

# REMITTANCES' SIDE EFFECTS ON ECONOMY: COMPARATIVE APPROACH OF THE REPUBLIC OF MOLDOVA AND OTHER EX-SOCIALIST COUNTRIES

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## **Abstract**

*The purpose of our research has been to ascertain and elaborate on why some countries could not take advantage of migrants' remittances or even are experiencing some adverse side effects due to them. Moreover, the paper aims to identify an adequate set of policy recommendations for the remittances dependent countries. In order to elucidate the multiple implications of remittances, apart from introduction, literature review, and conclusions, we have structured the research into 3 sub-chapters, examining the connection between remittances and some macroeconomic issues, investment climate in remittances recipient countries, and drawing some policy recommendations. To generate and analyse data we have relied on both qualitative and quantitative secondary data analyses. For quantitative data, we used statistical analysis of relevant indexes elaborated by the World Bank and the Heritage Foundation. While for the qualitative approach, we used thematic analysis of the bibliographic sources. A major finding of our research is that there is a thin line between remittances' pros and cons, since in fact almost every short-run advantage can turn out into a long-run side effect, primarily as a result of mismanagement and conspicuous consumption of these financial inflows, due to unfavourable business climate and decreased marginal propensity to investment of the population. Therefore, the benefits and adverse side effects of remittances are interdependent.*

*Keywords: remittances, remittances dependent countries, remittances' side effects, migration, marginal propensity to invest, investment, resource trap, ex-socialist countries*

## **1. Introduction**

In the worldwide economy, remittances continue to be one of the major financial sources for families and play a crucial role of co-insurance or risk mitigation in times of hardship [6, p. 9]. Remittances can enhance the well-being of family members left behind and boost the economies of receiving countries [1, p.1]. Taking into account that the volume of remittances is continuously growing, it is supposed that these flows could potentially finance the socio-economic development in the Republic of Moldova, as well as in the other ex-Soviet countries. Moreover, if these remittances will sustain the investment in human capital and technology and by that increase labour productivity, they would then help to mitigate economic consequences caused by population aging and working population drain. At the same time, different economists

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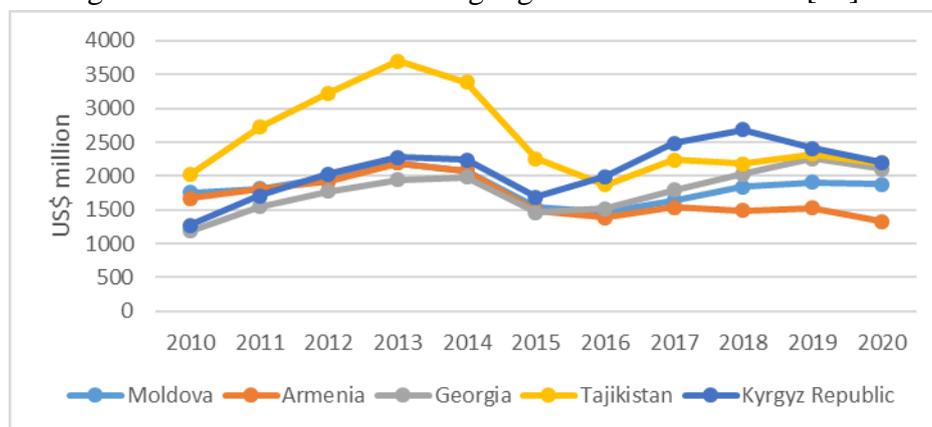
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continuously argue about the consequences of remittances on economic growth and development. Thus remittances may create a culture of dependency in the receiving country, promoting conspicuous consumption and slowing economic growth. Therefore, a better understanding of their impacts is needed to enable developing economies to get the greatest benefit from these monetary inflows [1, p.2]. Furthermore, we have sought to formulate relevant policy recommendations, with the aim to create a favourable business and legal environment, boost population's willingness to invest and get out of the resource trap.

When talking about the current trends in migrants' remittances, we must take into account the economic crisis caused by the COVID-19 pandemic which negatively affected wages and employment for migrant workers. Even if globally remittances flows remained resilient in 2020, registering a smaller decline than previously projected, and the recorded decline in remittance flows (1.6%) in 2020 was smaller than the one during the 2009 global financial crisis (4.8%), remittances to Europe and Central Asia fell by about 9.7% to \$56 billion in 2020 as the global pandemic and weak oil prices had a significant impact on migrant workers across the region. In addition, the depreciation of Russian rouble significantly lowered the US dollar value of remittance flows to the region [12].

The dynamics of migrants' remittances flows in some countries from the region is presented in figure no. 1. The countries were selected based on a number of similarities with the Republic of Moldova. For instance, all of the countries are ex-Soviet countries from Europe and Central Asia with a relative high share of remittances in GDP, between 11% and 29%, comparing to the region average of 1.92% in 2019 excluding high income economies [11].



**Figure 1. Migrants' remittances inflows, years 2010-2020**

**Source:** Elaborated by the authors, based on The World Bank's Migration and Remittances Data, available at:

[https://www.worldbank.org/en/topic/migrationremittancesdiasporaissues/brief/migration-remittances-data?fbclid=IwAR0thh4rWXNOpnWxLBJdz7YMk82VMe4xElvaFYJyCoyrTsk7OKXtnvgc\\_E](https://www.worldbank.org/en/topic/migrationremittancesdiasporaissues/brief/migration-remittances-data?fbclid=IwAR0thh4rWXNOpnWxLBJdz7YMk82VMe4xElvaFYJyCoyrTsk7OKXtnvgc_E)

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As we can notice from the graph, beginning with 2016 countries started to register an overall increase in remittance inflows, except Kyrgyz Republic where remittances tend to significantly decrease starting with 2018. However, in 2020 these declined, because of the economic crisis caused by the COVID-19 pandemic and weak oil prices. Moreover, "for 2021, remittance flows are estimated to fall further by 3.2% as the region's economies are expected to recover from the crisis slowly" [12].

## 1. Literature Review

In the case of ex-socialist countries, the phenomenon of migration and remittances is tackled in various studies, mainly from the perspective of their impact on the social and economic development, becoming the focus of a number of discussions and analyses made by researchers, public authorities and the entire civil society. For instance, the authors of *Economic consequences of remittances. Case of Moldova* [9] claim that remittances have played a significant role in boosting economic growth, through their effect on consumption. However, GDP growth is driven mainly by the rise in consumption, which is not a sustainable growth. *Olga Kupets* states that an efficient financial system can channel the saved remittances towards the most lucrative projects, in that way harnessing the development potential of remittances, while limiting their counterproductive side effects [3]. The author of *The good and the bad in remittance flows*, mentions that at a macroeconomic level, remittances have been found to hurt exchange rates and the export sector through the so-called Dutch disease [1]. Dutch disease refers to negative impacts of large increases in a country's income, whether from natural resources, foreign direct investments, foreign aid, or remittances. "The increases lead to a decline in the competitiveness of a country's manufactured exports and an increase in imports" [1, p.2]. Similarly, *Uladzimir Valetka* claims that in a sense, labour migration and remittances create a moral hazard for the government, as remittances take the pressure off governments [10].

## 2. Connection between remittances and macroeconomic issues

### 3.1. Remittances and inflation

The effect of remittances on inflation can be viewed from different perspectives.

According to experts "under a flexible exchange rate regime, the resulting effect of a large inflow of remittances will be appreciation of the exchange rate and a rising price level. The inflow of remittances determines an increase in the household income, which leads to a rise in aggregate demand. The higher demand can imply a rise of inflation" [8].

Also a part of demand is oriented to non-tradable goods, thus generating inflation. Moreover, the conversion of the foreign exchange into domestic currency raises the money supply, thus fuelling inflation. An increase in the household income results in a decrease of the labour supply, this in turn resulting in an increase in inflation, due to higher production costs.

"In order to analyse the presence of mutual causality and price level was used a VAR model. Two variables were included in the model: quarterly remittances and quarterly CPI, for the period of Q1 2000 – Q1 2012 (base period is Q1 2000). Time series which represent evolution of remittances and CPI was seasonally adjusted using TRAMO SEATS techniques. Further logarithmic data was differentiated, and as result time series became stationary" [8].

However, the VAR model shows a surprisingly small influence of remittances on inflation and mostly this fact is because of the huge share of negative net export in GDP which determines depreciation of national currency and compensates appreciation pressure from remittances inflow [8]. It is hard to quantify how much of remittances are consumed on national products and on foreign, but one thing is clear, scarce national production capacities are causing the imports to increase in the same sense as remittances. As a result, the national currency has little appreciation and inflation rate has an adequate trend.

### **3.2. Remittances and unemployment**

The most obvious effect of migration on the economy of a donor country is the reduction of labour force. Moreover, “remittances from migrants to their families raise the income of the unemployed individuals from home. This will reduce the difference between the income of the employed and unemployed in the home country, thus limiting employing intentions and causing the unemployment rate to rise” [8].

At the same time, high levels of remittance flows into labour markets may increase aggregate demand and hence the demand for labour and they do. As a result, remittances, indirectly, reduce unemployment by having a consistent impact on investment. So, as in the case of inflation, we can observe a neutralization.

### **3.3. Remittances and human capital development**

The remittances impact on human capital development in the Republic of Moldova is debatable. Pursuant to researches, “remittances contribute to reducing liquidity constraints of receiving households to finance their children’s education and thus influencing positively the development of human capital, the evidence shows that households receiving remittances are more likely to invest in education, the remittances share being hired in disposable income of households with children than without” [8].

At the same time, the positive spillovers of remittances on human capital are offset by negative effects of the mass emigration of qualified specialists and brain drain. Moreover, migration has a strong negative impact on the psychological and emotional state of children, which affects their academic performance.

### **3.4. Remittances and poverty reduction**

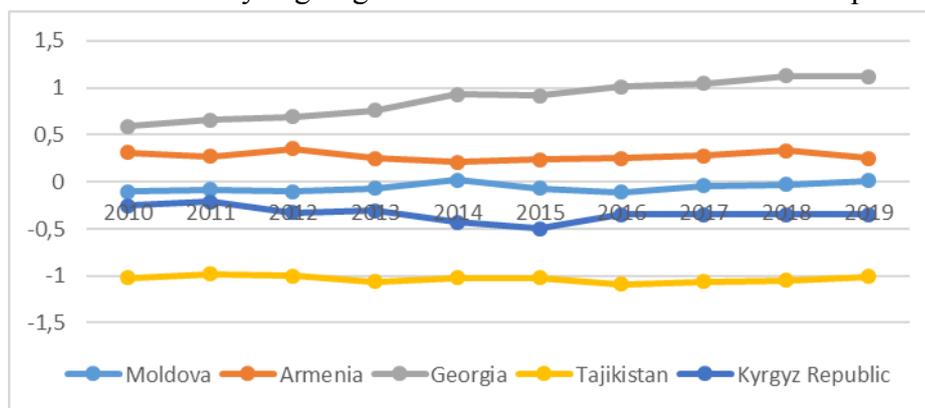
In general, remittances directly contribute to the reduction of poverty, providing financial resources for everyday consumption, education and medical service. Having a migrant abroad, a poor-income family receives not only a source of financial help, but also a type of social insurance, protecting them during the economic crisis in their country. However, remittances have contradictory effect on income inequality in the CIS countries. On the one hand, they give a chance to the poor to improve their financial situation by working in a more developed country. On the other hand, those families that are not able to send their members abroad find themselves in a negative economic situation. An example of the negative impact of remittances on income inequality is Moldova, where richer families may send their members to the EU and the migrants from poor-income families are able to work only in Russia.

## **4. Investment climate in remittances recipient countries**

In the last decades, the migration phenomenon 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 [9]. Moreover, Republic of Moldova is one of the countries that relies on remittances the most, being one of the top 3 remittance receivers (as percentage of GDP) in Europe and Central Asia, among other two ex-Soviet countries: Tajikistan (28.6%), Kyrgyz Republic (28.5%) and Moldova (16%) in 2019 [11].

Not many works deal with the distributional impact of revenues from abroad. Whilst available statistics and surveys suggest that remittances are only invested to a limited extent and have only a limited impact in terms of poverty reduction. GDP growth is driven mainly by growth of consumption, which is not a sustainable pattern of growth [9]. This phenomenon is usually explained by unfavourable investment climate, low public governance and weak institutions in developing countries. As well, our major finding is that these factors are the main reason why a country receiving remittances cannot properly benefit from these flows.

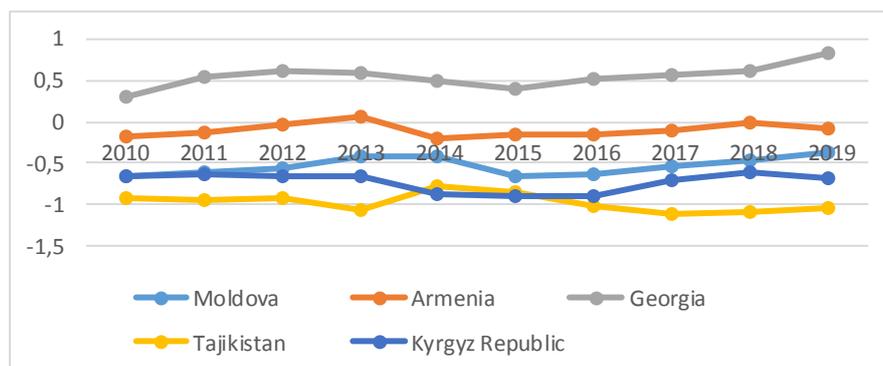
We are further presenting three indexes which describe the investment climate in the Republic of Moldova, in comparison to some other countries in the region. We selected the same countries as in the case when analysing migrants' remittances inflows in the first part.



**Figure 2. Regulatory Quality Index, 2010-2019**

**Source:** Elaborated by the authors, based on The World Bank's Worldwide Governance Indicators data set, available at:

[https://govdata360.worldbank.org/indicators/h5083f593?country=MDA&indicator=394&countries=ARM,GEO,TJK,KGZ&viz=line\\_chart&years=2010,2019](https://govdata360.worldbank.org/indicators/h5083f593?country=MDA&indicator=394&countries=ARM,GEO,TJK,KGZ&viz=line_chart&years=2010,2019) [last visited on 25.05.2021]



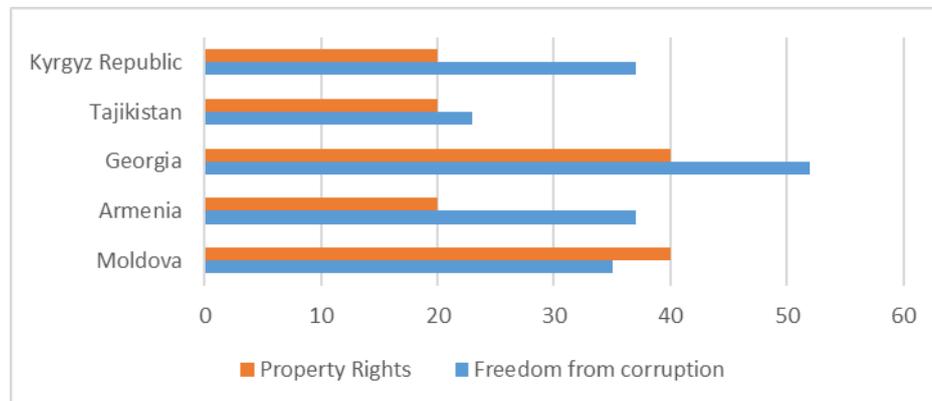
**Figure 3. Government effectiveness index, 2010-2019**

**Source:** Elaborated by the authors, based on The World Bank's Worldwide Governance Indicators data set, available at:

[https://govdata360.worldbank.org/indicators/h580f9aa5?country=MDA&indicator=388&countries=ARM,GEO,TJK,KGZ&viz=line\\_chart&years=2010,2019](https://govdata360.worldbank.org/indicators/h580f9aa5?country=MDA&indicator=388&countries=ARM,GEO,TJK,KGZ&viz=line_chart&years=2010,2019) [last visited on 25.05.2021]

In the second and the third figures is described the regulatory quality index and government effectiveness index, estimated by the World Bank in a number of countries and we can observe that over the recent decade, Moldova progressed modestly compared to other countries in the region for the quality of governance, remained relatively low, but outpaced Tajikistan and Kyrgyz Republic. The largest, and growing, discrepancy being against Georgia.

Consequently, “whereas the regulatory reform marginally improved the life of existing investors, it did not make Moldova much more attractive for potential investors” [4]. In addition, the 2014 bank fraud brought out the issue of moral hazard that negatively impacts business climate in the country [4].



**Figure 4. Property rights and freedom from corruption indexes, 2016**

**Source:** Elaborated by the authors, based on Heritage Index of Economic Freedom data set, available at: [https://tcdata360.worldbank.org/indicators/prop.rgt.scr?country=MDA&indicator=750&countries=ARM,GEO,KGZ,TJK&viz=line\\_chart&years=2015,2017](https://tcdata360.worldbank.org/indicators/prop.rgt.scr?country=MDA&indicator=750&countries=ARM,GEO,KGZ,TJK&viz=line_chart&years=2015,2017) and [https://tcdata360.worldbank.org/indicators/free.corr.scr?country=MDA&indicator=751&countries=ARM,GEO,TJK,KGZ&viz=line\\_chart&years=2016,2016](https://tcdata360.worldbank.org/indicators/free.corr.scr?country=MDA&indicator=751&countries=ARM,GEO,TJK,KGZ&viz=line_chart&years=2016,2016) [last visited on 25.05.2021]

“Weak protection of the property rights makes the investors vulnerable to perpetrations and abuses” [4]. The 2016 Index of Economic Freedom, elaborated by The Heritage Foundation, states that “the rule of law in Moldova is undermined by high corruption and low protection of property rights” [4]. Some people consider corruption a kind of a tax, and from this point of view gaining a profit is quite hard in Moldova and this fact is repulsive for the investors for sure. “Moldova earned one of the lowest scores in the region according to the rule of law components of the index: freedom from corruption and property rights” [4].

While analysing remittances’ long-run impact, we consider these factors very relevant because of their substantial influence on the population’s willingness to invest in the countries, this in turn affecting the long-run economic development of the countries receiving remittances.

## 5. Policy recommendations

As mentioned before, the population's willingness to invest and business climate in a country are some of the key-factors when talking about harnessing income’s potential of Moldovan migrants. Hence, policy interventions play a crucial role and should target such objectives as spending of the remittances in the official economy, improving the information about business opportunities, increasing the access to formal money transfers from abroad and maintenance of emigrants’ interest towards the evolution and the development process of the country.

Following our investigation, we have sought to come up with some recommendations for policy improvement in the Republic Moldova, which may be also appropriate for other ex-socialist countries:

- ❖ It is important to keep remittances facilitation such as low transaction costs, growing financial literacy and widening set of financial instruments for households on the policy agenda in order to increase remittances contribution to the economy [10]. Moreover, to channel remittances for investment purposes the government could institutionalize a specialized organization, aiming to promote the use of remittances for economic development [4]. For example, this organization could offer cheaper credits or grants for business purposes for remitters. To apply for these benefits, migrants or their families would have to prove the provenance of remittances.

For instance, our country has implemented a program called “PARE 1+1”, deemed to be a good starting point for engaging in the economic development of the diaspora’s financial potential, something ignored until relatively recently.

However, the limited effects of programs such as “PARE 1+1” have been largely criticised. For instance, some beneficiaries of “PARE 1+1” claim they no longer want to resort to the state, because of bureaucracy, and that any charity from the state is hardly given, they have to allocate too much time for travelling and documents, whilst the time for them is important. Moreover, they testify a little is offered to them, whereas the requirements are very high and that this money are spent mostly on custom fees, when bringing equipment from abroad. They consider that once they have received this support from the state it would have been good to be exempted from VAT, but that way, they imported equipment in the country and gave the money back to the state, for VAT [7].

- ❖ There is a necessity to build the capacity of institutions and human resources to conduct research into the whole spectrum of remittances and labour migration issues in accordance with international standards [4]. Household and individual surveys on migration issues can supplement official sources based on the balance of payments providing important information on the sources, destinations and amounts of remittances received by the households.
- ❖ Reducing legal barriers to labour mobility between Moldova and EU countries is an important issue as well. The efforts should be coordinated in effective migration management, including such important subjects as illegal migration, cross-border human trafficking the mutual recognition of professional qualifications, skills matching between migrant workers and jobs abroad, and the portability of pensions, health, and other social benefits [3].

## 6. Conclusions

Remittances have an extremely important role in the economic development of the Republic of Moldova and other countries in the region and in general have a positive effect on the economic development of the ex-socialist countries. However, they also determine several negative effects.

Primarily, the loss of labour resources is a serious problem hampering the development of the Republic Moldova’s economy. Also, a large share of remittances in the national economy results in macroeconomic problems, such as the Dutch disease and import growth.

Furthermore, empirical studies suggest that a growing number of labour migrants and remittances from them, decrease the pressure to implement economic reforms in their home countries, something that seriously challenges the long-term development of the whole ex-Soviet space. In this context, it is worth mentioning the importance of adequate state policy interventions which could orient the remitted financial inflows towards the most lucrative projects.

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