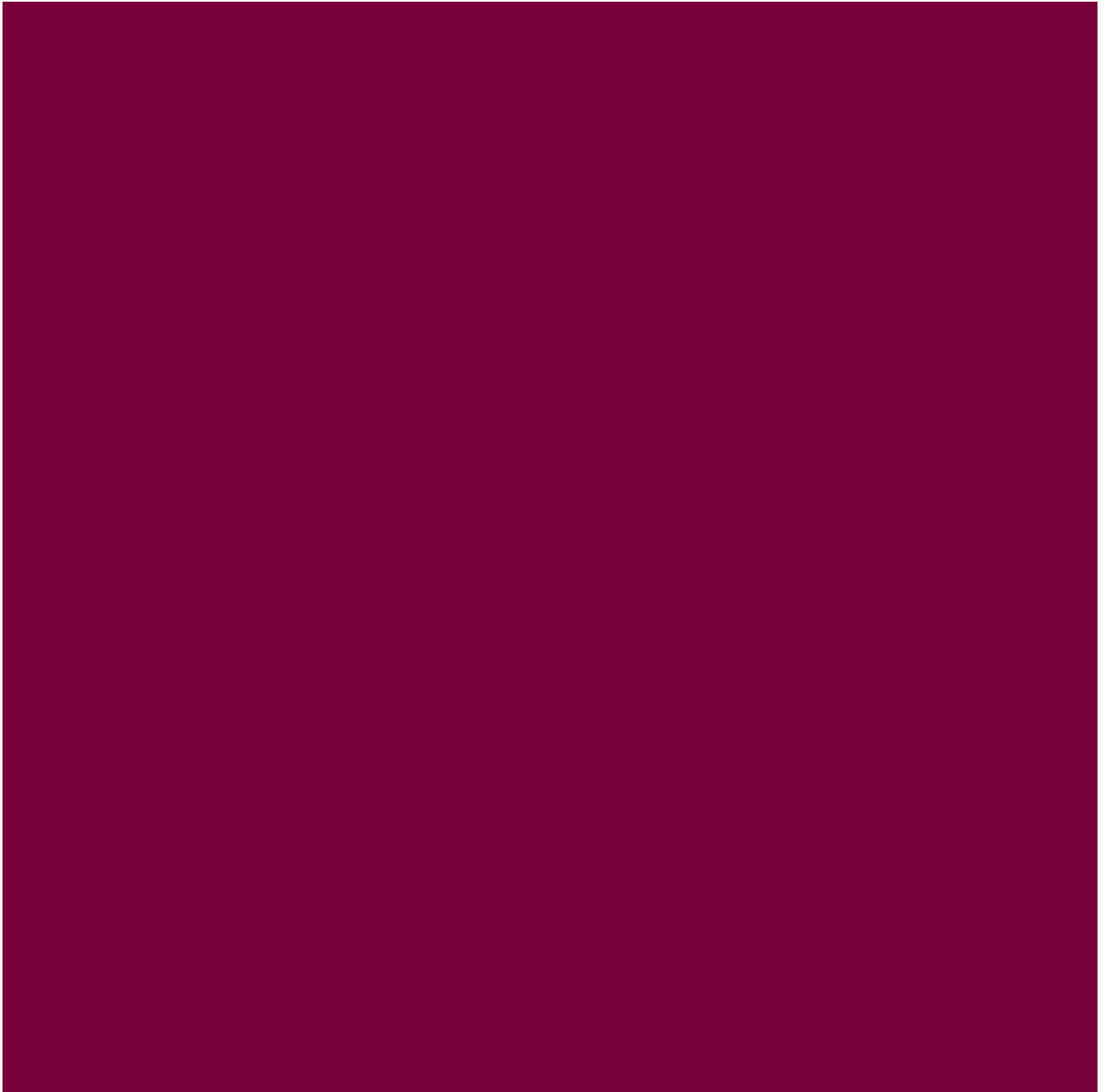


Investing in a Brighter Future Abroad?

The Need for a Domestic Alternative in Moldova



Foreword

This country economic report on Moldova focuses on labour migration abroad as an investment option for households living in an economy with limited employment and income opportunities at home. The study is based on a conviction that the poverty reducing impact of growth depends on the ability of the poor themselves to participate in the creation of growth, and on the assumption that improved employment and income opportunities for people living in poverty provide the main avenue for reducing income poverty. Hence, the economy is viewed from the role of poor people as economic actors and the constraints they face in pursuing this role.

The study is undertaken against the backdrop of the dramatic transformation of the Moldovan economy and society since independence in 1991. The challenge of making better and more sustainable use of the country's rich human resources are in the focus. Moldova stands out as one of the countries with the highest rates of overseas labour migration in the world. Indeed, labour migration abroad has reached such proportions that the Moldovan economy now has to compete with those of other much richer countries for their own labour. Yet, a migration and remittance based economy hardly provides a sound basis for sustainable development. Thus the need to create a conducive environment for sustained and equitable economic development within Moldova has become imperative.

The study is part of a series of country studies, undertaken by Sida itself and by various universities and research institutes in collaboration with Sida. The main purpose of these studies is to enhance our knowledge and understanding of current economic development and challenges in Sweden's main partner countries for development cooperation, and to stimulate domestic discussion on development issues in these countries.

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Table of Contents

Executive Summary.....	5
Sumar.....	7
1. Introduction.....	11
2. Economic Rollercoaster.....	12
2.1 The Rise and the Fall.....	12
2.2 ... and Rise Again.....	13
2.3 Economic Collapse, Resulting Migration and Macroeconomic Development	14
2.4 Trends in Poverty	15
3. Migration as a Response to but not as a Solution to Acute Poverty	17
3.1 Who Are the Migrants?.....	17
3.2 Where Do They Go?.....	19
3.3 Why Do They Leave?.....	21
4. Investment Opportunities for a Rational Household.....	24
4.1 The Smorgasbord of Investments.....	24
4.2 Migration as an Investment	25
5. Adjusting the Incentives Towards a Domestic Alternative	29
5.1 It's All about Investment Opportunities.....	30
5.2 Access to Finance	32
5.3 Focus on Regional Development.....	34
6. Turning Investments into Productive Employment.....	36
6.1 Enhancing Employment.....	36
6.2 Productivity and Employability of the Labour Force	39
7. Conclusions	42
References.....	44
Country Economic Reports.....	46

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Executive Summary

Moldova experienced a massive economic decline shortly after gaining its independence in the 1990's. Rapidly declining living standards combined with an inadequate policy response to quickly address the new situation forced the Moldovan labour force to search employment opportunities outside their home country. At first, the emigration could be described as a way to escape the dismal situation at home, but today as the migration trend has continued for over a decade, more people are tempted to try their luck abroad. The cost of migration has become more affordable thanks to the established migrant networks abroad. This has also lead to an increased out-flow of migrants and an increase in the remittances that are sent back to Moldova. Even though migration started as a stress reaction to acute poverty and the remittances indeed played a major role in alleviating poverty in the early years of independence, a long term sustainable growth strategy cannot be based on benevolent transfers from abroad.

The current study analyses the phenomenon of migration by taking the households as the starting point. Household members are seen here as economic actors who pro-actively form their future grasping the opportunities that become available rather than being passive victims of the circumstances. Many migrants are entrepreneurial, somewhat risk seeking and they possess capital that they are willing to invest.

The analysis focuses on migration as an investment opportunity for a household living in an economy where the business environment provides scarce opportunities for other investment. Also in Moldova the households are looking for the optimal solution for improving their welfare. Owing to bad investment climate, insufficient basic market infrastructure and endless red tape, combined with high levels of corruption the possibilities to invest smaller amounts of money profitably are scarce in Moldova. The investment option that lends itself easily to all households in the country is indeed migration. For a reasonable cost of transport and other travel documents a household can send one family member abroad and the inflow of remittances will shortly pay back the initial savings invested in the migration. From the micro perspective, migration decision boils down to making a rational decision of the most profitable way of investing the household assets for the most reliable profit in the situation where other investment and income earning opportunities are exhausted.

Even though migration involves a lot more than a monetary investment, its economic returns are high and this is the alternative against

which investment opportunities in Moldova are rated. Even if such high returns on investment would be impossible in the more traditional investment sector, the returns must improve considerably if the Moldovan economy is to attract more investments away from migration and lure the productive labour force back into the domestic production.

From the macro point of view, the Moldovan investment rates are usually deemed to be too low to obtain sustainable growth rates. Still, adding investment in migration into the debate reveals a different type of picture. Private investment in Moldova actually reached highly respectable levels of roughly 33 percent of the GDP in 2006. However, half of the investment is used on migration rather than on productive investment domestically. Thus, it is not about the level of investment that should be a cause for concern, but the investment climate that provides little incentive in investing the money in Moldova.

In order to achieve sustainable levels of pro-poor growth Moldova needs to create an incentive system that would reverse the out-flow of migrants and encourage re-channelling the private investment into domestic productive investment to ensure that migration does not become chronic and that Moldova would not be trapped into remittance dependency. The reform agenda to turn the investment flows around is massive and thus prudent prioritisation and sequencing of the necessary policy measures is crucial. The priority should be given to policy solutions that address so-called binding constraints, i.e. constraints that affect pro-poor growth the most. The following areas of intervention are advocated in this study:

- The general business environment needs immediate attention in order to achieve an enabling environment for investing in Moldova.
- Financial markets should be developed to facilitate taking advantage of the available investment opportunities and lowering the cost of financing.
- Regional imbalances hinder pro-poor growth. In order for growth to benefit the poor, it needs to be ensured that the poor have access to employment opportunities.
- Creating productive employment opportunities is a key to more sustainable growth that benefits the poor potential migrants. Economic diversification is crucial for long-term favourable prospects. Out of the current sectors, special attention and priority should be given to developing export led agro-industry.
- Gender related discrimination in Moldova is a major constraint for more effective and poverty reducing use of human resources and a contributory push-factor for emigration that requires urgent attention.
- Long run priorities that do not constitute an immediate constraint but will need preparatory policies already in the near future include
 - (i) improvement of the pension system,
 - (ii) negotiations of possible EU membership and the requirements that Moldova needs to fulfil to reach this goal,
 - (iii) increasing not only the immediate reparatory spending on infrastructure but also long term strategic investment in improved transportation network will provide a necessary condition for continuous growth in the future, and finally,
 - (iv) investing in education should be a long-term priority of the government.

Sumar

Investind intr-un viitor mai bun peste hotare? Necesitatea de a crea alternative in tara

La scurt timp dupa obținerea independenței în 1990, Moldova a trecut printr-un masiv declin economic. Standardele de viață care înregistrau un declin rapid, în combinație cu reacția inadecvată din punctul de vedere al politicilor care erau menite să contribuie la soluționarea situației nou create, au pus forța de muncă din Moldova în situația de a căuta noi oportunități de angajare înafara țării lor de baștină. La început, procesul de emigrație putea fi descris drept o modalitate de a evada din situația deprimantă din țară, totuși astăzi, dat fiind faptul că fenomenul migrației continuă deja de mai mult de un deceniu, tot mai multe persoane sunt tentate să-și încerce norocul peste hotarele țării. Datorită rețelilor de migranți stabilite peste hotare, costul migrației a devenit mai accesibil. Acest fapt, de asemenea, a contribuit la creșterea fluxului de migranți și creșterea volumului remitențelor care intra în Moldova. Deși migrația ca fenomen a apărut drept o reacție de răspuns la stresul impus de sărăcia acută, iar remitențele într-adevăr au jucat un rol hotărâtor în atenuarea sărăciei pe parcursul primilor ani de independență, o strategie de creștere durabilă pe termen lung nu poate fi bazată pe transferurile benevole care vin de peste hotarele țării.

Studiul actual analizează fenomenul migrației, utilizând gospodăriile casnice drept punct de pornire. Membrii gospodăriilor casnice sunt priviți în acest studiu mai degrabă ca actori economici care își formează viitorul într-un mod proactiv, folosindu-se de oportunitățile care sunt puse la dispoziția lor, și nu ca victime pasive a circumstanțelor. Mulți migranți posedă spirit de antreprenor, sunt gata să-și asume anumite riscuri și dețin un anumit capital pe care doresc să-l investească.

Analiza curentă privește fenomenul migrației drept o oportunitate de a investi pentru gospodăriile casnice aflate într-o economie, în care mediul de afaceri oferă oportunități restrânse pentru alte investiții. De asemenea, gospodăriile casnice în Moldova caută soluția optimă pentru a-și îmbunătăți nivelul de trai. Posibilitățile de a investi profitabil sume mai mici de bani în Moldova sunt limitate dat fiind climatul investițional nefavorabil, infrastructura de bază a pieței slab dezvoltată și birocrația interminabilă combinată cu nivelurile înalte ale corupției. Opțiunea de investiție cea mai rentabilă pentru toate gospodăriile casnice din țară devine într-adevăr investiția în migrație. La achitarea unui preț rezonabil al călătoriei și a altor documente de călătorie, o gospodărie casnică poate trimite un membru al familiei peste hotarele țării, iar fluxul

remitențelor ulterioare va returna în scurt timp economiile inițiale care au fost investite în migrație. Din perspectiva microeconomică, decizia de a emigra se rezumă la luarea unei decizii raționale cu privire la modul cel mai profitabil de a investi bunurile gospodăriei pentru a obține un profit sigur în situația în care alte oportunități de investiție și de câștig sunt practic epuizate.

Deși migrația implică mult mai mult decât doar o investiție monetară, beneficiile economice ale acesteia sunt înalte și aceasta reprezintă cea alternativă la care sunt comparate celelalte oportunități de investiție din Moldova. Chiar dacă astfel de venituri înalte ale investițiilor ar fi imposibile în sectoarele mai tradiționale de investiții, rata de întoarcere trebuie să crească în mod considerabil, dacă se dorește ca economia Moldovei să atragă mai multe investiții în alte sectoare de la sectorul migrației și să atragă forța productivă de muncă înapoi în țară în producerea domestică.

Din punct de vedere macroeconomic, ratele de investiții în Moldova sunt considerate în general a fi prea joase pentru a asigura o rată de creștere economică durabilă. Însă, dacă includem în analiza noastră investițiile făcute în migrație, relevăm o situație de altă natură. Investițiile private în Moldova au atins, de fapt, un nivel considerabil în 2006, ajungând aproximativ la 33 percent din PIB. Însă, jumătate din aceste investiții sunt canalizate către migrație, și nu către sectorul domestic de producere. Astfel, problema care ar trebui să ne preocupe nu este nivelul/ volumul investițiilor ca atare, ci climatul investițional care oferă puține stimulente pentru investirea banilor în Moldova.

Pentru a atinge un nivel durabil de creștere economică, care ar contribui la reducerea sărăciei, Moldova trebuie să creeze un sistem de stimulente care ar reversa fluxul de migranți ce pleacă din țară și ar încuraja re-canalizarea volumului de investiții private în investiții domestice productive, pentru a asigura ca fenomenul migrației să nu devină un fenomen cronic și Moldova să nu fie prinsă într-o dependență de remitențele primite. Agenda de reformare pentru a redirecționa fluxurile de investiții este grea și, din acest motiv, este crucială o prioritizare bine chibzuită și o implementare consecventă a măsurilor de politici necesare. Prioritatea trebuie atribuită politicilor ce țin de înlăturarea constrângerilor critice, cum ar fi constrângerilor care afectează în mod cel mai semnificativ creșterea economică orientată spre reducerea sărăciei. În acest studiu sunt recomandate următoarele domenii de reforme /intervenție:

- Atenție imediată trebuie acordată mediului de afaceri în ansamblu pentru a stabili un climat investițional favorabil în Moldova.
- Trebuie dezvoltate piețele financiare întru facilitarea utilizării oportunităților disponibile de investiție și întru micșorarea costurilor de finanțare.
- Dezechilibrele regionale constituie o piedică în calea creșterii economice orientate spre reducerea sărăciei. Pentru ca creșterea să aibă un impact pozitiv asupra săracilor, trebuie să fie asigurat accesul persoanelor sărace la oportunitățile de angajare în câmpul muncii.
- Crearea oportunităților de angajare în sectorul de producție este o precondiție –cheie pentru asigurarea unei creșteri mai durabile care să beneficieze potențialii migranți săraci.
- Discriminarea în baza criteriilor de gen în Moldova necesită o atenție urgentă, deoarece aceasta reprezintă o constrângere majoră în utilizarea mai eficientă a resurselor umane, care ar contribui la reducerea sărăciei, și care la fel este un factor de presiune causal

contributiv în ce privește migrația.

- Prioritățile pe termen lung, care nu constituie o constrângere urgentă, însă vor necesita o elaborare preliminară a politicilor deja în viitorul apropiat includ:
 - (i) îmbunătățirea sistemului de pensii,
 - (ii) negocierea posibilității de obținere a statutului de membru al UE și condițiile pe care Moldova trebuie să le îndeplinească pentru a obține acest statut.
 - (iii) sporirea nu doar a cheltuielilor urgente pentru reparația infrastructurii, ci și efectuarea investițiilor strategice pe termen lung în îmbunătățirea rețelelor de transportare, care vor servi drept precondiție pentru creșterea stabilă în viitor; și în final,
 - (iv) investiții în educație trebuie să fie o prioritate a guvernului pe termen lung.

1. Introduction

Moldova's recent history presents examples of economic development that are unique in modern times. After the collapse of the Soviet Union, the newly established Republic of Moldova got the worst possible start for its independence: between 1990 and 2000 its economy declined by 60 percent leaving 71 percent of the population in absolute poverty by the end of the decade (World Bank & IFC 2004, 5). This radical deterioration of living conditions in the home country led to a massive exodus of labour force towards better income earning possibilities abroad. As of mid 2006 approximately one quarter of the economically active Moldovan population was working abroad and their remittances amounted to one third of Moldova's GDP (Lücke et al. 2007).

Given the exceptional economic development in Moldova during the last decade, several studies have described and explained the observed changes in the economy. Furthermore, many analyses have shed light on the ever-growing phenomenon of migration and remittances describing them from the macro perspective. However, few studies so far have approached migration from the micro perspective as a result of individual optimising. Taking the households as the starting point of the analysis will give a different angle to the observed phenomenon and may also guide the way towards more favourable economic development if the determinants that have led the households to make their current decisions would be adjusted. In this study, household members are seen as economic actors who pro-actively form their future grasping the opportunities that become available rather than being passive victims of the circumstances. Many migrants are entrepreneurial, somewhat risk seeking and they possess capital that they are willing to invest. Many are not waiting for jobs to be created for them, but would be willing to create their own income generating activities if the proper environment existed.

The current analysis will focus on migration as an investment opportunity for a household living in an economy where the business environment provides scarce opportunities for investment. Furthermore, the remittances and their significance for household income will be discussed in particular from the perspective of the poor households. Based on the analysis of the current situation, policy reforms are suggested that would gear the development towards more sustainable pro-poor growth.¹

¹ I gratefully acknowledge the constructive comments from Per Ronnäs, Matthias Lücke, Toman Omar Mahmoud and the Swedish embassy in Chisinau which have helped me to improve this paper.

2. Economic Rollercoaster

The Republic of Moldova is a small (total population of 4.3 million²) land-locked country in the South-Eastern Europe bordering Romania in the West and Ukraine in the North, East and South. This European nation has demonstrated dramatic economic development that is a result of a sweeping external shock, the partially ill-advised political response, and the failure of the Western countries to assist in the transition when the help was most badly needed.

2.1 The Rise and the Fall...

Up until 1991 Moldova was part of the Soviet Union and its domestic economy was specialised in agriculture with wine as the primary product for export. Moldova's almost complete lack of energy resources, of non-agricultural raw materials, machinery, equipment and components of production as well as subsidies for the country's agrarian sector from the Union budget made Moldova dependent on the imports from and subsidised exports to the other parts of the Union (Pantiru et al. 2007). After the collapse of the Soviet Union, the young Republic of Moldova was faced with an uphill struggle against the sharply deteriorating terms of trade: Moldovan export prices declined as the high subsidies from the Soviet regime were withdrawn from agriculture while Moldova's import prices moved closer to world market level (Görlich et al. 2006). Still, lacking energy and other natural sources, export became the only survival strategy for the country even though its energy-intensive and inefficient production was poorly equipped to face the world market (Ronnås & Orlova 2000). Furthermore, as Moldova failed to cut its extensive public expenditures at the pace of the economic collapse Moldova needed to borrow money from the international markets ending deep into indebtedness. Despite the ever-shrinking economy Moldova had to lend international finance at the full cost of capital and first after 1997 the country was granted IDA-status and could access more affordable loans. By this time, the stock of loans had already risen to unsustainable levels (UNDP Moldova 2004, 10).

Despite the discouraging start, the government of Moldova has persistently pursued a policy that aims to improve the economic performance of the country. The development in achieving stable prices and

² In this report, Moldova is defined according to its internationally recognised borders. This figure thus includes even Transnistria, a breakaway territory within the borders of Moldova, with a population of 555,000.

implementing structural reforms has led to the decline of inflation approaching the staggering 2000 percent in 1992 down to less than 30 percent by 1995 and 11 percent by 1997, when the economy grew for the first time after independence (The World Bank & IFC 2004). The government also initiated a range of other reform programmes including privatisation of state enterprises and development of a commercial banking system.

The socialist legacy left the newly established Republic of Moldova with close ties to Russia and other Commonwealth of Independent States (CIS): until 1998, 60 percent of Moldova's exports headed to Russia alone (Pantiru et al. 2007). The close economic links however ensured that the Russian financial crisis in 1998 would have a direct impact on the Moldovan economy. The devaluation of the rouble caused a major contraction in Moldovan exports to the Russian federation leading to a rapid 25 percent fall in industrial production and 20 percent fall in agricultural production in Moldova. Simultaneously the devaluation of the Moldovan lei more than doubled the dollar-denominated foreign debt (Ronnås & Orlova 2000). The cumulative decline of the Moldovan economy between 1990 and 2000, i.e. the years after the collapse of the Soviet Union in 1991 and the Russian crisis in 1998, exceeded 60 percent; a total collapse second only to Tajikistan among the transition economies (The World Bank & IFC 2004, 12). The Moldovan government was pushed into an impossible situation of servicing the foreign debt with diminishing revenues leaving almost no resources left for the extensive social expenditure on health care, education and social security that the country inherited from the Socialist regime.

2.2 ... and the Rise Again

If the collapse of the economy was rapid, so has been the recovery. The Moldovan economy has grown on average by 7 percent per year for the past five years (IMF 2006). The high level of economic growth is mainly demand-led and dependent on the remittances flowing into the country. The government has also succeeded in maintaining stable macroeconomic policies that have led to manageable inflation rates around ten percent and the relative reduction of fiscal deficit to a more reasonable level. Despite the high levels of growth in recent years, it is important to keep in mind that the level from which the growth process started was very low and thus the growth in absolute terms has not been high.

Furthermore, it is not likely that the pace of growth will continue to be as impressive due to the fact that the growth in Moldova relies on one off events such as reallocation of production factors after regime shift from Soviet rule into a more market based economy. The Moldovan growth is still recovery growth and the productivity gains that are due to reallocation of productive resources from import substitution into export production are close to be depleted. The higher consumption levels are withheld with the help of remittances flowing into the country that in their turn are spent on imported goods. Moldova has a massive trade deficit and the multiplier effects of remittances into the domestic production are modest. Due to years of underinvestment in infrastructure capital formation has stagnated and investment as a percentage of capital is falling. Possibly the most alarming sign of the poor structure of the economic growth is that it is no longer contributing to poverty reduction (The World Bank 2006).

2.3 Economic Collapse, Resulting Migration and Macroeconomic Development

During the free-fall of the economy, many households found themselves in an impossible situation trying to make a living in the ever-shrinking economy. As a result, many households immigrated to the near-by countries in a hope of gaining better income earning possibilities. Many of the migrants left to Russia and other CIS countries as temporary migrants, while others decided to try their luck in the more strictly controlled European labour market. By now, already a quarter of the Moldovan labour force is working abroad.

From the macro point of view, the emigration of labour force presents a reduction of the production factors available in the country. This outflow is rarely a random one, but as the Moldovan example demonstrates, the migrants are often well educated and productive, facing no difficulties in finding employment abroad. Furthermore, it is argued that migrants are usually intrinsically more prone to take risks and willing to alter their behaviour to meet the new situation (through migration) and via investment expenditures in e.g. education (see e.g. Ghencea & Gudu-mac 2004). This would imply that the migrants could be economically strong and thus more valuable to the host country as well as a higher loss for the country of origin, which would make economic policies that reduce emigration even more pressing (Pinger 2007).

In the case of Moldova, a large outflow of migrants and a large inflow of remittances also cause disturbances in the macroeconomic stability. In 2006 the remittances surpassed the USD 1 billion mark (Lücke et al. 2007). The inflow of foreign capital presents appreciation pressure on the Moldovan leu. This demand for currency is not linked to demand of the domestic production and thus does not reflect the competitiveness of the Moldovan economy but reflects purely a monetary flow. Due to the weak domestic economy and substantial supply constraints, the remittances are to a large extent used on imported goods. Moldovan trade balance shows thus a substantial trade deficit while at the same time the exchange rate becomes totally distinct from the performance of the domestic economy. The Moldovan economy is hence vulnerable to the fluctuation in the remittances as its imports are almost totally financed by income from abroad rather than exports.

However, the demand for the Moldovan currency and the resulting appreciation pressure makes it even more difficult for the exporters, the primary engines of growth, to sell their goods abroad as their prices in the foreign currency are rising. The Moldovan National Bank has tried to control the appreciation of the currency by purchasing foreign currency, but this policy, at least in the long run, will add to the money supply and drive up inflation (Tamas 2006, 23). The National Bank has in the recent years adopted low inflation rates as its main goal, and has pursued a strict inflation target by using the base interest rate as its main instrument (UNDP Moldova 2005, 11). This in its turn has raised the private commercial lending rates and has damaged the economic development in the private sector. Even though Moldova suffered from hyperinflation in the early years of independence, this was mainly a transitory phenomenon and the inflation has remained relatively low since. Thus, the high interest rates withheld by the Moldovan National Bank have proven to be rather inefficient and costly, as inflation in Moldova is a structural phenomenon resulting from domestic supply and inflow of remittances. (The World Bank & IFC 2004, 10-11). On the whole, Moldova has relatively little space to manoeuvre when it comes to mon-

etary policy. Addressing the structural constraints that cause migration in the first place would also provide a solution to the macroeconomic imbalances.

2.4 Trends in Poverty

The post-independence economic decline left behind a massive poverty in Moldova (see table 1). Not only did the average income decline but also the distribution of income became more skewed. The Gini coefficient deteriorated from 0.24 during the socialist regime before independence to 0.42 in 2000–2002 (The World Bank & IFC 2004, 17). After the Russian financial crisis the Moldovan GDP rose rapidly and poverty fell sharply during the first years of economic recovery. However, soon after the growth process started to accelerate, its poverty reducing effect reached its peak and today growth in GDP is no longer reducing poverty (The World Bank 2006, 2).

Table 1: Poverty Rate by Region (in Percentage Points)

	1997	1999	2002	2003	2004	2005 (Q1–Q3)
Large cities	32.1	50.4	28.6	22.7	17.3	14.7
Small towns	62.5	80.9	62.3	49.4	45.7	48.5
Rural	51.9	76.9	51.0	35.7	37.1	42.5

Source: The World Bank 2006, p. 5.

Note: Figures for 2005 Q1 through Q3 are seasonally adjusted.

Digging deeper into the structure of growth and poverty it can be concluded that the rural region lie at the heart of the problem. The poverty rates of the rural households stabilised in late 2002 and started then rising slightly upwards despite the positive economic development in the larger cities of the country.

One of the reasons behind the falling incomes in the rural areas has been the evolution of the relative prices for farmers. In the 1990's the prices paid to Moldovan farmers at the farm gate were far below the world market price for their products. The price difference could and still can partially be explained by the inferior quality of the Moldovan products that at present cannot meet the quality standards imposed by the EU, and the export restrictions to Russia. However, the main barriers to the European markets still lie in the asymmetric nature of the trade agreements that put the Moldovan sellers in a weak bargaining position or block them from the market altogether. Also domestic reasons contributed to the weak bargaining power of the farmers, as the introduction of new regulatory constraints gave more power to monopsonistic buyers and the recent land reform created a system with large number of small-scale farmers with slight possibilities to negotiate on prices (The World Bank 2006, 13). The mandatory status of the commodity exchange has now been removed and there is some anecdotal evidence suggesting that the farm gate prices are on the rise again. However, the poor market access remains as a serious constraint and the rural areas will still need special consideration in order to catch up with the growth levels of the more developed areas in the country.

As the economy in Moldova declined in the 1990's, ever larger groups of workers migrated abroad to earn a wage that they could then remit back home to ensure the survival of the household. As discussed in the section 3 below, this movement started as stress migration from the poor areas and aimed to alleviate the immediate needs. Migration flows are

now turning towards higher income countries in order for the migrants to grasp the economic opportunities that are unavailable in Moldova. Even though migration and remittances have succeeded in alleviating acute poverty after the economic collapse, it has not proven to be poverty reducing in the medium long run. Today with more than a decade of experience on migration it can be stated that remittances are not contributing to continuous poverty reduction and the private transfers mainly benefit the mid- and upper income groups (The World Bank 2006). It is important to note, however, that the middle-income groups receiving remittances would most likely belong to low income groups would they not have engaged in migration. Remittances fund currently more than half of the current expenditures in about 60 percent of all remittance-receiving households (Lücke et al. 2007). On the whole it can still be concluded that the high levels of remittances are not sufficient to substitute for the lack of income from other sources, and especially the lack of productive employment opportunities outside the major cities should stand in focus of the future poverty reduction efforts.

3. Migration as a Response to but not as a Solution to Acute Poverty

Abrupt economic decline combined with an inadequate policy response to quickly address the new situation forced the Moldovan labour force to search employment opportunities outside their home country. At first, the migration was executed as a form of a desperate escape from the dismal situation at home, but now as the migration trend has continued for over a decade, more systematic channels for migration has been developed. The lower cost of migration thanks to these established networks abroad has also lead to an increased flow of migrants and an increase in the remittances that are sent back to Moldova. Even though the migration started as a stress reaction to acute poverty and the remittances indeed played a major role in alleviating poverty in the early years of independence, a long term sustainable growth strategy can hardly be based on benevolent transfers from abroad. As discussed above, remittances are no longer assumed to be the answer to the prevailing poverty but other measures need to be sought to put the economic development on a sustainable growth path. In order to do this, it is important to understand the motives and characteristics of the migration movement and the driving forces that may seem optimal today but that could prove to be harmful in the long term.

3.1 Who Are the Migrants?

The large outflow of workers started as a response to the rapidly deteriorating economic conditions in Moldova in the 1990's. Lücke et al. (2006) divide the migration into three waves (see table 2) out of which the first wave started at the end of the 1990's and comprised of relatively young individuals with medium levels of education, they were mostly male and often from urban areas. This small but important group of migrants were the 'pioneers' of emigration that established the social networks that subsequently made it easier for other Moldavians to follow suit and paved the paths of Moldova as a migrant nation. The second wave of migration came soon after, in the beginning of the 2000s and is continuing yet today. This time the migrants are somewhat older, still predominantly male, but less educated and mainly from the rural areas. This massive wave of migrants is mainly needs-driven and originates from the areas where the possibilities for escaping poverty otherwise are slim. The mass-migration was a response to acute poverty rather than opportunistic response to employment opportunities abroad. As the migrants were in a desperate need to find alternative income sources abroad, they were

willing to endeavour risky strategies for leaving the country. As a result, many of the second wave migrants ended up as victims of trafficking.

Currently, the large scale exodus from the rural areas and smaller cities is about to reach its peak and the migrant flows from the country side cannot grow at the same pace for the years to come. Now the third wave of migrants has recently started to fuel the supply of migrants from the urban areas in Moldova. This wave consists of younger individuals who are to an increasing extent female and tend to be highly educated. The third wave-migrants are responding to the lucrative opportunities abroad rather than being pushed out by lack of opportunities at home. Migration of the well-educated urban dwellers is to be considered more as a well-calculated investment strategy for the future than an acute response to poverty. The third wave migration describes also the evolution of the migration movement from Moldova: The pioneering migrants have already created social networks that make it easier for others to migrate into more attractive areas in Europe and the short term migration to the CIS countries have given the opportunity for the households to save money for more expensive long-term migration into the EU. However, the emigration of the highly skilled labour force presents a risk of brain drain and loosing an important engine for growth and should thus be considered as a development challenge.

Table 2: The Three Waves of Migration and Socioeconomic Characteristics of Migrants (in Percent)

	Wave 1	Wave 2		Wave 3
	LFS * 1999	LFS 2005	CBSAXA 2006	Individuals planning to migrate
Age (years)	27.95	31.82	34.56	34.45
Below 30 years	65.98	49.40	37.34	44.31
30 –50 years	32.36	46.50	53.41	40.44
Above 50 years	1.66	4.09	9.25	15.26
Female	34.68	34.61	41.62	48.79
Education				
Primary	18.37	24.98	5.32	6.55
Secondary	64.85	55.01	38.45	30.50
Tertiary	10.81	12.05	35.76	30.66
University	5.97	7.96	19.12	29.28
Rural	58.59	70.41	64.82	43.62

Source: Lücke et al. 2007, p.35.

* the data comes from labour force surveys (LFS) conducted in 1999 and 2005 as well as a representative household survey conducted by CBSAXA in 2006.

To date, most migrants intend to return to Moldova and only 14 percent of the current migrants plan to settle abroad permanently (Lücke et al. 2007). This supports the hypothesis that the majority of migration is needs-based stress migration that is driven by the lack of opportunities at home rather than the superiority of opportunities abroad. Still, the length of the migration period is highly dependent on the educational level of the migrant when leaving Moldova. Among the group of perma-

nent migrants the percentage of people with tertiary education is roughly ten percentage points higher than for the group of temporary migrants (Pinger 2007). This would suggest that the risk of losing the young highly educated third wave of migration is higher than can be projected from the current migrant flows.

3.2 Where Do They Go?

The labour migration can be divided roughly into two main destinations: the CIS countries (predominantly Russia) and Western Europe (particularly Italy) (Lücke et al. 2007). As a legacy of the Soviet time Moldova has close ties to the CIS countries. The domestic migration within the Soviet Union became international migration after independence but the networks and connections that were created before remained unchanged. Even though Moldovan is the official language in the country, Russian, Ukrainian and Gagauz are widely spoken and thus language barrier does not constitute a problem when migrating into the neighbouring countries or Russia. A newer phenomenon is migration to the Western European countries that offer opportunities especially for female migrants that are mainly employed at homes as baby-sitters and care-takers.

The migrant flows to different destination countries are highly disaggregated by gender. Italy, Belgium, Germany, Israel, and Turkey are predominantly female destinations, while the reverse is true for Russia, Ukraine, Portugal, France, The Czech Republic, and the UK (Lücke et al. 2007). The availability of different employment opportunities and the strong traditional gender norms that guide occupational selection in Moldova explain this pattern (see table 3).

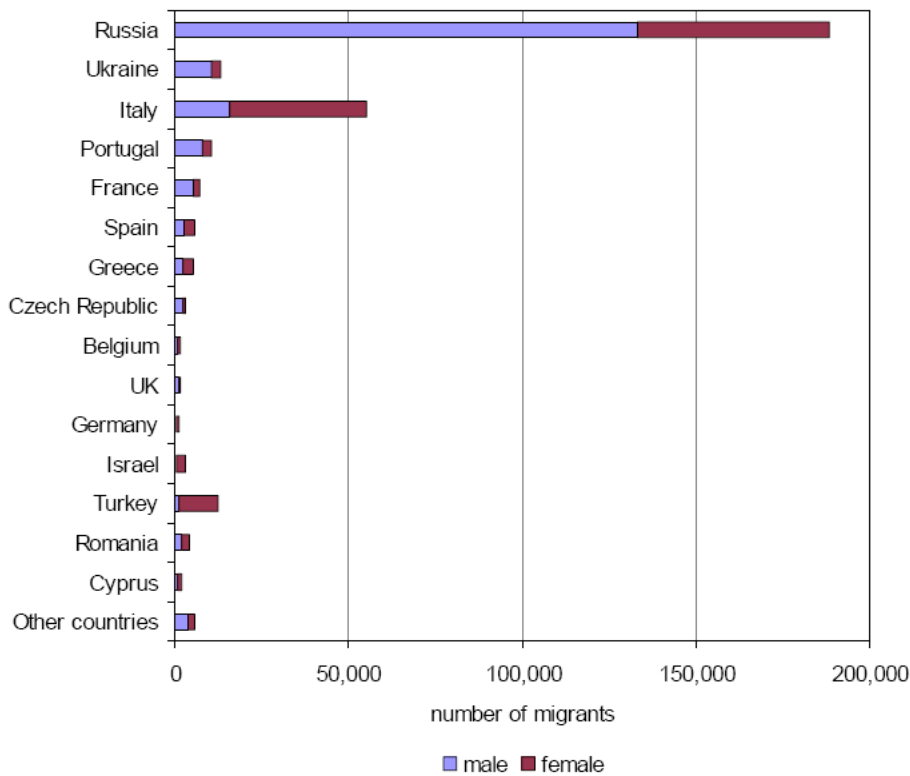
Table 3: Work and Occupations of Moldovan Migrants by Gender

Work and Occupations	percent	Gender	
		Men	Women
Construction, reparations	30.9	95.0	5.0
Baby-sitting, care-taking, social assistance	31.3	4.0	96.0
Trade related activities	10.8	36.4	63.6
Plant, factory workers	9.8	68.6	31.4
Technical & mechanic services	6.3	95.6	4.4
Agricultural works	4.5	75.0	25.0
Other	6.4	60.9	39.1
Total	100.0	54.5	45.5

Source: Ghencea and Gudumac 2004: 54.

Russia and other CIS countries tend to offer migrant jobs in construction and other physically demanding tasks that are traditionally performed by men (see figure 1). By contrast, countries like Italy rather look for migrant work in social services, which are preferred by women. (Lücke et al. 2007)

Figure 1: Destination Countries of Moldovan Migrants in 2006 by Gender



Source: Lücke et al. 2007, p. 16.

A special group of migrants of the third wave are highly educated women who migrate to the European Union. They see opportunities to earn high salaries abroad and escape the rather discriminatory working environment in Moldova. Despite their high education in Moldova, they are usually unable to find employment that would match their qualifications abroad but settle to work as house-keepers and baby-sitters in the other European countries. This is a massive waste of resources and demonstrates the distortive nature of market barriers in the market for migration: only the highly educated can afford to pay for migration into the EU but they face market barriers in the foreign labour market depriving them the possibility to use their skills while their uneducated countrymen who would have the basic skills for the employment abroad do not have the chance to pay for migration. This leads to brain-drain from Moldova and increasing income inequality between households who can afford and those who cannot afford to migrate to the EU.

Besides the traditional host countries, there is anecdotal evidence of the emergence of new destinations that gain popularity. Young university students participating in summer job and travel programmes pave the way for migration into the USA, Canada and Saudi Arabia. The students or recent graduates overstay the intended length of their visit and seek employment often in the low-skilled sector as waiters, care-takers or housekeepers. Even though Moldova is well integrated into the international labour market, the internal labour market seems more rigid. As a result, migration within Moldova into more affluent areas has been rather limited. A total of 44,400 people moved to Chisinau between 2002 and 2004 whereas around 5,600 moved to elsewhere in the country (Pantiru et al. 2007).

3.3 Why Do They Leave?

The debate on migration flows has traditionally separated two large categories of explanations for migration: the push factors and the pull factors. The push factors are mostly related to lack of opportunities at home and the migrants are driven by poverty and absence of jobs. These factors seem to dominate the Moldovan migration into the CIS countries. The pull factors are especially important to the migrants that are saving money to migrate into the EU. Well-established social networks and better working conditions were among the most important factors pulling people from the urban areas into the EU. (Lücke et al. 2007) Network effects play a major role on the migration decision even into other countries (Görlich and Trebesch 2006). Family and community networks abroad make it easier to obtain information and arrange the practicalities around the migration decision. This type of help plays a particularly significant role in rural migration. Furthermore, low travel cost to destination country and visa free travel leading to lower cost of migration is a factor that lures many poorer migrants into the CIS labour market. See further details on the push and pull factors in table 4.

Table 4: Push and Pull Factors of Migration, in Percent

	CIS construction	CIS other	EU	Other	All
Push factors					
absence of a job	38.61	37.72	26.43	33.01	34.27
consumption reasons	49.62	50.17	46.55	32.90	46.78
Poor	24.87	24.30	12.69	20.68	20.51
Pull factors					
existence of social contacts	22.48	20.83	31.90	50.97	27.54
existence of a job guarantee	33.97	33.91	38.57	42.18	36.06
good working conditions	29.90	32.52	44.72	25.36	34.21
was recommended the country	36.20	35.51	51.55	43.21	40.86
better way of life abroad	0.63	4.65	5.89	2.21	3.36
Low cost of migration	66.66	68.96	14.18	27.64	49.10

Source: Lücke et al. 2007, p. 19.

A closer look at the socioeconomic characteristics of the migrants is presented in table 5. These preliminary calculations report multinomial regression results for a set of independent variables. The dataset used for the analysis is the CBSAXA Survey conducted in July and August 2006³. Rather than regression coefficients, the table contains relative risk ratios as they have a more intuitive interpretation. For example, if a person is married (compared to being single, which is the default for this dummy variable), this increases the relative risk that the person has been a migrant in a CIS country – rather than not having been a migrant at all – by 69 percent.

³ The data were provided to the author by the courtesy of Dr. Matthias Lücke

Table 5: Multinomial Logit Regression results for Migration Decision

Independent variable	Relative risk compared to 'no migrant'		
	EU	RoW	
CIS			
Married	0.69***	0.21	0.16
Male	1.62***	-0.10	-0.31***
Rural	0.89***	0.19**	-0.22*
Poor or very poor	0.15**	-0.30***	-0.05
Education:			
Max primary	base	base	base
Secondary	1.24***	0.68**	0.02
Tertiary	1.50***	2.08***	0.61*
University	0.58***	2.41***	0.75*
Nationality:			
Other	base	base	base
Moldovan	-0.47***	0.84***	-0.61***
Romanian	-0.60***	0.86***	-0.58***
Russian	0.37**	-0.01	-0.54***
Number of observations	13 832		
Pseudo R-squared	0.127		
Hausmann test for IIA fails to reject H0, i.e. Odds(Outcome-J vs Outcome-K) are independent of other alternatives			
Wald test rejects the possibility for combining outcome categories, i.e. categories are relevant and cannot be collapsed).			
Regressions are weighted by sampling weights and calculated with robust standard errors. Constant as well as continuous control variables, such as age and age squared are not reported in the table.			
* relative risk ratios are significant at the 10 percent level			
** relative risk ratios are significant at the 5 percent level			
*** relative risk ratios are significant at the 1 percent level			

Source: Author's own calculations.

The results are in line with previous observations as well as a similar estimation with an older dataset (see Görlich et al. 2006). The majority of the emigrants are indeed married and being married increases the probability of migrating into the CIS countries, mostly likely in order to provide for the family. It might also be the case that migrants who have families are more risk averse and tend to choose destination countries where the costs and especially the risks are lower. Marital status however does not make a statistical difference in the migration decisions into the EU or the rest of the world. Men are considerably more likely to migrate into CIS countries that provide mainly employment opportunities for manual labour but when it comes to migrating into the rest of the world the women have a higher risk of leaving. Living in a rural area increases the risk of migrating into the CIS by 89 percent while the risk of leaving for the EU is only modestly elevated.

There is a significant difference between the perceived poverty situations of the migrants into different destinations: while having a bad or very bad economic situation at the moment increases the risk of migrating into the CIS, it decreases the risk of migrating into the EU. This supports the hypothesis that emigration into CIS takes place due to push factors while EU migration requires relatively good possibilities to save up-front and is mainly reliant on pull factors. A similar reasoning

appears also in the education pattern of the migrants. Relative to the people who have not finished secondary school (i.e. have finished primary school, at maximum), higher education increases the risk of migration into all destinations. However, the risk of migrating into the CIS countries is the highest for workers with secondary and tertiary education, while tertiary education and university degree more than doubles the risk of migrating into the EU. On the whole, the wealthier and well-educated workers have an increased risk of emigrating into the EU while the worse-off workers with low education head towards the CIS countries.

Finally, even the nationality of the workers matter. Being a Russian national increase the risk of migrating into the CIS, as was to be expected, while the Moldovan and Romanian nationals prefer the EU. Migration into the rest of the world is mainly preferred by, and presumably easier for, the minority group of residents who have other nationalities than Moldovan, Romanian or Russian.

4. Investment Opportunities for a Rational Household

Economic phenomenon at the macro level is often a result of rational decision making at the micro level. Also in Moldova the households are looking for the optimal solution for improving their welfare. However, the opportunities for increasing their standard of living at home are currently rather limited and thus the households are more likely to look abroad for other options. Even though migration appears as perfectly rational from the perspective of the individual households, it is not an optimal growth strategy at the macro level. Migration is costly to the overall economy as it implies loss of productive resources, mainly labour, that is the cutting edge of Moldovan competitiveness. The remittances gained from migration are mainly used for daily consumption and imported consumer durables rather than productive investment, which means that the multiplier effects of increased income through remittances are very limited. Furthermore, remittances cannot provide a sustainable base for growth and increased income as the pool of new potential migrants is limited and the remittances from long-term migrants are diminishing rather than growing over time. Hence, an optimal strategy at the micro level turns paradoxically out to be a costly barrier for sustainable growth at the macro level.

4.1 The Smorgasbord of Investments

The landscape of economic opportunities in Moldova is rather monotonic. The slow progress in structural reforms and the lack of investment to acquire new technologies that would make Moldovan products competitive at the export market, have contributed to the slow diversification of the economy. Investments as a percentage of GDP fell from 19.4 percent in the 1994–1998 to 16.8 percent in the 1999–2002 (The World Bank & IFC 2004, 15) and lie currently at 17.9 percent (IMF 2007).

Moldova has succeeded in attracting foreign direct investments (FDI) relative to GDP better than its neighbouring countries. The major inflow of capital accrued as a result of major privatisation efforts in 2000, but as the privatization activity fell off in the subsequent years, also the level of new foreign investments has decreased. The absolute levels of foreign capital in the country are low: the cumulative net FDI stood at only USD 714 million at the end of 2002 (The World Bank & IFC 2004, 14).

The larger domestic firms are more constrained by financing costs and access to finance than their foreign competitors. This leads to double-bondage as the domestic firms both face a more hostile invest-

ment climate and have more difficulties in obtaining access to finance. In the latest survey, 73 percent of the businesses rated access to long-term finance at commercial rates as difficult or impossible (The World Bank & IMF 2004). When it comes to small informal businesses, obtaining long-term finance is, if possible, even more difficult and the business environment in which they invest is not providing abundant options for profitable investments either.

For a private household looking for investment opportunities, the variety of options is rather limited. Due to the lack of access to financial services that would provide an efficient way to allocate capital to the most profitable investment, most households and small businesses need to rely on their own capital for investments. However, owing to bad investment climate, insufficient basic market infrastructure and endless red tape combined with high levels of corruption the possibilities to invest smaller amounts of money profitably are scarce in Moldova.

4.2 Migration as an Investment

The investment option that lends itself easily to all households in the country is indeed migration. “For the individual or household concerned, migration for work abroad implies costs and risks, which must be weighed against the prospects of improved incomes, much like a decision to invest in an enterprise” (Akobirshoev et al. 2007). For a reasonable cost of transport and other travel documents a household can send one family member abroad and the inflow of remittances will shortly pay back the initial savings invested in the migration. From the micro perspective migration decision boils down to making a rational decision of the most profitable way of investing the household assets for the most reliable profit in the situation where other investment and income earning opportunities are exhausted.

Even though the Moldovan investment rates are usually deemed to be too low to obtain sustainable growth rates, adding investment into migration into the debate reveals a different type of picture. Table 6 discloses that private investment in Moldova actually reached highly respectable levels of roughly 33 percent of the GDP in 2006. However, half of the investment is used on migration rather than productive investment domestically. Thus, it is not about the level of investment that should be a cause for concern, but the investment climate that provides little incentive in investing the money in Moldova.

Table 6: Private Domestic Investments and Investment in Migration in Moldova 2006

	Million USD	percent of GDP
Domestic private investment	516.2	17.9
Migration to CIS	19.3	0.6
Migration to EU	397.4	13.3
Other migration	36.4	1.2
Total Migration	453.2	15.2
Total private investment	969.4	33.1

Sources: IMF 2007, 25; Lücke et al. 2007.

(Author’s own calculation of investments in migration are based on USD 100 per investment decision to CIS, USD 3600 to EU, and USD 880 to other countries and estimated 193200 migration decisions to CIS per year, 110400 to EU, and 41400 to other countries, respectively.)

Migration into CIS does not require major investments from the poor households who are engaged in stress migration mainly to Russia. However, a partial explanation to the migration flow is the lack of investment in the regions from which these migrants come from. Reversing the investment from migration to CIS would not make much of a difference as they account to a modest share of the total investment. The majority of the potential domestic investment seems to be flowing out of the country into the more affluent areas in Europe. Especially migration to the EU seems to absorb a lion's share of the total amount of private investments. As discussed above, the migrants into the EU are not driven by the push-factors but they are entrepreneurial, well educated investors looking for a reasonable rate of return on their investment. The challenge for Moldova in the years to come is developing the nation into a lucrative investment option for the investors who have the possibility to choose.

4.2.1 Cost of Migration

Investing in migration is possible at a chosen risk and initial investment level. For the up-market investors who plan to migrate into the EU the cost of migration may end up at USD 3,600 whereas a train ticket to Russia, where migrants can enter without a visa, requires a more modest down payment of USD 100. The cost of migration to other countries (mainly Turkey Romania and Cyprus) is estimated at on average USD 880 (Lücke et al 2006). For more details, see table 7.

Table 7: Cost of Migration

	CIS (construction)	CIS (other)	EU	Other	All
USD spent on 1 st departure	74	132	3584	880	654

Source: Lücke et al. 2007, p. 26.

However, the cost of migration to Russia is de facto higher as the workers often lack the necessary work and residence permits, but the up-front cost of migration is low. About 70 percent of Moldovan migrants working in the CIS lack proper work permits (Tamas 2006). Most of them enter legally with a tourist visa, but take on employment during their stay and many overstay their visas (Lücke et al 2006).

Besides the monetary cost of migration, the non-monetary cost that affects people's welfare is high and thus a significant result of the migration movement. Some of the migrants, especially females, who have left Moldova have ended up in the hands of traffickers resulting in a life-long psychological if not also physical trauma for the victims. Even in the cases where the migration has gone according to the plans the non-monetary costs are noteworthy. The emotional stress due to the separation of couples and lack of parental care for children in migrant families were reported as significant effects of migration. Furthermore, as many of the migrants enter the host countries illegally, or alternatively do not obtain the necessary working permits, the migrants are prone to run-ins with the local authorities as well as exploitation. The migrants do not dare to report assault and theft to the police as they already are subject to arbitrary treatment by the policy due to their illegal status. In addition, the migrants are in a poor bargaining position against labour exploitation in the form of being paid less than their colleagues and even less than agreed for work performed. (Lücke et al. 2007)

4.2.2 Returns to Investment

Investing in migration pays off. Even though living costs in the host country are high, the wages the emigrants earn are enough to compensate for this, and more. The migrant remittances are an ever-increasing source of income in Moldova, amounting to over USD one billion per year (Lücke et al. 2007).

The incomes earned and consequently also the remittances sent back home vary by the destination country. While a CIS construction worker remit on average just over USD 1,000 back home in a year, a migrant into EU remits over USD 1,700 (see table 8). There is also reason to believe that the household with high remittances have a tendency to understate their remittances in the household surveys more than households with lower remittances, which would imply that the EU remittances can be even higher. Although the remittances from the EU are higher in absolute values, they represent a lower share of migrant income than remittances from CIS countries. This is also related to the reasons for emigration and the patterns of migration movement: migration into CIS is needs-driven seasonal migration with an average length of stay at 6 months, whereas migrants into EU are considerably more likely to be permanent migrants or at least staying for longer than a year in order to justify the higher cost of migration (Lücke et al. 2007). Different reasons for migration also lead to different reasons for remittances: the permanent migrants are observed sending remittances for purely altruistic reasons while the temporary migrants view the sending of remittances as a special form of saving (Pinger 2007).

Table 8: Average Amount of Remittances Transferred within the Past 12 Months (in USD)

CIS construction	CIS other	EU	Other	All
1,048	1,110	1,749	1,130	1,300

Source: Lücke et al. 2007.

The expected return on investment will depend not only on the expected wage levels in the host country compared to Moldova, but also the position and legal protection of the migrant. Illegal migrants earn, on average, 30 percent less than legal migrants (Ghencea and Gudumac 2004, 56).

On the whole, though, the return on investing in migration is higher than on any traditional investment. In economic terms, the standard measure for estimating the profitability of an investment opportunity is the return on investment measure (ROI), defined by a ratio of the net gain of the investment over the initial cost of investment. The return of migration thus would be determined in terms of an increase in the net-welfare of the migrant. In other words, income from abroad minus living costs abroad compared to the foregone income if the migrant had stayed at home minus the cost of living at home. Sufficient data for calculating reliable figures of returns on investment were not available for the current study. Still, in order to get a rough idea of the order of magnitude of the returns on investment, the remittances sent back home can be used as a proxy for the net income from abroad, i.e. income minus the cost of living. This will most likely lead to underestimation of the benefits, as previous research suggests that not all available incomes are sent as remittances, especially not from the EU countries. To estimate the counterfactual, i.e. the net-income foregone at home, a rough estimate can be calculated using the average wage for the republic, 867 lei (Na-

tional Bureau of Statistics of the Republic of Moldova) corresponding to USD 73. Unfortunately no estimations on the average cost of living in Moldova could be found for the purpose of this study. As an existence minimum, an average cost of one dollar per day is deducted from the monthly wage to estimate the net-income at home. This measure will thus overestimate the net-income at home and lead to underestimation of the benefits of migration.

Based on these premises⁴, investing USD 100 on migration into the construction sector in CIS countries pays off four times the investment within a year. This means that the return on investment is more than 400 percent. Assuming that the migrant only stays abroad for a six-month period, which is the average for CIS migrants, but withholds the level of remittances, the returns on migration are even higher. As the estimate is based on careful assumptions, this high rate of return is likely to underestimate the true returns on migration.

Even though the initial investment is higher when it comes to migration into EU, also the returns accrue during a longer period of time and could even end up with a lifelong higher standard of living in the EU. Furthermore, as migrants consume a larger part of their income while being away, the flow of remittances would underestimate the benefits from migration that are likely to be considerable, justifying the larger initial investment. In the case of permanent migration, the benefits of the migrant are likely to be large even though the remittances sent to the remaining family members in Moldova are decreasing. Still, as most of the migrants are married at the time when they leave the country, families are not seldom reunited outside Moldova. Sending the first migrant abroad could thus be considered as a part of the successive investment plan that raises the standard of living of the whole household permanently. As a mind-game one could consider a scenario where the husband migrates to Russia to save enough money to send the wife to Italy who then establishes the necessary networks and gain the standard of living that is necessary for bringing the rest of the family to the EU. Even though plausible as a hypothesis, this type of long-term investment behaviour has not been captured in the survey data.

Despite the lucrative prospects of the investment, the monetary profit comes with a high social cost as discussed above. Furthermore, the possibilities to invest in migration are limited in volume as for every USD 100 invested, the household has to ‘invest’ also a family member making scaling-up of this type of investment impossible and thus limiting the total returns available from migration. The bottom line still is that even though migration involves a lot more than a monetary investment, its economic returns are high and this is the alternative against which investment opportunities in Moldova are rated. Even if such high returns on investment would be impossible in the more traditional investment sector, the returns must improve considerably if the Moldovan economy is to attract more investments away from migration and lure the productive labour force back into the domestic production. “Good governance and a favourable investment climate will become crucial as Moldova increasingly finds itself competing for internationally mobile, highly educated individuals” (Lücke et al. 2007, 5).

⁴ Net return has been estimated as follows:
 Remittances (proxying income abroad – living expenses abroad)
 – (wage at home – living expenses at home)*12
 – initial investment
 = 1,048 – (73-30)*12 – 100
 = USD 432

5. Adjusting the Incentives Towards a Domestic Alternative

Moldova needs to encourage productive investments in order to reach higher levels of sustainable growth that could contribute to poverty reduction domestically. However, it is not the level of investment that is the main cause of concern, but the lacking opportunities for making profitable investments and channelling the available funds into more productive uses domestically. On the whole, Moldova is well-equipped for a reform as it has a well-educated labour force that has proven its competitiveness on the international labour market, and there is also potential to increase private investments on productive uses. However, Moldovan firms indicate that policy instability, legal and regulatory burdens, corruption and crime as well as access to finance are important constraints to business (The World Bank & IFC 2004). They are less concerned about e.g. labour costs, implying that Moldova does not need to embark on a growth strategy based on cutting prices of the factors of production. This argument is further supported by the calculations made by the World Bank and the IFC, which show the potential benefits of an improved business environment. If Moldova would have the same investment climate as its highest ranking peer in the region (Poland), its productivity would be 9 percent higher in the food processing and the garment industry (The World Bank & IFC 2004, 17). This would be a significant improvement, considering that these two sectors are already amongst the most productive in Moldova, which suggests that the productivity gains could be even greater in other sectors of the economy. The main challenges thus lie in the investment climate and the access to efficient financial systems that would allocate capital to the most profitable use.

Moldova is a young independent nation with an institutional framework still developing. Building a nation from scratch requires time and resources which are scarce in Moldova today. Institution building is also a learning process entailing a fair share of mistakes and abrupt changes in the rules of the game, once mistakes are discovered. The insecurity related to this process in itself will lead to a poor investment climate and instability during the period of transition. The government in Moldova has already implemented several changes aiming to improve the investment climate in the country. However, these changes have sometimes been badly sequenced and they remain insufficient as the rebuilding process is yet to be finalised. For example, the government is considering a tax relief for foreign investors and worry about the rising labour costs,

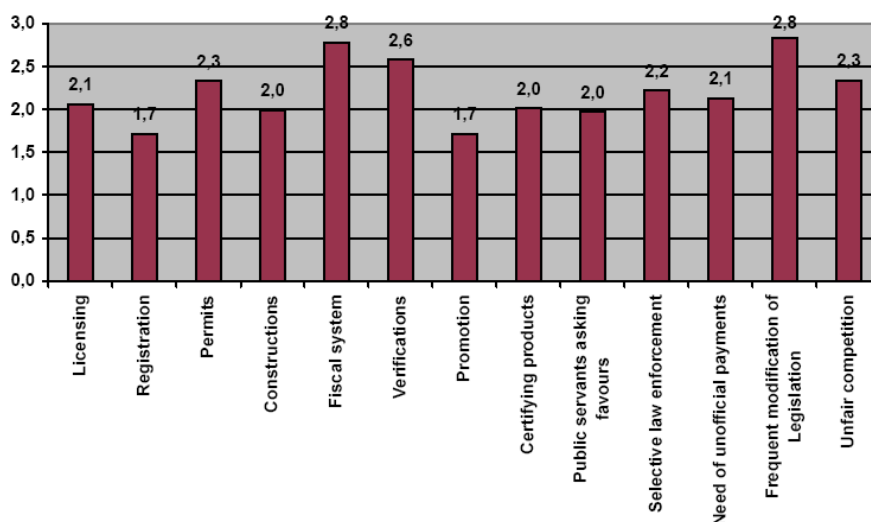
while the main concern of the investors in fact is the delays in the privatisation process and regulatory environment. The domestic businesses rank high sanctions for errors and lack of established rules (a rather unfortunate combination) as their main problems with the taxing system (The World Bank 2007). These problems rank higher than the level of taxation, and the government efforts should thus be directed into solving the actual problems rather than diminishing the tax base with less needed cuts. The government of Moldova will need a broad tax base in order to finance the productive investments needed to rebuild the economy and to increase social expenditure. Cutting taxes does not generate sufficient levels of new firm establishment to compensate for the lower levels of taxation (UNDP Moldova 2005, 14).

The government efforts should thus be reorganised and prioritised into solving the main bottle necks identified by the private sector, in order to turn Moldova into a lucrative destination for investment. When considering the incentives for investment in the future, it is important to distinguish between a bad investment climate due to poor governance, and a country in transition. In the case of Moldova the transformation towards an open economy is on its way and the problems related to shaky governance during the transformation are likely to be a temporary phenomenon.

5.1 It's All about Investment Opportunities

Administrative barriers are a major hindrance for growth and employment creation in the private sector. According to the Doing Business statistics published by the World Bank and the IFC, Moldova fell down to the general 'ease of doing business' ranking of 103 out of 175 countries in the annual review from 2006 (The World Bank & IFC 2006, 128). Figure 2 lists the main features of the Moldovan business environment. Companies were asked to assess difficulties generated by the main features of the business environment by grading them on a scale from 1 to 5 where 1 "do not face difficulties" and 5 "face significant difficulties". The biggest problems were generated by frequent legislation changes, a complicated tax system, numerous check-ups and unfair competition (The World Bank 2007, 17).

Figure 2: Difficulties faced in the private sector in Moldova



Source: The World Bank 2007, 18.

One should bear in mind, however, that the Moldovan Cost of Doing Business survey covers only formal established firms (mainly limited liability companies and joint stock companies), and excludes agricultural enterprises and sole proprietors. Anecdotal evidence indicates that the investment climate faced by the informal firms is more troublesome than the already dismal national review suggests. A previous study by the World Bank and the IFC (2004) notes that medium-size and large enterprises report improvement in the registration procedures, while the smaller businesses report increased complexity in registration. This is alarming as the micro and small enterprises are often crucial for creating new pro-poor employment opportunities and growth.⁵

5.1.1 Legal Framework

A well functioning private sector is rule-based rather than dependent on personal contacts. The Moldovan business environment in general, and the enforcement of the legal framework in particular, fail to provide the framework in which the businesses, especially the small and medium sized enterprises, would flourish. Even though the commercial law is good on paper, its implementation and enforcement is lagging behind (The World Bank & IFC 2004). Moldova ranks worse among the transition countries when it comes to efficiency and contract enforcement. Even though the businesses are relying on the court in case of disputes more often, they are displeased with the time it takes to get a ruling, they are suspicious about the corruption in the court, and the legal services are considered too costly (The World Bank 2007). Low confidence in the system leaves enterprises insecure when dealing with suppliers and customers they do not know, which limits their business opportunities and opportunities for growth (The World Bank & IFC 2004).

Corruption is not a problem for the legal system alone, but affects the investment climate at large. Nearly 60 percent of firms identified corruption as a major or moderate constraint and, presumably related to this, 58 percent identified business licensing and obtaining permits as constraining (The World Bank & IFC 2004). According to the Transparency International's Corruption Perception Index, which measures the degree of corruption as seen by the business people and country analysts, Moldova scores the humble overall assessment of 3.2 on a scale from 0 (highly corrupt) to 10 (highly clean) (Transparency International 2007, 328). Corruption hits the small and informal businesses the hardest and paying bribes to 'get things done' is pervasive especially for the smaller firms (The World Bank & IFC 2004).

5.1.2 Infrastructure

Moldovan firms generally do not see infrastructure as a major constraint for their business (The World Bank & IFC 2004). This should, however, by no means be interpreted as a sign that the infrastructure is in good condition; on the contrary the statement mainly reflects the very low level of economic activity. Once the economy starts growing, the price of neglecting the maintenance of the road network will become obvious. Moldova has more paved roads than an average transition country, but the majority of the roads are in a bad or very bad condition. Ensuring a sufficient provision of public goods, in this case transportation infrastructure, is a prerequisite for higher growth. The problem has become acute

⁵ The net job creation of private microenterprises in Moldova in 2001 was staggering 27.9 percent while in the state-owned enterprises job destruction dominated over job creation ending up in a net job creation of -5.4 percent (UNDP Moldova 2005, 142).

especially in the country side where smaller towns have poor access to the main growth centres, which constitutes a constraint for small-scale industrial development and economic diversification. Here public investment in infrastructure is needed to crowd-in private investment in companies (UNDP Moldova 2005, 13). Ensuring good transportation connections also has important regional aspects at the time of ever-increasing polarisation of the Moldovan economy into few growth centres and large regions of economic decline.

5.1.3 The EU Market as an Opportunity For the Future

The Moldovan economy is developing as a close neighbour to the European Union. The EU market provides lucrative business opportunities both for domestic businesses as well as for the Moldovan labour force. However, as a non-member of the EU, Moldova is facing limited access to the European market and is thus pushed closer to the Russian hegemony. Costly access for the Moldovan products to the EU market leads to the phenomenon that Moldova is exporting production factors, in this case labour force, instead. Labour force is exported in the form of illegal migration as also the EU labour market is officially closed for the Moldavians, but unofficially migration is widely accepted and openly talked-about phenomenon in many of the EU countries. As a result, the EU economies get to enjoy the benefits of a highly skilled Moldovan labour force without having to pay for their social security nor having to have to face price competition from the Moldovan farmers. The price of this asymmetric market access falls on the population in Moldova.

The possible EU membership would boost economic growth and provide an answer to several of the development challenges Moldova is struggling with today. Firstly, it would create more employment opportunities domestically as the demand for the Moldovan products would increase by the removal of the trade barriers. This would reduce the migration flows directly. The part of the migration heading towards other EU countries today would also change character as the migrants would no longer be illegal workers but would enjoy the same rights as the EU workers. This would make it easier to transport the social security benefits back to Moldova once the migrants return. Also this would be likely to reduce migration flows as the cost of hiring a Moldovan migrant would consequently increase. Efforts to move Moldova closer to EU membership is likely to create hope for the future both for the domestic investors as well as the Moldovan workers and provide an incentive to invest in Moldova. A membership in the EU is not an option for Moldova at present but as investment decisions are made, based on the projections on the future, the Moldovan domestic economy is likely to be a winner if there is a chance that the large EU market would become a part of the home market in the foreseeable future.

5.2 Access to Finance

Not merely the use of investment but also the access to funds that could be invested is problematic in Moldova. Currently massive flows of remittances are transferred, primarily in cash, over the border, but these funds are not used for productive investment. Small agricultural producers have virtually no access to commercial lending and overall supply of long-term financing is extremely limited (UNDP 2005, 154).

5.2.1 Investing Remittances

Migrants use three principal ways of transferring remittances to Moldova: bank transfers, express money transfer services (e.g. Moneygram), and cash transfers, where they carry their cash foreign exchange themselves on home visits or rely on trusted individuals like bus drivers as informal money couriers (Lücke et al. 2007). As a large amount of money is transferred through informal channels, these flows are not visible in the official banking system and thus not accessible for potential investors. Arguably, “encouragement of the use of formal remittance channels is best done through banking reform and encouragement to the development of financial products better targeted at migrants, rather than through government regulation; given widespread (and sometimes justified) mistrust of banks, it is not sufficient simply to encourage more use of banks” (Pantiru et al. 2007, 23).

Acknowledging the fact that the majority of remittances are used on increased consumption as well as consumer durables, investment is an additional potential use of remittances. Households with migrants boost their savings, which can be regarded as a proxy for their capacity to invest (Lücke et al. 2007). According to the recent surveys, roughly 20 percent of remittances are saved either in the bank accounts (around 50 percent) or under the mattress (around 50 percent). The domestic, informal savings are estimated to be worth around USD 90 million, equal to a third of the total bank deposits in Moldovan banks. Most deposits are still short term, and long term investments are rare, not least due to the lack of established long-term investment options such as treasury bills or life insurance funds (Tamas 2006, 25).

A reform of the banking system is called for to facilitate economic development in Moldova. Restrictive regulation, such as a ban against banks paying wages and salary or lending to exporters in foreign currency (The World Bank & IFC 2004), are hindering economic activity. A regulatory reform in this area might be a way for alleviating appreciation pressures as well as protecting the exporters from exchange rate risks. The main problem beside the rigid regulation still is the lack of financial products available in the market and the poor ‘financial literacy’ among the migrants which forms a barrier for them to use financial services (Tamas 2006, 27). Especially the long term saving alternatives seem to be in high demand but short supply in Moldova.

A burning form of long term saving that should be urgently developed is pension schemes and other forms of saving for a rainy day. Providing ways to decrease income insecurity would directly impact poverty, and allowing savings for pensions would ease the pressure on the ticking time bomb of the current public pension system that is poorly equipped to support an ever-increasing number of elderly with ever-decreasing number of workers contributing to the system domestically (Tamas 2006, 28). One way to tackle the problem is to encourage the Moldovan government to engage in negotiations of better portability of pension claims from the host countries that are currently benefiting from the inflow of Moldovan workers, but who do not have to pay for their pensions once they return. Encouraging better coherence within the social security systems would also require stronger legal status of the migrants in the host countries. In the meantime, the Moldovan migrants may want to save for old age now when the remittance inflows are strong. To facilitate this and to mobilise the funds saved into pension schemes for the benefit of the private sector, the financial infrastructure should provide products

like investment funds directed at long term investment as a complement to pension.

5.2.2 Investing in a Migration Fund?

Matching the skill levels of the migrants with the work assignments that they actually perform is of crucial importance. As the Moldovan migrants are usually highly educated but end up in low-skill professions abroad their professional skills are often wasted. Furthermore, few migrants (apart from the construction workers) are likely to acquire relevant occupational skills through their work abroad that would be of advantage upon their return (Lücke et al. 2007). As a mind game one might consider a market arrangement that would allow optimal allocation of labour across countries and even out income gaps between the different groups in Moldova. At the moment, the highly skilled are migrating to the EU as they can afford to do so, not because their skills would be on high demand in the host country. If the necessary financial infrastructure would be in place, it should be possible for the highly skilled work force in Moldova to invest in migration without migrating themselves, i.e. to invest in a migration fund that provide loans for unskilled migrants to travel to the EU to work in the positions that match their qualifications at home (baby-sitting, construction work, etc.). As investing in migration is profitable, the migrant would then pay back the initial investment with interest. This way the highly educated could continue contributing to the development of Moldova with the skills they have, the unskilled would get the possibility to migrate, and the returns on migration would be more equally divided between the different population groups in Moldova. Establishing a migration fund might also contribute to solving the large problem of trafficking as the poor households would escape the common necessity of borrowing money from non-trustworthy sources for their migration and ending up in a life-long debt that binds the migrant to the money-lender.

This type of financial intermediation should be possible, but there are no such funds in operation at the moment that are known to the author. It is also important to bear in mind that the migration fund would not be a panacea against poor employment situations for the highly skilled workers in Moldova, but is meaningful only if the highly skilled workers would prefer staying in Moldova if they could find other means of improving their income. At the moment, the highly skilled workers find it difficult to find employment that matches their education level in Moldova, and work instead in construction and other blue-collar occupations where the wage level is higher. Unless the domestic wages for the highly skilled improve and the conditions for finding a rewarding employment get better, accepting a job abroad even if it is at the unskilled sector may be preferred by the educated in Moldova, weighted against the alternative of lending their very limited savings to others who wish to try their luck abroad. At present, there are informal though insufficient means for borrowing available from the family members who have already migrated abroad. These funds are often made available for altruistic reasons and even the highly skilled Moldovan workers will often need to rely on these transfers to compensate for the dismal wage level at home.

5.3 Focus on Regional Development

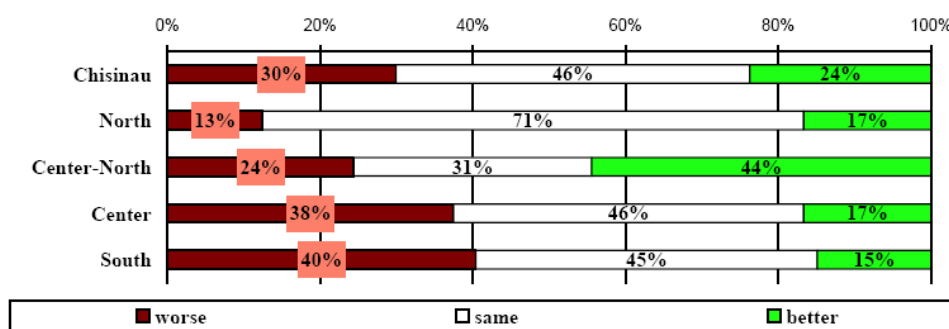
Economic development in Moldova has concentrated around two growth centres in Chisinau and Balti. In 2003 –2004, 60 percent of all investments in fixed capital were channelled to these two cities, leaving the

other areas with very modest levels of investment (Pantiru et al. 2007). The flow of investments paint also the overall picture of the economic development in the country: while the main cities are almost alone responsible for the GDP growth and poverty reduction at the national level, the rural and peri-urban areas are lagging behind. As discussed above, economic growth is no longer benefiting the poor in Moldova, as the poor are excluded from the growth process. Investment needs to benefit the poor potential emigrants in case sustainable poverty reducing growth is to be achieved.

Even though Moldova is a small country assuming that general regulatory improvements in Chisinau would filter into the other areas in the country would be false. The economy within the country is not well integrated and the labour is not mobile, which is demonstrated by vast differences in wages between the larger cities and other areas. Also opportunities for economic development differ broadly. While the main cities offer access to business development services and a critical mass of other enterprises and customers, the markets outside the cities are fragmented and the transport infrastructure is not sufficient to connect them to the larger markets.

Furthermore, the way in which the bureaucratic framework is handled in the different regions is not equal. This presents both a challenge and an opportunity for local decision makers to make a change. While the Center-North region is improving its investment climate rapidly, the business opportunities in the South are getting scarce (see figure 3).

Figure 3: Changes in the Business Environment by Region



Source: The World Bank 2007, 17.

Thus, the nation-wide regulatory improvements in the investment climate should be complemented with a conscious effort to integrate the domestic economy and improve the business environment in different regions. This would ensure that the resources in the country are better utilised and that the benefits of economic growth will be more equally divided.

6. Turning Investments into Productive Employment

Addressing the issue of migration requires tackling its root causes. In general, emigration is always a second best option weighted against staying at home, if only the domestic economy would provide reasonable prospects for the future. As migration is a household-level decision one needs to ensure that the economic opportunities perceived from the household level are attractive enough to divert the mass-migration and investment flows back towards the Moldovan economy. Investment in general infrastructure and regulatory reform will not suffice unless it leads to concrete productive employment opportunities for the households contemplating migration.

6.1 Enhancing Employment

The households need more and better jobs in order to supply for their families. The ideal situation would be to provide employment in their home country rather than forcing the households to migrate abroad. Concrete measures are thus required for creating such opportunities in Moldova. Even though general improvements in the overall investment climate is a prerequisite for private sector development, pro-active measures are required to address the specific needs of a sample of sectors that are identified to have the most potential.

Positive economic development in Moldova will require economic diversification that would enable moving away from a few fragile sectors into a robust and broad-based economy. Creating employment opportunities will crucially depend on the possibilities for fostering economic development in a variety of sectors that will have synergies, utilise the production factors efficiently, and facilitate the emergence of different types of companies. Further analysis will be required for identifying the priority sectors that will have the biggest impact on economic growth and poverty reduction in Moldova. Within the limited scope of this study, the agricultural sector and the construction sector are discussed in some detail as they have obvious links to the migration dynamics.

6.1.1 Priority for Agriculture and Export-led Agro-industry

Prior to the collapse of the Soviet Union, Moldova was dominated by the agricultural sector. Even today, agriculture is a significant contributor to economic growth and provides employment opportunities for many: about 40 percent of the economically active population has agriculture as their main source of income (Tamas 2006, 34). However, the agricul-

tural sector has lost its status as a provider of productive employment. After the Soviet Union collapse the subsidies were cut and the export opportunities diminished. The agricultural sector ended in a crisis and an era of poor harvests and tightening international competition, which Moldova was ill-equipped to manage due to inferior health and environmental standard of Moldovan agricultural products. Furthermore, there is evidence that lack of competition among buyers at the wholesale markets further depress the farm-gate prices and thus also the incomes of the farmers (The World Bank 2006, 13).

There is a large potential in developing and modernising agriculture so that it is able to absorb the excess work force and provide higher incomes for the people already active in the sector. Agricultural development could also contribute to closing the large trade gap and possibly reduce migration if employment opportunities in the rural areas were improved. At present, rural roads, market infrastructure, irrigation systems, and communication networks are not sufficient to achieve high levels of production. Besides investment in infrastructure, there is need to develop markets and related services for inputs, output and rural finance (UNDP Moldova 2005, 150). Higher productivity in the primary agriculture is also important, as some companies report that it is difficult to find agricultural labour during seasonal peaks. Present salaries are simply not competitive compared to opportunities abroad.

Secondly, there is an urgent need to diversify the export market for the agricultural products, as Moldova being a small open economy will be dependent on export as its primary engine of growth. Considering the economic size and proximity of the EU market, the principal trading partner of Moldova should be the EU (The World Bank 2004, 38). Instead, the Moldovan exports currently rely on a narrow and politically insecure CIS market.⁶ Further efforts towards expanding the exports into the EU would provide considerable potential for growth. Moldova is a beneficiary under the EU's Generalised System of Preferences (GSP) scheme allowing products to be exported to the EU at favourable rates. However, most of Moldovan exports fall outside the general rules for the GSP as they are classified as sensitive products, implying that the true tariff protection of the EU is much higher. If the GPS preferences were extended to all Moldovan agricultural products (including wine), the average tax rate confronting the Moldovan exporters would fall, which in its turn would help in redirecting the trade flows towards the EU market. However, removing the tariff barriers are not likely to be the ultimate cure for Moldovan economy: according to the World Bank (2004, 46) halving the average tariff rate to the EU would increase the Moldovan exports by 18 percent at most implying that further measures must be undertaken in order to boost the terms of trade and set the Moldovan economy on a growth track.

In addition to tariff protection, Moldova's access to the EU market is constrained by the EU agricultural subsidies to the domestic EU producers (The World Bank 2004, 46). These subsidies are still mainly benefiting the meat, dairy, fruits and nuts as well as sugar products which are not the main export products of Moldova. Furthermore, EU export

⁶ An example of the insecurity concerning the market access to CIS is the recent import ban of Moldovan wines to Russia issued in 2006. Wine trade with Russia is responsible for the lion share of the total wine export in Moldova. The Russian side argued that the ban was raised as a result of finding heavy metals and pesticides in the Moldovan wines whereas the Moldovan side argues that no proof was ever provided by the Russian side and that several other countries that imported Moldovan wines had not encountered any problems. Moldova argued that the ban was a demonstration of political power and economic blackmail and thus the embargo resulted in a diplomatic crisis between the countries.

subsidies affect Moldovan producers through their influence on competition in the third markets, but even here the main impact is on meat, dairy and cereal comprising only 3.5 percent of the current Moldovan export (The World Bank 2004, 64). Another non-tariff barrier to the EU market is health and safety regulations. At present, the quality of the Moldovan agricultural output is not high enough to meet the standards required from exports to the EU. Besides the needed improvement in following health and quality regulations, streamlining and simplifying the trade procedures to the EU could involve a marked improvement in the trade performance (The World Bank 2004, 65).

Moldovan agriculture would benefit from more liberal trade arrangements, especially with the EU, and from the desperately needed investment in the domestic production, to regain Moldova's comparative advantage in agricultural production. In order to facilitate export led growth, the domestic informal barriers for export should also be abolished and the cumbersome framework streamlined. The efforts towards more transparent regulation and practices in the agricultural sector should also address the barriers caused by corruption leading to unnecessary transaction costs for the farmers. However, enhanced trading channels for the farmers would lead to rising costs for the domestic processors, who would need to face world prices for their inputs. One of the main priorities within agriculture is thus increasing productivity of agro-industry, creating effective demand for the domestic primary production and resulting in higher value added of agricultural products. Investing in the industrialisation of the agribusiness and training the entrepreneurs on sanitary and phyto-sanitary measures is likely to be a pro-poor policy as agribusiness has large potential to employ people directly and indirectly by generating demand for the farm production outside the major cities. A growing agribusiness sector, in combination with a modernised primary production, will also create alternative employment opportunities relieving agriculture from the continuing heavy burden of absorbing excess, unproductive labour (UNDP Moldova 2005, 157).

6.1.2 Potential in Construction

Another sector that deserves urgent attention is construction. Even though this sector is not as big an employer as agriculture, it has a particular relevance when it comes to migration: roughly one half of all emigrants are employed in the construction industry (Lücke et al. 2007). The majority of these migrants leave as the employment opportunities at home are dismal. The skills the workers have upon departure and gain while being abroad are valuable in reconstructing the Moldovan economy as well. Indeed, during recent years the construction industry has grown radically and the sky-rocketing prices of real estate in Chisinau provides further evidence for the demand for new and better housing. The recent real estate boom in Chisinau is financed at least partly by remittances (Lücke et al. 2007) and the trend is unlikely to reverse in the near future.

The measures required for improving the state of the construction industry in Moldova differ from the acute investment and training needs in the agro-industry. Unfortunately, the construction sector seems to be plagued by an exceptionally poor business environment (see table 9). Getting licences for construction is difficult, time consuming, and costly, both in terms of official as well as unofficial payments (The World Bank 2007). Solving the administration and legislation around the new licenc-

es would bring down the cost of production and create incentives to employ further workers. Creating employment opportunities in the construction industry in Moldova would be highly desirable both from the perspective of the total economy as well as for the individual households who would avoid sending their family members abroad.

Table 9: Average Duration and Costs for Obtaining Permits

Activity/survey time frame	2002	2003	2004	2005	2006	2007
Duration (days)						
Construction	141	171	170	157	143	124
Repairs, renovation	32	53	73	66	67	67
Expences (USD)						
Construction	764	1082	716	374	560	622
Repairs, renovation	313	876	712	145	227	313

Source: The World Bank 2007, 27.

6.2 Productivity and Employability of the Labour Force

It is not sufficient to find employment for all but the employment the workers are engaged in needs to be productive and pay enough for the families to escape poverty. In 2002, 75 percent of the people who were in poverty in Moldova had work; the problem was that the work did not pay sufficiently to escape poverty (UNDP Moldova 2005, 20). In this light, the productivity and wage setting at the labour market in Moldova deserves particular attention.

The failure of employment to keep up with increase in production has led to sometimes rapid increases in labour productivity. Overall, the labour productivity in Moldova has risen by 4.8 percent per annum over the period of 1996 to 2003 (see table 10). On the other hand, how the gains of the increased productivity will be divided between the production factors is a matter of bargaining power of the workers versus the owners of capital.

Table 10: Labour Productivity by Sectors and Annual Growth Rates in 1996 to 2003 (1996 = 100)

	1997	1998	1999	2000	2001	2002	2003	Rate of growth
Agriculture	116.5	99.8	98.8	96.1	103.2	111.4	130.3	3.9
Industry	91.1	81.0	88.7	97.3	101.3	98.0	116.4	2.2
Services	99.0	106.8	135.2	131.7	141.7	151.8	159.1	6.9
Construction	88.9	67.9	93.1	64.9	82.6	81.6	87.0	-2.0
Trade	92.6	143.3	285.0	200.5	202.3	195.7	213.9	11.4
Transport	96.0	82.4	88.2	117.1	127.7	144.2	143.1	5.3
Public admin	106.3	100.1	86.4	92.2	95.0	110.2	111.1	1.5
Others	101.5	108.3	139.3	176.7	216.1	232.4	235.7	13.0
Total	102.3	96.5	107.5	106.4	113.7	120.6	139.1	4.8

Source: UNDP Moldova 2005, 136.

6.2.1 Wage Setting in the Split Labour Market

The labour force seems to have been split into two during recent years: the highly educated workers are becoming scarcer, while the unskilled are getting more unorganised and thus loose bargaining power over their wages. Large scale emigration from the country push up the local reser-

vation wages for high skilled workers in the growing sectors, leading to situations where some employers find it difficult to attract workers unless they pay high wages by local standards. Success in creating incentives and a lucrative working environment for the highly skilled workers will be a decisive factor in the future economic development of Moldova that at present is competing for the workers in the international labour market.

For the unskilled, however, the situation is quite different. At the time of the economic collapse, both the employment rate as well as real wages of unskilled workers caved in (UNDP Moldova 2005, 144). This demonstrates exaggerated flexibility of the labour market in Moldova in disfavour of the workers. Even though the labour laws provide protection of the workers rights on paper, the employers do not experience any difficulties in hiring and firing workers due to the weak position of the labour unions who should act as watchdogs (UNDP Moldova 2005, 139). Albeit a smooth system for hiring and firing labour force is a corner stone in a good business environment, pressed wages and poor workers' rights will never be a decisive competitiveness factor for Moldova, whose labour market is small and the vast majority of workers are rather well educated. One should thus be observant not to throw the baby out with the bath water and bargain away decent working conditions in the strive towards better productivity, as this will backfire in the future in terms of increased migration flows. Unless the labour unions are empowered to act in favour of their members, the expected economic growth will result in higher returns to capital while the returns to labour will remain at the current low level fuelling further emigration.

6.2.2 Gender in the Labour Market

The position of women in the labour market in Moldova is largely disadvantaged compared to that of men. Even though women have responsibility for most of the reproductive work, they are to large extent missing from most decision-making processes as well as powerful and well paid positions in the private sector. The legislation that in theory rules against pay discrimination is easily evaded within a discriminatory culture that relegates women to low-paid jobs (UNDP Moldova 2005, 133). Support to implementing non-discriminatory policies is needed to ensure equal treatment of women in all areas of social life as well as to revert the out-flow of highly educated young women that are increasing their participation in the third wave of migrants. Should the mass-exodus of women in a fertile age continue, this might lead to changes in the demography that will e.g. lead to problems with a deteriorating dependency ratio.

The massive emigration would also lead to problems in the domestic labour market, as the occupational choices are strictly gender biased. Encouraging more men into joining the social sectors may be one way of increasing the status of the traditional female occupations and help Moldova prepare for an increasing burden that is facing the deteriorating social welfare system.

6.2.3 Employability and Education

A further cause of concern in terms of productive employment is the deteriorating levels of human capital, so far constituting the cutting edge of Moldovan competitiveness. The population is yet today rather well educated thanks to the legacy of the Soviet rule that emphasised spending on education. However, unless the high levels of spending are restored, the reserve of human capital will soon be depleted. At the mo-

ment, the number of pupils is declining rapidly, especially in the country side, due to household migration to the urban centres or abroad and anecdotally due to the absence of migrant parents putting their children in school. On the other hand, the demand for university education is on the rise and demonstrated by the ever-increasing popularity of private universities, as the children of the migrant families often use remittances to finance education. In general, the households receiving remittances invest in longer education of their children compared to households without migrants (Lücke et al. 2007). This is a positive effect of migration, but only if the economic situation in Moldova is improved in the near future so that the children do not choose to migrate abroad after gaining their education.

Furthermore, massive migration adds a spin to the labour market dynamics as the well-educated workers are attractive on the foreign labour market as well – though seldom within professions matching their education. Ensuring adequate returns to education in Moldova, by improving the compatibility of the supply and demand of educated workers through fostering of economic development and improving working conditions for professionals, constitutes a challenge that Moldova needs to solve in order to put its development on a sustainable path. Additionally, ensuring that the quality of education remains at a high level requires an increased focus in the future: the sudden investment increase in new privately funded universities and the economic constraints of the older public universities, will impose pressure on the regulatory framework to ensure the standard of the new establishments while maintaining adequate funding arrangements for the public education system.

7. Conclusions

The massive emigration, which started as a reaction to rapid economic decline, is no longer reducing poverty in Moldova. A pro-poor growth strategy needs to be put in place in order to ensure profitable income earning opportunities locally, to obtain sustainable levels of economic growth, and to reverse the outflow of labour force. To achieve this goal, Moldova needs to create an incentive system that encourage re-channeling the level of private investment into domestic productive investment. This, on the other hand, requires a rapid improvement of the investment climate in order to ensure that migration does not become chronic and that Moldova is not trapped into remittance dependency.

The reform agenda to turn the investment flows around is massive and prudent prioritisation and sequencing of the necessary policy measures is crucial. The priority should be given to policy solutions that address so-called binding constraints, i.e. constraints that affect pro-poor growth the most. As some policy options will have an immediate effect, while others need time to gain impact, it may also be motivated to initiate long-term projects that address constraints that are not binding at the moment but will be binding in the near future. The following areas of intervention are recommended:

The general business environment needs immediate attention in order to achieve an enabling environment for investing in Moldova. An improved business environment will play a decisive role in diverting the migration and investment flows and ensuring a more sustainable base for economic growth in Moldova. Reducing the amount of red tape, fighting corruption, and ensuring a transparent and equitable system of legislation correctly enforced would improve the productiveness of the Moldovan economy and increase its attractiveness as an investment object.

Financial markets are weakly developed in Moldova, despite the massive flows of remittances and relatively high levels of total investment. In order to take advantage of the available investment opportunities, the cost of financing should be decreased. Developing reliable ways of transferring remittances, allowing export and import transactions in foreign currency, and improving access to finance for domestic enterprises, in particular the small and medium sized enterprises that currently are disadvantaged, are high priority actions.

Regional imbalances hinder pro-poor growth. In order for growth to benefit the poor, it needs to be ensured that the poor have access to employment opportunities. The current economic development is concentrated to a few domestic growth centres and the possibility to emigrate abroad. The coordination and information failures that are currently constraining the economic development in the semi-urban and rural areas are likely to need government support to be solved. Furthermore, regional infrastructure should be developed to divert the isolation of the rural areas and the regional development plans should be designed to foster the potential of economic growth in different regions, including cluster development and improved provision of business development services in rural areas.

Creating productive employment opportunities is a key to more sustainable growth benefiting poor potential migrants. General improvements in the investment climate and regional support to economic development will go a long way into improved employment, but complementing support should be given to the organisation of the workers and development of the labour intensive sectors. Economic diversification should be a long-term priority for the economic development. One of the promising sectors at the moment, which should be given priority, is the development of export oriented agro-industry (productive investment, training in SPS and TBT, etc.) where Moldova is likely to be able to gain back its comparative advantage (UNDP Moldova 2005, 157).

Furthermore, *the gender related discrimination in Moldova is a major constraint* for more effective and poverty reducing use of human resources and a contributory push-factor for emigration, which requires urgent attention. The outflow of competent highly-educated women is likely to intensify in the near future and the domestic resource base necessary for pro-poor growth will thus diminish unless the discriminating labour market practices are abolished from the domestic economy.

Long run priorities not constituting an immediate constraint but will need preparatory policies already in the near future include (i) improvement of the pension system, which in its current state combined with a decreasing number of working aged adults will not be able to provide for the ever-increasing number of elderly. Negotiating legal migration quotas that involve an agreement of pension contributions to be transferred to Moldova can be a step in the right direction. Related to this, (ii) negotiations of a possible EU membership and the requirements that Moldova needs to fulfil to reach this goal would partially support the agenda on social welfare, but also improve the investment climate and future perspectives for economic growth in the country. Also (iii) increasing not only the immediate reparatory spending on infrastructure but also long term strategic investment in an improved transportation network will provide a necessary condition for continued growth in the future. Finally, (iv) investing in education should be a long-term priority of the government. The highly educated labour force of Moldova at the moment is a legacy of the socialist times and a result of massive social spending. Human capital in the country is currently deteriorating rapidly and even though the alarming signs cannot be immediately observed, losing its advantage in the labour market would be destructive to the whole economy. Thus, restoring the high levels of spending in education should be a priority for the future.

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