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Final report

Balance of payments financing in Romania. The role of remittances

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Contents

Introduction

The main goal of this paper is to illustrate and analyze the sources of financing the balance of payment deficits in Romania. Within this context, it is provided - for the first time, at the best of our knowledge - an assessment on the rising role and significance of foreign remittances in the Romanian economy; an attempt is also made to understand what lies behind the high level of errors and omissions.

The first section of the paper looks at the balance of payment dynamics in Romania over the last decade. Additional focus is placed on the balance of payment evolution in section two, which is devoted in part to the remarkable adjustment that occurred in 1999. Section two also tests the hypothesis of potential correlation between the budget and the current account deficits. Section three tackles the sensitive issue of financing the balance of payment deficits, emphasizing two items: foreign remittances, respectively errors and omissions. The paper ends with a section on comprising conclusions.

The limits of the research come mainly from the fact that data are either too scarce and unreliable, or too aggregated. For example, the number of Romanian, legal and illegal, migrants that work abroad for less than one year is only an estimate. Furthermore, the way The National Bank of Romania collects statistical information makes no distinction between different types of current private transfers (cash remittances, gifts, inheritances, etc.), while in-kind remittances are entirely not accounted for. In addition, by the very nature of the subject, the analysis on errors and omissions can provide explanations, and can interpret their overall impact, but it can not accurately rank the relevance of each of those explanations - otherwise, precise figures would have replaced those errors and omissions.

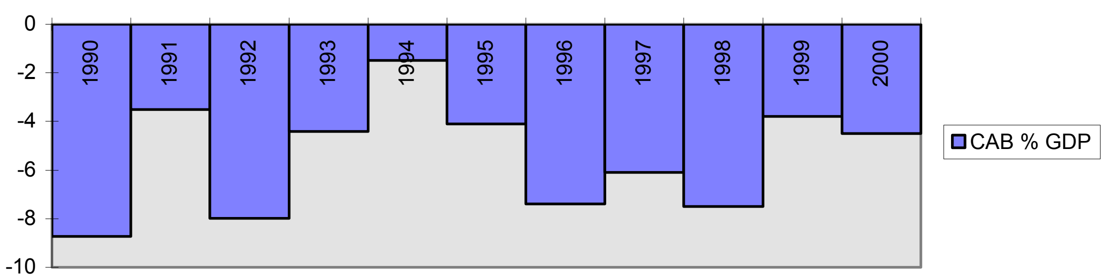
1. The balance of payments dynamics

Romania has started transition from an inconvenient grid. The unfavorable initial conditions have been reflected both in the burden of misallocation of resources, that led to structural strain, and in the institutional fragility, that explained the stop-and-go type of policies applied over the last decade[1].

Table 1.1. Selected balance of payment items, 1990-2000

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Current account	-3337	-1012	-1564	-1174	-428	-1174	-2571	-2328	-2968	-1288	-1400
of which: goods	-3427	-1106	-1420	-1128	-411	-1577	-2470	-1980	-2625	-1511	-1684
Capital and financial account	3449	872	1167	1022	334	1316	2214	1040	2723	408	926
of which: direct investment	-18	37	73	87	320	417	263	1224	2040	1007	1009

Figure 1. Current account balance, as percentage of GDP



Due to the severe cut in imports during the 80's, in both production and consumption goods, an enormous pressure erupted *bottom up* after 1989 encouraging heavy imports of final and intermediate foreign goods. The largest trade deficit was recorded in1990, both in relative and absolute terms, since "buy foreign" were the words of the day (anecdotal evidence suggest that the foreign exchange reserves were depleted to finance imports of, among others, chewing gum and orange juices). As current account deficit in Romania is mainly driven by the trade deficit, the current account balance followed the same path in that year.

The new government took steps, that resulted in real wage increases (an average of +5.1% in 1990) against the backdrop of a production decline (GDP decreased by 5.9% in 1990, 12.9% in 1991), while price controls were still in place, and the exchange rate was overvalued. In the face of fast deterioration of the economy, an IMF-supported stabilization plan was introduced in 1991, targeting the tightening of monetary and fiscal policy, a tax-based income policy, an exchange rate depreciation and inter-bank foreign

[1] Daniel Daianu "Structure, strain, and macroeconomic dynamics in Romania", *Economic transition in Romania*, The Romanian Center for Economic Policies and The World Bank, 2000.

exchange auctions. This policy led to shrinking trade deficits (first quarter: -547 mil.USD, second quarter: -270 mil.USD, third quarter: -154 mil.USD, fourth quarter: -135 mil.USD), but it failed to stop inflation from rising (December/December rate reached 222.8%), the interest rates remaining at negative real levels. Moreover, the very low domestic saving and investment rates failed to be balanced through foreign capital inflows. The latter were either insufficient (only 37 mil. USD in net foreign direct investments), or seemingly even mismanaged (1991 witnessed the largest current transfers in the official sector, and the largest IMF financing, in the whole transition period).

Table 1.2. Selected official flows of foreign capital, 1990-2000

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Net current transfers - official sector	19	198	7	111	101	63	47	64	52	44	70
Net use of IMF credit and loans from IMF	0	772	261	0	216	-315	-356	28	509	10	20

The problems persisted in 1992 and most of 1993. Very high inflation became usual (end-of-year rates of 199.2% in 1992 and 295.5% in 1993[2]), while the nominal depreciation, although dramatically high, stayed well behind the inflation rate (end-of-year rates of 143.3% in 1992 and 177.4% in1993). Large amounts of preferential credits were granted, real interest rate remained negative[3], foreign exchange inflows were scarce (as exports did not exceed a 5bn. USD threshold, and portfolio investments were net negative: -11 mil.USD in 1992 and -73 mil.USD in 1993). In 1992 the tensions accumulated in the economic system - as compared to the previous year, figures shown another 8.8% decrease of GDP, a record 21.9% shrink in gross industrial production and 13.4% downward change in labor productivity. In addition, unemployment surged to 8.2% in 1992 and 10.4% in 1993, and real wages went down by 13%, respectively 16.7% in the same years. With such pressures mounting, decisive steps had to be taken.

A breakthrough occurred in the last semester of 1993, when critical decisions were reached, with the aim of taming inflation and promoting the remonetization of the economy. The main step was to substantially increase the nominal interest rate, so that real interest rate turned to positive levels. The National Bank's average refinancing rate rose from an annual rate of 59.1% in September 1993 to 136.6% in January 1994. A fast process of remonetization was induced (and the leu became a currency worthy to be

[2] In the same year, inflation rates in other transition countries were as follows: 35.3% in Poland, 22.5% in Hungary, 20.8% in Czech Republic, 72.8% in Bulgaria - statistical data from WIIW database; see Josef Poschl et al. "Transition Countries Clamber Aboard the Business Boom in Western Europe. Upswing masks persistent transition-related problems", *WIIW Research Reports* no.264 / February 2000. Ceteris paribus, this comparison demonstrates the delay with which the reform process was initiated in Romania.
[3] Which explained the popularity of tricky private financial schemes .

held), without a credit contraction[4], therefore without a cut in production. Furthermore, the exchange rate was largely devalued, which led to the creation of a more transparent foreign exchange market. The official rate almost overlapped the gray market rate, hence the market entry costs for foreign currency holders were diminished. The control of the monetary base was tightened, and a number of subsidies were eliminated (the removal of implicit subsidies explains why the budget deficit went to 4.3 in 1994). As a result of this policy, the annual rate of inflation fell to 62% in December 1994, and the trade deficit was reduced to only 411 mil. USD.

In the following year, GDP grew by 7.1%, and the inflation rate decreased further, to reach 28%. The remonetization of the economy, that continued in 1995 (as the money supply expanded by 71%), involved the increase of net domestic assets (the expansion of the monetary base also originated in quasi-fiscal operations), and not the accumulation of net foreign assets - which would have been an ideal situation; furthermore, remonetization probably slowed down the development of open market operations, by taking potential liquidity pressure away from the NBR. A consumer spending boom occurred, that enhanced demand for imported goods - hence, the trade deficit started to deteriorate again, in the absence of real structural transformation of the economy that would had allowed more competitive local products to enter the market.

Pressures mounted in 1996, as the budget deficit was clearly financed on an inflationary basis. The monthly inflation emerged to double-digits rate in the last part of the year, the fiscal imbalance, including the quasi-fiscal deficit, hit a record 8.4% of GDP, and, despite heavy external borrowing, NBR's reserves were only 700 mil.Usd at the end of that year. To defend the exchange rate, in such context, would have been pointless.

A second policy shock occured in early 1997, and was signaled by the heavy depreciation of the leu - from 4000 ROL/USD in December 1996 to around 7000 ROL/USD in the spring of 1997, after a peak of 9000 ROL/USD in February 1997.

The first step of the government in this new macrostabilization effort was to liberalize the foreign exchange market and other administered prices. The corrective component of inflation, the substantial overshooting of the leu, the underestimated role of monopolies and the relaxation of the monetary policy in the previous, electoral, year contributed to a sharp increase in inflation. A severe fiscal adjustment took place, as well as improved performances in the consolidated budget deficit, the current account deficit, and the level of foreign exchange reserves. On the other hand, the total real credit declined by 52.5%, the GDP plunged dramatically and the underground economy was lucrative again.
The GDP continued to decrease in 1998, and the current account deficit looked threatening again. In 1999, Romania came on the eve of a financial crisis and external default - decisive action toward the adjustment of the balance of payment had to be taken. Section two of our study describes in more detail what happened at that time.

[4] As it was not the case in 1997.

Exports grew by almost a quarter in 2000, but imports outmatched their growth again. Foreign direct investments recovered by the end of the year, after ridiculous monthly levels of 3 mil.USD recorded in the spring. Foreign debt started to increase again, and approached the 10 bn. USD threshold. For the first time, foreign remittances exceeded 1 bn. USD, being the most important single source of financing the deficit after external borrowing (if we exclude exports, that, as we will discuss later, are often “mirrored” by imported inputs). The level of inflation rate was influenced by a number of concurrent targets which were pursued by the NBR simultaneously: liquidity control, export competitiveness, lower interest rates to help financing the budget deficit, supporting banks in distress, increase of reserves. The inflation target was missed not only due to these conflictual objectives, but also to exogenous conditions (oil price rise, the euro depreciation). Nonetheless, after three years of deep recession, a modest recovery of GDP occurred in 2000, driven by export growth.

2. The balance of payments adjustment

2.1. The 1999 episode

In 1999 Romania was confronted with a peak in its medium and long term debt service – about 2.8 billion USD. In addition, the Russian crisis and increasingly adverse emerging markets sentiments prohibited Romania’s access to external financing at reasonable rates[5]. The need for a severe balance of payments adjustment became urgent, and the efforts undertaken in this regard targeted a classical combination of expenditure-reduction and switching policies.

Thus, a gradual real depreciation of the leu was pursued beginning with the last quarter of 1998; an equilibrium level was almost reached in March 1999, after which the nominal rate moved in step with the inflation rate over the following months, in an attempt to preserve the competitiveness of the Romanian foreign trade. The banking sector witnessed an important restructuring process, involving the transfer of a large amount of non-performing loans from two state-owned banks[6] to the Bank Assets Recovery Agency. The scarcity of sterilization instruments, and the NBR 's net debtor position against the banking system led to a rise in the reserve requirement ratio to 30% as of December 1999.

Fiscal policies focused mainly on tax collection; the revenues from taxes continued their upward trend, reaching 31.4% of GDP. More courageous restructuring policies were implemented, including liquidation proceedings initiated for 170 companies, and the total or partial shutdown of the productive and auxiliary facilities of some important "names" of the Romanian industry. As a result, unemployment rose to 11.5%, as compared to 10.3% in 1998, and the net average real wage decreased slightly.

These policies led to a strong adjustment in the current account deficit (see table 2.1.).

Table 2.1. The current account adjustment: 1999 versus 1998

	1998		1999		1999 / 1998
Current account balance	-2968		-1288		0.43
	mil. USD	% of CAB	mil. USD	% of CAB	
Trade balance	-2625	0.88	-1092	0.85	0.42
Balance of services	-654	0.22	-419	0.33	0.64
Balance of incomes	-442	0.15	-403	0.31	0.91
Balance of transfers	753	-0.25	626	-0.49	0.83

The foreign debt was timely and fully serviced, being accompanied by the reduction of the foreign debt stock from 9.3 bn.USD to 8.4 bn.USD.
The consolidated budget deficit (including privatization revenues) recorded 2.2% of GDP in 1999 (down from 3.1% in 1998), whereas the total deficit (including quasi-fiscal operations) reached 8.4% (up from 7.0% in 1998), pointing out the question addressed in the following part of this section.

2.2. The correlation between current account and budget deficit

[5] IMF placed Romania, along with Ecuador, Pakistan and Ukraine, in a group of countries that, in order to be eligible for IMF's loans, had to prove their ability to borrow from international private markets.
[6] Bancorex was tecnically merged with Banca Comerciala, and Banca Agricola was finally privatized in the spring of 2001.

Table 2.2. Current Account Deficit and Consolidated Budget Deficit, % of GDP

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Current Account Deficit	8.7	3.5	8.0	4.5	1.4	5.0	7.3	6.1	7.2	3.8	3.8
Consolidated Budget Deficit	0.4	-3.2	4.6	0.4	1.9	2.6	3.9	3.5	3.1	2.2	3.7

Data presented in table 2.2. do not suggest a relevant correlation between the current account deficit and the budget deficit. Among factors that could provide explanations in this respect, one must consider the different roles associated with the exchange rate as a macroeconomic tool during transition (the practice of multiple rates in the period 1990-1996, together with asymmetric price liberalization, the failure to use the exchange rate as an anchor against inflation, the fear for depreciation due to the heavily foreign-denominated public and private debt, and the need for depreciation linked to the competitiveness of exports). Another factor could be the presence of high quasi-fiscal deficits (due to external debt recorded at historical rates, loss-making state companies, bank rescue operations, etc). And finally, non-governmental surges of foreign borrowing can be listed in this respect.

*Table 2.3. Calculation of quasi-fiscal deficits**

		1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
1.	Internal Public Debt Stock (Lei bn.)	-	-	221	421	1260	1336	5464	15093	26919	65153	74026
2.	External Public Debt Stock (Lei bn.)**	8	194	925	3024	5271	8734	17455	38638	52723	71824	120613
3.	Total Public Debt (Lei bn.)	8	194	1145	3445	6531	10070	22920	53731	79642	136977	194639
4.	Public Debt Stock/GDP (%)	0.9	8.8	19.0	17.2	13.1	14.0	21.0	21.2	21.5	24.4	24.4
5.	Public Debt Flow/GDP (%)	-	8.5	15.8	11.5	6.2	4.9	11.8	12.2	7.0	8.4	7.2
6.	Consolidated Budget Deficit/GDP (%)	0.4	-3.2	4.6	0.4	1.9	2.6	3.9	3.5	3.1	2.2	3.7
7.	Quasi-fiscal Deficit/GDP (%)	-	11.7	11.2	11.1	4.3	2.3	7.9	8.7	3.9	6.6	3.5

* The method used to estimate the quasi-fiscal deficits is based on the assumption that these deficits are, sooner or later, reflected in the accumulated stock of public debt.
**Exchange rate at the end of period.

When adding the quasi-fiscal deficit to the consolidated budget deficit (hence calculating a total deficit), the correlation coefficient between the current account deficit and this total deficit is positive (0.5624); yet, it does not indicate a strong, direct correlation. Therefore, it can be submitted that the relationship between the current account deficit and the budget deficit is neither clear, nor sustained.

3. Financing of the balance of payments deficit

3.1. General issues concerning the financeability of the deficit

The problem with the external imbalances is not how large the deficit is (there are examples in recent history when countries have survived with 10%, or even 25% deficits), but whether, and how, it can be financed. The financeability of the deficit is therefore a matter of primary interest.

In this respect, there are two issues of concern. First, whether financing can be secured. Although it might look like approaching it on several occasions, Romania has not faced an open balance of payment crisis in the transition period. The evolution and adjustment of the balance of payment, as well as some correlation between external deficit and the fiscal deficit, were already discussed in the previous sections. The financing has been secured so far, but at what costs? Table 4.1. illustrates the time when Romania's current account deficit got increasingly financed by private sectors creditors.

Table 3.1. National Bank of Romania's borrowing from capital markets, 1995-1999

Lead manager or creditor	Amount (mil.USD)	Maturity (years)	Spread*	Currency	Date	Date of withdrawal
Citibank Syndicated Loan	110	1.50	225	USD	Dec 7, 1995	Dec 13, 1996
Union Bank of Switzerland	60	2.00	50	USD	Dec 29, 1995	Dec 29, 1997
Union Bank of Switzerland	20	2.00	50	USD	Jan 12, 1996	Aug 29, 1996
Merrill Lynch	25	3.00	200	USD	Feb 15, 1996	Feb 15, 1996
Merrill Lynch	25	5.00	225	USD	Feb 15, 1996	Feb 15, 1996
Sanwa Bank	90	1.25	175	USD	Apr 26, 1996	May 8, 1996
Nomura Securities**	480	3.00	280	JPY	May 28, 1996	May 28, 1996
Merrill Lynch	225	3.00	225	USD	Jun 12, 1996	Jun 25, 1996
Nomura Securities**	269	5.00	307	JPY	Sep 20, 1996	Oct 9, 1996
ABN AMRO-Citibank	175	3.00	188	USD	Sep 26, 1996	Oct 23, 1996

* Over LIBOR in case of floating debt rate.
**Liabilities in yen (valued in USD at the exchange rate prevailing at the closing date); the spread is calculated over equivalent government bond yield for fixed debt rate.
Source: IMF, *Romania, Selected Issues and Statistical Appendix*, November 6, 2000

The market sentiments have turned out to be one of the macroeconomic fundamentals[7], sometimes more important than cold figures. As a result, the contagion effect of the Russian crisis hit Romania in the spring of 1998, when spreads surged to over 1200-1300 basis points over LIBOR, which was in fact a prohibitive level[8].

The relationship with the IMF has neither been too lean. Negotiating IMF agreements has almost became a ritual practice in Romania's political and economic life; it is not the final sum drawn that counts (as it has constantly been lower than the sum approved), but the "signal" sent to the markets when an agreement is reached.

Table 3.2. Stand-by agreements with the IMF, 1991-2001

Date of approval	Date of expiry	Amount approved (mil.SDR)	Amount drawn (mil.SDR)
Apr 11, 1991	Apr 10, 1992	380.5	318.1
May 29, 1992	Mar 28, 1993	314.0	261.7
May 11, 1994	Apr 22, 97	320.5	94.3
Apr 22, 1997	May 21, 1998	301.5	120.6
August 5, 1999	Feb 28, 2001	400	139.7

Source: www.fmi.ro

[7] For a challenging perspective on the role of market feelings (attitudes) in triggering crisis, see Paul Krugman, *The Return of Depression Economics*, Norton, 1999.
[8] For a comprehensive study on the recent emerging markets crisis, see Daniel Daianu, *Where are the post-communist countries heading to?*, Vilnius, 1996.

The second issue, linked closely to the first one, refers to the composition of the financing sources of the deficit. What the Mexican-type of crisis teaches us is that heavy reliance of a country on speculative flows for financing the deficit will make that country paying price for excessive vulnerability. This is, for sure, not the case of Romania, where, except for a short period when portfolio investments were triggered by the starting operations of the Bucharest Stock Exchange and Rasdaq, the net flows were slightly positive, or even negative (the important outflow of 1999 is a perfect exemplification of the low attractiveness of the operations performed on the local capital market).

Table 3.3. Portfolio investments, 1990-2000

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Portfolio investments, net credit (mil.USD)	0	0	-11	-73	75	32	1222	883	130	-715	110

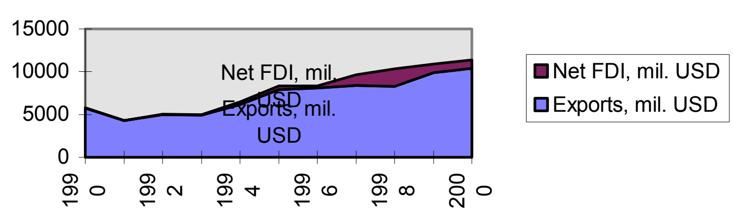
Source: NBR statistics

In addition, the only limited liberalization of the capital account provides some protection for the time being against speculative flows[9].

The most desirable way to finance the deficit is by way of autonomous flows. Exports and foreign direct investments are the lasting, much needed, sources of foreign exchange. This section briefly analyze them, before placing the emphasis on foreign remittances, an increasingly important source of financing the current account deficit. In the last part of thissection, some explanations are provided for facts that contribute to the very large, and positive, residual sums presented as errors and omissions.

3.2. Exports and foreign direct investment

Figure 3.1. Exports and foreign direct investments

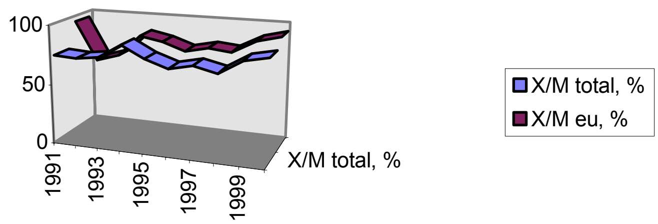


FDIs increased significantly in 1997 and 1998, while exports expanded in the following years. A corelation between FDI and exports can be considered, with a time gap.

[9] For more on this, see "Assessing external vulnerability", chapter prepared by Ward Brown, in IMF, *Romania*, *Selected Issues and Statistical Appendix*, 2000.

Exports, as a source of foreign exchange inflows, are a sword with two faces. The increase in exports also attracts a rise in imports, because most of export products require imported inputs - a structural feature of the Romanian foreign trade.

Figure 3.2. The export/import coverage ratio, total and with the EU, 1991-2000



However, the trade imbalances, as reflected in the export / import coverage ratio, have been improving since 1998, especially in the commercial links with the European Union.

We export labor-intensive products, such as textiles and footwear (that make up to 47% of our exports to the EU), and components for machines and equipment[10]. These are low value-added products, therefore perpetuating a vicious circle of low value-added, low profits, low investments, low wages, low value-added.

We can even identify a whole culture of subcontracting[11] being widespread in the Romanian economy, with most local companies producing either under licensing agreements, or in lohn. Such a reality would enhance the depletion of foreign exchange resources in order to finance the imports of intermediate goods.

Foreign direct investments are driven by the cheap workforce. In recent years, a turn in the pattern of FDIs occurred[12], with export-oriented FDIs replacing the ones focused on servicing the local market. Another reason for FDI inflows, that was prevalent in 1997-1998, referred to the method of privatization - direct negotiation was likely to attract more important foreign investors; on the other hand, the market power inducements granted at the time of direct negotiation might prove damaging to the local market competition[13].

Table 3.4. Foreign direct investment stock, selected transition economies, 1999

the Romanian foreign trade, based on revealed comparative advantages
viu Voinea, Bianca Pauna, Flaviu Mihaescu, Manuela Stanculescu *Winners*
ropean integration. A look at Romania, The Romanian Center for Economic
2001.
pting to the economic status of periphery", *Ten years of adaptation*, The Pro

FDIs patterns in Romania, see Costea Munteanu, Voicu Boscaiu, Daniela Liusnea, Lucia Puscoi *The impact of FDI on productivity in Romanian manufacturing industry*, The Romanian Center for Economic Policies, Working Paper no.22, 2000.

[13] See Liviu Voinea, "Competition problems on the Romanian cement market", *Oeconomica* no.3-4/2000.

	FDI stock (bn.USD)	Year in which Romania's 1999 stock level had already been exceeded
Romania	5.5	-
Hungary	19.0	1994
Czech Republic	17.0	1995
Poland	28.0	1995

Source: WIIW Database

Foreign direct investments have, at their turn, secondary effects on the balance of payments. In the initial stages of development, technology transfer is needed. The problem comes when imports substitute intermediate products that could have been produced locally as well. As a matter of fact, it appears that the vast majority of the productive inputs in the foreign-owned Romanian textile industry are imported.

Another type of foreign exchange outflows that intervene as a result of FDIs consists of making use of a number of transfer pricing practices. Statistical data available indicate, for 1998, that 46% of FDI-driven exports are loss-making. Transfer pricing is a method of tax avoiding. One should actually consider the fact that, apart from improving the Romanian exporters' position on the learning curve, the significant increase in exports in the year 2000 might reflect a rise in the recorded exports, stimulated by the cut of the profit tax on export-earnings to 5%. Such a hypothesis could get support from foreign trade performance in the first two months of 2001 - exports are rising, but at a slower pace than in the similar period from the last year.

3.3. Foreign remittances

3.3.1. The relevance of foreign remittances in the Romanian economy

Broadly defined, remittances are the money migrants earn abroad that are sent back home. They represent a private flow of capital from the country of employment to the country of origin. If one considers labor as an export, then remittances are the payment for this export.

According to the IMF interpretation, remittances have three different components:
- workers remittances, that are the value of monetary transfers sent home from workers abroad for more than one year;
- compensation of employees, that are the gross earnings of foreigners residing abroad for less than 12 months, including the value of in-kind benefits;

- migrant transfers, that are the net worth of migrants who move from one country of employment to another.

It is the time to make a very important methodological remark, that helps us to understand both the complexity of this issue, and the technical limits that appear in studying it.. The balance of payment prepared by the National Bank of Romania records workers remittances under item 1.C., as "current transfers - other sectors[14]" and compensation of employees under item 1.B., as "incomes from work"; as for migrant transfers (if any), they are not distinctly recorded. This remark qualifies later in this paper - for now, just keep in mind that not all types of remittances are recorded in the same item of the balance of payment.

There are a number of economies that rely heavily on remittances. Most of them are traditionally labor exporting economies, concentrated in Northern Africa, Central America, and Continental Asia. Within European Union, Greece, Portugal and, to a lesser extent, Spain, receive considerable amounts of remittances, that are significant also when compared with flows of foreign trade. The theory of remittances[15] considers that a correct analysis of remittances must place them in the context of other foreign currency flows. When compared to exports, remittances prove their relevance as a source of foreign currency for the local economy. When compared to imports, remittances prove their importance as a potential source of payment for inputs in the local economy. Of course, high shares of remittances in the trade flows show distortions, inability of local economy to develop through other means, and reliance on what can be seen as random financing.

Table 3.5. provides an international comparison on the volume and relevance of remittances for different economies. This comparison has its limits, as the international data refer to "public and private remittances" - we do not know whether or not compensation of employees are counted in those statistics. Hence, when introducing the data for Romania in table 4.5, we have considered only what our balance of payment records as "current transfers" (public administration and other sectors). In doing so, the results for Romania represent minimum levels and shares that can be accounted for. Even in such conditions, the striking feature that appears from table 4.5. is that, among countries in transition[16], remittances are most relevant in the Romanian economy.

Table 3.5. International comparison on the volume and relevance of remittances for countries of origin, 1998*

Country	Remittances, mil. USD**	Remittances as % of exports	Remittances as % of imports
India	10280	21.6%	17.3%
Greece	7510	50.5%	29.3%

[14] Others than "current transfers - public administration", that are recorded separately, also under 1.C.
[15] Deborah Waller Meyers (1998)*Migrant remittances to Latin America: reviewing the literature* The Tomas Rivera Policy Institute.
[16] We refer here only to CEFTA members.

Mexico	6014	4.6%	4.3%
Turkey	5727	10.5%	10.3%
Egypt	4403	32.6%	20.1%
Portugal	4031	11.6%	8.8%
Pakistan	3430	34.2%	26.7%
Korea	3352	2.1%	2.9%
Spain	3249	2.0%	2.0%
Lebanon	2689	147.9%	30.8%
Morocco	2345	23.5%	20.6%
Bangladesh	2017	34.3%	25.0%
Romania	753	7.9%	5.8%
Poland	2897	6.6%	5.5%
Hungary	1018	3.9%	3.7%
Czech Republic	408	1.2%	1.1%
Slovak Republic	366	2.8%	2.3%
Bulgaria	230	3.8%	3.8%
Slovenia	112	1.0%	0.9%

* data are either missing or clearly being underestimated for a number of economies known for their reliance on foreign remittances, such as: Algeria, Cuba, Moldova, Nicaragua, Peru, Philippines.
** data include both public and private remittances.
Source: calculated based on data from World Development Report 2000/2001, a World Bank publication.

As we already mentioned, the data above can be misleading. The right way to calculate the level of recorded remittances is to add workers remittances and compensation of employees. Moreover, we believe that we should only look at the credit position in the balance of payment, as it records the inflows of foreign exchange[17]. The results are presented in table 4.2, while figure 4.3. offers a visual comparison between this aggregated level of foreign remittances and the current account deficit.

Table 3.6. Total inflows of remittances,
and their impact on the current account, 1990-2000

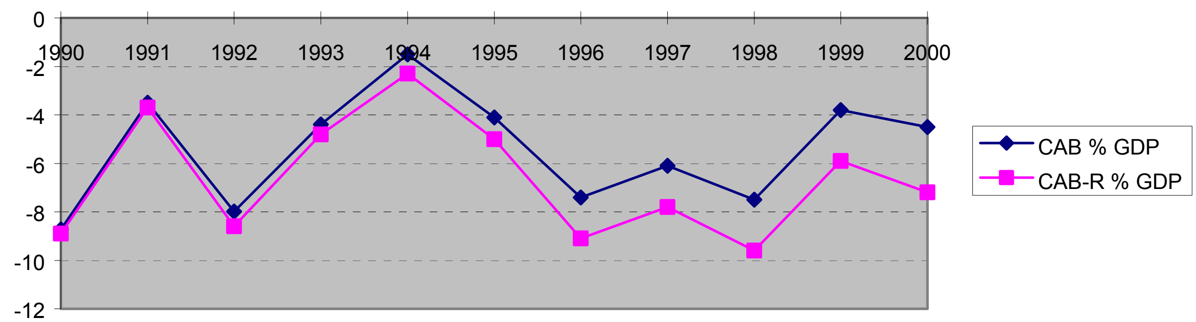
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Total inflows of remittances recorded (mil.USD)	102	69	122	116	234	392	613	662	858	722	1074
Current account	-3439	-1081	-1687	-1290	-662	-2166	-3183	-3000	-3826	-3732	-2474

[17] To look at the net position would mean to disturb the reality, by putting together two different aspects: money earned abroad by Romanian migrants and sent to Romania, on the one hand, and money earned in Romania by foreign migrants and sent out of Romania, on the other hand. We will discuss the latter figures as well, later on.

deficit in the absence of foreign remittances (mil.USD)											
Current account deficit in the absence of foreign remittances (% of GDP)	8.9	3.7	8.6	4.8	2.3	5.0	9.1	7.8	9.6	5.9	7.2

Source: computed based on NBR statistics

Figure 3.3. The relevance of foreign remittances in the current account, 1990-2000



where: CAB = current account balance; CAB-R = current account balance without remittances inflows

Foreign remittances have represented, especially in the last five years, a major source of financing the current account deficit - their absence would have led to likely unsustainable deficits (e.g. 9.8% in 1998). Their present impact on the Romanian economy as a whole is revealed in table 4.3.. Annual inflows of remittances have a magnitude of over 10% of exports and about 9% of imports, representing 3.3% of GDP (data for comparison: the international aid[18] received by Romania does not exceed 1% of GDP[19]). In the year 2000, the inflows of remittances exceeded the foreign direct investments (1074 mil.USD, against 1065 mil.USD), and amounted to almost half of foreign exchange reserves. Moreover, the stock of remittances in the past eleven years of transition (4964 mil.USD) equals two thirds of FDIs' stock in Romania over the same period, while covering more than one half of the total foreign debt accumulated.

Table 3.7. Remittances, volume and relevance, in the Romanian economy, 2000

	Total, mil. USD	Percentage of GDP	Percentage of exports	Percentage of imports	Percentage of FDI inflows	Percentage of foreign reserves*

[18] Net official development assistance and official aid.

[19] According to World Development Indicators 2000, a World Bank publication.

Romania	1074	3.37%	10.36%	8.91%	100.8%	44.3%

*gold reserves not included
Source: calculated based on NBR data

A legitimate question follows from this remark: is it good or bad to have an economy in which remittances play an important role? The theory is controversial on this issue. There are two main perspectives, summarized by Russell in a cornerstone scheme (see table 3.8).

Table 3.8. Benefits and costs of remittances from international worker migration

Benefits	*Costs*
Ease foreign exchange constraints and improve balance of payments	Are unpredictable
Permit imports of capital goods and raw materials for industrial development	Are spent on consumer goods which increases demand, increases inflation and pushes up wage levels.
Are potential source of savings and investment for capital formation and development	Result in little or no investment in capital generating activities
Net addition to resources	High import content of consumer demand increases dependency on imports and exacerbates BOP problems
Raise the immediate standard of living of recipients	Replace other sources of income, thereby increasing dependency, eroding good work habits and heightening potential negative effects of return migration
Improve income distribution (if poorer/less skilled migrate)	Are spent on 'unproductive' or 'personal' investment (e.g. real state, housing)
	Create envy and resentment and induce consumption spending among non-migrants

Source: Russell, Sharon Stanton. (1986) "Remittances from International Migration: A Review in Perspective" *World Development* 14:6: 677-696.

Let us enlarge this framework, by describing in more detail different opinions. As this is, to the best of our knowledge, the first study on remittances in Romania, detailing the theoretical background could be a meaningful effort.

On the positive side, supporters of remittances rank first their impact on increasing recipients' standard of living, by providing money for basic needs[20]. Remittances create a social safety net, easing tensions due to unemployment and disparities[21]. While increasing individual well-being, they also raise the national income, contributing to financing imports and shrinking current account deficits[22].

[20] Taylor, Edward J., Joaquin Arango, Graeme Hugo, Ali Kouaouci, Douglas Massey, and Adela Pellegrino (1996) "International Migration and Community Development." *Population Index*, 62:3: 397-418.

[21] Keely, Charles B. and Bao Nga Tran (1989). "Remittances From Labor Migration: Evaluations, Performance, and Implications. *International Migration Review* 24:3: 500-525.

[22] Durand, Jorge, Emilio A. Parrado, and Douglas S. Massey (1996) "Migradollars and Development: A Reconsideration of the Mexican Case." *International Migration Review* 30:2: 423-44.

On the negative side, critics of remittances look first at their psychological impact. Some economists[23] consider that such discretionary incomes decrease the likelihood of healthy economic growth, as they create dependency and they develop a subsistence ethic. Others[24] go even further, stating that remittances alter the working habits of the recipients, by reducing their incentive to work (of course, this is not valid for retired people). Instead of alleviating inequality, they promote it. In addition, remittances stimulate the demand for imported goods, increase inflation (in Romania, however, inflation is primarily fueled by other factors) and encourage continous migration[25].

By encouraging continous migration, remittances contribute to the "brain drain" phenomenon. In the recent years, indeed, the flows of Romanian migrants seem to have changed their composition (as detailed in the following sections) in favor of better educated people, most of them being IT specialists. According to estimations made by the National Association of the Software Industry[26], 2000 out of the 5000 fresh annual graduates from IT faculties in Romania leave the country and choose to work abroad; if this rhythm continues, Romania will risk facing a crisis of IT specialists by the year 2003. When specialists leave from networks (functional organizational structures) for which switching costs are very high in the short run, they can badly disrupt the operation of those networks. Nevertheless, there are arguments in favor of the brain drain - the main one refers to the fact that exponents of migratory flows can return home after accumulating money and experience abroad, and put them at work in the local economy.

Finally, there is no doubt that everyone should spend his money the way he or she wants. There are not the people (receivers of remittances) that should be held responsible for spending money prevalently on current consumption, imported goods; quite the contrary, it is the underdeveloped local economy that makes these people to depend on foreign remittances. Spending additional income for the fulfillment of basic needs (e.g., food products) is (by way of interpreting the utility theory) a clear indicator of the incapacity to fulfill those needs in the absence of remittances. At the same time, spending additional income on "personal" investments (e.g., real estate) is (by way of interpreting the investment theory) an indicator of the lack of functional financial instruments available, and possibly of the lack of trust in the local banking system.

As foreign remittances consist of different types of flows, it is suitable to analyze them separately: workers remittances, respectively compensation of employees.

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[23] Pastor, Robert (1990) "Migration and Development: Implications and Recommendations." *Report of the Commission for the Study of International Migration and Cooperative Economic Development*. Washington, D.C. Government Printing Office.

[24] Itzigsohn, Jose (1995) "Migrant Remittances, Labor Markets, and Household Strategies: A Comparative Analysis of Low-Income Household Strategies in the Caribbean Basin." *Social Forces* 74:2:633-55.

[25] Martin, Philip (1996) *International Migration: Challenges and Opportunities*. prepared for the International Monetary Fund.

[26] See "Migration file" *Capital*, no.13/2001

4.3.2. Workers remittances

Workers remittances must be linked to the dynamics of emigration, as both of them involve long-time commitment, and the IMF methodology considers workers remittances as current transfers from people living abroad for longer periods of time

For the proper understanding of table 4.9., four methodological notes must be made here. First, we refer only to net private current transfers. Second, the net remittances shown above represent only estimate figures. This is because these flows include money transfers from gifts, inheritances, awards, etc., that, under normal circumstances, do not qualify for remittances. Workers remittances are therefore lower than stated in table 4.5. However, in-kind remittances are completely not accounted for. There are reasons to believe that they might have a certain magnitude, that escapes statistical recording. Hence, the remittances figure in table 4.5. both overestimate and underestimate the real flows. Third, we do not consider the calculation of monthly remittance / migrant as being very accurate, as the sum sent back home varies a lot depending on the period of time spent abroad, the occupation, the level of education, the marital status, etc.. However, the monthly remittance / worker is needed for its indicative value. Fourth, and last, we do not take into our analysis the emigration that left the country before 1989. The main argument in doing so is that experience indicates that the longer the length of stay abroad the less the amount of remittances sent[27]. While this argument may be questionable, it is still preferably to operate only with figures starting from 1990, for simplicity reasons at least.

Table 3.9. Remittances and emigration, Romania, 1990-1999

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Net workers remittances mil. USD	102	69	122	116	227	387	605	648	813	677
Dynamics of net workers remittances, % (last year =100%)		67.6 ↘	176.8 ↗	95.0 ↘	195.6 ↗	170.4 ↗	156.3 ↗	107.1 ↗	125.4 ↗	83.2 ↘
Emigration, thousands of persons (new migrants only)*	96.9	44.2	31.2	18.4	17.1	25.7	21.5	19.9	17.5	12.5
Dynamics of emigration, % (last yea r=100%)		45.6 ↘	70.5 ↘	58.9 ↘	92.9 ↘	150.2 ↗	83.6 ↘	92.5 ↘	87.9 ↘	71.4 ↘

[27] Nicholas Glytsos "Migrant Remittances in the MENA Region: Issues and Policies for Consideration", *Forum*, vol. 5, no.1, May 1998. The author is the Head of the Labor Economics Division of the Center of Planning and Research (KEPE) in Athens, Greece.

Monthly remittance/ migrant, USD**	87.7	40.7	59.0	50.6	91.0	138.1	197.7	196.4	231.7	185.0

*temporary migrants are not included
**computed as: annual flow of remittances / total emigration
Source: calculated based on data from:
National Bank of Romania, *Human Development Report Romania* 1999,
Zaman,Gheorghe, Vasile,Valentina "Trends and structures of Romanian emigration between 1980 and 1999", *Economic problems* no.32/2000.

Following conclusions can be drawn:
- in absolute terms, remittances have increased by 10 times between 1990 and 2000 (for the last year, there were 980 mil.USD in private current transfers).
- after a period of four years of relatively small variations, remittances skyrocketed between 1994 and 1996. This may have been helped by what Daianu[28] called "interest rate shock" - in the last quarter of 1993 when the decision was taken to set net positive interest rates. The remonetization was doubled, in 1994, by the substantial depreciation of the exchange rate, creating incentives for foreign currency holders to enter the official market[29]. This scenario matches previous findings from international literature[30] claiming that foreign remittances are positively correlated to the interest rate differentials between host and home economy, as well as with the transparency and increased liberalization of the foreign currency market.

This increased inflow of remittances might have contributed itself to the expansionary evolution of private consumption in late 1994 and during 1995, and also to the improved situation of the current account. In 1996, however, the continuos boom of remittances (that exceeded half billion dollars for the first time) might have added some tension in a system in which the budget deficit was inflationarily financed.

The "second transformational recession"[31], in 1997, had an initial taming impact on the volume of remittances, as the latter is negatively correlated to short-term risks and performances of the recipient economy[32]. Nevertheless, the impact was rather slight. In that year, international reserves were fueled by significant portfolio and foreign direct investments. It should be mentioned that the Stock Exchange started to operate in 1997. Likewise, political changes gave a motif to some wealthy Romanians living abroad to consider direct investments in the country. It is possible that, in a way, the relative boom

[28] Daianu, Daniel *Macroeconomic structure, strain and dynamics in Romania* (2000) Economic transition in Romania, Romanian Center for Economic Policies and World Bank.
[29] Unification of the official and black market exchange rates led to a surge in the recorded amounts of remittances in other countries as well, such as Marocco (1986), Tunisia (1990) and Egypt (early "90s).

[30] See Russell, Sharon Stanton and Michael Teitelbaum (1992) *International Migration and International Trade.* World Bank Discussion Papers no.160. Washington, D.C; see also Straubhaar, T. (1986) *The determinants of Remittances: The Case of Turkey* Weltwirtschaftliches Archive, 122(4), 728-40.

[31] Idem 22.
[32] Idem 24.

of FDIs and portfolio investments contributed to the relative decrease in the rate of growth of foreign remittances, by changing the final destination of money. However, the effects of measures taken to promote liberalization probably overcame the taming impact of recession - since late 1997, remittances had been rising once again. Within a fourteen months period, between November 1997 and December 1998, more than 1 billion dollars were sent back home by Romanian emigrants. This might had also been linked to a completely reversed situation of the one that occurred in the previous year. As the enthusiasm for portfolio and foreign direct investments got tamed, the money of potential small investors were redirected through foreign remittances' channels. The mixed signals given by the Romanian economy in 1999 let us with no clear explanation of the decline in the level of foreign remittances recorded in that year; the decline could rather be attributed to a record low number of emigrants[33], but such explanation is quite unlikely.

The 44.7% increase[34] in remittances in 2000 was probably recorded due to at least three reasons:
- the ridiculous levels of portfolio and foreign direct investments, in particular in the first half of the year (following the same logic as for 1998);
- the significant (over 25%) rise in imports, some of them being probably financed by remittances[35];
- the improved and secured means of transferring remittances, as a wider range of banks have either started, or developed, their transferring capacity.

■ The value of the monthly remittance / migrant has been constantly exceeding the net average monthly wage in Romania for the last five years. Furthermore, if we isolate the ethnic emigration to Germany[36], the same situation can be identified for the first three years after Revolution. The consequences of having monthly remittance / migrant higher than net monthly average wage stay in creating a moral hazard environment. Recipients might be tempted to give up work, or to abandon searching for a job; a culture of dependency is promoted.

Especially in the case of recipients that are either retired (which can actually represent a consistent part of total recipients, due to two reasons: first, the aging process of the

[33] To take this explanation for granted means, however, to apply a different logic than the one used before. As we will insist further on, no consistent relationship can be proven between the flows of emigrants to countries of employment and the flows of remittances to Romania, as the country of origin.
[34] From 677 mil. USD in 1999 to 980 mil. USD in 2000 (only private remittances, we do not account here for what BoP calls "public administration current transfers").
[35] There is anecdotal evidence from El Salvador that such a remark can apply not only to individual demand for imported consumption goods, but also to the financing of small and medium sized enterprises. According to a field research, two-thirds of SMEs required remittances to stay in business, with remittances almost taking the place of the normal business income that was not available because of the social, political, and economic problems in El Salvador. See Lopez, Jose Roberto and Mitchell Seligson (1990) *Small Business Development in El Salvador: The Impact of Remittances* Report of the Commission for the Study of International Migration and Cooperative Economic Development. Washington, D.C. Government Printing Office.
[36] In the period 1990-1992, a number of 99935 Romanian citizens emigrated to Germany, most of them being of German origin. As entire families emigrated at that time, there was no family-related incentive left to send remittances to Romania.

Romanian population; second, the fact that "the power of example", in other words the imitative behavior, is more likely to appear to young people, resembling the emigrants in this respect) or unemployed, this culture of dependency doubles another type of culture of dependency: the public social assistance system. Hence, as cynical as it may sound, some social assistance funds (which ones are they - we cannot know in the absence of any detailed recording mechanisms) are probably directed in the wrong direction - some people in need get two types of cash transfers, while others get none, or an insufficient one. Nonetheless, in many cases there is not only one recipient of remittances, as an entire family (composed of two, even three generation) benefits from it - proportionally, each individual receives less additional cash.

The fact that monthly remittances / migrant exceeds net average monthly wage appears in the context of rising flows of remittances and decreasing flows of emigrants. Apart from the explanations linked to the evolution of the Romanian economy, described above, we can make the following hypothesis: a new type of Romanian emigrants has developed over the years. They send home more money, which means, *ceteris paribus*, that they earn more money. At its turn, this means that their jobs are better paid, therefore requiring higher education. This hypothesis is supported by the fact that the USA[37], where high-tech jobs are much wanted, replaced Germany in 1999 as the first destination of Romanian emigrants, receiving 18.95% of total Romanian migration flows.

3.3.3. Compensation of employees

The other main inflow of remittances, compensation of employees, is also the more difficult one to estimate. It has been presented in the balance of payments only since 1994, and the figures in table 4.10. represent only the remittances sent home through legal banking channels (and aggregated by the National Bank from the reports of commercial banks) by the workers who registered their contracts abroad at the Romanian Labor Ministry.

Table 3.10. Recorded compensation of employees, 1990-2000

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Net compensation of employees, mil.USD	-	-	-	-	7	5	8	14	45	45	94

Source: NBR statistics

At a first glance, although severely underestimated, these flows reveal a spectacular surge in the level of remittances as compensation of employees. The problems with these data are, however, many-fold.

[37] USA has a tremendous negative balance of current transfers (-44 billion USD in 1998). A large portion of it appeared after the fall of communism, and the subsequent immigration of East Europeans (the deficit was only -27 billions USD in 1990) .

We have no aggregate figure available for temporary workers legally employed abroad for less than one year. We should make again a distinction between workers registered with The Romanian Labor Ministry, and those unregistered, yet with legal working contracts abroad.. According to estimations made by The Romanian Association of Construction Groups[38], 20,000 workers are employed every year, due to the opportunities provided by thisorganization, in the construction industry, in countries like Germany, Spain, Iran, Nigeria, India, Malaysia. Temporary workers abroad that are registered at The Romanian Labor Ministry enjoy significant facilities at sending money (that are remittances, in the form of compensation of employees) home through banking transfer practices. Official data[39] reveal, for 1995, a number of 510 legally employed temporary workers in Germany, and 9648 others in Austria, Hungary[40] and former Soviet Republics. Between 1997 and 2000, officially registered Romanian workers in Germany mounted to 11,566 persons in areas such as constructions, wood processing, informatics; 2,820 persons in services (waiters, social workers, etc.); 48,966 persons in other sectors. Between 1996 and April 2001, a total of 67,803 persons were officially registered as Romanian workers in Israel, 61,024 of which being employed in constructions. In total, a number of 26,005officially registered Romanians worked temporarily abroad in the year 2000. By dividing the total sum recorded as compensation of employees to this number, it results that the monthly remittance/temporary worker is 301 USD - twice and a half than the average net monthly wage at home.

Another 80,000 Romanian migrants work every year also in the construction industry abroad, most of them in Israel, but on the black market. They, and others like them (Hungary is another favorite country of destination), constitute a different category of temporary migrants. They are not necessarily illegal migrants, as they might have left the country with tourist visa (or they don't need a visa), and they operate in legal businesses - true, without a legal contract. Although they tend to send money home (the precarious living conditions pose high safety risks on holding money), the channels chosen are less official (through friends, legally employed workers, flight personnel, regular mail, etc.), because of the quite high transfer costs (around 10% of the sum that is sent). These costs are prohibitive for them, because migrants in this category are less paid than any other Romanian legal income-earners abroad.

Finally, it is hard to account for the remittances sent by the illegal migrants, but one should not rule out the existence of a certain sum of "black remittances". Data[41] from 1996 discover 10019 illegal Romanian migrants in Hungary, 1226 in Poland, 188 in Slovenia. Only in the first 8 months of 2000, 3640 illegal Romanian migrants were found

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[38] Idem 20.

[39] According *to The migration phenomenon in Central and Eastern Europe* (2001) study made by The Center for Studies and Research, The Department of Parliamentary Information, The Parliament of Romania.

[40] 47% of total legally employed foreign workers in Hungary are Romanians - according to Langewiesche, Renate and Lubyova, Martina *Mobility and free movement of persons: an issue for current and future EU members* working paper in a WIIW ongoing project, 2000.

[41] Idem 32.

in Croatia. An Insomar research[42] estimates the existence of 70000 illegal emigrants in Germany, and 60000 others in Italy, for the year 2000, while a number of 400000 Romanian migrants of Gipsy origin is believed to "travel" throughout Europe every year. At least as these Gypsy migrants are concerned, field studies show that they bring with them the money earned abroad.

From a theoretical point of view, these potential unrecorded flows of remittances could be estimated by revealing them in the increased consumption[43] or saving patterns. However, in the current context of the Romanian economy, with persistent consumption contraction - over the last years - and low saving ratios, even the recorded flows of remittances fail to have a visible impact on changing the consumption and/or the saving behavior[44].

Tabel 3.11. Savings ratio

1994	1995	1996	1997	1998	1999
22.5%	19.0%	17.6%	13.7%	13.3%	15.5%

Sursa: IMF Report, 2000

This leads us to suggest that the impact of recession has been felt even deeper than official figures indicate, and that the downward trend of consumption and saving ratio would have been even steeper in the absence of foreign remittances. This remark is also supported by the large current account deficits that would have been recorded in the absence of remittances (only in 2000, the deficit would had widened by 75% had the remittances inflows not occured- see figure 3.3.).

3.3.4. The other side of the coin

Just as Romanian migrants work abroad and send remittances home, foreign immigrants work in Romania and send remittances back to their countries of origin.

Table 3.12. Recorded outflows of remittances

	1990	1991	1992	1993	1994	995	1996	1997	1998	1999	2000
Compensation of employees, debit (mil. USD)	-	-	-	-	0	1	2	1	6	5	5
Private current transfers,debit	15	49	18	13	45	81	59	133	112	118	190

[42] See 20.
[43] The impact of the underground economy on consumption levels is also important, but it does not change the essence of the observation.
[44]There is plenty international literature sustaining that the utilization patterns of foreign remittances do not differ substantially from utilization patterns of other types of incomes - and, as we now, Romanian households spend most of their income on current consumption. An interesting remark for the case of Romania is that, at least over the last four years, about one fifth of all remittances is sent in December, which probably fuels the holidays consumption.

(mil. USD)											
Total outflows of remittances (mil. USD)	15	49	18	13	45	82	61	134	118	123	195

Source: NBR statistics

While compensation of employees are at very low levels, the outflows of workers remittances are not negligible, reaching almost 200 mil.USD in the year 2000. Although details are practically missing, we believe that most of these remittances fall under one of the following two categories. First, a part of this sum is due to the massive presence in Romania of citizens originating from the Republic of Moldova. When they are engaged in legal activities, the wage differential is eight to ten times higher in Romania than in Moldova, not to mention the large number of Moldavian students living in Romania.

Second, another part of this sum, maybe the bulk of it, is sent by representatives of foreign communities that have established their businesses in Romania (coming from Arab and Asian countries such as Iran, Iraq, Libya, Syria, China, etc.); just as a hypothesis, it can be submitted that these people make gains by acting as company owners (although they may not register it accordingly in their accounting books) and send it home as individuals. The fact that remittances are not taxed may prove here an incentive for tax evasion practices.

The outflows of remittances do not account, of course, for the earnings of illegal immigrants. Their number is increasing in Romania, that is perceived by some migrant persons (from very poor countries, such as Somalia, Pakistan, Sri Lanka) as a transit area on the way to Western Europe.

3.4. Errors and omissions

In the *International Financial Statistics* presentation, errors and omissions are equal to the difference between reserves and related items and the sum of the balances of the current, capital and financial accounts. In a normal economy, errors and omissions represent a residual category (usually below 5% of the current account balance) needed to ensure that all debit and credit entries in the balance of payments statement sum to zero.

Table 3.13. Errors and omissions, 1990-2000

	1990	1991	1992	1993	1994	1995	1996	1997*	1998	1999	2000
Errors and omissions, mil.USD	-112	140	397	152	94	458	357	1097	245	794	474
Errors and omissions, as percentage of current account	3.3	13.8	25.3	12.9	21.9	25.8	13.8	51.3	8.2	61.2	33.8

balance, %											
Total net speculative flows (portfolio investments + errors and omissions)	-112	140	386	79	169	490	1579	1980	375	79	584

*data for 1997 were revised at the end of 1998, being reduced with about 20% due to the late recording of some private debt.
Source: calculated based on NBR statistics

A peculiar picture of the Romanian economy is revealed in table 3.12., where errors and omissions are always significant as a percentage in the current account balance, sometimes making for more than half of it (which is tremendously high).

Some specialists[45] regard errors and omissions as unrecorded short-term inflows, and assimilate them, together with portfolio investments, as “hot money”. If this assumption is accepted for Romania, no relevant conclusions can be drawn. Total net speculative flows were significant only in 1996 and 1997, when conditions were anyway favourable for them, due to the starting of BSE and Rasdaq operations, and the reliance on private creditors lending (as shown in section 4.1.).

The wide margins of variations, both in absolute and relative terms (even leaving 1990 aside, the variations range from 94 mil.USD in 1994 to 1097 mil.USD in 1997, and from 8.2% of CAB to 61.2% of CAB in two consecutive years, 1998 and 1999), indicate the difficulties in explaining errors and omissions in the Romanian balance of payment, and in attributing relative importance to each of the potential sources of unrecorded flows.

By rating the constant net positive values of what should be a residual item, and having in mind the complex reality of the Romanian economy, several explanations regarding these errors and omissions can be submitted, that reflect inputs that are either unrecorded, or unregistered:

- the functioning of the underground economy. On the one hand, goods such as cigarettes and alcohol are smuggled over the borders (escaping custom controls that would document them), into the country, and are then supplied on the black market. The sums cashed are then laundered through private exchange houses and put at work in the official economy. On the other hand, payment is cashed for illegal traffic with demerit goods such as guns or drugs.
- cash inflows brought in-hand by illegal Romanian emigrants, or transferred through more or less official channels by Romanians that are legally abroad, but who have not registered their contracts with The Romanian Labor Ministry.
- unregistered contracts granted to Romanian individuals, companies or authorities. There are numerous research contracts, development-enhancing and institutional

[45] See Nouriel Roubini, Paul Wachtel *Current Account Sustainability in Transition Economies*, Stern School of Business, November 1997.

grants, from European and U.S. - public mostly - funds, that are not registered as such in Romania. Money directly received, or transferred at a later time, in Romanian accounts, without the simultaneously registration / declaration of the contracts justifying them.

- unregistered exports of Romanian companies selling intangible goods. E.g., unofficial estimations say that at least a few tens of million dollars in exports are earned by Romanian software companies each year. Selling software solutions over the Internet escape official recording, but the sums obtained from these exports are, sooner or later, used by companies in recorded operations.

Conclusions

This paper deals with the issue of current account financeability. On the one hand, the paper looks at Romania's ability to finance its current account deficit. The paper concludes that current account financing was relatively secured until 1999 when, in order to avoid external default, a severe balance of payment adjustment took place. Likewise, a strong and sustained correlation between the current account deficit and the budget deficit is not found.

On the other hand, the paper looks at the sources of financing the current account deficit. It concludes that foreign remittances (including compensation of employees and workers remittances) play an increasing role in the Romanian economy, as they represented, in 2000, the main source of financing the current account deficit. As of the end of 2000, the flow of foreign remittances exceeded that of FDI, it amounted for almost half of NBR's foreign exchange reserves, and it represented more than 10% of exports, while reaching 3.3% of GDP. Among CEFTA countries, Romania records, by far, the highest volume of foreign remittances, in relative terms. A simple calculation shows that, in the absence of foreign remittances, the current account deficit would have been as high as 7.2% in 2000 (as compared to actual 3.8%).

Experience shows that foreign remittances are mainly used to buy current consumption goods, which bolsters the demand for imported goods. In addition, substantial remittances can create liquidity control problems due to the low monetization of the Romanian economy (base money represents only 4.5-4.6% of GDP) . The receivers of the foreign remittances should not, anyway, be blamed for these side effects; after all, they indicate the difficulties to fulfill basic needs from other sources of income, and the lack of spending alternatives (underdevelopment of financial instruments available, lack of trust in the local banking system). This suggests that the difficulties of transition have been felt even deeper than official figures indicate, and that the downward trend of consumption and saving ratio would have been even steeper in the absence of foreign remittances.

Workers remittances and compensation of employees must be connected with the dynamic of permanent, respectively temporary migration. In both cases, however, the average monthly remittance / migrant is higher than the net average monthly wage in Romania. The consequences of having monthly remittance / migrant higher than net monthly average wage are likely to promote a culture of dependency; recipients might be tempted to give up work, or to abandon searching for a job. Especially in the case of recipients that are either retired or unemployed, it doubles another type of culture of dependency: the public social assistance system.

The fact that monthly remittances / migrant exceeds net average monthly wage appears in the context of rising flows of remittances and decreasing numbers of official emigrants. It can be submitted that a new type of Romanian emigrants has developed over the years. They send home more money, which means, *ceteris paribus*, that they earn more money. At its turn, this means that their jobs are better paid, therefore requiring higher education. (this hypothesis is supported by the fact that the USA, with a prevalence of high-tech jobs, replaced Germany in 1999 as the first destination of Romanian emigrants, receiving 18.95% of total Romanian migration flows).

Another reason for the increase in the level of remittances lies with the improved and secured means of transferring remittances, as a wider range of banks have either started, or developed, their transferring capacity. This is supported by the "mirror" evolution of foreign remittances as compared to errors and omissions.

As for errors and omissions, which have constantly reached high levels during transition, they can be attributed to a number of factors, such as: the functioning of the underground economy; the cash inflows brought in-hand or transferred by either illegal or unrecorded migrants; the value of in-kind remittances; the unregistered contracts granted to Romanian individuals, companies or authorities; and the unregistered exports of Romanian companies selling intangible goods.

To address these issue is not an easy task. Many countries (Middle Eastern and Asian countries, in particular) tax foreign remittances; others (Latin American countries, at a large extent) implement different types of schemes to attract remittances (including preferential exchange rates, investment opportunities, etc). In our opinion, the inflow of foreign remittances should not be discouraged by taxing it, as it represents now an important source of financing the current account deficit. A redistribution of funds may be operated in the area of social assistance programs, in favor of the non-receivers of foreign remittances, but it would highlight the opportunity cost incurred to determine individual eligibility for funds. Attracting remittances by use of the exchange rate policy may contribute to increasing distortions, while attempts to channel the spending of remittances on specific investment targets would likely fail as long as low (decreasing) living standards direct foreign remittances towards current consumption goods.

What can and should be done, however, is to try to account for more types of remittances (including in-kind remittances, earnings from contracts legally completed abroad - but unregistered at home, etc.), which would, at the same time, diminish the extent of errors and omissions.

Further efforts are needed, based on extensive field research, to design a regional “map” of the distribution of remittances, to estimate how many persons actually benefit from one transfer.