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MIGRANT REMITTANCES AND THE FINANCIAL MARKET IN MOLDOVA

by **Cerstin Sander** cs_sander@yahoo.de, **Doina Nistor** DNistor@cca.globnet.md, **Andrei Bat**, **Viorica Petrov**, and **Victoria Seymour**

An opportunity to expand the economy

MIGRANT REMITTANCES ARE A GROWING FACTOR in the Moldovan economy. Anecdotal evidence suggests that rural households have surplus liquidity, most likely from remittances, which is kept in autarchic savings mechanisms. Primarily, these take the form of slow construction of secondary residences and money kept "under the mattress." If these resources could be mobilized through the development of more formal savings mechanisms, then remittances might play an important role in expanding economic activity in the country, especially in the rural communities that are home to many migrants.

This brief focuses on the financial infrastructure for remittances and the potential for attracting a greater share of these funds to savings and investments. It draws on a combination of secondary sources (studies, reports, and statistics) and primary data collected through individual interviews and focus groups. Conducted with people in financial institutions, the interviews had the goals of creating a picture of the financial sector's infrastructure and identifying the services available for remittance transfers and complementary financial activities. Carried out with those who send remittances and those who receive them, the focus groups provided qualitative and illustrative feedback on remittance-sending patterns and use.

The remittance market

Moldova's recent economic growth has been largely consumption-led and driven by remittances. Although the number of emigrants is difficult to assess with any certainty, approximately one million Moldovans, or roughly one-quarter of the population, are believed to be living abroad. Most of these are illegal immigrants who entered their host country with a tourist visa and then remained. Among nearly twenty countries to which Moldovans migrate for work, Russia, Italy and Portugal are the top three destinations.

While estimates for remittance inflows vary between US$400 million and $1 billion, the effect on the economy is significant. Among European countries, Moldova has the highest percentage of remittance receipts, amounting to between 25-30% of GDP. Among developing economies worldwide, Moldova ranked seventh in terms of receipts relative to GDP, according to 2001 World Bank statistics.

Remittances have become a major source of domestic financing in the Moldovan economy. The country's average economic growth rate of 6.7% over the last three years is largely consumption-led and driven primarily by migrant remittances. A drop in remittance levels would affect both growth rates and tax revenues, as the latter are heavily dependent on imports financed in large part through remittances.

Current levels of remittances are approximately equal to the level of donor support to the country, and they could soon exceed donor support if estimates of growth in remittances are correct. Moldovan emigration and concomitant remittance flows into the country grew rapidly after the fall of the Iron Curtain and especially after the Russian and regional economic crisis in 1998, which strongly affected Moldova.

While the World Bank anticipates a continuing large inflow of remittances, it estimates that the growth rates will be lower than in recent years. Nonetheless, continued growth trends in emigration and remittance inflows are conceivable based on the demand for labor in Western Europe and the encouragement of labor mobility shown by some sectors of the Moldovan government.

Indeed, government policy on emigration is changing in an effort to manage rather than prevent migration and to protect the Moldovan population abroad. The government is working to identify the number of citizens abroad and pinpoint their destinations. The objective of this and related initiatives is to link Moldovans to their home country, to encourage them ultimately to return home, and to realize the economic and investment opportunities that will follow.

Remittance infrastructure

Perhaps as much as half of the remittances flowing to Moldova reach there via informal channels, either carried in person or sent with friends or informal services, such as those offered by bus drivers or train conductors. People in the Commonwealth of Independent States show a great preference for informal transfers, with some 90% of emigrants using informal channels to send money home. Informal transfers are common in countries located close to Moldova and in countries where migrants lack sufficient legal status to use formal services. Informal transfers also are very common where the Moldovan migrant networks and communities are large and well connected, for instance in Russia and Italy.

A seemingly growing share of remittances, however, is sent using regulated services offered by banks and "express transfer services," as money transfer services are called in Moldova. Moldova has seen a rapid growth in available express transfer services, and the fees for sending money have dropped. In recent years, these services have become part of a network linked with key originating markets and now offer a considerable range of attractive and competitive services. At the time of the study, there existed 15 express systems, of which three—Western Union, MoneyGram and Anelik Money Transfers—accounted for approximately 80% of the market share.

These developments appear to have encouraged a growing number of migrants to send money using formal, regulated services. Accordingly, remittances sent through bank services nearly doubled from US$232.6 million in 2001 to a projected US$401.5 million in 2004. Advantages in using banks and specialized financial systems include added security. Disadvantages include the expense, the lack of choice of currency, and the fact that many Moldovans either do not know how to use bank services or fear that the banks could go bankrupt.

Currently, only regulated banks are licensed to provide money transfer services. Non-bank and non-financial service providers, such as can be found in other countries, are not yet active in Moldova. According to the National Bank of Moldova, extending licenses to firms other than banks has not been considered because no such firms have requested licenses. Though the service spectrum is restricted to banks with their limited branch network (complemented to some extent by post offices in the district centers), feedback from our focus groups indicates that remittance recipients do not perceive this as a constraint. On the contrary, they tend to prefer receiving the money away from their location of residence so as to keep the receipt of funds more confidential. This is significantly different from the situation in other countries, where efforts often include bringing the services into the recipient communities to reduce transactions costs and to facilitate the use of financial services more generally.

Remittance use

In Moldova, receiving remittances via formal channels has become easier and more attractive. However, to a large extent, remittances are fully withdrawn in cash. As remittances are first and foremost family support payments, a high portion (nearly half) of the funds finance daily needs. The portion invested—typically in cars, housing, or land—accounts for approximately 20% of remittances. Another 20% are saved, though only about 10% of these funds are saved with banks. This profile of use is partly a function of the desire of remittance recipients to cover daily expenses and satisfy priorities. In part, though, it is also a function of an underdeveloped financial infrastructure for savings and lending and a regulatory environment that is not very conducive to people investing and saving remittances.

As mentioned, the typical recipient is one who prefers to fully withdraw the remittance in cash instead of managing the money through the use of a bank account, which might include putting money into savings. Moldovan banks have not been active in convincing those who receive remittances to open savings accounts or build assets through financial investments or loans. Nonetheless, remittances have had an effect on savings levels in Moldova. Deposit volumes in the banking system have recorded a steady annual increase of 20%, on average, during recent years. Annual deposits rose from some 2 billion *lei* (approximately US$165 million) in 2000 to an average of over 4.5 billion *lei* (US$367 million) in the first three quarters of 2004. Indications are that deposits continued to grow throughout the first half of 2005, with commercial banks accumulating deposits worth 2.4 times more than during the same period of 2004.

In part, the increase in deposits can be ascribed to larger remittance inflows. Commercial bankers believe that the main reason behind the growth of deposits, however, is a rekindled trust in commercial banks that was seriously affected by the collapse of the financial system in the early 1990s and the Russian crisis in 1998, which caused a devaluation of the local currency. Our findings suggest that more remittance savings could be attracted by the banks, as only about 10% of remittance receipts are saved with banks, whereas a roughly equivalent amount is saved "under the mattress." A deposit insurance scheme was instituted by the government in 2004, financed by contributions from commercial banks, which are required to transfer approximately 7% of their deposits into the National Deposit Guarantee Fund. The fund ensures a guarantee worth 4,500 *lei* (US$367) for each deposit. At this early stage, however, the compensation procedure and size of guarantee are not well known and have not had an impact on people's willingness to deposit.

Deposits are predominantly short term. Deposits of more than 12 months constitute a very small share (7-8%) of overall deposits. The longest term offered is 3.5 years, though such products are not available at all banks. A quick survey of the banking sector showed that only five of fifteen banks offer deposits for three-year terms. Long-term deposits are a relatively new product in Moldova and were launched only a few years ago by the larger banks. Many commercial banks hesitate to enter this market niche. The reasoning seems to be that term deposits are not always attractive to savers who may wish to have flexibility in accessing their funds at any time, especially for consumption.

To the extent that remittances are disposable income, Moldovans frequently use the money to buy used cars or invest in apartments, housing, or land. Though no direct supporting data are available, real estate appears to be a sector that absorbs a substantial portion of remittances. People use the accrued remittances to purchase housing, either from need or because they view real estate as a safe investment. The choice is typically for an urban apartment, particularly in Chisinau and neighboring areas, where there has been a housing boom in recent years. The housing is usually leased out until the migrant who sent the remittance (and has become the owner of the property) returns from work abroad.

Consequently, real estate investment has become a competitor to bank deposits. In Chisinau, for instance, the annual price increase for apartments exceeds the increase in deposit interest rates. Even though apparently now stabilizing, apartment prices in Chisinau have increased 20-25% per year since 2001, which is 5-10% higher than deposit interest rates over the same time.

Investment options such as T-bills, life insurance with accrual of funds (which may be regarded as a quasi-savings substitute), and securities are virtually unused. Investments in businesses are scarce; only about 7% of total remittances are reported to have been used as start-up capital or invested in current business activities.

BASIS Briefs

Cerstin Sander
Victoria Seymour
Bannock Consulting, United Kingdom

Doina Nistor
Viorica Petrov
Consulting and Credit in Agriculture, Moldova

Andrei Bat
AGREX, Moldova

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Comments encouraged:
Department of Agricultural and Applied Economics, University of Wisconsin, Madison, WI 53706 USA
basis-me@facstaff.wisc.edu
tel: +608-262-5538
fax: +608-262-4376
http://www.basis.wisc.edu

Integrating remittances into the financial system

The Moldovan economy could benefit if the country continues to attract a growing share of remittances into the formal financial system. Analysis indicates that further improvements to the available money transfer services and complementary financial services are possible. The study identified the following areas for improvement.

Transfer services. While Moldovan banks have become proactive about providing a wide spectrum of express transfer services, marketing of these services seems weak. Service improvements that take into account client needs, such as confidentiality, are important to attract a greater share of remittance transfers as well as to make savings an attractive option. Areas for attention include improving ease of partial withdrawal of remittances, refining money transfer services to better accommodate the client concerns of confidentiality, and increasing awareness of the availability of money transfer services.

Deposits. Remittances constitute a largely untapped market for deposits. As the research findings indicate, of the 20% of remittances flowing into savings, 45% are kept as cash in the household. This leaves an estimated US$90 million that could be mobilized for deposits, roughly equivalent to 30% of current total term deposits by individuals. Areas for further attention include building client relationships using the money transfer service as an entry point to attract clients, improving cross-selling of financial services, and offering attractive savings products, especially longer-term deposits.

Lending. Intermediation of remittance deposits as lending sources should be enhanced. Mobilizing longer-term deposits is a key to low-cost and longer-term lending in Moldova. Also, it is important to link remittances with business and personal loans. Currently, none of the commercial banks takes remittance flows into account when assessing a potential borrower. Remittances are viewed as a positive factor but not a decision-making factor, and they cannot be assessed along with salary or other recognized forms of income. Commercial banks lack a mechanism whereby remittances could be a formal part of the income assessment for a borrower and could contribute to building a client profile with the bank, similar to regular receipts of salary payments.

Policy and regulation. While some service and product adjustments are a matter of willingness, capacity, and finding solutions that make business sense for banks, other aspects hinge on the regulatory environment. Where new technologies are involved, a dialogue with and support by the regulatory authorities can be critical to avoiding obstructions or suspensions later on. Including remittances as part of income assessment in lending is also subject to changes in supervision. Areas for further attention include identifying regulatory impediments to financial service provision to remittance recipients, engaging in dialogue with the National Bank of Moldova as the regulator, and facilitating dialogue between this regulator and the financial industry.

Overall, such improvements would strengthen the integration of remittances into the financial system in Moldova. Some banks and regulators already are actively engaged in some of these improvements. Further market data and information on product offerings and technology adaptations in other markets could lead to more progress in this area.

Related reading

Sander, Cerstin, Doina Nistor, Andrei Bat, Viorica Petrov, and Victoria Seymour. 2005. "Migrant Remittances and the Financial Market in Moldova." BASIS CRSP. Madison: University of Wisconsin.

These websites offer additional information:

www.microlinks.org/ev_en.php?ID=5192_201&ID2=DO_TOPIC

www.livelihoods.org/hot_topics/migration/remittancesindex.html#3

www.sendmoneyhome.org/Contents/industry%20news.html