

# THE IMPACT OF REMITTANCES ON THE EFFICIENCY OF THE FINANCIAL SYSTEM OF THE REPUBLIC OF MOLDOVA

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## **Abstract**

Currently the attraction of the investment resources to the Moldovan economy has become a very important process, which requires the banking community as intermediaries and businesses as beneficiaries to identify the sources of funding.

Household savings occupy a special place in the system of economic processes, as they affect the interests of many economic entities: from households to financial institutions. On the one hand, the savings are an important indicator of the population's living standards on the other hand they constitute a source of investment

**Keywords:** financial system, financial system efficiency, financial remittances.

## **Introduction**

The financial system plays several essential roles in any modern economy, which includes the provision of facilities for carrying out financial transactions, channeling funds from savers to borrowers and offering businesses and household's means of managing the financial risks. If these functions are performed well, the financial system will contribute positively to economic prosperity and development. But if these functions are performed inefficiently, additional costs would be imposed on the society undermining its economic performance. The symptoms of inefficiency could include high transaction costs, limited financial products and services or of poor quality, lack of response to the customer needs and misallocation of resources within the economy in the long run. [1]

The efficiency of the financial system may influence population's savings growth, which may contribute to the development of investments. In general, the financial sector provides a better allocation of resources. [2]

At the same time the financial system efficiency is determined by both external environmental factors and the quality of management of the system. The problem of updating the financial system and the improvement of its operating efficiency is complex and multifaceted.

## **The intermediation role in the process of attracting investment resources**

At present the attraction of investment resources into the Moldovan economy is a very important process, which requires the banking community as an intermediary and the businesses as beneficiaries to identify the sources of funding.

Household savings occupy a special place in the system of economic processes, as they affect the interests of several economic entities: from households to financial institutions. On the one hand, savings are an important indicator of living standards of the population; on the other hand they constitute a source of investment.

Traditionally, in the Republic of Moldova a competitive advantage in attracting household savings belongs to the commercial banks among other financial institutions. The banks as financial intermediaries meet the needs of economic agents for investments, into which are transformed inclusively the household's savings. Thus, the banks' investment activity contributes to obtaining income not only for banks.

As the information asymmetry is well defined in the Republic of Moldova, the behavior of the population denotes a fear in efficient investment commitments and the preference to other investments (e.g. bank deposits), which are less profitable but more liquid. Banks as intermediaries use this money and can offer it as loans to entrepreneurs. In addition, banks in the event of a weak currency demand and of a large number of deposits can reallocate the money supply for productive purposes. Also, in this situation the entrepreneurs will not have problems with the risk of liquidation, which would face a single creditor seeking to regain the capital. The bank as an intermediary minimizes the liquidity, increases the savings available for productive investments and thus promotes economic growth. Banking intermediation leads to economic growth.

The financial intermediaries can stimulate economic growth by diversifying the risk, thus encouraging the projects which are more innovative. This distribution facilitates the use of some productive and challenging techniques resulting in raising the physical and human capital. The endogenous growth models demonstrate positive externalities that represent a source of growth.

On the other hand the information asymmetry is one of the main barriers to the participants 'entry into markets, which at the same time increases the costs of the already existing activities.

Moreover, as the financial services market largely depends on the mood of individual investors and borrowers, who have even fewer opportunities for a real analysis of the market functioning and which are largely based only on external information related to a large

amount of "rumors", the financial trends can quickly change the way both in terms of growth and decrease, incomparable to the real situation [3].

### **The effects of remittances on the financial system development in the Republic of Moldova**

With globalization the challenges, which are faced by Moldova's economy, acquire an increasingly shaped character. The complex solvation of these issues supposes the creation of foundations for the implementation of progressive structural economic changes, able to contribute to the sustainable economic development.

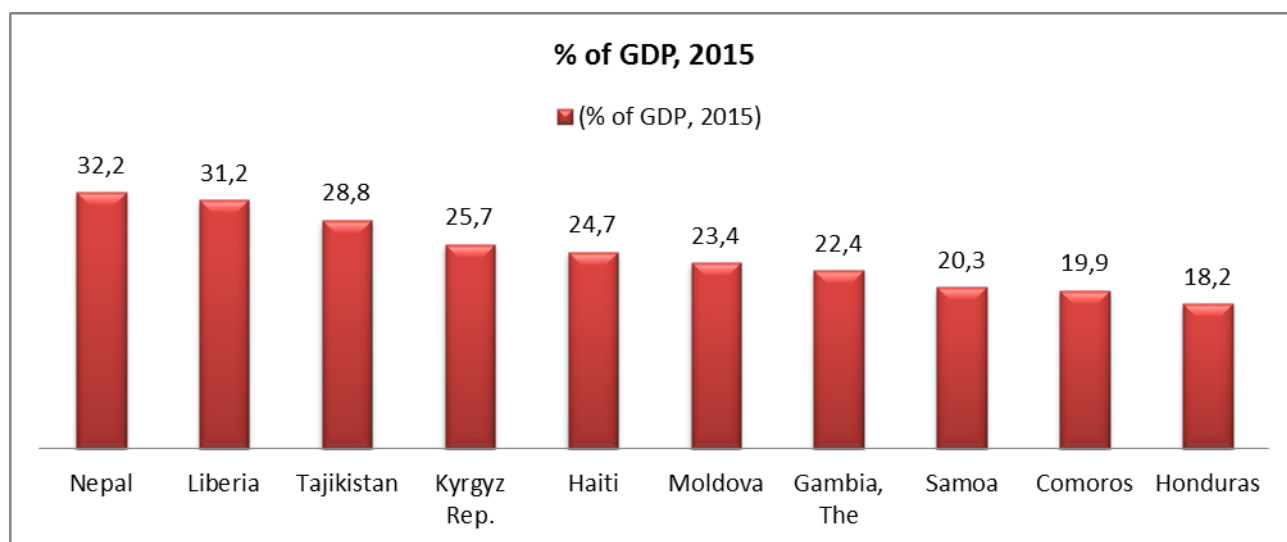
Clearly, the level of development of our financial system and of its basic element - the banking system - largely determines the real possibilities of the Moldovan economy. The Moldovan banking system is a key component of the national infrastructure, which determines the efficiency of transformation of savings into investments and also determines the competitiveness of the Moldovan economy. But in the current conditions, the Moldovan banking system in its present form is inadequate for the requirements of our economy and society.

The household savings have a considerable contribution to the sustainable development of the national economy and of the financial system, which are turned into investments in the national economy through the financial system, thus leading to economic growth. According to the prudential reports in December 2016 the share of deposits in the national currency attracted from individuals accounted for 75.50 percent of the total time deposits in the national currency [4]. This indicator highlights the importance of household savings for the increase of the financial system efficiency.

Until recently, the Moldovan banking system could be considered relatively safe among the countries of Eastern Europe. Unfortunately, in the recent years the situation in the banking system has worsened considerably as a result of dubious deals made by the Savings Bank, the Social Bank and Unibank. As a result of these suspicious transactions, the financial sector has created a huge capital hole, which has had a negative impact on the national economy and the living standards of the population.

Given the fact that lately Moldova's economy was exposed to a crisis, the causes of which are directly related to the operation of the banking system, it should be taken into account that the considerable savings of individuals do not come from their employment in the national economy. The international statistics also confirms this.

Thus, according to the statistics presented by the World Bank [5], the Republic of Moldova is in the top ten countries with the share of remittances in GDP considerably large and the only country in Europe represented in this top. However, the transfers of our co-nationals working abroad for different reasons are steadily declining, which should make the governors develop a concept regarding the financial system's mission.



Source: [5]

**Table 1. The share of remittances in GDP in 2015**

As for the banking system of Moldova, at present it consists of two levels: the National Bank and 11 commercial banks, including four branches of foreign banks and groups.

**Table 1**

**General data on the banking system of Moldova (November 2016)**

Total number of banks.	nr.	11
Bank subdivisions:	nr.	804
- branches	nr.	287
- representatives	nr.	0
- agencies	nr.	517
The total number of bank employees	nr.	7,864
Foreign investments share in the banks' equity	%	81,03

Source: [6]

To assess the efficiency of the banking system, as a rule they analyze the impact of the specific characteristics of each country on its banking activity. These include, for

example, the economic structure, the nature of macroeconomic policy, the specific nature of structural and institutional reforms in the financial sector.

The next group of factors, affecting the efficiency of banks, is the ownership structure of the banking system, the major changes in its operational activity, the share of banks in the market deposits and bank capitalization.

The main indicators of the banking system efficiency are shown in the table below.

**Table 2**

**Profitability ratios of banks in Moldova (2016)**

Return on equity (ROE%)	11.95
Return on assets (ROA)	1.97
Net Interest Income / Total income	37.84
Non-interest expenses / Total income	48.57
Net interest margin (NIM)	5.50
Efficiency Index (Efi)	135.09
Annual net interest income / Average monthly interest-bearing assets	10.50

*Source: [6]*

In assessing the efficiency of the banking system a number of indicators are calculated, the main being ROE and ROA.

The indicators of banking system efficiency calculated on the basis of 11 banks show an increase in efficiency after a period of decline of the same indicator in 2008 (the top record of Moldovan banks in the bank system efficiency was established in 2007 ROE (23.97%) and ROA ( 3.91%))

In addition to the approach outlined above, they also use calculations which link efficiency with the indicators of bank assets and liabilities' structure and with certain types of operations. Thus, according to the analyzes conducted by several international financial organizations, the maximum impact on the aggregate value efficiency have the following factors: the volume of attracted deposits (0.14), the value of offered loans (0.59), the share of deposits in the capital value (0.49) and the ratio of loans to capital (0.76). The figures in parentheses indicate the dependence of efficiency changes on the size of the indicator. For example, if the volume of deposits increases by 1%, the efficiency of the banking system will increase by 0.14%.

## Conclusions

The financial system's core mission is to provide financial services, which must meet the requirements of the economy and of the society in raising the investment levels and in social stability. To meet the needs of the economy and society, the financial system of Moldova requires a concept to highlight the following:

- The needs of the real sector resources to supplement working capital, the extension of the production base, renovation of infrastructure; without these resources an effective innovative growth and development is not possible;

- The provision of population demand for financial instruments to protect and enhance the living standards achieved; thus, the financial sector contributes to the achievement of social stability necessary for the population and the ensurance of minimum social guarantees;

- The state needs for maximizing the added value created in the country and for the financial infrastructure to conduct economic policy, designed to help ensure sustainable economic growth and economic competitiveness.

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