

Emerging Markets Queries in Finance and Business

Economic consequences of remittances. Case of MoldovaAlexandru Stratan^{a,*}, Marcel Chistruga^a^a*Institute of Economy, Finance and Statistics, Chisinau, Republic of Moldova*

Abstract

Economic literature continuously argues about the consequences of remittances and scholars try to capture the effects of migration and remittances on economic growth and development. In the last decades, these phenomena became a proper pattern for the Moldovan economy. High remittances impose the Moldovan authorities to concern on better understanding of the following issues: ways of legalization and securitization of remittances inflows, in the short run, and attracting of remittances in economy and their better utilization, in general. At the same time, the paper will analyze migration and remittances patterns in order to formulate relevant policy recommendations for decisions makers.

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1. Theoretical approach to Migration and inevitability of remittances

Migration is a distinctive process of modern economy, which has a major impact on development, especially on sending countries. International migration has become an important subject for policy-makers and scientists. In the last decades, these phenomena became an indispensable pattern for the Moldovan economy. The society's aspirations for a better future and its motivation to seek higher earnings, as well as other incentives have spurred movement of Moldovan citizens across the world. Scholars and civil society have begun the analyses of migration patterns in order to formulate relevant policy recommendations for decisions makers.

* E-mail address: alex_stratan@yahoo.com

This paper, attempts to examine various aspects of the effects of remittances in particular those related to economic growth in Republic of Moldova and can represent a step further towards increasing the knowledge required by national decision makers. In principal, scholars distinguish between different impacts and consequences of remittances :

Demographic Consequences. Migration may have profound effects on the size, structure and growth patterns of populations. These effects may vary in time; also, for example depending on the gender of migrants, in the long run it can affect population growth rates.

Social Consequences. Migration may have important impact on the cultures and societies. These effects vary with different types of migration and the lengths of time involved.

Economic Consequences. Migration can have significant effects on economies. Migration has impacts on the economies that people leave and those in which they re-settle. These effects vary with different types of migration, the skills of the migrants and the lengths of time involved.

Political Consequences. Migration can have an impact on politics, depending on the skills, education and age of the migrants.

International migration can potentially create significant financial and social benefits for migrants, their families, the destination country and the country of origin. Migrants benefit if the net return to their skills is higher in the host country than in their home country while their families benefit from increased consumption and investment as a result of remittances sent by migrants. However, a large number of literatures have also highlighted the negative aspects as well, primarily that of the brain drain. Although, it is believed that it is compensated by remittances inflows. This flow of money across borders has profound social and economic impacts on various aspects of the home economies. In particular, it is argued that, remittances promote access to financial services for the sender and the recipient, thereby increasing financial and social inclusion.

The main driving force of international migration is international wage differentials Rapaport and Docquier, 2005, whereas altruism is the main reason for remitting Stark 1995, Chapter 1. According to classification presented by A. Culiuc, 2006, there are additional reasons for migration and remittances:

Remittances are used to pay services. Remittances are used for repayment of cost incurred during the migration process. Migration will assure a kind of protection against different idiosyncratic risks and high volatility. Temporary migration as a source of financing, which implies that savings will be transformed in investments, thus promoting economic growth. A genuine mapping of the consequences of migration and remittances could be found below.

2. Economic aspects of migration and remittances. Moldova's "benefits" from remittances, stylized facts.

Worker's remittance began to grow at fast rates after the regional crisis in 1998. Since then, despite a recovery of national economy the flow of emigration has intensified, thus, the estimated number of the migrant contingent is nearly 590,000 persons. This number constitutes more than 30% of economically active population. According to the National Bank of Moldova NBM, remittances to GDP ratio are estimated at more than 30 % in the last 3 years. Workers' remittances have become the single most important net source of foreign exchange currency in Moldova. Obviously, such high levels of workers' remittances have huge macroeconomic consequences. Workers' remittances have played a significant role in boosting growth in recent years, through their effect on consumption. Indeed, GDP growth is driven mainly by growth of consumption. This is not a sustainable growth.

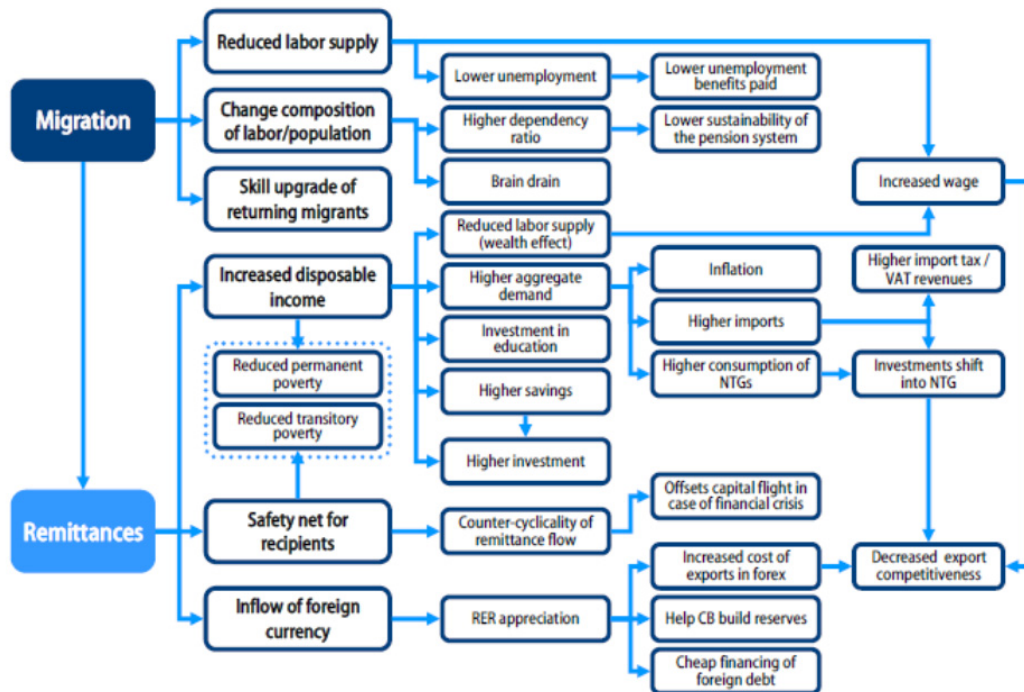


Fig. 1. Economic effects of migration and remittances. Source: A. Culiuc, Integrating migration and remittances into a development strategy. 2006.

Worker's remittances have increased households disposable income which in turn has sustained high consumption growth rates. According to the CBS-AXA survey, on average, remittances constitute at least 65% of the income of the recipient family in 41% of families with a migrant and between 35-65% for another 25%. The largest part of remittances is used to meet basic current consumption needs and the remainder to buy houses and land.

Emigration has had a significant influence on the labor market by reducing both unemployment and labor supply. This may explain why wages have pushed up. However, the increase in wages was not accompanied by an improvement of labor productivity, thus causing inflation pressures in the economy. As far as the BoP is concerned, remittances have had a major impact on the current account balance and mainly on the import side. Moldova does not have the productive capacity to meet the increasing aggregate demand. The huge increase in imports is driven mainly by the boom of the aggregate consumption. An analysis of the situation reveals that workers' remittances are financing a large part of the trade deficit. The large inflows of workers' remittances may explain the international reserves accumulation that has put the Moldovan Leu under appreciation, which might have weakened the domestic economic competitiveness level and constraining national exporters.

At the same time, remittances have positively affected the government fiscal revenue in the short run, but they might imply negative effects in the long run. The increasing inflow of remittance has alleviated the fiscal burden of the government and has helped to finance social spending. Nevertheless, in the long run, fiscal balance might be negatively affected by the financing of the pensions. Indeed, emigration changes the demographic dependency ratio by decreasing the number of contributors to the pension system.

Another problem is external shocks, like financial crisis that down-turned remittances, triggering a fall in

consumption, imports and government revenues from import taxes one of the main sources of revenues for the public budget.

In many member countries of the Commonwealth of Independent States CIS, international labor migration and remittances received by relatives at home now play a large role in financing private consumption and in shaping the labor supply and education decisions of households.

At the same time, migration and remittances matter not only at the level of individual households. The large size of remittances suggests that they have probably affected output and income distribution not only directly at the level of remittance-receiving households, but also through general-equilibrium or indirect channels. For example, in many CIS countries, a large share of government revenues derives from taxes on imports, especially VAT, which grew rapidly as a result of growing remittance inflows. With higher revenues, governments were able to maintain and expand social transfers so that transfer-receiving households may have benefited indirectly from migration and remittances although they received no remittances of their own.

3. Do remittances promoted growth in Republic of Moldova?

Among studies dedicated to relationship between remittances and economic growth there are no common points of view. The main debates about the impact of remittances on growth refer to *the use of remittances for productive investment that would contribute to long-run development*.

1. However, the impact of remittances on the economy should be viewed not only from the point of view of remittances-investment relationship. As Glytsos pointed out - remittances can affect positively the economy in the following ways:

- improvement of financial intermediation managing remittances e.g. by banks;
- extension of investment credit allowed by the increase in the liquidity of banks from remittance deposits;
- investment in human capital in the form of spending on certain consumption items e.g. education, health;
- purchase of more investment goods from abroad, made possible by remittances.
- In addition, we can add some more elements:
- smoothing income inequality in the short term;
- diversification;
- growth of investment as a result of the multiplier effects of spending on consumption.

Summarizing, we can elaborate the following chart, including the effects of remittances on the economy:

Unfortunately, higher share of remittances does not increase the marginal propensity to invest. Moreover, the higher is the dependence on the remittances; the lower is on margin the inclination to invest. This trend can be partially attributed to the differences in socio-demographic characteristics of the groups with respect to the share of remittances in the budget. High marginal propensity to spend on personal investments of the least dependent on remittances group might be explained by a higher demand and need for health services, as the members of this group are older, average age of head is 50.5 years old, and therefore, may have a poorer health status. Unlike this group, the most dependent on remittances households, younger families with children, prefer to spend the increment to their income on consumption rather than on personal investments. This fact is disturbing, because this group is the youngest and represents the potential human capital of the country. Having consumption-oriented spending the households from this group have the lowest willingness to invest in their education and health.

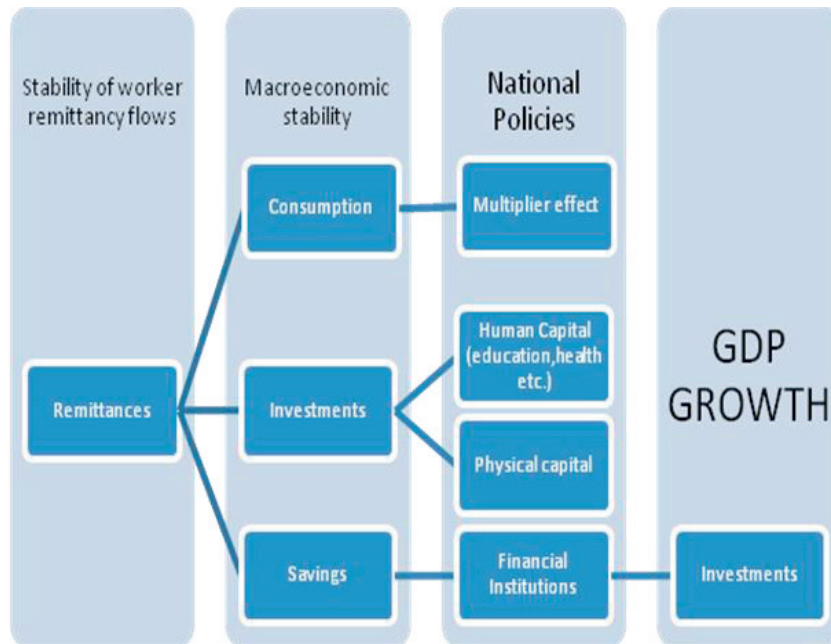


Fig. 2 Influence of the remittances on economic growth. Source: Adopted by authors

Remittances increase when economic activity in the home country accelerates and they decrease when economic conditions deteriorate, an indication that investment considerations are at play. In particular, an increase in real GDP by 1% will increase remittances by 2.7%. This suggests that remittances respond to investment opportunities and the business and political climate in the home country as much as to altruistic and insurance considerations.

Thus, in order to benefit from remittances and encourage a sustainable GDP growth there are some pylons. **First**, it is important to assure the stability, at least for medium-term period, of these flows, because of their importance to the disposable income and poverty. **Secondly**, macroeconomic stability is another goal of the policy makers. **In addition**, finally, sound national policies that encourage the development of quality factors of economic growth factors that are shifting the potential GDP. A good business environment, investment climate and functional national institutions, including the financial ones, should trigger the growth of potential GDP. In addition, we should add a strong national educational system and some additional policies/national programs that could channel remittances to productive sectors of the economy.

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