

# Republic of Moldova 2013

STATE OF THE COUNTRY REPORT

With the support of:



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**Contents:**

- Key policy messages ..... 6
- Overview ..... 8
- Demography: Transition and the Unique Window of Opportunity ..... 11
- Human Capital: the Real Wealth of Nation ..... 18
- Moldovan Economy: Challenges for Tapping the Potential ..... 24
- Technological Endowments: The Path towards the Economic Possibility Frontier ..... 34
- Domestic Politics: From Semi-Authoritarian to Semi-Anarchical and to New Hopes. What Next?..... 40
- Foreign Policy: Success Story versus Hard Reality ..... 44
- Interpretation of Poll Results: Did Moldova turn into a Hopeless Place?48
- Annex: Questions addressed during the poll ..... 53
- About EXPERT-GRUP ..... 54
- About FES..... 55

*List of figures:*

Figure 1. Key demographic indicators in regional and gender profile, 2012 .....	11
Figure 2. The ratio between the population aged 20-64 years and 64+ years .....	12
Figure 3. Shares' evolution of urban and rural population in total population, beginning of the year, % .....	13
Figure 4. The forecasted evolution of the population structure according to the main age groups .....	13
Figure 5. Correlation between the share of public expenditures for education in GDP – horizontal axis (average for 2005-2010, %) and Education index – vertical axis (2012).....	18
Figure 6. The share of workers whose employment specialization corresponds to the educational specialization, breakdown according to the educational background, % .....	19
Figure 7. The shares of students enrolled to professional/trade schools, colleges and universities in total enrollments, %.....	20
Figure 8. The share of employed population in total employed, breakdown for higher, post-secondary and professional secondary education, % .....	21
Figure 9. Correlation between the share of public spending for health to GDP – horizontal axis (%) and inequality-adjusted life expectancy index – vertical index, 2012 .....	21
Figure 10. The death rate (per 1000 people) and infant mortality rate (per 1000 live births), 2011 .....	22
Figure 11. GDP per capital, average for 2005-2012, purchasing-power- parity, USD .....	24
Figure 12. The discrepancy between the current and potential GDP, constant prices (2000=100%), natural logarithms.....	25
Figure 13. The structure of GDP, expenditure approach, constant prices (2005=100%), billion MDL .....	26
Figure 14. The correlation between the share in exports to GDP and GDP per capita, USD, average for 2005-2011 .....	27
Figure 15. Domestic credit provided by banking sector (% of GDP), average for 2005-2011 .....	27
Figure 16. Total government revenues and expenditures, average for 2005- 2012, share in GDP, % .....	28
Figure 17. The share of foreign trade in GDP, average for 2005-2011, %.	29

Figure 18. The share of current account deficit in GDP, average for 2005-2012, % .....	30
Figure 19. The main financing sources of current account deficit in Moldova, USD mil. ....	30
Figure 20. External debt stocks (% of GNI), average for 2005-2011.....	31
Figure 21. ICT service exports as % of total service exports, 2011.....	35
Figure 22. The share of IT service in GDP, %.....	36
Figure 23. The share of telecommunications sector in GDP .....	36
Figure 24. ICT profiles: Moldova versus Lower middle-income group, average .....	37

*List of tables:*

Table 1. Total expenditures for training one student for each level of professional education in public institution, MDL (number per year per student) .....	20
Table 2. Comparison of the implications of foreign policy options on Moldova's development objectives.....	46

## ■ Key policy messages

- The robust growth registered during 2010-2011 was jobless and kept the economy below its potential level. It points on the deficient growth model followed by the Moldovan economy, with scarce capital (investments), labor and technology. Hence, the business climate and export competitiveness remained overall weak. It led to raising current account imbalances at very challenging levels, whereas the primary source for financing this gap switched from FDI to foreign borrowings.
- The policy measures aimed at tapping the economy's potential should be focused on its three major components. Firstly, scarce capital should be addressed by promoting an efficient regulatory reform, strengthening property rights, improving fiscal administration and modernizing the judicial system. Secondly, the human capital issue could be addressed by easing immigration policy, facilitating the domestic mobility of labour and decentralizing the education system and involving more private companies into this process. These measures will overcome the issues of quality and shortage of labour. Last, but not least, it is necessary to speed up the privatization process and eliminate the business constraints for SMEs' activity which will induce more efficiency in using the available capital and labour.
- Whereas the quality of human capital is the main prerequisite for the long-term development of any country, it is rather a development constraint for the Republic of Moldova. Thus, the knowledge and skills supplied by the educational institutions are of poor quality and outdated, while the healthcare system is very inefficient. Emigration added to this burden, while the underemployment of Moldovans abroad turned the process of brain drain into "brain waste". Hence, the Moldovan authorities should regard the human capital in a three-dimensional perspective, increasing the correlation between the supply of educational system with the labor force demand, strengthening the praxis component of education and improving the healthcare system.
- Moldova is passing through an unprecedented demographic transition, with declining birth rates and raising the share of aged population. It implies fiscal effects, with raising burden on public PAYG pensions' system, which sooner or latter will have to be reformed. Consequently, it could create a political segregation based on an intergenerational conflict between the younger generations requiring the transition to a cumulative pensions' system and the older ones favoring the current system. Besides these fiscal and political effects, the demographic ageing will have social and economic consequences implying lower long-term domestic demand with repercussions on public revenues. An additional pressing problem is the spreading phenomenon of ghost villages, which will pose significant policy challenges in the near future.
- The pressures of population ageing might be mitigated if the Government could wisely and timely explore the window of opportunity, which consists in approaching the reproduction age of the cohort born during the baby boom of '80s. It could be done by both vertical measures (e.g. income-tested child support programs for families in need, unification of family support programs etc.) and horizontal measures (e.g. broad healthcare and education reform, stimulating the supply of mortgage programs).
- A major culprit of the underperformance of the Moldovan economy with respect to its potential level is related to its poor technological endowment. The low level of business absorption of new technologies in Moldova is due to the perceived too high opportunity costs of doing it. To lower the costs of adopting, adapting and using products and processes with advanced technological content requires: (a) institutions that enforce contracts impartially, and (b) institutions that make property rights secure over the long run so that companies expect to appropriate all the gains from technology-intensive production.
- The confrontational politics that marked the country in 2010-2013 pose a high risk of undermining the model of governing in coalition in Republic of Moldova. The polls suggest a growing number of citizens disappointed by the political 'disorder' associated with the coalition governments and a spreading willingness among the people to see a one-party government ruling the country in the future. In order to keep the country on the right track and create incentives for cooperation among Moldovan elites, EU needs to maintain an active presence in Republic of Moldova. Additionally, the

new government supported by the Pro-European Coalition needs to regain the public confidence, which can be done in such a short period only through a higher level of transparency and inclusiveness in the policymaking.

- State-owned companies play an important role in diverting public money from the economic sector into the political parties' coffers. A radical reform of the state-owned companies' management is needed in order to close the opportunities for corruption and crony arrangements. The reform should be based on two key assumptions: 1) a state-owned company needs to be privatized if there is a competitive market for its services and products and 2) managers of the state-owned companies have to be well paid, especially if the state-owned company has a competitor in the private sector. They need also to be subjects of a higher public responsibility and scrutiny, to ensure that state assets and money are not tunnelled in private hands or off-shore. In this regard, the previous decision of the Government establishing severe wage limits for the SOE managers needs to be reviewed, while the financial and economic activity – more transparent. The companies' performances should be the only criteria for establishing the managers' remuneration.
- Despite the short-term risks associated with the signing of DCFTA with EU, Moldova should continue its European integration vector, as it is the single feasible strategic option, which is consistent with the modernization of the country. DCFTA allows the possibility of entering free trade agreements with any other country or regional integration structures, including the Russia-Belarus-Kazakhstan Customs Union. As a result, it will increase the foreign trade, which will boost the wealth of the nation. Moreover, reduction in tariffs and non-tariff barriers for imports from EU will make EU technologies more competitive on the Moldovan market and will provide the support for technological upgrade across all economic sectors. On the contrary, joining the Customs Union will lead to trade diversion and slowdown in economic modernization Moldova. The reason is that the higher customs tariffs imposed will make less competitive the technologies originating from outside the Customs Union.
- The sociological outcomes underscore that the state of nation is precarious and that urgent actions should be taken by the authorities to mitigate the effects of migration and demographic malformation, intervening primarily in education and realizing irreversible structural reforms. Moreover, public mistrust in elections as one of the key democratic institutions, coupled with worsening of living conditions and poor confidence in the key state institutions, traditionally fuels the electoral demand for extremist political powers. To prevent this, the reforms' pace should be speeded up and population's living standards – improved and public confidence in the democratic institutions strengthened. Failure to do so in the upcoming years creates a fertile ground for an authoritarian regime, which definitely will be a suboptimal outcome for the entire nation.

## ■ Overview

### **Demography: Transition and the Unique Window of Opportunity**

Undoubtedly, the population ageing can be considered the most worrisome demographic trend observed in Moldova during the last years, which is going to have fundamental implications on how the institutions will function in a medium and long-term perspective. The immediate implications are on the fiscal side, especially due to higher demand for healthcare services and inflating pensions' bill, amid eroding tax base. Demographic ageing imply political effects as well, though on a long-term perspective. Hence, it will fuel an intergenerational conflict between younger population, which will demand right-wing parties, and older ones, which will demand left-wing parties. Last, but not least, population ageing and demographic decline will also shape the regional policies and overall economic behavior of households. Thus, the phenomenon of ghost villages will become increasingly widespread, while these processes will be even more acute in rural areas. Consequently, it will challenge the regional development policies and especially the implementation of the decentralization reform. This issue can be addressed through vertical and horizontal measures. The first ones should include improving the services for families with children through increasing the financing for childcare providers and early education facilities, assistance programs for young people and residential facilities, as well as income tested child-related cash transfers to families in need. A comprehensive pensions' and healthcare reform, coupled with easing the immigration policies could mitigate the burden of demographic ageing as well. However, these vertical policies will not have the desired impact unless young generations will be more confident in the long-term prospects of the country and will have more and better employment opportunities. This is the role of horizontal policy measures, which should consist in improving the business climate, modernization of public services and developing the mortgage market.

### **Human Capital: the Real Wealth of Nation**

People are born the same and the only factors that make them different over time are the quality of education, training and healthcare services: three components defining the quality of human capital. Moldova has a very costly educational system, while its outcomes are very poor, which is reflected in increasing underemployment and declining returns to education. The vocational training system suffers from low social prestige and is poorly correlated with the labour market demand. Finally, the healthcare system, similarly to education, is relatively expensive, whereas the service quality and access to healthcare are very low. Hence, the death and infant mortality rates are among the highest in the region, whereas the life expectancy is among the lowest. The policy measures should target each of these pillars of the human capital. Hence, the key policy priority in the education sphere should be diminishing the mismatch between the system's supply of qualifications and demand for skills from the economy. This can be done by granting more autonomy to educational institutions and creating the right incentives for companies to get more involved within the process of education. In the healthcare system, it is necessary to eliminate various redundant subsidies for various categories of insured persons, and to provide the right incentives for people to participate within the system.

### **Moldovan Economy: Challenges for Tapping the Potential**

Despite the robust growth registered over the last years, the Moldovan economy hovered well below its potential level, denoting the deficiencies of this growth model. The large number of working-age, but jobless population, paralleled with a very tepid investment activity, primarily determined this output gap. As a result, the economic growth has been fueled by foreign (remittances), rather than domestic factors (investments, labor or technological innovations). It eroded the economy's competitiveness, leading to the accumulation of huge current account and trade imbalances, which since 2010 are financed primarily from foreign loans. In order to make the Moldovan economy explore its potential, the policy actions should address three key issues: (i) scarce capital, (ii) scarce labour force and (iii) low efficiency of combining these production factors. The first issue can be addressed by enhancing the business climate, mitigating the banks' reluctance towards lending and improving the infrastructure. The issue of scarce labour force can be solved by



stimulating the domestic migration, easing immigration regulations and encouraging all forms of partnership between educational institutions and firms. The third issue – low efficiency – should be addressed by privatization programs and strengthening the SME sector.

### **Technological Endowments: The Path towards the Economic Possibility Frontier**

Besides the shortage of investments and quality constraints of human capital, Moldova's economic underperformance in terms of tapping its potential is explained as well by its poor technological endowment. A major reason lies in the institutional factors, such as a poor justice system, which hamper the technological absorption, at both business and government levels. As a result, the country's technological readiness is close to the level registered by lower middle-income group of countries. Moreover, the shares of IT and telecommunications sectors in GDP is shrinking, which have important implications on the quality of Moldova's economic system. In order to increase the level of technological absorption by businesses and government, it is necessary to ensure the proper institutions that enforce contracts impartially that make property rights secure over the long run. Additionally, policies that are appropriate to success in the production of products with high technological content would encourage industries to be aggressive in seeking out product and process improvements.

### **Domestic Politics: From Semi-Authoritarian to Semi-Anarchical and to New Hopes. What Next?**

Since the last State of the Country Report launched in March 2010, the Republic of Moldova has witnessed a period of extraordinarily combative politics. This period has been featured by a number of negative trends that will severely affect the country's politics and general development in long-term. On the background of the political in-fight between the 'allies' founding the Alliance for European Integration and of the resulting administrative handicap at the central level, the simmering separatist tendencies gathered more steam. The confrontational politics that marked the country in 2010-2013 pose a high risk of undermining the model of governing in coalition in Republic of Moldova, as the polls suggest a spreading willingness among people to see a one-party government ruling the country in the future. It also leads to diminishing the public's respect for the rule of law and complete loss of trust in state institutions. EU should continue playing an active role in motivating the politicians to be more cooperative and create incentives for local decision makers to engage in structural reforms. Moldovan Constitution has to be reviewed, or indeed, a new Constitution needs to be developed in order to avoid in the future the political and institutional blockages. However, this should not be approached as short-term objective implementable in political bureaus. Additionally, in order to get rid of its oligarchs, Moldova needs faster European integration and legislative harmonization, with an emphasis on corporate legislation, competition promotion and state aid. Moreover, a radical reform of the state-owned companies' management is needed in order to close the opportunities for corruption and crony arrangements. Finally, the new government supported by the Pro-European Coalition needs to regain the public confidence, which can be done in such a short period of time only through a higher level of transparency and inclusiveness in the policymaking.

### **Foreign policy: Success Story versus Hard Reality**

Since 2010, the foreign policy became the most successful policy sector of the country, as the messages were clearer and lacked the traditional ambiguity of the Moldovan diplomacy. In fact, the Ministry of Foreign Affairs and European Integration is the main to 'blame' for the 'success story' case that Moldova produced. However, without domestic political support, the 'success story' eventually broke into an uncomfortable reality. In fact, Moldova became a geopolitical battleground between EU and Russia: while the first one increased its presence through the direct budgetary support, Russia did through NGOs, church and media. Pressures from Russia have built up in 2012-2013 for Chisinau to change the orientation of his external policy, from declared vector of European integration to the Russia-led Russia-Belarus-Kazakhstan Customs Union. However, it will bring to an end Moldova's sovereignty in the area of trade policy and will have harsh repercussion on the country's wealth, as the customs tariffs will increase by about 2.5 times increasing the prices of imported goods and technologies. At the same time, in case of further economic and trade

integration with the EU, Moldova will have the freedom to negotiate an FTA with the Russia-Belarus-Kazakhstan Customs Union, or with any other country in the world.

### **Interpretation of poll results: Interpretation of Poll Results: Did Moldova turn into a Hopeless Place?**

Compared to the 2009 survey, in 2013 Moldovans became more pessimistic. There are many culprits that determined a clear worsening of citizens' perception about the current situation and the future prospects of Moldova's economic development: long-standing domestic political crisis, difficult economic conditions in Europe, the grown slowdown in Russia and slower-than-expected pace of domestic reforms. The poll results reveal the existence of a rather "closed society", where the citizens are deterred from participating in the decision-making process and mistrust the elections. It causes a deficient trust in basic public policies, which creates a fragmented and weak relationship between state and its citizens. Low expectations regarding the country's potential are mirrored in the high interest for emigration, which has been thickened over the years since 2009. The sociological outcomes underscore that the state of nation is precarious and that urgent actions should be taken by the authorities to mitigate the effects of migration and demographic malformation, intervening primarily in education and realizing irreversible structural reforms.

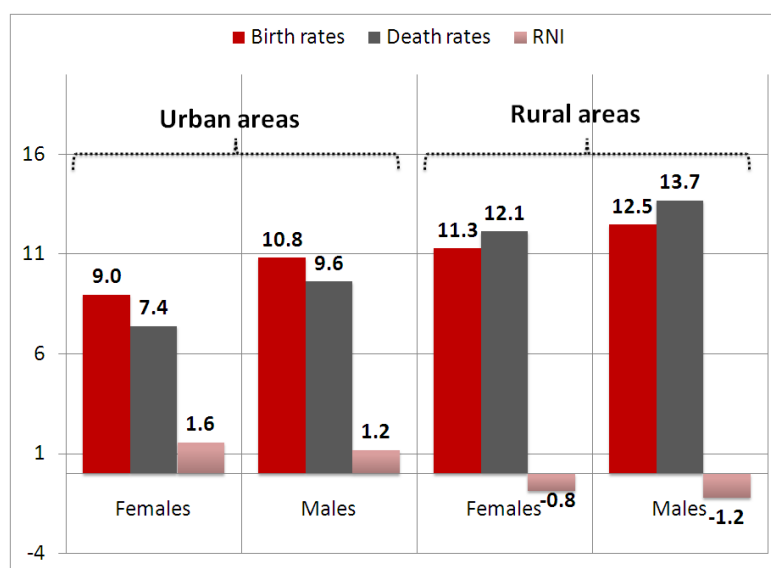
## ■ Demography: Transition and the Unique Window of Opportunity

*Moldova passes through a unique demographic transition, with declining fertility rates and amplification of population ageing. This process will continue and even accelerate in the near perspective, which inevitably will shape the economic, social and political landscape of Moldova. In this chapter, we analyze the main demographic trends and constraints, their implications, as well as the feasible policy options the authorities have in order to mitigate the repercussions of this demographic transition.*

### Analysis of key developments and trends:

The tumultuous period of 1990s followed by massive emigration of 2000s involved strong repercussions on the demographic situation of Moldova. Since 1999, despite peaceful times and lack of significant catastrophic events, the country experienced a negative natural growth rate, with death rates exceeding the birth one. These trends had an uneven distribution gender- and region-wise. The darkest spots on this demographic picture belong to rural areas and, especially to males, where the natural growth rate is the lowest. On the contrary, in urban areas the birth rates exceed the death rates (Figure 1). It reflects the high disparities between rural and urban regions on at least two dimensions: (i) employment opportunities, which motivated the rural-urban migration of the young population, influencing the birth rates, and (ii) access to health services and basic utilities (e.g. clean water, sanitation, sewage) which influenced the population's health status and hence the death rates. The worst situation is attested in the northern rayons where, due to higher ageing level, the natural growth rate of the population is lower as compared to southern and central rayons, on average, by 2.5 points and, respectively, by 3.8 points.

**Figure 1. Key demographic indicators in regional and gender profile, 2012**

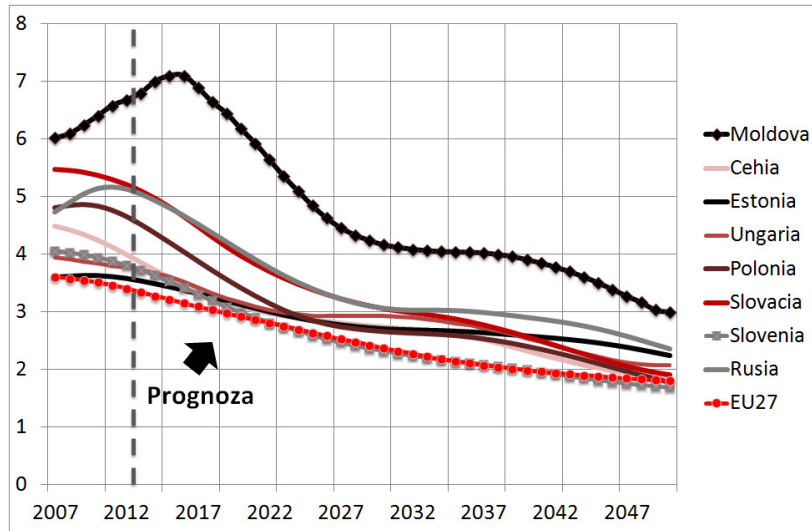


Source: National Bureau of Statistics

The main reason of this demographic decline is the population ageing, which traditionally is the strongest in the northern rayons. Consequently, it positively influences the death rates and negatively – the birth rates, especially in localities with highest ageing (the share of pensioners in total population exceeds 20%): Donduseni, Drochia, Edinet, Briceni, Rascani and Ocnita. On the other hand, the rayons with better economic situation are less affected by population aging. These are mainly Ialoveni, Anenii Noi, Ungheni, as well as Chisinau, Balti and Gagauzia where the working age rural population migrated due to more employment opportunities.

Undoubtedly, the population ageing can be considered the most worrisome demographic trend, which is going to have fundamental implications on the way how Moldova and its institutions will function in a medium and long-term perspective. Currently, the Moldovan society can already be considered demographically aged: the share of 60+ year population is well above the threshold of 12% (in 2011 it was 14.8%). The highest values are attested in rural areas, which for the last 2 decades have been largely affected by emigration of the working age population. Despite the fact that nowadays Moldova is in a slightly better position than most European countries, the *speed* of ageing anticipated for the next decades will be much higher. The biggest challenge will arise from the declining ratio between working age and old population (Figure 2).

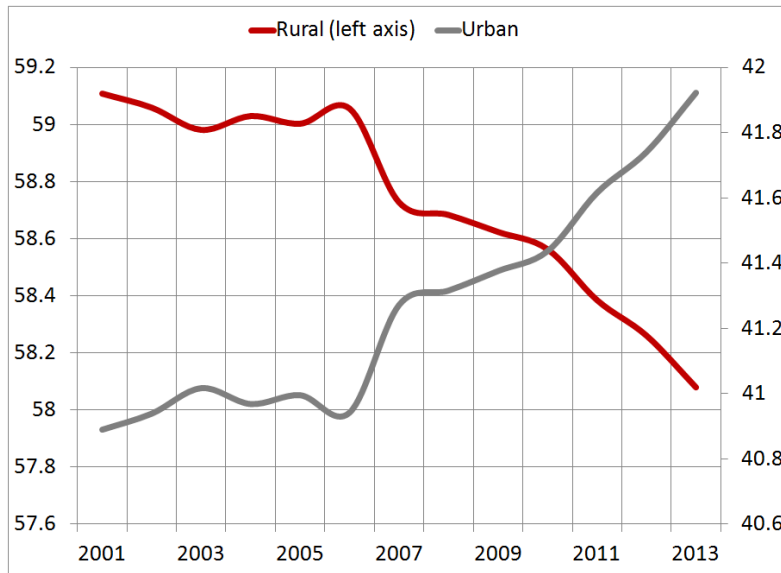
**Figure 2. The ratio between the population aged 20-64 years and 64+ years**



*Source: OCDE for other countries and author estimations for Moldova*

Two main factors which shaped the demographic structure in the last years and will continue influencing it in the short- and long-run are: (i) the transition to a western model of reproduction, with fewer children and older parents; and (ii) the emigration of the working age population. The domestic migration has also shaped the family structure. As people changed their lifestyle after moving from small villages to larger cities (Figure 3), so did their perception about reproduction change. These trends have already started over the last years. Thus, during the period 2000 – 2012, the fertility rates hovered at around 1.3, (the European level – 1.6) which is much lower than the necessary minimum for ensuring the replacement rate. Additionally, the average age of mothers increased from 25.5 to close to 27 and about 200.000 people migrated abroad (unofficial numbers are obviously higher), about 40% of whom being between 25 and 34 years.

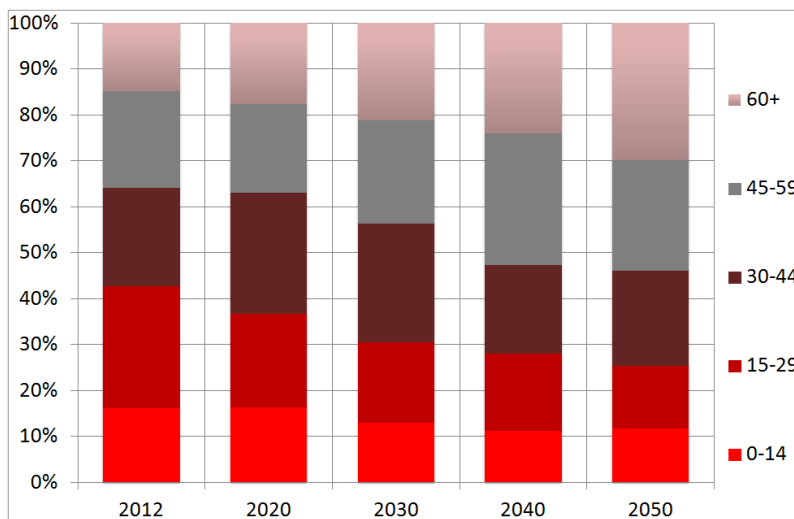
**Figure 3. Shares' evolution of urban and rural population in total population, beginning of the year, %**



*Source: Author calculations based on NBS data*

In the following years, these processes will continue and even accelerate, due to large discrepancies between the economic development in rural and urban areas. Consequently, it will continue shaping the reproduction model and family structures. Due to higher expenses for education and living costs coupled with bleak employment opportunities, the costs of raising children in urban areas are higher as compared to rural areas while the economic benefits are lower. Hence, the urbanization process will make the Moldovans to optimize their costs by having fewer children and at higher ages. Lower birth rates will automatically fuel the population ageing which will accelerate in the following decades. As a result, by 2050 the share of population above 60 years will double reaching about 30%, while the share of the population with the main reproductive potential (15-29 years) is going to shrink twice to only 13.5%.

**Figure 4. The forecasted evolution of the population structure according to the main age groups**



*Source: Report "The Price of Intergenerational Solidarity and the Optimal Model of Pensions' System Reform", Expert-Grup, 2012*

## Wider implications and risks

The demographic transition that Moldova is currently passing through and, particularly, the population ageing phenomenon will have important fiscal, economic, social and political implications.

### Fiscal effects

The immediate implications are on the fiscal side. The increasing share of aged population will permanently inflate the pensions' bill and fuel the demand for healthcare services, whereas the shrinking share of young and working age population will erode the fiscal base. As a result, it will pose increasing pressures on the social and medical insurance budgets both on their revenue and expenditure sides. In fact, this process has already started, as since 2009 the state social insurance budget is constantly relying on transfers from the state budget for covering its deficit. The low employment rate and tax evasion add to this burden. As a result, the effective dependency ratio for 2012 has been estimated at 1.1 contributors to the state pensions' fund for each pension receiver, while the minimal threshold for ensuring the stability of pensions' system is 4:1 or even 6:1. The vulnerability on the state pensions' fund is aggravated by its old-fashioned redistribution mechanism (Pay-As-You-Go), which is estimated to be unsustainable in the long run due to demographic constraints<sup>1</sup>. Thus, for 2012-2050 the inter-temporal deficit is estimated at about 6.2% of GDP, which is much higher than other countries from the region<sup>2</sup>

Given the acceleration of population aging coupled with the decline in birth rates expected for the near future, the Government will be forced to undertake unpopular reforms in order to preserve the feasibility of its social and medical insurance systems. Based on the experience of other countries with similar problems it could imply consolidating the fiscal base by raising social and medical security contributions and enforcing the payments, and expenditures' optimization by cutting off various tax exemptions and benefits. For the state pensions' system it will also mean a gradual transition to more funded pension schemes (e.g. mandatory private pensions).

### Political effects

As most of these actions will aim for fiscal consolidation and efficiency, they inevitably will mean an intergenerational redistribution of wealth in favor of the younger generations. It will make the latter to demand right-wing parties, which are more likely to promote such reforms<sup>3</sup>. At the same time, the rational reaction of older generations will be to increase their demand for left-wing parties, which would oppose such reforms in order to protect the interests of their main electorate. The main risk is that this intergenerational conflict of interests could turn into a raising ideological segregation between the younger and older generations. Given the regional demographic structure, it automatically will imply a wider political segregation between rural and urban areas. Moreover, the rise of younger generations of Moldovans with no memories of the Russian/Soviet rule will continually deepen the ideological discrepancies with the older generations.

Consequently, this segregation is likely to spill over at least on two important dimensions. Firstly, it will translate into parties' representation in the Parliament, which is likely to complicate the activity of the legislature. Secondly, it could fuel the political divergences between local administrations represented by more aged population (mostly Northern localities) and the central Government, which might hamper the regional development policies. Important risks stem from raising separatist sentiments in several hotspots (e.g. Balti, Taraclia, Gagauzia) which pose resistance on the implementation of various optimization reforms at the local level.

<sup>1</sup> A. Lupusor, "The Price of Intergenerational Solidarity and the Optimal Model of Pensions' System Reform", Expert-Grup, 2012

<sup>2</sup> M. Soto, B. Clements, F. Eich, „A Fiscal Indicator for Assessing First and Second Pillar Pension Reforms”, IMF Staff Discussion Note, SDN/11/09, 2011

<sup>3</sup> T. Leers, L. Meijdam, H. Verbon, "The Politics of Pension Reform under Ageing", CESifo Group Munich, 2001

## Economic and social effects

Besides the fiscal effects and political implications, the population ageing and demographic decline will also shape the regional policies and overall economic behavior of households in the near future.

During the period 2000-2012 the total number of population has been on a permanent downfall. It reduced by about 84.5 thousand people or approximately 7 thousand people or about 5 average Moldovan villages per year. The emigration, as well as rural-urban domestic migration, has left many small villages almost without population. According to the latest available data at the local level, in 2009 there were about 120 villages with less than 100 inhabitants. Additionally, about 1/3 of all villages have an advanced degree of ageing (the share of population that reached the pension age in total population exceeds 20%). This situation is likely to worsen in the short- and long-term, while the phenomenon of ghost villages will become increasingly widespread.

These demographic constraints directly challenge the regional development policies and especially the implementation of the decentralization reform. Hence, in the near future the authorities will have to combine apparently contradictory policy measures: granting more administrative and financial powers to local authorities while concentrating the main social services (mainly education and health) in bigger localities. Consequently, it could additionally fuel the ideological segregation between the central and local governments, with the most risks stemming from the hotspots of separatism (e.g. Balti, Taraclia and Gagauzia).

Finally, the population aging will influence the economic behavior of households. Following the life cycle hypothesis, it will imply a growing share of net creditors (older age categories) in relation to net debtors (younger population). As a result, on the one hand, it will undermine the long-term growth in demand for consumer and investment goods, while on the other hand will make the population to save more. Higher savings will also be a reaction to the inefficiencies of the social and medical insurance systems, which will become more and more obvious over time. Given the strong reliance of the national economy and public finances on consumption taxes (VAT, excises and custom duties), the long-term cooling of demand will trigger additional pressures on the revenue side of the state budget. On the bright side, higher savings and lower consumption could ease the burden of current account deficit, which in 2012 has been estimated at -7% of GDP – above the minimum inter-temporal solvency threshold of -6.2%<sup>4</sup>.

## Policy recommendations

The population ageing process is usually determined by: (i) sliding birth rates (ageing from the bottom), (ii) increasing life expectancy (ageing from the top) and (iii) emigration of the working age population (aging from the middle). All of them challenge the demographic structure of the country and imply harsh long-run economic and social repercussions. Therefore, the key strategic priorities which should be followed by policy makers in order to mitigate this issue should be: (i) stimulation of the birth rate; (ii) transition of the social insurance system to a fully funded mechanism, and (iii) improvement of investment climate, along with easing the immigration policy, in order to weather the incentives to emigrate and increase the share of working age population. Each of these priorities can be successfully achieved only under a consolidated effort of key policy authorities (e.g. Ministry of Labor, Social Protection and Family, Ministry of Economy, Ministry of Finances, Ministry of Interior Affairs, Ministry of Justice, the Central Bank of Moldova). The main policy actions can involve targeted and specific actions (vertical measures), as well as more comprehensive reforms (horizontal measures).

### Vertical measures

- Stimulation of the birth rate should be immediately reflected on the policy makers' agenda, at least due to two important reasons. Firstly, it has strong and long-lasting effects on the population ageing

<sup>4</sup> R. Giucci, R. Kirchner, "Current Account Sustainability in Moldova: Policy Implications", PP/01/2013, German Economic Team Moldova, 2013

process, while the transmission of birth stimulation policies on people's behavior is relatively slow. Secondly, despite the rather bleak demographic outlook, Moldova is granted with a short window of opportunity, which, if wisely explored, might mitigate the phenomenon of population ageing. It consists of approaching the reproduction age of the cohort born during the baby boom of '80s. Hence, if the right policies would be put in place, Moldova could explore these demographic dividends and ease the long-term burden of population ageing on the economy. On the contrary, losing this opportunity will lead to a continuous fall in dependency ratios, as the shares of working age population will decline where as those of aged population will grow.

- Currently, Moldova spends about 0.1% of its GDP for family and child support programs financed from the state budget. This is well below the levels registered in other European countries (Slovenia and Poland – 0.8%, Czech and Slovak Republics – 1.2% and 1.6%, Estonia – 2.2%), the fertility rate being also very low. Although, it does not necessarily imply some causal relationship, it points on some room for strengthening this financial support. It should be primarily focused on improving the services for families with children. Particularly, they can include increasing the financing for childcare providers and early education facilities, assistance programs for young people and residential facilities, family services etc. Additionally, income tested child-related cash transfers to families in need might also bring the right outcomes. Finally, enlarging the financial envelope for such purposes will be efficient only if it will be paralleled with a qualitative improvement of institutional mechanisms, which govern the redistribution of these resources. Thus, it should at least be based on the means tested financial support so that the programs could better achieve the target, while the family support programs should be unified under a single and fully accountable public authority (e.g. Ministry of Labor, Social Protection and Family).
- The fiscal burden of population ageing may be well weathered under a comprehensive pensions' system reform. According to a recent study<sup>5</sup>, it should imply three key elements. The first and the most important measure for consolidating the long-term feasibility of the pensions' system is the development of a second mandatory pillar. It means that part of the contributions paid by employers and employees which are currently redistributed to pensioners will be accumulated on individual accounts, invested in financial instruments and paid at the pension age of the contributor. The transition to this second pillar of the pensions' system should be smooth in order to avoid any liquidity shortages at the first pillar, but at the same time, it should not be postponed for too long. Additionally, the reform of the pensions' system should be complemented with some parametric adjustments. It implies a gradual raising of the pension age up to 63 years, both for males and females. Moreover, if the employment rate will not revert from its downward trend for the next years, the authorities might consider a gradual increase in the social security contributions by 1 or 2 p.p.
- As the emigration amplifies the population ageing process by eroding the tax base for state social and health insurance programs, the authorities should consider easing the immigration policies in order to counterbalance this trend. Hence, it is necessary to essentially optimize the process for employing foreign workforce, by granting those equal rights and treatment as to locals. Additionally, the procedures of obtaining Moldovan visas and residence permits should be simplified. It will allow for the substitution of the emigrated labor force with the foreign one, with positive fiscal and demographic spillovers.

## Horizontal measures

- The specific policies which target the birth rates will not have the desired impact unless young generations will be more confident in the long-term prospects of the country and will have more and better employment opportunities. It is critical to enhance the business climate by removing all institutional barriers for investments and free up the entrepreneurial activity. It should also imply a broad modernization of Moldova's public services, through reforms in healthcare, education, road infrastructure and public administration. Besides increasing the birth rate, the improvements in the

<sup>5</sup> A. Lupusor, "The Price of Solidarity between Generations and the Optimal Reform Model for the Pensions' System", Expert-Grup, 2012



long-term outlook of the country will diminish the incentives to migrate of the working age population and, in this way, will mitigate the ageing process.

- As confirmed by several national surveys, an important determinant for the emigration of productive age population is the poor affordability of own flat or house. It also undermines the birth rate, due to higher uncertainty about the future. Hence, developing long-term mortgage products, especially for young families, would solve, at least partly, this issue. Nevertheless, it should be done only through market mechanisms, while the responsibility of the regulator being limited to improving the incentives of banks to develop affordable mortgage programs in order to meet the demand for real estate in Moldova. Particularly, it should imply strengthening the creditors' rights, easing the procedures of collateral execution in case of debtors' defaults, developing the credit bureaus system in order to diminish the informational asymmetry between creditors and debtors and overall improving the judicial system.

## ■ Human Capital: the Real Wealth of Nation

The quality of human capital is the main source driving the technological progress, the efficiency of resources' utilization and, hence, is the main prerequisite for the long-term development of any country. Given its scarce natural resources and geographic lock-in, which has always altered capital accumulation, the issue of human capital is especially important for Moldova. While geography related factors cannot be changed, the quality of human capital can. Indeed, people are born the same and the only factors that make them different over time are the quality of education, training and healthcare services. The status in Moldova of these three key aspects of human capital will be analyzed in this chapter.

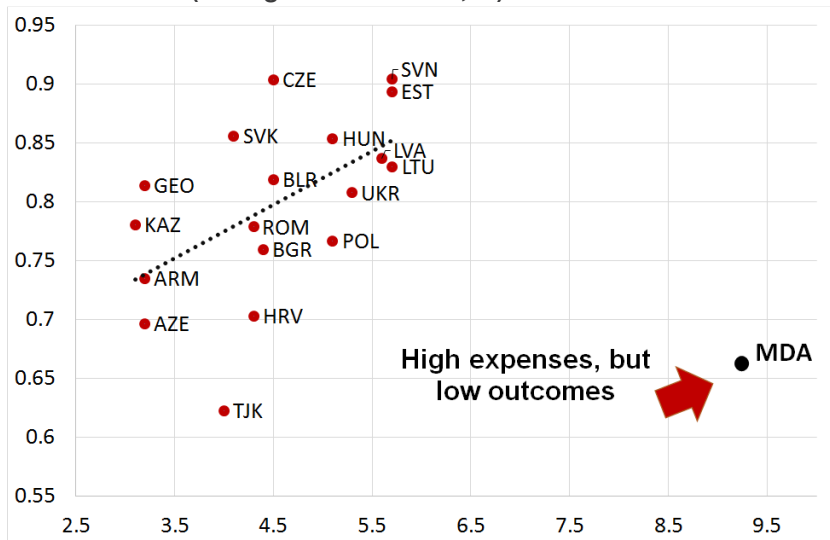
### Analysis of key developments and trends

Education, training and healthcare are the most important determinants of human capital. Indeed, in most cases, the knowledge, skills and health influence the productivity, raise earnings and welfare of individuals. Hence, we will adopt a comprehensive approach to the notion of human capital, by analyzing briefly each of these three components.

#### Education

Over the last years, Moldova has permanently spent relatively large amounts of public money on education, with total budgetary expenditures accounting for over 8% of GDP, which is the highest level among the region countries. At the same time, the outcomes lagged behind, with respect to quality rather than quantity: Moldova registers one of the lowest scores of the Education index computed by UNDP for its human development index (Figure 5).

**Figure 5. Correlation between the share of public expenditures for education in GDP – horizontal axis (average for 2005-2010, %) <sup>6</sup> and Education index – vertical axis (2012) <sup>7</sup>**



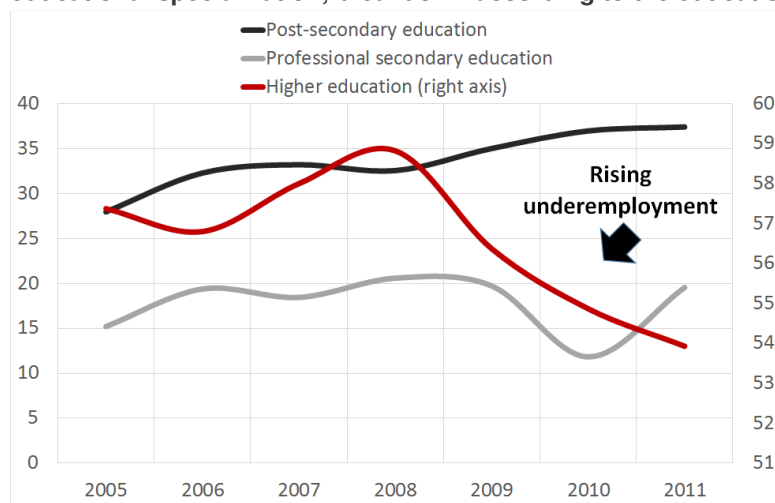
Source: Human Development Report 2013, UNDP

<sup>6</sup> Data for 2010, 2011 and 2012

<sup>7</sup> Due to its lagged effect on the quality of education, the average share of public expenses for education in GDP was correlated with the Education index for 2012.

An outcome of poor quality of education is the continuous decline in wages of employees with secondary and, especially, tertiary education relative to those with gymnasium level<sup>8</sup>. This decline in returns to education can be explained by at least two important factors, both being symptomatic for the Moldovan educational system. Firstly, it is the result of poor skills and knowledge gained by students, which translates into their low labor productivity once getting employed. Secondly, Moldova faces the problem of inflation of tertiary education, which literally means that the system is producing much more university graduates than the economy needs. For example, while the share of employees with tertiary education constantly grew from 17% in 2005 to 23.7% in 2011, the share of workers whose employment specialization corresponds to the educational specialization shrank (Figure 6).

**Figure 6. The share of workers whose employment specialization corresponds to the educational specialization, breakdown according to the educational background, %**



Source: NBS

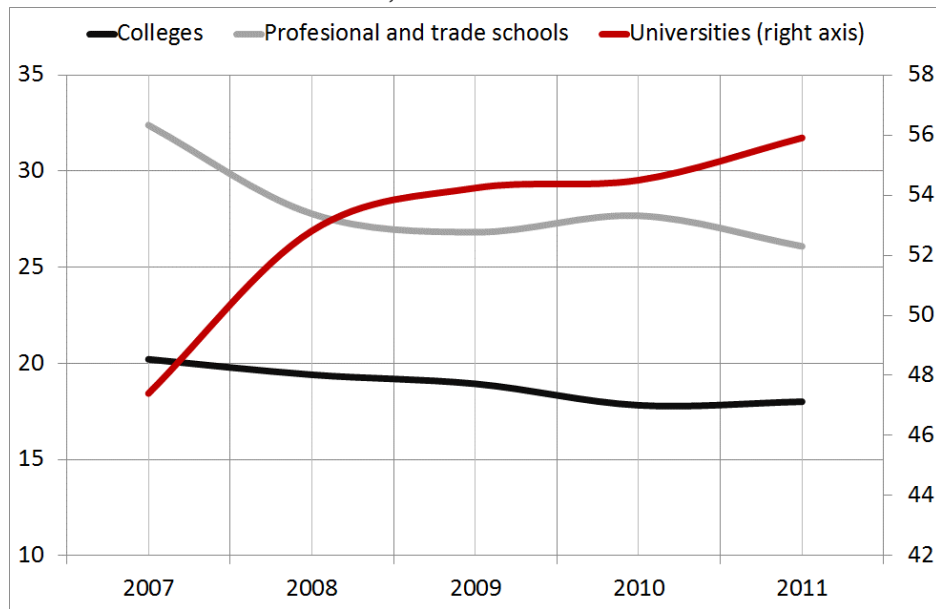
Hence, there is an increasing number of people with university diplomas, but who undertake jobs suitable rather for college graduates. As a result, besides being of poor quality, the human capital is distributed inefficiently, which implies harsh repercussions on its returns. This phenomenon of underemployment of university graduates reveals at least two important flaws of the Moldovan education system. First of all, there is a large mismatch between the economy's demand for workforce and system's supply of qualifications. This is often confirmed by companies, which can spend several months in order to fill a vacancy for a qualified job. Secondly, the strong demand for tertiary education is paralleled with low interest for the vocational education and training (VET), which should be treated separately in this chapter.

### Vocational education and training (VET)

VET is the second pillar of human capital, which is usually the main source for acquiring and enhancing practical skills for the workforce. However, in Moldova it is one of the main reminiscences of the Soviet period, with excessive educational, managerial and financial centralization around the Ministry of Education. As a result, the system is not flexible enough to adjust rapidly to labor market demand, leading to a large mismatch between the educational system and the economy. There is no surprise in the fact that the VET system in Moldova suffers of poor social prestige, as its graduates are less likely to get a well paid job, while the risks of unemployment are much higher. It also makes the opportunity cost of investing in tertiary education very low, which is reflected in rising shares of higher education enrolments in total number of students enrolled, paralleled with declining shares of college and professional/trade schools (Figure 7).

<sup>8</sup> "Moldova after the Global Crisis: Promoting Competitiveness and Shared Growth", World Bank, 2011

**Figure 7. The shares of students enrolled to professional/trade schools, colleges and universities in total enrollments, %**



Source: NBS

However, this downwards trend in enrolment to VET institutions was not matched by a corresponding decline in the number of teachers or schools. As a result, the system accumulates large fixed costs which are often unjustified and which pose significant burden for the public purse. This issue is even more pressing for professional and trade schools (the lower layer of the VET system), where the state spends several times more for educating one student as compared to colleges and especially universities (Table 1). Therefore, the repercussions for the human capital are not limited only to the poor quality of training provided, by also by high opportunity costs associated to the large amounts of public money spend inefficiently.

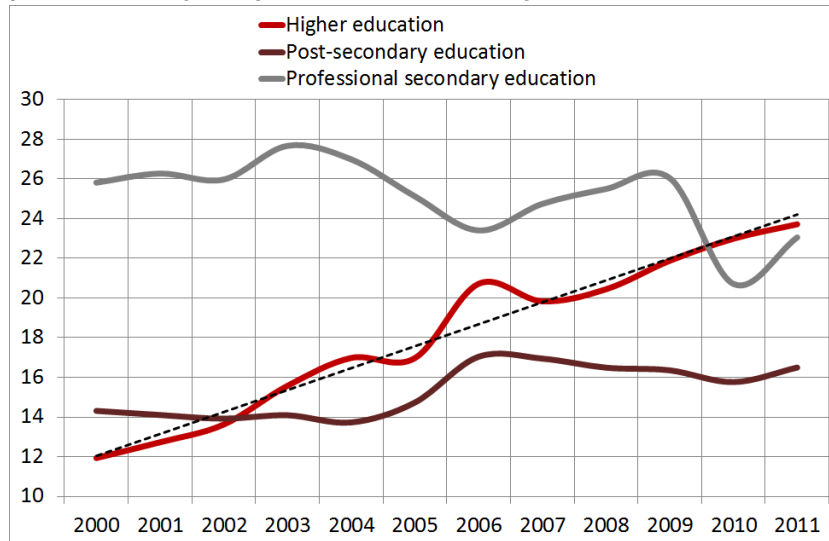
**Table 1. Total expenditures for training one student for each level of professional education in public institution, MDL (number per year per student)**

	2005	2006	2007	2008	2009	2010
Professional schools	8667.1	12267.1	14911.4	17977.7	23127.2	25575.9
Trade schools	7731.9	10306.3	12788.7	15057.7	23563.8	21809.8
Colleges	4443.5	5537.5	5818.1	6569.6	7955.9	9310.3
Universities	3674.6	4412.6	5002.7	5890.5	6524.8	7492.0

Source: Expert's calculations based on the data from BOOST database

The heavy regulation by the Government and extensive subsidizing of VET education hampered the interest of private companies to take a more active stake in training provision, which again contributed to enlarging the mismatch between the system's supply and economy's demand for qualifications. Consequently, VET graduates were getting increasingly difficult to integrate on the labor market, as revealed by decreasing shares of employees with VET education in total employment (Figure 8).

**Figure 8. The share of employed population in total employed, breakdown for higher, post-secondary and professional secondary education, %**

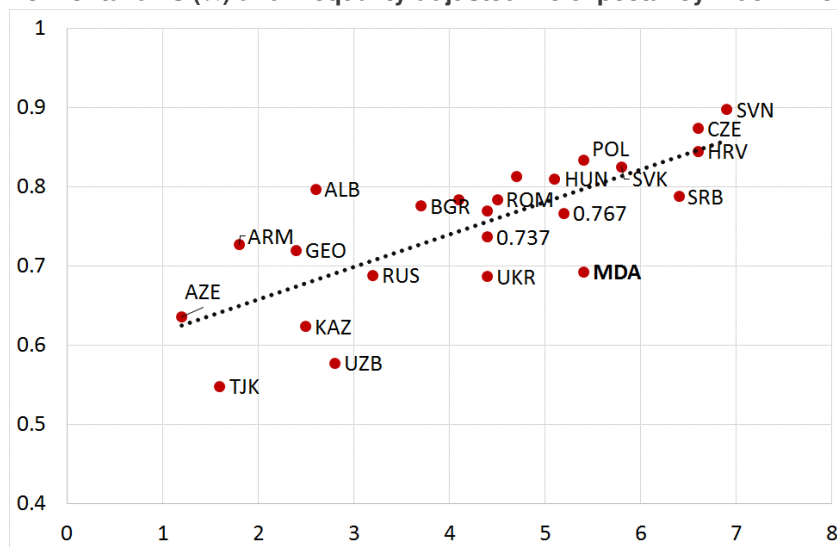


Source: NBS

### Health system

The third pillar of human capital – health – is also strained by many systemic deficiencies. Just like in education, the public expenditures for healthcare are relatively high (the share of public spending to GDP exceeds the average among region countries), while the system’s outcomes are low. Hence, the life expectancy index computed by UNDP for Moldova registered in 2012 one of the lowest levels from the region (Figure 9).

**Figure 9. Correlation between the share of public spending for health to GDP – horizontal axis (%) and inequality-adjusted life expectancy index – vertical index, 2012**

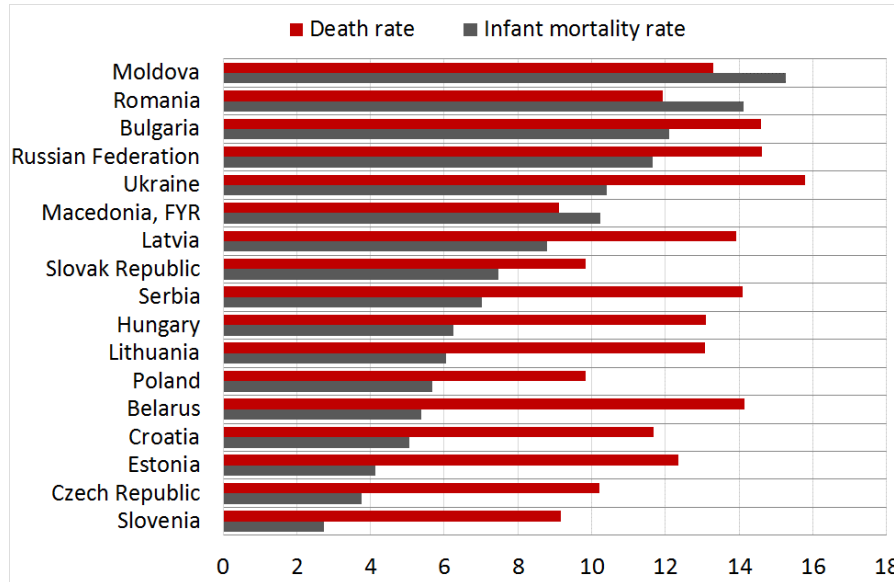


Source: Human Development Report 2013, UNDP

The inefficiencies and poor quality of the Moldovan health system is also confirmed by the relatively high death and infant mortality rates as compared with other countries from the region (Figure 10). It mostly owes

to the high share of rural population, with worse health status due to lower access to healthcare services. Thus, a recent study showed that the share of rural population, which resorted to healthcare services in the last 4 weeks, is much lower (16.8%) as compared to the urban population (22.9%)<sup>9</sup>. Another problem relates to the poor coverage of mandatory healthcare insurance: about 30% of the population is not insured at the National Commission for Health Insurance.

**Figure 10. The death rate (per 1000 people) and infant mortality rate (per 1000 live births), 2011**



Source: World Bank

Moreover, the healthy life expectancy is relatively low, whereas the sick life expectancy is comparable to other countries from the region. It creates additional fiscal pressures on the public healthcare budget, as people switch sooner from being contributors to the public healthcare system to its beneficiaries<sup>10</sup>. As a result, the sector struggles with a vicious circle, as the poor quality of public healthcare services hamper people's health status, which, in turn, pose additional pressures on the system and makes even more difficult to modernize the services.

## Policy Recommendations

The quality of human capital is a crucial prerequisite for enhancing the competitiveness and the economic and social development of Moldova. However, currently it is more a constraint, rather than a stimulating factor. The main reason lies in multiple structural deficiencies related to the quality of knowledge and skills provided by the educational institutions, as well as the weak healthcare system. Moreover, these issues have a self-fulfilling tendency, as the poor quality of human capital leads, in its turn, to even weaker institutions, which hamper even more the quality of human capital. The resulting emigration aggravate this process further, as Moldovans usually get jobs with lower qualifications as opposed to their educational background, which turns the brain drain process into a "brain waste" one. Therefore, the measures aimed at enhancing the quality of human capital should be directed towards all three pillars discussed in this chapter: education, skills and healthcare. The most strategic policy priorities should be the following:

- The phenomenon of inflation of tertiary education cannot be solved simply by imposing enrolment quotas to universities. At the macroeconomic level, this mechanic approach leads to sub-optimal allocation of human resources within the economy, as the Government has limited knowledge about

<sup>9</sup> "Population Access to Healthcare Services", National Bureau of Statistics of Moldova, 2011

<sup>10</sup> A. Oprunenco, A. Popa, E. Ghergheliiu, "Investigation of Transparency and Economic Efficiency in the Use of the National Health Insurance Company's Funds", Expert-Grup, 2011

the real demand on the labor market. At a micro level, it fuels the risk of corruption, limits the autonomy of higher education institutions and, generally, does not properly address the fundamental causes of high interests of student' for tertiary education. In fact, the key priority targeted by public policies in the education sphere should be diminishing the mismatch between the system's supply of qualifications and demand for skills from the economy. The best way to accomplish this is to undertake a comprehensive reform of the educational sector by granting more autonomy to educational institutions and creating the right incentives for companies to get more involved within the process of education supply. This objective is even more important for the VET system, where the private sector should have a larger stake in the decision making process regarding the enrolment plans and curriculum, as well as participate more actively at examination and provision of practical skills. It will address the current rigidity of the educational system and will enhance the correlation between the supply of and demand for qualifications.

- The education and mostly the practical training is also provided outside the universities or VET institutions. Private companies often invest in the initial training, retraining or continuous training of their personnel. However, in Moldova this process is constrained by many legal barriers. For example, the expenses for education are treated as benefits in kind for employees and subject to taxation; the labor code is not well elaborated in order to allow companies to sign apprenticeship contracts; or, in some areas (e.g. electricity), the training is monopolized by the state. Hence, the Government should ensure fiscal deductibility of reasonable education expenditures, the labor legislation should be clear about allowing companies to sign apprenticeship contracts to bind students for a period and the market of training services should be completely liberalized and entry barriers – removed.
- The Moldovan healthcare system is one of the weakest among other countries from the region. The key problems are related to the efficiency of public spending (especially for maintaining the extensive infrastructure); blurred division of responsibilities between the main institutions involved; poor quality of healthcare services; and poor corporate governance within the National Commission for Health Insurance<sup>11</sup>. In order to solve these issues, it is necessary to consolidate the fiscal base by increasing the number of contributors (currently only about one third of insured persons contribute to the system). Particularly, the Government should tighten the eligibility criteria for those benefiting of public subsidies for their health insurance and should make the system better targeted. Additionally, it is necessary to provide the right incentives for people to participate within the system, by increasing the transparency and accountability of key institutions involved (Ministry of Education and the National Commission for Health Insurance), expanding the list of medical services and drugs covered by the health insurance and enhancing the overall quality of healthcare services.

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<sup>11</sup> A. Oprunenco, A. Popa, E. Ghergheliiu, "Investigation of Transparency and Economic Efficiency in the Use of the National Health Insurance Company's Funds", Expert-Grup, 2011

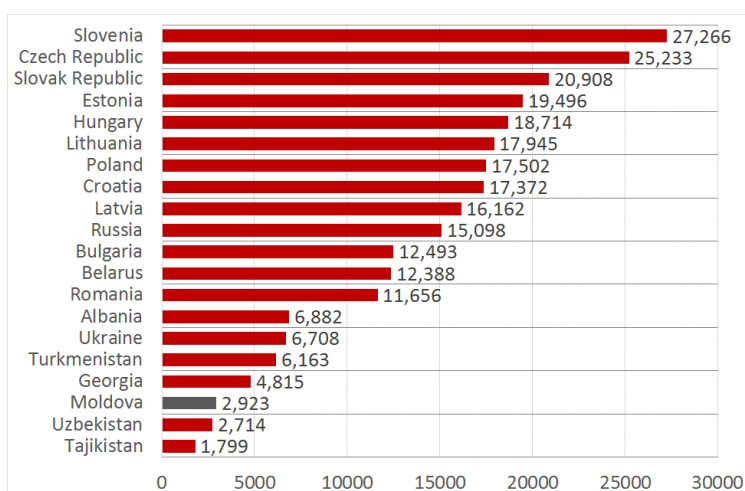
## ■Moldovan Economy: Challenges for Tapping the Potential

*In this chapter, we argue that despite a robust growth registered by the Moldovan economy over the last years, it remained below its potential level. The main constraints are related to all the key components of the national economy: the capital and labor are scarce, while the efficiency of their allocation – poor. In order to explore this idle economic potential, it is necessary to address each of these components through vertical and horizontal policy measures.*

### Analysis of key developments and trends

Moldova has a small and open economy with large structural imbalances. Over the last years it was mainly driven by migration and remittances which fueled consumption, curbed poverty and mitigated labor market pressures. On the downside, it kept the policy makers in the ‘comfort zone’ and did not provide the right incentives to anchor the economy on a sustainable growth path. The business climate remained weak, banking credit – tight and investments – scarce. As a result, while one engine of the Moldovan economy (consumption financed from remittances) was gaining steam, another one (exports supported by investments) was almost invisible. It drove the country into a policy trap<sup>12</sup>, hampering the foreign competitiveness of exporters and elevating the current account imbalances at unsustainable levels<sup>13</sup>. No surprises, Moldova registers one of the lowest GDP per capita among CIS countries and the lowest in Europe (Figure 11). Thus, even if the Moldovan GDP per capita will grow by 50% faster than the median value among CEE countries, it will converge in about 30 years to the CEE levels. This catch-up period may be longer or shorter, depending on the quality of public policies and the ability of the Moldovan economy to withstand the growing competition for production factors (FDI, labor) in the region. Anyway, it is a plausible indicator of how much Moldova lags behind its peers in terms of economic development.

**Figure 11. GDP per capital, average for 2005-2012, purchasing-power-parity, USD**



Source: IMF World Economic Outlook

Despite the robust growth during 2010-2011 (cumulating about 14%), the Moldovan economy hovered below its potential level (Figure 12), before sinking back into recession in 2012 with a 0.8% contraction in real GDP. Such a strong volatility have been induced by the combination of difficult economic situation in the region, bad weather conditions and domestic policy uncertainty. Thus, Moldovan economy needs a robust growth

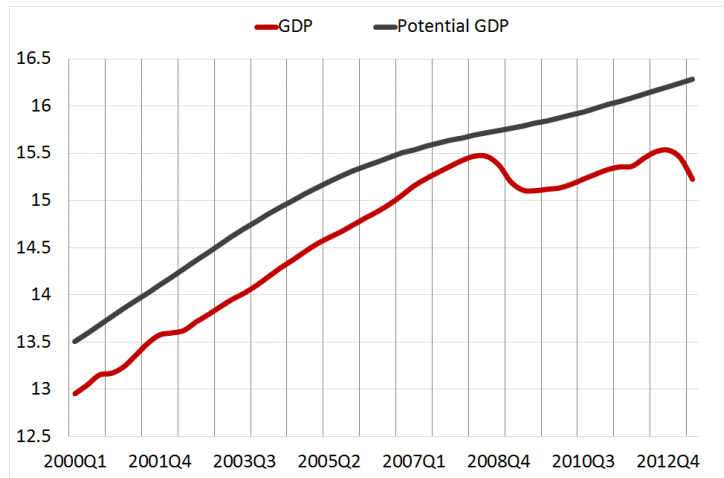
<sup>12</sup>World Bank, “Moldova after the Global Crisis: Promoting Competitiveness and Shared Growth”, 2011

<sup>13</sup> R. Giucci, R. Kirchner, “Current Account Sustainability in Moldova: Policy Implications”, German Economic Team Moldova, 2013



not only to catch up with the median values registered in other CEE countries, but also to be able to tap for its potential.

**Figure 12. The discrepancy between the current and potential GDP, constant prices (2000=100%), natural logarithms**

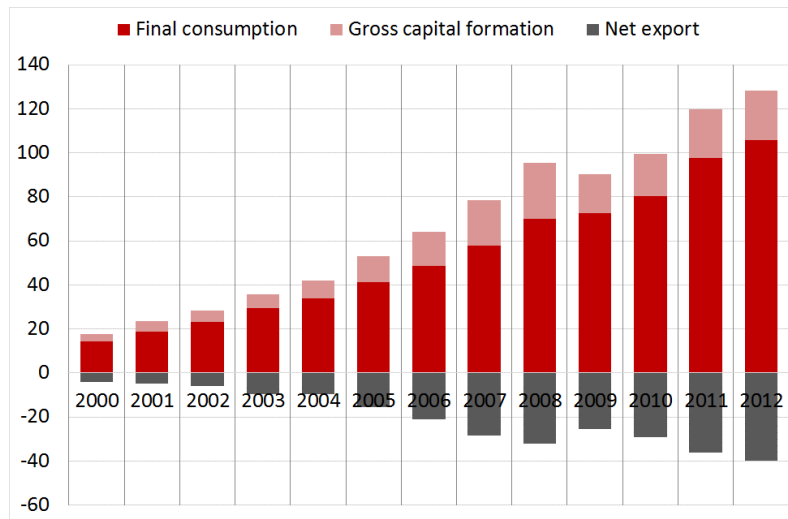


Source: Own calculations<sup>14</sup> based on NBS data

The underperformance of the Moldovan economy with respect to its potential level during the last years is probably the most telling feature which denote the deficiencies of its growth model. This output gap was primarily determined by the large number of working-age, but jobless population. Over the last years the occupation rate sloped, from 54.8% in 2000 to 38.4% in 2012. The largest contribution came from the rural areas where occupation almost halved due to continuous decline in the agricultural sector: the share of agriculture in total gross value added shrank gradually from 29% in 2000 to only 13.1% in 2012. It was also conditioned by massive emigration of working age labor, as well as by high reservation wages due to the growing inflows of remittances. The decline in employment was paralleled with a very tepid investment activity: total investments per capita are among the lowest in the region, while the positive contribution to the economic growth from the consumption of investment goods has systematically been offset by the negative contribution of the trade deficit (Figure 13). Hence, the economic growth was jobless, being fueled by foreign (remittances), rather than domestic factors (investments, labor or technological innovations).

<sup>14</sup> The potential GDP has been derived from the empirical estimation of the Cobb-Douglas production function of the Moldovan economy: . The potential level of labor has been determined by assuming that the number of employed working-age population is higher by 25%. The potential level of capital was obtained by applying the Hodrick-Prescott filter ( $\lambda=1600$ ). Additionally, in order to ensure the diminishing returns to scale the following assumption has been applied: The estimation period is 2000:1 – 2012:4.

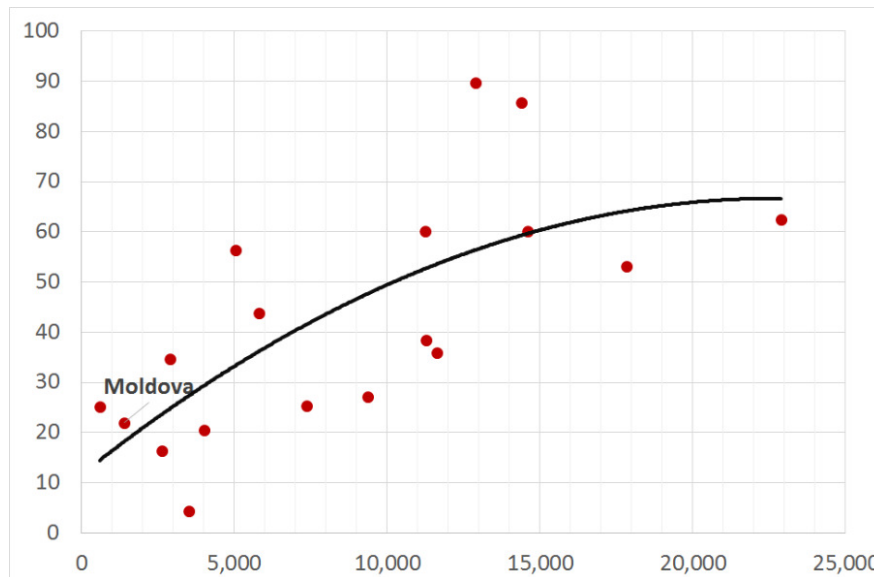
**Figure 13. The structure of GDP, expenditure approach, constant prices (2005=100%), billion MDL**



*Source: Own calculations based on NBS data*

The raising trade imbalances confirm the deficient growth model followed by the Moldovan economy and is a symptom of poor business climate and low export competitiveness. Moldova's exports of goods and services during the last years accounted for about 35%-40% of GDP, which is more than in Tajikistan (30%) or Armenia (20%), but much less than in Latvia (45%), Ukraine (47%), Kyrgyz Republic (52%), Bulgaria (59%) or Lithuania (61%). Besides being low, Moldovan exports are highly concentrated both in terms of geographic and products' structure: more than one half of total exports of goods are directed to only three countries (Russia, Romania and Italy) and one third are represented by fruits and vegetables, apparel and beverages. Whereas the high concentration of exports according to destinations can be explained by geographic proximity, no language barriers and historical ties (trade gravity model), the concentration of exported products reveals significant structural constraints. Importantly, these constraints are of domestic origin, rather than foreign one, as Moldova can export duty-free almost all products to EU under autonomous trade preferences and CIS under the bilateral free trade agreements. Hence, domestic non-tariff barriers to trade are a big issue, which are related primarily to poor road and quality infrastructure. Moreover, it is difficult to export, when the level of economic development is low (chart #), which means that poor export performance of the Moldova producers is simply the outcome of a weak economy.

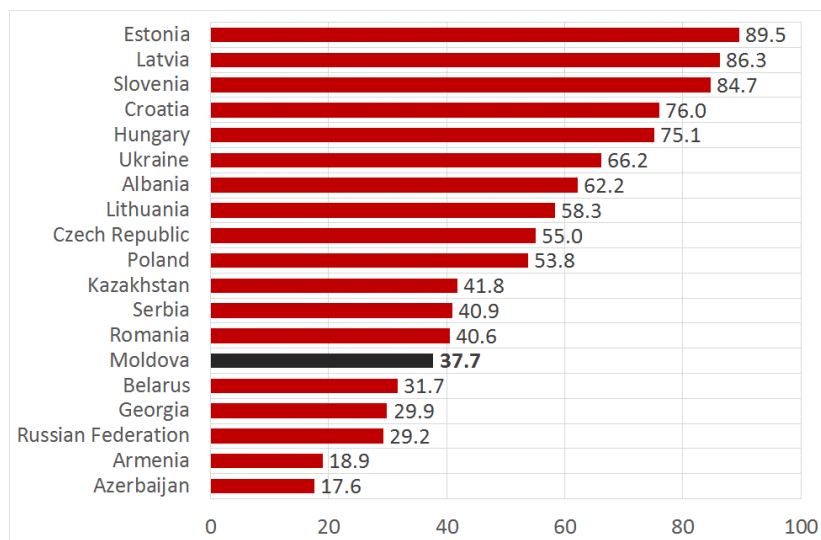
**Figure 14. The correlation between the share in exports to GDP and GDP per capita, USD, average for 2005-2011**



Source: Author calculations based on IMF and WB data

The competitiveness of local producers is also undermined by the low access to credit. The share of banking credits in GDP is one of the lowest in the region (Figure 15), which is explained by primarily by supply-side factors (e.g. strong risk aversion of banks due to low and poorly enforced lenders' rights, information asymmetry and persistent macroeconomic uncertainty). These liquidity constraints do not allow companies to modernize their equipment or smooth the production cycle, which translates into low value-added and volatile industry and exports: the share of technologically advanced products in total Moldovan exports is only 5%, which is the lowest from EU and one of the lowest among CIS countries.

**Figure 15. Domestic credit provided by banking sector (% of GDP), average for 2005-2011**



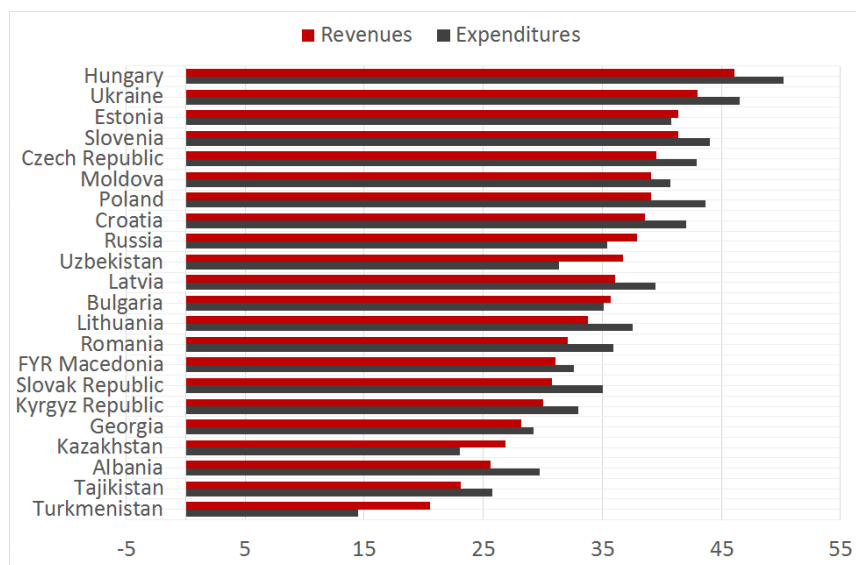
Source: World Bank

## Wider implications and risks

The burden of weak institutions, low access to financing and limited access to foreign markets was primarily felt by the small and medium enterprises (SMEs). As they continuously starved for investments, SMEs significantly underperformed as compared to the big enterprises. While accounting for about 98% of total number of companies, SMEs employ only 58% of total labour, which is much less comparing to other European countries (~65%-70%)<sup>15</sup>. Moreover, total profits accumulated by SMEs during 2005-2012 accounted on average only 60% of the profits earned by big enterprises. The implications of a weak SME sector on the Moldovan economy is two-fold: (i) it creates incentives for many small entrepreneurs to practice informal activities mainly for tax evasion reasons, and (ii) it limits the competition in various economic sectors which, in its turn, undermines the incentives to innovate. The outcome is that the production factors, besides being scarce as we saw in the previous chapter, are used inefficiently in the short-run and wasted in the long-run. The large share of the national economy which is out of taxation and formal accounting, along with high opportunity costs associated with inefficient utilization of resources, explains once again the wide output gap registered over the last years.

This huge and untapped potential of the Moldovan economy is the most important repercussion of its structural problems: weak institutions, policy uncertainty and poor infrastructure. Another important culprit is the excessive state implication in the economy: over the last years the share of total government expenditures to GDP hovered at around 40%. It has at least two major consequences. Firstly, it is an additional factor that induces inefficiency in allocation of existing resources, mainly through the extensive system of state-owned enterprises which usually have worse performance compared to their private counterparts<sup>16</sup>. Secondly, it crowds out private investments due to the fiscal pressure necessary to finance the extensive public sector, which is revealed by relatively high share of government revenues in GDP (Figure 16).

**Figure 16. Total government revenues and expenditures, average for 2005-2012, share in GDP, %**



Source: IMF World Economic Outlook

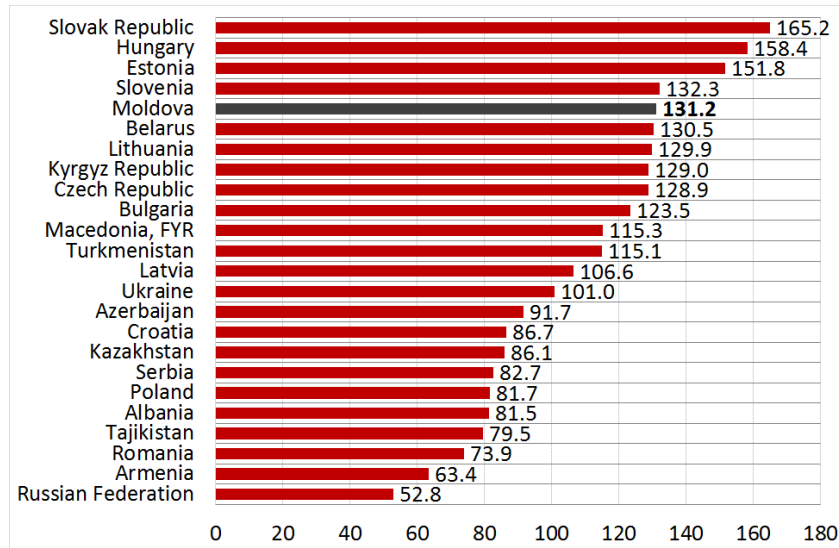
The weak SME sector and extensive state-owned enterprises explain the relative rigidity of the Moldovan economy and, hence, undermine its capacity to rapidly accommodate various foreign shocks. The effects of fluctuations in foreign demand, terms of trade or FDI are not trivial for Moldova, as it is one of the most

<sup>15</sup> The data are calculated as average for the period 2005-2011

<sup>16</sup> World Bank, "Moldova after the Global Crisis: Promoting Competitiveness and Shared Growth", 2011

opened economy in the region (Figure 17) and hence very exposed to global economic conditions. Indeed, the empirical estimations<sup>17</sup> confirm the large exposure of the Moldovan economy to shocks in GDP of its main trading partners (EU and Russia), which are estimated to last for 2 years and even more. Hence, Moldova did not remain immune to economic difficulties experienced by EU and CIS which aggravated during 2012, the main transmission channels being the decline in FDI and exports by 43.3% and, respectively, 2.2%, and a slowdown in remittances' growth.

**Figure 17. The share of foreign trade in GDP, average for 2005-2011, %**

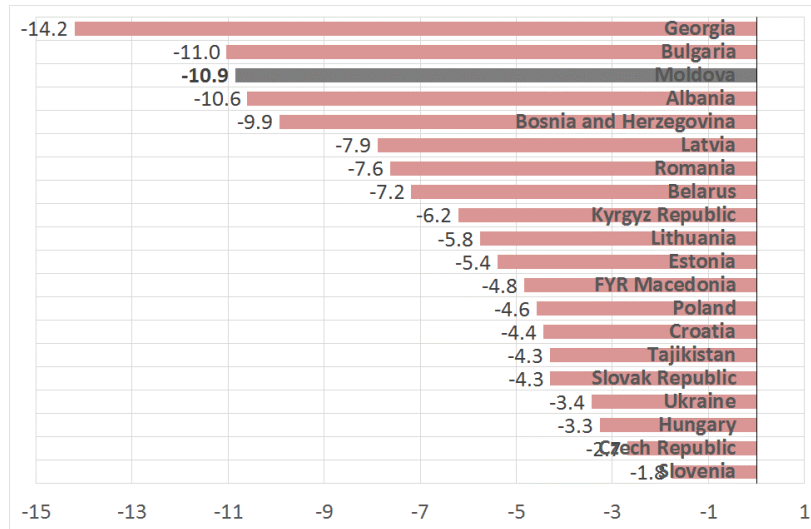


Source: World Bank

This exposure to foreign shocks aggravate the issue of current account deficit, which is likely to have strong long-term repercussions unless a sustainable financing source will be developed. As usually the current account deficits are counterbalanced with capital and financial accounts, these sources could come from portfolio and foreign direct investments. Additionally, it could be mitigated with a higher rate of national savings, which in Moldova is currently one of the lowest from the region. . As a result, Moldova spends much more abroad than the incomes it receives from the outside of the world, which makes its current account deficit one of the largest among other CIS countries (Figure 18).

<sup>17</sup> A. Lupusor, A. Babin, A. Popa, "How Vulnerable the Moldovan Economy is to Foreign Economic Shocks? Forecasts for 2012", Expert-Grup, 2012

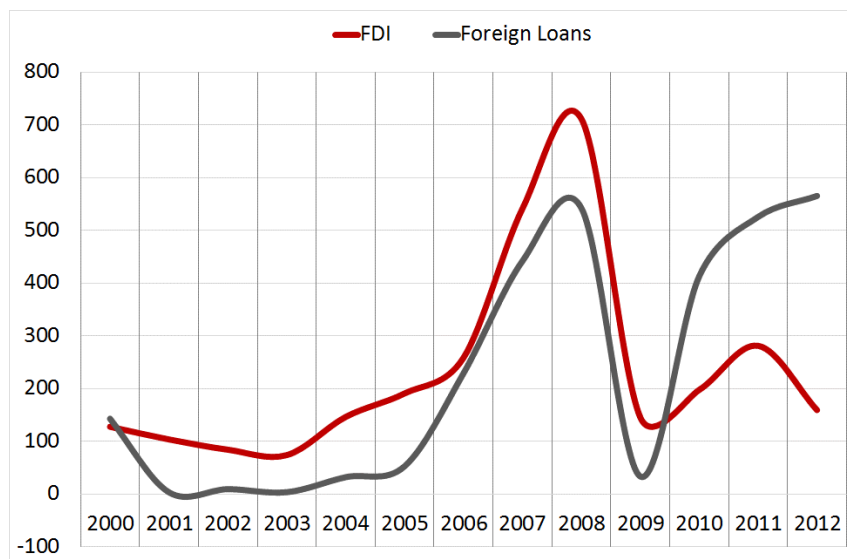
**Figure 18. The share of current account deficit in GDP, average for 2005-2012, %**



Source: IMF

However, the key challenge associated to this imbalance is not related to the deficit size, but rather to its financing sources: since 2010 the current account deficit is covered primarily from foreign credits, both public and private, visibly outpacing FDI (Figure 19). Hence, the sustainability of this imbalance in the long-run is conditional on the way how efficient this money is spent in order to generate future surpluses and compensate for today's deficits. There are at least three key challenges here: (i) a large part (about 40% in 2012) of this external credits were contracted by the monetary or governmental authorities, which usually are not the best investors; (ii) poor business climate induces uncertainty and undermines the efficiency of private investment activity; (iii) Moldova's foreign indebtedness is relatively high mainly due to the private sector, which limits the room for further expansion (Figure 20).

**Figure 19. The main financing sources of current account deficit in Moldova, USD mil.**

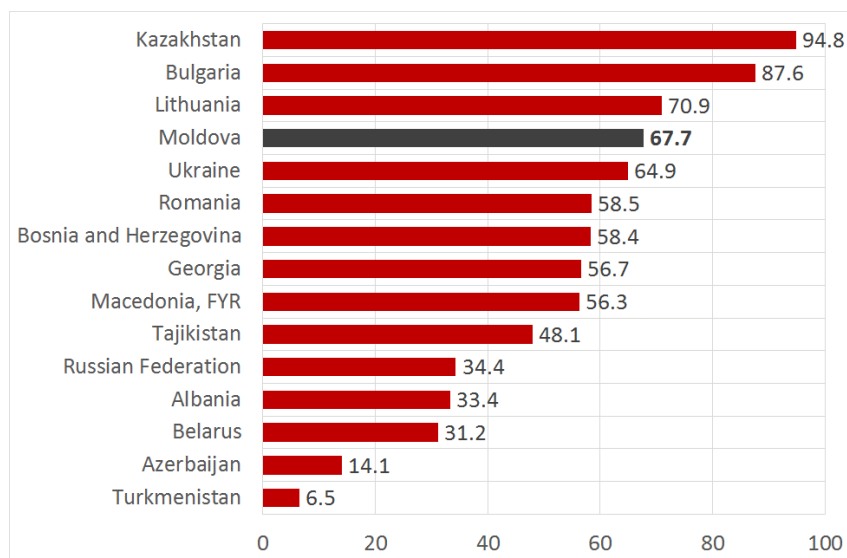


Source: NBM

Thus, under the current conditions, the prospects that the current account deficit will be fully offset by future financial flows generated by these investments are quite bleak. Consequently, it challenges the long-term

current account sustainability, which has also been confirmed by empirical evidence<sup>18</sup>. In the end, somebody will have to pay the bills which poses a large burden on the future generations and which could hamper the confidence of investors in the long-term prospects of this country.

**Figure 20. External debt stocks (% of GNI), average for 2005-2011**



Source: World Bank

## Policy recommendations

The Moldovan economy is constrained by three key components: (i) scarce capital, (ii) scarce and poorly-trained labour and (iii) low efficiency in combining the two factors. Particularly, investments are scarce due to weak business climate and high cost of capital; labour is scarce due to emigration and high reservation wages as compared to the current wage, while the efficiency is poor due to weak SME sector, extensive system of state-owned enterprises and scarce capital. Poor infrastructure and weak institutions add to this burden. As a result, the Moldovan economy, despite its relatively robust growth, has constantly underperformed as opposed to its potential level. Therefore, the main policy actions should be aimed at exploring this potential by targeting each production factor: capital, labor and efficiency. Fixing the shortcomings will in the end result in a more competitive economy based on an investment- and export-led growth model. It will also restore the current account sustainability, as it will increase the sources of its financing, and hence strengthen the long-run macroeconomic stability.

### ***Measures addressing the scarce capital***

- Low domestic savings, coupled with depreciated production facilities, fuel the strong necessity for foreign direct investments. Nevertheless, this demand for FDI is hardly met due to the weak business climate, macroeconomic instability and policy uncertainty. Addressing the issue of scarce capital requires easing the regulations for doing business (especially related to obtaining construction permits and access to land), modernizing the judicial system, strengthening the property rights, consolidating the capacities and granting more independence to the competition authority, reforming the system of public procurement, improving the fiscal administration primarily by implementing IT solutions and one stop-shops and reducing the costs and time related to border crossing. However, these institutional adjustments will not bring the right results if the public authorities and their employees do not change their approach in communication and interaction with

<sup>18</sup> R. Giucci, R. Kirchner, "Current Account Sustainability in Moldova: Policy Implications", German Economic Team Moldova, 2013

businesses. Particularly, the custom and fiscal authorities should facilitate the trade and economic activity, rather than acting as police officers.

- The issue of scarce capital can also be addressed, at least partially, with local sources. The Moldovan banking sector has traditionally been abundant in liquidities due to the strong risk aversion of banks and limited investment opportunities. This money is usually parked either in safe assets (e.g. t-bills or NBM certificates) or are left idle with negative implications on banks' efficiency and profitability. In order to facilitate the access of local investors to these funds it is necessary to address the causes making the banks reluctant towards lending. Thus, the policy makers should aim: (i) to strengthen the lenders' rights, in order to ensure the banks that in case of debtors' default they can easily convert the collateral into cash; (ii) to mitigate the information asymmetry between lenders and borrowers by developing a functional credit bureau system; (iii) to develop the non-banking financial sector (e.g. capital market, leasing, insurance) in order to foster the competition and motivate banks to innovate.
- The capital, irrespective of its origin (domestic or foreign), tends to be attracted by countries with good public infrastructure, stable macroeconomic and political environment and friendly business climate. Thus, improving the roads infrastructure, ensuring a broad convergence of national standards to the European ones, preserving the political stability and fighting corruption form, in the long run, the most efficient investment attraction strategy.

### ***Measures addressing the scarce labor force***

- In times when the scarce labor is determined by emigration, the policy makers might have the incentive to impose some limits on the export of labor force. This is definitely the wrong approach in case of Moldova. In fact, the authorities should rather concentrate on protecting the rights and interests of their citizens abroad by signing bilateral agreements for diplomas recognition, social protection etc. with countries serving as destinations for Moldovan migrants. Additionally, the state should permanently keep in touch with their citizens abroad, with a crucial role to be played by the Bureau for Relations with Diaspora. It will help to maximize the developmental impact of remittances sent by these migrants, which in the long-run could motivate many of them to come back.
- The domestic labor shortage could be addressed by liberalizing the immigration policy. It should imply easing the procedures of getting work permits and eliminating the burdensome bureaucratic barriers faced by domestic firms in employing foreign citizens. Given the worsening demographic situation and emigration which is likely to last in the long run, attracting foreign labor force will mitigate the pressures on the domestic labor market and will strengthen the competitiveness of local producers. Obviously, it will not compensate for the brain drain, due to relatively low domestic wages. Nevertheless, easing the immigration policy will provide an additional source of low skilled, but scarce labor force, which construction and agrifood firms often demand.
- Besides being scarce, the available labor force in Moldova is, in many cases, of either poor quality or wrong qualification. This is the result of the wide mismatch between the demand for labor from firms and the supply of qualifications from the educational system. This issue can be addressed by making the national education system more flexible and integrated into the economic life, which can't be achieved without a more active participation of the private sector. Hence, it is necessary to encourage all forms of partnerships between educational institutions and firms, allow representatives of companies to take more active part at students' evaluation and include them in the supervisory boards of educational institutions, enhancing the schools' heads accountability to the supervisory boards, as well as facilitate the periodic communication between both parts. In this regard, the vocational education and training (VET), especially at the secondary (professional and trade schools) and post-secondary levels (colleges) should have a special role to play. Strategically, the VET system have to be based on the so-called "Dual Apprenticeship Approach" which implies on a close cooperation between firms and schools.



### ***Measures addressing the low efficiency of capital and labor utilization***

- The extensive public sector and the state-owned enterprises undermine the efficiency of capital and labor allocation, which is empirically confirmed<sup>19</sup>. Hence, it is necessary to speed up the privatization process, following the best principles of transparency and competitive procedures. It will foster the competition in various sectors, attract more FDI and increase the productivity.
- Developing the SME sector should have a crucial role in improving the efficiency of production factors' utilization, as they are usually more flexible and opened to innovations. Importantly, these policies should not be based on discrimination between SME and large firms because they could create the wrong incentives for big companies to become SME or for SME not to be willing to grow into big firms. Such measures as providing subsidized loans, collateral guarantees and other subsidies to the SME sector should be approached carefully. Instead, any SME, as any other company, needs friendly business environment, stable political and macroeconomic framework, decent attitude from state authorities and good public infrastructure. Besides these horizontal measures, the policies which would target specifically the SME sector could imply providing good quality consulting on all stages of firm development (starting from startup and getting a bank loan, up to production enlargement, merging or acquisition).

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<sup>19</sup>World Bank, "Moldova after the Global Crisis: Promoting Competitiveness and Shared Growth", 2011

## ■ Technological Endowments: The Path towards the Economic Possibility Frontier

*The purpose of this chapter is to pose and reflect about the role of technological endowments for Moldova's long run economic prosperity. The phenomena we wish to put forward are the possibilities and consequences of advanced technologies, and in particular the ICT sector in Moldova, on the internal transformation of the economy. The relevance of adopting, adapting and using new products and processes of organizing production is defined primarily by the way technological constraints affect present and future economic possibilities.*

### Analysis of key developments and trends

Theorizing about economic growth can be framed by two simple observations<sup>20</sup>. The first one is that most economies in general and the Moldovan economy in particular do not exploit all the opportunities available to increase people's living standards. To put it differently, the Moldovan economy is well inside the so-called production possibility frontier. The second observation consists in the awareness that the frontier, which defines the feasible economic decisions, changes continuously. That is, our economic opportunities are expandable. Hence, the main challenge for Moldovan policy makers and the economists' community is to pose and reflect on two central questions. The first one consists in asking what prevents us from operating at the production and consumption possibility frontiers – *idem* why don't we exploit all the opportunities available? The second question concerns the factors that prevent us from moving the current possibility frontier to higher levels.

A number of explanations may offer a better understanding of Moldova's current economic situation and provide valuable insight on how to answer both questions. First of all, the reason of Moldova's relatively poor economic performance lies in the shortage of human capital. Mismatches between the quality of the supplied labor force and employers' needs are a real problem and this is the subject of the chapter "Human Capital: the Real Wealth of the Nation". Secondly, Moldova's economy is poorly endowed with certain types of natural resources and land. Notwithstanding its economic importance, natural resources cannot account for neither Moldova's nor other countries' long run economic possibilities. A third element, which will be analyzed in this chapter, concerns the shortage of technology. It consists of equipment, machinery and knowledge (a certain know-how). Accordingly, the shortage of latest technology seriously affects the country's possibilities to take advantage of its economic opportunities. The reason is that it raises the cost of production as compared to other economies with a more favorable ratio of labor/technology, and hence undermines the country's competitiveness.

As mentioned in the chapter "Moldovan Economy: Tapping the Potential", the share of technologically advanced products in total Moldovan exports is only 5%. Institutional factors, such as a poor justice system, may explain the main domestic barriers to specialization in technologically advanced goods. The contracting and monitoring costs for sophisticated products and contracts are high and therefore efficient courts are crucial to lower business uncertainties. Consider, for example, Moldova's scores on judicial independence and the efficiency of dispute settlements for 2010 and 2011, calculated in the latest WEF – Executive Opinion Survey. Moldova ranks 132 out of 142 countries on the judicial independence criterion and 108 for the efficiency of the legal framework for private businesses to settle disputes<sup>21</sup>. Institutional failures is the main reason why developing countries specialize in goods and services with low technological content, which makes these countries highly vulnerable to external shocks that generally translate into high volatilities on the markets for unsophisticated goods. Indeed, an important empirical observation made by economists is

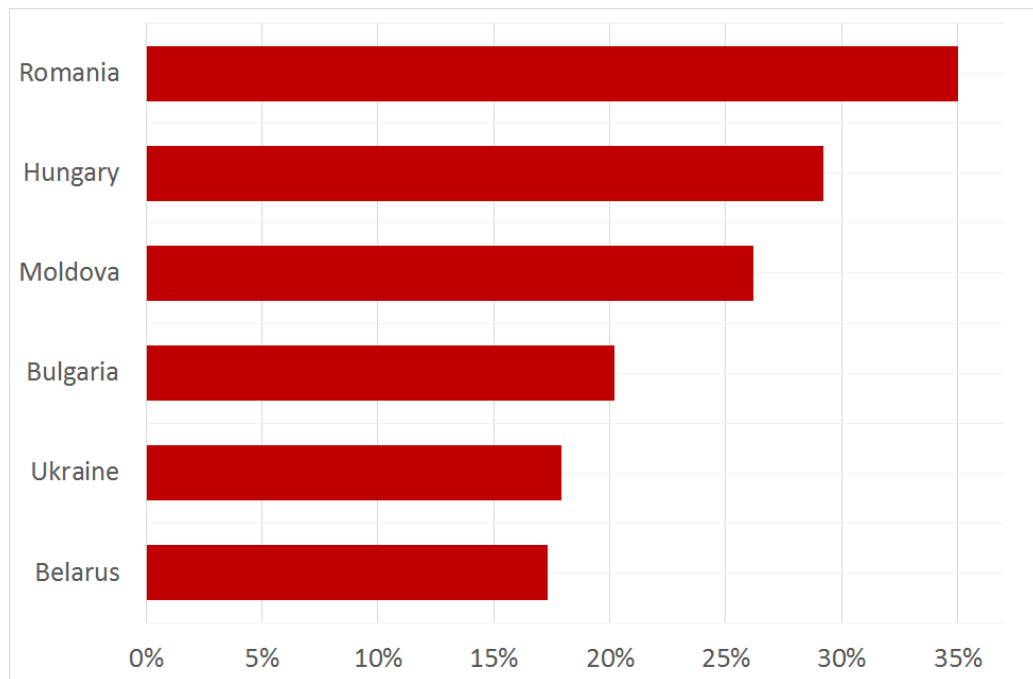
<sup>20</sup> The two observations are summarized in Olson, M. 1996. "Big Bills Left on the Sidewalk: Why Some Nations are Rich, and Others Poor" 10 *Journal of Economic Perspectives* 3 – 24.

<sup>21</sup> See the World Economic Forum, *Executive Opinion Survey*, 2010 and 2011 editions.

that “less developed countries with lower institutional ability to enforce contracts will specialize in less complex goods which are also characterized by higher levels of output volatility.”<sup>22</sup>

It is also worth noting that the share of technologically advanced goods in total imports was only 3.9% in 2011, compared to 8% for Romania<sup>23</sup>. The picture is however different if one considers the share of technology related services in total service exports. In effect, the share of information and communication technology (ICT) services in total service exports for Moldova is 26.2% in 2011 and 25.3% in 2012. Although other countries, such as Romania score higher (35% in 2011), the divergence is not substantial and in many other cases, Moldova largely outperforms its neighboring states<sup>24</sup> on this indicator (see Figure 21).

**Figure 21. ICT service exports as % of total service exports, 2011**



Source: *World Development Indicators, World Bank*

The ICT sector is admittedly one of the most dynamic sectors in the Moldovan economy. However, its share in Moldova’s GDP cannot be ascertained with reasonable accuracy. This is because the national accounts do not allocate a distinct section for the ICT sector. Nonetheless, we have a clear picture of the IT services (Figure 22) and telecommunications’ share (Figure 23) in GDP, which together account for more than 80% of the Moldovan ICT sector<sup>25</sup>.

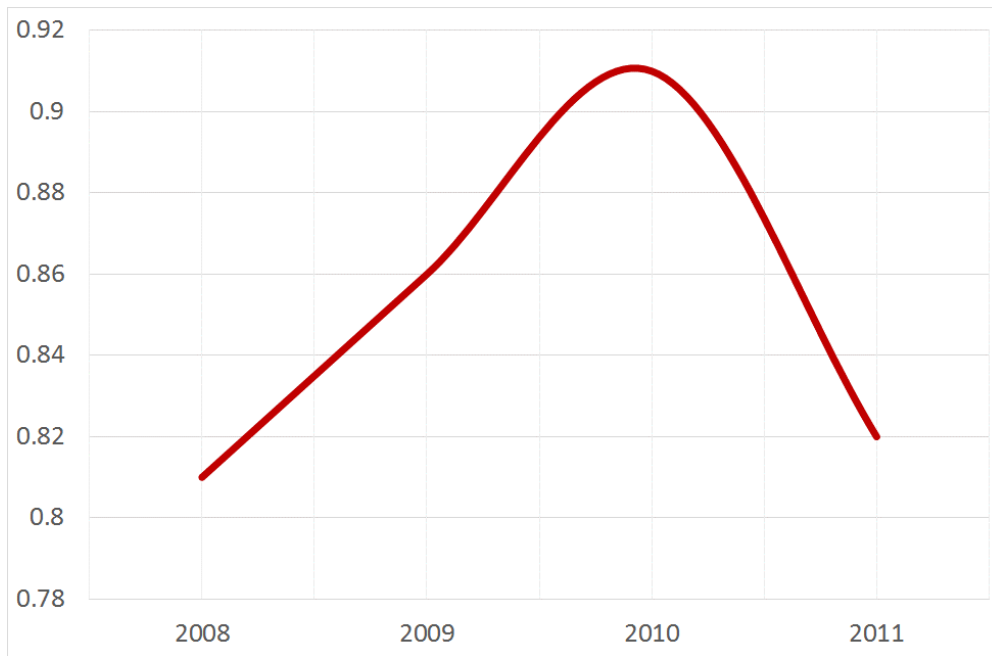
<sup>22</sup> For further details, see the seminal work by Krishna, P. and Levchenko, A. 2009. “Comparative Advantage, Complexity and Volatility” *National Bureau of Economic Research Working Paper* 14965.

<sup>23</sup> See the World Bank, *World Development Indicators*, <http://data.worldbank.org/indicator/BX.GSR.CCIS.ZS/countries/1W?display=default>

<sup>24</sup> Ukraine has a share of 17.9% of ICT services in total service exports in 2011, while Belarus only 17.3%.

<sup>25</sup> See the publication by The National Association of Private Companies in the ICT sector, *The ICT sector in Moldova – 2012*, <http://www.ict.md/files/White%20Book%202012%20Romanian%20Version%20FIN.pdf>

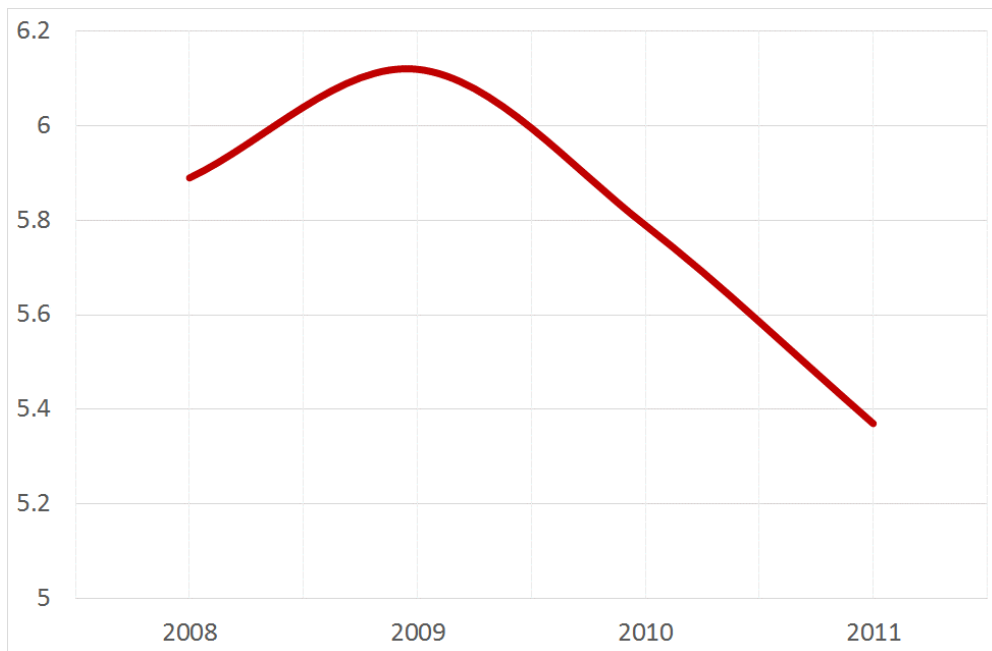
**Figure 22. The share of IT service in GDP, %**



*Source: ICT Sector in Moldova, Policy White Book 2012*

After the 2008–2010 expansion of the IT sector, we observe a decline in its share in GDP which means that it grew at a rate inferior to the rate of growth of GDP. The dynamics of the IT sector are thus slowing down. The same conclusions apply to the telecommunications sector – Figure 23.

**Figure 23. The share of telecommunications sector in GDP**



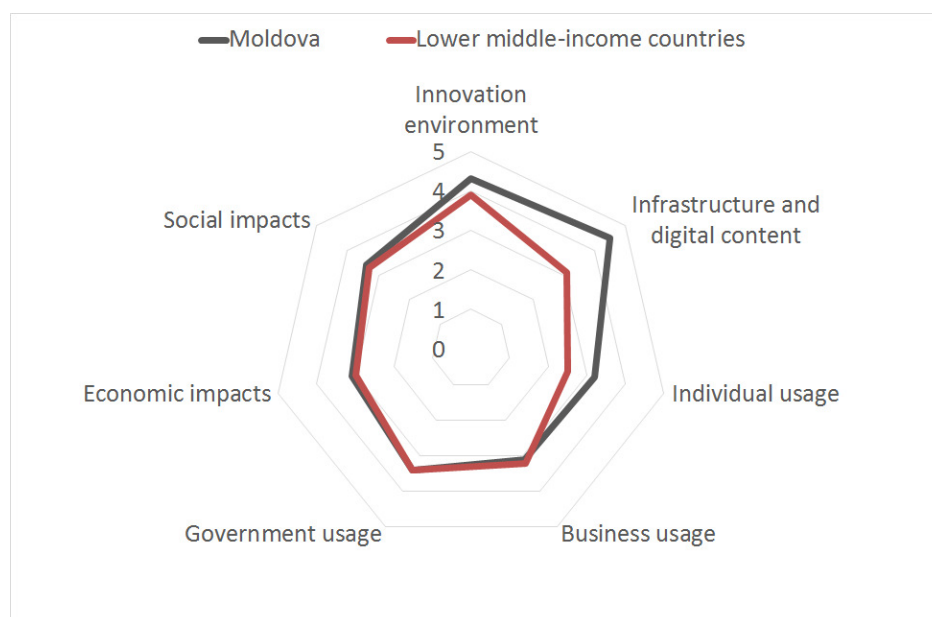
*Source: ICT Sector in Moldova, Policy White Book 2012*

These results are alarming for the following reasons. The IT services have long been considered as a sector generating positive returns and important feedbacks into the economy. In effect, in 2008–2010 the number of IT companies increased at high rates, which had a positive effect on the market’s dynamics and visibility. Curiously enough, the ICT sector in general and IT services in particular do not exhibit the same characteristics as other more “traditional” goods and services. From the supply-side, the increasing number of firms generates positive externalities – firms rely upon the web of knowledge interactions that are defined by their geographical location. From the demand-side, the ICT sector is a fundamental infrastructure resource that enable people to satisfy their private, public and social wants – communicate their private and public preferences, consume valuable information, etc. – which makes them better informed consumers and citizens. This is why the sloping shares of IT (in 2011) and telecommunications (2009-2011) sectors in GDP have important implications on the quality of Moldova’s economic system.

## Wider implications and risks

The share of technologically advanced products in exports, imports or GDP is an important indicator of a country’s technological readiness. Thus, the results mentioned above have implications for Moldova’s business and innovation environment and have economic and social impacts. Figure 24 illustrates how Moldova scores on a series of ICT related criteria, where 1 is the lowest score and 7 is the highest. The results are contrasted with the performances of low middle-income countries included in the latest Global Information Technology Report 2012, published by INSEAD and World Economic Forum<sup>26</sup>.

**Figure 24. ICT profiles: Moldova versus Lower middle-income group, average**



Source: *The Global Information Technology Report 2012*

One observation is particularly alarming. The rate of absorption of advanced technologies by the business and government agencies is similar to the average of the low middle-income group – yet, at very low levels. Consider, for example, firm level technology absorption. Moldova ranks 126 out of 142 countries analyzed in The Global Information Technology Report 2012. It “simply” means that Moldovan firms do not investigate new products or processes of production – that is, new technologies. These new technologies are codified ‘know how’ that may be more or less costly to acquire. The cost will depend on a number of factors, such as formal (property rights, contracts enforcement) and informal (tolerance towards novelty, curiosity, lower risk

<sup>26</sup> See INSEAD and World Economic Forum, *The Global Information Technology Report 2012*, [http://www3.weforum.org/docs/Global\\_IT\\_Report\\_2012.pdf](http://www3.weforum.org/docs/Global_IT_Report_2012.pdf)

aversion) institutions. The process of technology absorption is at the center of developing countries' tryst with (technological) 'catching-up'. Put it differently, there are bills lying on the sidewalk but because of mainly domestic barriers to exchange – that is the cost of absorption of new technologies – Moldovan firms find it too costly to pick them up quickly.

## Policy recommendations

Albeit at a high level of aggregation, this chapter (and report) suggests a number of factors that may explain (a) why the Moldovan economy does not operate near its production possibility frontier and (b) what prevents us from moving the current possibility frontier to higher levels. The main constraints undermining the country's economic development are scarce natural resources, undersupply of marketable human capital and low technology adoption. The technological constraint is one of a particular importance, as it has a widespread impact on the entire economy and affects growth in two ways. First, technologies and in particular knowledge technologies define the final outcome generated by any combination of labor and capital (natural resources included under the label of capital). The productivity of the same quantity and quality of labor and capital will vary with the firm's codified and tacit knowledge (daily use of advanced technologies generate productivity gains from learning by doing). Second, technologies engender effects that tend to accumulate over time, leading to an internal transformation of the economic system. Not only the costs of producing high-technology products fall as a firm makes more of them, but the benefits of using them increase and affect the course of the entire economic system (technologies serve as inputs in a variety of economic and noneconomic activities).

Despite the positive spillover effects the ICT sector generates for the entire economy and its importance for the country in tapping its potential, currently, there are many internal constraints, which hamper the technological absorption, at both business and government levels. In order to support long run economic prosperity, policy makers should consider the following key messages:

- The hypothesis advanced in this report is that economic prosperity does not come solely from resource endowments, it is determined mostly by the structure of incentives. The bills lying on the sidewalk (mostly in the form of new technologies to be adopted and adapted) cannot be picked up through uncoordinated individual actions. Thus, the low level of business absorption of new technologies in Moldova is due to the perceived too high opportunity costs of doing it. To lower the costs of adopting, adapting and using products and processes with advanced technological content requires: (a) institutions that enforce contracts impartially, and (b) institutions that make property rights secure over the long run so that companies expect to appropriate all the gains from technology-intensive production;
- Policies that are appropriate to success in the production of products with high technological content would encourage industries to be aggressive in seeking out product and process improvements. They would strengthen the national research base on which high technologies are built. They would encourage firms in a single industry to pool their resources in joint ventures that share up-front costs, technical knowledge and standards. These measures are meant to create a web of interacting firms that through cooperation would lower the (technical) costs of adopting new technologies. The value of other policies, such as subsidizing and protecting new industries is debatable;
- What matters for an optimal industrial, scientific and trade policy based on positive feedbacks – such as defined above – is to prevent firms, scientists and engineers from taking the shortest and less risky roads. For firms, it is essential to guarantee an efficient legal framework so that businessmen can enter sophisticated contracts involving the production and exchange of technologically advanced products. The Moldovan legal system is one of the weakest among other countries in the region and this is precluding socially valuable but risky investments in developing or adopting new products and production processes. The scientific community is another key element. Scientists together with engineers are supposed to work out more productive ways of combining inputs or to adapt to the local needs some imported technologies. In Moldova, they often fail to fulfil these two functions. The reason is not always the lack of public funds to finance R&D. The financially constrained policy

maker should guarantee an optimal level of accountability for researchers and also that they do not get locked-in what *they* think is valuable for society to have as new technologies.

## ■ Domestic Politics: From Semi-Authoritarian to Semi-Anarchical and to New Hopes. What Next?

*In 2009-2013 Moldova has seen one of the most politically turbulent episodes of its post-1991 history. This left a negative impact on the country's economy, which is already troubled by the crisis in EU and the slowdown of economic growth in Russia, and on the Moldovan society, which has developed a sense of chronic political disappointment. Rehabilitation of the political confidence is primarily responsibility of the national political elites, however, this mission is hardly achievable without constant oversight from the part of external and domestic stakeholders, including the media.*

### Analysis of key developments and trends

Since the last State of the Country Report launched in March 2010, the Republic of Moldova has witnessed a period of extraordinarily combative politics. This period has been featured by a number of negative trends that will severely affect the country's politics and general development in long-term.

By and large, it can be said that Moldova has been a 'failing student' in learning how a coalition government should run the country. Between January 2010 and May 2013 the cooperative political process was gradually substituted by a zero-sum game. The initial cooperation atmosphere between the political forces composing the Alliance for European Integration turned into a war of every political party against all others. As a result, the semi-authoritarian political regime in place until April 2009 morphed into a semi-anarchical one, with open neglect, abuse or misinterpretation of country Constitution and laws. Political parties represented in the national Parliament allied and split without carrying too much for the ideological compatibility, mutual commitments and political culture. A defining feature of the Moldova politics in this period of time, the language used by politicians degraded significantly and senior politicians often happened to borrow words and expressions from the gambling and from the underworld, thus emphasizing their real, underlying 'values and principles'. The high degree of political intransigency has revealed that the real interest of many Moldovan elites is not to implement reforms (which effectively became a buzzword) but rather to remain in power or to regain the power at any price, with the purpose of protecting their electoral fiefdoms, businesses or assets.

On the background of the political in-fight between the 'allies' founding the Alliance for European Integration and of the resulting administrative handicap at the central level, the simmering separatist tendencies gathered more steam. Authorities in two 'hotspots' on the Moldovan political map – municipality of Balti in northern part and the autonomous territorial unit of Gagauzia in the southern one – adopted many decisions contesting and reversing those adopted by the national government (such as the law on principles of equality, equity and objectivity, known better as 'anti-gay' law adopted in Gagauzia, rejection by the Balti municipal council of the Ministry of Education order prohibiting sell of 'junk food' in the shops in immediate vicinity of schools and kindergartens, Gagauzia's threats to reject the new policies adopted by the Ministry of Education to ensure the integrity of the national baccalaureates exams). At the same time, Moldova entered a dubious 'small-steps strategy' of settling the conflict with the breakaway Transnistrian region, a strategy which only consolidated political positions of regime in the region, without getting Chisinau any closer to its objective of reintegrating the country. Escalation of the regional resentments against the Government in Chisinau did not take place without external involvement: the number of visits of Russia's emissaries to Tiraspol, Comrat and Balti doubled in 2011-2012 compared to the two years before. To mention only one of the most symptomatic occurrences, an international conference took place on 6 of February 2013 in Tiraspol, which has been attended by a delegation from Russian Duma to discuss the topic of harmonization of the Transnistrian legislation with the Russian one.

The political and economic life intertwined even more than under the Communists Party's regime. In early days of the Alliance for European Integration, there was a naive public expectation that a higher number of



business representatives in the Parliament may lead to a swift reform of the business regulatory environment. Instead of engaging in such reforms, these representatives engaged in the fight for redesign of the spheres of influence in the realm of public finance and state-owned enterprises, and passed many laws to shield their businesses from the free competition. Since 2009, several international companies working in Moldova complained of harassments and pressures orchestrated by members of the national Parliament, which were 'helped' by representatives of other state bodies, including policy, tax office, customs service. The coupled political and economic capitals helped many vested interests to effectively capture the state institutions and use them for their own ends. While this is not a characteristic completely new for the Moldovan political model, in the recent years this process of erosion of state went from 'the behind the curtain' into open, public sphere.

A phenomenon of corporatization of the mass-media and an evident 'berlusconization' of the sector took place at dizzyspeed in only a couple of years. Controlled economically and politically, many of the Moldovan media institutions became active part of the political game, displaying strong political partisanship and becoming an indispensable tool in the political fights across the entire political scene. A professional ethics in this sector is only in an embryonic form, which helped political parties to manipulate the public opinion, even though, at first sight, there is a 'diversity' of opinion in the Moldovan media.

A new Government was sworn in on 31 of May 2013, after benefiting of votes of 58 MPs which formed the Pro-European Coalition. The new Prime-Minister Mr. Iurie Leancă is expected to transfer a part of his personal image and reputation on the Cabinet and to set in a new model of communication and cooperation between representatives of the political forces providing support to the Government. The political heavyweights leading political parties have either withdrawn or have been removed from the frontlines. The new Government will have a very short mandate, considering that new elections are to be held at latest in March 2015. While this may create a sense of discomfort, this also may contribute to formulation of a less ambitious agenda to the benefit of a more focused policy. The immediate risk for this Government is that with general elections getting closer, the tensions between the parties in the Pro-European Coalition may escalate again.

## **Wider implications and risks**

The confrontational politics that marked the country in 2010-2013 pose a high risk of undermining the model of governing in coalition in Republic of Moldova. The figures of the sociological polls suggest a growing number of citizens disappointed by the political 'disorder' associated with the coalition governments and a spreading willingness among the people to see a one-party government ruling the country in the future. While one year ago emergence of a mono-color government seemed quite improbable over the next 1-2 electoral cycles, due to already high political fragmentation of the Moldovan society, presently the situation is very much different. According to the IMAS socio-political barometer's results published on 5 of June 2013, if next weekend general elections are held, the Communists Party can easily get around 55 mandates in the new Parliament, more than enough to form a government. This popular sentiment of disappointment with coalition government may easily turn into dismissal of the virtues of the democracy as such.

Uncooperative national political elites also send wrong signals to the rest of the society and to the local and regional authorities. As reported by Moldovan media, the later tend to reproduce the intransigent political behavior at levels closer to the common citizens. This educates an over-politicized society, worsens the climate of inter-personal and community-level relations, and, as second round effects, this may lead to degradation of the inter-ethnic relations in a country that is already internally fragile. Achieving common understanding on strategic development issues may become impossible in such a social-political climate, while the Government risks its attention being diverted from long-term development objectives to short-term priorities.

Diminishing the public's respect for the rule of law and complete loss of trust in state institutions is another set of risks associated with the politicians gambling with the country's Constitution and laws. According to the Moldovan folklore, 'the fish rots from the head', which means that if politicians are allowed to neglect the law,

this is a model that is certain to be reproduced at the grass-roots level. To mention only one of the most telling examples, the public image of the tax office suffered terrible losses in result of the leaked mobile discussions involving the head of the office and senior politicians. Restoring the public confidence in the tax office is currently one of the most challenging and high-priority tasks.

A common occurrence in other countries of the former USSR, the domestic political process in Moldova has an important 'geopolitical' component. However, what is particular for this country is the fact that its external orientation rather than economic and social policies serves as the main political watershed among different parties. This is a sort of political marker for the politicians themselves but also for wider socio-political groups. European integration was defined as key development vector for the country by the ruling coalition, but this choice is opposed by the leftist political parties and forces, both in the Parliament and outside which peddle for Moldova joining the Russia-Belarus-Kazakhstan Customs Union and other Russia-led regional integration projects. However, the strong interplay of political and economic interests suggests that for many representatives of the Moldovan political elite, the 'European integration' is a buzzword rather than a promising outcome. They will not buy in a political target threatening their positions and business interests. Nor the promoters of the Eurasian vector are more credible. In fact, with dysfunctional institutions (protection of property rights, enforcement of honest competition), remaining in power or regaining the power at any price will be the key motivator for political elites. This is a clear oligarchic political structure of the state. From here to a truly mafia-like state is only one single step, which, once made, may turn irrelevant any discussions of the external orientation of the country.

## Policy recommendations

- EU has been so far the only external factor able to create incentives for cooperation among Moldovan elites. In order to keep the country on the right track, EU needs to maintain an active presence in Republic of Moldova. While the 'more for more' principle is fine, a 'less for less' antithesis should also be clearly framed by the EU in order to keep Moldovan politicians awake and sober.
- Moldovan Constitution has to be reviewed, or indeed, a new Constitution needs to be developed in order to avoid in the future the political and institutional blockages that surfaced in 2009-2013 and to ensure a more balanced power play. However, this should not be approached as short-term objective implementable in political bureaus. Opposite to that, the elaboration of the new Constitution should be a credible and public exercise, involving as many as possible representatives of different socio-political groups.
- Media will play a central role in reshaping Moldovan politics and in transforming it from 'bunker'-based model into a more transparent and inclusive model. To play this role, media requires financial independence, an independence which can be ensured only from outside, by external actors (such as EU). As lack of financial independence is the key problem of the Moldovan media institutions, the advertising services market and mail delivery services market have to be freed of monopolistic structures and open to free competition. It is also equally important to consolidate the sector's self-governing capacities.
- In order to get rid of its oligarchs, Moldova needs faster European integration and legislative harmonization, with an emphasis on corporate legislation, competition promotion and state aid. Significant progress has been achieved so far by adopting a set of European-like laws, but with devils hiding in details, civil society, extra-Parliamentary parties and EU need to monitor closely the development of the secondary regulations and their effective implementation. The national Competition Council needs further institutional consolidation and support, while judges – higher degree of specialization and more training to enforce competition.
- State-owned companies play an important role in diverting public money from the economic sector into the political parties' coffers. A radical reform of the state-owned companies' management is needed in order to close the opportunities for corruption and crony arrangements. The reform should be based on two key assumptions: 1) a state-owned company needs to be privatized if there is a competitive market for its services and products and 2) managers of the state-owned companies

have to be well paid, especially if the state-owned company has a competitor in the private sector. They need also to be subjects of a higher public responsibility and scrutiny, to ensure that state assets and money are not tunnelled in private hands or off-shore. In this regard, the previous decision of the Government establishing severe wage limits for the SOE managers needs to be reviewed, while the financial and economic activity – more transparent. The companies' performances should be the only criteria for establishing the managers' remuneration.

- The new government supported by the Pro-European Coalition needs to regain the public confidence, which can be done in such a short period of time only through a higher level of transparency and inclusiveness in the policymaking. The legislative framework regulating the public participation (including the law regarding the freedom of information, law on transparency of the decision-making process) needs to be reassessed and those loopholes closed that allowed in the past decision-makers to avoid public consultations. This is especially the case of the Parliament, which has yet to deserve its name of supreme democratic forum.

## ■ Foreign Policy: Success Story versus Hard Reality

*This chapter deals with the Moldova's foreign policy in the period 2010-2013 from the angle of Moldova's economic and social development imperatives. It outlines the defining trends for this period, assesses the implications of existing foreign policy strategic options on the country's long-term development and makes a number of recommendations of how to establish closer links between the foreign policy and Moldova's development framework and imperatives.*

### Analysis of key developments and trends

The foreign policy's quality has improved significantly after 2009. In fact, it became the most successful policy sector of the country. The policy benefited of the outstanding professional skills of the minister and two deputy-ministers and of a new opening from the part of some external partners. However, the Ministry also served as attractor for many talented and promising graduates of the political departments. The foreign policy message was clearer, and lacked the traditional ambiguity of the Moldovan diplomacy, which was accustomed to speak one thing in Moscow, another one in Brussels and the third one in Chisinau. In fact, the Ministry of Foreign Affairs and European Integration is the main to 'blame' for the 'success story' case that Moldova produced. In 2012, the EU perceptions on Moldovan reforms were better than the domestic feelings. However, without domestic political support, the 'success story' eventually broke into an uncomfortable reality.

Under the two Alliances for European Integration, European integration was by far the dominant vector of the Moldovan foreign policy. On the one hand, this allowed Moldova to concentrate its diplomatic resources to nurture the image of the 'success story' of the Eastern Partnership. At some point in time, somewhere in mid-2012, Moldova was even credited with good chances to sign an Association Agreement with EU before Ukraine. On the other hand, Moldova missed to put in place a meaningful policy with another key actor shaping Moldova's development – the Russian Federation. Partly a symptom of the chilly relationship between Chisinau and Moscow, partly an outcome of Moldova's domestic political struggle, but Moldova did not have an ambassador to Russia for almost eight months after recalling the former ambassador Andrei Neguta in April 2012 for statements incompatible with his diplomatic statute and before appointing Andrei Galbur as new ambassador in December 2012.

In the recent three years, both Russia and EU increased their 'soft' presence in Moldova. EU is doing this mainly through the direct budgetary support offered to the Moldova government, while Russia – through NGOs, church and media. Russia has also used Transnistria to test Moldova's reaction to Russia's harder tools (the Varnitsa incident on 27 of April 2013). In fact, Moldova became a geopolitical battleground between Russia and EU; stakes of both parties rise as Moldova's prospects for signing the Association Agreement with EU improve. The core interests of the two actors also differ: while EU is interested in a sustainable reintegration of the country and its economic, social and political stabilization, Russia is interested in widening the divide between Chisinau and Tiraspol and in educating anti-European social attitudes in Moldova with the ultimate end of maintaining Moldova in its exclusive 'sphere of interests'.

In this regard, failing to understand that the world is much larger and diverse than the Russia – EU dichotomy would imply, has been a key weakness of the Moldovan foreign policy. As developed countries struggle to recover from the economic and financial crises, the international economic centres are shifting globally. China, India, South Africa, Brazil, Turkey and Qatar emerge as new global and regional economic and financial powers. Moldova was slow, so far, to follow these changes and to harness the investment and commercial interests of businesses from these countries. To put it as it is, Moldova has virtually no economic diplomacy and very little human resources understanding the business opportunities arising. While in late 2012 in the Southern Ukraine emissaries from Middle East countries were fervently looking for companies

able to enter long-term agreements to supply agricultural products and food-staples, not a single Moldovan official or firm showed interest to offer Moldova as potential source of imported food.

## **Wider implications and risks**

Pressures from Russia have built up in 2012-2013 for Chisinau to change the orientation of his external policy, from declared vector of European integration to the Russia-led integrationist projects, including the Russia-Belarus-Kazakhstan Customs Union (which is the first pillar of the to-be-created Eurasian Union). To achieve his goal, Russia has been using a diverse set of tools, including traditional and Internet media, church, leftist political parties, economic and security instruments. A key argument was the promise of reduction of the price for gas for Moldova and of increasing the volume of external trade of Moldova within the Customs Union. While these promises may sound very charming, there are many risks related to the change of external vector.

The most important risks relate to the fact that joining the Customs Union can trigger severe economic consequences, which are not fully understood by the Moldovan public. This economic shortsightedness explains the wide support that sociological polls reflect for Moldova joining this Union. A cure for this would be a better communication from the part of the Government regarding how the promoted foreign policy helps Moldova achieve its key objective, which is economic modernization and development. This modernization requires creating political conditions, which are conducive to:

- Growth of exports in all destinations, which is key precondition for the growth of households' income and formation of a middle-class, including in the rural areas;
- Adoption of new, modern, and efficient technologies, which are key for increasing labour productivity across the entire economy;
- Education of a business culture based on transparent and predictable rules and sound market institutions;

As these preconditions are of utmost importance for achieving the economic development imperative, it is necessary to assess how existing strategic options (further trade liberalization and economic integration with the EU versus joining the Customs Union) will help Moldova achieve this imperative. Table 2 highlights and compares the implications of the two foreign policy strategic options on the development objectives of the country.

Thus, joining the Customs Union may have some positive result on the trade with the Customs Union members, but this will also bring to an end Moldova's sovereignty in the area of trade policy. To join the Customs Union, Moldova will have to denounce its other free trade agreements (CEFTA, DCFTA, FTA with Turkey) and will have to abide to the common trade policy. This will immediately and negatively impact the trade with the countries covered by these trade agreements, but also the trade with other countries, because Moldova's foreign trade policy will transform from a liberally-oriented to a protectionist one. This will preclude the technological modernization of Moldovan economy and society, because, in result of adopting the CU customs tariffs (2.5 times higher than those in place in Moldova), the Western technologies will become more expensive against the Russian ones. The promised cheaper gas for Moldova may end up as another bluff, especially considering the fact that Russia, after becoming member of the WTO will have to gradually align its domestic tariffs to the external ones and there is no point for Russia to subsidize Moldova at expense of its domestic consumers.

In case of further economic and trade integration with the EU, Moldova keeps the freedom of defining its trade policy against other trade partners (obviously, in line with its WTO-membership commitments). This means, inter alia, that Moldova will have the freedom to negotiate an FTA with the Russia-Belarus-Kazakhstan Customs Union, or with any other country in the world. This is completely in line with Moldova's economic objectives and development imperatives. So far, the economic integration with EU already brought some really spectacular results: for instance, the EU-originating foreign direct investments into Moldovan economy helped the country to discover that it has strong competitive advantages in completely new

economic sectors, such as automotive parts and components. It also equally important for the long-term development of Moldova, which is poor in natural resources, to boast a business-friendly and encouraging investment climate. Coupled with better-trained human capital, a clean and predictable investment climate is extremely important for Moldova to progress not only economically, but also socially, and even democratically. The direct financial and technical support that EU offers to Moldova is a prerequisite for the country to depart from its oppressive business climate and to adopt one which is in line with expectations of the modern business culture.

**Table 2. Comparison of the implications of foreign policy options on Moldova’s development objectives**

<i>Objective</i>	<i>Customs Union</i>	<i>European Union</i>
Growth in exports	Joining the CU may result in a slight growth in Moldova’s trade with the CU members, but will cause trade reduction with other destinations. Exports to EU, will decline in result on EU abolishing all its trade preferences for Moldova and denunciation of the DCFTA, while imports from all other destinations are going to decline in result of higher customs tariffs adopted by the CU member.	Implementation of the DCFTA increases the trade of Moldova with EU but does not cause a trade diversion with other destinations. Moldova remains with the freedom of entering free trade agreements with any other country or regional integration structures, including the Russia-Belarus-Kazakhstan Customs Union.
Technological modernization	Import tariffs that Russia enforced on CU members are 2.5 times higher than Moldova currently has in place. Rising Moldova’s tariffs to the CU level will make less competitive the technologies originating from outside the CU, which will significantly slow down the economic modernization of Moldova. The promise of smaller price for the natural gas imported from Russia is not credible, as Russia is set to increase its own domestic prices and gradually adopt a more business-minded tariff policy.	Reduction in tariffs and non-tariff barriers for imports from EU will make EU technologies more competitive on the Moldovan market and will provide the support for technological upgrade across all economic sectors. While not offering any energy bonuses, the deeper economic integration with EU will attract FDI in modernization of the energy infrastructure and improve energy efficiency across economy and society. Integration with EU already led to emergence of completely new economic sectors, such as automotive components and parts.
Modern business culture, business environment and market institutions	Impact is uncertain, but in general, the CU countries are not among the world champions when it comes to modern business culture and sound market institutions.	DCFTA has a strong institutional component which will target consolidation of the basic market institutions in Moldova – fair and effective justice system, competition, property rights protection.

*Source: own assessments;*

## Policy recommendations

- Moldovan foreign policy needs to acquire a more dominant economic flavour. This requires diplomats which are economically better trained and with an excellent understanding of Moldova's business and investment opportunities. Cultivating these skills should start in relevant university programs and departments, but it should also encompass an on-the-job training program, which can benefit of financial and technical support offered by the European Union or by EU members individually.
- Even with diplomats well trained economically, a better collaboration between the Ministry of Foreign Affairs and European Integration and the economic policy authorities (especially Ministry of Economy), the business facilitation structures (such as Moldova Investment and Exports Promotion Organization, Moldovan Chamber of Trade and Industry) and with business associations. Such cooperation would result into a synergy of efforts and resources and will bring about higher outcomes than under currently weak cooperation.
- Moldovan foreign policy needs wider and more consistent domestic support. This means both support from the line ministries, but also wider social buy-in of the foreign policy objectives. One of the key weaknesses of the Moldovan pro-European policy is that it did not touch the minds and hearts of the Russian-speaking populations in Moldova, which remain mostly interested in Moldova reversing its foreign policy course. In this regard, a better communication strategy is required, with proper selection of messages, channels and communicators is necessary.

## ■ Interpretation of Poll Results: Did Moldova turn into a Hopeless Place?

*The following analysis describes the outcomes of a nationwide poll<sup>27</sup> held in 2013 and compares them with the sociological figures obtained in 2009 during the elaboration of the first edition of the State of Country Report. The comparative approach allows us to distinguish clearly the trends, which proliferated since 2009.*

### Poll Interpretation

Compared to the 2009 survey, in 2013 Moldovans became more pessimistic. There are many culprits that determined a clear worsening of citizens' perception about the current situation and the future prospects of Moldova's economic development: long-standing domestic political crisis, difficult economic conditions in Europe, the grown slowdown in Russia and slower-than-expected pace of domestic reforms.

Inevitably, the deepening of the political crisis, particularly in the beginning of 2013, has negatively marked the population opinion regarding the country's image abroad (Question E1). Therefore, the poll's results show a substantial drop among those who believe that Moldova is seen in a "rather positive" than negative way (from 29% in 2009 to 18% in 2013). A very negative perception can be encountered especially among respondents in 45-59 age category (the answer "very bad" - 17.6% by the age criteria). Similar results can be noticed at the following categories that answered "rather worse": people with diplomas of professional schools and of secondary educational institutions (43.9% by the education criteria), individual businessmen (40.1 % by the occupational criteria), the wealthiest category of the population with revenues higher than 3000 lei (41% in the category of revenues per household), and the inhabitants of small towns (53.3% in the category of place of residence).

Notwithstanding the fruitful foreign policy in relation with the EU and the constant support offered by the international partners and donors, a quite balanced and cautious though timid approach towards Russia, the populations is disappointed with the way Moldova promoted the national interests on the international arena (Question E2). Comparing with 2009, the number of content citizens has tremendously shrunk from 25% to 14% (respondents answering that Moldova pursued its interest at "a high level"), while the share of those who oppose to this has increased from 30% in 2009 to 44% in 2013. The most disappointed citizens belong to the category of Moldavians/Romanians, including the population with high revenues. The poor results unveiled here might be determined by the abundance of domestic political crisis overcoming the foreign policy's agenda, whereas the latter previously provided the governance with a large pool of supporters representing different social segments.

A deep erosion of social mood could be noticed when citizens were asked to assess Moldova as a place to live (E3). Although a positive mark is given by 40% of respondents (answer – "good"), in comparison with 2009 the share of negative answers has soared (answer "bad" - from 13% to 25% in 2013). The leading role in forming the current negative perception is held by the 18-29-years-old category (29% answering with "bad"). These figures are alarming taking into account the high level of migration at the expense of young people and the overall downfall of the rate of birth that brings about serious demographic challenges for the country. Also, it shows a decline of credibility among youngsters towards the actual governance, credited with high expectations in 2009.

The worsening of social mood has altered the feeling of pride (E4). The increasing share of regrets (answer - "rather regret") of being a Moldavian citizen characterizes the young age category (17.3% by age category) and the wealthier citizens (18.6% by revenues category). Hence, this situation implies a high probability of

<sup>27</sup> The sociological poll was developed as a component of the State of Country Report 2013. It was held nationwide by the sociological company "IMAS", within the period June 6 – July 8, 2013, on a sample of 1054 respondents from 74 localities. The poll is representative for the entire population, including for Transnistrian region, and has a margin of error of  $\pm 3\%$ .



migration of the young population, and the reluctance of the wealthier Moldovans to invest their savings in the domestic economy.

Additionally, the poll draws the attention to the loosening of the bond between state and citizens (E5), by increasingly claiming the inexistence of concepts/ideas that could attract the citizens around the state (answer “rather there is no such a goal or idea” – from 12% in 2009 to 24% in 2013). According to the poll of 2013, the biggest gap between state and citizens is claimed by poor segments of population (answer “rather there is no such a goal or idea” – 31.9% by the revenues category). That might be explained by a low level of their social integration and a lack of efficient inclusive social policies regarding the people in need.

Neither the constant contradictions at the decision-making level between the central authorities and those representing Gagauzia and Balti (which are regions known for an abundance of Russian speaking population and also gathering compact communities of ethnic minorities) nor Russia’s actions involving Russian speaking minorities has produced any serious damage to the interethnic relationship (E6). Nevertheless, the share of citizens that appreciate positively (with answer “very good”) the bonds between ethnic minorities has dropped from 17% (2009) to 8% (2013).

Although the first attempts towards reforming the educational system have already been done, the process of transformation of the educational institutions consists of dealing with systemic shortcomings, which cannot be eliminated in a short run. This inadequacy is precisely reflected in the findings of the present poll. Accordingly, the share of citizens considering that the education is important to ensure life achievements has significantly diminished in 2013 comparing with figures of 2009 (E7). Hence, 31% of citizens expressed their mistrust towards the importance of achieving education qualification in order to succeed afterwards (answer “to small extent” – 15% in 2009 versus 31% in 2013). These results confirm the reality in which the educational system fails to respond properly to the economy’s demand. In fact, it keeps on producing graduates with rather poor skills, who undertake jobs which differ from their educational specialization. Surprisingly, the negative perception about the education’s quality is spread among all age categories and is not formulated exclusively by those directly involved in the educational process, which underscores a general attitude utterly shared across the entire society.

Also, a pessimistic mood seems to grip the labour market and the expectations from the population to find a job (E8). By 10% has increased the percentage of citizens who believe that is “much more difficult” to get employed today (23% in 2009 and 33% in 2013). It points out the existence of a deficient economic environment, which consists of vicious business climate and scarce capital that hamper the economy from delivering jobs to the population.

The limited prospects about the country’s development can be deduced from the citizens’ opinion about the country’s capacity to face natural disasters (E9). Hence, the share of those who question the preparedness of the state institutions to deal with floods, draughts etc. constitutes 31% in 2013 (answer “it’s not ready at all”) compared to 15% in 2009. In fact, it implies serious uncertainties about the sustainability of country’s development, but also it shows a weak public confidence in the state that might also alter the support of the population for the public policies run in the process of current reforms.

Another area of public policies where the poll detected a dramatic downfall of confidence among population is the healthcare system (E10) while more than 1/4 of population suffers health problems (E23). Thus, the citizens led by young population (18-29-years-old) and persons close to the age of retirement and upper (45-59-years-old) consider that in case of disease they cannot count to any extent on the help from the state (answer “to no extent” – from 18% in 2009 to 39% in 2013). The latter added to the existent inefficiency in the healthcare public services reveals the adverse effects they can have on the human and labour capitals, without which the economic progress cannot take place.

The public confidence in banking system remained quite stable (E11). Though the European banks are still involved in solving the problem of ailing banks, their difficulties at home did not affect their activity in Moldova. Nevertheless, due to the sound raiding cases referring to particular Moldovan banks, the mistrust in banks among the wealthiest categories of the population has been emphasized (answer “no trust” – from

18% in 2009 to 22% in 2013). The deepening of this trend can have painful consequences for the economy, which is fueled by the remittances transferred via banking systems. Also, it can bring about the exodus of Moldovan depositors abroad as a result of damaged integrity of the domestic banks.

Low expectations among citizens were unveiled by the poll while describing the public perception towards local public administration (E12). The dropping of confidence can stem from the constant “politization” and polarization of the local administrations, especially intensified during the open political confrontations between the ruling parties since 2009 (answers “no confidence” and “not so much confidence” aggregated – from 32% in 2009 to 45% in 2013).

A significant area where a substantial downfall of indicators was detected is the perception about the citizen’s participation to the decision making process in their locality (E13). Hence, large share of citizens claimed that they can “rarely” influence the decision-making at the local level. It underlines a lack of responsibility from the politicians at the local level and the potential decreasing of public interest in public money management. Additionally, it means that the public finances cannot be channeled under the close scrutiny of the population, thus failing to achieve the needs requested by people.

Striking results were obtained while assessing the perception of the population about the participation in elections as a way to change the state of affairs in the country (E14). The downfall of the confidence in elections might derive from the anarchy of the ruling elites, fragility of the “check and balances” institutions in the state, and permanent political crisis with periodic deadlocks. Thus, the confidence in the institution of elections has dropped from 46% in 2009 to 28% in 2013 (aggregated results for answers – “surely yes” and “rather yes”). The misuse of power by the actual rulers and the episodic open conflicts for the influence over particular state institutions have generated a profound mistrust in the power of elections as a form of democratic exercise. The pessimistic mood can also be stemming from the absence of trustable alternatives when deciding to vote for one of the existing political parties.

Previously mentioned declining of trust in education and healthcare system has a more extended impact that implies all public policies coordinated by the state (E15). In this respect, a significant share of citizens disagrees with policies that the state implements because they miss to approach public interest (answers “rather are reflected” and “are not reflected at all” are aggregated – from 40% in 2009 to 72% in 2013). The individual businessmen are the category of population mostly claiming that the state’s policies are irrelevant for their interests (40% by the professional occupation criteria in 2013). It confirms the flaws of the domestic business environment, which in its turn hampers job creation and the ability of the Moldovan economy to tap its potential.

The political shift of 2009, with allegedly more democratic political forces, presumed a better protection of human rights. Notwithstanding the achievements reported by the international organizations and Moldova’s partners in the EU, the population has another point of view, which has changed slightly since 2009. Accordingly, about 47% (2013) of citizens consider that the majority of their rights are not respected in the society (E16). Unavoidably, this state of affairs does not allow for the creation of a friendly and safe community that ensures equal treatment both for local citizens and for different categories of foreigners settled in Moldova. Particularly, it concerns the immigrants, in case they would be attracted by the governmental programs aimed at replacing the massive number of emigrated Moldovans..

The latter issue is related to the trust in justice and its quality (E17). Hence, the poll shows a deteriorating of the perceptions in comparison with 2009 (answer “surely no” – from 10% in 2009 to 19% in 2013). Therefore, the doubts about the effectiveness of the justice pose the problem of security for the foreign investments causing reluctance regarding the existing conditions to set up and operate safely a business in Moldova.

Another sociological indicator that has worsened refers to the lack of confidence (answer “surely no” – from 9% in 2009 to about 20% in 2013) in the country as a secure place for the citizens and their families (E18). Though all categories of citizens evaluated rather positively the relationship between ethnic groups, a large share of people belonging to ethnic minorities has expressed fears about their personal security (44.9% by the nationality criteria, 2013).

Clear predisposition for emigration and later abandoning of the country by its citizens can be deduced from the perception about the bonds within Moldavian families (E19), which according to the present poll has been seriously damaged (answer “it is noticed a significant deterioration of the relations within family” - from 17% in 2009 to 27.4% in 2013).

Contrary to the previously mentioned negative indicators, the citizens think more positively about the conditions existing in the country for the young families (E20) in comparison with 2009. Although the share of negative answer has been reduced (answer “a little bit unfavorable” and “much more unfavorable” are aggregated – from 53% in 2009 to 45% in 2013), the share of people for whom the conditions remained the same considerably increased (from 22% in 2009 to 37% in 2013).

The present poll reveals that the majority of population perceives no change in terms of the amount of their revenues (56%) that became higher than in 2009 (47%) (E21). This disparity is explained by the systemic issues of the Moldovan economy, which is burdened by scarce investments, technologies and poor human capital. Notwithstanding that the figures show a slight rising of the share of people whose conditions of life have been lowered (E22).

Insignificant changes of indicators have been detected assessing the perception on environment and its transformation in the latest years (E25, E26). It underscores that the current economic constraints delay the penetration of technologies in areas linked to environment, which would allow improving the quality of the environment.

Since 2009 the perceptions about rural living conditions have suffered considerable changes by increasing the share of persons who believe that the situation remained unchanged (answer “the conditions didn’t change” – from 26% in 2009 to 38.6% in 2013). Moreover, the share of optimists has declined (answer “the conditions are worsening slower than in towns” from 19% in 2009 to 22.4% in 2013 versus answer “the conditions reach slowly the standards of towns” – from 34% in 2009 to 20.20% in 2013) (E26).

Notwithstanding that, the number of households benefiting from public services and goods has soared in 2013 comparing with 2009. The main breakthrough (assessed by answer “have the access without any restriction”) has been registered in the access to clean water (from 43% to 50%), natural gas supplying (40.10% to 46%), and electricity (from 76.4% to 80%) (E31). Additionally, the penetration of technologies has been extended, predominantly by higher share of computers’ acquisition and Internet connection (from 19% to 48%) (E32).

Even though, the citizens would prefer rather to move from their village to the urban zone (E27). Hence, the poor infrastructure and limited public services still constitute factors that fuel the internal migration from rural areas to urban ones.

Though large share of citizens prefers for their descendants another country than Moldova (E28), the current indicators have substantially changed from those presented in 2009 (answers “surely yes” and “rather yes” are aggregated – from 76% in 2009 to 55% in 2013). By posing the question pragmatically (E29), the citizens would choose rather to leave Moldova in order to work abroad (answers “surely yes” and “rather yes” - from 39% in 2009 to 45% in 2013). This tendency shows that people perceptions about the economic conditions did not advance significantly. Moreover, the existent mismatch of educational specializations of graduates with offered jobs in the country determines especially the young age population to look keenly for a job abroad (answer “surely yes” – 39.1% by the age category of 18-19-years-old, 2013).

Consequently, the emigration is considered to be an option to leave the country forever by people among all categories, but predominantly among youth (E30). Thus, the share of such category has significantly extended (answers “rather yes” and “surely yes” – from 23% in 2009 to 32% in 2013). That will continue to generate problems for the labour capital, posing risks for the economy and the demographic transition in Moldova.

## Conclusions

To sum up, we can emphasize that the provided findings show the existence of a rather “closed society”, where the citizens are deterred from participating in the decision making process and mistrust the elections’ contribution in transforming the society. Deficient trust in basic sectoral public policies, considered by the majority of population as useless and distant to them, creates a fragmented and weak relationship between state and its citizens. Big segments of the population are preoccupied by the issue of surviving rather than self-fulfillment, which stems from the underperforming economy with a vicious business environment, that generates a scarce human capital and withhold the country from the inclusive economic growth. Low expectations regarding the country’s potential are mirrored in the high interest for emigration, which has been thickened over the years since 2009. The sociological outcomes underscore that the state of nation is precarious and that urgent actions should be taken by the authorities to mitigate the effects of migration and demographic malformation, intervening primarily in education and realizing irreversible structural reforms. Moreover, public mistrust in elections as one of the key democratic institutions, coupled with worsening of living conditions and poor confidence in the key state institutions, traditionally fuels the electoral demand for extremist political powers. To prevent this, the reforms’ pace should be speeded up and population’s living standards – improved and public confidence in the democratic institutions strengthened. Failure to do so in the upcoming years creates a fertile ground for an authoritarian regime, which definitely will be a suboptimal outcome for the entire nation.

## ■ Annex: Questions addressed during the poll

Questions	
E1	How do you evaluate the country's image abroad?
E2	Do you think that the country manages to promote its interests on the international arena?
E3	Generally, how do you assess Moldova as a place to live?
E4	What are your feelings as a Moldovan citizen?
E5	Certain Moldovan citizens believe that there is no goal or idea related to the national development around which would gather citizens
E6	How do you assess the relationship between people of different nationalities living in Moldova?
E7	Talking about our society, how do you think to what extent are important studies (education) to ensure life achievements?
E8	Compared to the last year's situation, today is easier or more difficult to find a well-paid job in Moldova?
E9	How do you assess the capacity of the country to face natural disasters (for example, draughts, floods, massive fires)?
E10	In case you or your relatives will encounter a problem (disease, lost of the job, natural disasters) would you count on any help from the state?
E11	How much do you trust in banking system of our country?
E12	How much do you trust the local public administration in your locality?
E13	Do you believe that citizens, directly or by initiative groups, are able to influence the decision-making in your locality?
E14	Do you believe that by participation in elections you can influence on the situation in the country in a favorable way for you?
E15	To what extend do you agree that public policies run by the state correspond with your interests?
E16	Generally, do you think your rights are respected in our society?
E17	In case your rights would be infringed, do you believe that the justice would help you to regain them back?
E18	Do you believe that in our country it is ensured your personal security and the security of your family?
E19	Compared to the situation of 10 years ago, how do you assess the bonds within Moldovan families?
E20	Imagine the young families and their decision to have children. In this respect, how do you assess their conditions in comparison those from the last year?
E21	How did change your life conditions during this year?
E22	Compared to the last year's situation, how did change your revenues?
E23	How do you assess your health?
E24	How much do you like the environmental conditions?
E25	How do you assess the environmental conditions, during the last 3 years ?
E26	How do you assess the evolvement of the life quality in the rural area?
E27	(Only for those from rural area) In case you would have the opportunity will you move to the urban area?
E28	Do you want your children or nephews to live in Moldova?
E29	In case you would obtain the possibility to work abroad in the upcoming 3 months, would you choose to emigrate?
E30	In case you would have the opportunity leave forever Moldova, together with your family, and to begin a new life, what would you decide?
E31	What describe better the situation in your household concerning the following utilities and public services?
E32	Which are the workable technological products that you possess in your household?
E33	How many TV channels do you receive?

## ■ About EXPERT-GRUP

### WHO WE ARE

Expert-Grup is a Moldovan non-governmental and not-for-profit organization specialized in economic and policy research. Expert-Grup does not represent any economic, corporate or political interests. As independent organization, Expert-Grup reflects the ideals of the young Moldovan intellectuals who have created the institution with the purpose of contributing to Moldova's development. Among other types of organizations in the Moldovan civil society, Expert-Grup positions itself as a politically and ideologically neutral think-tank.

### OUR ACTIVITIES

Our core activity is economic analysis, forecast and policy research. In this area, we offer a wide range of analytical products and services helping our beneficiaries to take decisions supporting the development path of Moldova. Our key competence lies in the ability to provide professional, high-quality and objective research in such broad fields as:

- Macroeconomic analysis and forecast;
- Political economy;
- Public finance;
- Human development and poverty reduction;
- Labor market and consumers' behavior;
- Foreign trade;
- Financial markets;
- Economics of European integration;
- Sector-level economic analysis;
- Regional and local economic development;
- Energy and environmental economics.

### PARTNERS AND DONORS

In the period 2006-2012 the Expert-Grup has implemented more than 50 research and advocacy projects in different areas related to economic and policy research. More than 100 associated and non-associated experts from Moldova and other countries were involved in these projects. We have worked with such donors as Moldova Soros Foundation, Eastern European Foundation, Konrad Adenauer Stiftung, Balkan Trust for Democracy, Black Sea Trust, Friedrich Ebert Stiftung, UNDP Moldova, UNICEF, European Commission, Council of Europe, Open Society Foundation, Swiss Agency for International Cooperation, United Kingdom Department for International Development. In 2010 and 2012 the Expert-Grup was elected member of the National Participatory Council of Moldova. Since 2008 the Expert-Grup is member of the Policy Association for an Open Society – a network of policy centers uniting 56 think tanks from countries across Europe.

## ■ About FES

Friedrich-Ebert-Stiftung (FES) is a German political social-democratic foundation which aims at promoting democracy, peace, international understanding and cooperation. FES fulfils its mandate in the spirit of social democracy and devotes itself to public debates finding social-democratic solutions to current and future issues of the society.

## **FES IN MOLDOVA**

In the Republic of Moldova, FES aims at fostering European integration, democracy, peace and social justice through political dialogue, education and research. Our main areas of activity are the following:

### **DEMOCRATIZATION AND POLITICAL PARTICIPATION**

Moldova faces the challenge of consolidating its democratic institutions and developing a democratic culture that brings the country fully in line with standards of the European Union. FES contributes to this process by promoting political participation in civil society organizations, political parties and local self-governing bodies. A particular focus of FES activities in this area is on empowering citizens in the regions. Citizens need to be empowered to be able to critically follow public debate, monitor political stakeholders, articulate their views, and act on behalf of their interests. Therefore FES has engaged activities to promote participatory democracy and an enhanced citizens' civic and political culture on the local level.

### **EUROPEAN INTEGRATION**

Moldova is part of the European Neighbourhood Policy and the Eastern Partnership. FES supports the European Integration Process of the country. Through a series of instruments such as radio debates, news bulletins, policy papers, publications and conferences FES focuses on the main challenges related to the European Integration process, facilitating the access of the public to up-to-date and reliable information on the topic, improving the dialogue between the civil society and decision makers on the requirements for successful European Integration, and contributing to strengthening the European integration efforts of Moldovan authorities. Additionally, FES supports non-governmental organizations in contributing to a peaceful resolution of the Transnistrian conflict as a prerequisite for successful European Integration in the long-run.

### **ECONOMIC, SOCIAL AND ENVIRONMENTAL POLICY**

In this area the FES supports its partners in developing and implementing policies for a functioning market economy which is sustainable, socially balanced and able to address the needs of all citizens. Input and projects in the area focus on topics such as reforming social security systems, improving working conditions and labour market opportunities and fostering sustainable development. Additionally, FES runs programs which aim at promoting Social Democratic values.