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# Policy Note

May 2021

## Microfinance's role in Mitigating Human Capital Flight

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Microfinance institutions are in a key position to help mitigate the effects of human capital flight that manifests between East and West Europe. We want to propose public-private partnership initiatives that would combine the social mission of microfinance with the solidarity mechanisms within Europe, to renew investment in local entrepreneurship and innovation.



In collaboration with





## Understanding the problem

Many talented young citizens, skilled workers or professionals in Eastern Europe and the Balkans are seeking a brighter economic future in Western Europe. Even in the cases where they are educated, own a small business or have an established professional reputation, many choose to seek employment abroad.

While on one side this is a testament to the richness that intra-European exchange allows, and the benefits of such population flows are also well-documented, it also has a dark side that must be addressed:

- ➔ The flight of working-age people **leaves the economic fabric of society weaker**. High-talent individuals that would otherwise have contributed to the local economy are gone, which is not only a missed opportunity, it also weakens the remaining local actors who have a poorer ecosystem to work within, and a less developed infrastructure.
- ➔ The migration of highly educated and skilled workers **leaves essential functions unfilled** in the home country. A lack of local career paths for highly educated workers leads to a perception that there is no meritocracy, and that the solution must be found elsewhere.
- ➔ **Education and local knowledge are eroded**, leading to a negative spiral, further reducing the future prospects of those in the country and feeding the idea of emigration as a necessary step to improving one's life. Young people are less likely to contribute to the economy of their home countries, leading to less innovation.

According to the [Global Competitiveness Index](#), many eastern and southern EU Member States are currently among the world's countries least able to retain their talent.

The European Committee of the Regions (CoR) warns that the phenomenon of brain drain poses a risk to the long-term sustainability of the European project if social and economic imbalances between sending and receiving regions remain unaddressed<sup>1</sup>. The IMF similarly published a study entitled "*Demographic Headwinds in Central and Eastern Europe*"<sup>2</sup>, which maps the economic pressures related to the demographic shifts in these countries.

Covid-19 has also brought to light more imbalances: with mass returns home, unemployment and social tensions suddenly manifest, including crime. Populist and Eurosceptic movements can build upon the narrative that such demographic imbalances are hurting their national economies, which undermines the general trust in the European Union.

From Poland to Greece, all Eastern, Central and Southeast European countries are facing a massive emigrational wave: projections show that by 2050, Bulgaria's population will decrease by 38.6% if compared to 1990, Romania 30.1% and Croatia 22.4% etc., Moldova has already lost 33.9% of its population, while Albania has among the largest diaspora with 1.64 million emigrants vs. 2.8 million living in the country. SEE region appears to be heavily affected as official UN projections show that the biggest percentage worldwide decrease in population by the end of the century are expected in Eastern European nations, led by Albania (-62%), Serbia (-52%), and Moldova and Bosnia-Herzegovina (both -50%)<sup>3</sup>.

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1 <https://cor.europa.eu/en/our-work/Pages/OpinionTimeline.aspx?opId=CDR-4645-2019>

2 <https://www.imf.org/-/media/Files/Publications/DP/2019/English/DHICAEAAA.ashx>

3 <https://population.un.org/wpp/Download/Standard/Population/>



## Microfinance's Value Proposition

Microfinance delivers loans with an inclusive mission and complements those loans with non-financial business development services. Concretely this means that microfinance:

- ➔ Lowers the barrier to entry for entrepreneurs to begin building a place for themselves in the economy.
- ➔ Accompanies the business development of less experienced entrepreneurs, developing their skills and leveraging their ideas.
- ➔ Provides an important complement to welfare systems, by providing a path out of unemployment, leading to savings on unemployment payments and generating taxable economic activity.
- ➔ Operates on a high-touch basis with the entrepreneurs it finances, with more attention for the challenges and objectives of their clients than traditional financiers.
- ➔ Serves as a promoter in funding best entrepreneurial practices such as for example relating to innovation and the new green economy, thus supporting directly EU regional cohesion.
- ➔ Increases the overall European SME competition level by promoting entrepreneurship and trade by adopting uniformised financial practices (for example EU Code of Good Conduct for Microfinance Providers)

With these objectives, microfinance is clearly an ally to policymakers, not only in terms of achieving public policy objectives for inclusive employment and entrepreneurship, but also in monetary terms. Studies estimate that every euro of support for microfinance generates more than 2 euros of net return to the public budget. However, a recent study by the European Commission also estimates that the European microfinance sector suffers from an annual financing gap of €12.9 billion – a sign that its potential is still drastically underused, and much more can be done to benefit from its effects.

Stimulating the development of microfinance actors in the countries that are suffering from Human Capital Flight would thus lower the barriers to entry for aspiring entrepreneurs and open the doors to economic development for young people, innovators, and others who currently would seek to develop themselves abroad.

Beyond its role in entrepreneurship, microfinance is also a tool that enables people to access credit to cover their immediate family needs, when the only existing available alternative would be resorting to loan sharks. Microfinance, as it is described and certified in the European Code of Good Conduct, is a tool that many use to move from focusing on everyday survival to planning for the future, and it is one of the measures that can be leveraged to manage the need for credit, provided strong customer protection measures are upheld.



## Policy Proposals

1. We call on the **European Commission** to increase its efforts to reduce the regional imbalances through tailored policies and instruments, both from cohesion funding sources and its social budget instruments. We also call for microfinance to be placed at the heart of such initiatives, taking its place amongst key regional and local stakeholders in delivering strategic plans.
2. We endorse the messages put forward by the **Committee of Regions** in their paper on tackling brain drain<sup>1</sup>. We particularly see a role for microfinance in the following statement: *"Cities and regions can increase their attractiveness by promoting policies and instruments to develop local entrepreneurship, self-employment and alternative models of business development. Partnerships between local authorities, businesses and universities are important engines of local growth and development"*. We advocate for the development of innovation ecosystems, in partnerships with regional governments, city administrations, NGOs and microfinance institutions. We would urge the CoR to include microfinance more explicitly in their list of supportive actors.
3. We call upon the **Committee of Regions** to recognise the many ways in which microfinance contributes to the EU Pillar of Social Rights. We call upon the CoR SEDEC commission to integrate microfinance into their Knowledge Exchange Platform (KEP) sessions.
4. In the **European Social Fund Plus**, we recommend to:
  - ➔ Increase the linkage between lifelong learning, vocational training, and microfinance actors. Specific initiatives must be developed to support returning emigrants and stimulate young & rural entrepreneurship.
  - ➔ Further encourage the use of financial instruments to support entrepreneurs via microfinance, including seeking more exchange with mechanisms such as mezzanine funding, venture capitalism, seed financing and business angels.
5. In the **European Regional Development Fund and Cohesion Fund**:
  - ➔ Infrastructure investments should be accompanied by job-creation projects. For instance, a new rural road, should be accompanied by a new development project targeting beneficiary regions through the intermediary role of MFIs or similar institutions supporting job-creation & entrepreneurship; Improve the alignment between the Cohesion Fund and EIF Funds, so the first is not just hard infrastructure investments, but also participation in financial instruments.
  - ➔ Facilitate contractual procedures for micro & SME local companies so they can participate at a higher rate in ERDF infrastructural projects, also through the funding they can receive by MFIs.

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1 <https://cor.europa.eu/en/news/Pages/tackling-brain-drain.aspx>



## Further reading

*Organisation for Economic Co-operation and Development (OECD)*

- ➔ **Talent Abroad: A Review of Romanian Emigrants**  
<https://www.oecd.org/countries/romania/talent-abroad-a-review-of-romanian-emigrants-bac53150-en.htm>

*European Committee of the Regions (CoR)*

- ➔ **Brain Drain in the EU: addressing the challenge at all levels**  
<https://cor.europa.eu/en/our-work/Pages/OpinionTimeline.aspx?opId=CDR-4645-2019>

*International Monetary Fund (IMF)*

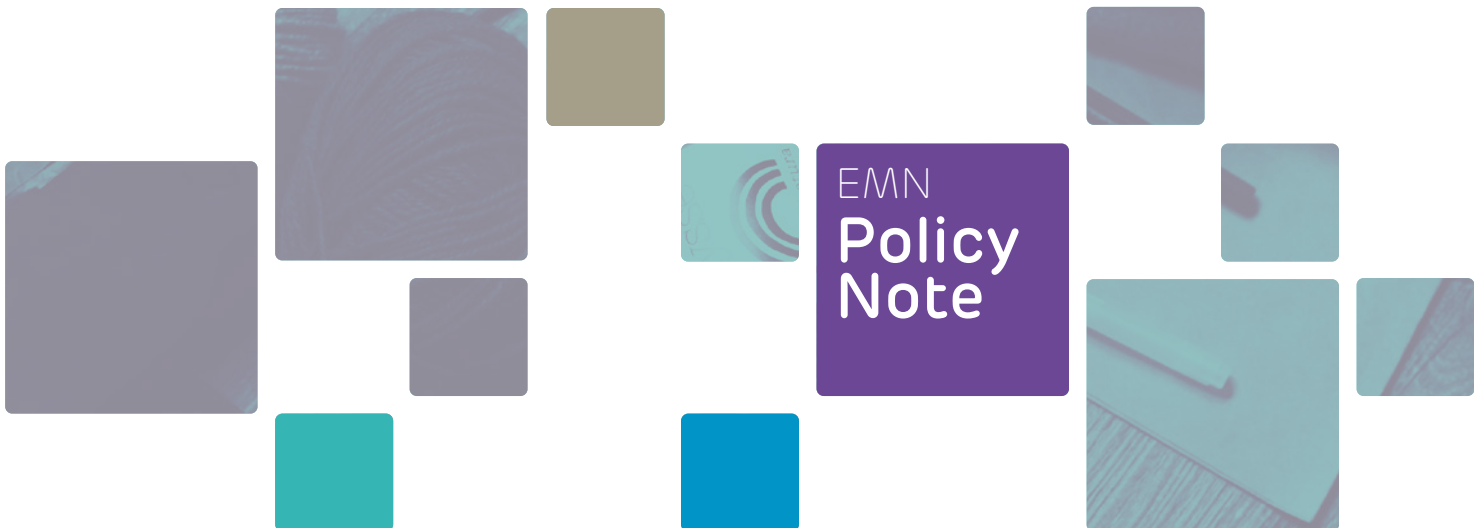
- ➔ **Demographic Headwinds in Central and Eastern Europe**  
<https://www.imf.org/-/media/Files/Publications/DP/2019/English/DHICAEAAA.ashx>

*World Bank Group*

- ➔ **From Uneven Growth to Inclusive Development: Romania's Path to Shared Prosperity**  
<https://openknowledge.worldbank.org/bitstream/handle/10986/29864/9781464813177.pdf?sequence=2&isAllowed=y>

*European Committee of the Regions (CoR)*

- ➔ **Tackling brain drain requires joint efforts to improve the quality of life in all EU regions**  
<https://cor.europa.eu/en/news/Pages/tackling-brain-drain.aspx>



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