

MOLDOVA: REKINDLING ECONOMIC DYNAMISM COUNTRY ECONOMIC MEMORANDUM*



WORLD BANK GROUP
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Key Messages

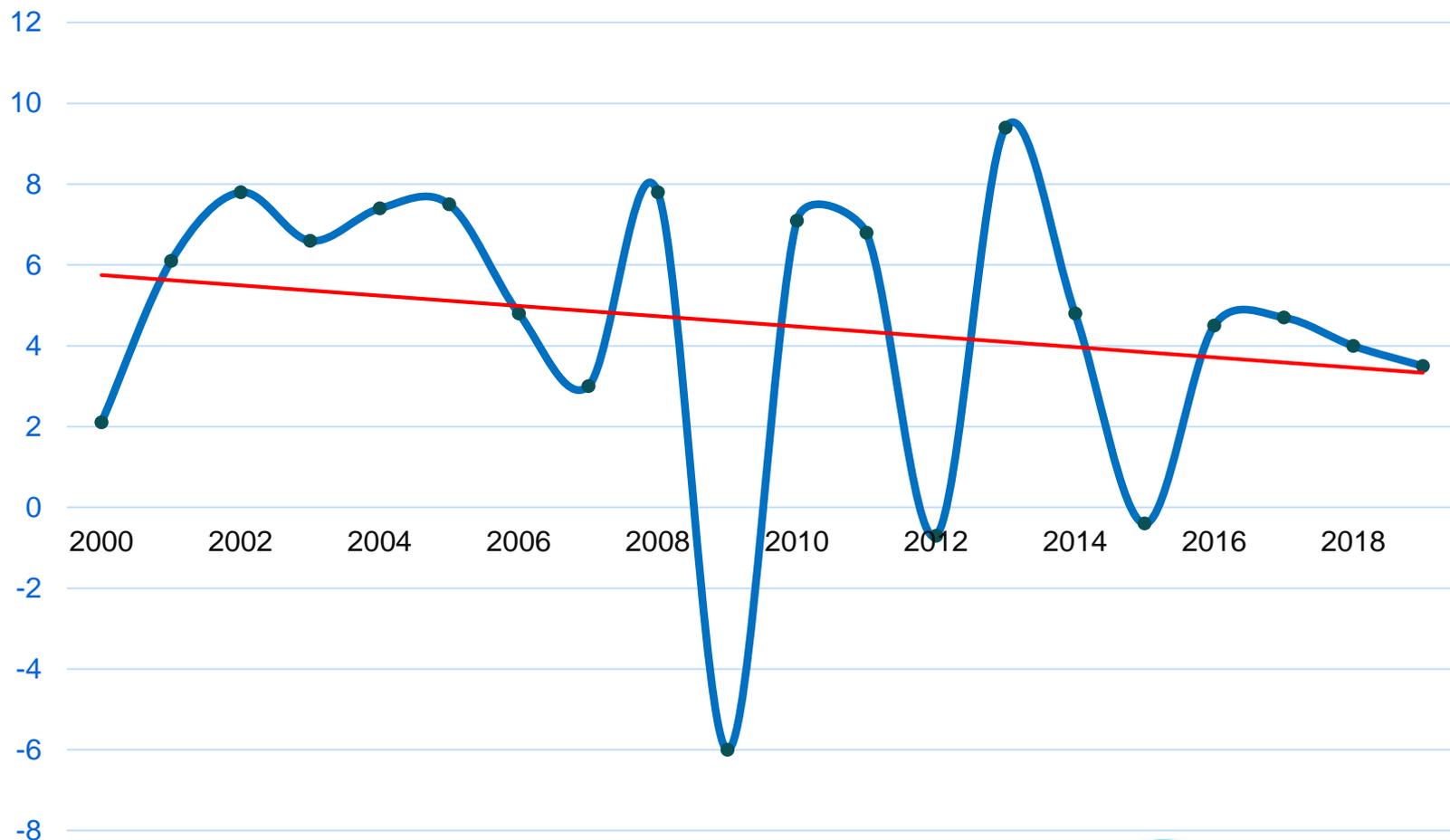
Trend growth in Moldova has been slowing... primarily because of slow productivity growth in enterprise performance

A major concern is the low productivity of state-owned companies

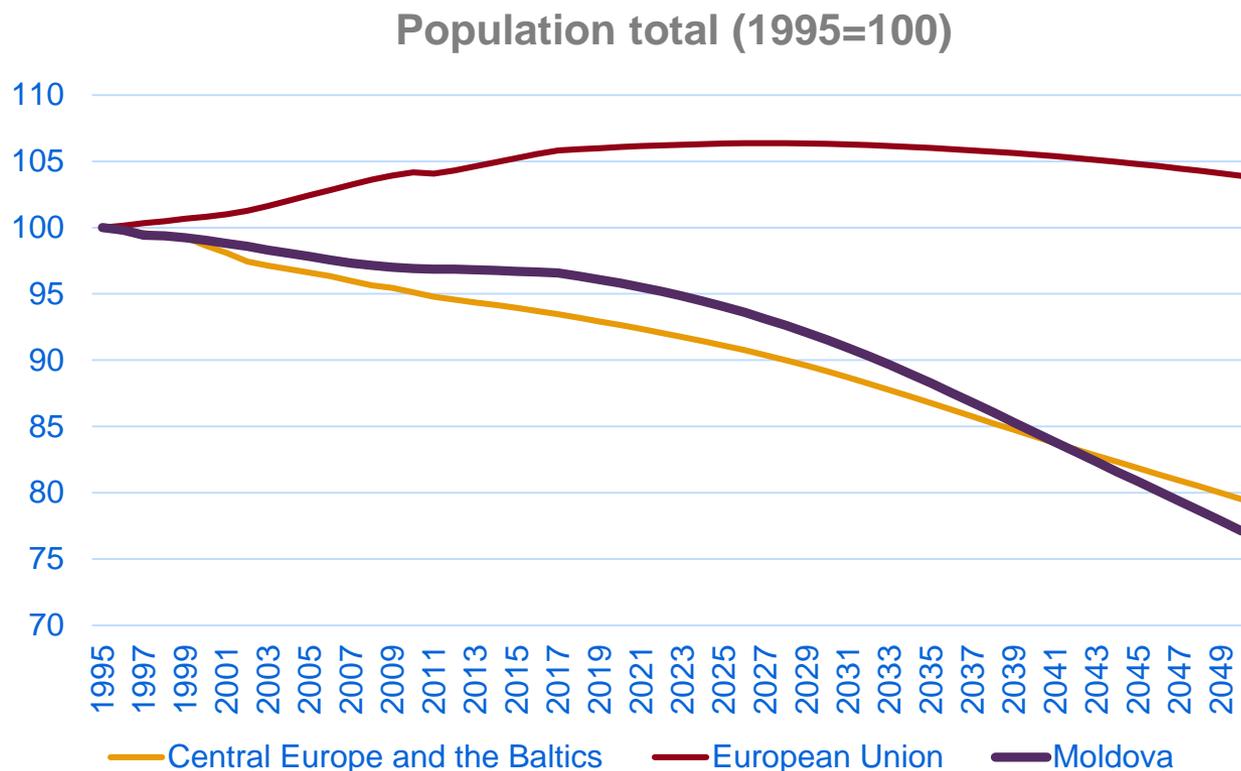
That said, several bright spots in the economy suggest ways to rekindle high growth momentum..

Question: How can policy promote productivity dynamism? Some ideas....

Trend GDP growth is slowing... and is much below the 6% goal of the national plan



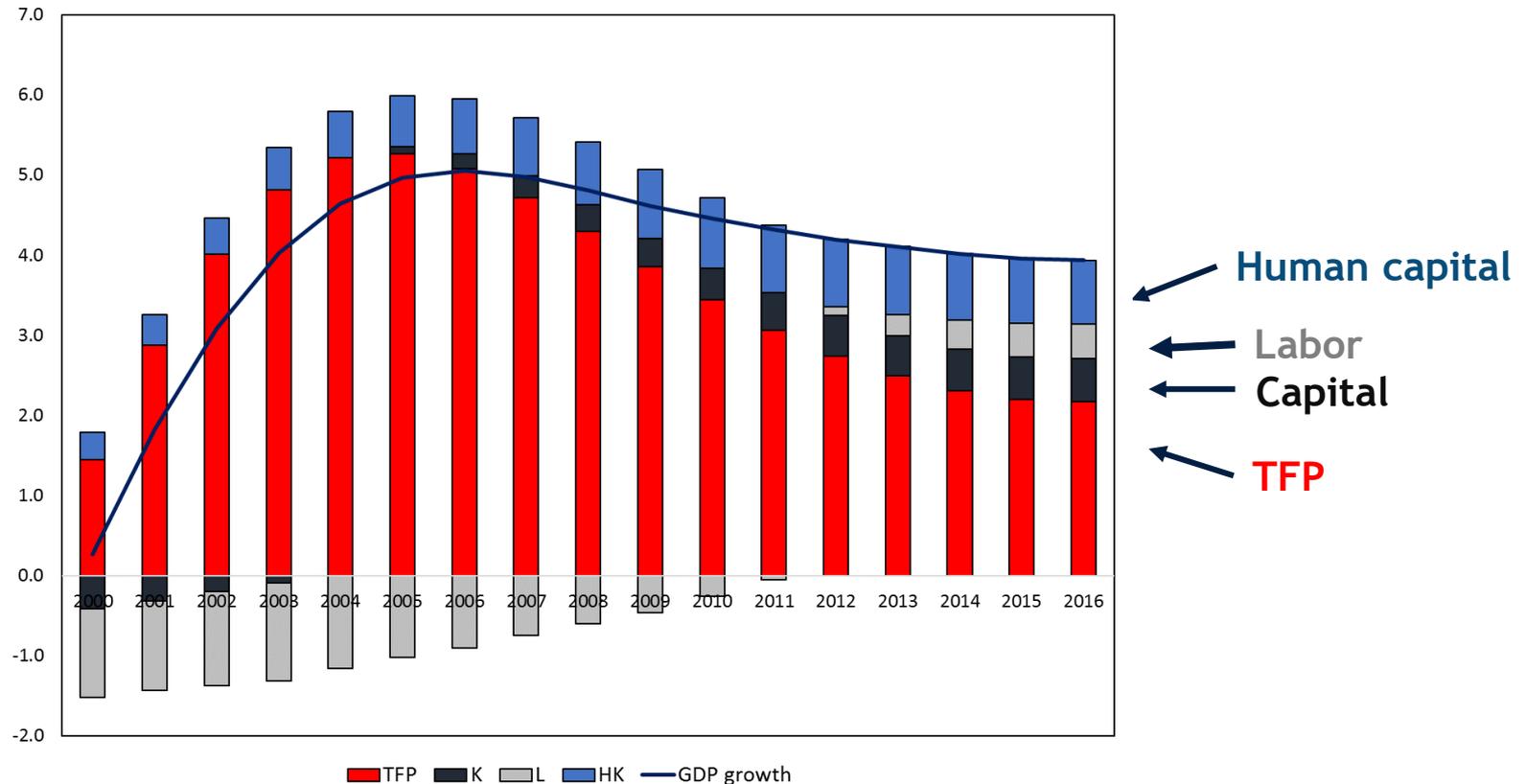
And not sufficient to create jobs and leading to the steady outflow of young workers that are contributing to population losses



Source: World Bank Population database

Trend productivity growth is weakening, undermining growth

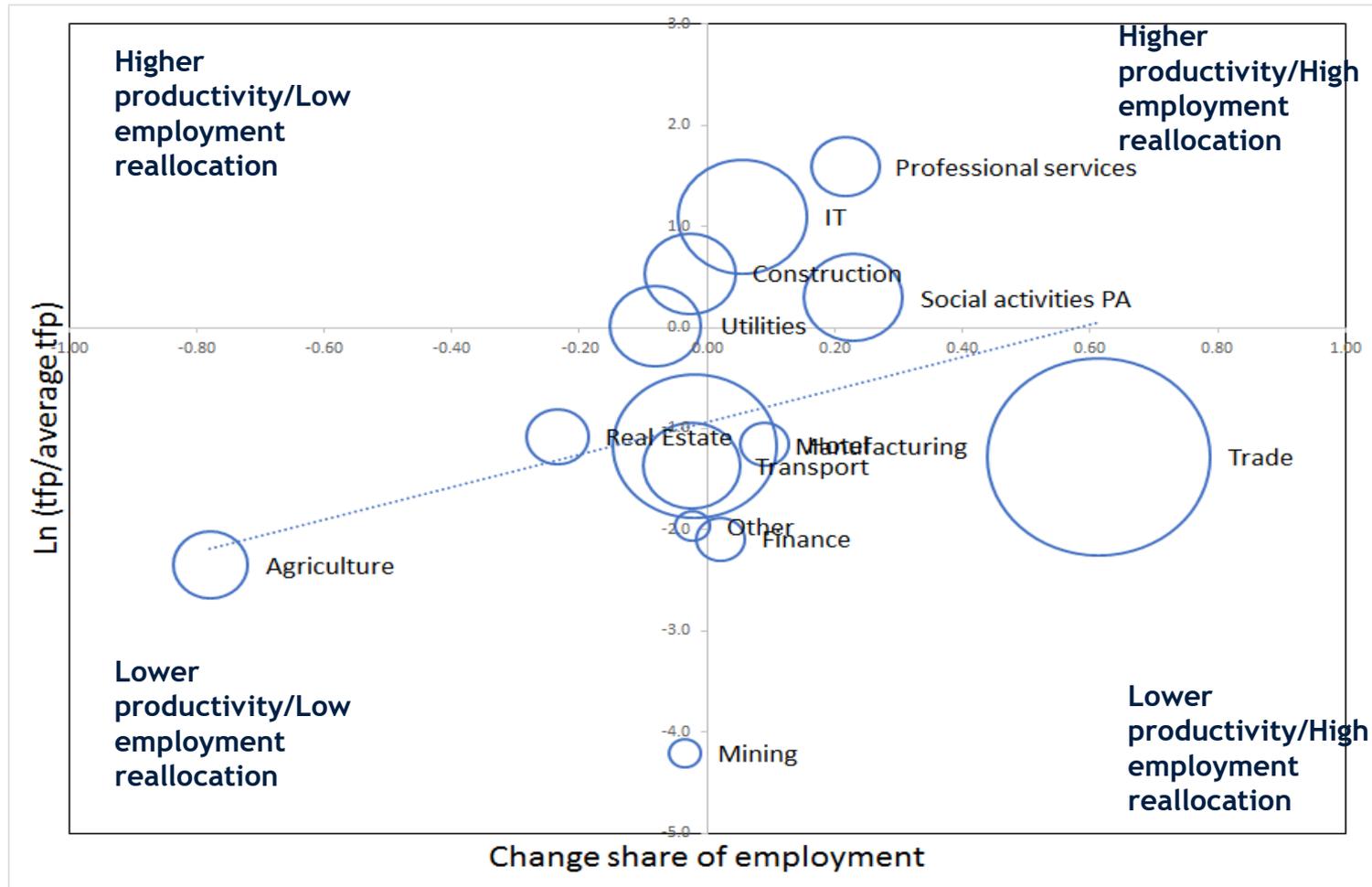
Decomposition of potential GDP growth by factors of production (1995-2016)



Source: World Bank Staff calculations based on PENN World Tables until 2014. Decomposition interpolated based on World Bank, World Development Indicators, ILO ILOStat database and PENN World Tables. Note: HP filtered series (smooth parameter=100) and using 2-years moving-averages of labor and capital shares.

Workers are moving to most productive sectors...

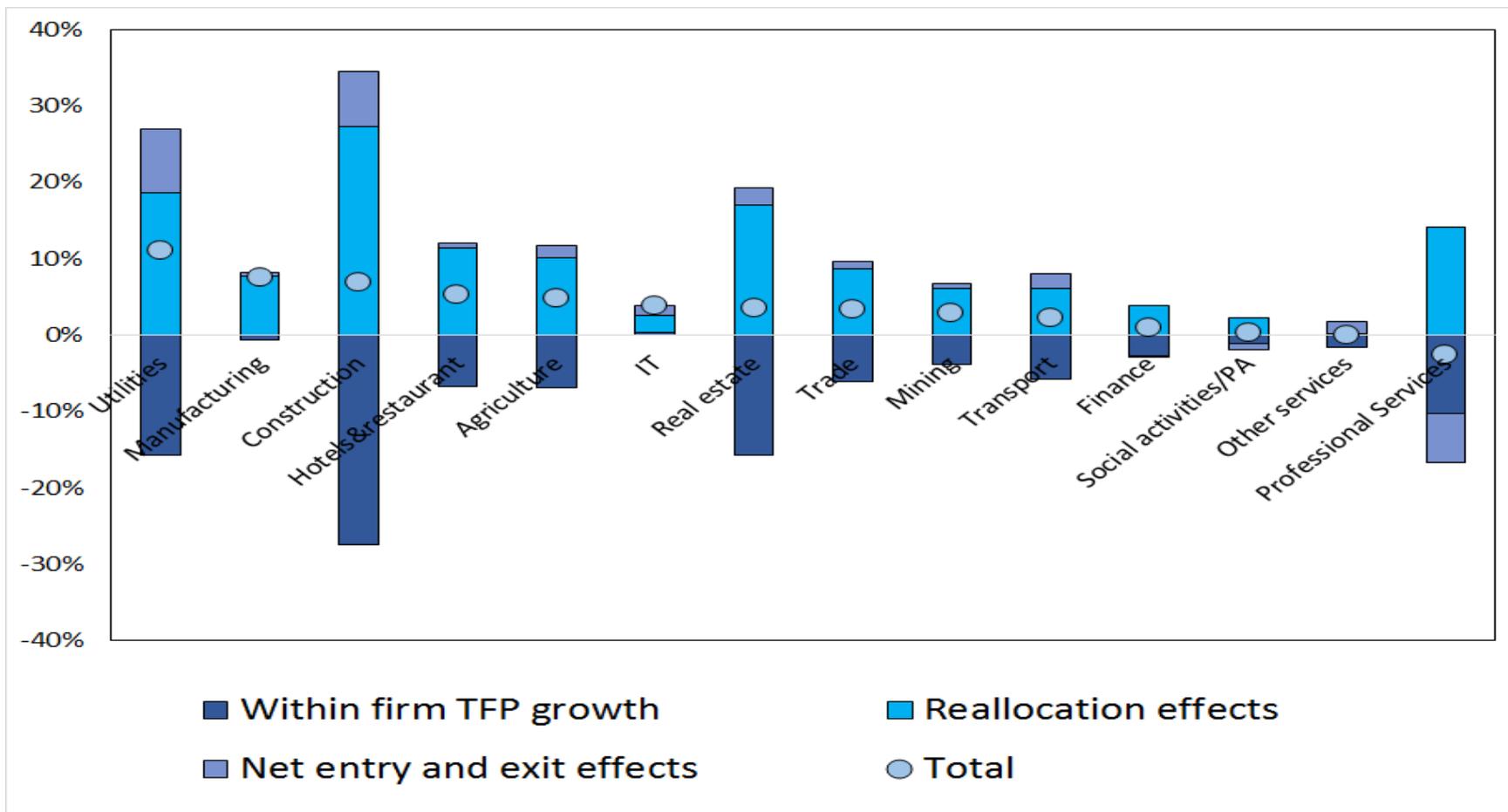
CHANGES IN SHARE OF EMPLOYEES AND DEVIATION OF TFP LEVELS



Source: World Bank Staff calculation based on INE Administrative data
 Note: size of the bubble denotes average share of value added

...But *within firm* productivity growth lags

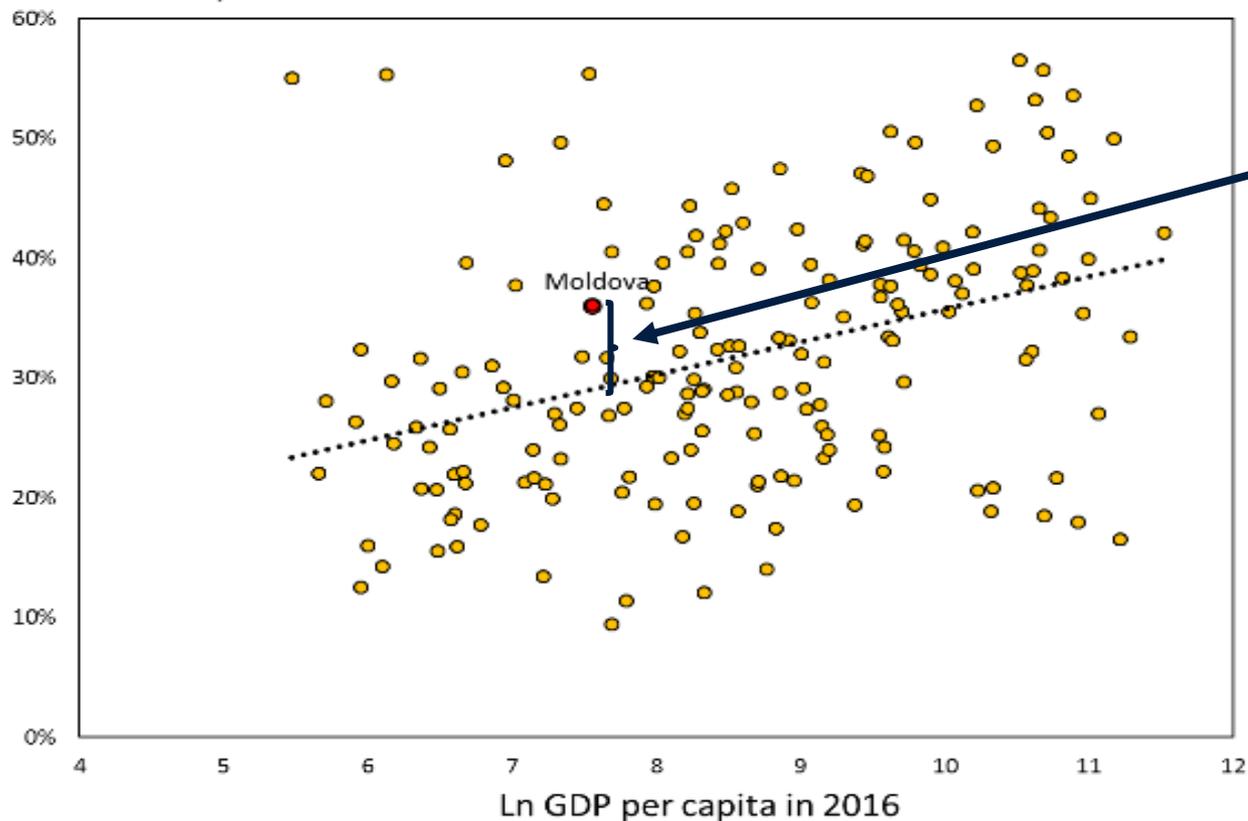
DECOMPOSITION OF TFP GROWTH ACROSS SECTORS-(AVERAGE 2010-2016)



Source: World Bank Staff calculation based on INE Administrative data and Foster, Haltiwanger, and Krizan (2001)

One reason: Moldova has a very large government relative to its income... and absorbs resources unproductively

General Government Expenditures as % of GDP in 2016

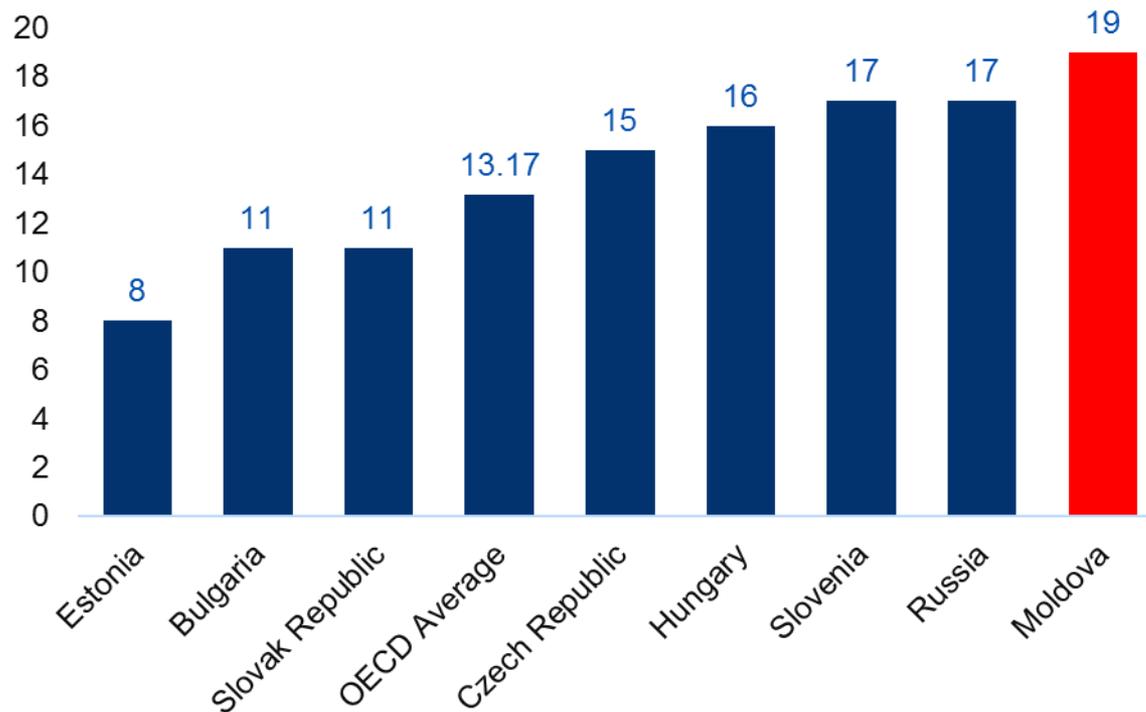


At 36% of GDP, MDA govt is some 7 percentage points larger than average at its pc income.

Source: World Bank Staff calculations based on IMF WEO and World Bank WDI databases

...with several sectors characterized by the significant presence of SOEs...

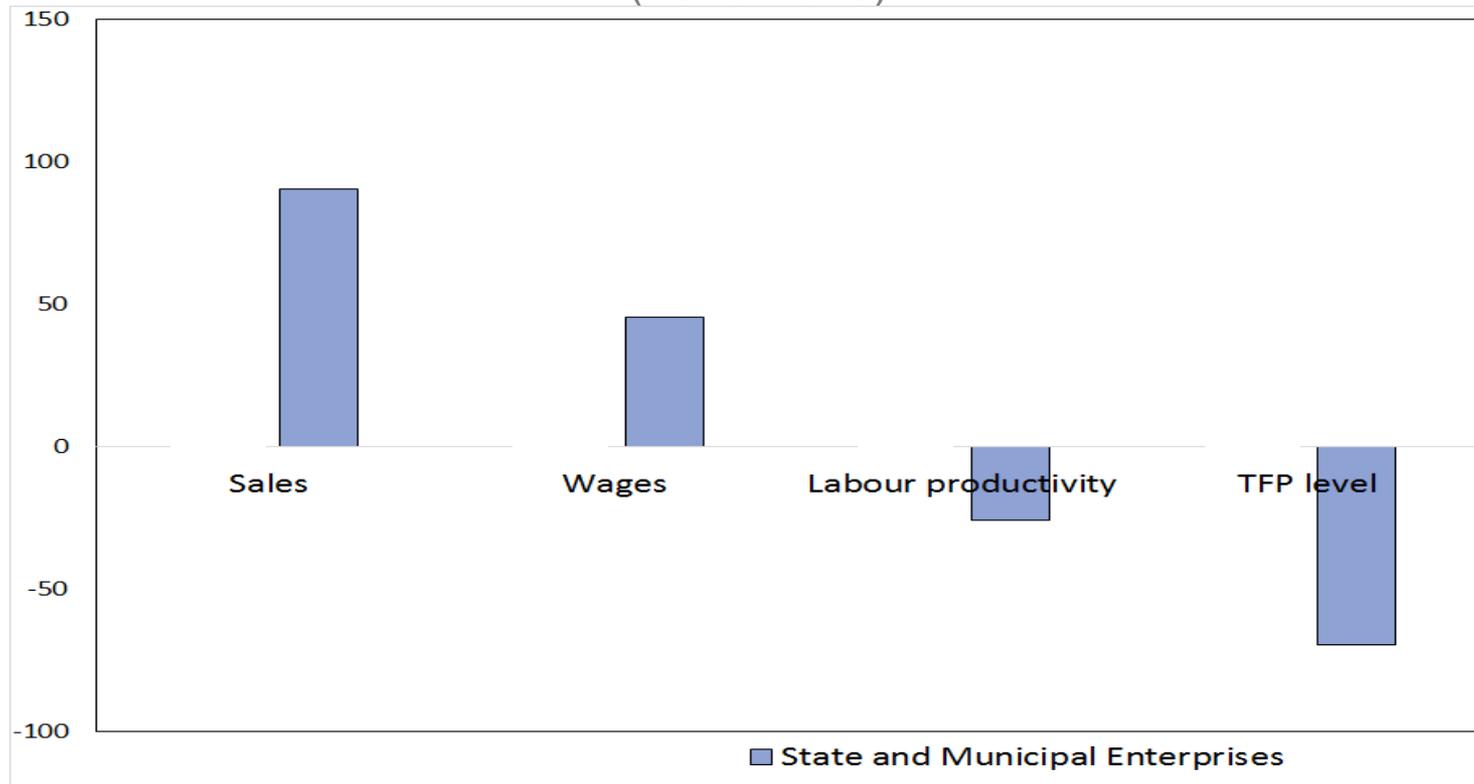
Number of sectors with SOEs, (various years)



Source: World Bank Staff calculations based on OECD-WBG Product Market Regulation indicators

SOEs are dragging down productivity in the economy...

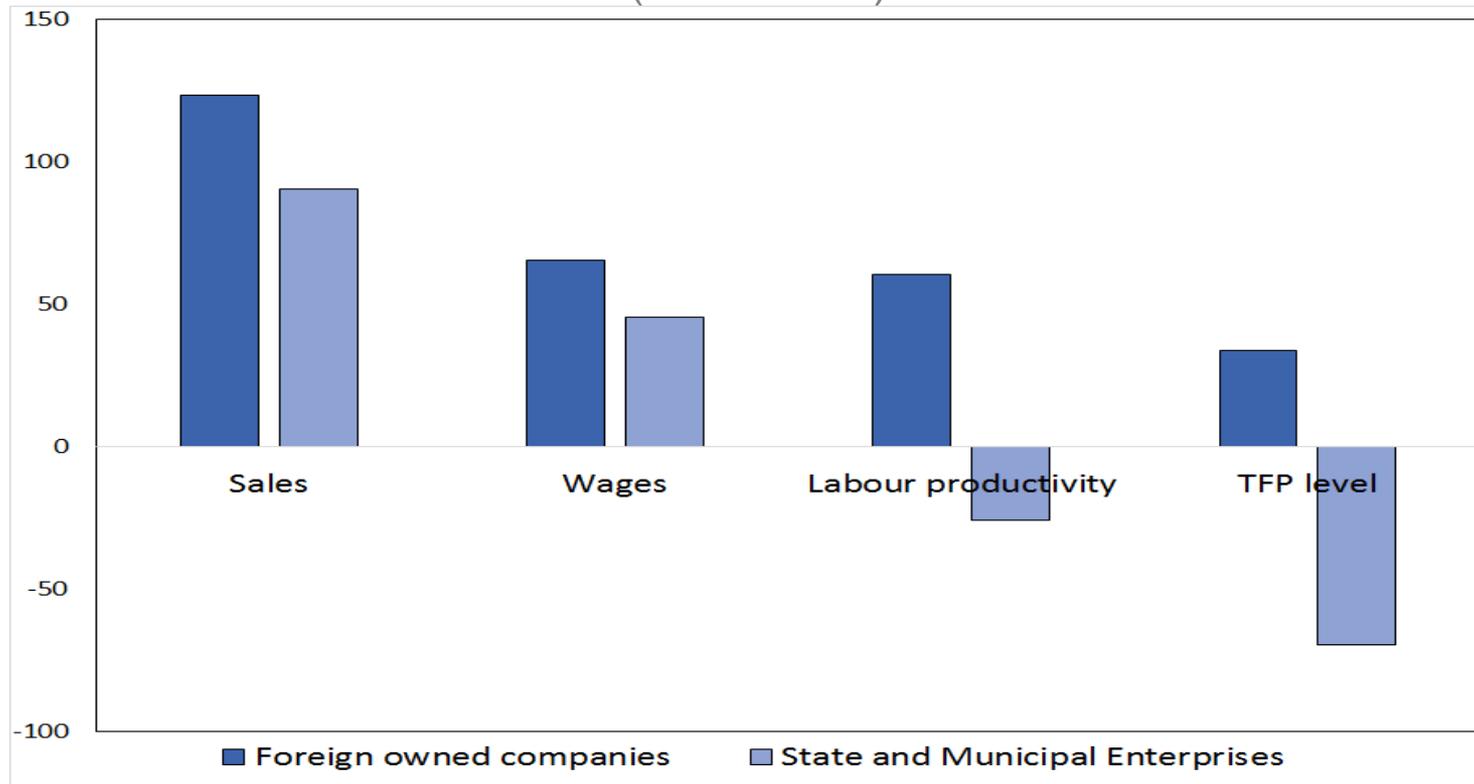
Average percentage differences relative to private domestic firms in the economy
(2010-2016)



Source: World Bank Staff calculations based on Moldova National Statistical Bureau administrative data
Note: Regressions controlling for sector and year dummies. Excludes the PA, Health, and Education sectors.

SOEs are dragging down productivity in the economy... while foreign owned firms outperform all others

Average percentage differences relative to private domestic firms in the economy
(2010-2016)



Source: World Bank Staff calculations based on Moldova National Statistical Bureau administrative data
Note: Regressions controlling for sector and year dummies. Excludes the PA, Health, and Education sectors.

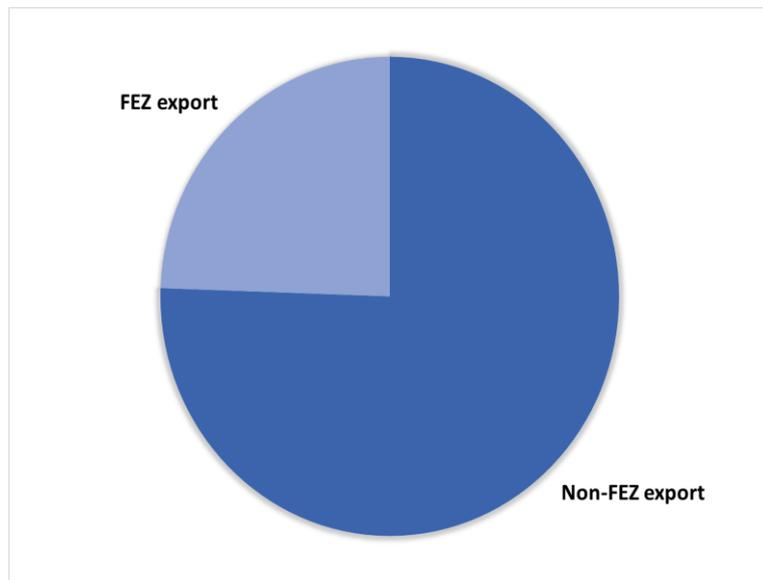
Recapping the story...

- Productivity growth has been slowing...
- Even though workers are moving toward productive sectors, productivity within firms is low
- Among firms, SOEs have much lower productivity than domestic firms, -
- and foreign firms.

But there's some bright spots in the economy that contain lessons for the future... consider FEZs, attracting FDI, and IT

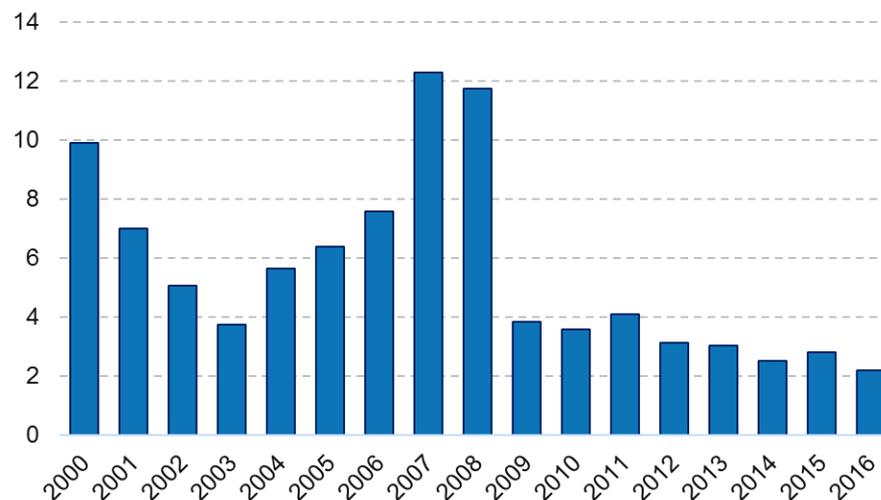
FEZs have been a laboratory to spur manufacturing exports... ...and Moldova has been attracting FDI

Export Composition, 2015-2017



Source: Ministry of Economy, Moldova

Total FDI Inflows as % of GDP



Source: World Bank Staff calculations based on FDI Snapshot using UNCTAD

...Foreign owned firms lead in innovation

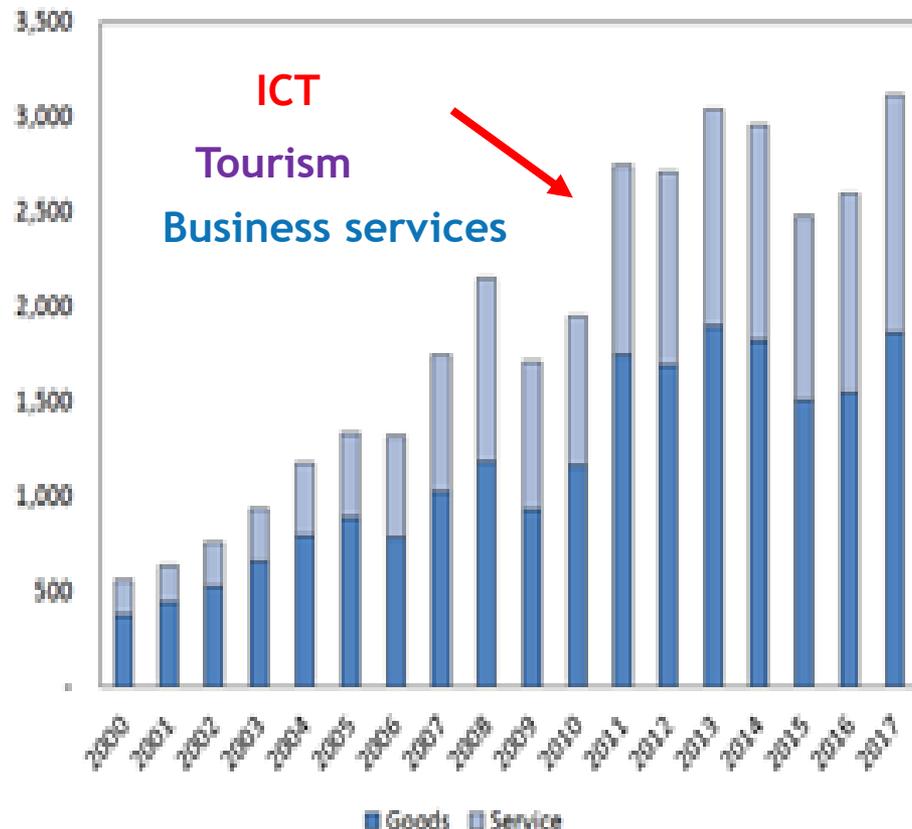
Foreign owned firms innovate: 65% of foreign firms spend for R&D compared to 4% of domestic firms

Foreign owned firms adopt international technology: 62% of foreign manufacturing firms license international technology compared to 14% of domestic firms

Foreign firms employ more skilled workers – and that allows them to employ new technologies : foreign firms employ about twice as many university graduates as a share of their workforce as domestic firms; three times as many foreign firms offer training (81%) as domestic firms (27%)

The removal of barriers to trade have spurred exports ...and exports have considerable potential to grow

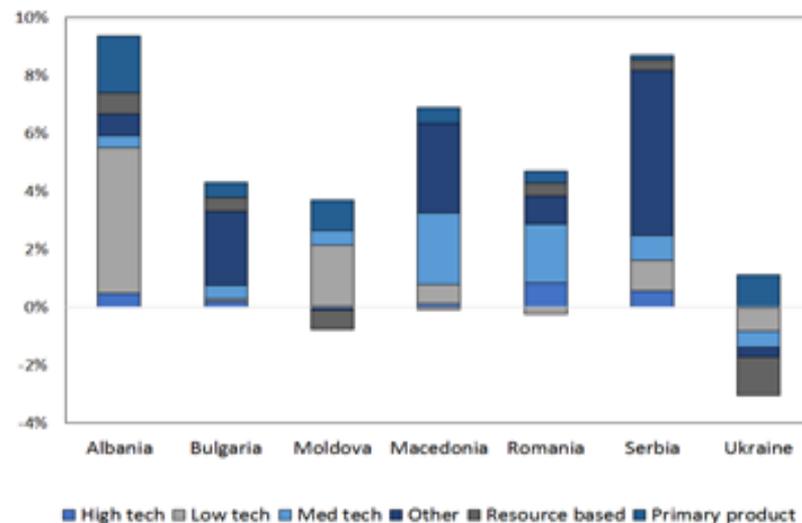
EXPORTS OF GOODS AND SERVICES-MILLIONS USD



Source: World Bank Staff calculations based World Bank, World Development Indicators

AVERAGE CHANGES IN ADJUSTED MARKET SHARE

(2006Q2-2016Q2)



Source: World Bank Staff calculations based on World Bank, Measuring Export Competitiveness database
 Note: Changes in adjusted market share net out effects associated with the mix of products exported and changes associated to the distribution of trading partners

Lessons from recent success...

These successes show that:

- Given **supportive economic policies**, they success can generate good jobs attractive to Moldovan workers;
- Their growth **hinges on new innovation and technology** to boost firm productivity;
- **Attracting foreign direct investment** as a source capital, technology and access to markets has had a high pay-off.

Even these success stories exhibit untapped potential that require new policies

Policies to propel growth

Reducing government size....while increasing its capability

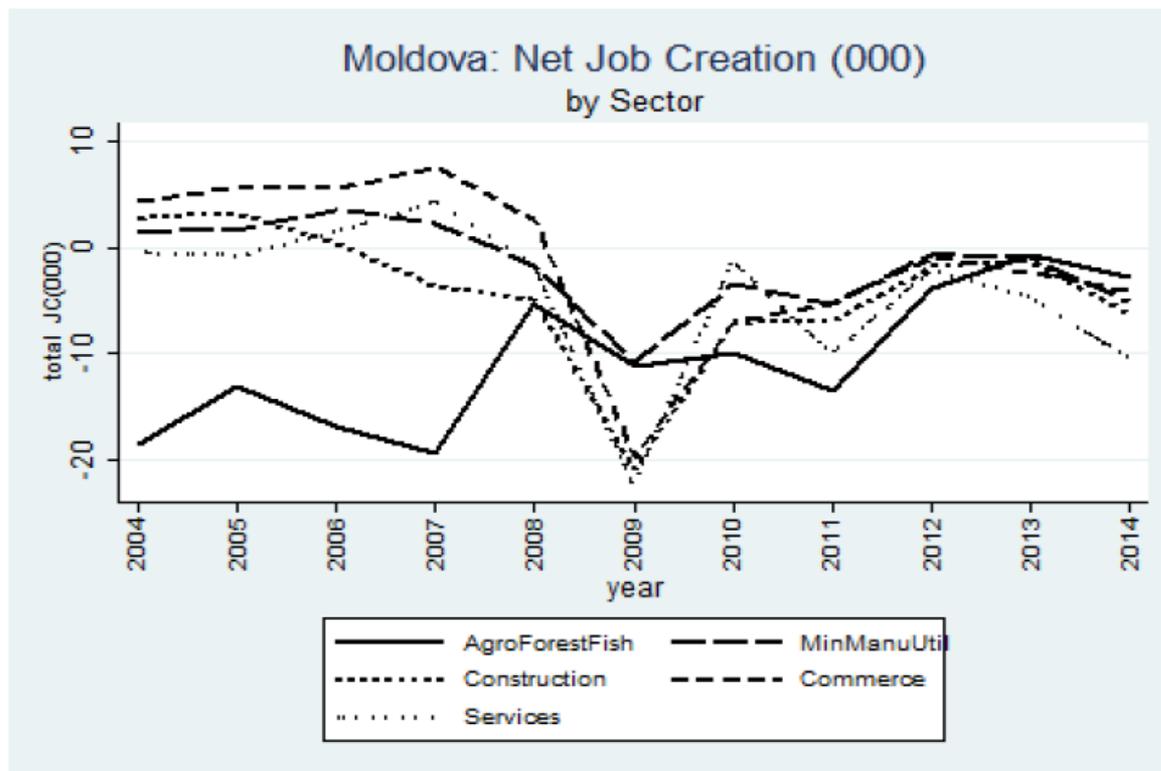
Reforming State Owned Enterprises

Promoting Foreign Direct Investments and exports

Changing incentives to foster enterprise productivity
(competition policy and tax policy)

Improving workers skills and increasing human capital (high
level education is key)

...not sufficient to create jobs...



Source: World Bank (2016a) Moldova Poverty Assessment 2016: A Jobs Diagnostic for Moldova World Bank: Washington, DC.

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