher remittances flows that other developing countries. In 2002, it was the case of Moldova, whose remittances represented 22, 8% of its GDP, or of Bosnia and Herzegovina, where remittances were 18, 4% of GDP [6, p.142]. Thus, small countries are dependent on remittances, while high-income states are their dominant source. Also, if we consider the top ten beneficiaries of remittances in 2007, we can notice that the first two countries are also the most populated ones (India-rank 1 and China- rank 2). On the other hand, Ratha (2003) finds that remittances do not strictly follow the trend of the economic activity in the receiving countries, taking the example of Turkey. During the 1990s the remittances absorbed by the Turkish economy increased, but began to slope during the 1999-2000 crisis, yet in smaller amount than financial capital inflows [7, p.162].

Emigrants choose to send their earned and saved incomes to the home country through various channels, depending on the information they find available in the host country, the cost they can afford to pay for the money transfer and the diversity of opportunities they have [6, p. 141]. They may decide on an informal way to remit, using hand-carries (parcels sent by bus-drivers on their way back home, friends carrying jewelry, money, clothes or other consumer goods), Hawala and Hunti systems (specific for Pakistan and Bangladesh).On the other side, migrant can use official channels such as "ethnic stores" in U.S.A., postal offices providing money transfer order systems (in the countries members of the Universal Postal Union), ATMs for credit card transfers Western Union and Money Gram (for non-banking financial operations) or the international inter-bank exchange - SWIFT.

Still the most important issue regarding remittances concerns their effects. The households left in the country of origin are the first on the beneficiaries' list. The rest of the migrant's family, still living in the home country can use the money for additional consumption, once the income is supplemented by the received sums. Generally, O.E.C.D. studies found that the remittances are used in expenses related to "housing, purchasing of land, financial savings and productive investment" [6, p.154]. Remittances may also act as back-ups for the periods when the income of the remaining members of the family falls for various reasons (in which case remittances turn into a financial support system, provided by the migrant abroad). However, if the exchange rate for the remitted currency worsens, additional gains might as well diminish for the family left behind. Remittances may also result in expanded expenditure for children's education in the home country, thus favoring human capital accumulation for the following generation [4]. Some members of the family might lose incentive to get involved in the labor market and fuel voluntary unemployment, based upon the more or less regularly amounts of money received from their relative working abroad.

Through a multiplying effect, remittances have a macroeconomic impact in the receiving country, noticed by an increase in domestic consumption (especially in rural and remote areas). But, when consumption demand exceeds national production capacity, inflation occurs. In the Sub-Saharan countries, remittances provided serious incentives to invest in construction sector, stimulating GDP growth and contributing to the creation of microenterprises [4, p.55]. Also, remittances may lead to an overvalued national currency in real terms, causing the Dutch disease effect, as exports became more expensive than imports, and tradable goods are replaced by non-tradable ones [5]. External competitiveness is lowered and exports are substituted by imports. Following this logic, the current account might be altered if the remittances are oriented towards imports, and not towards bank deposits or investments. However, empirical testing on the Egyptian economy, done by McCormick and Wahba (2004) showed that remittances have only a marginal effect in this direction. Therefore, the effect upon the balance of payments is generally seen as a relatively positive one, because remittances do not generate external debt and do not carry interests.

Thus, the receiving country's international credit worthiness is improved. In many developing countries, remittances are the main source of external financing for the economy. On the other side, the sending countries may gain from remittances may change with the type of migration (temporary or permanent), as the amounts remitted increase with the period spent abroad. The human capital accumulation, provided by migrants can also affect remittances' frequency and consistency (once those with higher education are correspondently remunerated). But, it may benefit from the taxes imposed on official money transfers, as the unofficial ones can hardly be recorded and detected at their real dimension.

The Impact of Remittances upon the Romanian Economy

According to World Bank estimations, official remittances for 2007 outran 300 bn. USD, almoust double in value compared to foreign direct investment (167 bn. USD). Considering unofficial channels used my emigrants, we assume total remittances to be much larger, when only about 60% of the transfers are officially registed. In the same time, the United Nation Development Program found that over 500 million people benefit directly from these remittances, coming from over 150 million emigrant workers. National Bank of Romania estimated for the last year (2007) that Romania received 7.16 bn. EUR in remittances, with a 29.13% growth compared to 2006, placing us on the eighth rank (considering a correction of two ranks done to the World Bank top of October 2007). The amout is not very large if we look at the first three countries in the remittances top (India -27 bn. USD, China-25.7 USD and Mexico-25 bn. USD), but it is sufficient in order to significantly influence the balance of payments, domestic consumption, exchange rate and inflation.

The influence upon the current account. The income transfers from abroad are accounted as assets of the current account. Therefore, a financial assessment might say that they have a substantial contribution to the balance of payments equalization. And, yet, the reality is quite different, because according to the same World Bank estimations, nearly 60% of the remittances received by developing nations are allocated to consumption. According to the statistics of National Bank of Romania (NBR) 56% of the sums received from the Romanian employees working abroad are domestically consumed. This fact can be explained by a limited supply on the market, unable to cover the demand. Also, Romanians have certain subjectivity in favoring foreign brands in their act of consumption. Therefore the demand generated by the remittances allocated to consumption is oriented mainly on imported goods. Thus imports increase in volume, and the current account's incomes surplus is undermined by the trade balance deficit, which reached 17.58 bn. EUR in 2007, with 49.6 percents higher than the year of 2006 (according to National Bank of Romania). Of course, remittances are not the single cause of the deficit. But their influence should not be neglected, especially when we analyze the change in consumption patterns, determined by increased expectations of future income flows. Individuals make the allocation of their available income by estimating future inflows on long terms. Therefore, they plan their lives, considering the same rates of growth for their future projects. So, at present they choose consumption instead of savings (using credits), considering the present utility of the future goods as higher. This is the explanation of the sharp increase in Romanian consumption, though not sustained by present income levels. Yet, this optimistic attitude related to the attractive remuneration of those working abroad must be tempered, because external labor markets accept emigrants as marginal employees, who are the fist to be fired in case of crisis. And this is the situation nowadays in Spain, Italy and Germany. The flow of remittances is thus interrupted, creating problems for household budget administration and initial credit reimbursement. And these are channels which may lead to major blockages in the entire economy. However, the influence of remittances upon the current account is not just a positive one, as there is the real possibility to generate indirect negative effects on medium and long run.

The influence upon exchange rates. The remittances are received as foreign currency, converted into the national one. The remittances inflow of 7.16 bn. EUR in 2007, next to the 7.069 bn. EUR of foreign direct investments and a large amount of speculative currency led to a substantial appreciation of the national currency, with an annual average of 9.46%. Such a refresh of the ROL would be very good news, if it had been the result of an increased competitiveness of the national economy. It comes instead as an effect of unproductive inflows of foreign currency, giving us real reasons to worry. A strengthened national currency contributes to additional purchasing power for foreign goods, encouraging imports. By adding the change in consumption patterns previously mentioned, we can understand the demand further increase. In the same time, the exports become expensive and Romanian goods lost their international price competitiveness and exporters visibly registered reduced profits. Important distribution markets were lost, due to high prices or export contracts cancellation, due to their weak profitability. The increase of imports correlated to diminishing exports and consumers' preference for foreign goods, generated the immense trade deficit representing 13.9 % of GDP (according to National Bank of Romania's assessments).

The influence upon inflation, purchasing power and standard of living. Coming back to the NBR's estimations, stating that 56% of those 7.16 bn. EUR remittances were allocated to consumption, this means that nearly 4 bn. EUR of liquid money entered national economy, which is 13.33 bn. ROL. If this money had had a domestic source, it would have been a contribution to the national product. Instead it is the result of incomes produced by nationals working abroad. In order to prevent inflation, this flow should be compensated by outflows generated by foreign agents involved in the national economy. These flows barely reached 1 bn. EUR in 2007. Therefore, the most part of money had no cover in goods and services, causing inflationary pressure. The National Bank had to massively buy currency from the market, in order to prevent excessive strengthening of the national currency, thus increasing the international reserves with 4 bn. EUR in 2007, which by the end of year reached the maximum historical level of 25,3 bn. EUR. Even so, the 2007 inflation surpassed the prognosis, being slightly over 7%. This increased level of inflation leads to a general downturn of purchasing power of the entire population. Yet this negative evolution is partially compensated on short term by the increased purchasing power of importable goods, which become cheaper due to the national currency's appreciation. But the overall effect upon general wealth is hard to asses. Certain negative evolutions can be noticed, as well as positive signals in domestic consumption dynamics. Though, we must emphasize that public policies, especially the monetary ones, are responsible for the turning of currency inflows of remittances into current consumption, savings and investments. A prudential credit policy would increase the saving rate, answering to the needs of an economy assaulted by the demand for investment credits. We must also consider an optimum level of the interest rate, meant to partially limit consumption in favor of the saving preference. We are aware that investments are possible as long as the market is able to absorb additional production. However, if there is a risk of a ex-post restraint in consumption, it would be compensated by the orientation towards exports in a liberalized European market. This trend would be favored by a repositioning of the exchange rates until they become sustainable and remunerating for exporters.

Conclusions

The phenomenon of migration is the result of the globalization process, reaching a significant level. The mirage of the developed markets gives the individuals living in poor or developing countries a special motivation, as they offer income advantages which for most of the cases are incomparable to those in the home country. Romania is in the same situation, having over two million nationals working abroad at present. They send considerable amounts of money, which must be considered when shaping macroeconomic policies. The effects of remittances are diverse and mainly positive. But they require monitoring, as their inflow may have negative consequences upon the long run economic activity, as shown above. Although the remitted sums apparently have a contribution to balance of payments' stabilization, we noticed it cannot happen in any kind of circumstances. As long as the propensity of consumption is high, disequilibria may occur. Thus, the deficit is deepened, by the significantly increased imports of goods and services as a result of consumption patterns' change. Also negative influences appear following the trend of exchange rates, price stability and purchasing power. Therefore, a prudential approach is required, both from the Central Bank and the Government.

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