

INTERNATIONAL MIGRATION PAPERS

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Identification of potential for increasing employment and productive investment in Albania, Moldova and Ukraine based on remittances

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Foreword

The ILO's International Migration Programme publishes two working paper series (*International Migration Papers* and *Perspectives on Labour Migration*) with the goal of making quickly available to ILO tripartite social partners, and the general public, current research on global migration trends, conditions of employment of migrants, and the impact of State policies on migration and the treatment of migrants. Their main objective is to contribute to an informed debate on how best to manage labour migration, taking into account the shared concerns of countries of origin and employment for generating full and productive employment of their nationals, while at the same time respecting the basic rights of individual migrant workers and members of their families.

Almost fifteen years after the collapse of communism, countries such as Albania, Moldova and Ukraine still lag far behind most of the European continent and rank among the poorest countries in Europe. These countries have not been able to integrate promptly in the European economic space and have been left out from international investment flows. Their economies, although recently benefiting from a moderate expansion, are still struggling with poor growth rates and fast emigration of the population. Migration routes and networks have emerged and a significant proportion of the labour force of these economies is now working abroad. Quite often, this emigration is conducted irregularly and migrants find themselves, irrespective of their education and work experience, in low-skilled jobs in agriculture, personal services and retail trade.

The present report attempts to assess the potential for increasing employment and productive investment based on remittances in Albania, Moldova and Ukraine. It has the objective of identifying strategic sectors and skill needs of domestic enterprises. At the same time, it presents some policy measures designed to attract remittances from Albanian, Moldovan and Ukrainian migrants and utilise them as productively as possible.

The paper provides a short background of the recent political, economic and social developments in each of the three countries. It then carries out an analysis of the situation in terms of the labour market and the current drawbacks for the favourable development of domestic businesses. Finally, the paper concentrates in identifying strategic sectors of the economy with potential for job creation and attracting productive investments from remittances in the three study countries.

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1. Introduction

The collapse of communism at the beginning of the 1990s came as a surprise to the international community and, very often, even to the nations directly involved. With their economic and political system completely disrupted, these countries entered into a difficult transformation that extends even to the present. However, the transition process has advanced very heterogeneously among them. Some states rapidly rebuilt their institutions and integrated into the global markets (notably, the Baltic countries and most of Central Europe, which are now members of the European Union); some other faced a severe deterioration of income, social security and stability, and they are still struggling to find a niche in the world economy.

Probably the most negatively affected economies were those in South-Eastern Europe and the former Soviet republics (with the exception of the three in the Baltic Sea). For them, the transition to democratic, market-driven nations has become an arduous process plagued by political instability, sharp economic recession and social discontent. The consequences of this situation emerged alarmingly in the social sphere: deterioration of education and health, falling household income, and growing inequality.

Some of the most distressed economies include Albania, Moldova and Ukraine. These countries, affected by decades of inefficient production methods and low investment, were not able to integrate promptly in the European economic space and were left out of most of the international investment flows. Their economies, although recently benefiting from a moderate expansion, still lag behind most of the continent. In fact, they rank among the poorest countries in Europe.

One of the most significant consequences of poor growth for these three countries is the emigration of its labour force. A variety of push and pull factors (such as political instability, lack of employment, significant wage differences with neighbouring nations, established communities of nationals abroad and many others) have motivated the population to travel to other countries to look for an employment. Most of the times, this is conducted irregularly and migrants find themselves, irrespective of their education and work experience, in low-skilled jobs in agriculture, personal services and retail trade. Migration routes and networks have emerged and a significant proportion of the labour force of these economies is now working abroad.

Although there are some positive aspects to this phenomenon, like the delayed pressure for the demand of social services and the inflow of remittances, there is also a worrying negative side. One of the most distressing developments is the trafficking of human beings carried out through these countries. This problem particularly affects women and children. Individuals are engaged by false promises and misleading stories; then, they are trafficked into Russia, the Balkans, Central Europe, the European Union or the Middle East, especially for purpose of prostitution and pornography.

This situation has attracted the attention of the international community, particularly of those institutions directly engaged in migration and human rights issues. The project "Employment, vocational training opportunities and national policy measures to prevent and reduce trafficking in women in Albania, Moldova and Ukraine", executed by the International Labour Organization (ILO), directly studies this topic in these three transition economies.

The present report attempts to assess the labour markets in the three nations in terms of its current trends, with the objective of identifying strategic sectors and skill needs of the domestic enterprises; as a connected issue, it presents some policy measures designed to attract remittances from Albanian, Moldovan and Ukrainian migrants and employ them as productively as possible. This study will be employed as part of the preparatory work for the implementation of the above-mentioned project.

The report will be structured in three parallel chapters covering each individual nation. Each one will include a short background of the recent political, economic and social developments in the country. Then, an analysis of the situation in terms of the labour market and the current drawbacks for the favourable development of domestic businesses will be introduced. Following, a section will concentrate on the strategic sectors of the economy with potential for development and their specific skill requirements. Finally, a subchapter devoted to emigration and the issue of remittances from citizens working abroad will be presented. After the three chapters for each country, a final one will briefly present the main conclusions of the report.

2. Albania

The transition from an isolated, centrally planned economy to an open, market-driven one has proven to be very costly for Albania. Since the collapse of communism, the country has experienced severe structural imbalances and has been afflicted with political and economic insecurity. These factors, aggravated by the recent conflicts in the neighbouring region, have left Albania as one of the poorest and less stable nations in Europe.

The structure, orientation and geographical distribution of the entire economic apparatus are changing. In terms of the labour market, the transition period has brought an intense transformation. The privatization of the economy uncovered the redundancies and rigidities that existed in the state sector; this resulted in massive lay-offs, high unemployment, unequal wages, rapid emergence of vulnerable groups, as well as internal and external migration.

Rural-to-urban migration has been on the rise during the past years. Although its consequences are important in terms of social and economic imbalances, much of the attention has centred on external migration. Albania is a country of both origin and transit of migration flows into Western Europe. It is estimated that over 500 000 Albanians emigrated only from 1990 to 1997.¹ More recent figures suggest that, by the beginning of this decade, there were around 800 000 Albanians living abroad.² Since this figure represents a considerable proportion of the population, emigration has become one of the main concerns during the transition.

Women emigrants are generally more vulnerable than men. A high proportion of Albanian women abroad end up with a low-skilled job in the informal market, without any type of health or social security. More worrying is the problem of women trafficking that originates in the country. For example, according to the International Organization for Migration (IOM), there

1 Council of the European Union, High Level Working Group on Asylum and Migration. 2000. *Draft action plan for Albania and the neighbouring region* at <http://www.poptel.org.uk/statewatch/semDOC> [16 Feb. 2004], p. 12.

2 European Training Foundation (ETF). *Albania country profile* at <http://www.etf.eu.int> [24 Feb. 2004].

were 3 600 cases of trafficking in Albanian women in Italy only during 1996.³ This is a major human rights problem for the international community.

2.1 Background

2.1.1. Political scenery

After the breakdown of communism in 1991, Albania turned into a parliamentary democracy. However, constant protests of electoral fraud, a divisive political scene and internal power struggles in the ruling party have left the country in an unstable political position. Weak institutions, an underdeveloped civil society, suspected corruption and conflicts in the neighbouring region (especially in Kosovo) have aggravated the situation.

This has diminished the confidence in the success of the transition, with negative consequences both inside and outside of the economy. In fact, one important reason for many Albanians to emigrate is allegedly the civil unrest under the political circumstances in the country. With the aid of European and other international efforts, the government has elaborated and started to follow a strategy with the capacity to substantially improve the political panorama.

To show his dedication to long-lasting political stability, Albania has also undertaken a set of commitments with the international community. Recently, it started the process of application for membership of the European Union (EU) through the negotiation of a Stabilization and Association Agreement. Additionally, the government signed the US-Adriatic Membership Charter with the United States, Macedonia and Croatia. This is an important step in Albania's intention to join the NATO.

2.1.2. Macroeconomic developments

Albania emerged from communism as an economy weakened by years of isolation and very low levels of investment. As a result, the country embarked on the transition process as one of the least developed economies in Europe. Still now, after more than a decade of almost continuous growth, Albania remains one of the poorest nations in the region.

Figure 1 depicts the growth of real Gross Domestic Product (GDP). After the turbulent transitional years of 1991 and 1992, the Albanian economy expanded at impressive rates. With the exception of 1997, when the collapse of the pyramid investment schemes caused a strong contraction, the country maintained a pace of growth of over 7% until 2000, albeit from a very low base. Expansion slowed down in 2001 and 2002 due to energy supply problems, adverse climate for agriculture, restrictive fiscal policy and global slowdown. The situation for 2003 did not show a recovery as substantial as anticipated: energy shortage persisted, planned privatizations were delayed and restrictive fiscal and monetary policy continued. Nonetheless, a rate of growth of 6% is still expected. The resolution of the mentioned problems, the achievement of structural reforms, the mounting confidence on the government's commitment to economic health and the resumption of growth in the EU could potentially reactivate the rapid rate of economic growth in Albania.

As Figure 2 shows, agriculture is the single largest sector in Albania. In 1991, it represented

³ Council of the European Union, High Level Working Group on Asylum and Migration, op. cit., p. 11.

42.5% of GDP. The industrial collapse that accompanied the fall of communism and the privatization of the collective farms had already raised this proportion to more than 55% by 1994. However, the high fragmentation of land, the numerous disputes over ownership, the lack of mechanization and the poor transportation and product marketing became obstacles for the efficiency of the primary sector. In fact, in spite of its large share in the economy, agriculture is unable to satisfy internal demand and many products, such as vegetables and tobacco, have to be imported.

Industry lost weight in the economy when the inefficient policies of industrialization followed under communism were dismantled. It contracted from almost 40% of GDP to just over 21% by 1995. But, as the structure of the economy changes, agriculture is slowly losing ground and industry is growing. This expansionist trend is mainly based in the construction sector. Increases in the demand for construction have originated in important infrastructure projects, house shortage and the emergence of many small and medium enterprises. This sector's output grew by 15% in 1999, 18% in 2000 and 14% in 2001.⁴ However, this rate is expected to slow down, as the market becomes saturated and the government tightens construction licenses in order to avoid further uncontrolled expansion of the cities.

On the other hand, mining has importantly decreased in the last decade. Although the country is rich in mineral resources, lack of investment, obsolete technology and unfavourable market conditions have led to the decline of the sector. Nowadays, most of the mining industry has been privatized. In addition, some foreign investors have become involved: Italian and Turkish companies now operate copper and chromium mines. Furthermore, some foreign oil companies have shown interest in developing the onshore potential of Albania in this energy resource.

Manufacture also contracted with the breakdown of the communist system, but it is now showing a modest recovery. This originates mainly in textiles and leather goods (where Albania works as subcontractor for European, especially Italian, investors due to its low labour costs and geographical proximity), as well as the food processing and metal products. The weight of manufacturing is expected to grow substantially in the short- and medium-term.

The services sector is still the smallest in the economy, responsible for less than 25% of GDP even by 2002. This reflects the low stage of progress of the Albanian economy. The financial sector is very underdeveloped; small units dominate the retail sector; business services are only available in Tirana and a few other important cities; and tourism, although a branch with large potential, remains unexploited. Despite its current state, the services sector is expected to increase importantly in the future, as the modernization of the economy continues.

The main macroeconomic indicators have recently shown positive signs. After a temporary increase in prices caused by the financial crisis of 1997, inflation has been kept at low levels. This gave some room to the Bank of Albania to relax, though conservatively, its monetary policy. The reduction of inflation and the recent stabilization of the country also affected positively the interest rates. For example, in 2001 and 2002 the 3-month Treasury Bills carried a single-digit interest rate.⁵

4 Economist Intelligence Unit. 2004. *Country profile 2004: Albania* at <http://www.eiu.com> [17 Feb. 2004], p. 40.

5 *ibid.*, p. 53.

In terms of fiscal policy, Albania has kept in line with the indications of the international organizations regarding government spending. The public deficit has been decreasing constantly and in 2002 reached 6.3% of GDP.⁶ A series of recent measures to reduce evasion and augment tax collection, together with the planned privatizations, can help reduce the deficit and allow the government to continue its investment agenda. Total external debt stock has been kept at a manageable level; indeed, Albania bears one of the lowest levels of foreign debt of the transition economies in Europe.⁷

In terms of foreign trade, Albania started its transition at a very low base. This derived from the policy of autarky and self-sufficiency followed during its communist era. However, the government has started a series of measures directed to promote the trade liberalization of the economy. Some of the most important are trade agreements with other South-Eastern European countries, bilateral reduction of trade barriers with the European Union and joining the World Trade Organization (WTO).

The main exports of Albania have shifted from minerals (particularly chromium) to manufactured products. One of the main components of the current exporting industry is the “maquila”. Many Albanian firms operate as subcontractors for EU firms, importing raw materials and semi-finished goods and manufacturing them into finished products according to strict patterns from abroad. The country has an advantage in this method of production because of its low labour costs, relatively well-prepared manpower and geographical proximity. These production facilities have centred around light, labour-intensive industries (textiles and footwear) and in 2002 accounted for 66.6% of all exports, an increase of 9.2% with respect to the previous year.⁸ Other important exports are metal products and vegetables. The main destinations of Albanian exports in 2002 were Italy (72%), Greece (13%) and Germany (6%).⁹

The structure of imports has also changed considerably. Textiles are now very significant, but most of them are subsequently re-exported to the EU as finished products. Electricity imports have crucially increased in the past few years, to cover for the power shortage that affects the country. Following a relevant rising trend, machinery and equipment accounted for 16% of all imports in 2002, the largest single category.¹⁰ This reflects the need to upgrade the industry’s capital stock and reveals a potential increase in manufacture. The main sources of imports into Albania during this year were Italy (35%), Greece (26%), Turkey (6%) and Germany (5%).¹¹

Figure 3 describes the upward trend of both exports and imports since 1992. It can be seen that the rise in imports has been substantially stronger than the increase in exports. This has generated an important trade deficit, shown in Figure 4. Even though the graph may depict an explosive tendency for the deficit, in fact it has been stable since 1994 as a proportion of GDP (at around 20% of GDP, see Table 1). However, this is a chronic level that generates much risk for the economy.

6 *ibid.*, p. 52.

7 *ibid.*, p. 47.

8 International Trade Center (ITC). 2003. *Albania: National competitiveness issues, constraint and strategic implications* at <http://www.intracen.org> [3 March 2004], p. 2.

9 Economist Intelligence Unit, *op. cit.*, p. 57.

10 *ibid.*, p. 56.

11 *ibid.*, p. 57.

During the first few years of transition, the trade deficit was financed through transfers from abroad, which arrived as humanitarian aid. As these inflows faded out in the mid-90s, they were increasingly substituted by remittances from Albanians abroad. But even this source of funds started to diminish in relative terms as the consequence of a greater distrust in the economy after the collapse of the pyramid schemes that occurred in 1997 and a curbing down in the flow of emigrants. Besides, there is no indication of serious investment made out of this capital. It appears that remittances are more a matter of survival for the inhabitants of Albania than a source of development.¹²

Subsequently, it was the official transfers related to Western support during the Kosovo refugee crisis and the international aid for poverty reduction and the stabilization of the Albanian economy that helped finance the trade deficit. Nonetheless, these transfers have been insufficient to cover the growing deficit in the commercial balance; this has led the current account deficit to its 2002 level of 8.1% of GDP (see Table 1).

Foreign direct investment (FDI) has remained at very low levels throughout the transition period. Some of the factors that explain the unwillingness of international investors to enter the country are political instability, corruption, poor legal framework and underdeveloped infrastructure. Table 1 shows a peak of FDI at 4.6% of GDP reached during 2001, although the delays in major privatizations caused this indicator to decrease in 2002. However, if the political and business climate improves in the near future, Albania could receive large inflows of FDI, particularly in the sectors of tourism, financial and business services and manufacture.

2.1.3. Poverty and inequality

In terms of per-capita income, Albania remains one of the poorest economies in Europe. The GDP per head was calculated at 1 575 US dollars in 2002, placing the country in one of the lowest echelons among the transition economies. The Institute of Statistics (INSTAT) of Albania undertook a Living Standard Measurement Survey (LSMS) in 2002, the first of its kind in the country. The survey revealed that one-fourth of Albanians are poor (their income is less than the poverty line) and a little less than 5% of the population live under extreme poverty. In spite of these findings, income inequality is still moderate in Albania. The survey revealed a Gini coefficient of 28.0.¹³ This appears as a positive indicator, compared to other economies: 28.2 in Romania, 32.7 in Greece, 41.5 in Turkey and 48.7 in Russia.¹⁴

Although these figures do not look very alarming, the most important negative aspects came from the non-monetary dimensions of poverty. The survey revealed that access to infrastructure, basic services, adequate nutrition and education is very low in the rural areas and inconsistent in the cities. For example, more than half of the rural population does not have access to running water.¹⁵ These aspects are not included in the monetary dimension of poverty, but they are

12 Barjaba, K. 2000. "Contemporary patterns in Albanian migration", in *South-East Europe Review of Labour and Social Affairs*, Vol. 3, No. 2, p. 63.

13 Government of Albania and World Bank. 2001. *Growth and poverty reduction strategy: Progress report* at <http://www.seerecon.org> [3 March 2004], pp. A2-3.

14 International Labour Organization (ILO). 2002. *Key indicators of the labour market 2001-2002* (Geneva), pp. 712-713.

15 World Bank and Albanian Institute of Statistics. 2003. *Albania: Poverty during growth* at

equally important in evaluating the socio-economic situation in an economy.

The LSMS provided a profile of poverty, which concludes that:

- incidence of poverty is much higher in rural areas;
- poor individuals live in large and/or young families;
- there is a geographical character of poverty: the North and North-Eastern parts of the country are much poorer;
- the poor and extremely poor possess a low-coefficient of school registration, benefit less from health service and show more cases of child malnutrition;
- unemployment among the poor is twice as high as that of the non-poor.

Poverty and social problems overlap and strengthen each other, especially in the North-East and rural regions, where the highest indicators of social exclusion are found. Divorced women, single women and victims of prostitution form an important vulnerable group, which accounted for 5.16% of all women according to the survey. They are strongly located in the regions of Berat, Fier and Elbasan, as well as the poor areas in the North-East of the country.¹⁶

In accordance with the United Nations Millennium Development Goals¹⁷ and the Stabilization and Association Agreements with the EU, the government of Albania designed in 2001 a National Strategy for Socio-Economic Development (NSSED), which specifically targeted the main causes of poverty. The following are the general objectives of the strategy: (i) improvement of health and education services; (ii) improvement of infrastructure and vital services to the population; (iii) institutional reform; (iv) economic growth; (v) macroeconomic stability; and (vi) social support.

In order to materialize the strategy, the government has defined a set of quantitative, long-term objectives (for 2015) under the NSSED: a duplication of GDP per capita; a reduction by half of poverty and elimination of extreme poverty; a complete enrolment in basic education, a 90% enrolment rate in secondary education and not less than 13.5 expected years of education; and a diminution of more than half of the indicators of infant-natal mortality (currently, 17.5 per 1 000 births) and diarrheic diseases (at present, 1 400 cases per 100 000 inhabitants).

To achieve this, a set of socio-economic short- and mid-term strategies will be set in accordance with the international organizations. One of such mid-term plans is the Growth and Poverty Reduction Strategy (GRPS), a comprehensive economic development tactic that is implemented and revised every three years. Another one is the Medium-Term Budget Programme (MTBP), a document updated yearly by the government, in which the long-term NSSED objectives are gradually incorporated into the public budget.

2.1.4. Demographic issues

The INSTAT population census for 2001 indicates that there were 3 063 300 inhabitants in Albania, a slight contraction from the pre-communist years. Even though the birth rate is high,

<http://www.undp.org.al> [4 March 2004], p. 21.

¹⁶ Government of Albania and World Bank, op. cit., pp. D2-4.

¹⁷ Eradicate extreme poverty and hunger; achieve universal primary education; promote gender equality and empower women; reduce child mortality; improve maternal health; combat HIV/AIDS, malaria and other diseases; ensure environmental sustainability; and develop a global partnership for development.

albeit diminishing, this reduction was caused mostly by the elevated rate of emigration. However, projections point out that the downward trend has reversed and population is expected to increase in the following years.¹⁸

The distribution of the population is also changing. Figure 5 demonstrates that Albania started its transition as a rural economy, with 63% of its people in the countryside. However, a rural-to-urban migration has been triggered off. The population of the cities started to increase, already representing around 45% of inhabitants by the end of the decade. For instance, the population of Tirana rose from 240 000 in 1990 to 340 000 in 2001.¹⁹

The specific reasons for this internal migration are the variations in economic development and structural changes, imbalances in the labour market, regional employment rates (much higher in the cities) and differences in the educational level. The migration flows are mostly of young, low-skilled and low-educated people, who are less demanded by the labour market. These people integrate as vulnerable groups in the poorest areas of the main cities, generating a serious social problem in many places.²⁰ This trend of internal migration is expected to continue in the future, as Albania's structure changes from an agricultural to an industrial/tertiary economy.

Equally worrying is external migration, which boomed during the first years of transition. This outflow of Albanians was undertaken mainly for employment purposes, most of the times under irregular conditions. This issue will be studied at a later section of the report.

2.2. Situation of the labour market

2.2.1. Employment and unemployment trends

The most relevant effect of transition on the Albanian labour market has undoubtedly been an important reduction in employment. As part of the initial packet of economic reforms that started in 1991, the government embarked on a widespread closure, restructuring and privatization of its enterprises. Many state firms disappeared, others were reformed and the ones that were successfully privatized had to be restructured in order to achieve market profitability. These changes uncovered the high level of redundancies and rigidities that existed in the public sector in terms of human resources.

The employment losses were transferred to either formal economic inactivity or unemployment. In the first case, people that found themselves without a job stepped out of the formal labour market. They became economically inactive (the case for many women), returned to education (the case for many young workers), started producing exclusively for self-consumption (the case for many agricultural workers) or enrolled in activities in the informal economy. In the second case, they became part of the unemployed, with or without benefits, actively looking for a job.

Figure 6 depicts these developments. Employment sharply fell in 1992 and, from 1994 afterwards, it has kept a downward trend. Formal employment was equal to 1.4 million persons

18 Institute of Statistics, Republic of Albania. 2003. *Social Indicators* at <http://www.instat.gov.al> [27 Feb. 2004].

19 Economist Intelligence Unit, op. cit., p. 36.

20 Zareva, I. 2003. "Access to employment in South-East Europe: A review of the major regional problems of labour supply and demand", in *South-East Europe Review of Labour and Social Affairs*, Vol. 6, No. 1/2, p. 89.

in 1991, while in 2002 it had descended to 920 thousand persons, a fall of almost 35%. Closely following the behaviour of employment, both the formal inactivity rate and the unemployment rate increased. However, unemployment stabilized after 1998, with a slight downward tendency, while inactivity continued on the rise. In 2002, 38% of the working age population was economically inactive in the formal market, a rise of more than 18 percentage points since 1991.

The unemployment rate augmented to 22% in 1993. However, after the initial shock, the unemployed adapted themselves to the new conditions of the labour market through taking different kinds of occupations, self-employment, inactivity or emigration. For these reasons, the rate decreased in the period 1993-96. However, the financial crisis in 1997 led many firms to reduce their activities or even disappear from the market. Also, many “inactive” workers that participated in the informal economy lost their savings or could not sustain themselves during the recession; a lot of them had no choice but to come forward and register as unemployed. This naturally increased the unemployment rate. Starting in 1999, the tendency reverted and registered unemployment started to diminish. This was the result of the recovery of the Albanian economy and the beginning of a new, active role of the government in the labour market.

A worrying situation on the labour market in Albania is the long-term nature of its unemployment. In 1993, long-term unemployed constituted 65% of all unemployed. The proportion augmented almost constantly and in 2002 reached 93%. This is a troubling characteristic of the labour market in the country, because it reveals that there are groups of people with labour “weaknesses” who have minimal chances of obtaining an employment.

All these recent events of the labour market have not been equally distributed between everyone. As was mentioned before, some groups were quickly driven out of employment. They presented some disadvantages, possessed only a limited amount of “human capital” and were thus dismissed by the enterprises, or were simply discriminated against.

This was frequently the case of women. Figure 7 shows the differences in the unemployment rate by gender. During the whole transition period, women have been afflicted by a higher rate than men. Moreover, their gap has been expanding since 1996. Although the disparity in the unemployment rate between genders in 1993 was only 2.9 points, it widened to 5.5 points in 2002.

Even if this difference, though important, is not alarming, there are other indicators that better describe the extent of the discrimination. Figure 8 describes the economically active population, separated by gender. Although both the male and female labour forces have decreased, they have not done so evenly. While women formed 47.5% of the total labour force in 1992, ten years later the proportion had reduced to only 38.8%.

Therefore, under the circumstances of the reduction in employment, women had importantly left the formal labour force. There are some essential reasons behind this: many women can choose whether or not to participate in the labour market, compared to their male counterparts; there exists a gender difference in the age of retirement (55 for women, 60 for men); and, female workers form a discriminated group in the labour market.

Another characteristic of the labour market is its changing age structure. In the situation of

shrinking employment, many young people became economically inactive. They reincorporated into the educational system, obtained a job in the growing informal market or emigrated. In 1993, at the early period of economic reforms, people between 15 and 19 years old comprised almost 15% of all unemployment; by 2002, this proportion halved to 7.8%. However, even if unaccounted by traditional labour market measures, these young people constitute a large and volatile group with a high migration potential. On the other hand, the unemployed aged 35 and over augmented from 36% to 47% of total unemployment in the period 1993-2002.

In terms of educational attainment, the configuration of unemployment has not been extensively affected by transition. During all this period, persons with only basic education (up to eight years of school) composed about half of unemployment. Those with secondary education formed another half of total unemployment, while unemployed with a university degree were residual. The unemployed with a low degree of education compose a vulnerable group, because their lack of skills and/or qualification makes more difficult the task of finding a job and, frequently, they end up as part of the statistics of long-term unemployment. As of 1999, 15.8% of formal employment was occupied by workers with complete or incomplete primary education; 49.4% by persons with completed secondary education (either general or vocational); and the remaining 34.8% by university graduates.²¹

One aspect of the labour market that evidently is changing is its sectorial composition. Before 1990, there was no private sector in Albania. Nowadays, 80% of employment is found in private businesses. This impressive evolution was caused by the rapid privatization of agriculture and a fast-growing non-agricultural sector. Figure 9 illustrates this adaptation of employment to the market economy.

Employment by economic activity has also evolved considerably. As Figure 10 shows, in 1994 two-thirds of employment was in the primary sector. The industrial sector (mining, manufacturing, construction and electricity and water) was responsible for only 11% of total employment. The remaining 22% of workers were part of the tertiary sector. In the following years, the economic reforms progressed and, by 2002, employment was structurally different (see Figure 11). In this year, agriculture and other primary activities accounted for 58% of total employment, while industrial activities augmented its share to 14%. Meanwhile, commerce and services also increased its proportion to 28%.

In industry, the important expansion of construction outgrew the contraction of mining and manufacturing employment. In the tertiary sector, the subsectors responsible for the increase in employment participation were trade, hotels and restaurants, and transportation and communication services. Even though the composition of the Albanian labour market is changing, as these figures explain, it remains economically immature. While agriculture even now generates the majority of formal employment, manufacturing is responsible for only 5%. As the modernization of the economy continues, there will be a tendency for an expansion in industrial/services employment and a parallel reduction in the agricultural sector.

Now that the private sector is dominant in Albania, it is sensible to describe the distribution of employment according to the size of enterprises. Approximately 80% of all employment was

21 European Training Foundation (ETF). 2002. *Key indicators on vocational education and training: Central and Eastern Europe* (Luxembourg, Office for Official Publications of the European Community), p. 61.

either self-employment or part of micro-enterprises of up to two employees; 18% of the jobs were found in small and medium firms of up to 49 employees; finally, only 2% of employment was generated by large enterprises of 50 or more employees.²² This demonstrates that the vast majority of employment in the country is created by small or medium enterprises. Consequently, labour policy should be concentrated in this segment of private businesses.

At present, there are no official statistics on the geographical distribution of employment in the country. However, since half of the private enterprises are located in central Albania (especially in the regions of Durres, Tirana and Elbasan), it is expected that employment is concentrated accordingly. The Ministry of Labour and Social Affairs (2003, p. 11) ascertains that the unemployment rate in the cities of Durres, Fier, Gjirokaster, Tirana and Vlore (all belonging to the prosperous central and southern regions of the country) is lower than the national average. On the other hand, North and North-Eastern Albania (particularly in Lezhe, Kukes, Mirdite, Puke, Tropoje and Shkoder) have significantly higher unemployment. The most important causes of this unequal regional distribution are the restricted possibilities of development of the North and North-East, the low stage of advancement of businesses in that area, the tendency of enterprises to move to big cities, and the social problems that emerged after the implementation of land distribution.

Hence, the collapse of employment has become one of the most negative developments of the economy during transition. But this problem is not equally distributed: there are significant differences in terms of gender, age, economic activity, size of establishment and geographical region. These aspects of the market need to be taken into account when designing labour market policies for Albania.

2.2.2. Labour market characteristics

According to the recent employment trends mentioned in the previous section, the labour market in Albania distinguishes itself by its mismatches. The changes in labour demand have occurred faster than the capacity of adaptation of labour supply, with a resulting disequilibrium in the market.

The main feature of labour demand in Albania is its continuous decline. As it was indicated earlier, the economic reforms that were introduced after the fall of communism revealed the inefficiencies of a multitude of state firms. As a result, much of the sources of employment had to be restructured or eliminated. This caused an important reduction of the manpower demanded internally, with a consequent fall of employment.

Another characteristic of labour demand is the alteration of its structure. During communism, mining and manufacturing were highly supported by the government. Throughout transition, many of the firms in this sector reduced or stopped their production: labour demand for manpower with these industrial skills decreased importantly. On the other hand, the market economy brought in a boom in the construction industry and services, such as trade, transportation and communication, and hotels and restaurants. Consequently, the demand for labour with skills relevant for these sectors augmented. Although labour demand has not started to recover, the reversion of its downward tendency is expected soon. When this happens, the

²² European Training Foundation (ETF). *Albania country profile* at <http://www.etf.eu.int> [24 Feb. 2004].

demand for human resources will concentrate in the industrial and tertiary sectors.

As of labour supply, it has been characterized by its slow deterioration as a consequence of the negative developments in labour demand. Under the circumstances of scarcer jobs in the economy, many persons have left the registered labour force in order to migrate, participate in the informal economy or become economically inactive. Even with this reduction, labour supply still remains at a higher level than labour demand, as the elevated rate of unemployment demonstrates.

Also, labour supply has not been able to keep the pace of evolution of labour demand. Although changes in terms of skill needs of the enterprises take place almost instantaneously, the characteristics of the workers change gradually. Besides, as it would be shown later, vocational education and technical training has decreased dramatically, creating a lack of skilled manpower for the different sectors of the economy. This has translated into an important mismatch in the labour market, one that could be importantly reduced through education and training in the specific skills demanded by the current and forthcoming strategic sectors of the economy.

Another troubling development that has appeared recently in the country is labour flexibility. Temporary contracts, part-time employment, multiple-jobs holding and other manifestations of this have been on the rise. Although this situation has permitted a freer adaptation of the labour market, its negative social consequences are undeniable.

In spite of the negative performance of employment, wages in Albania have not shown a diminishing behaviour. As Figure 12 shows, the real monthly minimum wage has increased constantly since 1993, with the exception of 1997, the year when the pyramid schemes collapsed and the economy fell in recession. The real average monthly wages in the public sector have also shown a positive development. The evolution of real average monthly remunerations divided by economic sector in both public and private enterprises is presented in Figure 13. In this case, wages in all sectors have also followed a growing trend. Nonetheless, Albania still remains as one of the countries in Europe with lowest remuneration per capita. If the above-mentioned salaries are converted into US dollars, minimum monthly wage stood at 69.6 USD in 2002. The average monthly wage in budgetary institutions represented 145.7 USD that same year. This large difference in remunerations between Albania and Western Europe has been one of the main incentives for emigration.

The government of Albania has recently created some institutions in charge of coping with the disequilibrium of the labour market. The main organism is the Ministry of Labour and Social Affairs (MOLSA), created in 1992 and in charge of all labour issues at a national level. That same year, the World Bank instituted the Training, Enterprise and Employment Fund of Albania (TEEF). The next major step occurred in 1996, when the National Employment Service (NES) was established to replace the network of local labour offices. At the same time, the TEEF came to an end and all its experience was transferred to the NES through the Law on Employment Promotion. However, the role of these institutions remains limited due to some obstacles, like the absence of a national development and employment strategy (which just recently have started to take shape through the NSSD), the lack of widespread and consistent labour statistics and the centralization of the labour administration.

There are other organisms, both inside and outside of the government, also dedicated to the

improvement of the conditions of specific segments of the labour market. An example of one of such government institutions is the Local Economic Development Agencies (LEDAs), which coordinate the interaction between various public and private sectors at a regional level and promote the employment strategies at the local level. An example of a non-governmental organization (NGO) is “The Women’s Centre”, which coordinates the activities of the 64 women-related NGOs in Albania, contributes to the support of women entrepreneurs, undertakes studies of the conditions of the labour market for Albanian women and conducts training sessions.²³

2.2.3. Gender discrimination

When the market faced a severe contraction of labour demand at the beginning of transition, the strong tensions were resolved initially by pushing a part of the manpower out of employment. This was composed of those workers with a lower “human capital”, with a disadvantage that hindered their productivity or which suffered discrimination in the labour market. These groups then found it very hard to reincorporate into new jobs because the downturn on labour demand continued and the competition inside labour supply grew more intense. Therefore, they either abandoned the formal labour force or became part of the (long-term) unemployment rate. Many economically active Albanian women experienced this situation.

According to the official statistics, gender inequality in Albania is not related to the level of remunerations but to the access to the labour market. While in 1991, 75.7% of women in working age (15-54 years old) were part of the formal labour force, this proportion importantly reduced to only 49.1% by 2002. In other words, three-fourths of the working-age female population was economically active at the beginning of transition; nowadays, less than half of working-age women are incorporated into the formal labour force. As a point of comparison, this indicator reduced only from 84.6% to 74% during the same period for the working-age male population.

The LSMS provides another measure to assess the gender segregation in the labour market. According to this survey carried out in 2002, 44.6% of men declared to be working in a full-time job, while the same indicator for women stood at only 22.8%. Furthermore, gender has an additional wedge in educational attainments. This means that at equal economic status, adult males are better educated than their female counterparts.²⁴

The withdrawal of women from the labour market has been caused by a lower demand for female manpower. The explanation behind this is the higher costs of women (retirement age for women is five years lower than that of men, obligation to offer parental leave and others), their family status as second income earners and their lower level of education and training relative to men. But it also reflects the deteriorating access to affordable facilities (such as childcare) and a latent social discrimination.

The most worrying problem is the segment of divorced women, single mothers and isolated individuals. They have no choice but to enter the labour market and, in frequent occasions, they

23 Bezhani, M. 2001. *Women entrepreneurs in Albania*, SEED Working Paper No. 21 (Geneva, ILO), pp. 21-22.

24 World Bank and Albanian Institute of Statistics, op. cit., pp. 29-30

are victims of discrimination or exploitation. This situation makes them vulnerable to the network of prostitution and/or trafficking that persists in Albania.

2.2.4. Persistent problems in the labour market

The most immediate difficulty in this context is the lack of employment creation. The socio-economic transition, the insufficient level of domestic investment and the still-present image of instability that deters the inflow of foreign investment have not promoted the reactivation of labour demand. A continuation of economic growth, the achievement of the remaining reforms and a commitment to financial and political stability are some of the key factors that could encourage an improvement of the employment situation in the country.

Another obstacle is the limited role that the government has taken in the labour market. The public institutions in charge of this field are very young and have characterized by the lack of a mid- and long-term strategy. With the help of the international community, notably by the ILO, the government has started to implement a defined labour market policy, with the aim of determining the priority sectors, encouraging the performance of the domestic firms and coordinating all the agents that participate in the labour market. This could be an essential element in reducing unemployment and inactivity, fostering employment, promoting the return of emigrants and providing the enterprises with the national and regional conditions they require.

In this same line, it has been identified that the educational system still does not meet the new needs of the economy. Synchronization is essential for the improvement of the social condition of the population and the adequate functioning of the labour market.

Finally, as it has already been mentioned repeatedly, one of the most alarming aspects of the labour market is the appearance of discrimination against some groups. The consequences of this situation, in terms of economic inactivity and social exclusion, can have serious repercussions on the path towards development of the country.

2.3. Difficulties for the propitious development of domestic enterprises

The development of private businesses in Albania has occurred at an impressively fast pace. In 1990, still during communism, there was almost no private sector in the country. A swift privatization followed and only three years later, in 1993, there were already 25 830 private enterprises. This figure continued to increase formidably and the next year the number of businesses reached 45 306. From 1995 afterwards, the number of firms stabilized between 55 000 and 60 000.

Figure 14 presents the sectorial composition of the 56 453 enterprises that existed during 1998, the last year with a complete census of business data (calculated by INSTAT with tax records). According to this information, 85% of businesses belonged to the tertiary sector (commerce and services). The rest of them were divided between industry (manufacture and construction) with 13% and agriculture with only 2%. This contrasts importantly with the proportion of these sectors in GDP, which is exactly in the reverse order.

In terms of the establishment size, 78.8% of enterprises were self-employed, while 19.2% had between two and ten employees and only 2% hired more than ten persons. Thus, the vast

majority of businesses in Albania belong to the category of small and medium enterprises (SMEs). In another consideration, the regional distribution of the establishments was very unequal. 46.6% of all businesses were concentrated in the prosperous central corridor of Durrës-Tirana-Elbasan; on the other hand, North and North-Eastern Albania (Diber, Has, Kukes, Lezhe, Malesi e madhe, Mirdite, Puke, Shkoder and Tropoje) accounted for only 12% of enterprises. Approximately 85% of firms were located in cities, while the rest were found in rural areas.²⁵

In Albania, entrepreneurship seems to be a male-designated activity. The proportion of private businesses owned or managed by women descended from 20.8% of the total in 1994 to 16.8% in 1996. In 1998, there were 9 902 establishments run by women, 17.5% of the total. The sectorial distribution of female-managed enterprises during this year is depicted in Figure 15. In this case, the proportion of transportation services, construction and agricultural activities is lower than in the previous graph. Instead, the main three categories of women's businesses were trade (wholesale and retail), general services (dentists, dispensing chemists, lawyers, public notaries, hairdressers, etc.) and industry-agrobusiness (processing of milk, publishing houses, textiles, dressmaking and craftwork).²⁶

Following with the size distribution, 84.6% of all establishments run by women were self-employed; 14.6% engaged between two and ten workers and only 0.7% had more than 10 employees.²⁷ So, SMEs is the dominant form of entrepreneurship among women, even more than in male-run businesses.

However, this rapid privatization of the economy did not mean that the optimal conditions for the development of private sector were present. On the contrary, the rapid liberalization of the interior markets and the assignation of a multitude of state enterprises to private owners occurred in circumstances of economic transition, instability, weak civil society, insufficient legal framework and other negative factors.

From the experiences of privatization and the opening of new businesses, the following negative factors for the development of the private initiative have been identified. Although this list may seem imposing, the government, with the aid of the international community, has already solved many difficulties and is currently tackling many others.

- Lack of credit. Financial services, in particular the banking system, still operate at a reduced scale. The probability of a SME to obtain a bank loan is low and then it is regularly denominated in a foreign currency. According to the results of a survey among Albanian businesses, 17.5% of new investments were financed by remittances, 29.8% from personal saving, 21.1% from family loans and the remaining 31.6% from other sources (including bank loans).²⁸ Many of the owners of firms have limited financial resources and their access to credit remains limited; this frequently hampers investment and business growth.
- Low labour productivity. Enterprises who hire workers usually find out that their level of qualification is low. This is a result of insufficient training and/or experience. In many

25 Bezhani, op. cit., p. 8.

26 *ibid.*, p. 5.

27 *ibid.*, p. 8.

28 Çuka, E. 2003. "Labor market developments in Albania: An analytical overview", in *Review of Development Economics*, Vol. 7, No. 2, p. 224.

occasions, employees possess skills, but they are obsolete or inadequate for the tasks assigned.

- Low capital productivity. Businesses often have to rely on deficient machinery, inadequate equipment and obsolete technology.
- Low managerial capabilities. Many entrepreneurs lack a business culture adapted to a modern, market-driven economy. The economical and technological environment is changing too rapidly and a high proportion of them are lagging behind. The new changes impose different business strategies and new techniques of production and marketing, which they are not always capable of implementing.
- Low product marketing. Quality, especially in manufactured products, can be very low. Besides, the products are frequently accompanied of poor packaging and inadequate distribution. These factors deter the success of many firms.
- Restrictive bureaucracy. Administrative regulations and the numerous certificates demanded by the governmental agencies are often excessive and confusing. A long time lapse is needed to set up a business because of the numerous requirements needed.
- Unfavourable tax laws. Not only are taxes considered high, but they also come in complicated schemes and its legislation continuously changes.
- Deficient public infrastructure. This causes a limitation, particularly in transportation, communications and basic services.
- Lack of sources of business information and limited access to information on modern technologies, expanding markets and possibilities of exports.
- Political and economic instability. The uncertainty about the political scene and the continuation of a healthy economic performance are major deterrents of new investments, both domestic and foreign.
- Low capability of responding to changing conditions in the business environment and the competition.
- Limited domestic markets for some products or services and lack of enough competitiveness to export them.
- Regional imbalances. Limited capabilities of business development in the poorest regions and high concentration in the capital and central Albania.
- Other problems (difficulty of internal mobility, soaring criminality, insufficient social infrastructure, etc.)

With the establishment of a long-term national strategy on socio-economic development, many actions will start to take shape to diminish many of the enlisted difficulties. The deepening of structural reforms is expected to improve the business climate through a sounder banking and financial sector, increases on FDI, better education and training of human resources, long-lasting stability and export promotion.

The major challenge will be to improve the long-term international competitiveness of private enterprises, which will be reflected in the ability to increase productivity and better respond to the changing domestic and external environment. The government and the collaborating agencies should coordinate their work in order to encourage the advances specifically directed to the SMEs operating in the priority sectors of the economy and with the objective of reaching a balance in all the regions of the territory.

2.4. Priority sectors with development potential

2.4.1. Primary sector

Although the primary sector will probably start to lose its relative weight in the economy, this does not mean that it will shrink; it is only its proportion of total GDP that will likely show a downward trend. There are still many strategic areas that can substantially improve the performance of this economic activity and expand its output. Furthermore, as the remaining disputes become settled through reforms in land distribution, resources will be used more effectively.

Albania is a country rich in natural resources and its climate conditions are very propitious for the development of the sector. This potential should be considered as an important component of the strategies for the development of the economy. Besides, positive development in this sector will direct and indirectly benefit the inhabitants of rural areas who, as was portrayed before, are more stricken by poverty and social exclusion than those in the cities.

The main area of current and future development in this sector is the cultivation of fruits and vegetables. This already forms one of the most important export categories for the country and has the possibility to grow substantially. In the short-term, the backwardness of this sector could be used as an advantage, as the low use of pesticides and fertilisers could be marketed as organic foods, a growing trend in Western Europe. Also, its favourable weather could allow for early- and late-season farming of many agricultural products. One category where the country already has a good reputation and could become a strategic platform is that of medical plants and condiments. Other subsectors that have a capability of development are fresh fish, meat, wine and honey.

In order to support the growth of these potential areas of development in the primary sector, some conditions are required: improvement of the transport infrastructure, development of local and regional markets, information on export possibilities, provision of credit, subsidies for mechanization and technological improvement and availability of labour with the necessary skills.

Rural training centres could concentrate on operational courses related to agriculture, such as farming techniques, greenhouse use, adequate orchard cultivation, vineyard development, livestock farms operation, apiculture and fishing skills. In terms of managerial abilities, courses should be directed toward product packaging, internal and external marketing and foreign trade.

2.4.2. Industrial sector

As it was exposed in Chapter 2, the role of mining and manufacture after the fall of communism has remained limited. So far, the main source for growth in the sector has been the construction industry.

Although the restrictions for new residential and non-residential buildings are mounting, particularly in the biggest cities, the inertia of the construction sector is expected to continue for some time. After decades of very low levels of investment, there still exist shortages and a high demand for this industry. If the regional development strategies of the government start to take

effect, the curbing down of construction in the main cities will be transferred to the rest of the country. Additionally, the government will very likely continue its agenda of investment, which will also keep the demand for construction at a high level.

Since the prospects for this sector seem favourable or at least stable for the short- and medium-term, the development of its required skills is especially urgent. Some of the most important subjects for training are electrician competencies, carpentry, hydraulics, welding, waterworks and sanitary systems, production of building materials and heating/cooling systems.

One of the areas with the highest potential of growth is agroindustry. Since agriculture is still the largest sector of the economy, there is a wide range of possibilities to add value to farming products through industrial processes. Some of the areas with envisaged development are preserved and canned vegetable products (such as olives, olive oil, tomato paste and many others), cigarettes, processed fish and meat products and cheese and other milk products. The specific skill needs in this industry are processing of agricultural goods, products' hygiene, quality control, packaging, delivery of merchandises, marketing, trade techniques and export possibilities. A related subsector is that of wood and wood products, which guards a positive promise because of the natural resources of the country.

In terms of general manufacture, the current situation suggests that the tendency of subcontracting for the production of EU firms will continue. Up to now, most of the existing "maquilas" have centred on the garments, footwear and leather industries. Other possible areas of development for this type of production are related to light manufactures: assembling of electronic products, basic metal goods, etc. For these areas, the basic skills demanded include machinery operation, quality control, sewing, optimization of processes, industrial safety and logistics.

A special branch of manufacture that can be promoted particularly in rural areas is handicraft work. The creation of traditional or non-traditional crafts can be encouraged through training in embroidery, work with different materials (silver, iron, cooper, wood, wool, stone, marble and others), product packaging and marketing.

Finally, some strategic industrial sectors have recently been sold to private investors or are now in the process of being privatized, to either national or foreign hands. Although their performance during the centrally controlled economy was not very efficient, they are currently being transformed to meet the needs of a market economy. Because of this, they hold a prospect of development in the medium- and long-term. The most important are mining (chromium, natural gas, etc.) and electricity industries. The channelling of productive investments for the creation of jobs in these areas should be considered as a priority.

2.4.3. Services sector

Although it remains at a modest level, tourism has a substantial potential for growth. Favourable climate, low costs, recent tourist development in the Adriatic coast in the Balkans (in Croatia and Montenegro) and geographical proximity to Western Europe are some of the factors that make of Albania a potential tourist destination. The sector is already starting to grow, based principally on internal tourism and visits from Albanians that live abroad; provided that the political situation in the region remains stable, a flow of international visitors is expected in the medium-

and long-term. In preparation for this, some important professions have to be developed in the population: cook, waiter, restaurant and hotel manager, receptionist, travel agent, tourist guide, etc. All this requires the knowledge of at least one foreign language, as well as familiarity with the history and cultural tradition of the country.

Concerning the other subsectors of the tertiary economy, the boom in transportation and communication services is expected to continue as public infrastructure improves, the economy recovers and the lingering privatizations in the telecommunication business are finally completed. The trade sector is already very important in Albania, in terms of employment and number of business; it is expected to continue its positive tendency with the development of the national industry and the progress of trade liberalization. Some of the general skills required by these subsectors are logistics, product distribution, tax regulation for foreign trade, use of information technology, technical competencies with communication equipment, automotive service and many others.

2.5. Emigration from Albanians and their remittances

2.5.1. The emigration phenomenon

Albania continues to have the highest emigration flow in Europe and recent estimates calculate that 15% of its population lives abroad, most of them irregularly.²⁹ The country is also an important transit territory used by emigrants from other places. These issues are of extreme importance for the international community, because of the economic and social problem that they cause both inside and outside of Albania.

There are many reasons that motivate Albanians to leave their country. The most important are the following:

- economic causes (emigration is perceived as the only response to the country's economic situation, like low standards of living, income gap between Albania and the main destinations, poverty, high unemployment and others);
- civil unrest caused by political and social tensions; failure of the public authorities to enforce law and order and to protect human rights; easy border crossing and established transit networks;
- pull factors (large Albanian communities in some countries, media broadcasts and others).^{30, 31}
- the main destinations of migration are, in order of importance, Greece, Italy, Germany, United States and Canada.³²

Emigration was at its peak at the initial stage of transition, when the population was exposed to the rest of the world after years of isolation. Nowadays, however, it is losing momentum. The principal causes for this change in tendency are the limited capacity of absorption by Italy and

29 Barjaba, op. cit., p. 61.

30 Council of the European Union, High Level Working Group on Asylum and Migration, op. cit., pp. 13-14.

31 Haxhiymeri, E.. 2000. *Vocational education and training against social exclusion: Albania* (Turin, ETF), p. 7.

32 Barjaba, op. cit., pp. 58-59.

Greece (the two main destinations) and the increased anti-immigrant actions and attitudes in host countries.

2.5.2. The potential of money transfers from nationals working abroad

Although proportionally less than in past years, monetary transfers from Albanians abroad still represent an important source of income for the country. Most of them, however, are used for consumption and only a marginal portion is directed to productive investments. An important opportunity is therefore being missed.

Remittances have two main positive influences on the economy. First, as part of the balance of payments, they function as a sizeable inflow of foreign currency, which serves to partially counterbalance the growing trade deficit. Second, as a mounting source of income for the families, they act as an alleviation of poverty and contribute to consumption and personal savings. Despite their possible perverse effects (inflation, “artificial” support for the domestic currency, temporary mask hiding worsening external imbalances, income inequality and others), remittances can have a very positive influence for the Albanian economy. If used properly, they can become an important mine for the investment that the country so badly needs. Therefore, there is an urgent need to implement incentives to lure remittances into Albania through official channels, and then formulate policy measures to guide them into the productive sectors mentioned on the preceding section.

2.5.2.1. How to encourage remittance inflows by formal channels

An important requisite for the alluring of nationals’ income earned abroad is economic stability. Experience from other countries and from Albania itself shows that an uncertain macroeconomic panorama seriously deters inflow of remittances, because emigrants do not want to send their money if inflation is high or there is a risk of devaluation. Another essential requisite is an enforced, up-to-date legal framework that can protect and guarantee any investment realized in the country.

In order to increase official remittance flows, there are basically two measures available: mandatory remittance requirements and incentive schemes. The first one obliges migrants to send a pre-determined proportion of their income back to the country through the domestic banks; failure to comply would result, for example, in the refusal to renew the worker’s passport. This policy is clearly effective only when the government has a direct control over the process of labour migration. In the context of Albania, where most of the emigration is irregular and the authorities do not have control over it, this solution would be unrealistic. The second measure consists of designing investment tools specially designed to appeal to migrants; they usually consist of banking instruments with added benefits. This policy is easily implemented and can be very effective. Migrants send remittances not only for family support, but also for purposes of saving, and these schemes can be an effective way to attract them.

From the various incentives schemes that the authorities could apply, one of the most efficient is the repatriable foreign currency account in domestic banks. The incentive of this instrument is that it is not subject to existing foreign exchange regulations and, thus, eliminates all exchange risk: it can be maintained in a foreign currency, which in the case of Albania could be the USD

or euro. Sometimes, an additional premium over the world market interest rate is added, in order to further incentive the transfer of remittances. Additionally, the balance in such accounts is usually exempt from income and property taxes. An important disadvantage of this tool is that, by their nature, they mainly attract professional and high-skilled migrants who earn relatively higher income and who are in position to evaluate different investment opportunities and transfer their “investable” resources.

A similar implement is the foreign currency bond. It is very similar to the preceding instrument, only that, being a bond, it ensures the anonymity of the investment. Thus, it could be an effective way to deviate black money into the official channels; a premium interest rate can also work as an incentive. Another scheme is that of banking instruments that simply use premium exchange rates or favourable interest rates, and that are heavily publicized to promote transfers.

2.5.2.2. How to guide remittances into productive uses

Remittances are private transfers, so market forces by themselves cannot normally conduct them to their most productive use. For this reason, a series of appropriate measures are needed. Policy measures in this subject normally take the following shapes: procedures that allow migrants to import industrial material at favourable conditions, training and business guidance, programmes aimed at converting return migrants into entrepreneurs, education allocation savings, joint social investments migrants-local government, and others.

- (a) In order to foment the establishment and/or modernization of industrial units, an urgent aspect for the Albanian economy, the government can promote the import of the required machinery, equipment, instruments and raw materials at preferential rates. Migrants and their families can then use this opportunity and use their savings in setting up a modern productive business.
- (b) Programmes of business guidance intend to inform the returnees of the priority sectors of the economy or those business opportunities with potential of growth in the near future. In case it is needed, the programme also provides specific training so that the investor can acquire the necessary skills for the chosen activity. Normally, these schemes are complemented by supplementary loans, if they are required. Pooling of savings from several migrants to form a joint venture has proven to be an effective idea.
- (c) Programmes of entrepreneurship development are aimed at those migrants who already possess the idea of an investment in certain business and they only require to learn the essential managerial skills. In the same manners, these schemes are usually complemented by loans at favourable terms.
- (d) Instruments that convert the migrant’s savings into an insured educational opportunity for his/her family can also be developed. Since education can be considered as investment in human capital, this can be an alternative way to direct remittances to constructive uses.
- (e) Joint social investments between the migrants of a region and the local government can be established. In these cases, a cooperative of migrants identifies some essential need on their community of origin (building of social infrastructure, acquisition of equipment for clinics or schools and others). The local government evaluates the project; if it is approved, a certain proportion of the migrants’ contribution is assigned from the local budget as a complement for the investment (for example, two units for

each unit put in by the group of migrants).

All these incentives should opt for those productive investments with a greater value added (industry over retail trade, for instance), that rely mainly on locally available resources (raw materials, human resources, etc.), that fall on the strategic sectors mentioned in the previous chapter and that have the potential to generate employment or trigger a process of regional development.

2.6. Conclusions

Political and economic reform in Albania has not been as smooth as expected. Transition has been characterized by instability, growing poverty, social exclusion and massive emigration. Even now, more than twelve years after the fall of communism, there are some encumbering structural imbalances; socio-economic development has not yet commenced to follow a stable path.

The analysis presented on this report shows that, so far, transition has had a harmful effect on the labour market: collapse on employment, growth in economic inactivity and informal jobs, emergence of different forms of labour flexibility, unequal distribution (by gender, region and sector) and appearance of discrimination against women, young school-leavers and unskilled labour.

This study summarized some of the strategic areas in the economy where an important growth is underway or where a high potential of growth exists in the near future. They are located particularly in agriculture, agroindustry, construction, general manufacture, tourism and other services.

An adequate training system in these strategic sectors has the potential to substantially increase the productivity of manpower, with positive results in the labour market and the economy in general. In economies where some groups are discriminated because of their labour “disadvantages”, training is one of the most effective ways to increase their employability and reincorporate them into economic activity. This is particularly important in the situation of Albanian women.

Taking in consideration the gender distribution in the present-day labour market in Albania, construction, transportation and some manufactures are activities normally performed by men. As a consequence, training and formation focused on women would be primarily directed to agriculture, trade, tourism, handicraft work, some manufacturing and agroindustry, with the respective skills requirements of the strategic development areas.

Women who follow a training programme in some skills like those included in the report will importantly improve their employability in some of the most active sectors of the Albanian economy. In this way, training can be a successful method in bringing female workers back to the formal labour market, with a resulting improvement of their social status.

In addition, the significant proportion of Albanians working abroad can be considered an important asset, in terms of the monetary transfers they make to their families. An adequate set of incentives could attract more remittances into the country through formal channels; after that,

they could be lured into productive uses, particularly to create SMEs in the strategic sectors mentioned before. This could become one of the most effective ways to give a new strength to the economy, develop its long-term potential, relieve the labour market and improve the quality of life for all Albanians.

3. Moldova

Compared to the other ex-communist countries in Central and South-Eastern Europe, most of the republics that integrated the Soviet Union are experiencing a more severe transition. While the former were independent, self-governing nations during communism, the latter were part of a totalitarian political and economic system directed by Moscow. After the collapse of the USSR in 1991, these countries had to undertake the cardinal transformations required to create free, democratic and market-driven states, without any experience in leadership or self-determination.

The shock suffered by the individual republics following the break-up of the Soviet Union probably hurt Moldova most of all. This agrarian country inherited an economic structure poorly suited for a small, open nation governed by world prices. Despite of the success in macroeconomic stabilization, transition has brought about an impressive collapse of production and a rapid deterioration of the social condition of the population. This has led to an economy dependent on imported energy, dominated by the informal sector, relying on subsistence farming and barter transactions and with a deficient industrial infrastructure. Politically, the situation presents no comfort, as corruption is rampant and the de facto secession of separatist Transnistria remains unsolved. Under these disheartening circumstances, it has even been asked if Moldova is a viable country at all.³³

At present, the republic is struggling to build a national identity that encompasses Transnistrians, Moldovans, Gagauzians and its other minorities. Economically, Moldova settled as the poorest state in Europe and, currently, it is still searching for a niche in the world economy that would allow its enterprises to recuperate their markets, both external and domestic.

Many Moldovans have considered emigration as the only solution to their economic and political problems. Depending on the source, between one-tenth and one-fourth of the population has left the country to look for a job abroad, most of the times irregularly. This has led to the creation of networks of human trafficking in the region. As stated by the International Organization for Migration (IOM), Moldova is the main country of origin of children and women trafficked for purposes of prostitution in the Balkans, Western Europe and the Middle East; some estimates conclude that nearly two-thirds of all prostitutes in South-Eastern Europe come from Moldova.³⁴

3.1. Background

3.1.1. Political outlook

When Moldova obtained its independence from the USSR on August 27, 1991, its society was unacquainted with the basic concepts of democracy, state of law, private initiative or market economy. In fact, the republic lacked a statehood tradition and experience in leading an autonomous government. As a consequence, it entered the transitional stage completely

³³ "Can Moldova get worse?", in *The Economist*, Vol. 356, Iss. 8179 (15 July 2000), p. 49.

³⁴ Conant, E. 2002. "The heart of the matter: Moldova and its lost women", in *Newsweek*, 19 August, p. 23.

unprepared.

Contrary to the other ex-communist countries in Europe and even to other former republics of the Soviet Union, Moldova became independent as a result of the collapse of the USSR and not because of the expressed desire of its population. The consequence of this exogenous change was a situation of frustration, insecurity and aggressiveness for its citizens.

The false unanimity present during the days of Soviet control was quickly replaced by violent political confrontations after independence. Moldova became known in the international scene in 1991-1992 because of the separatist movements in the Southern region (the Gagauz issue) and in the Eastern part of its territory (the Transnistrian conflict).

When Moldova was part of the USSR, the Turkic Christian minority that inhabited the region of Gagauz was denied national schools, its language was suppressed and its culture neglected. This was the root of separatist tendencies after independence. The dispute was settled with the formal creation, in January 1995, of the Gagauz Administrative Unit, a special legal territory within the Republic of Moldova with a large degree of self-determination in political, administrative and cultural matters. Although a mild tension between Chisinau and Gagauz lingers, the solution of the conflict was positively received by the international opinion.

In contrast, the problem in Transnistria remains active. The separatist activism in this region intensified after independence until armed violence broke out in March 1992. As a result, the government lost control over this strategic zone, which proclaimed itself a sovereign state called Transnistrian Moldovan Republic (TMR). Lacking the recognition of the government and the international community, the state of affairs in this region is an important source of political instability for the country. In addition, Transnistria has become an important source of corruption, informal transactions, smuggling and human trafficking. This subject will be tackled in a subsequent section.

In terms of its progress towards a democratic state, Moldova has escalated some positive steps. The state of law, through the adoption of a new Constitution in 1994 and the separation of the three branches of power, has been established. Other constructive outcomes have been the formation of a multiparty political system, free elections, liberty of press, emergence of NGOs, consolidation of private ownership and openness to the international community. Almost all the legislation of Moldova has been or is currently under reform, so as to incorporate the new values of the nation.

In an attempt to stabilize the country, modernize the economy and demonstrate its commitment to reform, the republic has joined a long list of international institutions since its independence. In March 1992, it became a member of the United Nations. Moldova commenced contact with the European Union (EU) at the same time and signed a Partnership and Cooperation Agreement (PCA) in 1994; the country also got involved in several European initiatives, such as the Council of Europe, the Organization for Security and Cooperation in Europe (OSCE), the Black Sea Economic Cooperation and the Stability Pact for South-Eastern Europe. In relation to the former integrants of the Soviet Union, Moldova has been part of the Commonwealth of Independent States (CIS) since the dissolution of the USSR and has also sought further integration through treaties like GUUAM (Georgia, Ukraine, Uzbekistan, Azerbaijan and Moldova). The country also keeps a close relation with its neighbours, Romania and Ukraine, and other important

political and economic partners, namely Russia and the United States. Relative to commercial and financial institutions, the Republic of Moldova has joined the International Monetary Fund (IMF), the World Bank (WB) and the World Trade Organization (WTO), among others.

In spite of all this progress, the institutions in the country remain weak, the society presents important structural imbalances and legal support is still incoherent and erratic. This, in addition to the Transnistrian issue, has favoured political instability, low quality of governance, proliferation of crime, expansion of the shadow economy and corruption. To mention one figure, Transparency International, through its Corruption Perception Index 2003, ranked Moldova in position 100 out of 133, below countries like Russia, Albania, Romania, India and Algeria.³⁵

The Communist Party of Moldova (CPM), in power since 2001, has been incapable of developing an adequate strategy to respond to the main political and economic problems. In fact, the party's resistance to an authentic reform in the main structural issues was one of the roots behind the recent suspension of credit to Moldova by the international organizations, notably the IMF and the WB.

Although the country has accomplished important measures in political, legal and political matters, it remains in a vulnerable position. Corruption, dominion of informality in economics and politics and the virtual secession of Transnistria are some of the most important concerns for the political well-being of Moldova.

3.1.2. Economic behaviour

During the existence of the Soviet Union, the economic situation in Moldova was based on the directions of a system administered by Moscow. During that era, the republic specialized in agriculture and agro-industry and its products reached the entire USSR; additionally, an important share of the output came from the manufacture of specialized components (including pieces for consumer durables and high-technology parts serving space and submarine programmes) that were subsequently turned into finished products elsewhere in the Union. In return for their production, Moldova received highly subsidised energy imports. The ideas of competition and productivity were totally unknown to the economic entities.

With independence, this economic organization irreversibly collapsed. Moldova found itself cut off from the traditional markets for its production and, as energy prices raised to world levels, it faced spectacular increases in import costs. Moreover, the separation of Transnistria further narrowed the possibilities of development, because an important part of the country's manufacturing base (notably, the majority of the non-agricultural industries) and its only electricity generation plant were located in this region.

The initial reforms undertaken by the country aimed at privatization, liberalization and creation of a market economy. Some of the achievements so far are the substantial transfer of property and enterprises to private hands, liberalization of prices, free internal and external trade,

35 Transparency International. 2003. *Transparency International Corruption Perception Index 2003* at <http://www.transparency.md> [7 April 2004], pp. 4-5.

institution of a capital market, creation of a labour market, establishment of a banking system, promotion of a land market, introduction of the Moldovan leu as the national currency and control over inflation.

Despite the creation of the necessary infrastructure for a capitalist economy and the attainments in macroeconomic stabilization, transition has been accompanied by the following important negative traits:

- impressive collapse of production (nowadays, it represents only a fraction of its pre-independence level);
- discrepancies between supply and demand;
- insufficient structural reforms;
- lack of investment;
- huge deficits in public budget and external accounts;
- uncontrollable external debt;
- rapid informalization of the economy;
- expansion of subsistence farming and barter commercial activities;
- deterioration of natural, technological and human resources;
- limited diversification;
- vulnerability to shocks; and,
- general instability.

The social costs, as will be studied further on, have also reached an alarming level. In fact, all these factors have led credit rating agencies to place Moldova among the economies with the highest default risk, even in 2003.³⁶ Although the conditions for growth exist, the cited harmful issues become risk factors and challenges for the sustainable development of the country.

Figure 16 illustrates the performance of the Moldovan economy since independence.³⁷ Three stages can be identified during this transition period. First, from 1991 to 1994, the breakdown of the Soviet Union and the beginning of the transformation to a market economy brought painful results to the economy. The massive redundancies and inefficiencies of the communist era were uncovered; the initial, difficult reforms were implemented. The result was a widespread situation of crisis and recession, in which the Gross Domestic Product (GDP) collapsed impressively.

Afterwards, from 1995 to 1999, the economy remained in a state of stagnation. The market reforms started to take shape and the country reached macroeconomic stabilization without growth. Although some conditions for growth were already sown, the effects of the financial crisis that overwhelmed Russia in 1998 spread to its main partners, including Moldova. The result was a contraction of real GDP of 6.5% and 3.4% in 1998 and 1999, respectively. At its lowest point, in 1999, the production of the economy represented only 41.3% of its 1991 value.

Finally, the third phase began in the year 2000 and continues today. With the fundamental conditions for a market economy already established, growth recommenced. According to the information provided by the National Bank of Moldova (NBM), the growth rates of the last three years were 6.1%, 7.8% and 6.3%, respectively. However, in 2003 the real GDP was just over

36 CISR. 2003. *Moldova in transition: Economic survey No. 11* at <http://www.cisr-md.org> [7 April 2004], p. 30.

37 All data presented, although otherwise indicated, do not include the region of Transnistria.

50% of its 1991 level.

In terms of the main macroeconomic indicators, the Moldovan administration was very successful in attaining a highly regarded stabilization. During communism, inflation was suppressed through far-reaching price controls. Immediately after independence, prices were liberalized, with the consequent appearance of inflation. In 1991, this variable reached 981%. In the following years, further relaxation of controls, political turmoil, economic factors (shortages of goods, lax monetary policy, huge distribution of subsidies and others) and external shocks triggered an explosive increase in prices, which spiralled to the level of a hyperinflation: 1 277% in 1992 and 1 751% in 1993.³⁸

By the end of 1993, the NBM started to take measures against this problem. A national currency, the Moldovan leu (MDL), was introduced in November of that year and replaced the uncontrollable circulation of Russian roubles and coupons previously issued by the monetary authority. Furthermore, an end of credit emissions, a policy of high interest rates and the fact that wages were not index-related helped to dominate the high inflation. In 1994, the increase in prices reduced by 485% and the next year only by 30%. Figure 17 shows that, starting on 1995, inflation has been kept at a relatively low level, with the exception of the turbulent years of 1998 and 1999, when the financial crisis in Russia spread its instability to Moldova.

The same graph depicts the behaviour of average interest rate for the state securities. As inflation was controlled and the economy stabilized, the rate decreased. It reached its minimum level of 5.8% in 2002.

Another indicator of the “successful” macroeconomic policy undertaken by the Moldovan government was the relative steadiness of the exchange rate. Figure 18 includes the behaviour of the Moldovan leu against the United States dollar and the Russian rouble. When it was introduced in 1993, the currency was supported by the NBM; this, and the remarkable control of inflation, maintained the currency stable against the USD until 1998. Nonetheless, an intense speculation against the MDL originated in the Russian crisis; the result was the end of official support and an important depreciation during 1999. Starting in 2000, as volatility in the region diminished and domestic growth resumed, stability also returned to the Moldovan leu. On the other hand, the national currency has strengthened against the Russian rouble since its introduction, situation that was further encouraged by the financial crisis of that country at the end of the 1990s.

One of the more urgent dilemmas for the economy during transition was the public deficit. Poor planning, haphazard expenditures, impractical budgetary assumptions, tax evasion and shrinking production led to a high government deficit, which reached 9.7% of GDP during 1996 (see Figure 19). As a result of the pressure from the international creditors, the government reduced its negative balance to around 3% of GDP by 1998. However, this came at the expense of reduced social spending and arrears in pensions and wages to employees of the state.

An important reform of the fiscal system brought about an augmented tax collection; also, the distribution and targeting of benefits were improved. The result was a disciplined public budget, which maintained very low deficits from 2000 to 2002 and even reached a surplus in 2003.

38 EIU. 1997. *Country profile 1997-98: Belarus, Moldova* at <http://www.eiu.com> [22 March 2004], p. 64.

Additionally, arrears in pensions were completely cleared out and greatly reduced for the case of wages.

Despite these noteworthy achievements in stabilization, the country retained structural troubles and imbalances. This condition led to the absence of growth during the past decade, important periods of instability and persistent weakness of the economy. The main problems that have been identified in this matter are the following: inability of the private sector to generate sustained growth, emergence of shadow economy, mounting debt and external imbalances and vulnerabilities.

Quantitatively speaking, Moldova has made a great progress towards the privatization of the economy. Most land has been transferred to particulars and communal companies, the bulk of small and medium businesses are now property of the private initiative and many productive units in strategic sectors are owned by private investors, either domestic or foreign. Additionally, two-thirds of privatized enterprises were restructured in order to increase their viability in a free-market environment. By 2003, more than 80% of GDP was already being produced by the private sector, which dominated activities in agriculture, manufacture and services. The state property is only prevalent in infrastructure (energy and water, air and railway transport, communications, etc.)³⁹ Nevertheless, political issues and internal antipathy has led to the delays of some strategic privatizations (energy sector, agro-industry and telecommunications).

Although the private sector has become predominant, it has not improved the productivity or efficiency of the economy. This was caused primarily by two sets of factors. First of all, as a consequence of the poor financial condition and the low competitiveness and technology level existent in most companies after decades of communism. Secondly, as a result of the scarce stimulation conceded by the government (insufficient fiscal incentives, subsidies, protection and favourable credits), the low capacity of investment of the new owners, the encumbering economic and political climate that persists in the country and the loss of markets. As a result, decline persisted during the decade of the 90s; despite the apparent recovery in recent years, the situation of most private enterprises has not improved significantly. If effectiveness of privatization is measured in terms of superior economic performance (growth, investment, employment creation and other aspects), then the reform in Moldova has been, so far, a failure.

Another problem that seriously affects the performance of Moldovan economy is the informal sector. According to official sources, the share of the shadow economy in the country was equivalent to 31.6% of registered GDP.⁴⁰ However, other sources estimate that the informal sector makes up about 40%⁴¹ or even 60-65%⁴² of the official economy. Irrespective of its precise quantification, it is generally accepted that informality has become one of the most worrisome problems in the development of the economy.

The origin of this negative phenomenon lays in the imperfections of legislation, imposing

39 CISR. 2003. *Moldova in transition: Economic survey No. 11*, op. cit., p. 5.

40 Olan, I. 2003. *Economy: Events and commentaries. Note 10: Shadow economy as a driving force* at <http://www.cisr-md.org> [7 April 2004].

41 ETF. 1997. *The VET system in the Republic of Moldova: Recent changes, challenges and reform needs* (Chisinau, National Observatory of Moldova), p. 19.

42 Munteanu, A. 2000. "The social costs of transition in Moldova", in *South-East Europe Review of Labour and Social Affairs*, Vol. 3, p. 39.

bureaucracy, negative climate for business development, volatile and burdensome fiscal laws, uncontrolled borders and other factors. In Moldova's specific case, the gaps and vague spots in the relation between the republic and Transnistria is the source of an important share of the informal activities.

The consequences of this situation can be very damaging for the country. Informal transactions are an important source of criminal networks and an incentive for corruption, two of the most problematic issues in Moldova. In economic terms, it creates an unsteady environment that deters investment and development of "legal" entrepreneurship; besides, the income for the public sector, as a consequence of tax evasion, shrinks. From the social perspective, the main problems are the lack of protection for the participants of unofficial activities and the reduced public budget for social allocations.

The third troublesome trend in the Moldovan economy is external debt. Starting from a minimal amount inherited from the soviet days, the country rapidly became heavily indebted both to multilateral and bilateral creditors. Figure 20 depicts the stock of total external debt at the end of the year for the period 1995-2003. In 1995, Moldova had a total outstanding debt equivalent to 59.1% of its GDP (level: 851 millions of USD). This figure augmented and, at the end of 2000, it reached an imposing 95.5% of GDP (level: 1.23 billions of USD). As the graph shows, this proportion has started to decrease during the last three years, but this is a consequence of the recent economic growth in the country. In fact, the actual level of external debt has steadily risen to 1.44 billions of USD by 2003. However, a mission of the IMF and the WB arrived to Moldova in 2003 and their conclusion was a deficient performance of the government in terms of its commitment to structural reforms; the result was a temporary suspension or delay of credit from these and other organisms.

This same graph also includes the breakdown of external debt into energy and non-energy arrears. As it can be seen, energy-related liabilities form a substantial part of total debt. This dependence on external sources of energy and the incapacity to reduce this type of debt remain one of the crucial problems for the Moldovan administrators. This topic will be further explored subsequently.

Concerning debt servicing, the situation still represents a taxing difficulty. Principal repayment and interest expenses represent an important outflow for the economy. Figure 21 gives an idea of total debt service by expressing it as a proportion of exports. This ratio increased importantly and reached its peak of 28.6% in 1999. Since then, it has lost inertia, although it remains a red point for Moldova.

The fourth difficulty that has been identified in the economy refers to the external accounts. Moldova depends completely on imported inputs for all its economic sectors. Local products are struggling to maintain at least a share of the foreign markets they enjoyed during the soviet epoch, but low quality and poor marketing are the main obstacles.

Moldova is now a highly liberalized economy in terms of external trade. In IMF's trade restrictiveness classification, the country is ranked in the most liberal category. Trade tariffs have decreased gradually and, in 2002, the weighted-average tariff represented merely 4.1%.⁴³ In addition, there are no import quotas, while import licenses requirements and price controls are

43 IMF. 2004. *Republic of Moldova: Statistical appendix* at <http://www.imf.md> [7 April 2004], p. 31.

very limited. To sustain its commitment to this liberal trade policy, Moldova became a member of the WTO in May 2001.

During transition, the terms of trade of the economy were severely deteriorated, with a consequent imbalance in the balance of the foreign trade bill. Figure 22 includes the behaviour of exports and imports during the past few years. As it can be seen, exports are suffering a clear, though gradual, downward trend. With the exception of 1999, when the devaluation of the MDL temporarily made exports more competitive, the performance of Moldovan products abroad is deteriorating. From representing 48.6% of GDP in 1996, total exports descended to 39.7% in 2002. The main goods exported by the country are food products, textiles and vegetable products; the principal buyers of Moldovan products are Russia (35.4% of total exports), Ukraine (9.1%), Romania (8.4%) and Germany (7.4%).⁴⁴

On the contrary, imports have maintained at a fairly stable level (always superior to exports). In 1996, they represented almost 64% of GDP. They kept around this level, with the exception of 1999, when the stability of the region caused a devaluation of the national currency and goods from abroad became more expensive. However, purchases from abroad quickly recovered and by 2002 they were back at a 62.5% of GDP. Major imports bought by the economy are mineral products (energy resources), machinery and equipment, chemicals and textiles. These goods come primarily from Ukraine (20.4% of total imports), Russia (15.3%), Romania (11.4%) and Germany (9.2%).⁴⁵

The result of these trends in exports and imports has been a significant deficit in the trade account. As Figure 23 shows, the deficit in the trade balance augmented from 15.3% in 1996 to 22.9% in 1998. In 1999, as was reported before, the crisis in Russia spread to the Moldovan economy, with an ensuing depreciation of the leu. Thanks to this external factor, the deficit shrank to a still-significant 11.7% of GDP during that year. But, while exports could not recover, imports quickly rose to its pre-crisis level and the terms of trade did not improve. By 2002, the deficit in the trade balance was again equivalent to 22.8% of the total production of the economy.

Referent to the current account deficit, it mirrored the behaviour of the trade balance from 1996 to 1999. But after that year, it has maintained very low levels. The reason behind this, as it can be seen in Figure 23, is the alleviating effect of migrant remittances. Official transfers from Moldovan abroad have exploded in recent years. From almost 80 millions of USD in 1996, they rose gradually until 1998. During 1999, the instability of the country became a setback for the transfer of migrants' income abroad. However, the rate of growth since then has been truly exponential, growing to 132, 186 and 240 millions of USD in the following three years. The subject of remittances will be explored more extensively in a later chapter of the report. However, it can be said that they managed to push the current account deficit down to 5.5% of GDP in 2002.

Not only the amount of the trade deficit is worrying, but also the vulnerability of Moldova's external commerce. The economy is highly concentrated in a few countries as destination for its exports. Although there is a tendency for its loss of weight, the CIS is the country's main trading

44 EIU. 2003. *Country profile 2003: Moldova* at <http://www.eiu.com> [22 March 2004], pp. 39-40.

45 *ibid.*

partner. In 2002, 54.5% of its exports were directed to these states. The most important nation of this block is undeniably Russia, which received 37.1% of total exports during this same year. This explains why the crisis of the Russian rouble and the recent decision of this country to introduce import quotas have had such a big influence on the Moldovan economy. Worryingly, instead of attempting to diversify its markets, the CPM's policy has favoured trade links with the CIS states. Albeit from a low base, commerce with the EU (especially Germany and Italy) has been gaining relevance, although at a much slower pace than other Central and South-Eastern Europe nations.

In terms of the products sold outside the country, agricultural and agro-industrial products composed 63% of Moldova's exports in 2002. This high concentration makes the economy highly vulnerable to world commodity prices and weather conditions. In addition, Western European agricultural protectionism has become a serious obstacle for the export possibilities of Moldovan products.⁴⁶ The low diversity also shows the inability of the industrial sector to develop sufficiently and gain a greater importance.

Investment from foreigners in Moldova has been very modest during transition. Figure 24 includes the recent levels of both foreign direct investment (FDI) and foreign portfolio investment (FPI). FDI kept at practically negligible levels during the last decade; however, recent privatizations attracted 136 millions of USD in 2000. By 2002, this indicator had lost momentum and descended to 116.7 millions of USD. The same graph shows that, though volatile, FPI are, in average, nonexistent.

The main direct investor in Moldova is Russia, followed by the United States, Spain and The Netherlands. Russia's interest centres in Moldova's complete dependence on energy imports. Also, the country has potential for Russian enterprises to serve as a bridge to the South-Eastern Europe markets. Furthermore, with its recent enlargement, NATO arrived at the border of Moldova; this increased the strategic importance of the country for Russia. By sector, energy has attracted the largest share of FDI, followed by manufacture and trade. The primary sector, despite its crucial importance for the economy, has been completely neglected by foreign investors.

The internal investment level in Moldova is too low for a successful economic development. However, despite the definite potential of several sectors, FDI has not entered substantially into the country. The main reason for the low attractiveness of the Moldovan markets for foreign investors is the political and economic instability that overshadows the country. In addition, delays in privatizations, bureaucracy, corruption, contradictory signals sent by the authorities, limited information on business opportunities and the economic concerns cited above deter investment inflows.

3.1.3. Sectorial trends

3.1.3.1. Agriculture

A little over 20% of the Moldovan GDP of 2002 originated in the primary sector (see Figure 25).

⁴⁶ EU's protectionism represents an obstacle for the entrance of Moldova's agricultural products into this market. Additionally, the distribution of highly-subsidized agricultural products from the EU into Russia and other CIS markets undercut Moldova's traditional markets.

Nonetheless, the country is considered an agrarian economy. The basis for this classification falls on the fact that much of the other activities (in industry and services) are based on agricultural production; additionally, a big share of the labour force and of the population is affianced to this sector.

The reasons behind Moldova's specialization in agriculture are its favourable climate and high proportion of fertile land (75% of the territory).⁴⁷ This led the economic planners of the USSR to give preference to the development of this sector in the republic. For decades, Moldova concentrated in farming and agriculture-related products, whose production was then distributed to the whole Soviet Union. Nowadays, despite the inherent risk of its reliance to weather conditions⁴⁸ and imported inputs, the primary sector remains the strategic sector in triggering a process of sustainable growth in the country. Moldova should profit from the definite comparative advantage that it enjoys in agrarian activities. The main crops produced in the country are fruits and vegetables, cereals, sunflowers, sugar beet, tobacco and grapes.

Currently, agriculture is in a state of commotion as a result of the changes in relative prices; privatization of land and adoption of free-market schemes; loss of markets, both domestic and international; rise in prices of energy, fertilizers and other indispensable inputs; and, lack of tradition in business activities. In fact, an important part of the agricultural system has regressed to subsistence farming and the use of barter transactions to buy the necessary inputs.

The vast majority of land is now in private ownership. Privatization proceeded through the conversion of kolhozes – large collective farms – into joint stock companies. Each farmer was assigned a land and a capital share and then he or she could choose either to remain part of the new agricultural company or to claim its share and set up an individual farm. However, not only do the land shares usually represented a very small portion on land, but also those who chose to assume their stake were required to inherit a proportion of the debt of the converted kolhoz.

The decollectivization has also been a slow and difficult process because of the large political power of the representatives of the kolhozes. In addition, the land reform only sought to convert the communal farms into companies, without the necessary actions to break up the inefficient collective structures or reinvigorate the sector.

Some proceedings have been successful, though. For example, a USAID-supported programme did well in converting communal holdings into business-like corporations or individual farms. It achieved this through conceding debt forgiveness in exchange to voluntary dissolution of collectives.

The reforms in land privatization and reorganization need to go together with the creation of functional support structures (distribution links, chains of agro-shops, commodity exchange, specialized financial institutions, producers' cooperatives, association with other sectors and others). Also, since farmers are generally inexperienced in commercial agriculture, they need advise in technical, legal and marketing topics.

47 United States Embassy in Chisinau. 2001. *Country commercial guide to Moldova FY 2002* at <http://www.bisnis.doc.gov> [7 April 2004].

48 Moldova is situated in a region of risky climate for agriculture: experience suggests that the ratio of favourable to unfavourable weather for this sector is 40:60. (CISR. 2003. *Moldova in transition: Economic survey No. 11* at <http://www.cisr-md.org> [7 April 2004], p. 16.)

In addition to this, other essential conditions are fundamental to achieve prolonged growth in this crucial sector: conception of a well-defined medium- and long-term policy for the development of agriculture; productivity increase through the introduction of modern technology and adequate management practices; disintegration of the monopolistic and communal structures unfavourable to competitiveness; availability of preferential credit; and, promotion of risk insurance. This will allow building up an efficient, commercial agriculture that can serve as a springboard for the development of the entire economy.

3.1.3.2. Industry

From almost 39% of GDP, industry currently represents only 20% of the total production (see Figure 25). This important decline originated in the separation of Transnistria, in whose territory originated one-third of the industrial output of the republic, and the collapse of the economy. Figure 26 depicts the trend in the production of the industrial sector during the last ten years. The period 1993-1999 was characterized by a significant decay of the sector, whose yearly output fell by 28% in 1994 and 15% in 1998. However, since the beginning of this decade, industry has displayed optimistic rates of growth. This is due to the advancements in privatization, the progress of reforms, the revival of the Russian economy and the appearance of new development sectors. However, industrial capacity utilization remains at extremely low levels, only reaching 10-20% in some industries.⁴⁹

According to some analysis, the industrial policy for Moldova is composed of three stages: (i) halt of the decline and stabilization; (ii) restructuring, reorganization and renewal of production, with an eventual recovering of the level of production of the period prior to transition; and (iii) integration into the world markets.⁵⁰ From the performance of industrial output reviewed in Figure 26, it can be argued that the first phase has been achieved. In this case, Moldova needs to develop an adequate industrial policy that will allow the restructuring and revitalization of the different industrial branches, especially those with a long-term potential. This can be achieved by finalizing privatization (which, although already advanced, has shown important delays in strategic sectors), canalization of domestic and foreign investment, and further adaptation to a market economy (enhancement of distribution links and supply channels, internationalization, efficient production techniques, modern marketing and management practices, focus on quality, technological improvements and others).

The primary branch of the industrial sector is food and beverages, which accounts for about 51% of total industrial production. This extreme concentration in agro-processing, as was mentioned in the preceding section, is based on the country's comparative advantage in agrarian activities; in addition, the secession of Transnistria brought about the loss of most of the hard industries and the only electricity-generation plant of the country. The single most important item and one of the main exports produced by the Moldovan industry is wine. Other important goods of this subsector are sugar, processed/canned meat, processed/canned fruits and vegetables, milk products, oils and fats, bakeries and essential oils.

49 High Economic Council under the precedent of the Republic of Moldova and UNDP. 2000. *National strategy for sustainable development* at <http://www.undp.md> [29 March 2004], p. 50.

50 CISR. 1998. *Republic of Moldova: Strategy for development* at <http://www.cisr-md.org> [7 April 2004], p. 118.

Tobacco is another important subsector. During Soviet times, Moldova was the supplier of 40% of all cigarettes consumed in the USSR. Nowadays, it accounts for over 7% of total industrial output. Although this agro-processing branch has weakened as a consequence of declining exports and low purchasing power in the local market, it remains with a significant potential of growth.

Textiles, apparel, footwear and other light industries have expanded importantly in the last years. In this case, the typical pattern is that of Moldovan companies working offering labour-intensive, subletting (“maquila”) services to foreign partners (particularly German and Italian). Although much of the work consists on assembling imported materials into finished goods, local production of cotton cloth, natural and artificial silk, natural and artificial leather and other inputs are partially encouraged. Also, the geographical situation of Moldova as crossroads between Central Europe, South-Eastern Europe and CIS markets is appealing. Finally, the low labour costs increase the attractiveness of these subsectors for foreign investors.

The production of construction materials is another subsector with a growing trend and a development potential in the future. This arises from the local availability of raw materials. The main products are cement, pipes, gypsum, stone blocks, linoleum, ceramics, etc.

As of construction industry, it has been hurt by both the contraction of the central budget assigned to public work projects and the reduction of housing due to the shrinking purchasing power of the families. In 2002, this industry represented only 2.9% of total GDP, an important decline from its pre-transition level. However, the approval on new infrastructure projects, like the construction of the Giurgiulesti passenger and cargo terminal on the Danube by Russian investors, and the recent revitalization of the economy promise to bring about a resurrection of this sector.

In relation to energy provision and distribution, Moldova still encounters many problems. Due to the lack of natural resources, the state is completely dependent on imported energy (circa 98% of the total amount of energy consumed in the country is imported).⁵¹ Russia and Ukraine are the main providers of coal, diesel and natural gas the Moldovan economy. These two countries, plus Romania and the thermal-energy plant situated in Transnistria, are its principal suppliers of electricity.

Deficient tariff policies, excessive involvement of policy-makers in contractual relations between distributors and consumer, culture of non-payment, theft, leakage and wastage have led to a problematic situation. Currently, the cost of energy resources consumer per GDP unit in Moldova is the highest in Europe.⁵² This has raised enormous debts for the country, which reached 311 millions of USD (15.9% of GDP) in 2003.

However, recent reforms have improved the situation. In 2000, three of the five distributors of electricity were sold to a Spanish company, with a resulting progress in payment and in achieving a stable provision of energy. Although constantly deferred, the privatization of the remaining distributors of electricity and other energy-related entities will most probably improve the condition of this essential sector for the Moldovan economy.

51 High Economic Council under the precedent of the Republic of Moldova and UNDP, op. cit., p. 54.

52 *ibid.*, p. 55.

3.1.3.3. Services

Services account for the largest share of the economy, and this trend has accentuated since transition. As Figure 25 shows, the tertiary sector grew from 33% of total GDP in 1996 to 47.5% in 2002. In terms of total value added (TVA) in the economy, the breakdown of services for 2002 was as follows: repairs, personal services and trade: 13.2% of TVA; transport, warehouses and communications: 11.7%; financial services: 5.1%; education: 6.2%; public health and social assistance: 3.2%; and, other services: 12.0%.⁵³

Since trade and personal services are mainly performed by small economic units, they were privatized at the initial stage of transition. For example, around 85% of retail trade is carried out by private businesses.⁵⁴ Modern-style shops and retail stores are mainly concentrated in the capital, Chisinau.

Financial intermediation and banking services are highly concentrated. In 2002, the five largest banks concentrated over 70% of all assets. This condition and the persistent volatility of the economy have sustained the lending rates at high levels: in 2002, they stood at 24%, in average (compared with an inflation rate of 5.2%). As a result, credits for productive investments are deterred. FDI is responsible for 60% of total capital in the banking sector.⁵⁵ Although from a very low level, insurance services are gaining importance in the economy; foreign capital is also very present in this sector.

Due to the poor state of communication infrastructure in the country, there is a great potential of growth in these services. For this reason, investments have grown in areas like mobile telephony, business networks, data transmission, internet provision, protocol conversion, etc. This development is expected to sustain as economic growth continues.

Finally, tourism is very underdeveloped. Despite the country's favourable cultural and natural conditions for its development, tourist services remain very limited. The reasons for this stagnation are the declining purchasing power of families, lack of investment and practically no state support. However, the sector retains its long-term potential.

3.1.4. Social developments

Economic reform in Moldova followed the main principles of neo-liberal economic transition: liberalization (of trade, prices and economic activity), macroeconomic stabilization and privatization. The first two elements were achieved very soon after independence and the third one, although still incomplete, has advanced considerably. But the social aspects of reforms were constantly neglected and the negative costs for the population have been dramatic: exploding poverty, inequality, worsening indicators of education and health, urban/rural imbalances and massive emigration. As examples of this detrimental process, the liberalization of prices led to important inflation at the beginning of the decade, which translated into high levels of poverty; the reduction in public budget in order to control the deficit caused a shrinking support to education and health services; incorrect policies in privatization caused economic inefficiency; and so on.

53 IMF, op. cit., p. 4.

54 High Economic Council under the precedent of the Republic of Moldova and UNDP, op. cit., p. 49.

55 EIU, 2003, op. cit., p. 28.

Moldova now stands as Europe's poorest country, measured in terms of GDP per capita. Life expectancy has plunged by 10 years during transition, while the educational attainment of the population has considerably fallen.⁵⁶ According to official sources, the proportion of the population living under the poverty line is 22.8%.⁵⁷ However, some independent surveys concluded that the share of the population living under subsistence level in 1999 reached 46%.⁵⁸ The Human Development Index for Moldova, calculated by the UNDP, has shown a deterioration during the course of transition. By 2000, the country was in rank 102 (for the purpose of comparison, Belarus was in position 57, Russia in 62, Romania in 64, Ukraine in 78, Armenia in 93, Turkmenistan in 100 and Tajikistan in 110).⁵⁹ Despite the critic spread of poverty among the population, the government constantly delayed the elaboration of a Poverty Reduction Strategy Paper approved by the IMF.

In addition to the worsening condition for the average Moldovan, a distressing fact is the spread of income inequality. In 1990, the income of the poorest quintile was equal to 4.9% of global income, while the richest 20% possessed 44.8% of the total. By the end of the decade, these two figures were 3.4% and 50.3%, respectively.⁶⁰ The appearance of a small elite of "new rich" and a large proportion of "new poor" is one of the main social concerns for the country.

An opinion survey conducted during 2003 concluded that as much as 60% of Moldovans considered that their situation had not improved or actually worsened over the previous year.⁶¹ But both 2002 and 2003 were years with strong economic growth (7.8% and 6.3%, respectively). This can be interpreted as a negative trait for society: the welfare derived from growth and prosperity is now exclusive of a small part of the population, while the rest experience a stagnation or even deterioration of their standards of living.

Education and health have rapidly deteriorated during transition. This has been caused by the allocation of a diminishing budget for the social sphere by the central government. Public expending on education fell from 7% of GDP in 1998 to 4.8% in 2001; although then augmented to 5.6% in 2002. Similarly, health allowances on the public budget descended from 4.3% of GDP in 1998 to 2.8% in 2001, followed by a modest increase to 3.6% by 2002.⁶² Infrastructure and quality of the services have eroded quickly. In addition, the low wages in both sectors have left many teachers and doctors with no choice but to take one of the survival routes: setting up a private business, informal activities or emigration.

The imbalances between the conditions of the rural and urban population have also shown signs of worsening. While the provision of dwelling in both cities and villages is satisfactory and practically all houses have electricity, the differences in amenities between rural and urban

56 European Community CARDS Programme. 2001. *Moldova: Country strategy paper 2002-2006 and national indicative programme 2002-2003* at <http://europa.eu.int> [18 March 2004], p. 8.

57 CISR. 2003. *Moldova in transition: Economic survey No. 11*, op. cit., p. 12.

58 Munteanu, A., op. cit., p. 41.

59 UNDP. 2000. *National human development report: Republic of Moldova* at <http://www.undp.md> [29 March 2004], p. 116.

60 *ibid.*, p. 39.

61 Hensel, S. and Gudim, A. *Moldova's economic transition: Slow and contradictory* at <http://www.cisr-md.org> [7 April 2004].

62 IMF, op. cit., p. 19.

homes are stirring.⁶³ In addition, the countryside is experiencing a more dramatic deficiency of education, health and social assistance provision, plus deteriorating roads, communications and other essential infrastructure. Villagers' possibilities to earn a living have also importantly narrowed. This has motivated an important internal migration to the urban centres and to other countries.

3.1.5. The Transnistrian issue

Occupying 12% of the territory of Moldova and almost 15% of the overall population (635 000 persons), the TMR is virtually a separate state. It has its own government, legislation, currency, security and economic entities. The 1995 Constitution of Transnistria actually proclaims the republic a "democratic, sovereign, independent state of law".⁶⁴ For all practical purpose, the central power in Chisinau has lost all administrative control over this region and its capital, Tiraspol.

Because of the strategic importance of Transnistria, both in political and economic grounds, the Moldovan government has continuously attempted to approach the TMR administration. The main proposal of Chisinau is to regain unity through federalization, while conceding widespread economic and cultural autonomy to the region. There are three main motives behind the importance of reintegration.

First, solution of the issue would eliminate an important source of political instability. This could improve the risk rating of the country, permit greater investment and announce that Moldova is on the track of political consolidation.

Second, the economic advantages are undeniable. The economic policy during the times of the USSR placed a considerable share of non-agricultural industry in the territory of Transnistria. An export-oriented steel mill, the only significant power plant of the country and other major hard industrial companies are located there. In addition, the gas pipelines and an important part of the international trade of Moldova cross through the TMR. Reunification would restore the economic links that were active before secession, broaden the industrial base of the country and resuscitate many links with other ex-Soviet republics.

And third, it would reduce the dominion of illegal activities in the country. The TMR has become an important source of illegitimate enrichment through smuggling of products in and out of Moldova. This contraband takes advantage of the diffuse legal status of the region and its unclear relation with the rest of Moldova. In fact, it has been estimated that losses to the economy due to illegal transactions in Transnistria are equivalent to the entire financial assistance received by the state from international organisms.⁶⁵

However, the process of reintegration would have considerable short-term costs for the Moldova due to the poor development of the TMR. The separatist republic has lagged behind the structural changes already implemented in the Republic of Moldova during the first decade of transition.

63 Piped water: 79.1% urban vs. 1.1% rural; sewage: 76.2% urban vs. 4% rural; central heating: 77.3% urban vs. 1.6% rural; bathroom/shower: 70.3% urban vs. 4.3% rural; natural gas: 89.5% urban vs. 8.7% rural; hot water: 59.9% urban vs. 0.5% rural. (High Economic Council under the precedent of the Republic of Moldova and UNDP, op. cit., p. 62)

64 UNDP, op. cit., p. 36.

65 *ibid.*

Privatization in this territory only began in 2001. The Land Code approved the following year stated that land remains a state property that can only be rented or transferred into use to TMR nationals residing inside the territory. Besides, other inconvenient traits are extremely low levels of investment, falling productivity, inefficient system of social protection, widespread non-payment, corruption and others.

In September 2001, after accession to WTO, the government of Chisinau reinforced its borders and adapted its customs procedures to international requirements. Additionally, a Moldovan-Ukrainian Protocol took effect in May 2003; it allowed the trade of goods between the two nations only on the basis of the waybills, commercial and customs documents of the official Chisinau. Clearly, this excluded the Transnistrian enterprises. Since Moldova and Ukraine are, after Russia, the main importers of TMR's products, the result of these two measures was a sharp decline in exports. Since the Transnistrian administration interpreted this as an attempt of the Republic of Moldova to blockade its economic development, the TMR responded by imposing a 100% customs fee for all commodities imported from Moldova and a transport fee (10% of the goods' value) for all non-TMR cargo vehicles traversing the territory.⁶⁶

Political tensions have affected the economic sphere in the two regions. However, since both economies are highly dependent on foreign trade, these recent events have also stimulated the search for an improved cooperation between the two administrations. Although it is unrealistic to consider reintegration as a panacea to all Moldovan problems, it is nonetheless an indispensable factor for the stability of the country and a vital step towards economic and political development.

3.2. Situation of labour in Moldova

3.2.1. Employment and unemployment

Transition to market structures in Moldova was not conducted through sudden transformations. Instead, a slow process was preferred. The number of employees, particularly in state enterprises, decreased gradually without massive personnel cuts. Thus, labour has not experienced the sharp decline suffered in other ex-communist countries. Moldova's method, though economically inefficient, was conceived for its social perspective.

However, even if it happened gradually, employment has fallen. Figure 27 shows this downward trend for the last years. When Moldova entered a market economy and its enterprises were exposed to the profit-driven system of capitalism, many redundancies with origin in the communist times were disclosed. This excessive demand for employment created a widespread inefficiency that had to be confronted during transition. The result was the elimination of many job positions in the vast majority of economic units, spanning all sectors and geographical regions. As companies were privatized, this process was accelerated. This situation was exacerbated by the imported instability of the Russian recession in 1998. From a level of 1.67 million persons in 1995, formal employment diminished to 1.36 millions by 2003. Despite the economic growth of the last four years, the number of employed persons has not changed its descending path.

66 CISR. 2003. *Research paper on Transnistria* at <http://www.cisr-md.org> [7 April 2004], pp. 3, 10.

These employment losses were transferred either to inactivity in the formal economy or to unemployment. In the first case, people who found themselves without a job disappeared from the formal labour market: they became economically inactive, returned to the educational system, started producing exclusively for self-consumption,⁶⁷ enrolled in informal activities or emigrated. In the second case, they became part of the unemployed, with or without benefits.

The labour force of Moldova, who includes all persons in working age, both active and inactive in the economy, reached 2.09 millions of persons in 2001, equivalent to 57.5% of the total population. The Economically Active Population (EAP) that year was equal to 77.4% of the labour force, while the remaining 22.6% was officially inactive.⁶⁸ However, some estimates deduct that 47% of the working-age population is employed in the shadow economy.⁶⁹

The behaviour of unemployment is depicted in the same Figure 27. The difference between the two indicators is that the official rate only includes the registered unemployed. However, the majority of the jobless does not bother to register because of the extremely low benefits that this represents.⁷⁰ For this reason, it severely underestimates the actual rate. The ILO series, although closer to the real situation, probably also understates the true level of unemployment, since it fails to include the hidden unemployment (forced part-time jobs and workers on unpaid leave, for instance). However, in the circumstances of scarce data, the latter is the best reliable indicator on hand.

The unemployment rate provided by ILO exceeded 10% in 1999, during the worst year of economic instability for Moldova, although later diminished to 7.3% in 2001, 6.8% in 2002 and 7.9% in 2003. For the year 2001, the breakdown of ILO unemployment was as follows: 8.7% among men, 5.9% among women, 13.8% in cities and 2.7% in rural areas.⁷¹ Under the circumstances of contracting employment, these levels seem too low. An interpretation of this is that Moldovans who find themselves without a job know that social benefits for the unemployed are extremely meagre; since they cannot rely on it to survive, they have to use another resource to earn a living for their families and themselves: participation in the shadow economy or emigration.

Composition of formal employment during 2001 showed the imbalanced state of employment. In this year, 51% of total employees were part of the primary sector, while industry (mining, manufacturing and electricity, gas and water) was responsible for just 11%, construction for 2.9% and services accounted for the remaining 35.1% (see Figure 28). So, even if the services sector kept an important share of employment, industry's proportion stayed at an extremely low level and agriculture still dominated the labour market. In this same year, the distribution of the employed population according to type of ownership was as follows: 22.7% of employment in

67 The land reforms carried out in the last years created many small private farms; these have worked as a buffer during transition, absorbing displaced workers from the declining industrial sector.

68 Department for Statistics and Sociology of the Republic of Moldova. 2003. *Labour market in the Republic of Moldova* (Chisinau, Ed. Statistics), p. 16.

69 Munteanu, op. cit. p. 39.

70 Unemployment benefit in 2003 stood at 176 lei (less than 13 USD or 14% of the minimum consumption basket) per month. ("Moldovan jobless statistics at odds with international agency's figure", in *BBC Monitoring Former Soviet Union – Political*, 8 July 2003, p. 1)

71 Department for Statistics and Sociology of the Republic of Moldova, op. cit., p. 19.

public sector, 71% in private sector, 4.3% mixed and 2% in foreign joint ventures.⁷²

At this point, attention should be centred not only on the quantitative component of employment, but also on the deterioration of its qualitative aspects. One of the more upsetting new developments is the expansion of flexible forms of employment. Non-remunerated jobs, irregularly-paid positions, part-time contracts, temporary/unofficial hiring and other manifestations of this situation have spread in Moldova. Underemployment and long-term unemployment have also become common phenomena.

It should be mentioned that employment levels are biased towards some sectors of the labour force. Because of some inherent disadvantage or latent discrimination, young people, women, pre-pension redundant workers and socially vulnerable groups (low-educated workers, elder people, etc.) are systematically underprivileged in the labour market.

Particularly worrying is the situation of women, who are being pushed out from the labour market (they have a higher inactivity rate than men). Having the same profession as men, three-fourths of women found an employment sufficiently suited for their qualification, while their salary elevates to only 70-80% that of men. Additionally, the working day for most women has a double intensity, as they have to take care of their families in addition to their job.⁷³ Although several measures has been take to improve the status of women in Moldova, like changing the legislation that contained discriminatory statements against them, their unequal situation is only expected to improve gradually over the following years.

3.2.2. Labour market characteristics

The labour demand of Moldova has shown a continuous, although gradual, decline during transition. The reforms undertaken to shift the economy from a centrally planned system to a market structure revealed the inefficiency and lack of competitiveness of most public entities. Meanwhile, the private sector was in an immature state and it could not achieve economic growth. The result was a considerable reduction in the demand for labour. Despite the relatively prosperous developments of recent years, the productive mechanism has been unable to create jobs: even in a setting of economic growth, labour demand remains depressed.

Another characteristic of labour demand is its altering structure. As was stated before, ownership has transferred from public institution to private hands. In the near future, it is forecasted that agriculture will lose weight in the economy, while there will be an augmenting participation of services and, especially, industry. Demand for human resources is expected to change accordingly.

Under the situation of a shrinking demand, labour supply has also faded out. With scarcer jobs in all sectors of the economy, Moldovans have stepped out from the formal labour market, looking for an occupation elsewhere (shadow economy, self-consumption and emigration). In spite of its contraction, labour supply still stands at a higher level than demand, as the presence of unemployment indicates.

72 *ibid.*, p. 27.

73 UNDP, *op. cit.*, p. 66.

The geographical distribution of labour supply is not even. The two main municipalities (Chisinau and Balti) account for over 45% of the employees of the country, with the remaining spread throughout the rest of the country. The North and Central regions concentrate the vast majority of total employees.⁷⁴

Labour supply has not been able to keep the transformation pace of demand. While sectorial composition of the economy changes and strategic sectors appear very rapidly, the supply of skills can only be altered slowly. As a consequence, there is an important educational and training mismatch in the labour market. This has created an urgent need to adapt the educational system to the new requirements of the labour market. Also, the provision of updating/retraining opportunities to the displaced workforce is mandatory, so that it could become employable once again.

Despite the oversupply of workers in a situation of weak demand, wages have relatively improved in the last years. Figure 29 illustrates the performance of the average real wage per month in Moldova. With the exception of 1999, all years have reported a positive change. Especially since 2001, the growth has been significant. However, it should be remembered that these advancements started from a very low base. Notwithstanding the recent growth, the purchasing power of wages is still low. As Figure 30 shows, the average wage covers 71% of the minimum consumption budget. Although there is an undisputable improvement (in 1995, this proportion was only 46% and in 2000 plunged to 43%), the situation remains precarious.

The central regulation and monitoring of the labour market is carried out by the Ministry of Labour, Social Protection and Family. But the lack of a medium- and long-term economic development and employment policy is a major hindrance for the adequate functioning of this office. Furthermore, labour relations are still regulated by the old Soviet Labour Code of May 1973. Although it has been amended in the past decade, its framework is outdated, especially concerning the activities in the private sector. In fact, it is known that many enterprises do not sign contracts with their employees in order to avoid the compliance of the provisions of this obsolete law.⁷⁵ The need of a new Labour Code is evident.

3.3. Difficulties for the adequate development of private enterprises

Since the early stages of the transition period, a wide variety of economic units were privatized; they were mainly small entities belonging to the agricultural and tertiary sectors. Progressively, land has been privatized and many strategic businesses have already been sold to private investors or will soon be (energy distribution, telecommunications, wine industry, etc.) It can be said that Moldova is now an economy dominated by the private initiative, thanks to its almost 200 000 registered economic agents.⁷⁶

At present, around 80% of Moldovan businesses are auto-employed workers, mainly in the rural economy.⁷⁷ Real progress would originate from their development into SMEs. Given the dimension and structure of the economy, enterprises of this size are the most adequate forms of entrepreneurship. They are the primary element in a developing country for the growth of the

74 Department for Statistics and Sociology of the Republic of Moldova, op. cit., p. 47.

75 CISR. 2003. *Moldova in transition: Economic survey No. 11*, op. cit., p. 13.

76 ETF, 2002, op. cit., p. 4.

77 European Community CARDS Programme, op. cit., p. 19.

economy, creation of employment, generation of income for the population and tax collection.

Nonetheless, in Moldova there is an unfavourable environment for business. This deters the creation of new enterprises, obstructs the development of the existing ones and motivates the transferring of activities towards the shadow economy. The consequences of this can be extremely harmful for the country. The following difficulties for the propitious development of private enterprises in Moldova have been identified:

- Inherited inefficiencies and debts in many privatized companies.
- Limited entrepreneurial tradition or experience in a market economy.
- Unfavourable image of Moldovan products, due to low quality of production and lack of marketing techniques.
- High concentration of new businesses in sectors requiring low capital and human potential (trade, construction and services).
- Perpetuation of vested interests in some sectors, which impedes investments and delays structural reforms.
- Instable politic climate that discourages both domestic and foreign investment; this leads to scarce resources for the reorganization and modernization of productive activities.
- Dominion of smuggled products.
- Volatility derived from periods of inflation and currency devaluations, which increases the degree of risk of business in the country.
- Excessive bureaucracy and regulation for the setting up of business activities (authorization, licenses, certifications and inspections).
- Persistent corruption.
- Unstable and opaque tax system, which remains hostile towards private initiative.
- Limited access to bank credit and high lending rates.
- Deficient business infrastructure (energy provision, transportation, communication, commodity markets, etc.)
- Lack of technical support and information on priority sectors.
- High trade liberalization without the necessary support or protection schemes.
- Insufficient stimulation of entrepreneurship due to the lack of fiscal incentives and subsidies.
- Limited availability of knowledge or skills required by the key sectors for economic development.
- Low competitiveness in internal and external markets, caused by inferior productivity of labour and capital.

The Moldovan administration needs to create a comprehensive medium- and long-term strategy for the development of SMEs in the strategic sectors of the economy. This will require tools and actions, like a structure of subsidized micro-credits, export promotion, productivity increase, technology modernization, regional development, training in the skill requirements of new businesses, acceleration of structural reforms, clarification of fiscal system, promotion of banking services, gender equality in entrepreneurship and internationalization.

3.4. Priority sectors with growth potential and their skill needs

3.4.1. Agriculture and agro-industry

Due to its propitious climate, fertile land and decades of specialization, Moldova possesses a comparative advantage in agriculture and agro-industry. Although this sector has an unmanageable degree of risk due to weather conditions and world prices, the hazards can be diversified through an expansion in the number of major crops and an extension of the destination markets of the products. This will undoubtedly remain the strategic sector for the development of the economy, at least in the short- and medium-term projections.

The primary crops and agro-industries, which currently have an important weight in the economy and/or will probably gain importance, are the following:

- Wine. As it was mentioned before, wine is the single most important agricultural product for Moldova. Although production has shrunk to only a fraction of the pre-Soviet level, it remains highly significant. Now that most of the wineries have been privatized, particularly to Russian and Western European investors, a resumption of growth is expected soon. In fact, the government currently places the wine industry as the number one priority in the export promotion strategy. Most wine companies are located in the grape-growing areas of Southern and Central Moldova, and their production includes a wide variety of red, white and sparkling wine. The major destinations of wines are the CIS markets, although they have an enormous potential to penetrate into Western countries (United States, Canada and the EU).
- Tobacco. Moldova was an important provider of cigarettes and other tobacco products in the USSR. Although product quality and diversification has fallen, appropriate investment could restore the full capacity of this subsector.
- Sugar. Moldova has been a traditional producer of sugar beet for a long time due to its comparative advantage of low production costs. Very importantly, the country owns several refineries in the Northern region to process this product into sugar. A German investor now dominates the industry.
- Processed fruits and vegetables. Using as raw materials the crops grown locally, this industry remains essential for the economy. Goods produced include juices, concentrates, jams, marinades, tomato paste, baby food, frozen products and dried fruit. Companies in the Northern part of Moldova concentrate in apple juice concentrate, while those in the Centre and South specialize primarily in processed vegetables and juices.
- Processed meat. Moldova is an established pork-producing country. Poultry also has an important potential.
- Dairy products. Milk powder, cheese, yoghurt and other dairy items are the goods with a prospective of development.
- Vegetable oil. Although oil represents only a small share of the total output of the food industry, it remains a strategic branch. Sunflower, cultivated in the South of the territory, is the traditional oleaginous plant and, consequently, this is the main source of vegetable oil. The government recently approved a development plan in this subsector for the period 2002-2010.
- Essential oils. This is another industry with great potential. These goods are used as raw materials for the production of perfumes, cosmetics, confectionaries and medicine. The typical plants cultivated in the country for the purpose of deriving essential oils are dill, lavender, salvage and rose.
- Organic products. Although not commercialized as such, the low use of fertilizers and

chemical products can be of strategic importance for the fruits, vegetables and meat produced in the country. This type of products is currently enjoying a boom in Western Europe and could become an export niche for Moldova.

Skill development for this sector should concentrate in modern farming techniques, greenhouse utilization, new vineyard cultivation methods, animal husbandry, production of milk products, elaboration of essential oils, products' hygiene, fabrication of U.S.-style cigarettes (in contrast to the traditional fermented-type) and others. In relation to managerial skills, the most important are those related to product packaging, internal delivery, international commerce, marketing, quality control and international food/nutrition standards.

3.4.2. Non-agricultural manufacturing

The key area with immediate development potential in this sector is light industry. Moldova's proximity to Western Europe, its links with the CIS markets and its low-cost, skilled manpower make it ideal for the establishment of subcontracting, maquila-type production. The main goods that could be produced are textiles, clothing items, footwear, carpets, pharmaceuticals and chemicals. The availability of a variety of locally produced raw materials (cotton cloth, wool, silk, leather and many others) is an additional advantage.

Construction materials constitute another branch that has already started to expand and which, with the necessary investment, could become a priority sector with enormous potential for growth. Domestic resources of raw materials are the main incentive for its long-standing development. Some of the goods in this subsector are cement, glass, bricks, construction stone, gypsum, linoleum, ceramics, glues, insulation materials, etc. Mineral water, although currently neglected, could also become an interesting industry.

There is evidence of a medium- and long-term development promise of several branches of the machinery and equipment sector. Moldova has some experience in the production of parts and components for this type of products and it has already begun to implement subcontracting order for Western European companies. These include electro-technical equipment, electric and electronic devices, industrial refrigerators, pumps, tractors and agricultural machinery, medical equipment, communication technology, energy production, metal processing and other elements of the engineering industry.

For subcontracting firms, the necessary skills that need to be present are accounting, industrial safety, logistics, quality control, machinery operation, optimization of processes, plus the skills specific to the type of industry. Since most of the partner firms would come from Western Europe, knowledge of the English language would also be convenient. Relevant to the subsector of construction materials, the required skills are materials technology, mining/extraction techniques, production methods, industrial safety, quality control, product packaging, marketing and distribution. Finally, the hard industry with long-term development potential need a series of specialized engineering knowledge and skills in areas like electronics, hydraulics, mechanics and others, in addition to industrial skills (quality control, safety, optimization of processes, modern production techniques, product packaging and marketing, etc.)

3.4.3. Services

Based on the underdeveloped state of some services, there is an important prospective of growth

in this sector. Financial intermediation, banking services, insurance, marketing, communications, legal consultation and other business services are the main areas with positive potential. As the rest of the economy grows and investment increases, there will be a greater demand for these services.

The location of the country in the intersection of Europe and the CIS economies could be a strategic point for the impulse of the transportation services. Despite the bad conditions of the local network of roads, this remains an important area of growth. Additionally, the construction of the port on the Danube in the Southern tip of the country can also open many possibilities for the development of storage and freight services.

Tourism, although currently unsupported, could become a strategic sector for regional development. Initially, the main target group for these services could consist of the Moldovans who work abroad and who return temporarily and definitively to the country. Afterwards, the natural and cultural assets of the country (health spas, wine routes, historical places, hunting areas and others) could attract a broader population of visitors. However, due to the dismal condition of facilities and critic underdevelopment in most areas, this only remains a long-term possibility.

General financial and business services require human resources with specialized skills in accounting, banking services, evaluation and use of financial instruments, marketing, general management, human resources management, legal issues, tax regulation, information technologies, languages and many others. In addition to these, tourism needs the development of bar, restaurant and hotel personnel, plus travel agents, tourist guides and translators.

3.5. Emigration and remittances from Moldovans abroad

3.5.1. The incidence of emigration

Since independence, Moldovans have emigrated *en masse*, both regularly and irregularly. Some of the factors that have motivated this phenomenon are political instability, economic downfall, poverty, deficient border control and others. At present, there exist powerful trafficking networks and established migration routes.

Migration in a regular situation is mainly directed to Romania and Russia. By 2000, around 200 000 Moldovans had gained citizenship for the former country. An important number of highly qualified labour force migrated to the latter during the initial years of transition; in the same year, approximately 60 000 Moldovans were already holding a Russian passport.⁷⁸ Although marginal, two bilateral treaties of labour migration were signed with Greece and Italy, but countries like Germany, Poland, Hungary and Israel have refused an official agreement.

In relation to irregular and/or temporary migration, official Moldovan sources calculate that the stock of Moldovans abroad in 2003 was 234 000. However, most unofficial estimates point to a staggering figure of 600 000 Moldovan abroad, most of them irregularly.^{79, 80} This is equivalent

78 UNDP, op. cit., p. 36.

79 "Over 11% of Moldova's labour force abroad", in *BBC Monitoring Former Soviet Union – Political*, 19 February 2003, p. 1.

80 The range of unofficial estimates vary from 500 000 to 800 000, although the most common is the number presented.

to over 16% of the remaining population, around 30% of the labour force or more than one-third of the EAP. Moreover, it is calculated that around 120 000 Moldovans leave the country each year.⁸¹ The main countries of destination are Russia, Romania, Germany, Greece, Italy, Portugal, France, Hungary and others. The typical profile of an irregular emigrant is that of a young man from a rural area.

Though temporarily, emigration can bring some positive consequences for the Moldovan society: relief in the pressure for social expenditure, as migration generally originates in the marginalized strata of the population; upgrading opportunity for the labour force, as a possibility to acquire the skills present in modern enterprises in developed economies; income from remittances; etc. However, the negative consequences are worryingly numerous: “brain drain”, declining population, development of networks of human trafficking, illegal transit of goods, corruption and others.

One of the most important points on the harmful side of migration is human trafficking. As it was exposed before, Moldovan is the main nationality of women and children trafficked for purposes of prostitution in Europe and the Middle East. This problem is growing as a result of the pauperization and the impossibility of many women to sustain themselves and their families. They resort to “agencies” that promise them good prospects abroad. Those who are successful in reaching the country of destination end up, most of the times, working in prostitution or household help, without any legal status and left to the mercy of the traffickers. It is believed that up to 1 000 girls are trafficked from Moldova only into Western Europe every year.⁸² Despite the ratification of an anti-trafficking law, little real progress has been done to stop this problem.

3.5.2. Remittances from Moldovans working out of the country

A higher number of Moldovans working abroad also means a larger inflow of remittances. As Figure 23 showed, transfers from nationals abroad have grown exponentially over the last years. By 2002, net remittances sent through official channels represented 240 millions of USD; this quantity was equivalent to 36% of total exports, 205% of FDI, 18% of total external debt, 64% of public revenue or 14% of GDP. If transfers transmitted through unofficial conduits were considered, the amount would grow twofold or even more. Thus, it can be seen that this account has become a substantial income for the economy.

Remittances have two main positive influences on the economy. First, as part of the balance of payments, they function as a sizeable inflow of foreign currency, which serves to partially counterbalance the growing trade deficit. Second, as a mounting source of income for the families, they act as an alleviation of poverty and contribute to consumption and personal savings. Despite their possible perverse effects (inflation, “artificial” support for the domestic currency, temporary mask hiding worsening external imbalances, income inequality and others), remittances can have a very positive influence for the Moldovan economy. If used properly, they can become an important mine for the investment that the country so badly needs. Therefore, there is an urgent need to implement incentives to lure remittances into Moldova through official channels, and then formulate policy measures to guide them into the productive sectors mentioned on the preceding subsection.

81 Munteanu, op. cit., p. 40.

82 Cooke, K. 2003. “The sex traffic: Moldova’s shame and Europe’s sin. Up to 1,000 girls a year have been sold to Western saunas and bars” in *Irish Times*, 3 March 2003, p. 11.

3.5.2.1. How to encourage remittance inflows by formal channels

An important requisite for the alluring of nationals' income earned abroad is economic stability. Experience from other countries (for example, Albania) shows that an uncertain macroeconomic panorama seriously deters inflow of remittances, because emigrants do not want to send their money if inflation is high or there is a risk of devaluation. Another essential requisite is an enforced, up-to-date legal framework that can protect and guarantee any investment realized in the country.

In order to increase official remittance flows, there are basically two measures available: mandatory remittance requirements and incentive schemes. The first one obliges migrants to send a pre-determined proportion of their income back to the country through the domestic banks; failure to comply would result, for example, in the refusal to renew the worker's passport. This policy is clearly effective only when the government has a direct control over the process of labour migration. In the context of Moldova, where most of the emigration is irregular and the authorities do not have control over it, this solution would be unrealistic. The second measure consists of designing investment tools specially designed to appeal to migrants; they usually consist of banking instruments with added benefits. This policy is easily implemented and can be very effective. Migrants send remittances not only for family support, but also for purposes of saving, and these schemes can be an effective way to attract them.

From the various incentives schemes that the authorities of Moldova could apply, one of the most efficient is the repatriable foreign currency account in domestic banks. The incentive of this instrument is that it is not subject to existing foreign exchange regulations and, thus, eliminates all exchange risk: it can be maintained in a foreign currency, which in the case of Moldova could be USD or euro. Sometimes, an additional premium over the world market interest rate is added, in order to further incentive the transfer of remittances. Additionally, the balance in such accounts is usually exempt from income and property taxes. An important disadvantage of this tool is that, by their nature, they mainly attract professional and high-skilled migrants who earn relatively higher income and who are in position to evaluate different investment opportunities and transfer their "investable" resources.

A similar implement is the foreign currency bond. It is very similar to the preceding instrument, only that, being a bond, it ensures the anonymity of the investment. Thus, it could be an effective way to deviate black money into the official channels; a premium interest rate can also work as an incentive. Another scheme is that of banking instruments that simply use premium exchange rates or favourable interest rates, and that are heavily publicized to promote transfers.

3.5.2.2. How to guide remittances into productive uses

Remittances are private transfers, so market forces by themselves cannot normally conduct them to their most productive use. For this reason, a series of appropriate measures are needed. Policy measures in this subject normally take the following shapes: procedures that allow migrants to import industrial material at favourable conditions, training and business guidance, programmes aimed at converting return migrants into entrepreneurs, education allocation savings, joint social investments migrants-local government, and others.

(f) In order to foment the establishment and/or modernization of industrial units, an urgent

aspect for the Moldovan economy, the government can promote the import of the required machinery, equipment, instruments and raw materials at preferential rates. Migrants and their families can then use this opportunity and use their savings in setting up a modern productive business.

- (g) Programmes of business guidance intend to inform the returnees of the priority sectors of the economy or those business opportunities with potential of growth in the near future. In case it is needed, the programme also provides specific training so that the investor can acquire the necessary skills for the chosen activity. Normally, these schemes are complemented by supplementary loans, if they are required. Pooling of savings from several migrants to form a joint venture has proven to be an effective idea.
- (h) Programmes of entrepreneurship development are aimed at those migrants who already possess the idea of an investment in certain business and they only require to learn the essential managerial skills. In the same manners, these schemes are usually complemented by loans at favourable terms.
- (i) Instruments that convert the migrant's savings into an insured educational opportunity for his/her family can also be developed. Since education can be considered as investment in human capital, this can be an alternative way to direct remittances to constructive uses.
- (j) Joint social investments between the migrants of a region and the local government can be established. In these cases, a cooperative of migrants identifies some essential need on their community of origin (building of social infrastructure, acquisition of equipment for clinics or schools and others). The local government evaluates the project; if it is approved, a certain proportion of the migrants' contribution is assigned from the local budget as a complement for the investment (for example, two lei for each leu put in by the group of migrants).

All these incentives should opt for those productive investments with a greater value added (industry over retail trade, for instance), that rely mainly on locally available resources (raw materials, human resources, etc.), that fall on the strategic sector mentioned in the previous chapter and that have the potential to generate employment or trigger the development of the communities.

3.6. Conclusions

Moldova stands now as one of the most catastrophic cases in all transition economies in Europe. In spite of its compliance with the neo-liberal principles, its success in macroeconomic stabilization and its rapid establishment of the basis for a market economy, the social consequences have been disastrous.

Political instability, economic regression, external shocks, indebtedness and complete negligence of the social sphere left the country as the poorest in Europe and one of the most problematic. More than a decade after its independence from the USSR, the main conflict in the region – the secession of Transnistria – remains unsolved. Collapses of internal and external markets, lack of interest of foreign investors and disputes with the international lenders have severely restricted the financing of the economy and risked its future development. The private sector has been unable to be the thriving force that it promised.

During the last four years, growth has resumed, reforms have progressed and conflicts have

attenuated: the future finally starts to look brighter. However, there is still a long road before Moldova can attain its pre-Soviet level and surpass it.

This report enlisted the strategic sectors that could drive the Moldovan economy into real progress. They are concentrated in agriculture and agro-industry, the two primary areas where the country has specialized and where it enjoys an irrefutable comparative advantage. Other activities with a substantial potential of development in the near future are light industry (especially, maquila-type), construction materials, machinery and equipment, as well as most branches of services.

The progress of enterprises in these sectors is conditioned upon the creation of a propitious environment for the nurture of private initiative. Advancement of reforms, improvement of the economic and political atmosphere, encouragement from the government and sufficient investment are prerequisites for the prosperous development of a business structure. Updating the educational and training systems into the new requirements of the enterprises is essential for the improvement of the situation in the labour market.

Moldova is an important labour-exporting country. An important share of the population is currently working overseas, most of the times irregularly. This has important social and economic costs for the republic. However, Moldova could take advantage of the important flow of remittances that its citizens send from abroad.

A correctly designed financial mechanism could attract these transfers into the official banking system. Additionally, an adequate investment and promotion policy could guide these remittances into the key areas of future growth of the economy. The results would be an improved mechanism of development, an amelioration of the social condition of the entire population and an incentive for the return of the migrant workforce.

4. Ukraine

Ukraine possesses an immense stock of resources: its vast territory contains a significant proportion of the world's most fertile soil; it lies in an essential transit route from Central Asia and Russia into Europe; its port in Odessa is one of the most important of the Black Sea; in addition to a sizeable amount of coal, the country's mineral reserves include oil, gas, magnesium and iron ore; the legacy of Soviet industrial infrastructure is enormous, particularly in the Eastern and Northern regions; the labour force is very well-educated and skilled; there is a strong tradition of scientific research in some high-tech sectors; and some others.

In spite of these natural, geographical, industrial and human advantages, the transformation from a Soviet republic into an independent, market-based state has turned into a very turbulent process for Ukraine. In fact, the country was the only one of the transition economies not to have experienced at least one year of economic growth during the decade of the 90s.⁸³ Although this tendency has reversed in the last years, some of the key political and economic prerequisites for sustained development remain incomplete.

This adverse environment had a significant effect on the social conditions of the population,

83 Van Zon, H. 2002. "Alternative scenarios for Ukraine" in *Futures*, Vol. 34, p. 402.

which manifested itself as deteriorating health and education services, growing poverty, emergent income inequality and civil discontent. To escape the distressing socio-political situation, a substantial number of Ukrainians chose to leave the country, in search for a better life elsewhere.

The majority of this emigration occurred under irregular circumstances. Additionally, the location of Ukraine in a transit zone made it a strategic passage route for Asian migrants attempting to reach Central and Western Europe. This created, among many other troubles, an extensive network of human trafficking that frequently targeted women and children. This situation has become one of the major concerns of the international opinion about Ukraine.

4.1. Background

4.1.1. Political proceedings

Independence practically materialized as an external shock for Ukraine. Although anti-communist and nationalistic sentiments came to the surface since the decade of the 80s, the vast majority of the population opted to maintain the republic as part of the USSR, although as a looser association of sovereign states (according to a referendum that took place in 1991).⁸⁴

After the collapse of the Soviet Union, Ukraine became an independent state in August 24, 1991 to the surprise not only of the whole world but also of Ukrainians themselves. Before this event, the republic was part of an integrated union guided politically and economically by Moscow. Its dissolution left Ukraine with an incomplete and disordered productive apparatus, a lack of state institutions and a weak national identity. Although the early political measures applied by the government were relatively successful, they came at the expense of the social and economic well-being of the population.

As of today, the nation possesses a post-Soviet constitution that establishes the division of power between the president, the parliament and the judiciary. The national legislation has slowly taken shape, with the creation or reformation of most laws, like the electoral code, the criminal code, the budget code, the land code, the civil code and the tax code. Also, an important advancement in the transfer of ownership from the state to private hands has taken place. Finally, the only internal conflict with the potential to disrupt stability – the ethnic tension in Crimea – has been successfully settled through the creation of the largely self-governed Autonomous Republic of Crimea.

In terms of its position in the international arena, Ukraine has maintained good relations with all its neighbours (although with occasional frictions with Russia because of energy resources and commercial issues, and Moldova, due to the irregular situation of Transnistria). The country has also maintained a positive association both with NATO (through a Distinctive Partnership) and with the EU (by means of a Partnership and Cooperation Agreement). Besides, Ukraine participates in the CIS, the Black Sea Cooperation Council and other regional treaties. In terms of trade agreements, the republic has signed commercial pacts with several countries in Europe, Asia and America, while the negotiations for WTO membership continue.

84 *idem.*, p. 403.

Although these internal and external features demonstrate the positive changes taking place in Ukraine, the transition process is still in an unfinished stage and the system of governance remains ineffective. This has become apparent in the underdeveloped civil society, the limited application of the rule of law, the high discretionary power of the judiciary, the imbalance of power between the president and the parliament, the lack of transparency in the public administration, the deep-rooted vested interests that hinder an adequate policy-making, the unjustified intervention of the state in the economic activity, the weak support for real reform, the inability of the opposition parties to cooperate and the *de facto* curtailment in freedom of press, among others. The ability and sometimes even the will to overcome these problems are not always present in the government.

One of the most worrying political issues in Ukraine is the close link between the political sphere and the criminal world. This has frequently taken the form of an epidemic of corruption that has infected all the levels of the government and state institutions. This is a consequence of a lack of transparent decision-making, under-diffused legislation, high discretionary power of authorities and low public wages, amid many others. In the 2003 edition of its Corruption Perception Index, Transparency International placed Ukraine in position 106 out of 133 countries. This rank was one of the lowest of the former Soviet republics, below Russia, Moldova, Kazakhstan and Uzbekistan.⁸⁵ The infringement of human rights is another manifestation of the overlapping between politics and crime.

Although the evolution from a communist, externally governed state into an independent, democratic nation is in a fairly advanced state, it remains unfinished. The development of public institutions, the dominion of the rule of law, the strengthening of civil society, the control of corruption and political criminality and the stabilization of the political forces within the system are the main concerns in the Ukrainian political agenda.

4.1.2. Internal macroeconomic panorama

Based on its abundant natural resources, the communist planners assigned agriculture and primary industries (mining, oil processing, steel production and basic chemicals) as the main economic activities for Ukraine. During decades, it specialized in these sectors, obtaining raw materials and subsidized energy from other republics and subsequently distributing its production to the entire Soviet Union. Only 20% of Ukraine's output was made of finished goods, while the remaining majority consisted of intermediate goods that were later processed elsewhere in the USSR.⁸⁶

These strong ties with the Soviet republics were broken when the USSR disintegrated. Ukraine was left with only fragments of a production chain and an inefficient, obsolete industrial infrastructure. When the authorities applied the first transition reforms (price and trade liberalization, initial wave of privatization and creation of market structures) under these circumstances, the economic consequences were disastrous. The overall outcome was disintegration, hierarchical breakdown and decline.⁸⁷

85 Transparency International. 2003. *Transparency International Corruption Perception Index 2003* at <http://www.transparency.org> [10 May 2004], pp. 4-5.

86 International Labour Office (ILO), Central and Eastern European Team. 1999. *Ukraine: Country employment policy review* at <http://www.ilo.org> [29 April 2004], p. 3.

87 Van Zon, H., op. cit., p. 402.

Not only were the domestic entities ill-prepared for competition and a free-market mentality, but they were also dependent on enormous quantities of imported energy that suddenly soared to reach world price levels. The most part of Ukrainian industries found themselves with inefficient production and outdated technology; besides, the traditional markets for its products, both domestic and external, collapsed. As a consequence, the firms suffered large losses and reduced its investment to very low levels. Inter-enterprise debts, wage arrears and taxes unpaid started to accumulate, while barter transactions became more and more frequent. Haphazard policy measures and excessive political interference further complicated the situation.

In the ex-communist states, three phases can be normally identified during transition: decline, stagnation/consolidation and recovery. The first step covers the immediate years after the collapse of the former system and the application of the most painful market reforms. During the second period, the changes start to grow roots in the economy and the productive apparatus commences to adapt to the new ideology. Finally, in the third stage the transformation has been assimilated and growth resumes.

Figure 31 depicts these three phases in the Ukrainian economy. In the first years of independence, from 1991 to 1996, the economy had significant rates of contraction, even reaching 23% in 1994. This was the result of several factors: reduction of production in the presence of higher input prices and a new market structure; decline in competitiveness on internal and external markets; and, sharp decline of consumption as a result of devaluation of savings, fall in real wages and changes in the structure of income.

Eventually, the economy adapted to the new configuration and arrived at the second phase of transition: harmonization of distribution of income among sectors, reinforcement of enterprises and households, gradual resume of investment in fixed capital, etc.⁸⁸ However, the situation was negatively influenced by the financial crisis suffered by Russia, which spread to its main commercial partners, including Ukraine. In the period from 1997 to 1999, even though the rates of growth were still negative, a recovery was noticeable. As it can be seen in Figure 32, it was during this period that the country reached its economic nadir: in 1998 and 1999, the GDP was equivalent to only 45% of its level in 1991.

Finally, starting on the year 2000, the economy reached the third stage and accomplished an upward trend. The accelerated rates of growth during the first four years of the decade were 5.9%, 9.2% 5.2% and 9.4%, respectively.

Even if the positive development in recent years is promising, a more detailed analysis shows that the expansion is not entirely sustainable. One part of it was a consequence of some constructive changes: further advances in privatization, support for SMEs, improvement in public finances, macroeconomic stabilization, progress in the settling of wage and pension arrears, remonetization of the economy, and others. However, another part was based on more volatile factors, namely favourable external environment, an undervalued currency that encouraged exports and utilization of idle capacity in inefficient industries. Substantial progress in structural reforms, deregulation, industrial diversification, updating of infrastructure and a propitious business environment are necessary to maintain this strong recovery of the Ukrainian

⁸⁸ Ukrainian Centre for Economic & Political Studies (UCEPS). 2003. *Market transformation of post-socialist economy and macrostructural shifts in Ukraine* in National Security & Defence, No. 4 (40), p. 18.

economy in the future.

Macroeconomic stabilization was attained by the authorities in the mid-1990s, although less effectively than other transition economies. As a consequence of early price liberalization of energy and raw materials after independence, inflation stretched to 290% in 1991. But high interest rates for bank credits, exchange rate policy, indirect taxes and high public expenditure⁸⁹ caused an uncontrolled increase in prices that reached 2 000% in 1992 and an impressive 10 156% in 1993.⁹⁰

The energetic measures implemented by the NBU and the control over the fiscal imbalances were successful in dominating the hyperinflation and steadying the economy. Inflation fell to 401% in 1994, 182% in 1995 and a two-digit level starting in 1996. The recent trends of prices are illustrated in Figure 33. As the graph shows, inflation continued at manageable levels during the rest of the 90s, although it remained moderately high for international standards. Financial stabilization led inflation to a very low point in 2001 and 2002, but prices augmented by 8.2% in 2003 as a consequence of further liberalization and rising costs of imported goods. As the result of the control over inflation and the general stabilization of the economy, the interest rates also descended, especially after 2000.

One of the most important sources of instability during the last decade was the public financial status. As it is illustrated in Figure 34, since independence and until 1997, the government deficit kept at an unsustainable level. This was an outcome of the slow reform on the state's expenditure, poor planning and the existence of powerful interests reluctant to diminish many of the Soviet-era benefits. In 1998 and 1999, the deficit was controlled, but at the expense of shrinking social expenditure and growing pension and energy arrears.

From 2000, the consolidated finances of the government have considerably improved. Not only has the public balance maintained at sustainable levels (even reaching a surplus), but also pensions overdue have been eliminated and energy arrears somewhat diminished. This positive result was the outcome of a better administration, promotion of tax payment in cash and other measures. The situation is expected to improve further with the recent fiscal reforms approved by the parliament, which include a unified income tax rate of 13% in place of the burdensome scale of rates that existed before, a corporate tax reduction to 25% and a flat rate for the agriculture products. Although other fiscal issues remain unsolved (like the widespread fiscal exemption, the lack of an adequate social taxation, energy arrears and important VAT refunds owed to exporters), the recent developments are expected to make a partial progress in the health of public finances.

The privatization of economic activity in Ukraine has proceeded at a lower pace than in other countries in a similar situation. In the early years of independence, the government transferred virtually all SMEs to private hands and transformed the majority of the Soviet-era communal farms into joint-stock companies. By 1999, 80% of all enterprises, responsible for over 60% of GDP, had already been privatized.⁹¹ However, the state kept some of the most important

89 International Labour Office (ILO), Central and Eastern European Team, op. cit., p. 18.

90 Own calculations based on data from: Statistics Committee of Ukraine. *Annual statistical information* at <http://www.ukrstat.gov.ua> [28 April 2004].

91 United Nations Country team (UNCT). 2002. *Ukraine: Common country assessment* at <http://www.un.kiev.ua/en/undp> [20 April 2004], p. 13.

enterprises, particularly those in primary industries and energy production/distribution, and its strategic privatization has lagged indefinitely as a consequence of the unpopularity of the measure, the strong opposition from some groups and the stringent requirements.

In addition, privatization has so far failed to achieve its expected goal. The sale of many public enterprises was only a nominal transfer; businesses often continued to operate as before, with low investment, ineffective development strategies, wage arrears and a dependence on subsidies and protection from the government. This has deterred increases in competitiveness, productivity and profitability. Neither formation of capital nor structural modernization were attained in most of the cases. This negative outcome of the privatization process in Ukraine is attributed to factors like the initial level of monopolization in many sectors, non-transparency of the sales, weak legislation, heavy political interference, very limited interest of foreign investors, detachment of privatization from other necessary changes in the institutional environment and the negative economic environment during the 90s.⁹²

A connected issue is the high level of monopolization of the economy. As of today, the share of monopolized sectors in the Ukrainian GDP reaches 40%, especially in the sphere of natural resources. The factors that impede competition are the preservation of state monopolies; inadequate taxation and pricing system; lack of state control; legal and administrative restriction to the entry of new capitals; high level of criminal activities in business; and others.⁹³ This market structure is a serious obstacle for the restructuring and progress towards efficiency of production in the country.

Lastly, another relevant situation in the domestic economy in Ukraine is the expansion of the shadow activities. While estimates vary, the majority conclude that the dimension of the informal economy is in the range of 40-60% of total production.⁹⁴ For example, the World Bank reckons that informality amounts to 52.2% of the Gross National Income.⁹⁵

The reasons behind the extent and the rapid growth of the shadow economy are low income of the population, ineffective taxation system, trade regulations and restrictions, unstable legislation, inadequate financing of social services, incorrect process of privatization, uncontrolled borders and many others. The effects of this phenomenon are very negative for the country: corruption and crime, deterioration of the business climate, reduced public budget, lack of investment and social problems.

Despite the unquestionable progress in monetary stabilization and control over the public accounts, the Ukrainian internal economy still shows the effects of an incomplete transition. Not only have important structural reforms lagged behind, but privatization of strategic enterprises has also been blocked. Informality and monopolization have substantially appeared. Moreover, the external performance of the country, as will be exposed later on, is also mixed.

4.1.3. Sectorial tendencies

4.1.3.1. Primary sector

92 Ukrainian Centre for Economic & Political Studies (UCEPS). 2003, op. cit., pp. 6-9.

93 idem., p. 9.

94 International Labour Office (ILO), Central and Eastern European Team, op. cit., p. 7.

95 World Bank Group. *Snapshot of business climate: Ukraine* at <http://www.worldbank.org.ua> [16 April 2004].

The comparative advantage enjoyed by Ukraine in agricultural activities is enormous, thanks to its vast territory and its exceptionally fertile soil. However, the performance of the sector has remained restricted by the problems of the transition to a market structure. Currently, the republic has reached substantial results in privatization of the agricultural structures. The former collective Soviet farms were turned into collective agricultural enterprises and they were reorganized. Small land parcels, farmer households and subsidiary smallholdings were established. According to a recent figure, 70.5% of all arable land and 65% of total agricultural output is already under the responsibility of the private sector.⁹⁶

Nonetheless, a true competitiveness of the private agricultural enterprises has not been achieved yet. For several causes, the agrarian reforms failed to stimulate efficiency and increase productivity in the countryside. First of all, privatization took place in the absence of an adequate law (the new Land Code and Mortgage Law was approved only last year), a situation that often led to chaotic circumstances. Then, there were some technical issues, like the large inherited debts of the agricultural enterprises and the problems in the sharing of property of former collective farms. Finally, the sufficiency of privatization was overestimated, and it was carried out without the necessary support mechanisms: a structure of distribution and marketing networks, preferential credit, simple fiscal procedures (a situation that has just recently been improved), government deregulation, environmentally sustainable farming methods, improvement of the standards of living in the rural areas, etc. In addition, the adverse political and economic factors have also been detrimental for agriculture.

One of the most crucial issues for the primary sector is the downgrading or outdated of agricultural machinery and equipment and the lack of investment in new technology. This has brought about a return to manual farming and an important fall in productivity. It is believed that its current level of depreciation reaches 70-90%.⁹⁷ Thus, the need to replace the equipment is pressing. The main solution to resolve this and rejuvenate the technological stock is the access to an adequate crediting system. Although the reduction of interest rates, the approval of the Mortgage Law and the state support have lately improved the situation, the improvement has not been enough to overcome the state of underdevelopment.

Figure 35 shows the behaviour of agricultural production over the last years. During all the decade of the 1990s, the contraction of the sector was disastrous, surpassing the fall of the overall economy. From accounting around 20% of the total GDP before independence, the primary sector fell to only 11.7% at its lowest point in 1999.^{98, 99} This was a consequence of the above-cited problems in privatization, plus the loss of external markets, shortages of required inputs and inefficiencies introduced by the public sector. However, advances in agrarian reform and the improvement of the economy reversed the situation and agricultural production increased by 10% in both 2000 and 2001; by the latter year, the sector had already regained territory and

96 Ukrainian Centre for Economic & Political Studies (UCEPS). 2001. "Agrarian reform in Ukraine: Achievements and miscalculations" in *National Security & Defence*, No. 5 (17), pp. 6-9.

97 Embassy of the United States of America in Ukraine. 2003. *Ukraine country commercial guide FY 2004* at <http://www.bisnis.doc.gov> [20 April 2004].

98 Economist Intelligence Unit. 2004. *Country profile 2004: Ukraine* at <http://www.eiu.com> [20 April 2004], p. 38.

99 International Monetary Fund (IMF). 2003. *Ukraine: Statistical appendix* at <http://www.imf.org/external/country/UKR/index.htm> [20 April 2004], p. 8.

reclaimed 14.4% of GDP. However, a disastrous grain harvest caused by unfavourable weather provoked a fall of more than 10% in 2003; this event highlights the fragility of the sector and its dependence on uncontrollable climate conditions. The main products of the sector are grains, potatoes, vegetables, sunflower, meat and eggs.

4.1.3.2. Industry

Ukraine is one of the world leaders in terms of reserves and extraction of some mineral resources, particularly coal, iron and magnesium. The country also possesses some relevant deposits of gas and oil. Even in these days, mining is responsible for over 10% of the industrial output.¹⁰⁰ However, the necessary equipment for exploration and extraction is obsolete and this impedes a further development of the sector. Although foreign investors have shown an interest in mining, lack of reliable regulation and government reticence have discouraged them.

Manufacturing, which accounts for almost 75% of total industrial production, has been the main driving force of the pre- and post-independent Ukraine. A substantial part (almost 40% of total industry and over 54% of manufacturing) is composed of heavy industrial branches: metallurgy, chemicals, petrochemical, etc. These are characterized by a low degree of product processing and, as a consequence, a low value-added. In addition, they rely in technologically outdated, energy inefficient and environmentally hostile production methods. The rest of manufacturing output is composed of agro-industries (24% of manufacturing), machine building (17%), light industries (1.8%) and other branches (3.4%).¹⁰¹ However, a positive trend that has been observed recently is the fast growth of high-tech (i.e. machine building) and dynamic (i.e. food processing) subsectors.

The backward technological level of the industries is one of the main concerns for the long-term sustainability of the sector. It is estimated that 60% of the industrial equipment is obsolete or aged.¹⁰² To overcome this problem, a massive level of investment is required to upgrade equipment, foment innovation and improve the efficiency of the production chain.

Another important matter is the high inefficiency of most Ukrainian industries in terms of its energy consumption. In Soviet times, Ukraine specialized in energy-intensive industries and the resources for them were provided from other republics at highly subsidized prices; this promoted inefficiency. In fact, energy consumption per unit of GDP is several times higher than in Western Europe.¹⁰³ The lack of investment has become an obstacle in the improvement of this situation. As of today, Ukraine's energy stance remains precarious, with a very high dependence on imported oil and gas resources. The government has failed to take an adequate, long-term strategy in relation to this issue. Therefore, one of the main challenges for Ukraine is to deviate production from these inefficient, low-value-added industries into sectors with growth potential, dynamism and efficiency.

Overall, the tendency of industrial production has followed a similar path as other transition economies. The first years of transition uncovered the inefficient production methods; the

100 idem., p. 10.

101 idem.

102 Embassy of the United States of America in Ukraine, op. cit.

103 European Community CARDS Programme. 2001. *Ukraine: Country strategy paper 2002-2006 and national indicative programme 2002-2003* at <http://www.europa.eu.int> [28 March 2004], p. 9.

adjustment process led to the disappearance or downsizing of many industries. As a result, the country suffered a process of de-industrialization. However, this has started to revert during this decade and industrial activities are now responsible for one-third of total GDP.¹⁰⁴

Figure 36 follows the recent developments in industrial production. After an acute contraction during most of the 90s, the sector resumed growth in 1999. After 2000 the recovery has been impressive, even reaching year-to-year growth rates of 14.2% in 2001 and 15.8% in 2003. As was mentioned earlier, the prospects for the sector depend on further structural reforms, substantial investment and favourable external conditions.

4.1.3.3. Construction

The fall of both public and private investment led to an important collapse of construction, whose contribution to GDP has halved since independence: from around 7% in the early 90s to only 3.4% in 2002.^{105, 106}

Nevertheless, brighter prospects are expected for this sector. These arise from new works in the energy sector, increasing expenditure in roads and transportation system and infrastructure projects by the state. Additionally, the new Mortgage Law and rising demand are expected to produce a boom in housing construction, both in Kiev and into the regions.

4.1.3.4. Services

During the last years, the share of the tertiary sector in the economy has maintained at fairly stable levels. In 2002, they were responsible for almost 42% of total GDP, disaggregated as follows: trade, 9.8%; transportation and communication 11.5%; and, personal, financial, business and other services, 20.4%

The trade sector was one of the most severely hit by the fluctuations of the economy during transition. From a total number of 143 100 retail trade businesses in 1991, by 2002 there remained only 89 300.¹⁰⁷ Figure 37 depicts the trends in retail trade sales since independence. As it can be observed, trade reacted very similarly to the economic performance of the country, although in inflated proportions (for example, a contraction of 35% in 1993 against a real GDP fall of 14.2%). The economy recovery starting this decade led to positive results in this sector. The improving income and consumer confidence levels are expected to push consumption up and, thus, encourage trade.

One of Ukraine's strategic sectors is transportation. Its large territory, its location in the crossway of two continents and its availability of natural resources make this type of services particularly propitious. For example, a significant portion of the transportation of energy resources from Russia, the Caucasus and Central Asia into Europe is effectuated through Ukraine. As it will be exposed in the next section, these services are one of the most important sources of international income for the economy. An adequate tariff policy and an intensification

104 International Monetary Fund (IMF), op. cit., p. 8.

105 idem.

106 Economist Intelligence Unit, op. cit., p. 42.

107 State Statistics Committee of Ukraine. *Annual statistical information* at <http://www.ukrstat.gov.ua> [28 April 2004].

of infrastructure projects are necessary to realize the potential of this sector. The recent construction of a high-capacity oil pipeline from the Odessa port in the Black Sea to Brody, in Western Ukraine, gives the possibility to transport Caspian imports of oil into Ukraine and, thus, diversify purchases away from Russia; in addition, a further extension of the pipeline would make it possible to carry the Asian oil into CEE. Even though the project has remained idle since its completion, an attractive tariff and marketing policy may turn it into a profitable investment for the country.

In reference to financial and business services, they still remain seriously underdeveloped. Under these circumstances, they provide insufficient support for economic modernization and productive investment. The banking sector, for example, suffers from limited capital, deficient cost structure, high concentration, unsatisfactory legal framework and excessive regulation. Several factors have deterred the improvement of the situation; for instance, the fear of financial instability has led the NBU to maintain the tight regulation of the sector.

Finally, Ukraine has failed to create a niche in tourism, mainly because of its underdeveloped tourist and transport infrastructure and the stringent visa requirement that was active until very recently. However, the enormous potential for this sector remains latent.

4.1.4. External economic accounts

For a short period of time after independence, the RUR continued as the official currency in Ukraine. However, the country was forced to leave the rouble zone and, instead, maintained only the circulation of coupons, known as karbovanets. However, the high rates of inflation described before caused a parallel devaluation in this instrument, which earned the reputation as the most unstable currency in the CIS.

The control over inflation and the introduction of a new currency – the Ukrainian hryvnya (UAH) – in 1996 were essential in attaining exchange rate stability during that year. However, this proved ephemeral as the financial crisis that originated in Russia spread to the whole region. This set off a return to instability, as the UAH strongly devaluated against the USD and appreciated against the RUR. Starting in 2000, the positive macroeconomic trends alleviated the exchange market. Since then, the UAH has maintained at fairly stable levels against the USD and the RUR (although with significant variability for the latter), helped by some intervention of the monetary authority in the market and some foreign-exchange restrictions, like a 50% foreign-currency surrender requirement. Figure 38 depicts these events.

In terms of foreign commerce, Ukraine has had both positive and negative results. On one hand, trade has augmented and the economy has lately shown a positive balance in the current account of its balance of payments; geographical diversification has also intensified. On the other hand, exports have concentrated in only a few sectors, which not only are of low value-added and inefficient, but also face a strong competition from other countries. For this reason, although the overall trade performance appears positive, it is mostly unsustainable and very fragile.

Figure 39 shows the recent trends in the trade of goods. Starting with a deficit in the trade balance, the devaluation during 1997-1999 moderated imports and boosted exports. Since that period and until 2002, the economy has maintained a surplus in its trade of goods. However, a small deficit of 0.5% of GDP was reported last year.

The main Ukrainian exports in 2002 were non-precious metals (38.2% of the total), machinery and equipment (14.1%), food and agricultural products (12.8%), fuel and energy products (11.2%) and chemicals (9.7%).¹⁰⁸ As these proportions show, the country's exports are principally composed of heavy industry (with the exception of agro-industries) with relatively low value-added. Furthermore, the increase in the foreign sale of these products is based on a positive foreign environment and utilization of idle capacity in obsolete, inefficient industries. Most exports concentrate in sectors characterized by declining shares in world trade, tough competition, anti-dumping measures and large fluctuations in demand, while very few are directed to the highly dynamic, technological markets of today's global tendencies.

On the other hand, the principal goods imported by Ukraine in 2002 consisted of fuel and energy products (28.6% of the total), machinery and equipment (21.1%), chemicals (12.4%) and food and agricultural products (6.2%).¹⁰⁹ As these figures prove, energy resources are the main import of the Ukrainian economy, for which the inefficient productive apparatus is mostly responsible. The main resources bought are natural gas, which is needed for the industrial processes, and crude oil, which is subsequently processed internally. The import of high-tech equipment from EU countries is characteristic of Ukraine.

In reference to the destination of products, in 2002 the main buyers of Ukrainian exports were the EU and the accession countries (40.8%) and the CIS (23.4%); nonetheless, the most important individual country remains Russia, with 17.1% of all exports. This proves the tendency of diversification of Ukrainian exports after the financial crisis in Russia and the adoption of the Partnership and Cooperation Agreement with the EU. For example, in 1997 Ukraine exported 39% of its products to the CIS and 29% to the EU and accession countries; these participation ratios have practically switched.¹¹⁰ However, a more successful development of trade with the EU is hampered by a number of factors: low competitiveness, deficient quality, insufficient harmonization with European standards, restriction of access to some segments, very limited amounts of investment from the EU, lack of "market economy" status and others. Furthermore, there is the issue of the recent EU's expansion. On one hand, it can represent an opportunity, in terms of the growing purchasing power of the CEE countries and the elimination of some of the trade restrictions; on the other hand, it can also turn into a threat if the integration of the new members with the EU's common foreign policy directly affects Ukraine's exports.

Inversely, the source of the goods imported by Ukraine during 2002 were the CIS (49.9%) and the EU and the accession countries (31.7%); the main individual country was again Russia, with 35.2% of all imports. Russia is the main provider of energy resources, although the country is trying to diversify into Central Asian markets for these imports. In the last years, there is a tendency towards a rising participation of imports from the EU and a reduction from the CIS, but it is weaker than the diversification observed in exports.¹¹¹

In general, total trade in goods was equivalent to 88.4% of GDP in 2002. This high figure suggests a significant inclination of the Ukrainian economy towards the external markets, provoked partially by the collapsed state of the domestic market. In fact, a recent globalization

108 International Monetary Fund (IMF), *op. cit.*, p. 49.

109 *idem.*, p. 51.

110 *idem.*, p. 48.

111 *idem.*, p. 50.

index placed Ukraine in 11th position out of 62 countries, because of its extremely high level of international trade.¹¹² However, in spite of this indicator, Ukraine cannot be considered a nation integrated into the global economy, because of its low influence on the formation of trade flows and, as it will be explained subsequently, the imperceptible amounts of foreign investment that it receives. Besides, WTO membership has obstructed at the negotiation table for a decade now.

Figure 40 replicates the exercise for the international trade of services. As it can be distinguished, exports of services in Ukraine have consistently been superior to imports of services. In spite of the domestic economic turbulence, the devaluations of the currency and the financial instability in the region, this tendency has kept steady. In 2003, the surplus of the services balance was equivalent to 3.1% of GDP.

67.4% of overall exports of services were attributed to transportation in 2003. This reveals the strategic position of Ukraine at the crossroads of Europe and Asia. Most of these receipts come from cargo services and energy resources transportation from the Black Sea or Russia into Europe. Ukraine is one of the world's largest transporters of natural gas, for which it has a high transit capacity. In addition, it is an important distributor of electricity, oil and petroleum products. Imports, on the other hand, are more diverse: 21.6% in travel services; 15.8% in insurance; 15.6% in transportation; 8.0% in royalties and license fees; and the remaining 39% in other services (business, financial, construction, communication, professional and technical services).¹¹³

As a result of the recent positive results of external commerce of goods and the overall surplus in the services balance, the current account has significantly improved over the last year, as Figure 41 shows. From standing at a modest deficit, it jumped into black numbers in 1999, when it surpassed 5% of GDP. More recently, it reached 7.5% and 5.8% of GDP in 2002 and 2003, respectively.

Foreign investment has importantly kept off Ukraine. The same Figure 41 includes these trends. Net inflows of FDI only exceeded 2% of GDP in 2001 and 2003. The rest of the period they have flown into the country at negligible levels. In fact, Ukraine has attracted only 3% of the total FDI that has entered the into the CEE economies since the start of transition.¹¹⁴ The major reasons behind this negative investment environment are high level of corruption, political and macroeconomic risk, limited domestic market, slow privatization, daunting tax system, discouraging regulation and reputation for the deficient fulfilment of contractual obligations. This lack of foreign involvement in investment is one of the reasons for the lack of progress in the competitiveness of enterprises, especially in the energy sector, high-tech industries and banking. The creation of special economic zones (SEZs), which concede incentives for investment in certain regions, has not been particularly successful. Although the incoming investment was usually directed to light industries and trade, over the last few years machine-building and metallurgy have gradually began to attract attention. The main sources of FDI into Ukraine are the United States, the United Kingdom, the Netherlands, Germany and Russia.¹¹⁵ The negative factors cited above also led to outflows of FPI starting in 1998.

112 Ukrainian Centre for Economic & Political Studies (UCEPS). 2003, op. cit., p. 28.

113 National Bank of Ukraine (NBU). *Balance of payments of Ukraine* at <http://www.bank.gov.ua> [11 May 2004].

114 Economist Intelligence Unit, op. cit., p. 48.

115 idem.

As a final account, external debt has increased considerably over the last decade. From around 550 million USD in 1992, total external debt reached 12 800 millions in 2001. It is estimated that the foreign debt stock further increased to 15 949 millions of USD at the end of 2003.¹¹⁶ However, as a percentage of GDP, debt has maintained at balanced levels, only reaching a maximum of 44% in 1999, as it is depicted in Figure 42. Not only is this figure lower than that of other transition economies, but it also started to decrease as a result of strong GDP growth and monetary stability. Overall debt service has followed a similar trajectory, with an estimated ratio (debt service paid as a proportion of income from export of goods and services) of 11.3% for 2003.¹¹⁷

Although the global external picture for Ukraine shows a positive performance in terms of diversification and rising trade, most of the progress in export originates from inefficient industries that will not be able to sustain it for long without the necessary investment and structural changes. Furthermore, the absence of foreign investment proves that an adverse climate still prevails in the internal economy. These are the major issues that need to be tackled before healthy external developments can be achieved.

4.1.5. Social conditions of the population

As it was exposed in the previous sections, stabilization is consolidating and growth is gradually gaining momentum. For the past few years, the Ukrainian economy has shown reasonably positive signs. However, the same cannot be said of the social state of the population. The improvement of the standards of living of the population has still not arrived: poverty spreads, income inequality increases, social service deteriorates and demographical imbalances persist.

The dissolution of the USSR produced an economic collapse that was felt immediately in the social condition of the Ukrainians. Reduction in employment, falling wages and a disastrous devaluation of savings created a deep and broad poverty in the country. Nowadays, an important share of the population suffers deprived lives, marked by low and insecure incomes.

The United Nations, for instance, calculates that over 25% of the inhabitants are living under the poverty line.¹¹⁸ Other research estimates this indicator to be equal to 35%.¹¹⁹ However, a recent survey concluded that the majority of the citizens (90%) consider themselves poor by international standards.¹²⁰ Irrespective of the exact number, calculated by objective or subjective methods, it is widely accepted that poverty has importantly spread during transition and it has become one of the most worrying aspects of Ukrainian society.

Not only the quantitative aspect of poverty is important, but also the qualitative facet, which is normally assessed in terms of access to essential services. When the country gained independence, it was left with a high-standard system of social services, including education, health and social protection. But the shrinking resources of the public authorities and other

116 *idem.*, p. 31.

117 *idem.*, p. 32.

118 United Nations Country Team, *op. cit.*, p. 11.

119 Van Zon, H., *op. cit.*, p. 19.

120 Standing, G. and Zsoldos, L. 2001. *Coping with insecurity: The Ukrainian people's security survey* at <http://www.ilo.org> [29 April 2004], p. 48.

restrictions produced a deterioration of provision during transition.

Even though literacy is still virtually universal and around 95% of the population have received a secondary education, many concerns have emerged in the last years.¹²¹ To mention some figures, the number of preschool institutions fell from 24 400 in 1991 to 15 300 in 2002. Although the number of general education schools and of teachers kept stable during this period, the number of students decreased from 7.1 millions in 1991/92 to 6.4 millions in 2002/03. The number of vocational schools dropped 23.1% and the number of students decreased by 22.6% in the same period.¹²² In addition, more than a decade of insufficient funding has resulted in a declining educational infrastructure and outdated curricula, especially in the rural sector. Low wages and lack of training have eroded the quality of the instruction imparted by the teachers. The only stratum with consistently improved indicators is higher education, partially as a result of the appearance of private institutions. In 2001, the public expenditure on education was equal to only 3.8% of GDP.¹²³

The health sector is also suffering from a deterioration of services offered. The number of hospitals decreased from 3 900 in the mid-90s to 3 200 in 2001; expenditure in health per capita remains several times below that of other transition economies.¹²⁴ Scarce funding has led to poor quality of services, insufficient attention to preventive medicine and lack of access of services to low-income families. As in the educational services, the low wages paid to doctors and medical personnel have contributed to the decline. The consequences have started to become evident in the population: life expectancy has remained steady for women, but it has decreased for men; the rate of mortality from all causes has risen; nutrition has worsened; tuberculosis has reappeared; HIV is spreading rapidly; and others. Although some legislative modifications addressing these issues have recently taken place, they require strong state support for their effective implementation.

Social protection also reached precarious levels. The number of pensioners augmented from 13.1 millions in 1991 to 14.4 millions in 2002, but the monthly average of pension benefits has maintained at very low levels, especially in the early stage of transition. This can be remarked in Figure 43. Taking into account a poverty line of around 125.5 UAH in 2001 prices,¹²⁵ it can be deduced that the amount paid to pensioners was clearly insufficient during the whole period. The recent improvements were sufficient only to reach the poverty threshold in 2003.

Another social feature of the transition episode in Ukraine is the growth in income inequality. Some estimates calculate that the income of the richest decile of the population is seven times higher than that of the poorest decile.¹²⁶ Another indicator shows that, in front of the growing poverty, the number of millionaires increased from 17 to 1 221 only in the period 1997-2000.¹²⁷ The middle class is shrinking. In terms of geographical inequality, some regions are doing better

121 Economist Intelligence Unit, op. cit., p. 23.

122 State Statistics Committee of Ukraine, op. cit.

123 International Monetary Fund, op. cit., p. 34.

124 Economist Intelligence Unit, op. cit., p. 24.

125 Own calculations based on data from United Nations Country Team, op. cit., p. 11.

126 Ukrainian Centre for Economic & Political Studies. 2003, op. cit., p. 25

127 Standing, G. and Szoldos, L., op. cit., p. 48.

than others: in general terms, the West is lagging behind the more prosperous North and Centre. Some factors that exacerbated the phenomenon of inequality are the exclusion of a larger part of the population from formal economic life, biased privatization of the economy and corruption. The demographic variables are pessimistic as well. Starting in 1992, population has been constantly decreasing, as it can be seen in Figure 44. The number of inhabitants in the country in 2002 was 7.8% lower than in 1991. With this important depopulation trend, Ukraine is ranked in the third position in the world in terms of population decline for the first part of the decade.¹²⁸ This is the combined outcome of decline in the birth rate, increase in mortality and emigration. The future effects of this tendency on the society and the economy are distressing.

Contrary to the experience of other transition economies, the urban population of Ukraine is actually losing ground against the rural population. In 1991, 67.8% of the citizens lived in cities, while the remaining 32.2% was located in the countryside; in 2003, these two proportions were 67.3% and 32.7%, respectively. Although this is only a slight change, it shows the tendency of the de-industrialization of the economy that took place since independence. When firms reduced their labour demand or imposed restrictions on employment, a number of persons retreated to rural areas and integrated into agricultural activities, particularly subsistence farming. However, this phenomenon is starting to reverse, as the better economic performance in drawing people into the cities. Young people are the principal participants in this recent current, especially women (as their ratio of internal migration is 1.5 higher than men).¹²⁹

4.2. Recent events in the labour market

As it happened in all countries during the process of transformation from a communist state into a market-directed system, Ukrainian economic entities were very inefficient in the utilization of production factors. This was analysed in the last chapter, in relation to the wasteful use of energy resources in industry. A similar situation was observed in the labour force.

Under the communist regime, all able-bodied citizens were obliged to work. This created an excessive level employment in the state enterprises and, consequently, low labour productivity. When the country entered into the transition phase, privatization and the development of a market philosophy revealed the inefficiency. In addition, the strong economic collapse after independence further depressed the labour requirements of the enterprises.

However, contrary to what happened in other transition economies, employment only fell to a very limited extent in Ukraine. For example, while the GDP shrank by almost 48% in the period 1992-1996, employment only fell 5.2% in the same interval.¹³⁰ One of the reasons for this slow reaction was the paternalistic attitude (communist-style responsibility) of many enterprises towards their employees. It was also motivated by the high severance payments that firms had to disburse when dismissing workers; instead, they preferred to reduce the number of hours worked or put the employees in unpaid-leave for an indefinite period of time. This triggered off a vast under-utilization of the labour force and, as a consequence, productivity plummeted even further.

Figure 45 includes the recent trend followed by employment. As it was mentioned, although the

128 United Nations Country Team, op. cit., p. 14

129 United Nations Development Programme (UNDP). 2003. *Gender issues in Ukraine: Challenges and opportunities* at <http://www.un.kiev.ua/en/docs/?mdg=3> [20 April 2004], p. 49.

130 Own calculations based on data from: State Statistics Committee of Ukraine, op. cit.

GDP decreased 12.2%, 10% and 3% in the years 1994-1996, employment remained fairly stable. Nonetheless, this singularity of the Ukrainian labour market is fading out. As the enterprises adapt to the mentality of profit, the employment level is beginning to follow the economic cycle. This could already be observed in 1998-1999, when the crisis caused by the financial turmoil in Russia created an important decline in the number of employed persons. Since then, economic recovery has generated a modest increase in the employment level.

In terms of the qualitative level of employment, an important deterioration has taken place. Labour flexibility has become an important outcome of the under-utilization mentioned before. Part-time work has spread over most sectors, especially in industry. Temporary administrative dismissal, a period when the worker is still registered at the enterprise but he or she does not perform any job nor receive any wage, is commonplace.

Another effect of the under-utilization of manpower and the decrease in labour productivity was the unnaturally low level of real wages during the initial years after independence. The real average wage per month is plotted in Figure 46. In first three years, remunerations fell disastrously: in 1993 they stood only at 15% of their level in 1991. Since then, the situation has gradually improved, although the financial crisis at the end of the 90s temporarily stopped the recovery. By 2003, wages had almost reached their 1991 level. Currently, the highest wages are located in industry, transport services, financial activities and public administration; the lowest remunerations are offered in agriculture, healthcare, retail trade, education, and communal, personal and social services.¹³¹

An endemic difficulty in the Ukrainian labour market is the non-payment of wages, initiated by the collapse of demand, heavy taxation and the tight monetary policy. This started a vicious circle of growing wage arrears and falling consumption, in addition to important social insecurity. However, the increasing monetization of the economy and the bright performance of production have started to improve the situation: the amount of unpaid wages fell by 15.2% from 2002 to 2003.

Even if slowly, the structure of employment by economic sector is changing. Figure 47 shows that, while industry is losing ground, agriculture and particularly the tertiary sector are gaining representation. Industry lost 11.4% in the ten-year period 1992-2001, while agriculture and services put on 3.8% and 7.6%, respectively. This is not a result of a consistent growth in the number of employed in the two latter sectors, but rather a declining number of jobs in industry.

In a few words, labour demand has been contracting, as the above trends in employment and wages confirm. Although occurring at a slow pace, the reorganization and restructuring of enterprises have led to fewer jobs. Those who found themselves without a job had the possibility either to register as unemployed or to retreat from the labour market. Both situations had been occurring in Ukraine.

Figure 48 includes the aftermath of contracting labour demand on unemployment. This variable registered increases during the first years of transition and mainly during the financial crisis at the end of last decade. Since then, economic recovery (or formal inactivity) has contributed to

131 State Statistics Committee of Ukraine, op. cit.

diminish the indicator. According to the data, overall unemployment augmented from 5.6% of the labour force in 1995 to its peak of 11.9% in 1999; since then, it has slowly declined to 9.1% in 2003. Despite this reduction, the unemployment rate could rebound in the near future as a consequence of economic instability or further restructuring of important firms (especially in heavy industries and agriculture). The regions hardest hit by unemployment are in the Western parts of the country.

The variable plotted in the graph is the comprehensive ILO definition of unemployment; the official figures give number considerably smaller. The reason for this is that the official calculation only includes those persons that have properly registered as unemployed in the SES offices; but many workers who lose their jobs do not make the effort to sign up because of the low benefits that this entails: unemployment allowances are very low and the job vacancies available at the labour centres are scarce. However, even the ILO indicator underestimates the real situation, because a significant amount of employees are on unpaid-leave. Even though they do not actually work, or only do so a few hours per week, they choose to stay on the “payroll” to keep benefiting from the health and social services of their enterprises. This is usually considered a hidden form of unemployment. Although no accurate measurement is available, an estimation realized in 1997 calculated that actual unemployment was close to 30%, while the ILO figure only indicated 8.9%.¹³²

In recent times, one troublesome feature of unemployment is its long-term character. The depressed labour demand has restricted the number of available jobs; for this reason, those unemployed with low or obsolete skills, little formal education, no experience or other factors that limit their “human capital” usually take a long period of time to find a work. The strata more usually hit by long-term unemployment are young school-leavers, pre-retirement jobless persons and women.

Not all those who lost their employment became part of the statistics on unemployment. Many of them stepped out of the labour market and became part of the economically inactive population. Some became literally inactive, some returned to school, some emigrated and some integrated into the growing ranks of the informal economy. Figure 49 graphs the split of the working-age population into EAP and EIP. Although, the labour force grew at the beginning of the period, the contraction of labour demand derived from the crisis of 1998-1999 motivated many persons to abandon the market and labour supply grew smaller. Since then, the proportion of the EAP on the working-age population has maintained stable.

In addition to their forced decline, another negative feature of the labour supply in Ukraine is the mismatch between the skills offered by the population and those required by the enterprises. Although many of the Soviet industries and production structures have maintained virtually unchanged, it is true that many new enterprises have appeared in all sectors. Furthermore, the liberalization of the markets exposed the country to new technological, productive and administrative methods. The education system has shown a very slow response to these changes, mostly because of the lack of funds to develop new curricula and to train teachers. As a result, the training and education offered is becoming obsolete or inadequate for the emergent tendencies in the labour market. In fact, the highest unemployment rate is currently found in those with a vocational education. These mismatches have further aggravated the employment

132 International Labour Office (ILO), Central and Eastern European Team, *op. cit.*, p. 27.

situation and have contributed to the appearance of long-term unemployment.

As it is illustrated in Figures 45 and 48, Ukraine features an extremely gender-equal labour market in quantitative terms. In 2003, the EAP was formed of 51.1% men and 48.9% women. While the share of men and women in employment were 50.9% and 49.1%, respectively, the unemployment was actually found more often in men (53.0%) than in women (47.0%). Nevertheless, taking into account the qualitative aspects, there are important and systematic gender discrepancies in the labour market.

First of all, women's average monthly wages are 30.7% lower than male wages.¹³³ If one considers that both sexes possess approximately the same educational background (or women's is even higher), then a form of discrimination becomes apparent. In addition, women usually concentrate in activities like retail trade, real estate, education, healthcare and social services; as it was exposed before, these are precisely some of the sectors with the lowest remuneration. Women are also underrepresented in high positions in all sectors. An estimate concludes that the female share of top management reaches only 20.2% and it is relatively higher only in non-productive sectors.¹³⁴ Gender stereotypes and social problems have directed women to low-paid sectors. This limits their possibilities to expand their professional potential, develop their skills and gain higher incomes.

In addition, in a climate of shrinking labour demand, women have more frequently retired from formal economic activity. This can be explained in part by their "double burden" as income-earners and as responsible for their homes. The collapse of social services caused the disappearance of many childcare facilities and other infrastructure, a factor that limited their participation in the labour market: some reduced their working charge (a recent statistic shows that eight out of ten part-time workers are women)¹³⁵ while others gave up work altogether.

Although an important ingredient for the solution of the employment problems lies in a stable economic environment and in sustained growth, an active central policy is also essential. In Ukraine, the authority in charge of this is the Ministry of Labour and Social Policy. In accordance with the Law on Employment of the Population, this state institution develops the employment programmes (annual and short-term, national and local), which define the role of the government in the labour market.

4.3. The environment for the development of SMEs in Ukraine

The experience of developed countries and other transition economies reveals that the small economic units are very flexible in responding to market changes and can effectively incorporate new technologies and production strategies. In addition, they act as the main providers of employment. In Ukraine, the importance of SMEs has been recognized and they have become the target of an increasing amount of attention in the past few years.

The growing tendency shown in Figure 50 demonstrates the development of small-scale enterprises in Ukraine. From 47 084 in 1991, the number of economic units of this size had

133 United Nations Development Programme (UNDP), op. cit., p. 28.

134 idem., p. 30.

135 Shcherbak, O. et al. 2001. *National observatory report on vocational education and training in Ukraine* at <http://www.etf.eu.int> [26 April 2004], p. 8.

increase by more than five times by 2002. Their share of global employment is also growing: in 1998, they accounted for 13.7% of the employed; four years later, this proportion had augmented to 18.9%.¹³⁶ In addition, they are behind 20-30% of the total gross-value added of the economy and were an important element of the economic recovery of the last years.¹³⁷ These figures refer to the formal firms operating in the economy; taking into account the shadow economy, the total is surely much higher.

Because of the low level of investment required, most of the SMEs have concentrated in sectors like trade, repair services, real estate, construction, agriculture and services for legal entities. Enterprises of this size constitute the main form of economic entities in these sectors. Their share in manufacturing and in the most dynamic activities, however, remains modest.

In spite of the explosive growth documented in the cited graph, the political and economic climate for the development of SMEs remains adverse. The actions taken by the government to promote these businesses, like the provision of the new Tax Code, the Law on Entrepreneurship and other instruments, have had a limited effect so far. Some of the major aspects that have so far deterred the favourable progress of SMEs in Ukraine are the following:

- Prevailing macroeconomic and political instability that damaged the investment climate.
- Fiscal and monetary restrictive policies.
- Slow and erratic privatization in some sectors.
- Presence of monopolies and unfair trade practices.
- Unclear and ever-changing legal regulations.
- Dominion of corruption (estimates indicate that in order to open a small business, entrepreneurs need to hand out nearly 2 000 USD in bribes).¹³⁸
- Competition from businesses in the shadow economy, which do not pay taxes and skip state regulation.
- High bureaucratic load of operating a business (in registration, licensing and inspection).
- High, complicated and volatile tax burden (even though this is expected to improve with the new legislation, a deeper set of reforms are needed).
- Lack of capital for investment and difficult access to financing mechanisms because of the weak crediting system.
- Concentration of SMEs in low-dynamics sectors, like trade and some services, which require little investment.
- Low level of state support.
- Absence of a system of encouragement of innovation.
- Lags in the creation of an adequate market infrastructure and lack of market discipline.
- Although growing, limited domestic market and depressed consumption.
- Thinning middle class.
- Low level of domestic savings.
- Insufficient or outdated stock of skills in the labour force.
- Lack of tradition in entrepreneurship and business experience.
- Difficult access to foreign markets resulting from low quality and lack of uniformity with international standards.

136 Own calculations based on data from the State Statistical Committee of Ukraine, op. cit.

137 Ukrainian Centre for Economic & Political Studies (UCEPS). 2003, op. cit., p. 11.

138 Van Zon, H., op. cit., p. 406.

- Very low level of foreign investment in the country.
- Scarce availability of consultation and advisory centres.
- Restricted access to knowledge, information and technology.
- Reticence or negative attitudes towards private activities in certain areas of the country.

The answer to these problems requires an active compromise from the government and the entrepreneurs. Structural reforms, industrial policy, economic stabilization, educational update, deregulation, transparency, internationalization, credit availability and business promotion are some of the measures required. A long-term policy that incorporates all these aspects would help to clarify the panorama for the current and future SMEs in Ukraine.

4.4. Priority sectors with potential of development

4.4.1. Primary sector and agro-industry

Before its independence, Ukraine was known as the “bread basket” or even the “granary” of the USSR because of its extreme potential in agriculture and foodstuff production. In fact, the republic supplied one-third of the entire Soviet Union’s food needs.¹³⁹ Its exceptionally fertile land, propitious climate and labour availability give the country a significant comparative advantage in this sector.

Productivity has constantly declined since independence as a consequence of the scarce and deteriorating machinery, the unavailability of adequate inputs (seeds, fertilizers, etc.) and the lack of investment. However, the successful privatization of land and the reorganization of the communal farms, in addition to the state promotion of favourable credits, augur a positive trend. Although the share of agriculture in the GDP is expected to decrease as the country develops, it will remain significant as a consequence of the definite advantages and the available resources.

The most important commodity in Ukraine’s agriculture consists of grains. Not only are the natural conditions favourable, but the farmers also enjoy a long experience in this crop. Its potential of export remains enormous. Sugar beet, sunflower and vegetables comprise the other chief agricultural products.

Cattle breeding is another subsector with growth potential of the primary sector, especially for the production of beef, pork and eggs. Currently, virtually all the meat produced in the country is exported, principally to Russia. The absence of cattle diseases represents a good opportunity for Ukraine’s animal products.

In order to increase the value-added of these products, the food industry must be promoted. The potential of this manufacturing subsector is proven by the interests of foreign investors, who have directed most of their FDI towards it. Processed vegetable and animal products in a variety of forms (canned vegetables, purees and sauces, beer and wine, processed meat and many others) are some of the fastest-growing sectors in the economy.

In addition to the necessary reforms, state support and market infrastructure required, these activities call for a labour force prepared in the relevant skills. Some of these include modern

¹³⁹ Embassy of the United States of America in Ukraine, op. cit.

farming techniques, greenhouse utilization, animal husbandry, elaboration of vegetable oil, products' hygiene, industry-specific knowledge, compliance of food and nutrition international standards and others. In relation to administrative skills, the most important are those related to packaging, internal and foreign delivery, warehouse management, international commerce, relevant accounting, marketing and quality control.

4.4.2. Non-agricultural industry

As in other countries in a similar situation, Ukraine has an enviable potential for the development of light industry. It has a large, low-cost and high-quality labour supply with a tradition in manufacturing skills. In addition, its geographical position makes it the ideal country to reach markets in both Western Europe and Central Asia. Even though these promising advantages have not been fully exploited up to now, the positive economic performance and the ongoing reforms may attract the attention of investors, both domestic and foreign. The promotion of maquila-type production can prove very attractive due to Ukraine's favourable characteristics. Besides the food subsector, other branches of light industry that could be developed are textile and apparel manufacture, packaging elaboration and assembly lines.

For example, one specific area that has expanded in the last years is the production of computers based on imported components. The high customs rate applied to finished PCs motivated local manufacturers to assemble the finished products based on the separate elements imported at lower rates. This industry is thriving and still has a very positive expectative of growth.

But the potential does not restrict to the assembling of high-tech products. Ukraine has a strong tradition in such technological industries as aeronautics, shipbuilding, military equipment and space equipment. The availability of a research tradition, scientific experience and a highly skilled labour force may spread to other sector as well. For instance, the country possesses an opportunity in the production of bioethanol, one of the most promising and ecologically clean fuels.

Another area with good prospects is the production of construction materials. Up to now, domestic manufacturers' output was sufficient to satisfy the need of the construction industry, but imports are increasing. Ukraine has in its territory the essential raw materials required for this industry. Taking into account the expected boom in housing and infrastructure building, the production of materials is becoming a promising industrial branch.

Other subsectors with substantial prospects for development are the chemical industry (especially pharmaceuticals and fertilizers), oil and gas equipment, general machine building, agriculture equipment and automotive parts. The recent growth of these industries, in contrast to the stagnation of metallurgy and other heavy industries, confirms this potential.

A wide variety of skills are required for the favourable development of these sectors. Some of them are accounting, industrial safety, logistics, quality control, machinery operation, material technology, optimization of processes, product packaging, marketing and distribution, in addition to industry-specific skills to operate machinery, control the production process and market the output. Finally, the heavy industry and high-tech sectors with long-term development potential need a series of specialized engineering knowledge and skills in areas like electronics, mechanics, and others, in addition to industrial skills (quality control, safety, optimization of

processes, modern production techniques, welding, product packaging, etc.)

4.4.3. Services

Not only is transportation the main component of the tertiary sector in Ukraine, it also shows the highest potential for growth. Freight services by land or sea and energy transport between Europe, Russia, the CIS and other countries in the Caspian region and the Middle East are the main opportunities in this area. Both the growing importance of the region and the domestic recovery will incentive this sector. Although the extension and quality of the infrastructure are the most important points, an adequate tariff policy and a trained manpower (in skills like logistics, regional distribution and technical issues) are also essential.

The current lag in telecommunication translates into a potential of development. The gradually expanding purchasing power of the population will turn into a higher demand for this type of services, particularly in mobile telephony, wireless systems and internet.

A similar situation is experienced in financial services. The underdevelopment of the sector and its importance for the correct functioning of the economy make it a promising area. The main activities in this branch are financial intermediation, banking, insurance, marketing, communications, legal consultation and other business services. One specific feature concerns the development of software, in which Ukraine is already coming forward as a promising low-cost site. This sector is already employing between 10 000 and 15 000 professionals and experts estimate that it is prepared to boom anytime soon.¹⁴⁰

General financial and business services require human resources with specialized skills in accounting, banking services, evaluation and use of financial instruments, general management, human resources management, legal issues, tax regulation, information technologies, software development, marketing, languages and many others

Finally, tourism remains as one of the biggest promises for the economy. Beaches, mountains, nature activities, historic towns and bustling cities are the main assets of this sector. Political stability, reduction in entry requirements and growing purchasing power in neighbouring countries are some of the main reasons to believe that a stream of tourists will start entering the country soon. Some areas are already benefiting from these services; for instance, the proceeds from tourism already represent one-half of Crimea's government budget.¹⁴¹ However, the required infrastructure, including transportation, hotels and restaurants, need to be developed first. Additionally, the sector requires the development of bar, restaurant and hotel personnel, plus travel agents, tourist guides and translators.

4.5. Emigration and remittances

4.5.1. Ukrainians abroad...

¹⁴⁰ idem.

¹⁴¹ idem.

Ukraine is an important transportation country for goods and energy resources, as it was exposed before. Its location in the intersection of Europe, Central Asia and the Middle East grant it a status as the premier transit zone in the region. This has been noticed not only by cargo enterprises, but unfortunately also by the networks of migrants and traffickers.

Nowadays, Ukraine stands as one of the main transit countries from Asian migrants into Europe. From their country of origin, they get into Russia and, taking advantage of the transparent border policy with that country, they get easily into Ukraine. There, they convert it into a buffer zone, until they have the opportunity to reach Central or South-Eastern Europe.

Over the last decade, Ukraine has also become an important source of migration into other countries. The worsening labour opportunities, growing poverty, political instability, widening income differences with other economies and popularity of foreign lifestyle have motivated Ukrainians to leave their homes and look for better opportunities abroad.

Most of this migration is conducted irregularly. In the receiving countries, irrespective of their education and qualification, Ukrainians obtain employment as cleaners, construction site workers or seasonal farm labourers.

According to official statistics, there are circa two million Ukrainian citizens working abroad irregularly. However, specialists estimate that this figure is in reality closer to five million. The main country of destination is Russia, followed by Poland, Czech Republic, Italy, Germany, Spain and the United States.¹⁴²

The demographical effects have started to be felt, as the population has worryingly declined by almost 8% since independence, mostly because of the eroding effect of emigration. The loss of part of the highly skilled and working-age labour force is another negative trait. Additionally, emigration flows importantly incentive the appearance of trafficking networks, which usually target women and children. A UNDP study identified that most victims of trafficking in Ukraine are low-income women aged 22-27; they usually are smuggled into the Balkans and Western Europe, where they end up working in forced prostitution, pornography or criminal activities.¹⁴³ This problem has grown considerably, as official calculations conclude that around 400 000 women were trafficked during the last decade, and this figure is probably underestimated.¹⁴⁴

4.5.2 and their remittances

In spite of these concerns over emigration, one of the few constructive consequences is the inflows of money that Ukrainians working abroad transfer to their families. This is an important mitigating factor for poverty and declining social conditions. However, if managed properly, this income might also become an important source of investment for the development of the country.

142 "Five million Ukrainians working irregularly abroad" in *BBC Monitoring Former Soviet Union – Political*, 4 April 2003, p. 1.

143 United Nations Development Programme (UNDP), *op. cit.*, p. 54.

144 International Organization for Migration (IOM). 2001. "Trafficking in migrants" in *IOM Quarterly Bulletin*, No. 23, April.

Although no exact estimation of the amount of remittances that have entered the country is available, some estimation point to 65 billion USD since emigration started, although this figure could raise to 100 billion if informal transfers are taken into account.¹⁴⁵ This income was mainly directed into houses, cars or children's education, while very little was used to set up businesses.¹⁴⁶ If these transfers are directed through official channels towards productive uses, they could be a crucial factor in triggering long-term economic development and relieving poverty.

4.5.2.1. How to encourage remittance inflows by formal channels

An important requisite for the alluring of nationals' income earned abroad is economic stability. Experience from other countries (for example, Albania) shows that an uncertain macroeconomic panorama seriously deters inflow of remittances, because emigrants do not want to send their money if inflation is high or there is a risk of devaluation. Another essential requisite is an enforced, up-to-date legal framework that can protect and guarantee any investment realized in the country.

In order to increase official remittance flows, there are basically two measures available: mandatory remittance requirements and incentive schemes. The first one obliges migrants to send a pre-determined proportion of their income back to the country through the domestic banks; failure to comply would result, for example, in the refusal to renew the worker's passport. This policy is clearly effective only when the government has a direct control over the process of labour migration. In the context of Ukraine, where most of the emigration is irregular and the authorities do not have control over it, this solution would be unrealistic. The second measure consists of designing investment tools specially designed to appeal to migrants; they usually consist of banking instruments with added benefits. This policy is easily implemented and can be very effective. Migrants send remittances not only for family support, but also for purposes of saving, and these schemes can be an effective way to attract them.

From the various incentives schemes that the authorities could apply, one of the most efficient is the repatriable foreign currency account in domestic banks. The incentive of this instrument is that it is not subject to existing foreign exchange regulations and, thus, eliminates all exchange risk: it can be maintained in a foreign currency, which in the case of Ukraine could be USD or euro. Sometimes, an additional premium over the world market interest rate is added, in order to further incentive the transfer of remittances. Additionally, the balance in such accounts is usually exempt from income and property taxes. An important disadvantage of this tool is that, by their nature, they mainly attract professional and high-skilled migrants who earn relatively higher income and who are in position to evaluate different investment opportunities and transfer their "investable" resources.

A similar implement is the foreign currency bond. It is very similar to the preceding instrument, only that, being a bond, it ensures the anonymity of the investment. Thus, it could be an effective way to deviate black money into the official channels; a premium interest rate can also work as

145 "Five million Ukrainians working irregularly abroad", op. cit.

146 "Special report. Cash in their pockets: Emigration from Ukraine" in *The Economist*, Vol. 369, Iss. 8347, 25 October 2003, p. 24.

an incentive. Another scheme is that of banking instruments that simply use premium exchange rates or favourable interest rates, and that are heavily publicized to promote transfers.

4.5.2.2. How to guide remittances into productive uses

Remittances are private transfers, so market forces by themselves cannot normally conduct them to their most productive use. For this reason, a series of appropriate measures are needed. Policy measures in this subject normally take the following shapes: procedures that allow migrants to import industrial material at favourable conditions, training and business guidance, programmes aimed at converting return migrants into entrepreneurs, education allocation savings, joint social investments migrants-local government, and others.

- (k) In order to foment the establishment and/or modernization of industrial units, an urgent aspect for the Ukrainian economy, the government can promote the import of the required machinery, equipment, instruments and raw materials at preferential rates. Migrants and their families can then use this opportunity and use their savings in setting up a modern productive business.
- (l) Programmes of business guidance intend to inform the returnees of the priority sectors of the economy or those business opportunities with potential of growth in the near future. In case it is needed, the programme also provides specific training so that the investor can acquire the necessary skills for the chosen activity. Normally, these schemes are complemented by supplementary loans, if they are required. Pooling of savings from several migrants to form a joint venture has proven to be an effective idea.
- (m) Programmes of entrepreneurship development are aimed at those migrants who already possess the idea of an investment in certain business and they only require to learn the essential managerial skills. In the same manners, these schemes are usually complemented by loans at favourable terms.
- (p) Instruments that convert the migrant's savings into an insured educational opportunity for his/her family can also be developed. Since education can be considered as investment in human capital, this can be an alternative way to direct remittances to constructive uses.
- (o) Joint social investments between the migrants of a region and the local government can be established. In these cases, a cooperative of migrants identifies some essential need on their community of origin (building of social infrastructure, acquisition of equipment for clinics or schools and others). The local government evaluates the project; if it is approved, a certain proportion of the migrants' contribution is assigned from the local budget as a complement for the investment (for example, two units for each unit put in by the group of migrants).

All these incentives should opt for those productive investments with a greater value added (industry over retail trade, for instance), that rely mainly on locally available resources (raw materials, human resources, etc.), that fall on the strategic sectors mentioned in the previous chapter and that have the potential to generate employment or trigger a process of regional development.

4.6. Conclusions

In spite of the irrefutable progress in liberalization, deregulation and privatization, there is still a

long way ahead before Ukraine can leave its status of “transition economy” behind. Macroeconomic stabilization and international trade liberalization have advanced, and the authorities have approved essential reforms; however, the country remains fragile and its transformation into a market economy is still incomplete.

The main concerns of the present-day Ukraine are the immature political system, widespread corruption, extension of the informal economy, unfinished privatization, low levels of investment, poverty, income inequality, deteriorating social conditions and population decline. These issues need to be confronted in order to sustain the positive tendencies of the last few years over the long-term and improve the standards of living of the population.

Ukraine features comparative advantages in some strategic sectors; for this reason, most of the support should be directed towards them. In the primary sector, fertile land and favourable climate benefit the agricultural production of grains and vegetables, in addition to cattle breeding. In manufacture, the tradition and experience of Ukrainians in heavy industry and high-tech sectors could promote other subsectors, like chemicals, construction materials, machine building, light industries and assembly lines. Finally, the areas with more potential in the tertiary sector include transportation and communication, financial intermediation and banking, business services, software development and tourism.

However, the virtual lack of savings of the population and the low level of investment, among other factors, have importantly hampered the development of SMEs in these priority areas. As a significant opportunity, the country can take advantage of the remittances sent from its citizens working abroad. First, these transfers should be directed through formal channels, promoted by financial incentives; then, they should be guided into productive businesses in the strategic sectors. The preceding chapter described some of the measures that could be followed by the government to achieve this result.

The continuation of the favourable economic environment, the political compromise and the investments in productive areas are the main conditions to achieve progress. These points constitute the required conditions for the long-term development of the country, the support of a vigorous labour market and the improvement of the living conditions of all the Ukrainians.

5. Conclusions

In spite of their economic underperformance and political letdown since the collapse of communism, the three countries analysed in the present study hold a great potential. Although still struggling with obstacles, their institutions are slowly adapting to the structures of a free-market economy and democratic principles. This can be observed in the improving political climate and the positive macroeconomic accomplishments of the past few years.

Nonetheless, this positive trend has yet to show in the social sphere. In the three nations, the quality of life of the population continues to deteriorate: monetary and non-monetary poverty is growing, as well as the income inequality between social groups; health and education services are still below their pre-transition levels; social security is declining and a high level of discontent remains present. Among many other consequences, this situation has caused an impressive outflow of nationals into other countries. Although this labour migration has

stabilized in Albania, it stills continues to grow in the other two countries. Since the emigration figures have reached two-digit figures in terms of the proportion of the EAP, the issue should take a central role in the policy-making inside each nation.

But transition is underway and there is no way back. The government of each country should set the necessary conditions for the adequate operation of a free-market system: political transparency and effectiveness, respect for basic human rights, macroeconomic stability and many more. An essential element is the promotion of private entrepreneurship. The experience of other countries has shown that private businesses, especially SMEs, are quintessential during transition and indispensable to attain a lasting economic development.

Private enterprises, guided by the government, should take advantage of each country's strategic sectors with a potential for growth. In Albania, these include agriculture (particularly fruits, vegetables and medical herbs), construction, light industry, handicrafts, tourism and transportation services. For Moldova, they are located in agriculture and agroindustry, particularly wine, tobacco, sugar, processed fruits and vegetables, meat and dairy products, and oil; there is also a high potential for light industries, the production of construction materials and transportation. Finally, Ukraine shows good prospects in agriculture (grains, sugar, sunflower and vegetables), cattle breeding, diverse agroindustry, light industries and assembling, chemical industry, machine building, automotive parts production, transportation, financial and business services, and tourism.

The government institutions should provide the existing and the new enterprises with the necessary conditions for their propitious development. These generally include a sound economic environment, access to credit, reduced bureaucracy in opening and operating a business, favourable regulation, incentives for technological updating, skills development in the areas needed and some others.

As it was shown in the report, one factor that these three countries have in common is the large stock of nationals working abroad. The labour migrants usually send money to their relatives back in their homeland through formal or informal channels. However, as of today, most of these transfers are used for consumption and very little for productive investment. For this reason, there exists a strategic opportunity to use these remittances to start an SME or invest in an existing one and, thus, contribute with the development of the country.

There are several ways to achieve this. The first step is to attract the transfers to the formal (i.e. banking) channels. The most efficient method to accomplish this is to create instruments with incentives especially designed for migrants. For instance, they can take the form of a bank account in foreign currency and with a favourable interest rate. Next, the remittances need to be guided to productive uses. A correctly calculated policy that encourages investment or opening a new business in the strategic sectors where the country has a particular potential would be required. Some examples of these policies have been presented in the report.

Albania, Moldova and Ukraine need to take advantage of the circumstances. A significant portion of their labour force has left the territories to search an employment abroad. These migrants are not only acquiring important skills in the receiving countries, but they are also sending substantial monetary transfers to their families. Adequately applied, these remittances

can become an incomparable vehicle to develop private enterprises in the branches where each economy has a favourable prospective and, as a consequence, promote employment and growth.

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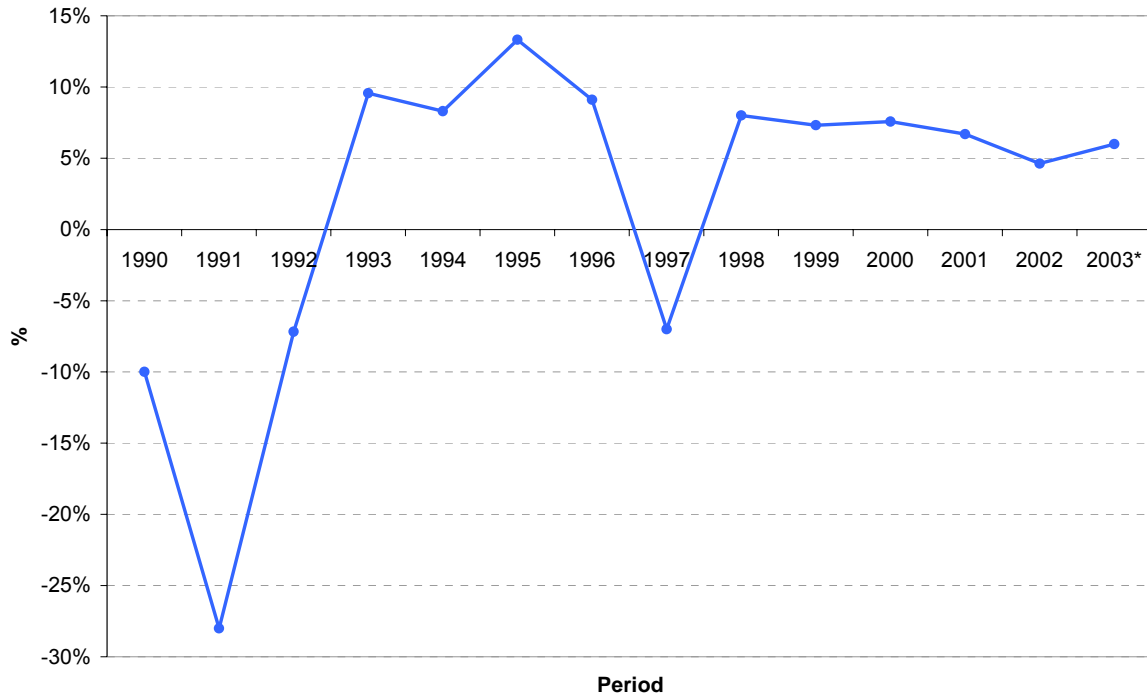
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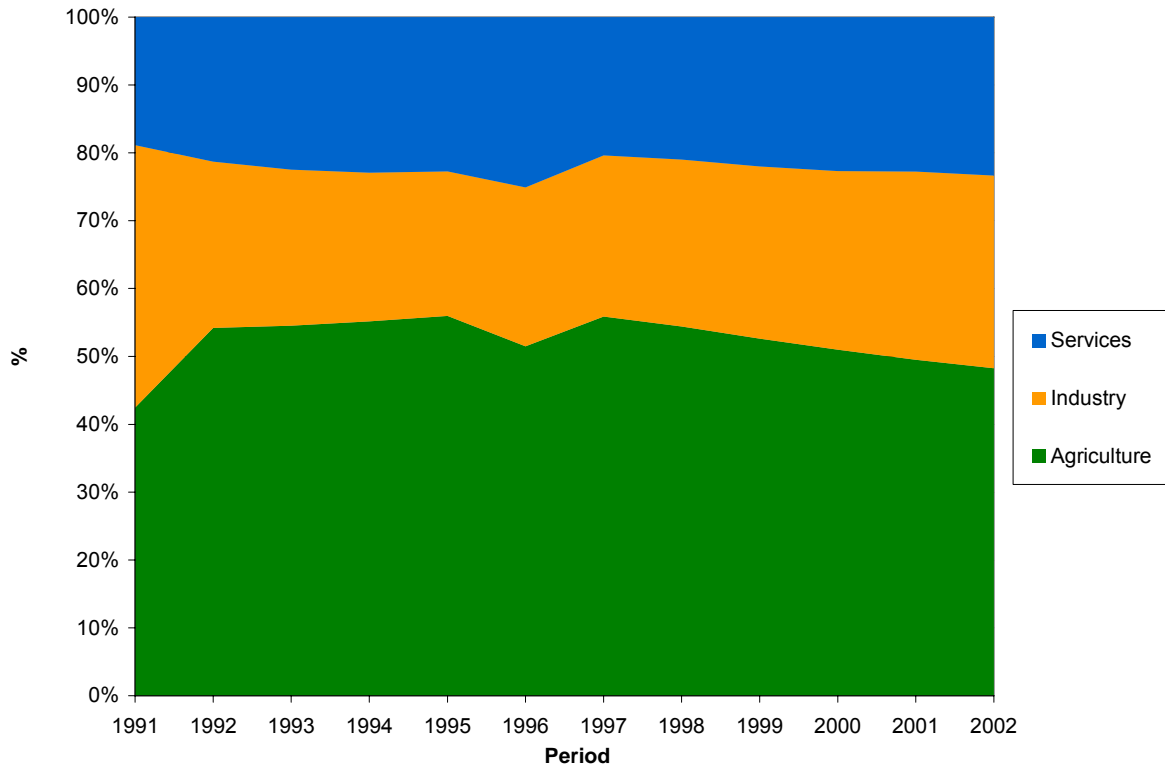
7. Annex: tables and graphs

Figure 1. Real GDP growth, 1990-2003*



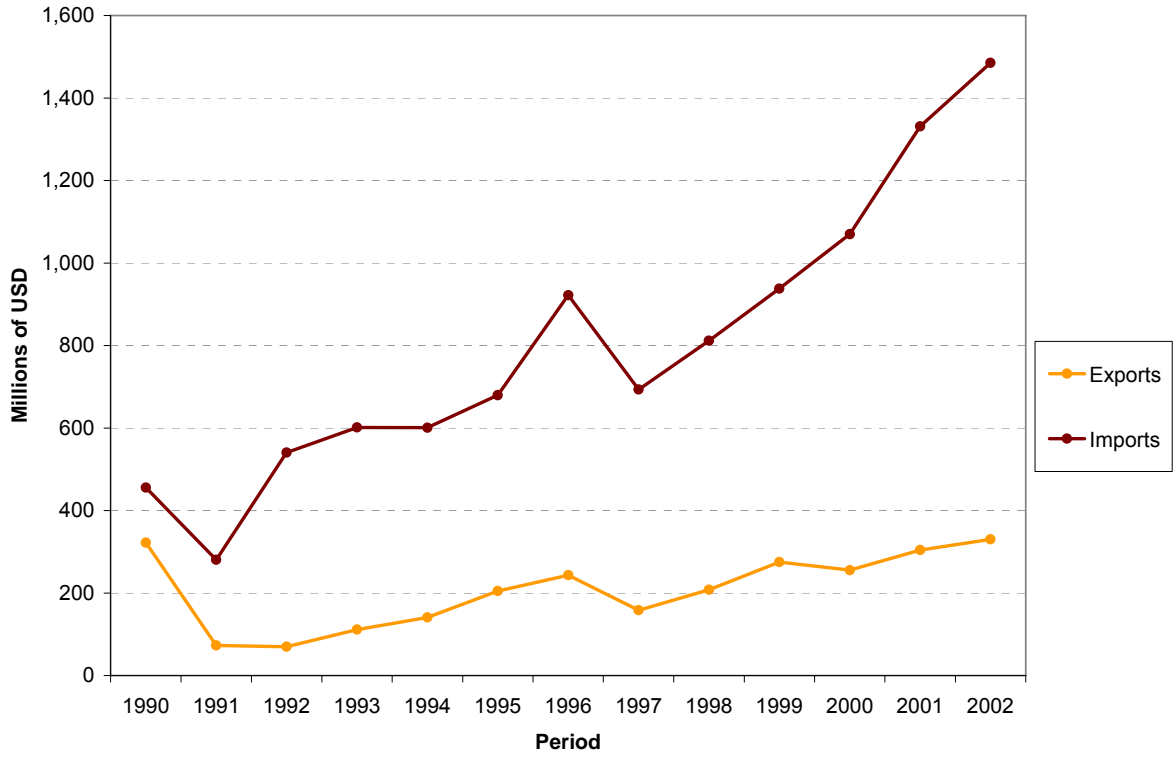
* Estimated.
 Source: Bank of Albania (1990-1995), The Economist Intelligence Unit (1996-2003).
 Note: Change of methodology on the calculation of GDP, only for the years 1996-2000.

Figure 2. Sectorial composition of GDP, 1991-2002



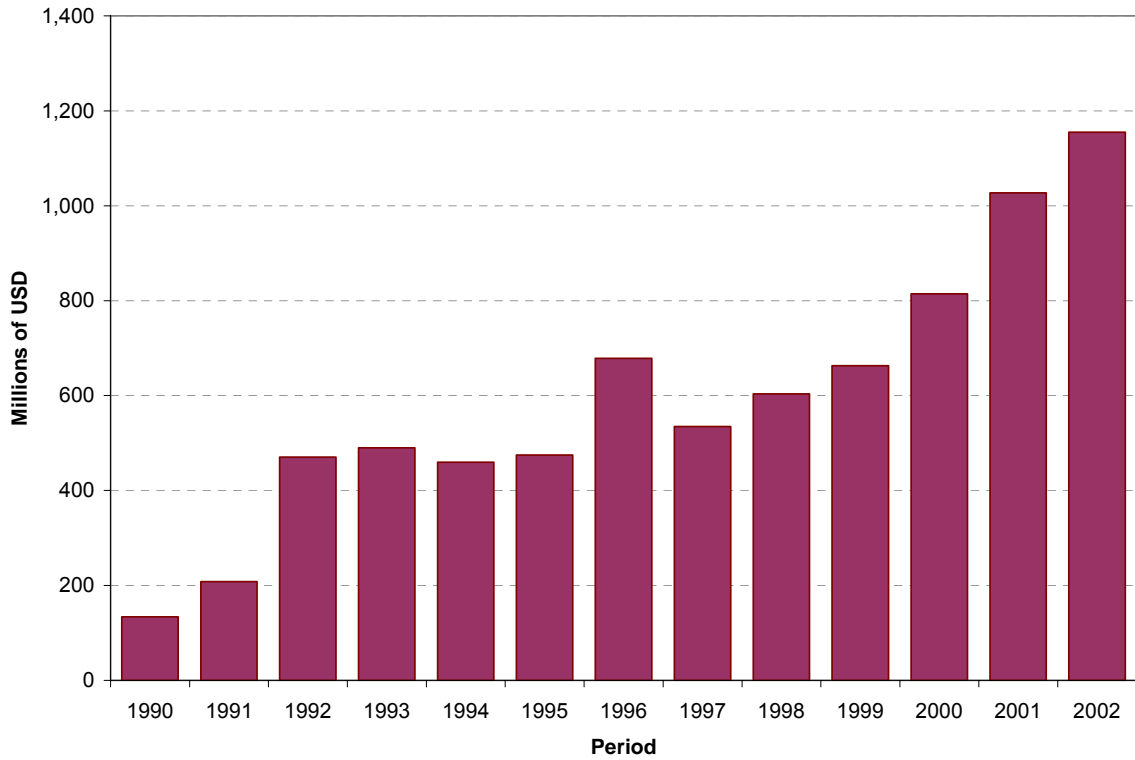
Source: The Economist Intelligence Unit.

Figure 3. Exports and imports, 1990-2002



Source: The Economist Intelligence Unit.

Figure 4. Trade deficit, 1990-2002

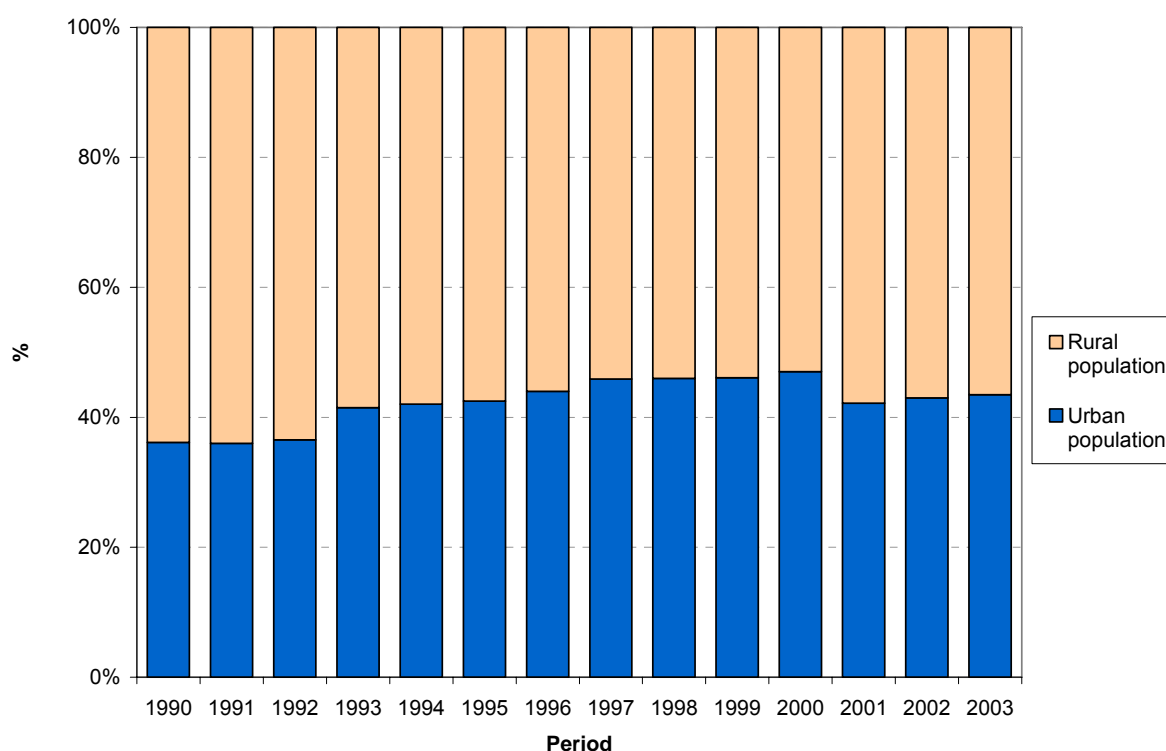


Source: The Economist Intelligence Unit.

Table 1. External accounts as percentage of GDP, 1993-2002

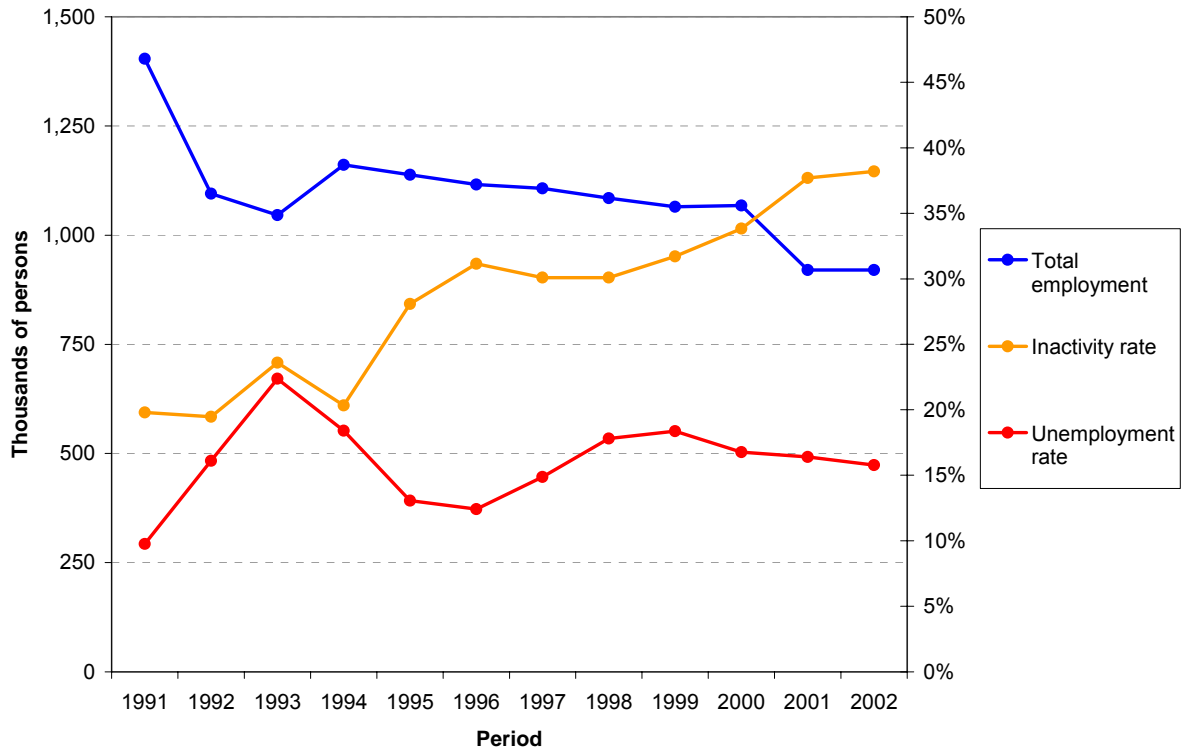
Year	Trade balance	Services balance	Transfers balance	Current account balance	Net foreign direct investment
1993	-38.3%	-6.6%	43.4%	1.2%	2.2%
1994	-23.7%	-2.7%	17.6%	-8.1%	1.2%
1995	-19.5%	-2.4%	19.6%	-0.5%	2.9%
1996	-21.9%	-1.9%	18.1%	-3.5%	2.9%
1997	-23.9%	-2.3%	11.8%	-12.2%	2.1%
1998	-19.9%	-1.4%	16.6%	-2.1%	1.5%
1999	-18.4%	2.9%	9.0%	-4.3%	1.1%
2000	-21.6%	0.5%	14.1%	-4.1%	3.8%
2001	-23.0%	2.0%	12.8%	-4.9%	4.6%
2002	-23.0%	-0.1%	12.5%	-8.1%	2.7%

Source: Bank of Albania (exchange rate, GDP), Economist Intelligence Unit (external accounts).

Figure 5. Distribution of population by urban/rural, 1990-2003

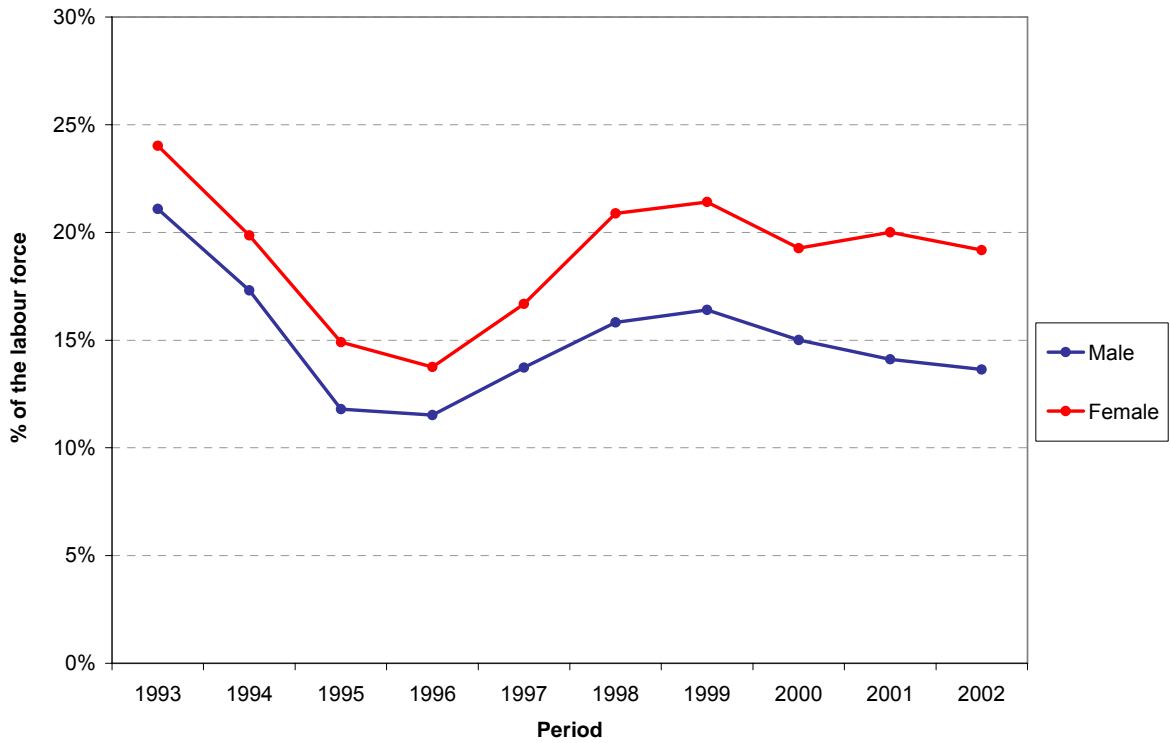
Source: INSTAT (1990-2001), The Economist Intelligence Unit (2002-2003).

Figure 6. Total employment, inactivity rate and unemployment rate, 1991-2002



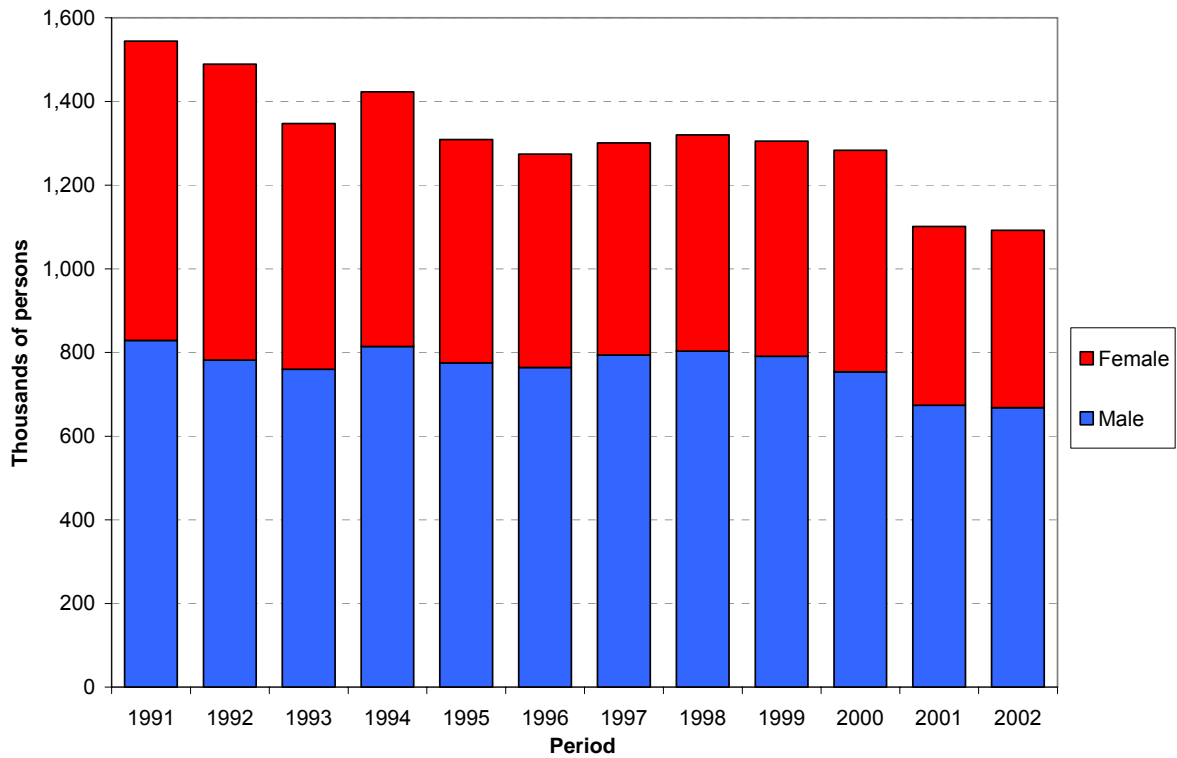
Source: Own calculations, based on data from Ministry of Labour and Social Affairs (2003) and INSTAT.

Figure 7. Unemployment rate by gender, 1993-2002



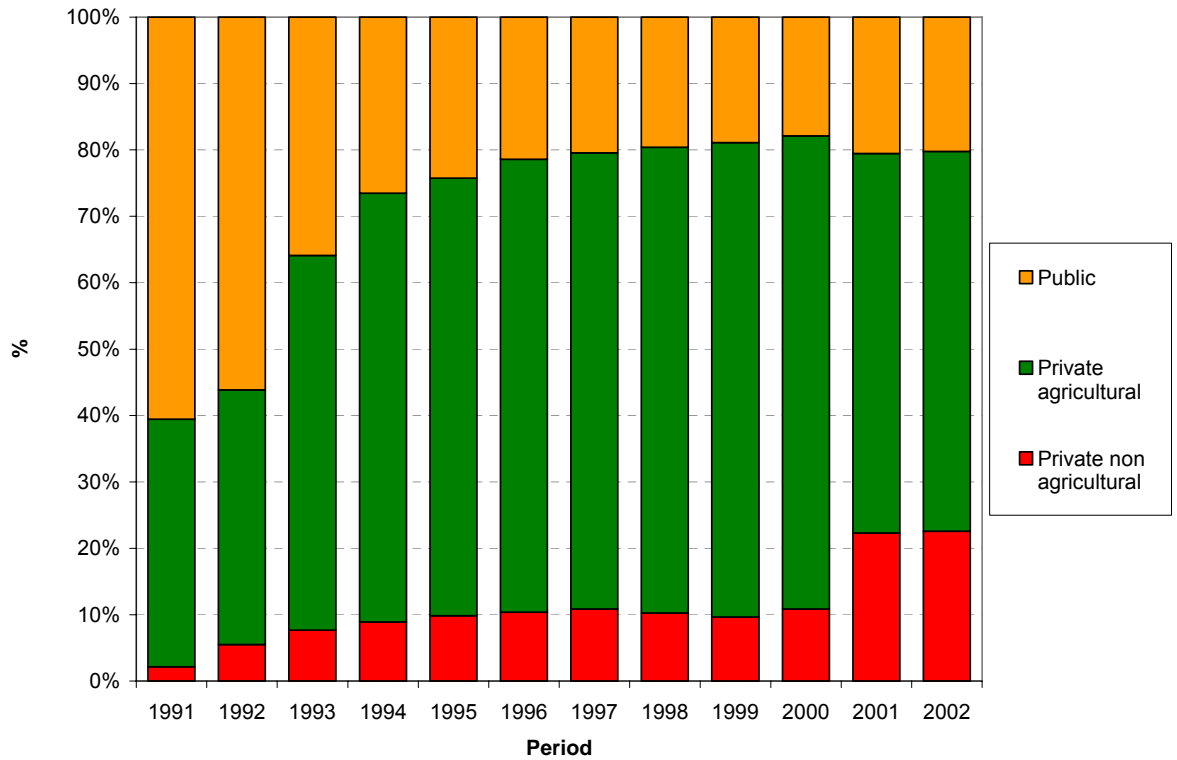
Source: Own calculations, based on data from INSTAT.

Figure 8. Economically active population by gender, 1991-2002



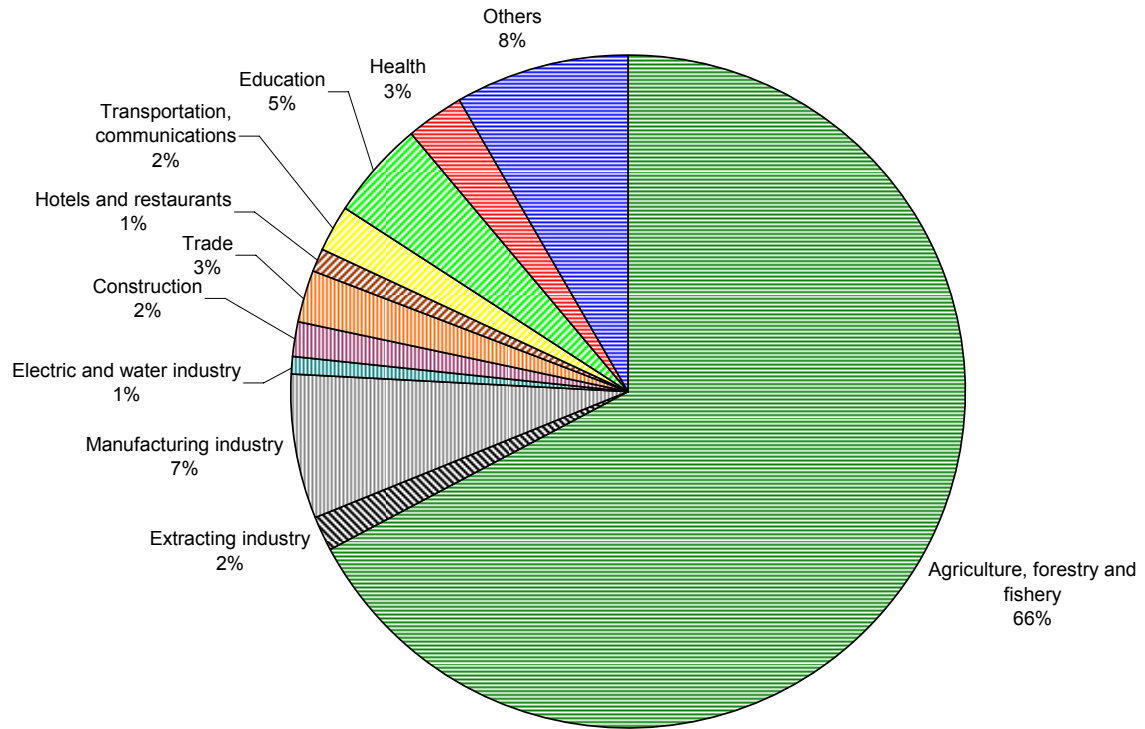
Source: INSTAT.

Figure 9. Employment by sector, 1991-2002



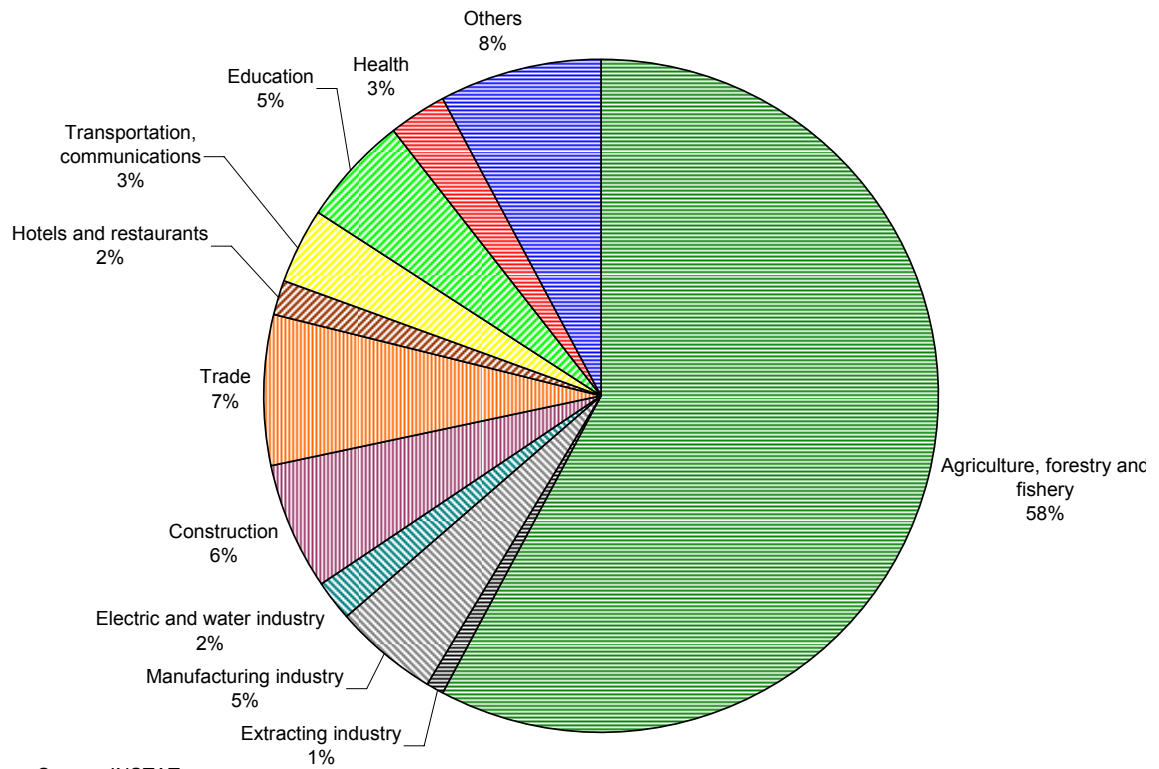
Source: INSTAT.

Figure 10. Employment by economic activity, 1994



Source: INSTAT.

Figure 11. Employment by economic activity, 2002



Source: INSTAT.

Figure 12. Real minimum monthly wage and real average monthly wage in the public sector, 1993-2002

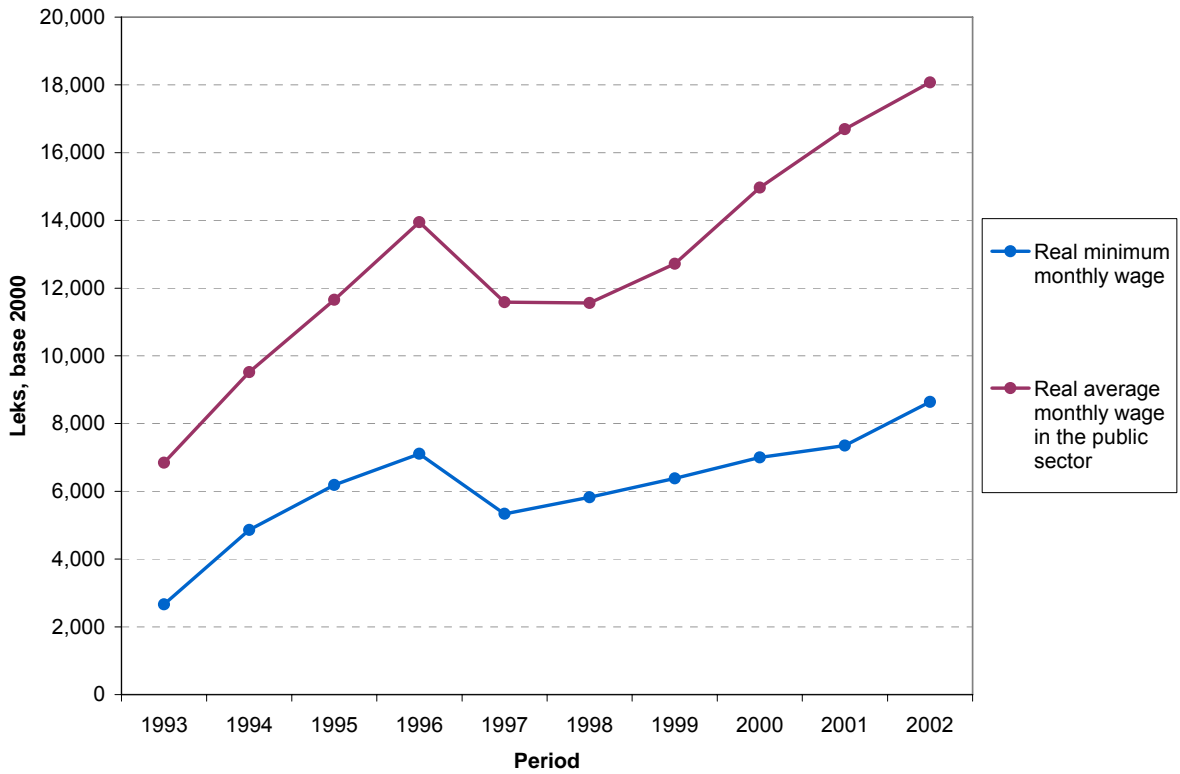


Figure 13. Real average monthly remuneration per employee by economic sector (including private and public sectors), 1997-2001

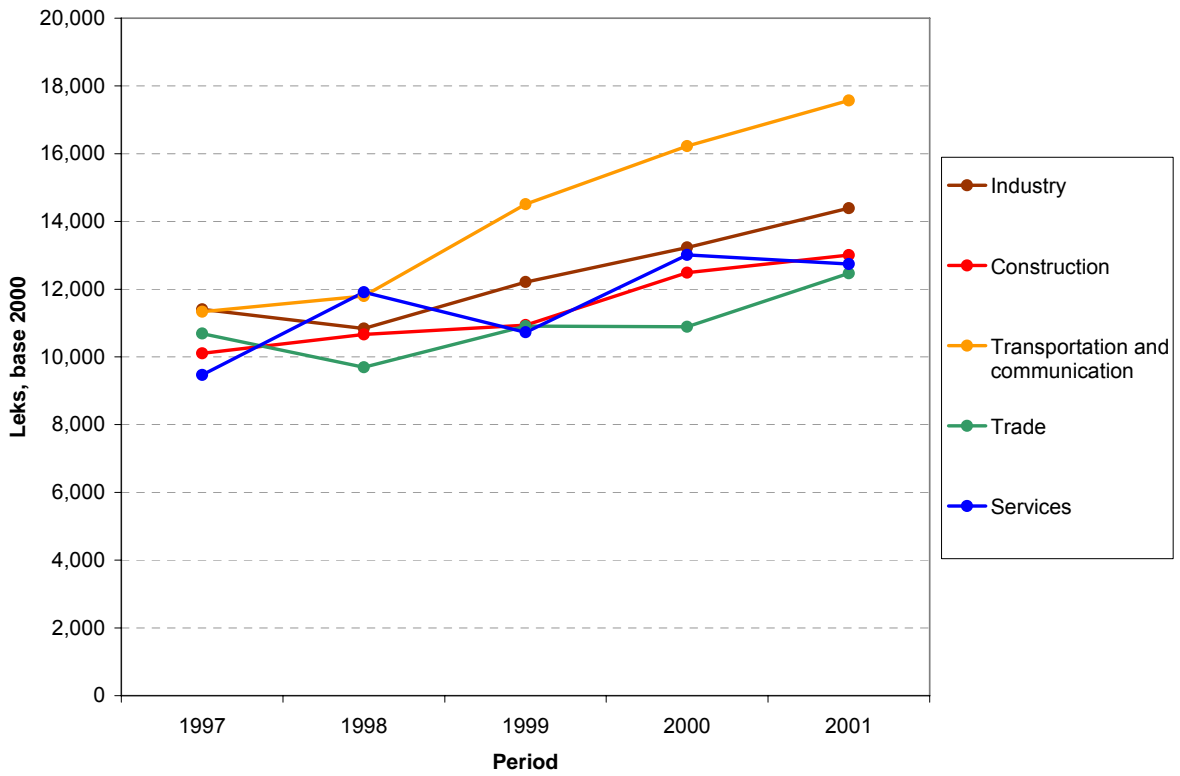
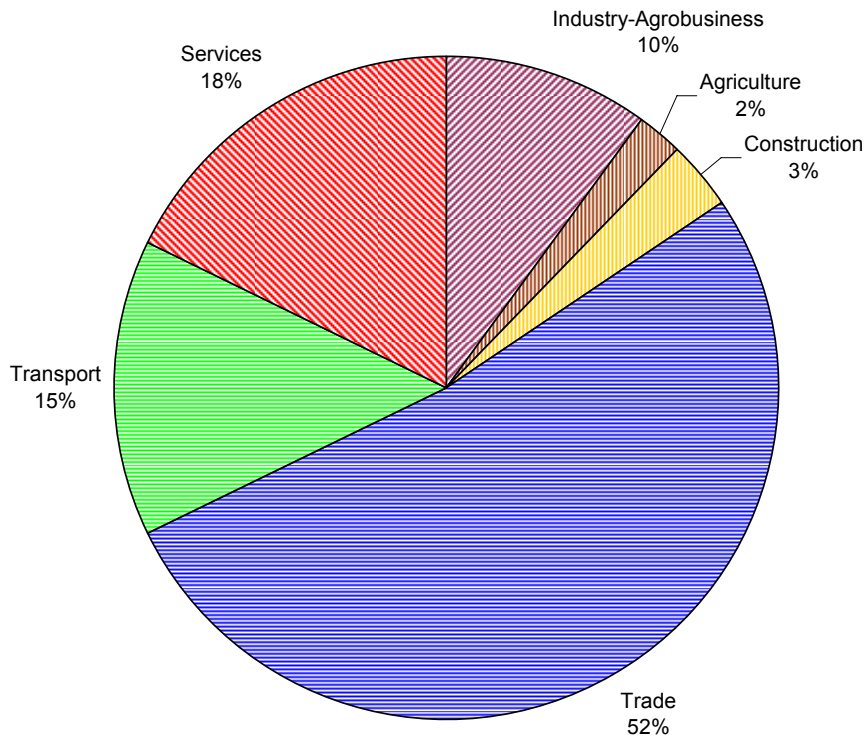
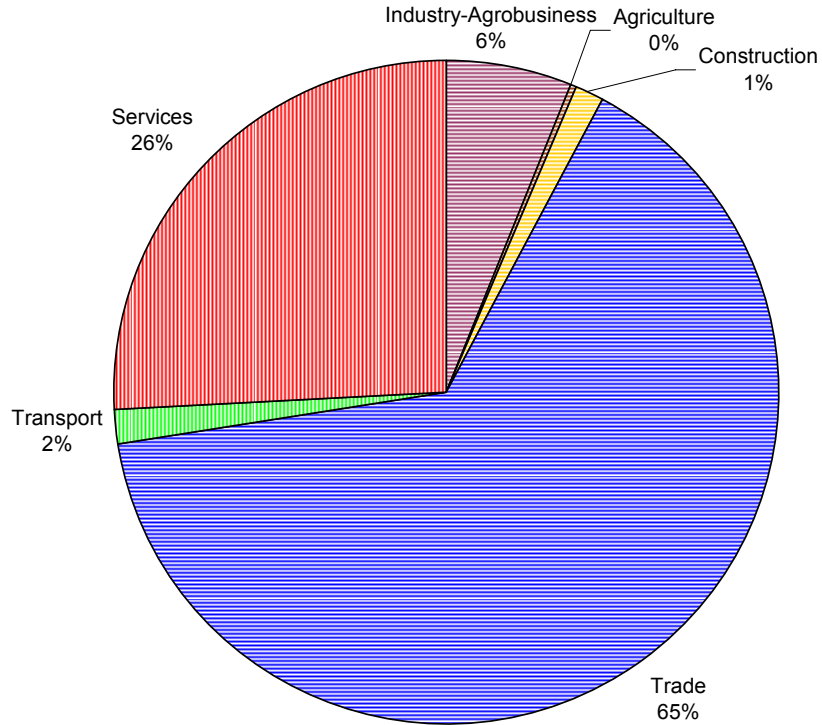


Figure 14. Distribution of private businesses by economic activity, 1998



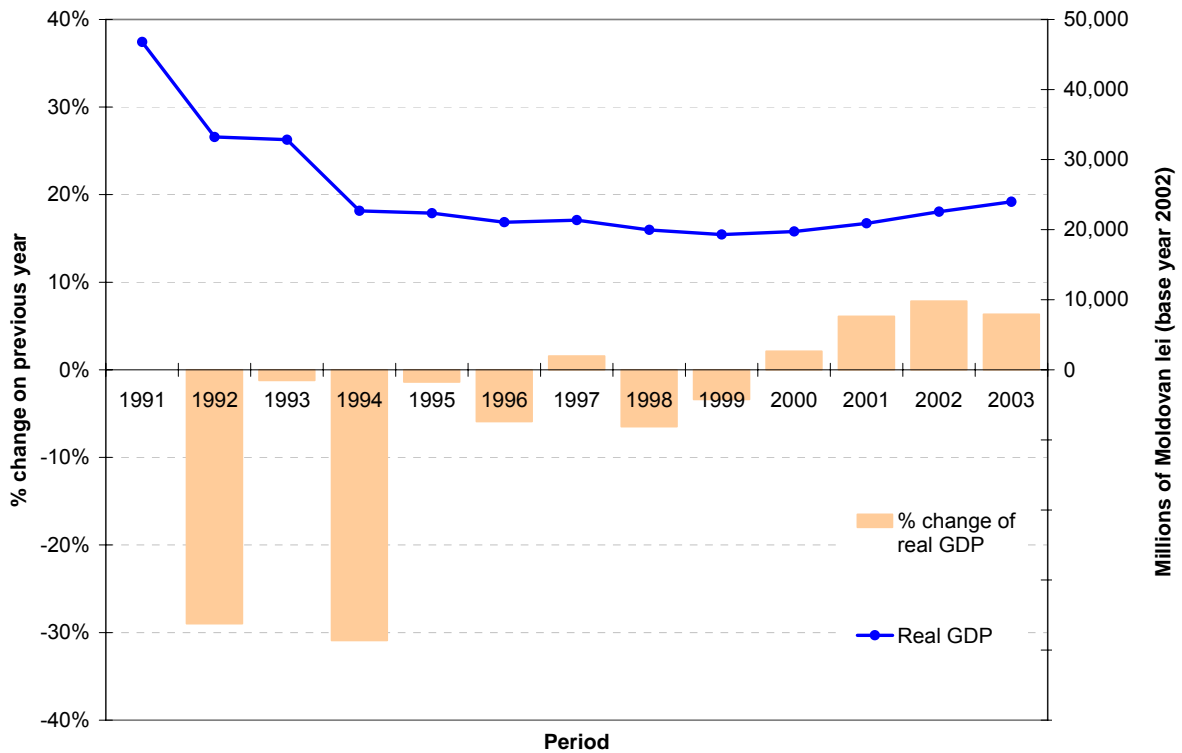
Source: Bezhani, M. 2001. *Women entrepreneurs in Albania*, SEED Working Paper No. 21 (Geneva, ILO), p. 5.

Figure 15. Distribution of women's enterprises by economic activity, 1998



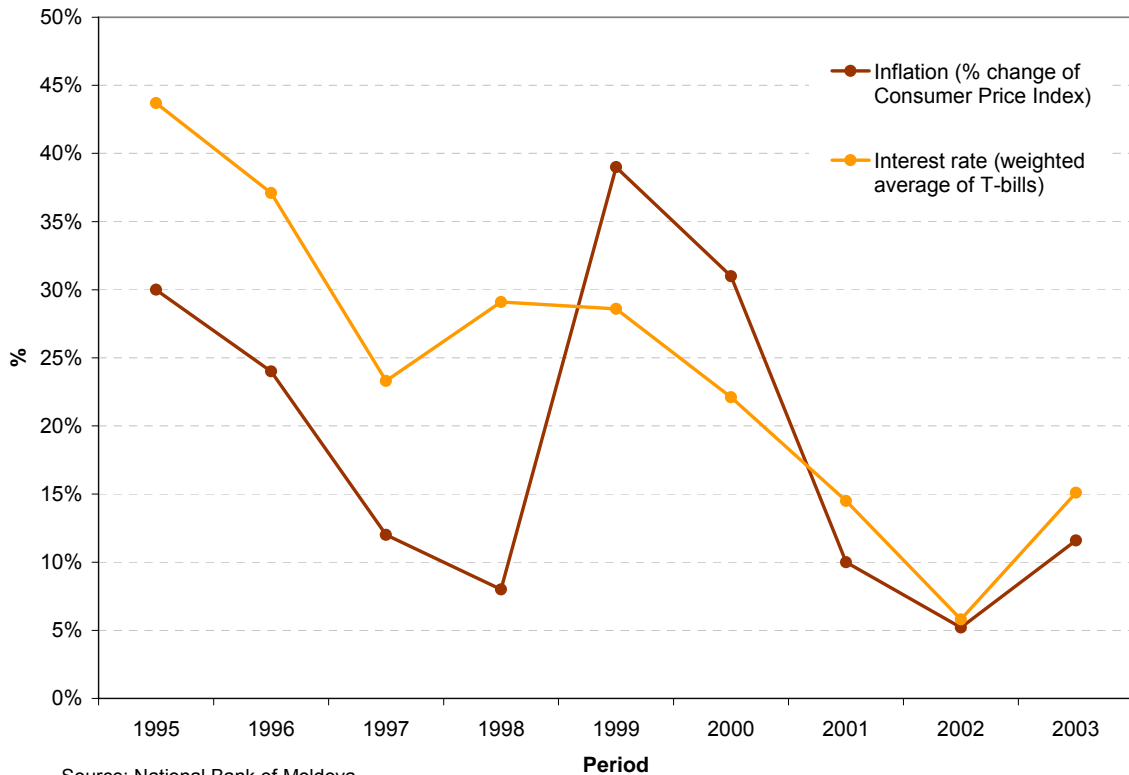
Source: Bezhani, M. 2001. *Women entrepreneurs in Albania*, SEED Working Paper No. 21 (Geneva, ILO), p. 5.

Figure 16. Real GDP and percent change in relation to previous year, 1991-2003



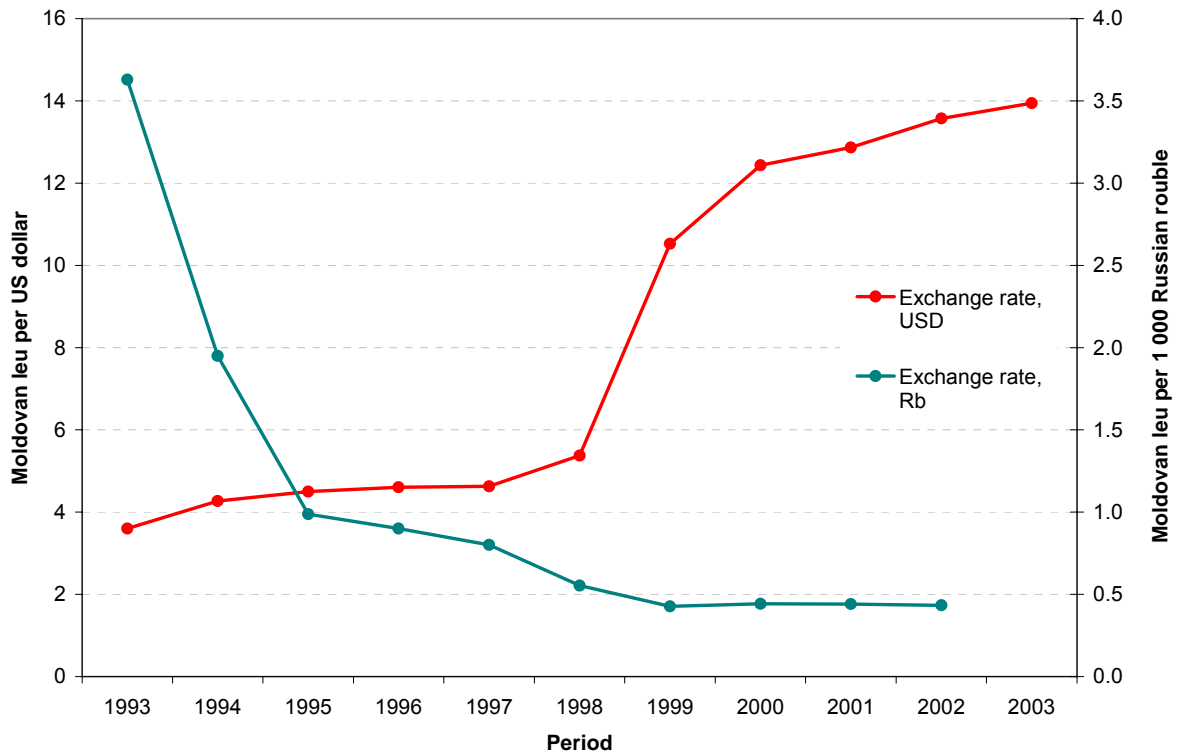
Source: Own calculations based on data from National Bank of Moldova (1995-2003) and The Economist Intelligence Unit (1991-1994).

Figure 17. Inflation and average interest rate of the state securities, 1995-2003



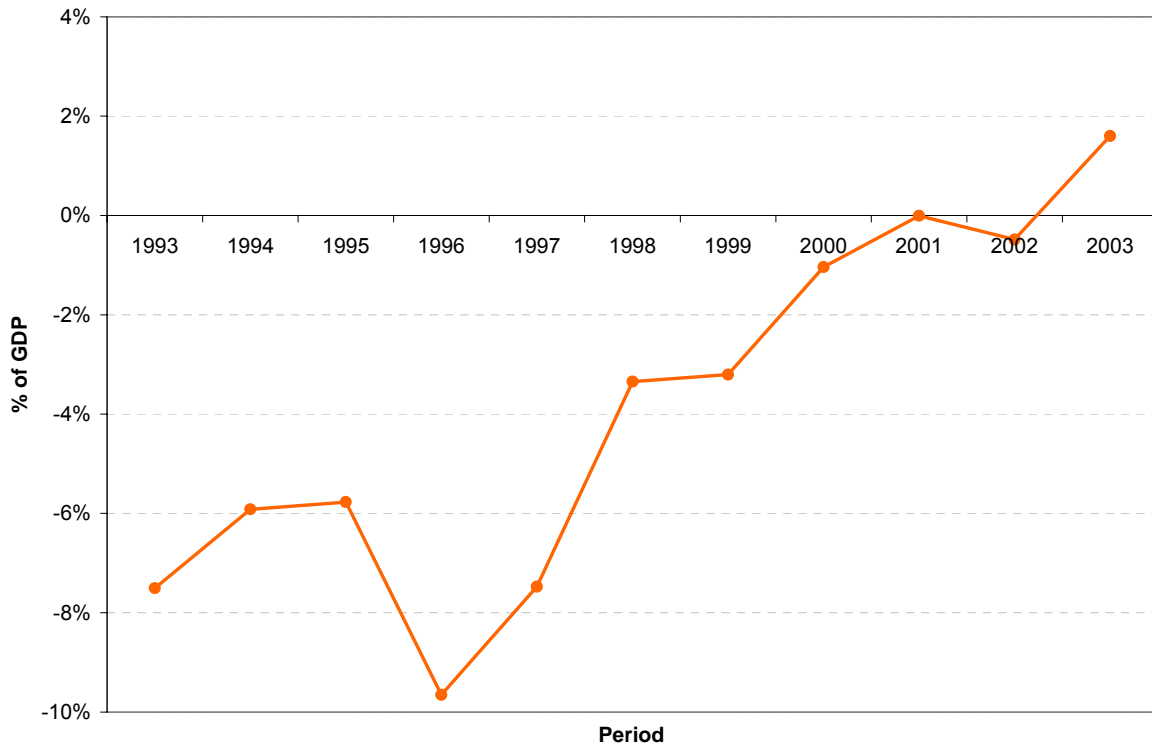
Source: National Bank of Moldova.

Figure 18. Exchange rate of the MDL against the USD and the Russian rouble, 1993-2003



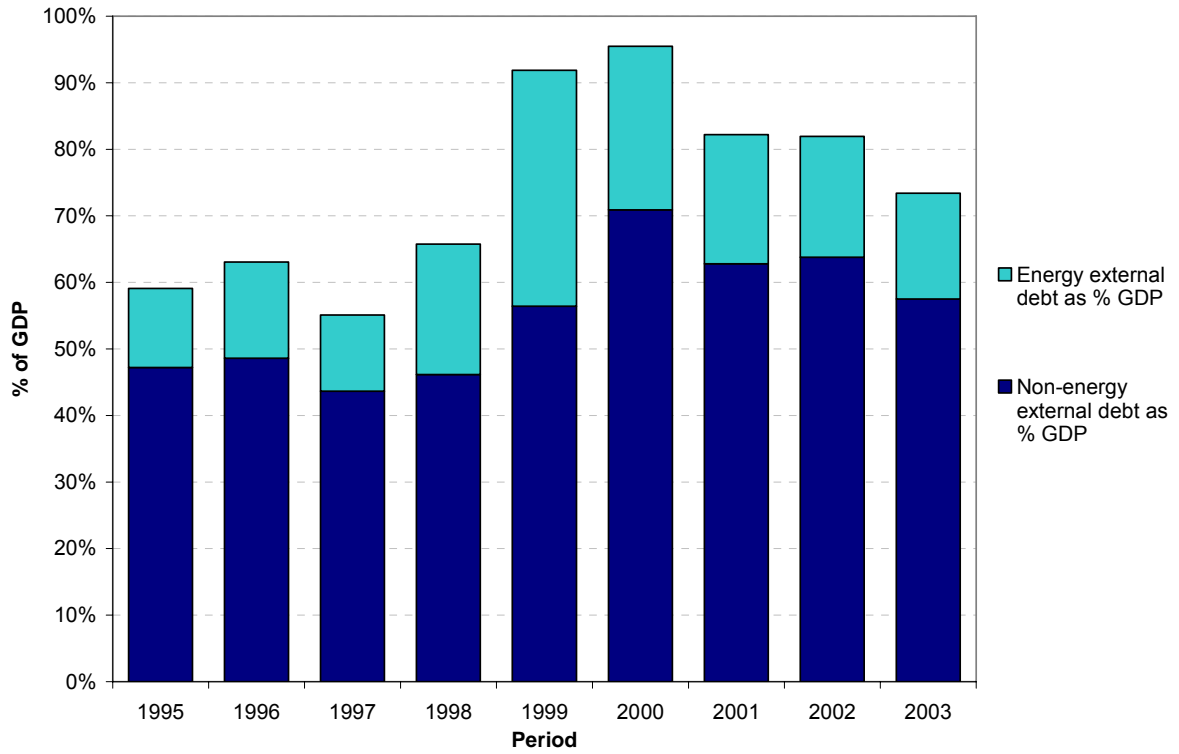
Source: National Bank of Moldova (1995-2003 for USD) and The Economist Intelligence Unit (1993-1994 for USD, 1993-2002 for Rb).

Figure 19. Public budget balance as percent of GDP, 1993-2003



Source: Own calculations based on data from National Bank of Moldova (1995-2003) and The Economist Intelligence Unit (1993-1994).

Figure 20. Energy and non-energy external debt as a percent of GDP, 1995-2003



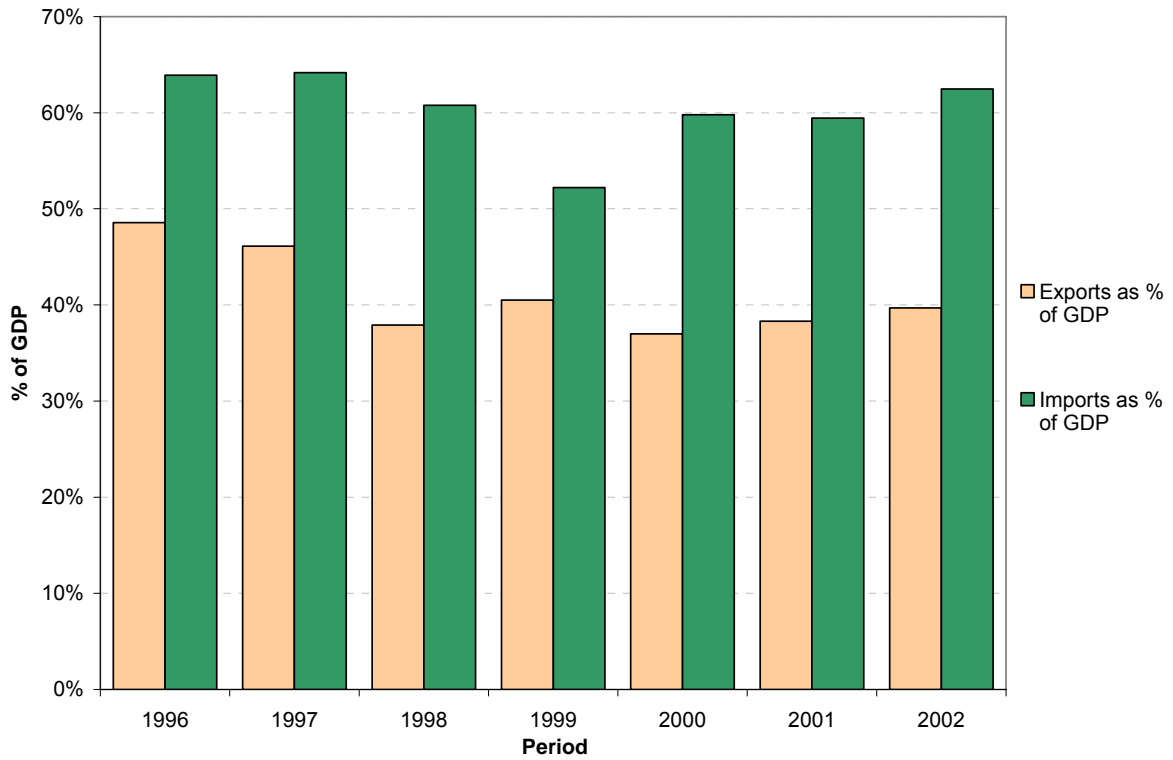
Source: Own calculations based on data from the National Bank of Moldova.

Figure 21. Total debt service as proportion of exports, 1995-2003



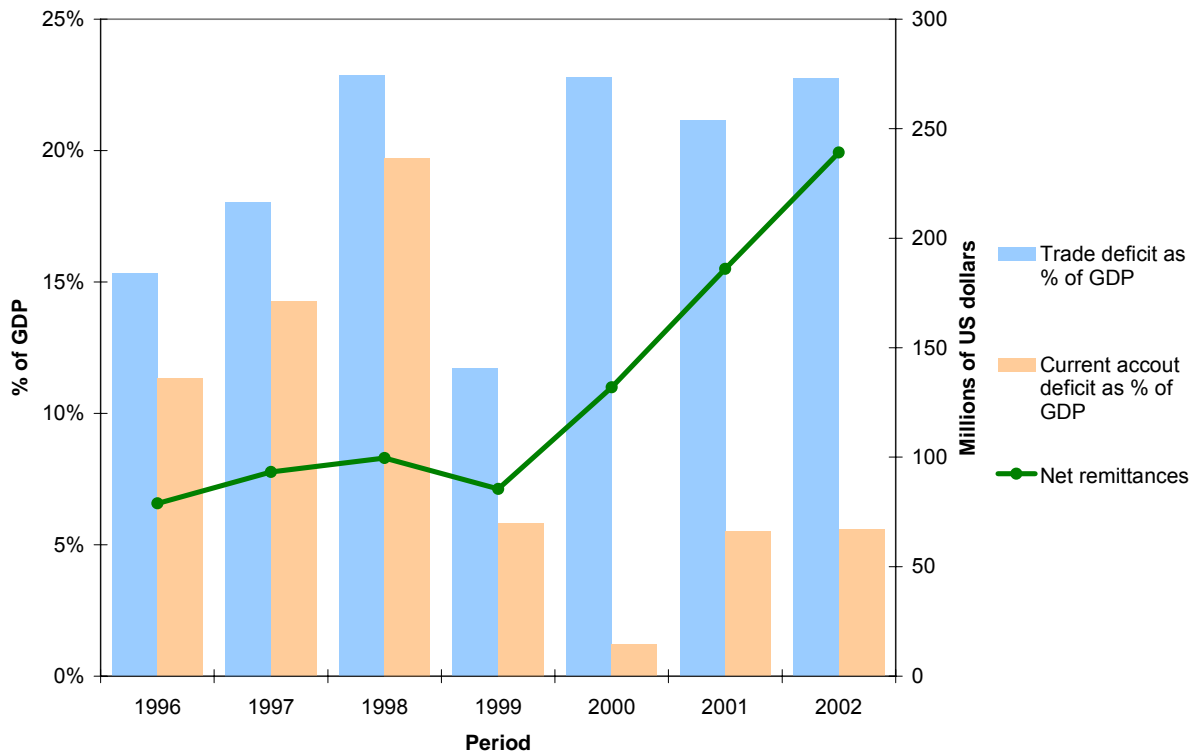
Source: National Bank of Moldova.

Figure 22. Foreign trade as percentage of GDP, 1996-2002



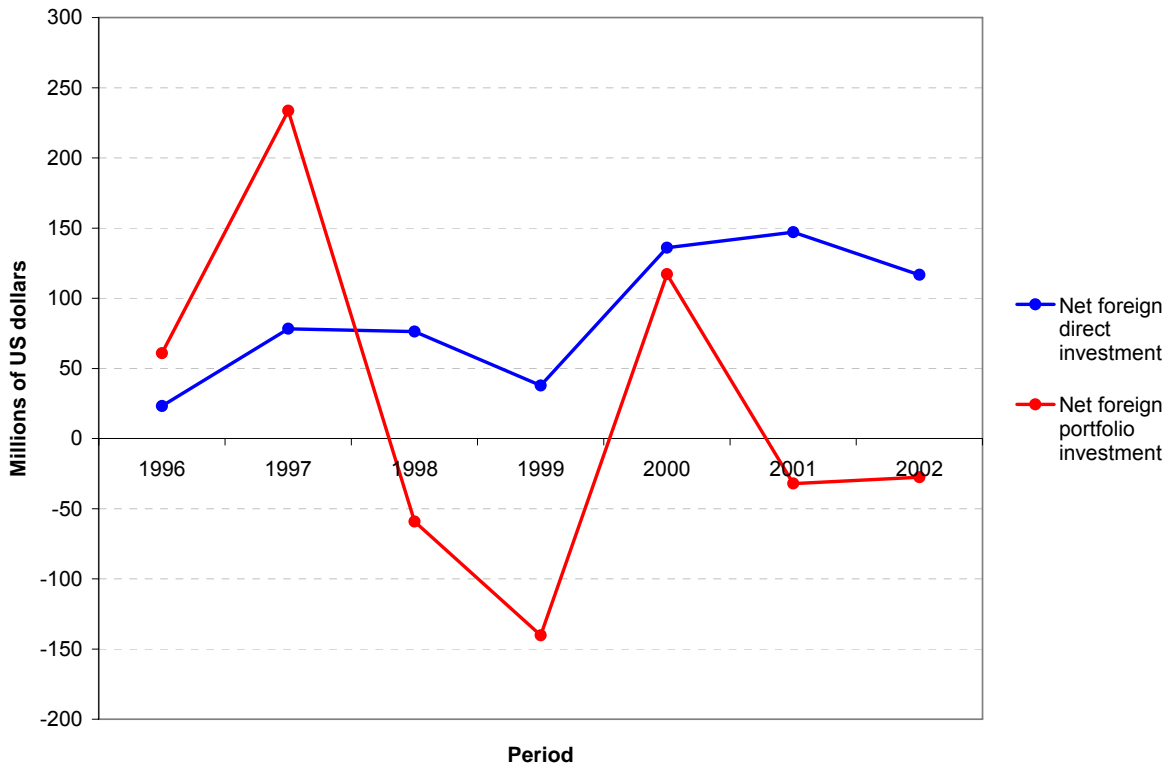
Source: Own calculations based on data from the National Bank of Moldova (1997-2002) and the Economist Intelligence Unit (1996).

Figure 23. Trade deficit, current account deficit and net official remittances, 1996-2002



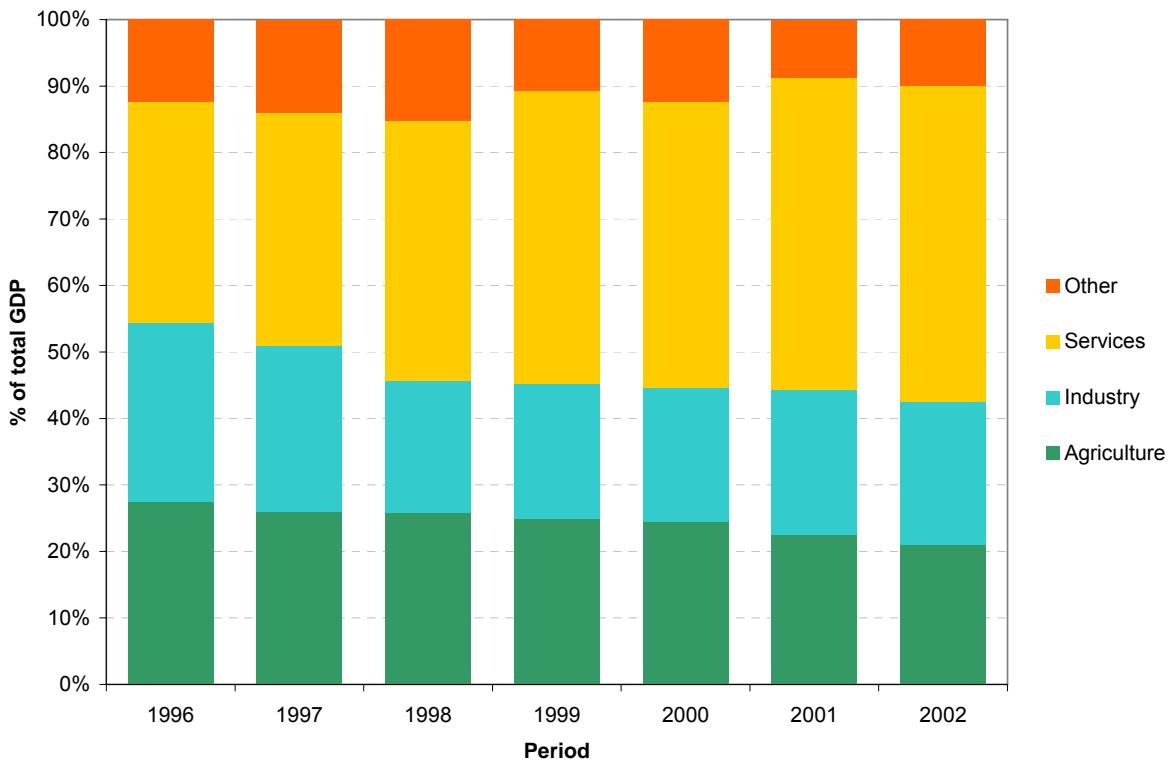
Source: Own calculations based on data from the National Bank of Moldova (1997-2002) and the Economist Intelligence Unit (1996).

Figure 24. Foreign direct and portfolio investment, 1996-2002



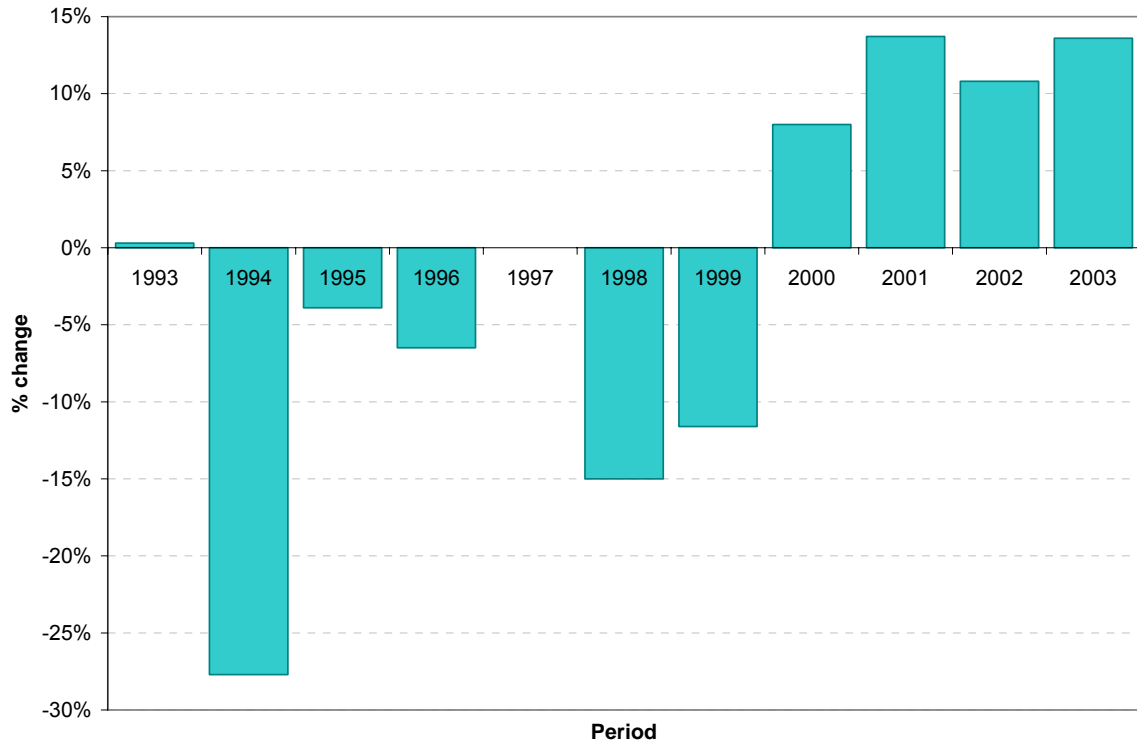
Source: National Bank of Moldova (1997-2002) and the Economist Intelligence Unit (1996).

Figure 25. Sectorial decomposition of GDP, 1996-2002



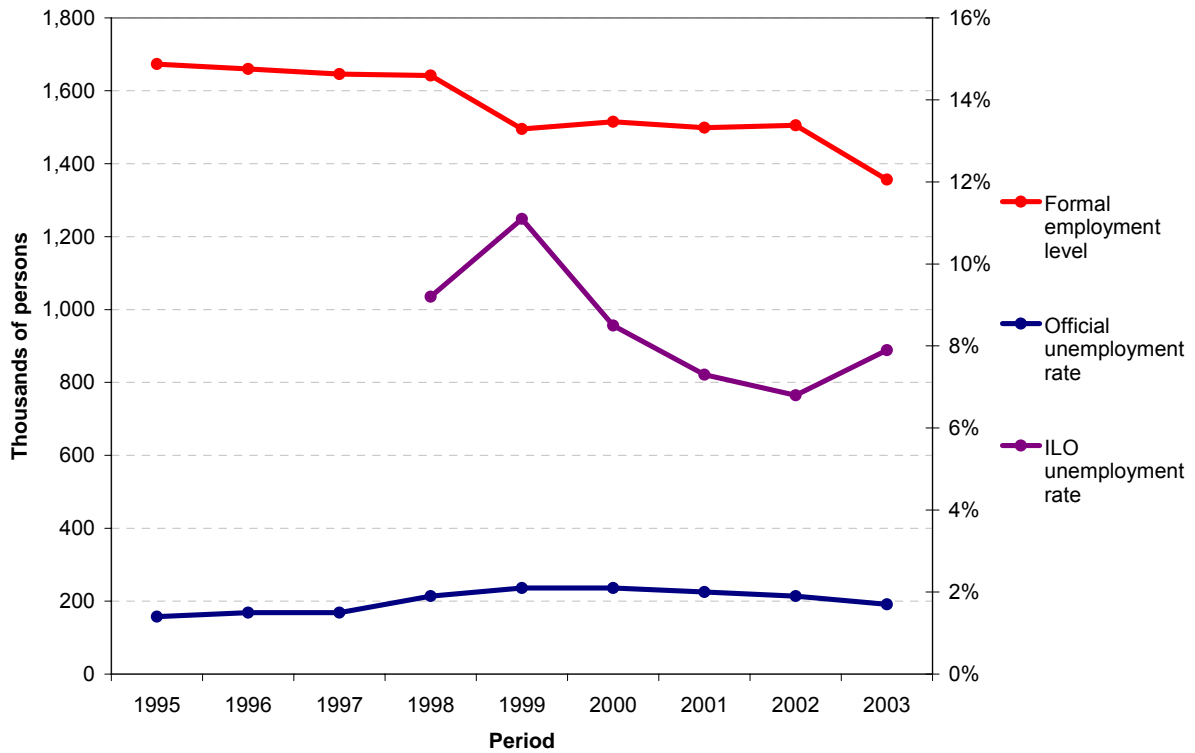
Source: Own calculations based on data from The Economist Intelligence Unit.

Figure 26. Percent change of industrial output in relation to previous year, 1993-2003



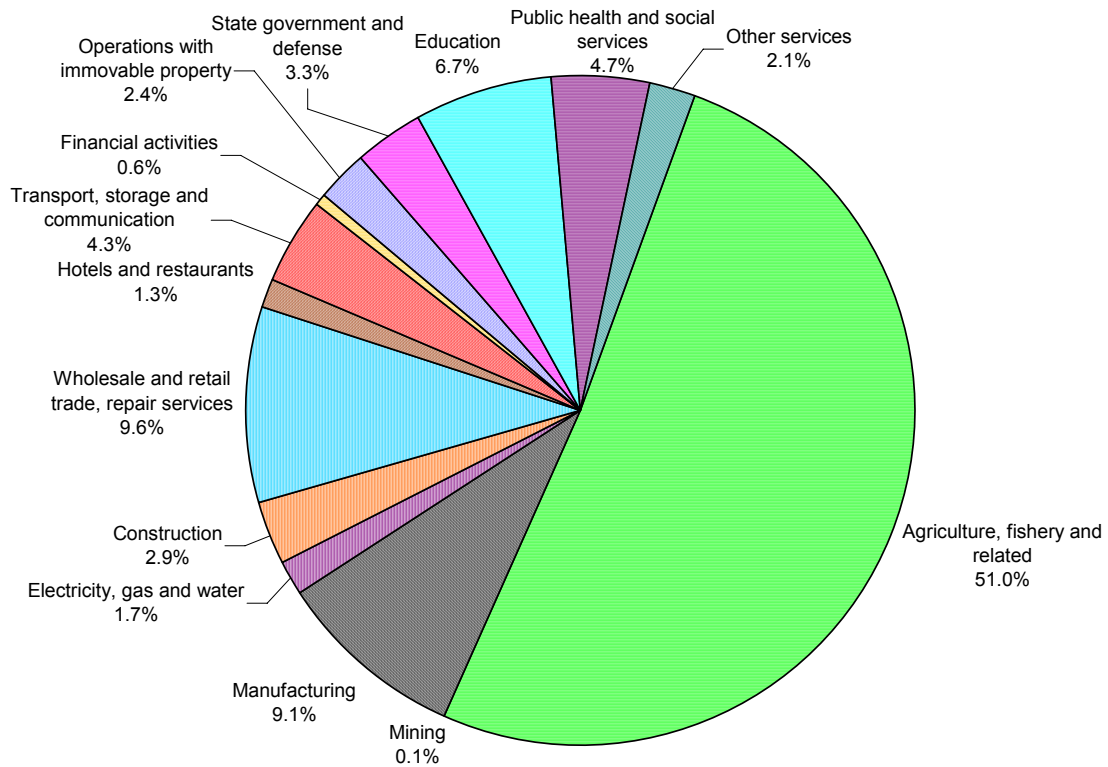
Source: National Bank of Moldova (1995-2003) and The Economist Intelligence Unit (1993-1994).

Figure 27. Formal employment level and unemployment rates, 1995-2003



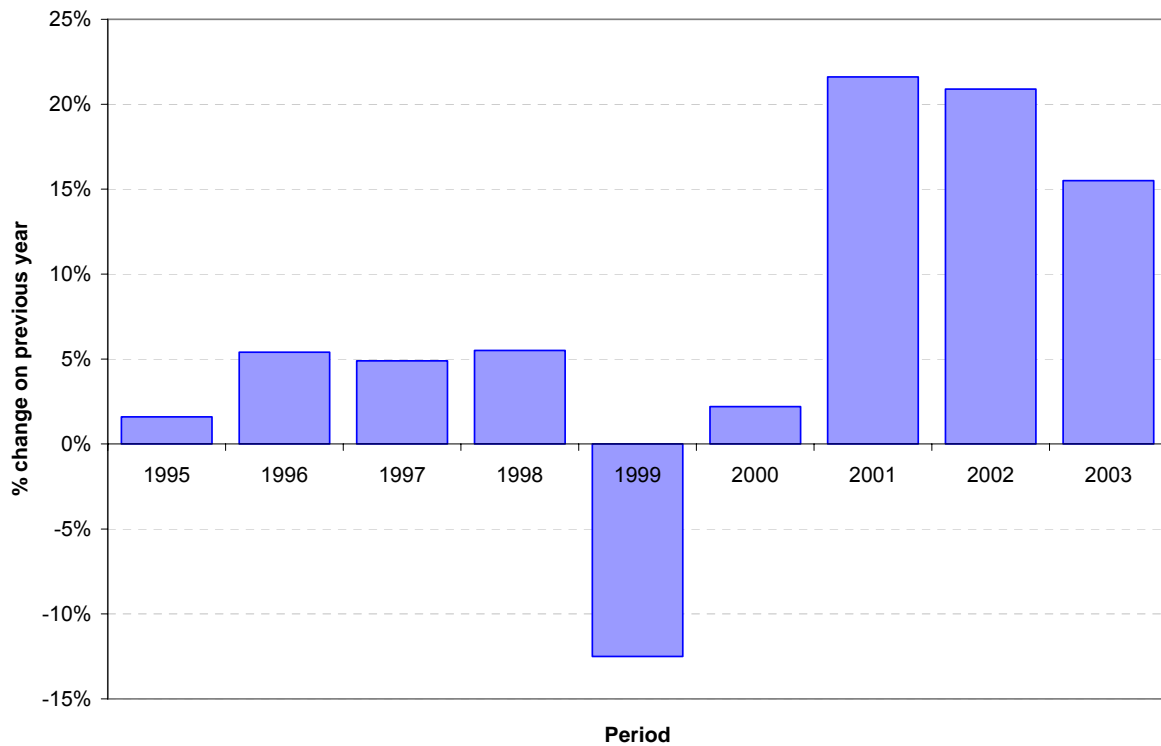
Source: National Bank of Moldova.

Figure 28. Composition of formal employment by sectors, 2001



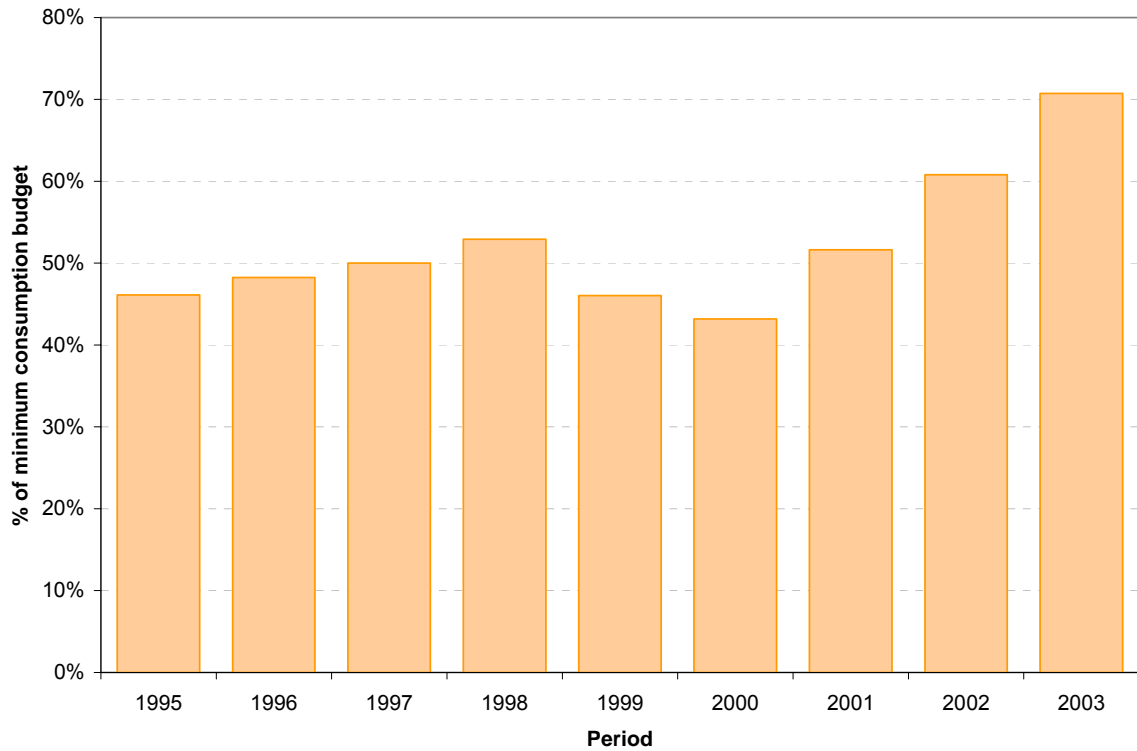
Source: Department of Statistics and Sociology of the Republic of Moldavia.

Figure 29. Percent change of average monthly real wage in relation to previous year, 1995-2003



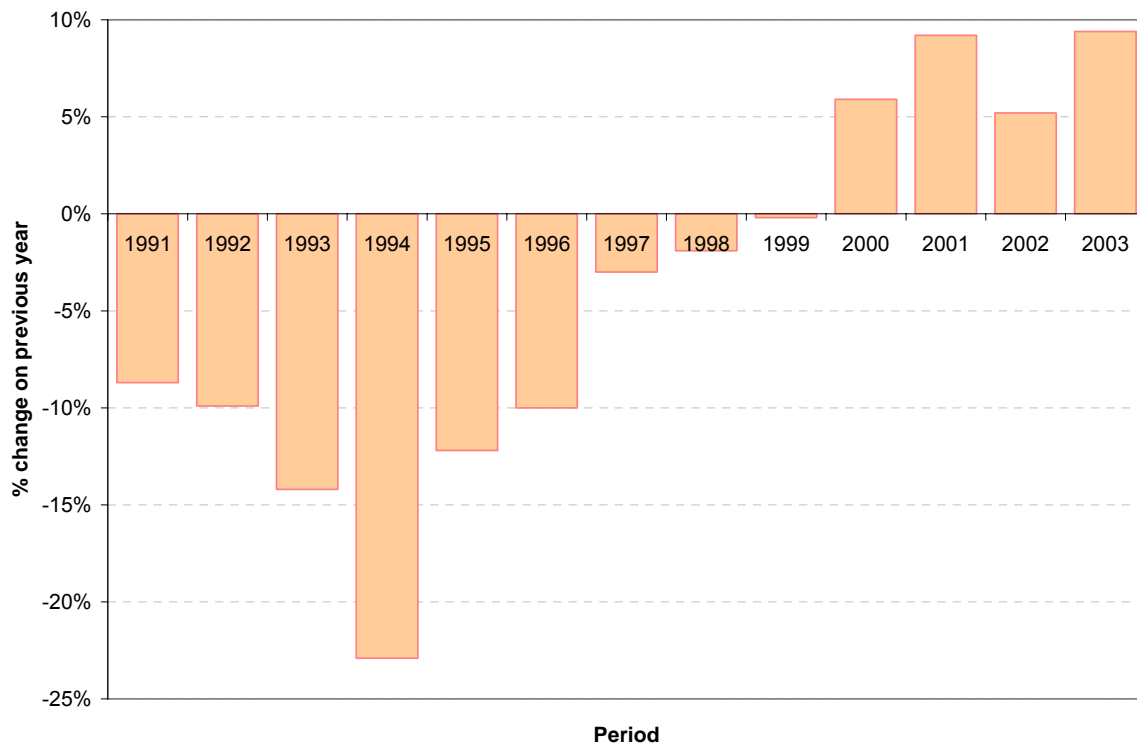
Source: National Bank of Moldova.

Figure 30. Average monthly wage as percentage of the minimum consumption budget, 1995-2003



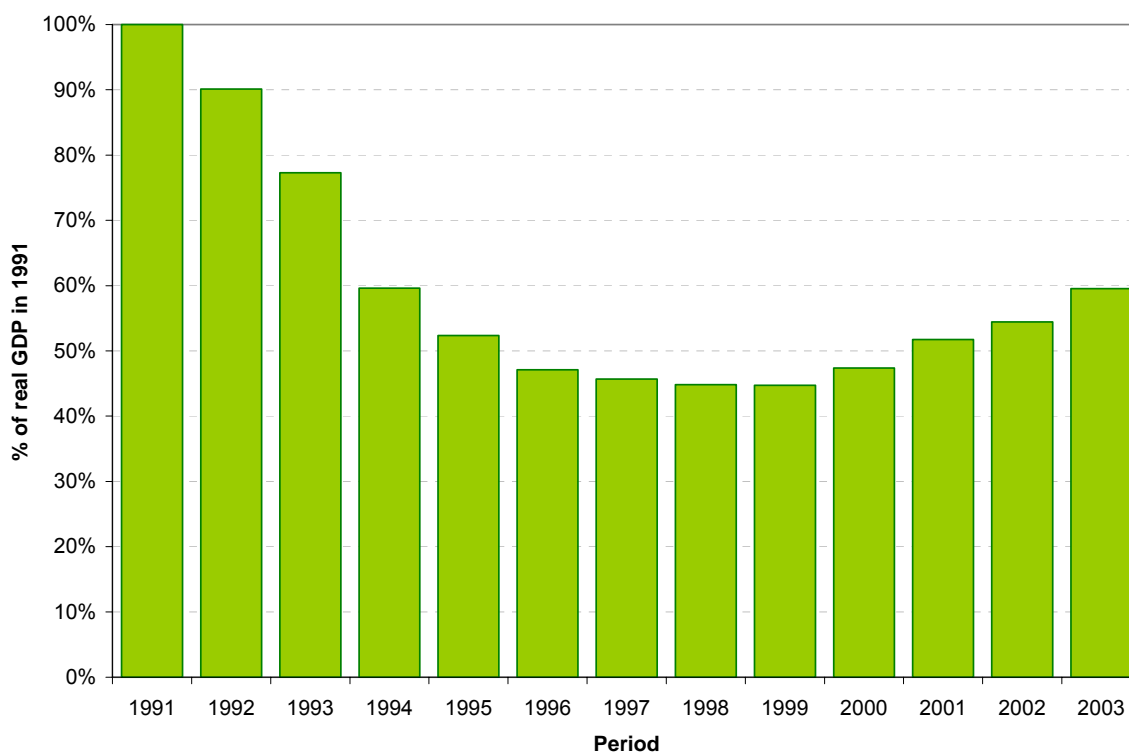
Source: Own calculations based on data from the National Bank of Moldova.

Figure 31. Percent change in GDP in relation to previous year, 1991-2003



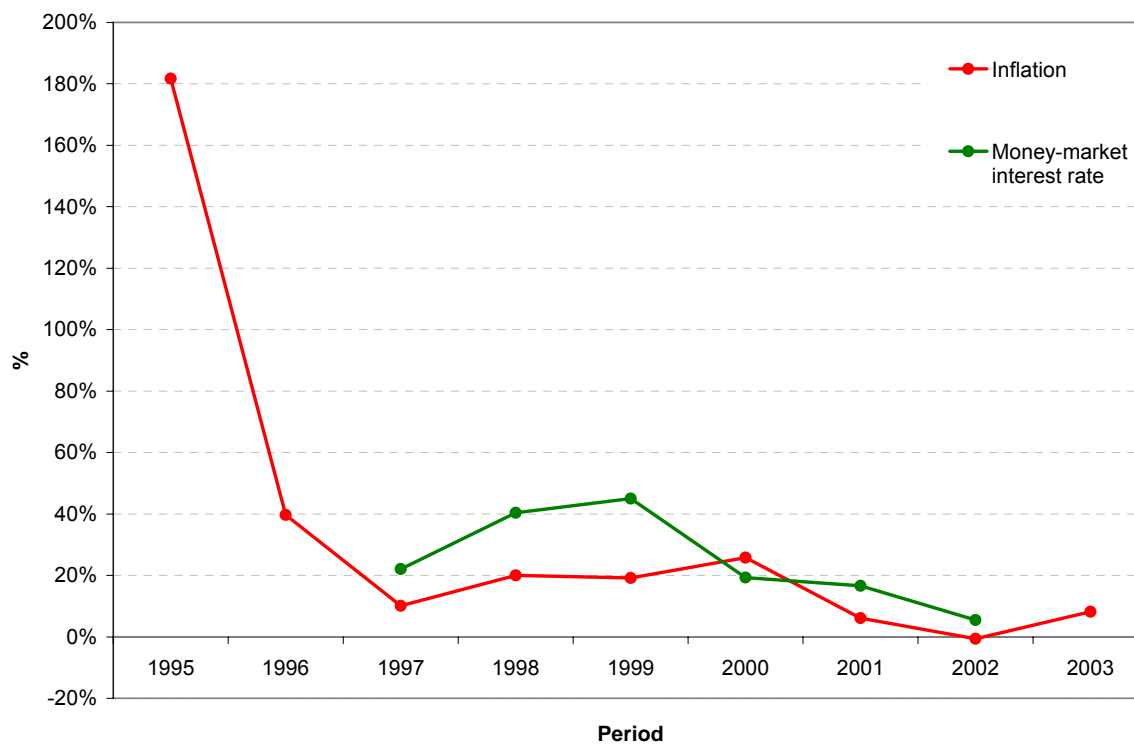
Source: State Statistics Committee of Ukraine (1991-2000) and National Bank of Ukraine (2001-2003)

Figure 32. Real GDP as a proportion of its 1991 value, 1991-2003



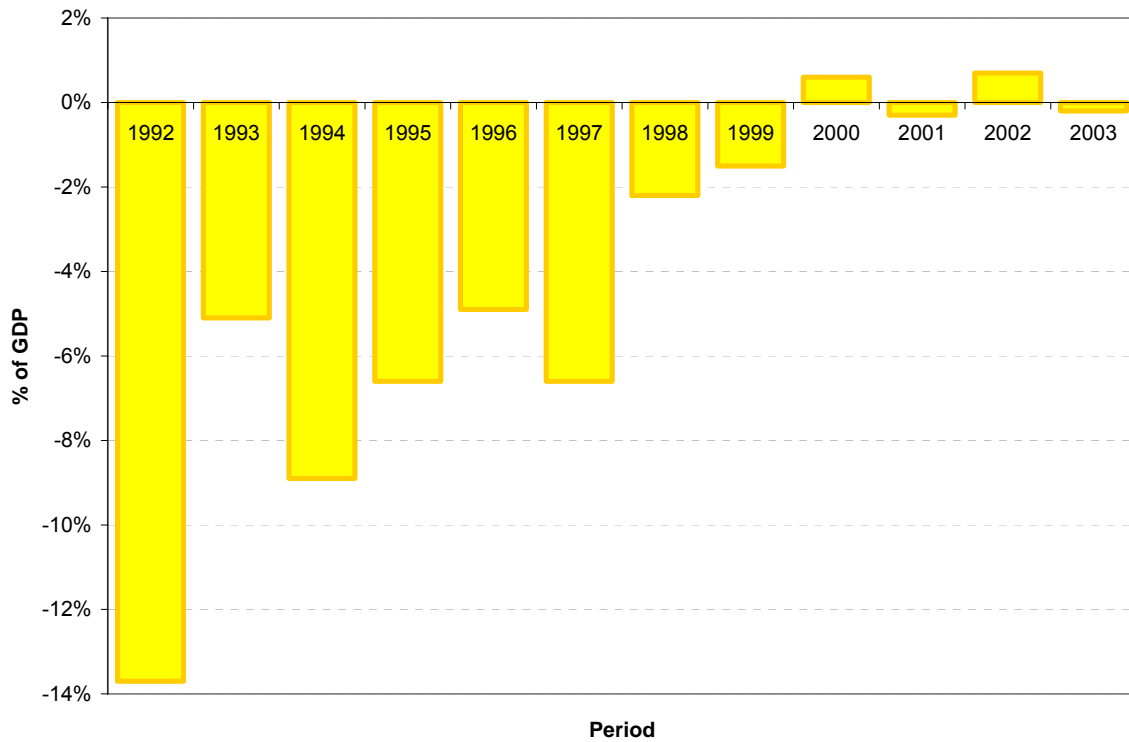
Source: own calculations based on State Statistics Committee of Ukraine (1991-2000) and National Bank of Ukraine (2001-2003)

Figure 33. Inflation (annual growth of the Consumer Price Index) and money-market interest rate, 1995-2003



Source: Own calculations based on National Bank of Ukraine (inflation) and Economist Intelligence Unit (interest rate)

Figure 34. Public balance as percentage of GDP, 1992-2003



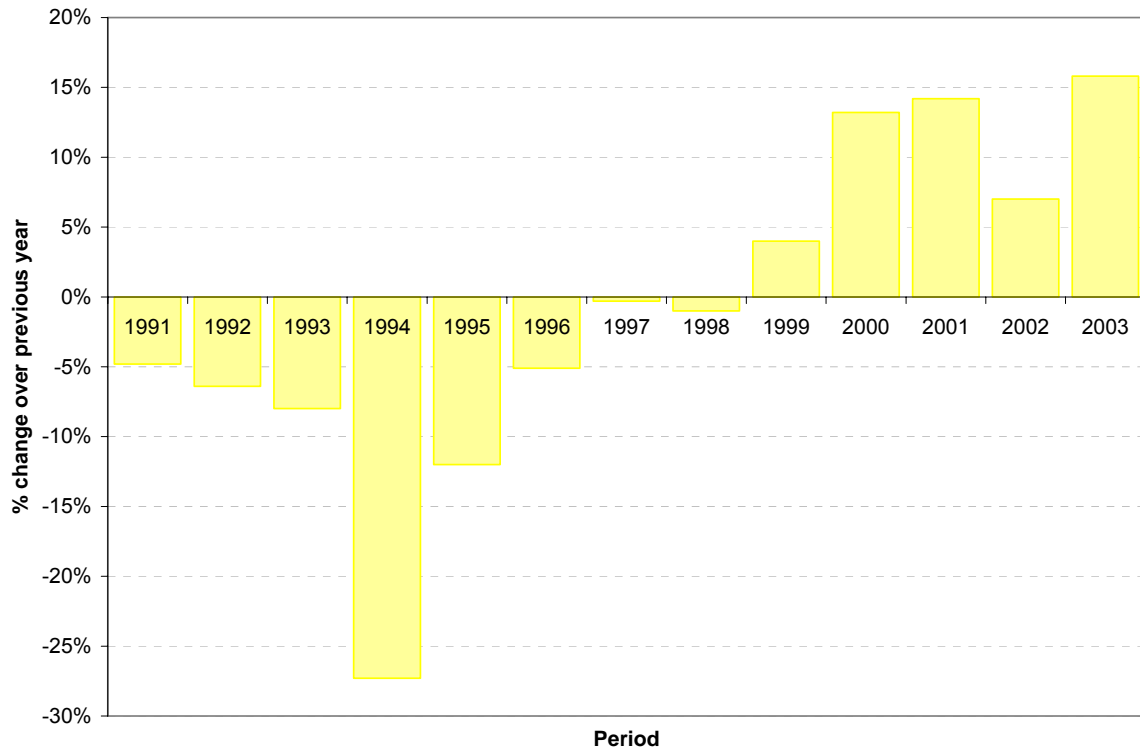
Source: State Statistics Committee of Ukraine (1991-2000) and National Bank of Ukraine (2001-2003)

Figure 35. Year-to-year percentage change in agriculture production, 1991-2003



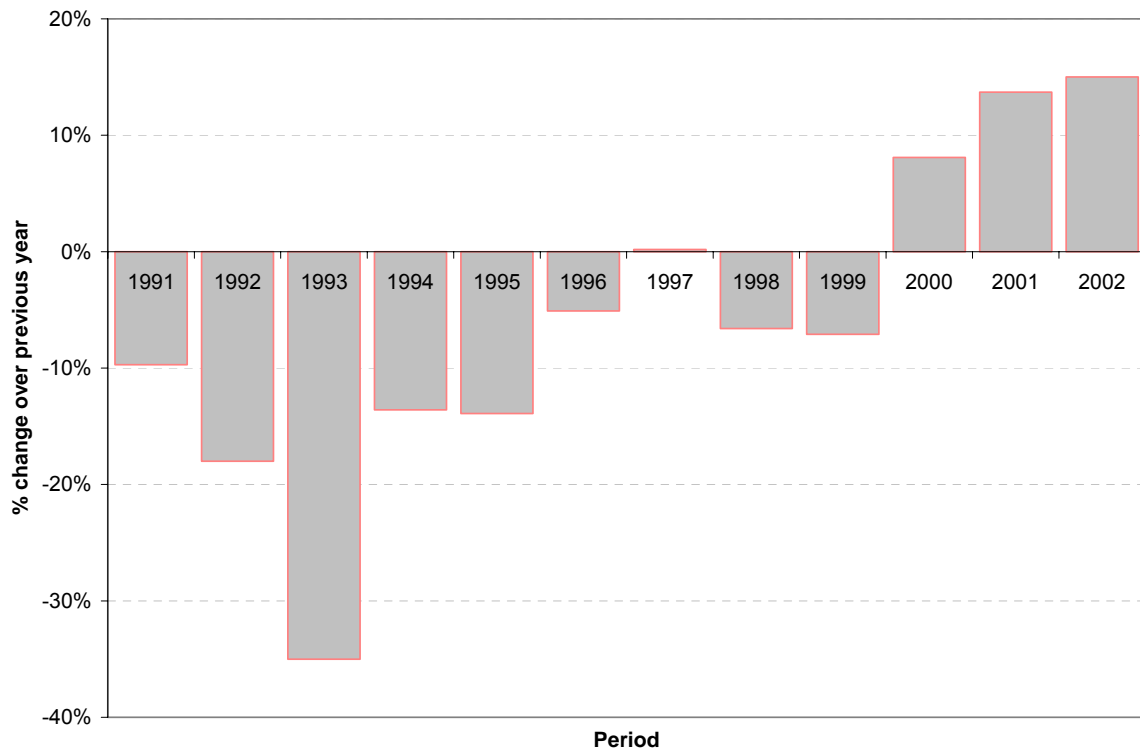
Source: Own calculations based on data from the National Bank of Ukraine

Figure 36. Year-to-year percentage change in industrial production, 1991-2003



Source: Own calculations based on data from the National Bank of Ukraine

Figure 37. Year-to-year percentage change in retail trade turnover, 1991-2003



Source: Own calculations based on data from State Statistics Committee of Ukraine, National Bank of Ukraine

Figure 38. Exchange rate of the Ukrainian hryvnya against the USD and the RUR, 1993-2003

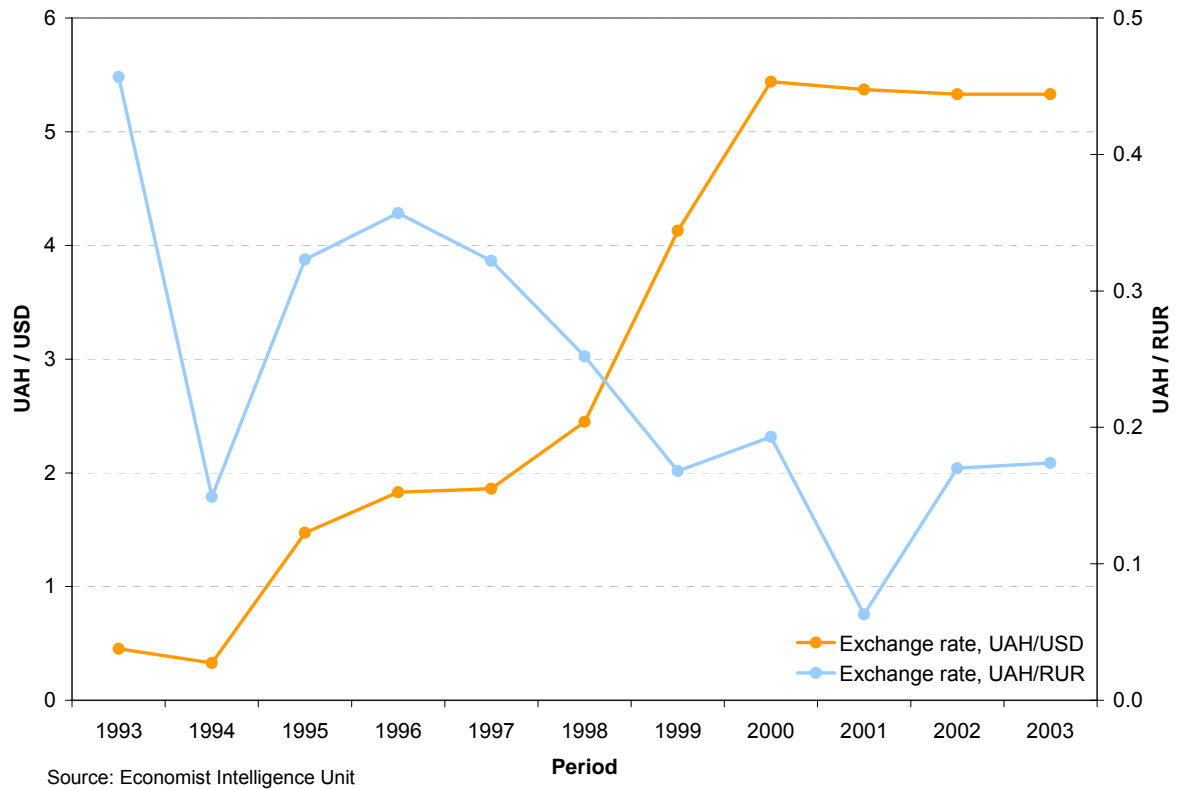


Figure 39. Exports and imports of goods and services as percentage of GDP, 1994-2003

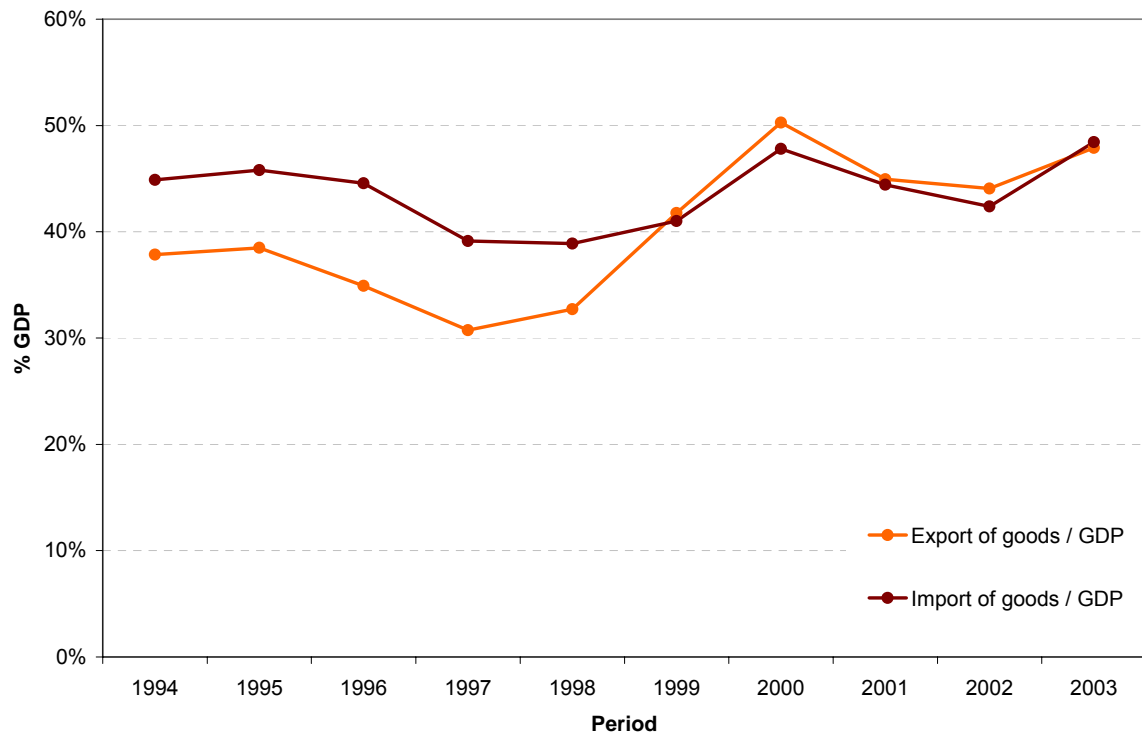
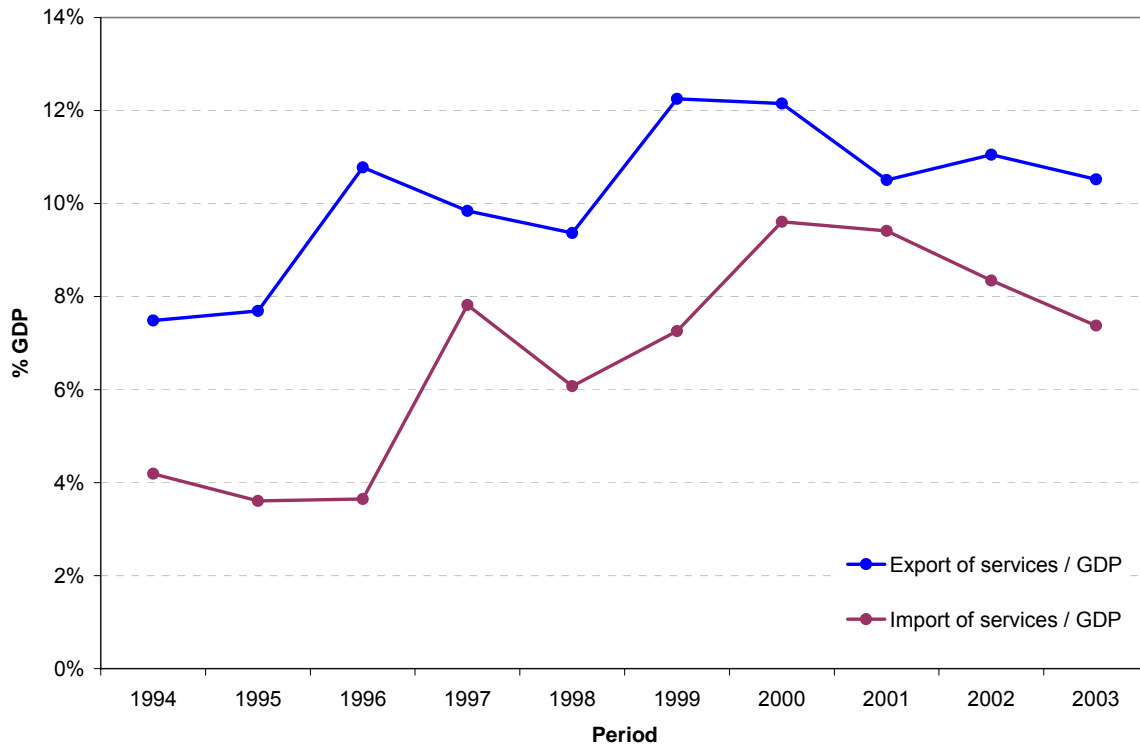
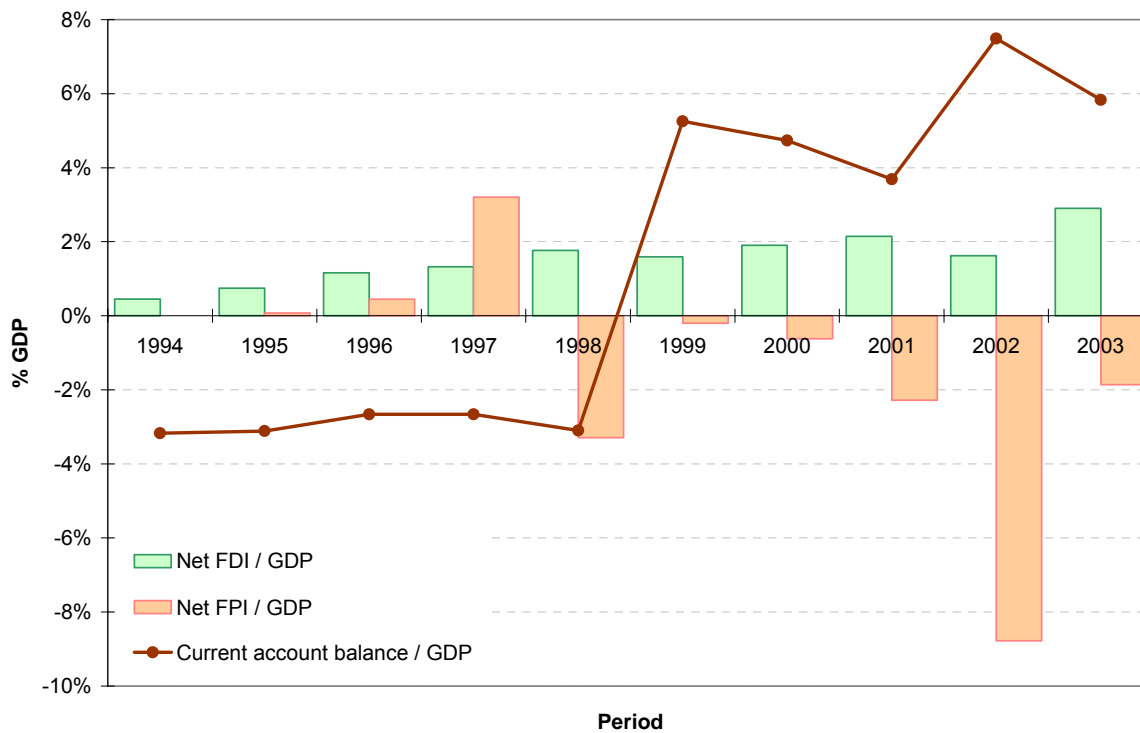


Figure 40. Export and import of services as percentage of GDP, 1994-2003



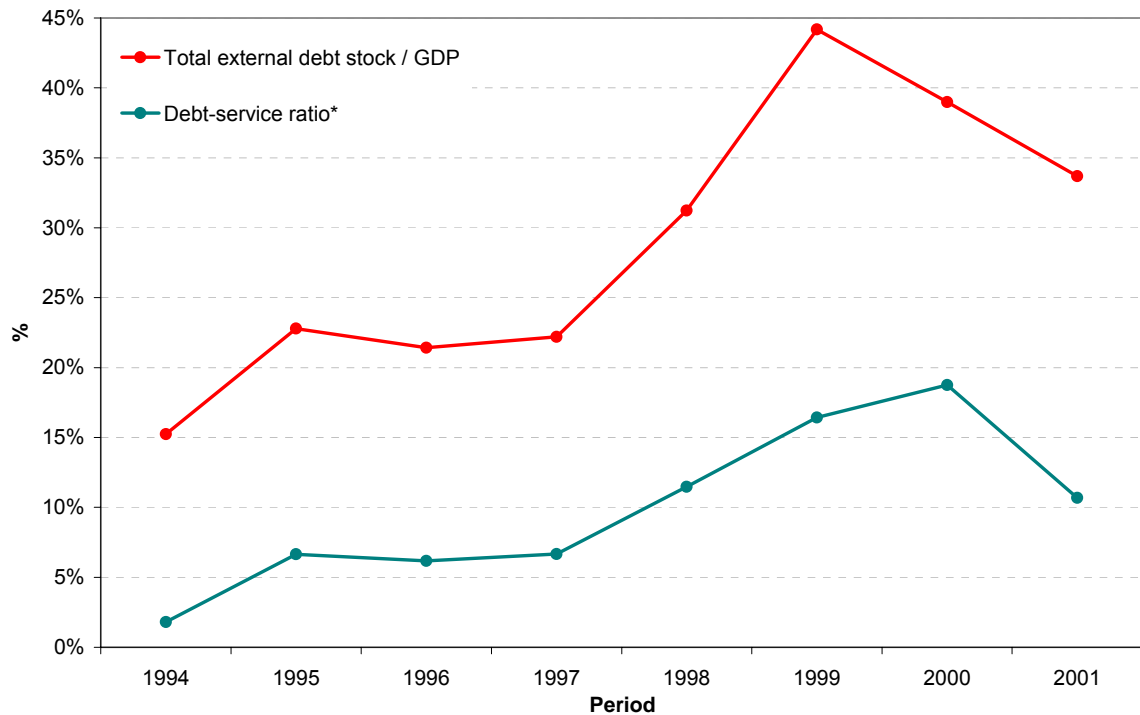
Source: Own calculations based on State Statistics Committee of Ukraine, National Bank of Ukraine and Economist Intelligence Unit

Figure 41. Current account balance and foreign investment as percentage of GDP, 1994-2003



Source: Own calculations based on State Statistics Committee of Ukraine, National Bank of Ukraine and Economist Intelligence Unit

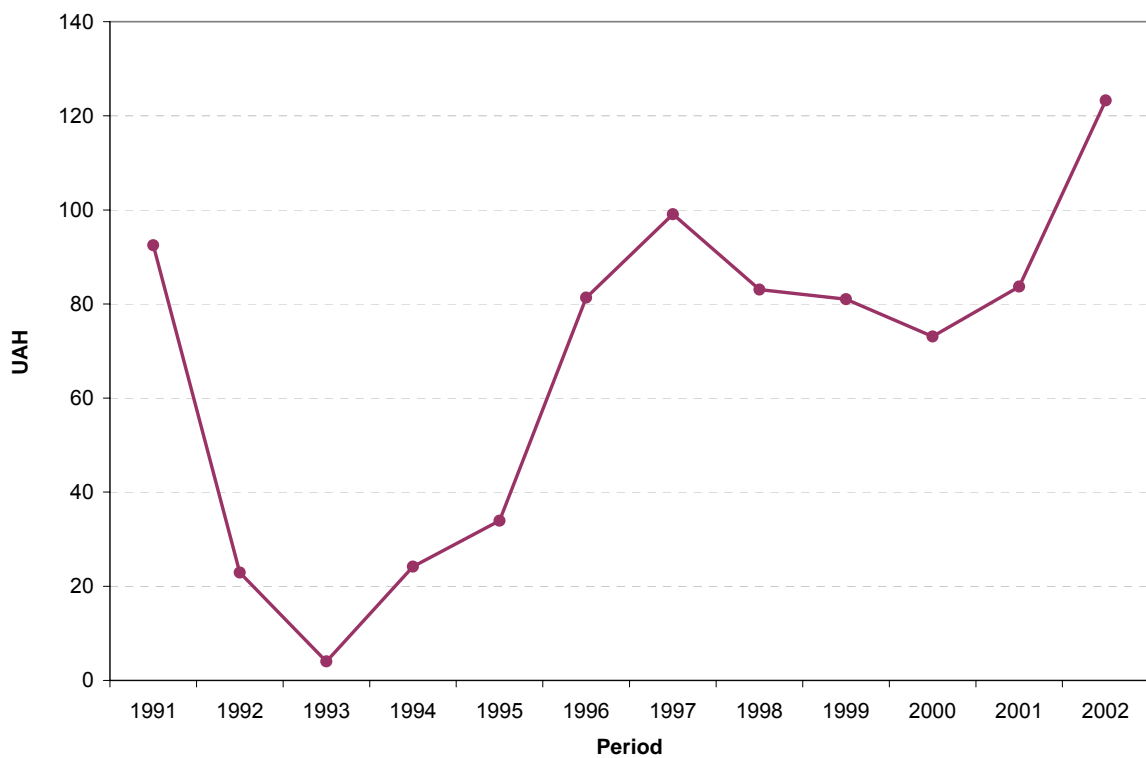
Figure 42. Total external debt as percentage of GDP and debt-service ratio, 1994-2001



* Debt-service ratio is defined as the share of debt service on the earning from export of goods and services

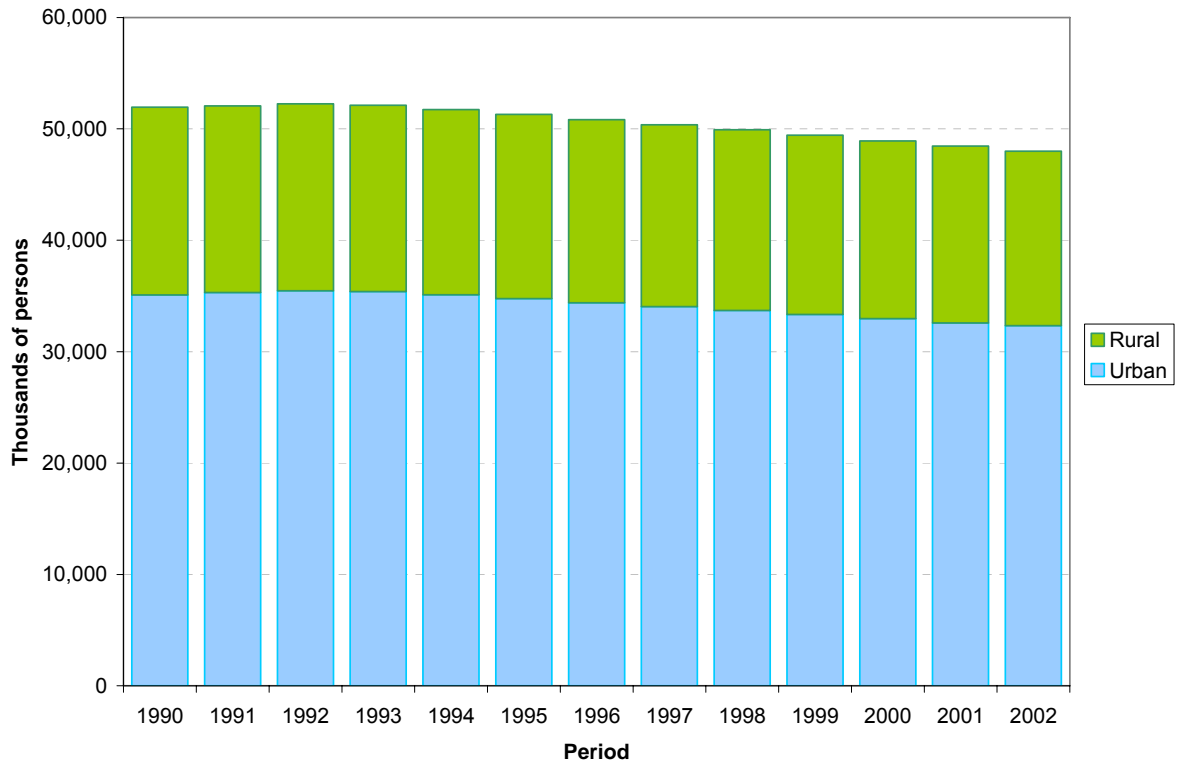
Source: Own calculations based on State Statistics Committee of Ukraine (GDP) and Economist Intelligence Unit (exchange rate, debt stock, debt service and trade)

Figure 43. Monthly average pension benefits at social protection agencies (fixed 2001 prices), 1991-2002



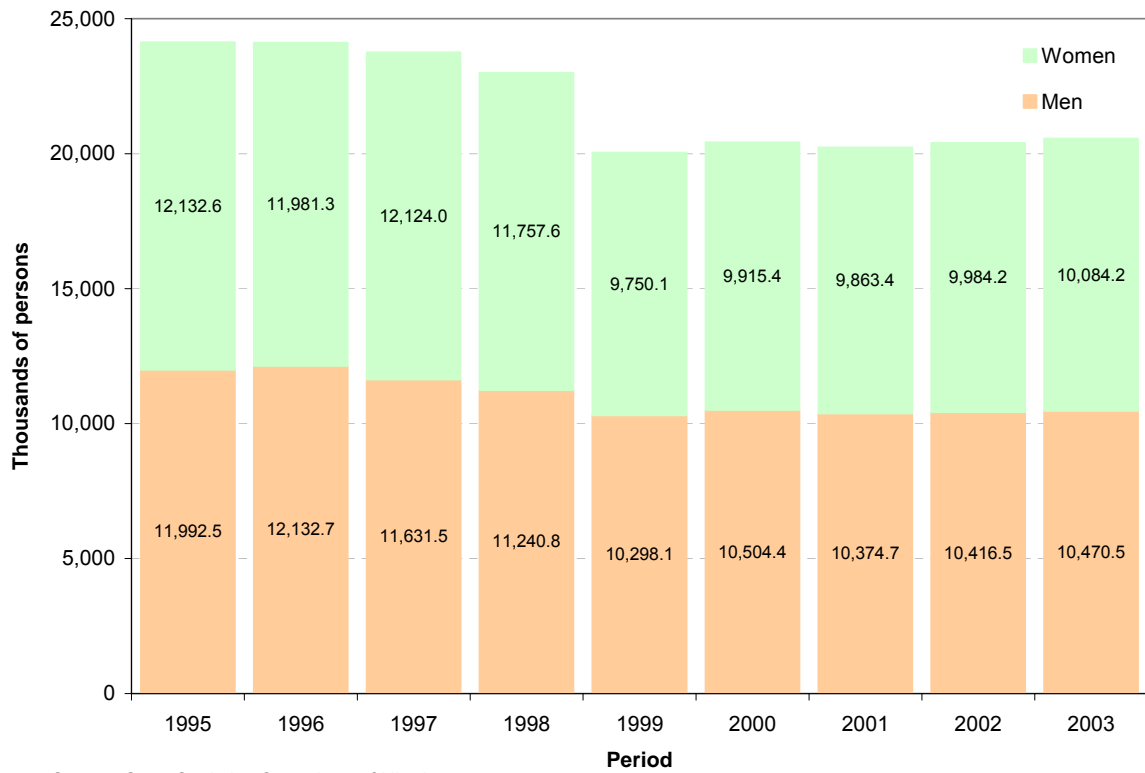
Source: Own calculations based on State Statistics Committee of Ukraine

Figure 44. Population by area, 1990-2002



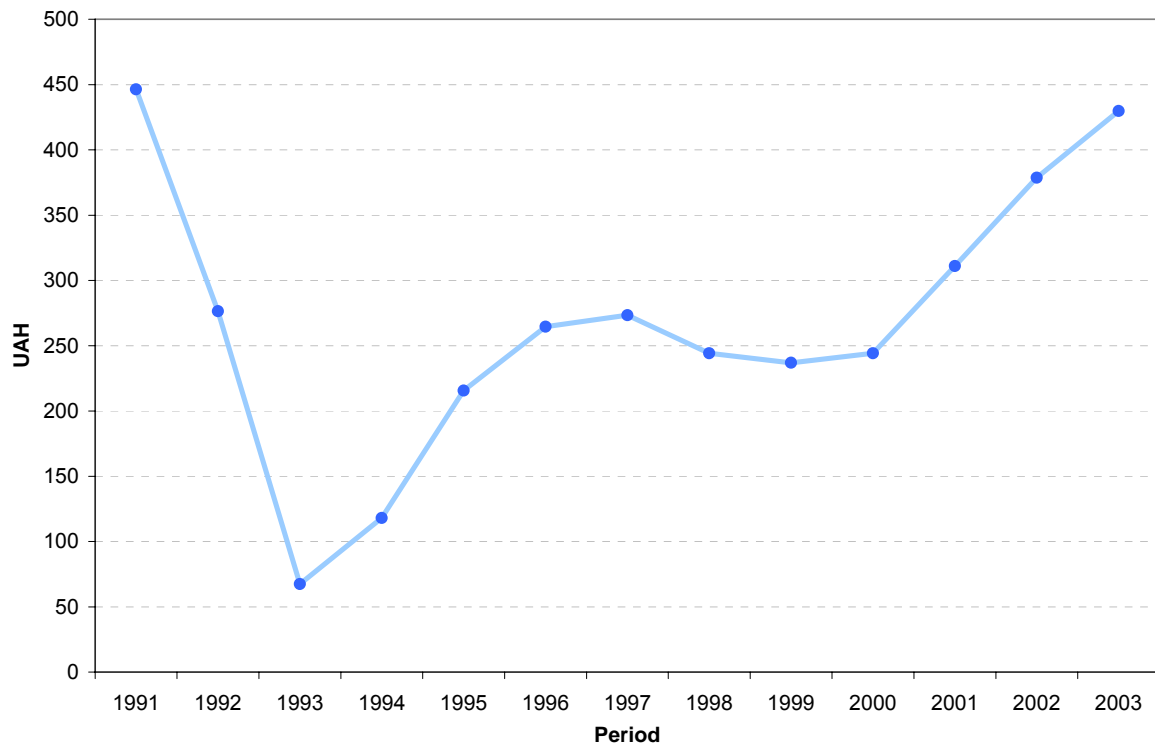
Source: State Statistics Committee of Ukraine

Figure 45. Employed population by gender, 1995-2003



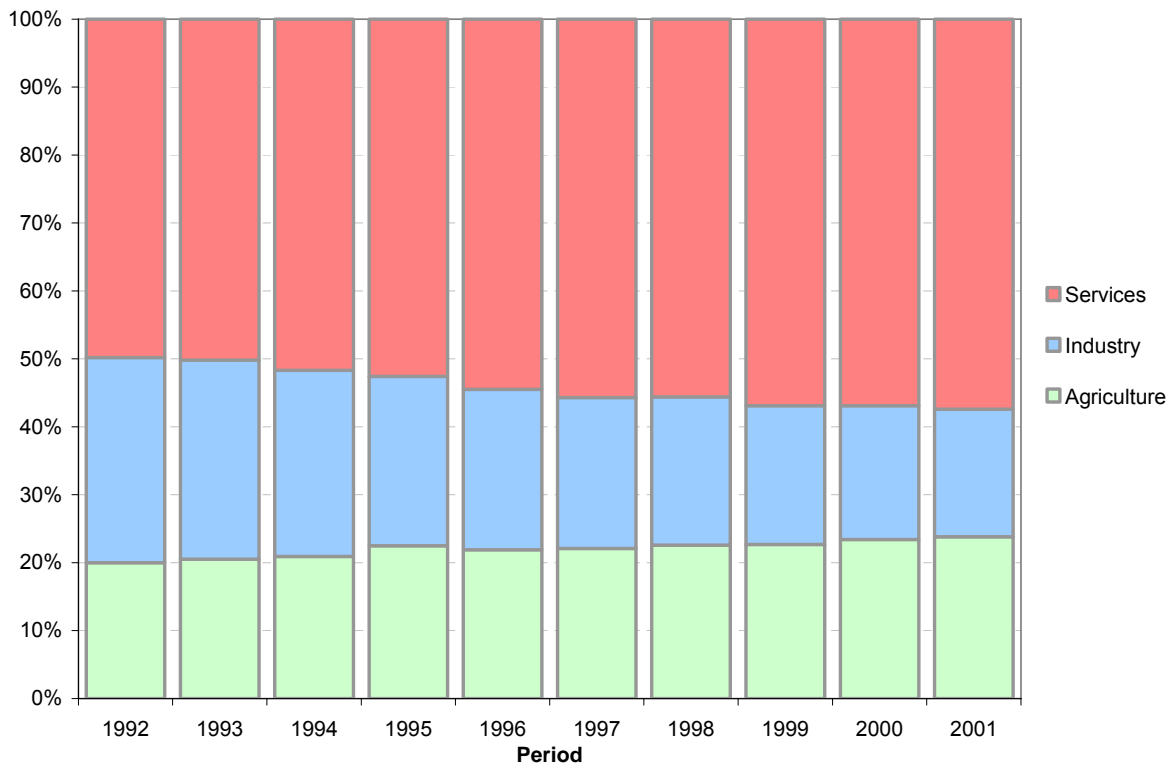
Source: State Statistics Committee of Ukraine

Figure 46. Real average monthly wages (fixed 2001 prices), 1991-2003



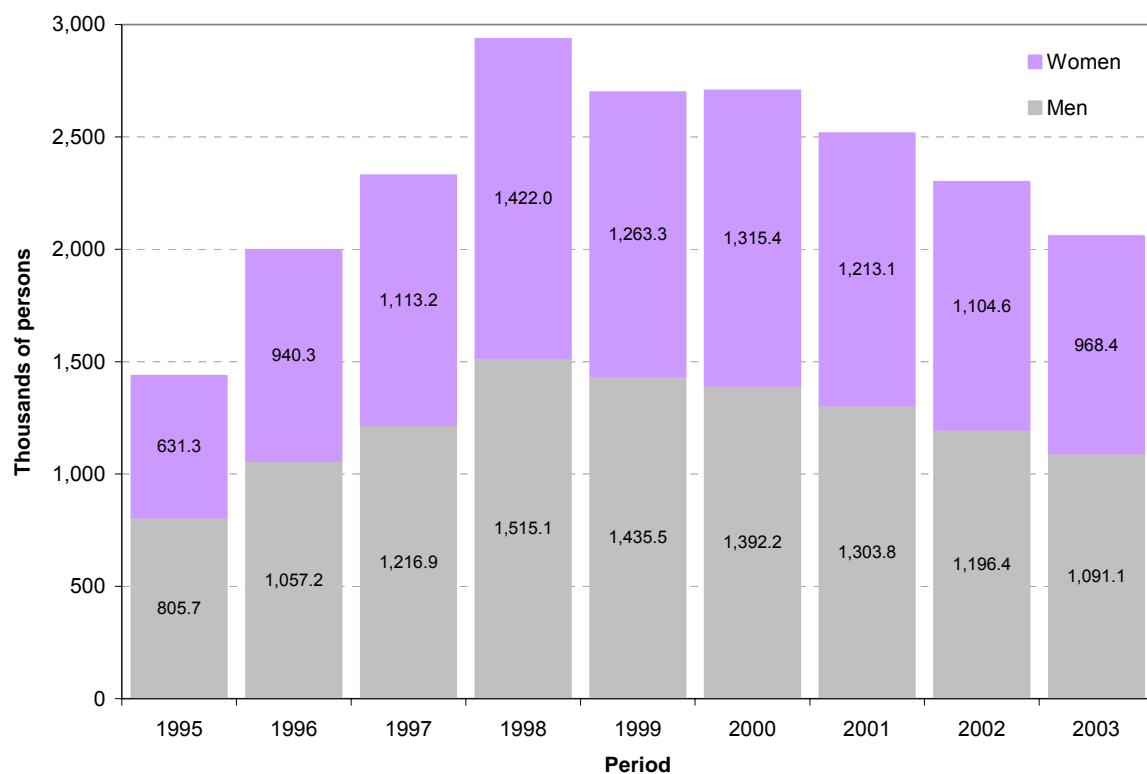
Source: Own calculations based on data from the National Bank of Ukraine

Figure 47. Distribution of employment by sector, 1992-2001



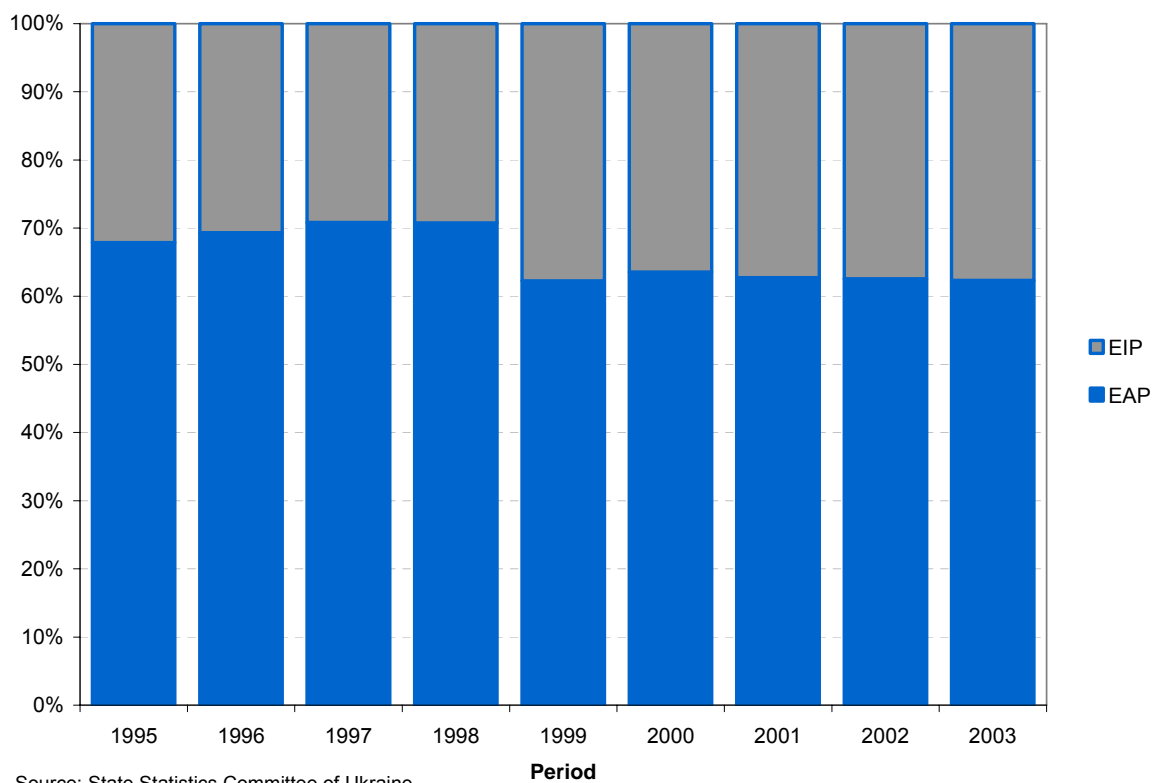
Source: Economist Intelligence Unit

Figure 48. Unemployed population by gender (ILO definition), 1995-2003



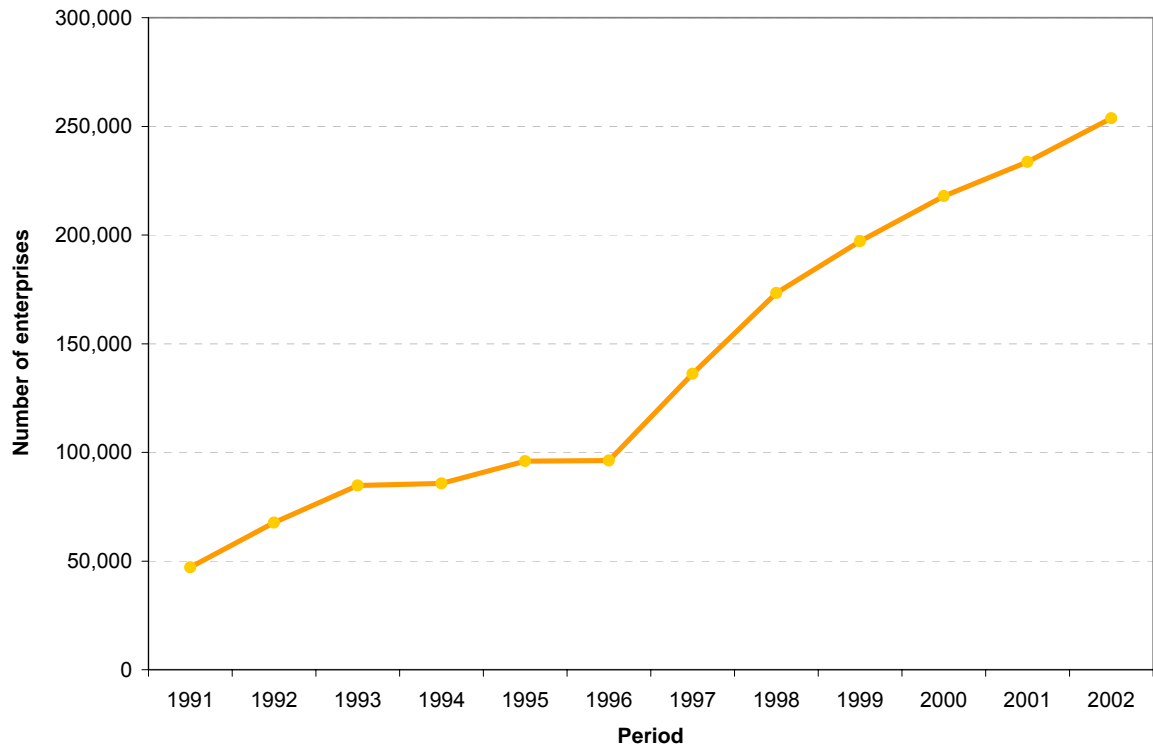
Source: State Statistics Committee of Ukraine

Figure 49. Economically active (EAP) and inactive (EIP) population, 1995-2003



Source: State Statistics Committee of Ukraine

Figure 50. Number of small-scale enterprises, 1991-2002



Source: State Statistics Committee of Ukraine

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