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SIGNIFICANCE OF EFFECTIVE USE OF REMITTANCES IN SERBIA

Significance of remittances for Serbia

Remittances have been a significant source of Serbia's foreign exchange inflows ever since major economic migrations to developed European countries, the United States, Canada, Australia, New Zealand and South Africa began back in the *1960s*. Though varying in intensity, economic migrations never ceased. Another very important feature of economic migrations from Serbia (and other former SFRY countries) is that most migrants tend to maintain strong ties, including economic, with their homeland unlike migrants from other European countries in transition. Hence, the financial inflow from remittances and other migrant transfers to Serbia reaches an estimated 7–10% of the country's GDP per year.

During the *1990s,* the time of international sanctions and great political and economic upheavals in Serbia, remittances decreased substantially. This, however, did not diminish their significance much as they retained both their stabilizing function for households and the government, and their function of investment capital – employed to set up small enterprises. Extreme economic instability that plagued the country at the time resulted in a total collapse of confidence in the domestic financial system. There was practically no traditional foreign exchange savings in domestic banks, investment in real estate slumped, while investments into small enterprises were most often made in cash with little or no bank intermediation at all.

The main reasons behind such movements in the flows of remittances during the 1990s are as follows: *political instability, sky-high inflation rate, undervalued domestic currency due to inadequate exchange rate policy, salient lack of confidence in local financial institutions, weak property market as the legal regulations prohibited trading in foreign currency (though all trading actually took place in foreign currency), no bank loans for natural persons and non-residents, and restrictions on current and capital foreign exchange transactions.*

NBS and government actions aimed at bolstering remittances and their use for investment purposes

Following democratic changes, in *early 2001* Serbia embarked on an ambitious programme of sweeping reforms to ensure smooth transition to market economy and create the preconditions for integration into the EU. Aware of the significance of inflows from current transfers (notably remittances), the National Bank and the Government of the Republic of Serbia took a number of macroeconomic measures so as to restore confidence in the domestic economic and financial systems and their stability:

- Nearly all banks were privatized through sale to foreign banks;
- A special law was enacted to regulate the payment of foreign currency savings that banks owed to households, thereby restoring the public confidence within an astonishingly short period of time;
- Interest rates were market-based, and as such, are currently the highest in Europe;
- NBS devoted special attention to its primary objective – maintaining price stability which has been achieved within a relatively short period of time;
- Stability of the exchange rate has been maintained owing to its market-based formation (floating exchange rate regime);
- The Law on Foreign Exchange Operations was liberalised in two phases and there are currently almost no restrictions on the current and capital transactions;
- The stock of foreign exchange required reserves of banks with the NBS represents a guarantee for payment of sums under obligations on new foreign exchange savings – up to 40-50% of total savings deposits;
- In an attempt to pre-empt the backlash from the global financial and economic crisis, the government approved an increase of guaranteed deposits to EUR 50,000 (effective as of the beginning of 2009);
- From 2001 onwards, fast money transfer services are available to our citizens, most notably those of Western Union and Money gram; Komercijalna banka has made these services available via mobile telephony; in 2009 the Serbian Post Office introduced fast money transfer services as well;
- Non-residents may now fund their real estate purchase by a mortgage loan;
- The government has taken a number of fiscal policy measures to reduce tax on income and profits from investment creating new jobs, and to reduce taxes and contributions on wages;
- A law regulating bankruptcy and liquidation has been adopted.

Future amendments to foreign exchange regulations and cross-border transactions will enable:

- non-residents to issue guarantees for credit transactions between residents;
- residents to invest in foreign pension and investment funds;
- issue of regulations on securitisation and amendments to the Law on Bankruptcy and Liquidation to create scope for securitisation of remittances (special purpose vehicle method).

Flows and use of remittances in recent years

A rapid increase in the inflow of all types of remittances recorded after the implementation of the above measures increased their overall influence on economic flows within the country. It has been estimated that over 4 million Serbs reside outside Serbia, of which 550,000 or 16.2% of the country's active population regularly send money home. A tenfold increase in the annual inflow of remittances was recorded in 2009 from their usual inflow in the late 1990s, and though a notable amount goes into personal consumption, an increase has also been registered in their use for investment purposes.

SERBIA: REMITTANCES, TOTAL 2004-2008 and I-IX 2009

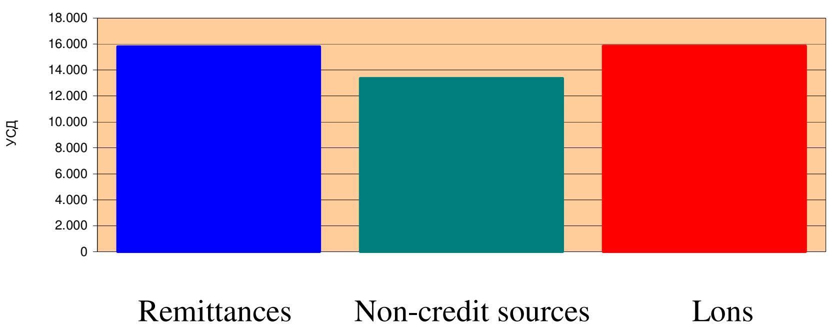
- u mln EUR

osnov	2004.	2005.	2006.	2007.	2008.	I-IX 2009.
1. Remittances, total	**1.903,912**	**2.241,283**	**2.563,259**	**2.657,037**	**2.600,851**	**2.421,501**
1.1. Remittances	**1.675,251**	**1.944,911**	**2.151,932**	**2.133,538**	**2.025,441**	**1.997,912**
1.2. Other transfers	**228,661**	**296,372**	**411,327**	**523,499**	**575,411**	**423,589**
1.2.1. Grants and gifts	**32,022**	**50,795**	**81,157**	**162,915**	**188,441**	**103,410**
1.2.2. Other current transfers	**196,639**	**245,577**	**330,170**	**360,584**	**386,970**	**320,179**
- Remittane, total in percent of GDP	**10,0**	**11,0**	**10,9**	**9,0**	**7,7**	**10,9**

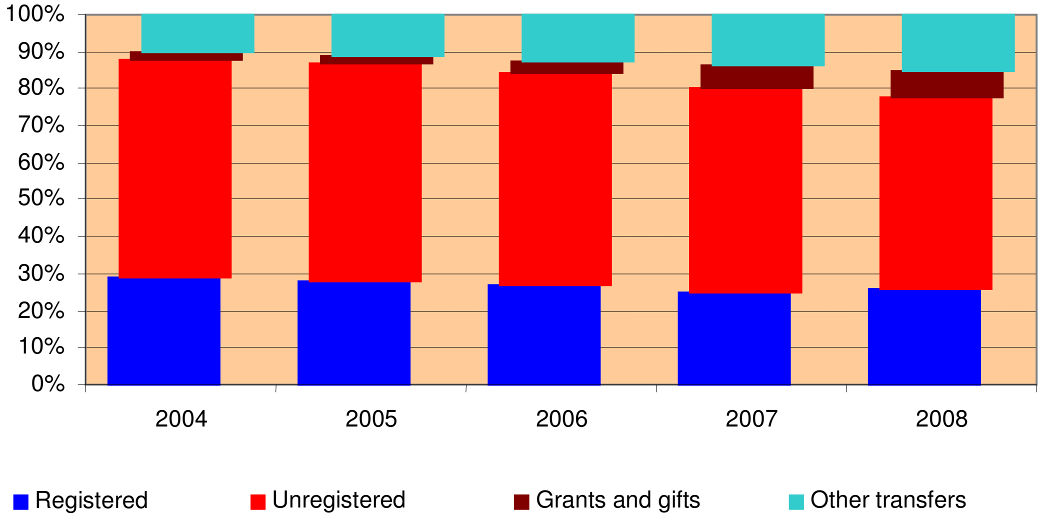
Izvor: NBS (ITRS)

Total inflow of remittances over the last five years stands at around EUR 12 million or 9.5% of GDP on average, which is equal to the volume of borrowed capital but higher than the inflow of capital from other sources. Therefore, we may conclude that though accumulation of investment capital was not the key motivation behind economic migrations, the stock of financial surpluses increased over time as well as the migrants' Propensity to invest.

Inflows 2004-2008.



However, the dominance of informal channels in the transfer of remittances remains an issue due to: a) the high costs of official transfer, b) development of financial infrastructure in the country of origin, c) relative distance of the country of destination, d) unharmonised regulations relating to cross-border transfers, and e) underdeveloped securities market, resulting in the lack of trust and inadequate opportunities for investment into pension and investment funds.



Trends in remittances in Serbia during the current global economic and financial crisis

Since the spill over of the global financial crisis in Q2 2008 until Q4 2008, a bulk of remittances went into mattress money, whereas foreign currency savings plummeted due to their rapid withdrawal from banks (around EUR 1 billion). However, the period from Q4 2008 until September 2009 saw an unexpectedly sharp increase in remittances (close to 50% y-o-y) and restoration of almost all foreign currency savings in banks.

The rationale behind such trends lies in: a) the preservation of the relatively favourable investment climate and wide profit-making possibilities; b) expected high inflow of foreign investments in the EU pre-accession period; c) greater trust of migrants in their country of origin and the expected improvement in the country's credit rating; d) expectation of rising property prices by contrast to their trends in the EU; e) high interest rates on foreign currency savings despite their being lowered in the EU; f) longer stays in the country due to episodes of redundancy.

Still, the exceptional growth in remittances in 2009 is assessed as rather one-off and is caused by the strong influence of the above factors.

Furthermore, in light of the lingering global economic crisis and slow recovery, the inflow of remittances is bound to decline due to:

- the general economic downturn in countries of both destination and origin, as well as the loss of motivation to invest; and

- a higher jobless figure among migrants and/or decline in their income.

The problem is manifest not only in underdeveloped, but also in developed countries (of destination) due to large redundancies and the fear that lesser possibilities of financing the undeveloped countries' balance of payments gap may jeopardise the global economic activity and help sustain the crisis over a longer term.

The above trends entail a broader coordination in the use of remittances for development purposes both among domestic institutions and in cooperation with international organisations.