The World Bank in Moldova

Country Snapshot

An overview of the World Bank's work in Moldova

April 2018

MOLDOVA	2017
Population, million	3.55
GDP, current US$ billion	8.1
GDP per capita, current US$	2,290
Life Expectancy at birth, years (2017)	71.2

At a Glance

- Moldova registered robust growth in 2017, supported by favorable conditions in agriculture and strong private consumption.
- Growth momentum is expected to continue in 2018 (3.8% growth) and 2019 (3.5% growth), buoyed by growing consumption and investments, particularly public investments.
- Although Moldova has rebuilt its macroeconomic buffers, there continue to be major policy challenges related to the upcoming elections, governance, particularly in the financial sector, the efficiency of public spending, and revenue mobilization.

Country Context

Moldova is a small lower-middle-income economy. Although the poorest country in Europe, it has made significant progress in reducing poverty and promoting inclusive growth since the early 2000s. The economy has expanded by an average of 5% annually, driven by consumption and fueled by remittances. The latter account for a quarter of GDP, among the highest shares in the world.

European integration has anchored the Government's policy reform agenda, but reforms that are good on paper have yet to materialize in reality. A vulnerable political system, polarized society, adverse external environment, and skills mismatch in the labor market, as well as climate-related shocks, are Moldova's biggest economic challenges.

Transparency, accountability, and corruption are crucial concerns. Business confidence is low and the macroeconomic framework remains vulnerable. External budget support, based on an agreement with the International Monetary Fund, has a high level of conditionality. Continuous economic stabilization, the advancement of key economic reforms, and the creation of a rule-based environment for businesses are Moldova's key goals.

With parliamentary elections due at the end of 2018, ambitious reforms in vital areas are highly likely to stumble.

Moldova also faces another important challenge. Large-scale emigration, combined with decreasing fertility rates, has led to an alarming decline in the population and hastened the pace of aging in Moldova, putting pressure on the pension system and limiting the country's long-term competitiveness.

The World Bank and Moldova

The FY18–21 Country Partnership Framework (CPF) supports Moldova's transition to a new, more sustainable, and inclusive development and growth model through a mix of analytics, advice, and financing. The CPF is grounded in the National Development Strategy, takes into account outcomes of the FY14–17 Country Partnership Strategy, and incorporates the three topmost priorities of the Systematic Country Diagnostic, namely: (a) strengthening the rule of law and accountability in economic institutions; (b) improving inclusive access to and the efficiency and quality of public services; and (c) enhancing the quality and relevance of education and training for job-relevant skills.

These three priorities define and inform the CPF's three focus areas: economic governance, service governance, and skills development, which are supplemented by climate change—a World Bank Group corporate priority—as a cross-cutting theme.

Key Engagement

Moldova is struggling with a burdensome bureaucracy involving excessive and redundant bureaucratic procedures. Key services need to be modernized and access for people and businesses must be improved. At the same time, improving economic governance and strengthening the rule of law and accountability in economic institutions are the key pathways to de-risking private sector investment for job creation. These issues define two major pillars of the CPF for 2018–21.

The US$20 million Bank-supported Modernization of Government Services Project will improve the access, efficiency, and delivery quality of administrative services through re-engineering and digitization, and assisted service delivery at the local level, including for vulnerable groups. It will gradually address administrative corruption by moving government service delivery online, thereby reducing face-to-face interaction between citizens and service providers.

WORLD BANK PORTFOLIO

No. of WB Projects: 9

IDA Net Commitments: $251 Million

IBRD Net Commitments: $100.5 Million

IFC Committed Portfolio: $38.8 Million
($34.9 Million Outstanding)

MIGA Exposure: $25.4 Million in 4 Projects

GEF: $6.4 Million in 2 Grants

Increased tax revenue collection is another priority. The Government has launched a reform of the administrative structure of the State Tax Service (STS), but more needs to be done to improve its effectiveness. The US$20 million Bank-supported Tax Administration Modernization Project will enhance revenue collection, tax compliance, and taxpayer services by tax administration automatization and integration.

The project will include tax policy reform, institutional and operational development, IT infrastructure modernization, capacity building, and change management.

State-owned enterprises (SOEs) play a major role in Moldova's economy. SOE assets account for more than 32% of GDP and approximately 10% of the corporate sector's assets. The top 10 SOEs—those engaged in nationally relevant operations and infrastructure—control over 74% of total SOE assets. Yet, SOEs are incurring losses and face growing long-term debt, thus exposing the Government to fiscal risk.

The World Bank, through technical assistance financed by the United Kingdom's Good Governance Trust Fund, undertook a comprehensive diagnostic of the SOE sector in Moldova that identified the governance issues directly impacting SOE performance and quality of service delivery. The diagnostic also established a foundation for the development of a roadmap for potential reforms.

Recent Economic Developments

In 2016–17, GDP growth resumed and reached 4.5% due to strong agricultural output and robust private consumption growth that was driven largely by remittances and public and private wage increases. Despite robust exports supported by the good harvest of the past two years, imports increased rapidly, resulting in a negative contribution of net exports to growth (-2.7%).

On the production side, growth has been driven mainly by retail and wholesale trade (+1.3%), followed by growth in agriculture (+1%) and industry (+0.4%). The inflation rate has been out of the target corridor since April 2017 due, among other factors, to stronger internal demand and increases in regulated prices in early 2017.

Yet monetary policy has a limited effect on the economy amid continued excess liquidity. Excess liquidity first appeared after the banking fraud scandal and the conversion of public guarantees on the emergency loans to the banking sector into state securities worth 13.6 billion MDL (10% of GDP in 2016) for a period of 25 years with a 5% average interest rate.

At the same time, credit growth remains negative, reflecting limited pass-through of the monetary policy stance to commercial interest rates and tighter prudential standards in the banking sector. The fiscal deficit reached 0.8% in 2017, lower than the deficit forecasted at the budget stage, and public debt remains sustainable under different stress scenarios.

Economic Outlook

Looking forward, growth is expected to remain robust and reach 3.8% in 2018. In the medium term, the recovery in remittances, together with an increase in private wages, will sustain private consumption, which will remain a key driver of growth. Import growth will outpace export growth, leading to a negative contribution of net trade to GDP growth.

The inflation rate is expected to re-enter the target corridor in 2018 due to base effects and lower regulated prices. As consumption and imports strengthen, the current account deficit is expected to gradually increase but remain below its historical averages, thanks to the revitalization of foreign inflows. Parliamentary elections in November 2018 not withstanding, fiscal deficits are projected to remain under control.

Key downside risks include the volatility of agriculture outputs, which remain vulnerable to extreme weather conditions. The banking sector has stabilized, yet it is important to continue with reforms and strengthen the transparency in the sector. The increased demand (+30% in the first half of 2017) observed in the unregulated and poorly monitored non-banking financial intermediation sector raises concerns.

Weaker growth among key trade partners and potential changes in international trade and migration relations could undermine exports and remittance flows.

Project Spotlight

Competitiveness Enhancement Project

Regulatory burdens and limited access to finance have further strained the competitiveness of domestic enterprises.

Moldova's private sector has struggled due to low investment and the resulting inadequate levels of productivity and export competitiveness. The regulatory burden and limited access to finance have further strained the competitiveness of domestic enterprises.

Moldova's policy agenda supports export-led economic growth. Its national development strategy focuses on improving the business-enabling environment and promoting better access to finance for enterprises.

The Second Competitiveness Enhancement Project (CEP II) helps the Government achieve its objectives by supporting a reform agenda to improve the business environment through regulatory reforms that reduce the cost of doing business and programs that support the export growth of small and medium enterprises. The CEP includes initiatives to improve access to medium and long-term finance for export-oriented enterprises in order to increase their export competitiveness and decrease the regulatory burden.

The annual "Cost of Doing Business" surveys conducted under the CEP have revealed that management time spent on regulatory requirements decreased from 11% in 2010 to 8% in 2017, the number of days to register a company decreased from fourteen in 2010 to four in 2017, and the number of annual inspections per firm declined from 7.9 in 2010 to 2.9 in 2017.

The Government has also amended legislation to reduce the number of permits from 416 to 150. The CEP had helped to introduce an electronic one-stop-shop platform, increase transparency, and reduce the cost and time required to obtain permits, saving over US$3.5 million annually.

The US$30 million credit line and US$3 million matching grants facility have already helped 150 companies to finance their long-term investment and working capital needs, enhance their competitiveness and productivity, launch new products, and expand their market presence. By the end of the project, approximately 250 exporters will have become its beneficiaries.

The "Country Snapshot" is a bi-annual update, highlighting the country's recent developments, economic outlook and major overview of the World Bank's partnership with the country. You can find the latest updates at http://www.worldbank.org/moldova

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