The World Bank in Moldova

# Country Snapshot

*An overview of the World Bank's work in Moldova*

**October 2018**

| MOLDOVA | 2018 |
|---|---|
| Population, million | 3.5 |
| GDP, current US$ billion | 9.6 |
| GDP per capita, current US$ | 2,692 |
| Life Expectancy at birth, years (2016) | 72.2 |

## At a Glance

- Supported by favorable conditions in agriculture and strong private consumption, growth in Moldova is estimated to reach a robust 4.8% in 2018.
- Growth is expected to slow down in the near term (at an average of 3.7% during 2019–20) and to rely on remittances and private wage–induced consumption.
- Investments are expected to grow by 7.9%, supported by more favorable financial conditions following a period of banking sector reforms.
- With the headwinds from parliamentary elections, major policy challenges remain, and further structural reforms are needed to improve governance, the efficiency of public spending, revenue mobilization, and the skills mismatch.

## Country Context

Moldova is a small lower-middle-income economy. Although it is the poorest country in Europe, Moldova 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 share in the world.

European integration has anchored the Government's policy reform agenda, 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, 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.

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 hastened the growth of the elderly component. This puts pressure on the pension system and limits the country's long-term competitiveness. In the near term, parliamentary elections, due in early 2019, will dominate the political agenda and slow down important reforms.

## 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 inthe National Development Strategy, takes intoaccount outcomes of the FY14–17 CountryPartnership 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 of economic governance, service governance, and skills development, supplemented by climate change—a World Bank Group corporate priority—as a cross-cutting theme.

## Key Engagement

Improving economic governance and strengthening the rule of law and accountability in economic institutions in Moldova are the key pathways to de-risking private sector investment for job creation.

The limited access, inefficiency, and poor quality of public services has led to social exclusion, persistent poverty, and vulnerability to shocks, especially in rural areas.

The World Bank and the International Finance Corporation (IFC) are working together to improve the governance and quality of public services, enhance the business environment, foster private sector development, increase the productivity of firms, and create decent jobs.

### WORLD BANK PORTFOLIO

No. of Projects: 11

Lending: $416.5 Million

IBRD: $100.5 Million

IDA: $316 Million

The program supports investments in human capital and anticorruption measures, enhanced transparency, secured property rights, and stable financial and legal institutions.

Results are expected to include: a more transparent business regulatory framework, better advice and financing for small businesses and farmers, more efficient and accessible public services, an improved state budget allocation process, more effective energy sector regulation, a better functioning district heating system, improved financial reporting in state-owned enterprises, systematic asset declaration by public officials, a strengthened stolen asset recovery regime, rehabilitated and inclusive schools, better primary care, and infrastructure improvements.

For example, the recently approved US$35 million Land Registration and Property Valuation Project will benefit Moldovan citizens, investors, and government institutions with more secure property rights and better developed real estate markets.

Improved fairness in the property registration and valuation system will guarantee citizens equal opportunities in exercising their property rights and enable Moldovan authorities to conduct mass registration and valuation nationwide with no direct costs to citizens and businesses. The new system will also strengthen the rule of law and accountability of institutions by enhancing property rights, increasing the transparency of property data, and improving the efficiency of the cadastre system.

## Recent Economic Developments

Growth remained robust in the first half of 2018, reaching 4.5% thanks to strong agricultural output and vigorous private consumption driven largely by remittances and public and private wage increases.

Despite buoyant exports supported by the good harvest of the past two years, imports increased rapidly, resulting in a negative contribution of net exports to growth (-2.2 percentage points). New investments in the economic zones and favorable financial conditions boosted gross fixed capital formation (+7.2%).

On the production side, growth has been mainly driven by retail and wholesale trade (+1.6 percentage points), followed by growth in industry (+1.1 percentage points). The inflation rate has been out of the target corridor since April 2018 due to, among other factors, lower regulated prices, the ongoing currency appreciation, and the higher base effect.

Yet, monetary policy has had limited effects on the economy amid continued excess liquidity. At the same time, credit growth remains negative, reflecting the limited pass-through of the monetary policy stance to commercial interest rates and tighter prudential standards in the banking sector.

On the back of overperforming public revenues due to buoyant economic activity (+29% in the first half of 2018), the fiscal position remains solid and public debt continues to be sustainable under different stress scenarios.

## Economic Outlook

Looking forward, growth is expected to remain robust. It is estimated to reach 4.8% in 2018 and to slow to an average of 3.7% in 2019–20. 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 overall 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 the third quarter of 2018 due to inflationary pressures stemming from domestic demand.

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. Although fiscal deficits are projected to remain under control, parliamentary elections in early 2019 pose risks to the fiscal stance.

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 to strengthen the transparency of the entire financial sector.

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

## Project Spotlight

### One-Stop Shop


Moldova's economic growth depends on the creation of favorable conditions for business development and an improved investment climate.

The regulatory burden has been a significant constraint for foreign and domestic enterprises.

The **Second Competitiveness Enhancement Project** supports the Government's reform agenda of improving the business environment through reforms that reduce the costs of doing business. One major achievement is the launch of an electronic One-Stop Shop (OSS) for business permits and licenses.

The One-Stop Shop marked a key milestone in facilitating communications, increasing transparency, reducing the cost and time to obtain permits, and limiting corruption opportunities and has led to savings of over US$3.5 million annually.

The launch of the OSS was preceded by a major reform of permitting documents, promoted by the IFC Investment Climate Reform Project, which reduced the number of permits from 416 to 152 and streamlined the procedures for obtaining the remaining permits.

The first 29 permits can already be applied for, processed, and issued online, which is a critical outcome with an immediate positive impact on businesses. Work is under way to fully digitize the remaining 119 permits.

For Moldova, this is a significant economy-wide structural reform, achieved through 3.5 years of close collaboration with the World Bank Group. It combined investment and development policy lending with the hands-on assistance of the IFC advisory project supported by the Swedish Government.

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