The World Bank in Moldova

Country Snapshot

An overview of the World Bank's work in Moldova

October 2019

MOLDOVA	2018
Population, million	3.55
GDP, current US$ billion	11.3
GDP per capita, current US$	2,724
Life Expectancy at birth, years (2018)	73.2

At a Glance

- Despite an unstable political situation, economic growth remained robust at 4 percent in 2018 and is estimated to reach a solid 3.4 percent in 2019.
- In the medium term, economic growth is expected to remain strong at 3.6 percent, though below the historical average.
- Provided the reform agenda continues, consumer and business confidence, together with the continued normalization of financial conditions, will further support private consumption and investment.
- With a fragile political environment and headwinds from local elections, it is critical that Moldova advance on its unfinished reform agenda to address governance issues, the efficiency of public finances, and the economy's low productivity.

Country Context

Moldova is a small lower-middle-income economy. Although it is among the poorest countries 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 percent 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 successive governments' policy reform agendas, but reforms that are good on paper have yet to materialize. A vulnerable political system, polarized society, adverse external environment, and skills mismatch in the labor market, along with climate-related shocks, are Moldova's biggest economic challenges.

Continued economic stabilization, the advancement of key economic reforms, and the creation of a rule-based environment for businesses are the country's key goals. Moldova's large-scale out-migration, combined with decreasing fertility rates, has led to an alarming decline in the population and increased the share of elderly people. This puts pressure on the pension system and limits the country's long-term competitiveness.

In the near term, the formation of a new government supported by a parliamentary majority established in June 2019 is an opportunity to regain trust among citizens and international partners, strengthen the political system, de-polarize society, combat corruption, and speed up the reforms.

The World Bank and Moldova

The current 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. Grounded in the National Development Strategy, the CPF incorporates the three top-most priorities of the Systematic Country Diagnostic:

- Strengthening the rule of law and accountability in economic institutions,
- Improving inclusive access to and the efficiency and quality of public services,
- Enhancing the quality and relevance of education and training for job-relevant skills.

These priorities define and inform the CPF's focus areas of economic governance, service governance, and skills development. The mid-term strategy assessment validates these focus areas, with adjustments to the evolving country context and to the country's priorities, including:

1) building momentum for sound economic governance,

2) maintaining solid progress under service governance,

3) shifting the focus toward higher education under the ever-important skills agenda, and

4) mainstreaming climate change across the Bank-supported program.

Key Engagement

The World Bank and the International Finance Corporation (IFC) work together to achieve Moldova's goals through improved governance, institutions, and the quality of public services; an enhanced business environment, private sector development, and improved firm productivity; and deeper investments in human capital, job creation, and infrastructure, including in the energy sector.

WORLD BANK PORTFOLIO

No. of Projects: 10
Lending: $431.3 Million
IBRD: $88.1 Million
IDA: $343.2 Million

Increasing energy efficiency and enhancing the security of the energy supply are critical to improving Moldova's economic competitiveness, which is a priority for the World Bank Group.

Moldova imports 80 percent of its electricity to meet domestic demand from a limited number of sources. The lack of effective power interconnections with the European energy system and the current electricity supply structure pose significant supply risks and hinder competition in the electricity supply, resulting in highly priced electricity and vulnerability to external shocks.

The recently approved US$70 million loan for the Power System Development Project will enhance Moldova's domestic transmission capacity and reliability, as well as support the interconnection of Moldova's power system with the European electricity grid through Romania.

This is vital to diversifying Moldova's electricity supply sources, allowing for a competitively and transparently priced electricity supply.

The project finances the construction of a new 400 kV high-voltage overhead line between Vulcanesti, in the south of Moldova, and the capital Chisinau; the upgrading and expansion of the substations in Chisinau and Vulcanesti; and the strengthening of the power dispatch and metering system.

Recent Economic Developments

After a 4 percent growth rate in 2018, growth remained healthy in the first half of 2019 at 5.2 percent due to strong investments and robust private consumption that was driven by remittances and the pre-election tax cuts.

Imports increased rapidly, resulting in a negative contribution of net exports to growth, while a public spending spree before the elections boosted investments and private consumption.

The inflation rate has been in the target corridor of 5 percent since April 2019 due to higher food prices and the depreciation of the lei.

Although the National Bank of Moldova (NBM) increased the policy rate from 6.5 to 7.5 percent to prevent overheating, credit growth intensified in 2019, as the banking sector stabilized five years after revelations of major bank fraud.

The NBM undertook significant reforms, and in June 2019, completed the process of transferring the three largest banks to fit and proper shareholders. On the other hand, the non-banking financial sector continues to pose risks to stability.

The strengthening of the legislative framework and enforcement of supervisory actions across the non-banking sector is currently underway.

The fiscal deficit remained contained at 1 percent of GDP as public revenue collection increased. Public debt decreased to 27.8 percent in June 2019, but with the resumption of external financial assistance in July, it is expected that public debt will grow and that national foreign reserves, which will be used to close the financing gap, will be recovered.

Economic Outlook

Growth is expected to remain robust at around 3.6 percent on average by 2021, but with significant domestic and external downside risks. In the medium term, the solid but declining remittances, together with private wage growth, will sustain private consumption, which will remain a key driver of growth.

If the reform agenda moves forward, consumer and business confidence, along with a continued normalization of financial conditions, will further support investments. In the medium term, inflation is expected to remain within the target range, also due to moderate import prices.

Despite the declared determination to accelerate reforms, major effort and political will are needed to implement them. Fighting corruption, strengthening institutions, and leveling the playing field for all market participants, including through the elimination of price controls and the demonopolization of several sectors, would unleash productivity that is currently held back by the weak performance of state-owned companies and the barriers to market competition.

In the medium term, the fiscal position may deteriorate due to structural inefficiencies in public spending and the increasing burden from wages and social transfers. Deficit financing also constitutes a risk, as it heavily relies on external financial sources.

Although the banking sector risks have subsided, the accelerated growth of non-bank credit organizations and the insurance sector could lead to an accumulation of systemic risks in the financial sector if the current weaknesses in the regulatory and supervisory framework are not addressed. The economy also remains susceptible to weather and external shocks, while persistent emigration weakens the country's human capital.

Project Spotlight

Second Competitiveness Enhancement Project

The $30 million credit line and $3 million matching grants facility have already helped 180 companies launch new products and expand their market presence.

Moldova's private sector has struggled due to low investment and the resulting limited productivity and export competitiveness. The regulatory burdens and restricted 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 the implementation of the reform agenda to improve the business environment through i) regulatory reforms that reduce the cost of doing business and ii) programs to 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 to increase their export competitiveness and decrease the regulatory burden.

The annual "Cost of Doing Business" surveys conducted under the CEP reveal that the number of days to register a company decreased from 14 days in 2010 to four days in 2018, and the number of annual inspections per firm declined from 7.9 in 2010 to 2.3 in 2018. The quality of regulations has also improved, as measured by the increase in the application of the Regulatory Impact Assessment on all laws and regulations that affect businesses from 35 percent in 2015 to 75 percent in 2019.

The Government's legislative amendments have reduced the number of permits from 416 to 150. The CEP has also helped to introduce the electronic one-stop-shop platform to 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 180 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 300 private companies will become its beneficiaries.

THE WORLD BANK
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CONTACTS

Chisinau
+373-22-262-262
Pushkin Street, 20/1, MD-2012, Chisinau, Republic of Moldova.

More about the World Bank in Moldova

Website:
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