Migration and Remittances in Moldova

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Preface

Labor migration and remittances have increasingly become a part of the global landscape, with profound economic and social consequences. By directly affecting growth performance, public finance, balance of payments, and exchange rate and monetary conditions, they are posing fresh challenges to policymakers. Moldova, a small, low-income country where an estimated third of the economically active population has been working abroad, is an interesting illustration of this trend.

This Special Issues paper examines the microeconomic characteristics, macroeconomic consequences, and policy challenges of labor emigration and remittances in Moldova. Drawing on household survey data, it attempts to explain why Moldovan workers go abroad and how their remittances are used. With this background, the paper provides insights into policy challenges of coping with, and maximizing benefits from, international labor mobility and the large inflows of remittances. Appropriate macroeconomic policies are important, but a more determined and sustained effort to improve the business environment is needed to enhance Moldova's attractiveness to foreign capital and stimulate more foreign investment inflows. It would also facilitate the allocation into productive use of larger portions of migrants' remittances, which today are predominantly used to finance household consumption and residential construction. The signing of the EU-Moldova Action Plan in early 2005 offers hope for reinvigoration of the structural reform agenda.

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CHAPTER

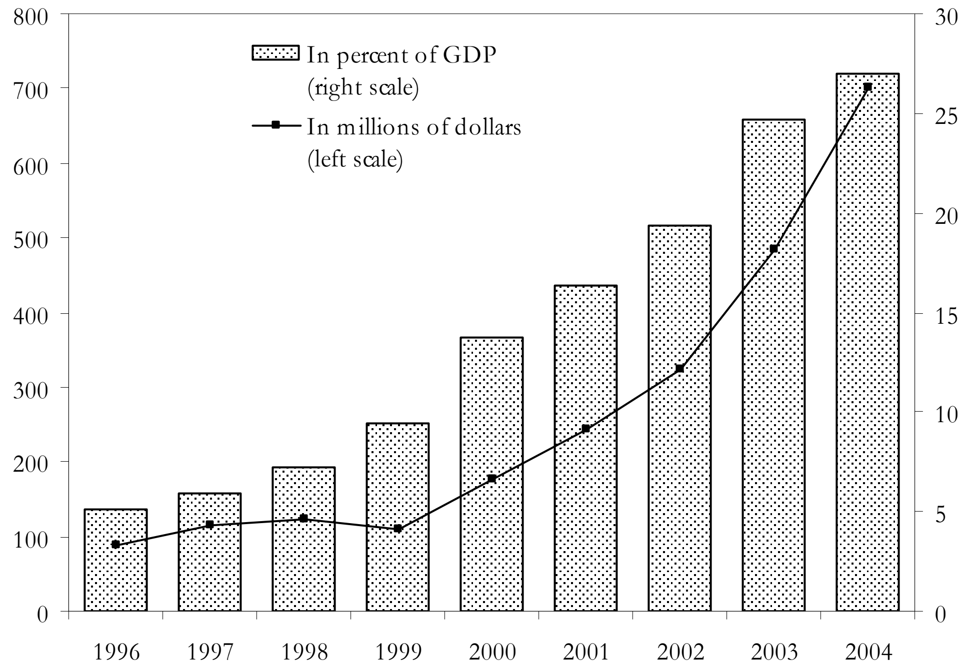
1 Overview

In today's globalized world economy, economic integration goes beyond international trade and capital movements, and increasingly involves international labor mobility. An interesting illustration of this trend is Moldova, where large-scale labor emigration and associated workers' remittance flows have played a dominant role in shaping the economic evolution in recent years. Although in Moldova much of the impetus for labor migration has come from unfavorable domestic conditions, the phenomenon is part of a wider trend of a growing movement of temporary and skilled workers across national borders.

Labor migration and workers' remittances picked up in the wake of the 1998 regional crisis, which hit Moldova particularly hard. The domestic economic situation was already difficult before the crisis, since the transformation from a centrally planned to a market-based economy implied drastic structural changes, resulting in output contraction and massive job losses. When hit by the 1998 crisis, many workers had few viable alternatives to seeking job opportunities abroad to support their families. Despite subsequent domestic economic recovery, these trends intensified over time, with new migrants benefiting from the informal support of the growing expatriate community. In 2004, the total officially estimated gross inflows of workers' remittances reached almost 27 percent of GDP (Figure 1)—large compared with other countries in which remittances also play a relatively significant role.

This paper examines the microeconomic characteristics, macroeconomic consequences, and policy challenges of labor emigration and remittances in Moldova. Drawing on household data from a recently conducted survey, it attempts to explain why Moldovan workers go abroad and how their remittances are used. With this background, the paper describes the profound impact the large inflows of remittances have had on the macroeconomic environment. Finally, the paper goes on to analyze key structural and macroeconomic policy issues and offers some insights into major policy challenges of coping with and maximizing the benefits from the large inflows of remittances and labor mobility.

Figure 1. Gross Workers' Remittances, 1996–2004



Source: National Bank of Moldova (NBM).

There are three main reasons this paper could be of general interest. First, the results presented from the survey add to the growing literature on the mechanisms behind and character of migration and workers' remittances. Second, the analysis of the macroeconomic consequences includes the potential impact of labor migration and workers' remittances on monetary and fiscal conditions. While the focus in the literature has chiefly been on "real" aspects of the economy—economic growth, investment, and competitiveness—extending the analysis to monetary and fiscal aspects arguably adds value, in particular from the perspective of policymakers. Third, and most important, the paper puts emphasis on economic policy implications. It highlights policy challenges that emerge from dealing with the causes and consequences of labor migration and workers' remittances. This is also where we believe the broad approach taken in this paper pays off. Specifically, when micro- and macroeconomic issues are looked at simultaneously, the decisive role of sound structural policies comes out clearly, highlighting the risk to slowly reforming economies and making a case for reforms to effectively address impediments to private sector investment and development.

The paper finds that the basic patterns of migration and remittances in Moldova are consistent with the stylized facts in the labor migration literature. Moldovan migrant workers, temporary and permanent, have a strong attachment to Moldova, remitting large portions of their earnings home. Transfers from migrants, who accounted for about 40 percent of the economically active population at end-2004, are primarily used to meet basic consumption needs and finance housing and education, with smaller amounts invested in business activities. Remittances are, moreover, likely to remain a stable and countercyclical source of foreign exchange in the short run. However, as more migrants settle permanently abroad, portfolio choice may become more important.

Household decisions to migrate and remit part of workers' labor income to their families in Moldova have important macroeconomic consequences. They (1) drive growth through household consumption, (2) reduce labor supply and put pressure on wages, (3) finance a large and widening trade deficit, (4) put the exchange rate under appreciation pressure, (5) fuel inflationary pressures, (6) contribute to higher tax revenues, and (7) threaten the sustainability of the pension system.

In the face of these challenges, policy choices in three broad areas—structural, monetary, and fiscal—become critical for determining whether labor migration and remittances will be good or bad for Moldova. In principle, higher factor mobility (of both capital and labor) offers potential benefits, permitting more efficient resource allocation. In this sense, a greater choice of employment opportunities, both at home and abroad, available to Moldova's workers is welcome. Moldova's problem today, however, is that much of the impetus toward migration stems from the lack of opportunities at home.

Appropriate macroeconomic policies are important, but will be effective only if underlying *structural weaknesses* are addressed. To limit and possibly reverse the upward emigration trend and the increasing dependence on workers' remittances, establishing a good business environment is crucial. It would both attract foreign capital and help channel the pool of savings from remittances into productive investment in the domestic economy. Domestic policy cannot influence the "pull" factor of labor migration (higher wages abroad). However, it needs to work harder to remove the "push" factors (poor investment climate and related lack of suitable employment opportunities at home). That way it can enhance the chances that labor and capital will link up in Moldova and that the benefits from remittances to Moldova will be realized more fully.

Fiscal policy faces both short-term and long-term implications from emigration and remittances. In the short run, the key challenge is to safeguard macroeconomic stability and resist procyclical spending temptations in the face of surging tax revenues. Over the longer term, considerations of fiscal sustainability become critical, as the government grapples with shifts in the demographic structure through the reduction of its economically active population. Initially, social spending pressures are attenuated as a result of reduced unemployment and improvement in household incomes from higher wages and transfers from abroad. At the same time, the composition of tax revenue changes, with indirect taxes (e.g., value-added tax (VAT) on imports) increasing their share at the expense of business and personal income taxes. The pension system, designed as "pay-as-you-go" (PAYG), with contributions from the current generation of workers financing retirement benefits of current retirees, is coming under pressure, as the exodus of workers reduces the base on which the contributions are levied.

Monetary policy has a key role to play in creating a stable macroeconomic environment, but needs greater support from fiscal and structural policies to discharge its task effectively. At this point, a strategy to maintain a flexible exchange rate regime, paired with a clear focus on low inflation, as the overriding goal of monetary policy appears to be a reasonable monetary policy alternative. Going forward, maintaining and improving external competitiveness in Moldova are inextricably linked to the overriding policy challenge of accelerating economic development. In that sense, competitiveness needs to be viewed not only in terms of safeguarding external sustainability but also as Moldova's ability to build solid economic growth by attracting much-needed foreign direct investment.

The paper is organized as follows: Chapter 2 gives a brief overview of the fast-growing body of literature on remittances; Chapter 3 provides a microeconomic perspective on Moldova's labor migration, drawing on a recent household survey; Chapter 4 assesses macroeconomic consequences of labor migration and remittances in Moldova; Chapter 5 discusses policy implications; and Chapter 6 concludes. The Appendix presents selected economic indicators of the Moldovan economy.