



MOBILISING EUROPEAN RESEARCH  
FOR DEVELOPMENT POLICIES



EUROPEAN REPORT  
ON **DEVELOPMENT**



# European Report on Development 2014

Financing and other means of implementation in the post-  
2015 context

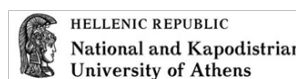
## Moldova Country Illustration

### Report

Prepared by:

**European Business Association Moldova**  
Olesea Ghedrovici

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## **Acknowledgements**

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## **ABBREVIATIONS**

**DCFTA – Deep and Comprehensive Free Trade Area**

**ERD – European Report on Development**

**EU – European Union**

**EUMAP – EU-Moldova Action Plan**

**FDI – Foreign Direct Investments**

**GNI – Gross National Income**

**GDP – Gross Domestic Products**

**MDL – Moldovan Lei (National Currency of Moldova)**

**NGO – Non-governmental organization**

**ODA – Official Development Assistance**

**ODI – Overseas Development Institute (UK)**

**OECD – Organization for Economic Co-operation and Development**

**PCA – Partnership and Cooperation Agreement**

**REM – remittances (only for the purpose of this paper)**

**SDT's – Social and Development Transformations**

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## 1. Introduction

Moldova Country Illustration has been developed as part of study for the European Report on Development 2014 (ERD 2014) on “Financing and other means of implementation in the post-2015 context”. ERD 2014 is aimed to answer on its main research question about how finance can contribute better to a post-2015 agenda by its effective mobilization and distribution.

The Republic of Moldova, a small country in the Eastern part of Europe is included in the European Report on Development 2014 because it is a challenging case from many points of view. Moldova was named a “success story”<sup>1</sup> of the EU principles promotion and it is a true leader of the Eastern Partnership initiative of the EU. When the ERD started, Moldova’s future was more unclear than it is now, at the end of June 2014. Rapid political, economic, geo-political and other changes lie mostly within the Moldovan way to Europe. On June, 27<sup>th</sup> 2014 Moldova signed the EU-Moldova Association Agreement. Many experts, but also simple people consider this event “the beginning of a great journey”. Despite the fact that Moldovan society is very polarized (about half of the population agree with the EU direction of development and another half is for stronger collaboration with Russia<sup>2</sup>), the political elite, the Parliament majority is strongly pro-European and signing the Agreement means the country chose its direction for development.

There is, however, much work to do in order to become a real European family member. Moldova is the poorest country in Europe. There are major problems with justice, education reforms and others. However, by sharing European values and principles, Moldova has an unique chance to grow.

The fact that Moldova was included in the ERD 2014, the report dedicated to financing and other means of implementation in the post-2015 context is an another opportunity to discover the country for those who did not do it before, it is an opportunity to rethink the way financing is distributed and accumulated in order to make it more efficient, it is an opportunity to understand the trends and processes from inside.

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<sup>1</sup> <http://www.moldova.org/eu-official-moldova-is-a-success-story-233320-eng/>

<sup>2</sup> <http://unimedia.info/stiri/sondaj-tot-mai-multi-moldoveni-vor-in-uniunea-vamala-euroasiatica-72117.html>

The methodology of the Report is based on preliminary discussions, which took place in Dhaka in February 2014 and May 2014 in Chisinau and followed agreement with the ERD team from ODI and other connected institutions. According to it, some enablers were identified, which contributed to certain transformation in each of the ERD 2014 countries. Economic transformation will involve a shift from low to high productivity, with a focus on infrastructure development, employment creation and trade. Social transformation is a shift from high to low inequality, with a focus on the creation of decent work, access to energy and social protection. Environmental transformation means a shift from high to low carbon energy systems, and the preservation of biodiversity.

The paper Moldova Country Illustration is based on descriptive approach with analysis of data from the National Bureau of Statistics of Moldova, the World Bank and other organizations.

The remainder of the paper consists of 4 sections:

2. Transformation in the Republic of Moldova, describing social, environmental and economic transformation, the enablers.
3. Role Finance Options, focusing on the main type of finance options for the country.
4. The Role of Complementary Policies.
5. Future prospects and conclusions.

The selected bibliography sources are proposed at the end of the paper and in the footnotes.

## **2. Transformation in the Republic of Moldova**

### **2.1. Country context**

The Republic of Moldova has a small (comparing to other neighbouring or main partners countries) economy with a significant role of agriculture and remittances. Economic performance during the last decades was relatively stable and despite significant internal political disturbances and external conditions (economic crises) it contributed to overall socio-economic stability. Some graphs below and comments will provide details about 2000-2012 period. In 2013 the GDP growth was 8.9% according to the latest data. However, some



experts consider that this fact is disturbing and negative (Lupusor, 2014)<sup>3</sup>, because is based on national currency depreciation and revival of agriculture (very badly affected last year). The main industries and exports decreased in 2014.

Economic and social transformations, however, are very interrelated. It is hard to imagine strong social improvements without a competitive economic basis. At the same time, sometimes social transformations are more convincing due to external support. The main problem in this case is how much sustainability these transformations provide and if these approaches worth to be continued.

## **2.2. Transformation**

### **2.2.1. Economic transformation**

The majority of experts and international organizations consider economic transformations in modern Moldova as positive and strong.

“Moldova’s economic performance over the last years has been relatively strong, aided by improved economic management, particularly in what regards fiscal, monetary and exchange rate policy. The existing macroeconomic framework in considered adequate...”<sup>4</sup>.

However, Moldova is still the poorest country in Europe; it has a small domestic market with limited competition, driven by high corruption.

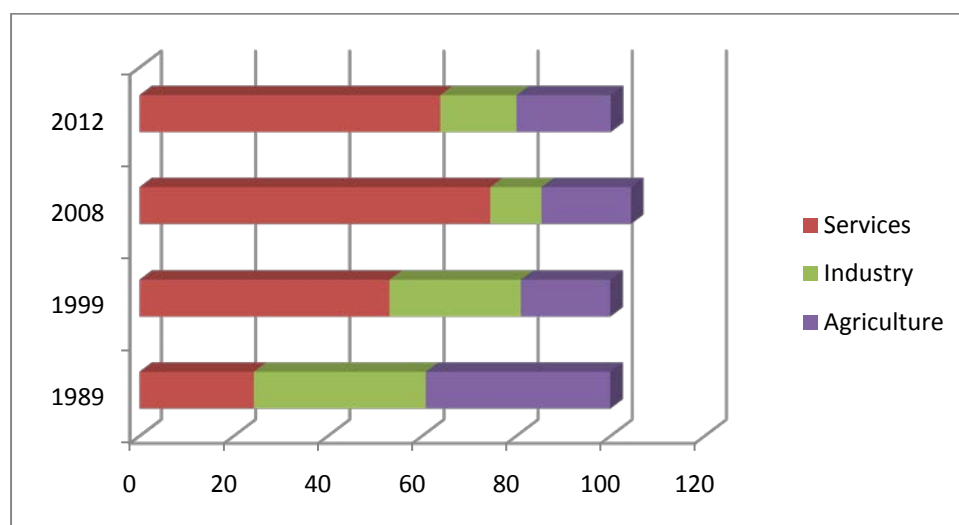
The country is very dependent on agriculture, however, during the last decades the dependence has reduced and services are playing a more convincing role in the GDP (figure 1.)

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<sup>3</sup> <http://agora.md/stiri/422/expert-cresterea-economica-a-moldovei-cu-8-9-ar-trebui-sa-ne-ingrijoreze>

<sup>4</sup> World Bank, Moldova Overview, [www.worldbank.org](http://www.worldbank.org)

Figure 1. GDP by sector in different years (% of GDP)



Source: NBS data

Thus, agriculture accounted about 40% of the country's GDP in 1989 and in 2012 the contribution of agriculture reduced to about 10%. However, about  $\frac{1}{4}$  of the working population is employed in agriculture, and, so, this sector is still important for national economy.

Despite some important progresses in economic indicators (export growth, stabilization of inflation etc.), the GDP growth rates are not very impressive and unemployment is still a challenge for the local government (table 1).

Table 1. Selected macroeconomic indicators for Moldova, 2000-2012

Indicators	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
<b>Overall economic performance</b>													
GDP growth, annual %, comparing to previous year	102,1	106,1	107,8	106,6	107,4	107,5	104,8	103	107,8	94	107,1	106,8	99,3
Per capita GDP, USD	354	407	458	548	720	831	950	1230	1695	1525	1631	1970	2038
GDP per capita	2,3	6.33	8,04	6,9	7.67	7.76	5,07	3.30	7,97	-5,87	7.20	6.48	-0.79

growth, annual													
Export, mil. USD	471,5	565,5	643,4	789,9	985,2	1090,9	1050,4	1340,0	1591,1	1282,9	1541,5	2216,8	2161,9
Inflation, CPI, annual average	131,2	109,6	105,2	111,6	112,4	111,9	112,7	112,3	112,7	100	107,4	107,6	104,6
Unemployment rate	8,5	7,3	6,8	7,9	8,1	7,3	7,4	5,1	4	6,4	7,4	6,7	5,6
<b>Balance of payment indicators</b>													
Import of goods and services, % of GDP	75	73,5,4	77,9	87,2	82	91,6	91,9	97,3	93,6	73,5	78,5	85,2	84,2
Export of good and services, % to GDP	49,7	49,8	52,7	53,4	50,7	51,1	45,2	47,4	40,8	36,8	39,2	44,9	43,6
<b>Sources of demand, structure of GDP by final users</b>													
Final consumption	103,1	101,1	103,3	110,3	103,9	109,9	113,9	113,5	113,6	113,5	115,8	116,7	116,8
Net exports	-27	-24,3	-24,9	-33,5	-30,3	-40,7	-46,6	-51,6	-52,8	-36,6	-39,3	-40,9	-40,5
<b>Sector contribution to GDP</b>													
Industry VA, % to GDP	21,7	24	23,2	24,5	17,3	16,3	15,6	14,8	14,3	13	13,1	16,8	16,8
Services VA, % to GDP	49,2	49,9	52,7	53,9	62,2	64,1	67	73,1	74,9	76,8	72,4	68,4	70,1

Source: National Bureau of Statistics, [www.statistica.md](http://www.statistica.md)

The overall economic performance is relatively acceptable with stabilization of inflation and unemployment during the last years, GDP growth (year 2009 is an exception due to effects of crisis) and per capital GDP (in USD) doubling in the last 5-6 years.

However, the growth is primarily “sponsored” by import contribution to GDP, which is twice bigger than export contribution, determining significant trade deficit. The growth is consumption-driven, financed by remittances and other external flows.

It is well known that statistical data are very subjective in terms of interpretations. Depending on point of view and indicators selected, different conclusions can be made. However, in our opinion, the following indicators are also relevant for some directions of thinking and further analysis (table 2):

*Table 2. Additional selected economic indicators for Moldova, 2000-2011*

Indicator	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Comments
Share of investments in the transportation sector in total public investments	13,7	12	16	15,7	12,3	8,2	19,5	6,6	17,6	7,2	16,4	10,7	Very oscillating in various years, however, practically unchanged in average
Share of foreign companies and joint ventures turnover on the local business environment	...	25,8	25,4	25,1	26,5	28,2	27,9	27,7	26,6	28,1	28,8	29,5	Almost unchanged

Source: National Bureau of Statistics, [www.statistica.md](http://www.statistica.md)

The table is shaping the following conclusions:

- Investments in infrastructure did not play important role in social or economic transformations. The share of investment in transportations is not correlated with other social or economic indicators, which registered positive changes and growth during the last years unlike investments for infrastructure, very oscillating in the respective period.
- Foreign capital is not very important for economic transformations. The share of foreign companies in local business environment is not correlated with growth or other economic indicators (see data and pictures below).

In order to make the analysis more extensive, it is proposed to observe economic transformations in comparison with neighbouring countries – Romania and Ukraine. The picture below shows GDP annual growth (%).

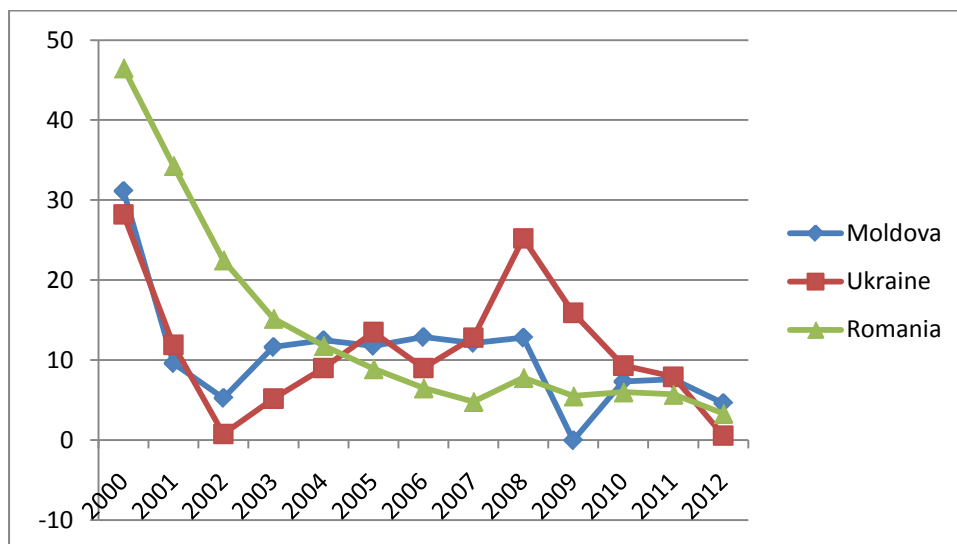
Figure 2. GDP annual growth, % in Romania, Ukraine and Moldova, 2000-2011



Source: World Development Indicators

The next pictures compares inflation rates for the same countries.

Figure 3. Inflation, consumer prices, annual, % in Romania, Ukraine and Moldova, 2000-2012



Source: World Development Indicators

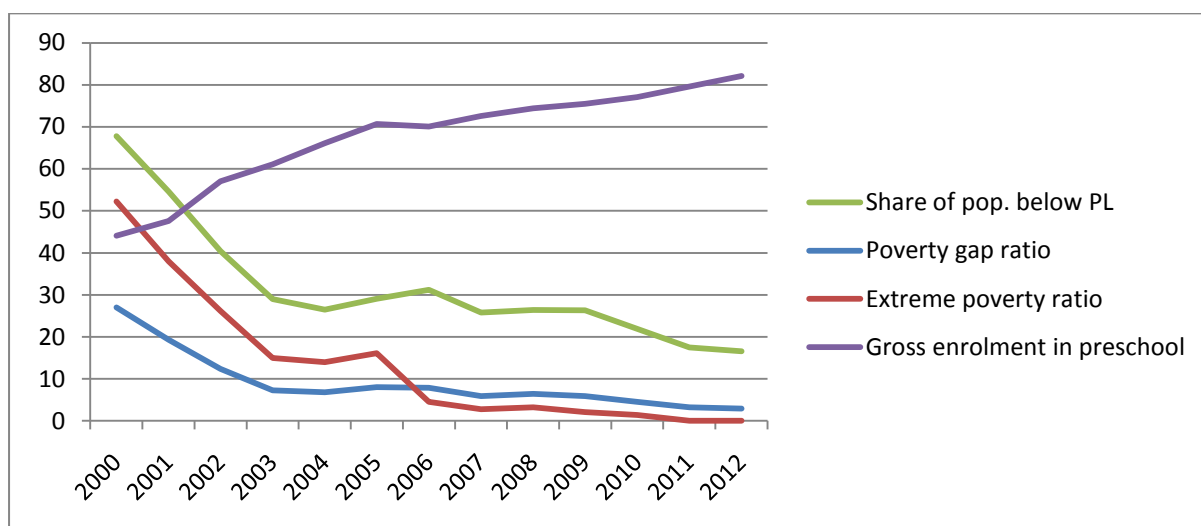
Both pictures (2 and 3) demonstrate that important economic development indicators in Moldova have followed similar to the rest of the region trends. There were no dramatic

successes and failures in policies, which could, for example, diminish inflation or facilitate GDP growth. Thus, economic transformations can be considered not really outstanding or substantially different from other neighbouring countries.

### 2.2.2. Social transformation

Social transformations were the most significant during the last decades. The picture below shows changes in the most important social development indicators – share of population below the poverty line, poverty gap ration, extreme poverty ration and gross enrolment in preschool institutions.

Figure 4. Selected social development indicators (%) in 2000-2012\*

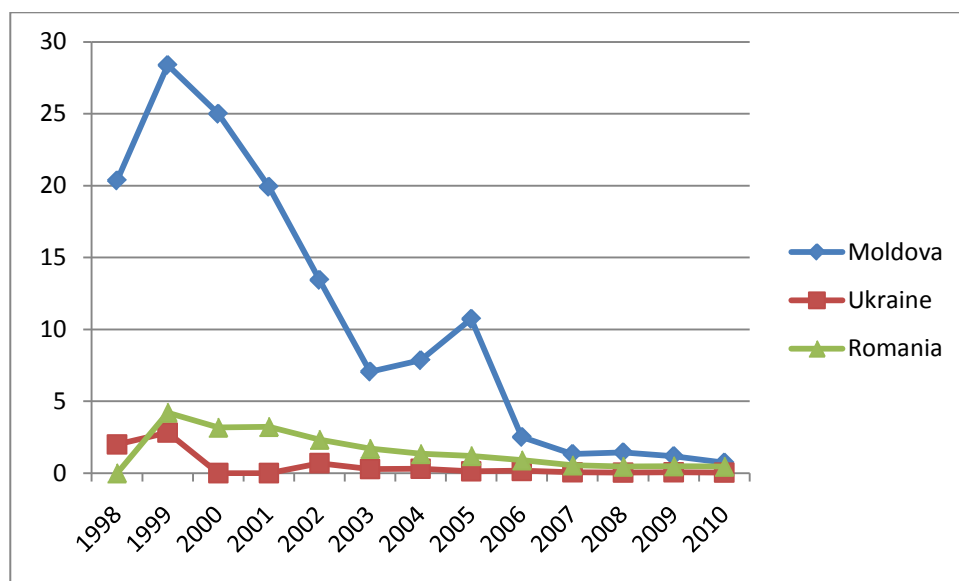


Source: developed by the author from the National Bureau of Statistics data

It is visible that all these indicators have a positive trend. Share of population below poverty line, poverty gap ration and extreme poverty ration decreased. At the same time, preschool enrolment significantly grew up, almost doubled in 2012 comparing to 2000. The literacy rate is about 98% of total adults.

When examining social transformations in neighbouring countries, the following results may be observed, figure 5.

Figure 5. Poverty gap, 2\$ a day, PPP, % in Moldova, Romania and Ukraine, 1998-2010



Source: World Development Indicators

Moldova made a tremendous jump in comparison with Romania and Ukraine, by reducing poverty gap from almost 30% in 1999 to less than 3 % in 2010.

Other social development indicators also registered favourable tendencies. Poverty headcount ratio at 1.25 \$ /day significantly went down. Inequality became less widespread.

Table 3. Selected social development indicators for Moldova, 2001-2012

Indicator	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Poverty headcount ratio(% of population)				27	29	30	26	27	27	23	18	17
GINI index			38,59	36,57	35,55	35,95	36,28	36,13	35,27	35,3	34,02	33,03
Life expectancy at birth, years	67,1	67,3	67,5	67,7	67,8	67,9	68,1	68,2	68,3	68,4	68,5	68,6
Mortality rate, per 1000 live births	12,7	12,1	11,6	11,1	10,7	10,4	10	9,7	9,3	9,1	8,8	8,6
Income share held			45,7	44	43,4	43,6	43,7	43,4	42,7	42,9	41,5	41,1

by the highest 20%												
Income share held by highest 10%			30,6	28,3	28,4	28,6	28,5	27,9	27,4	27,7	25,7	25,9
Income share held by lowest 10%			2,81	2,85	3,22	3,05	2,9	2,84	2,94	3,01	3,05	3,3
Income share held by lowest 20%			6,7	6,8	7,5	7,2	7,0	6,9	7,1	7,2	7,2	7,8

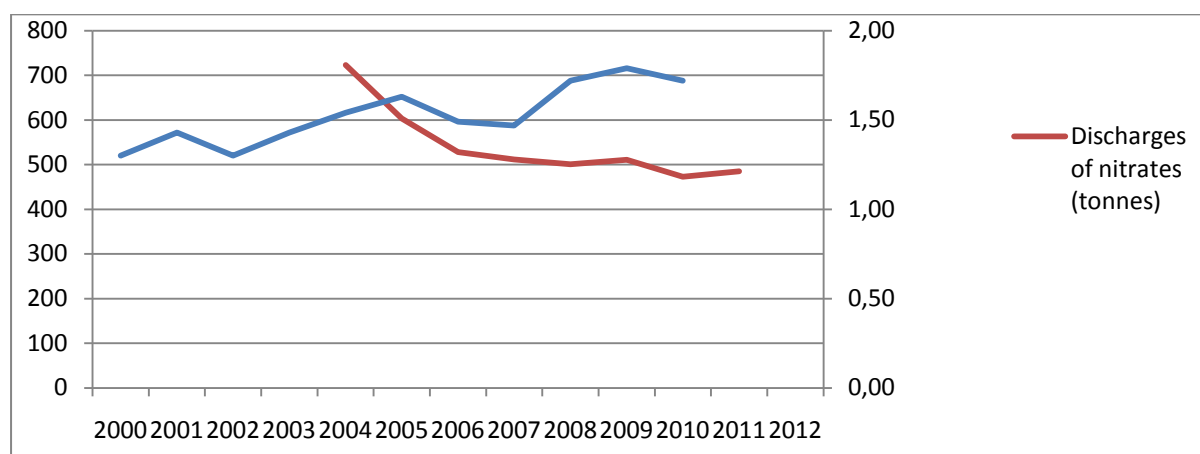
Source: World Bank data

### 2.2.3. Environmental transformation

There are very poor national or international data about environmental transformations in Moldova. This fact can be explained by a lack of serious attitude and understanding of importance of environmental issues. The culture of thinking about environment is not specific for policy and governmental agenda. Environmental transformations are not stable, well-targeted and promoted.

The picture below demonstrates situation with carbon dioxide emissions and discharges of nitrates in water wastes.

*Figure 6. Carbon dioxide emissions (tonnes per capita) and discharges of nitrates in water wastes in Moldova, 2000-2012*



Source: developed by author from the National Bureau of Statistics data



In this case, the trends are opposite. The situation with carbon dioxide emissions is alarming, at the same time, discharges of some pollutants (nitrates) decreased during the last years.

Other suggested indicators are presented in the table below; some are not available, confirming the statement above about the attitude towards the problem.

*Table 4. Selected environmental indicators for Moldova, 2001-2012*

Indicator	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Electricity production from renewable sources as % of total	Data not available from WDI											
GDP per unit of energy use (PPP GDP per kilogram of oil equivalent)		1,9	2,06	2,06	2,2	2,4	2,6	2,9	3,16	3,18	3,19	3,56
Forest area as % of land area	9,8	10	10,3	10,6	10,8	11	11,1	11,3	11,5	11,6	11,7	11,8
Improved water course (% of population with access)					94,4	Data missing				95,5	Data missing	96,5
Access to electricity	Data not available from WDI											

Source: World Bank data

In conclusion, it is observed that Moldova's development is characterized by positive transformations both in economic and social spheres; however, social transformations are more visible and relevant. Social transformations are significant at a national level, and, comparing with neighbouring countries, Moldova's results also appear significant and important.

Usually, economic growth and transformation represent the major sources of social welfare, however, in the case of Moldova we may observe that social changes are moving faster than

economic improvements. The conclusion in this regard relies on the fact that social transformations are not driven by economic growth and positive trends in economy, but by other external catalysers. We anticipate that ODA played an extremely important role in combating social problems and difficulties in Moldova (described more in the next paragraph). Money directly spent for various social programs and support contributed enormously to the development of basic social indicators. However, the logical concern in this case is related to the sustainability of this approach. Donors were giving directly the “fish”, not the “rod”. When the fish will not be available, people will remain hungry, because they are not able to produce, to contribute to growth.

Social transformation will be taken as basis for further analysis, because they are more significant in comparison with economic changes, although, these social transformations in the long-term perspective should be based on economic development, otherwise, the risk of social decline remains very high.

### **2.3. The main enablers of transformation**

Social transformation in Moldova has been driven by various enablers. The most important enablers will be briefly described in this section.

#### *i) Infrastructure*

Infrastructure played an important role in both social and economic changes. Improvement of the road chain and development and improvement of energy sector not only made Moldova more attractive for investments, but also contributed to better access of population to medical, educational and other services.

For Moldovan infrastructure development the following issues are important:

1. To make the use of energy more efficient.
2. Authorities have to develop and apply EU compatible legislation in the area of energy and its efficiency.
3. To improve the city’s environmental infrastructure.

The shift of the governmental spending from direct support of social needs of population to development of infrastructure, aimed to bring resources indirectly by business projects and investments became an important factor of infrastructural growth.

Foreign support via ODA was and is very important. ODA support covers institutional development and technical assistance. The World Bank is the largest donor in the energy sector. The EBRD, which has mainly been active in electricity supply and water, has now increased its involvement in the area of energy efficiency. If the EBRD Moldovan Sustainable Energy Financing Facility (MoSEFF) produces good results, further support should be possible. The EU is providing sector budget support to the energy sector starting in 2011. Cooperation should also be sought with international financial institutions such as NEFCO and EBRD for feasibility studies, capacity building and investment support. This collaborations would bring broader changes, including water and sewerage, energy (NEFCO projects) or consultancy in these areas (NEFCO's and EBRD's projects). Private finance via remittances also contributed to infrastructure development. PARE 1+1 program sponsored projects for businesses related to water supply, production of ecological fuel etc.

Necessity to develop and increase export contributed to infrastructure development via request of solutions from Moldovan authorities, which are interested to increase exports. Primarily, we can mention here the creation of free economic zones in Moldova. Free economic zones (FEZ) of Moldova is an exceptional project that has no analogues in Europe and Asia, neither in terms of the amount of tax and customs benefits, nor with regard to the extent of state guarantees offered to residents. Currently 7 FEZ located in all regions are operating in Moldova .

Free economic zones and areas with similar status in Moldova are:

- "Expo-Business-Chisinau"
- "Ungheni-Business"
- "Tvardita"
- "Otaci-Business"
- "Valkaneş"
- "Taraclia"
- "Balti"
- Free International Port Giurgiulesti
- Free International Airport "Marculesti"

According to the report developed by the Ministry of Economy, on July 1st 2012, there were 166 residents in the free zones, 60 of them are within the "Expo-Business-Chisinau" zone and 37 in "Ungheni-Business" zone. At the end of the reporting period, the number of employed residents in the free zones was 6035 individuals.

According to Law no. 440 from 27.07.2001 free economic zones (free business zones), are part of the customs territory of the Republic of Moldova, economically separate, with a delimited area, where the local and foreign investors are preferentially allowed , types of entrepreneurial activity in line with the law.

Benefits of locating in FEZ are:

- Investment protection by the State,
- The legal status of the Free Economic Zone is regulated and can be changed only by a Law of Parliament,
- Ability to transfer the profits abroad,
- Preferential treatment aimed at stimulating economic activity,
- Impossibility of expropriation, nationalization, seizure and confiscation other than by a court decision
- Ensuring legal provisions over the next 10 years since registration as a resident of FEZ
- Free movement of goods (services) located within the FEZ
- The possibility of transmission of goods (services) from a resident to another resident within FEZ only with the bill of lading, without a customs declaration.
- preferential customs treatment (customs post is located in the Free Economic Zone)
- Preferential duties

Tax Advantages:

- 50% exemption of the tax rate in RM for income from export of goods (services) originating from the FEZ outside the country
- Exemption of 25% from the tax rate set in RM for income obtained from other activities than export of goods (services)

- Total exemption during 3 years from the tax on income from exports of goods (services) originating from the FEZ outside the country as a result of investment in the free zone of at least one million dollars
- Exemption for 5 years from the total tax on income from exports of goods (services) originating from the FEZ outside the country as a result of investment in the free zone of at least five million dollars
- VAT does not apply to goods (services) delivered within free zones
- Zero rate VAT for goods (services) delivered in the free zone outside the Republic of Moldova, goods (services) delivered from the free area outside the Republic of Moldova, goods (services) delivered from the free zone from the rest of Moldova, goods (services) delivered by residents of different free areas of the Republic of Moldova to each other
- Exemption from excise duty on goods brought into the free zone outside Moldova, the other free zones from the rest of Moldova, as well as goods originating in the region and exported from the Republic of Moldova
- Goods delivered within the free zone and deliveries of goods from a free zone to another are not subject to excise.

It is important to mention that average salary within free economic zones is about 60% higher than in the rest of entities.

Therefore, infrastructural changes are significant in Moldova in recent years. There is no doubt that these changes contributed both to economic and social development.

#### *ii) Institutional development*

Institutions and their inefficiency, inherited from the former Soviet Union centralized system significantly contributed to stagnations and efficient reforms, economic and social development. Despite large institutional reforms announced after declaration of independence of Moldova, many qualitative changes remained indicated only on a paper. Lack of sufficient resources, low level of salaries did not permit to perform real transformation in institutional paradigm for a long time.

Political situation in the country during the last years, more prominent shift towards European values, created conditions for attraction of massive support from donors for institutional development.

There have been implemented some important programs, supported by foreign donors in order to improve institutions in Moldova. The UNDP launched the Joint Integrated Local Development Programme (JILDP) for the implementation of the decentralisation reform, which promotes local government autonomy and ensures that all people, particularly the most vulnerable, have access to quality public services. The main goals of the project are:

1. Improve the legal and policy framework to ensure local government autonomy, availability and more efficient management of local resources;
2. Build the capacity of the local public administration to provide efficient and accessible public services while ensuring sustainable development and social inclusion.

Another project aims to strengthen the institutional capacity of the Ministry of Foreign Affairs and European Integration (MFAEI) in the process of achieving its European Integration goals and commitments. It has a goal to build institutional capacity of MFAEI as part of the public administration reform process; develop capacities of MFAEI and the Negotiation Team (comprising of representatives from different Moldovan public institutions) for European Integration, with immediate focus on negotiating the Association Agreement between the European Union and the Republic of Moldova and implicitly its implementation, strengthen political and operational capacity to increase the impact of Moldova's participation in regional cooperation processes on its social and economic development.

The World Bank also supported initiatives to promote institutional efficiency. In June 2014 it was organized the workshop for collaboration between Agency for Public Acquisitions and other organizations in order create capacities for fruitful collaboration. The World Bank supported programs for the Ministry of Education, Fiscal Service, and Ministry of Finance (accounting reform).

Thus, the role of foreign assistance in development of Moldovan state institutions is important. Development of these institutions contributes to better quality of services provided, information offered and, of course, improves the economic climate in the country.

Other factors, such as private finance resources also cannot be omitted. The role of remittances in institutional development in Moldova is mostly visible through PARE 1+1 program. This is the first program, offered by Moldovan Government to support migrants financially by helping them to create proper businesses. It was a real challenge for the Government to launch such a program. However, the results are quite significant (see above). In terms of development of capacity of the state institution to communicate with people, to create good conditions for business, this indirect impact is valuable.

### *iii) Global Linkages*

As it has been mentioned before, Moldova made a great jump in its foreign relations, policy and general framework in 2014. In April, Moldovan citizens get the right to travel to the EU without visa, in June the EU-Moldova Association Agreement was signed.

There is a widely spread opinion that this gigantic steps were accepted by EU officials also because complicated situation in Ukraine. Thus, bad conditions at Moldovan neighbours and willingness of Europe to protect Moldova from same negative influences from the East, contributed to faster approximation.

Foreign support from donors influenced these linkages via all previously described factors and enablers, as strengthening institutions, developing infrastructure and skills are necessary conditions for being a good equal partner for the EU and the whole world. At the same time, these global linkages also will have a reverse impact. From one side, Moldova will get more assistance in order to attain the level of EU association partner. At the same time, control on aid efficiency should become more intensive and the aid will be directed on sustainable development, and, probably, more for economic infrastructure and transformations and less for social programs.

In case of global linkages it is worth to speak about migration. Diaspora networks are providing potential benefits for trade and investments, skills development. Remittances and migration make the relations between people from different countries more active. In Moldova the role of Diaspora during the last years strengthened. There was created a Diaspora Relations Bureau within the Government, which is responsible for cultural, economic and social activities carried out by various institutions to support the Diaspora representatives. The Moldova Government and political forces are interested in Diaspora

from many points of view, one of them is that Moldovans abroad can vote and the elections are in November 2014. However, not taking into consideration profound political interests, improvement and intensification of relations, achieved by the Bureau is a good sign for Moldovans abroad and in the country.

### 3. Role of Finance options

#### 3.1. Financial trends in Moldova

Social, but also economic transformations in Moldova were supported by various sources of financing. As suggested we have analyzed public finance vs. private flows.

*Table 5. The main finance options for Moldova, 2000-2012*

Type of flow	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
<b>Public Finance (% GDP or GNI), incl.:</b>													
<b>Domestic:</b>													
- Tax revenue (% GDP)	14,72	12,17	12,88	14,67	16,35	18,48	19,57	20,56	20,44	17,68	18,19	18,27	18,45
<b>Global</b>													
-ODA as % of GNI				5,52	4,04	5,05	6,03	5,53	4,47	4,24	7,47	6,12	6,05
<b>Private Finance (% GDP ), incl.:</b>													
<b>Global</b>													
-Personal Remittances	13,86	16,43	19,48	24,56	27,14	30,62	34,49	33,87	31,18	22,03	23,25	22,81	24,62
<b>-FDI, net inflows</b>	9,9	3,7	5	3,8	3,4	6,4	7,6	12	12	2,4	3,4	3,9	2,5
<b>-Export</b>	49,7	49,8	52,7	53,4	50,7	51,1	45,2	47,4	40,8	36,8	39,2	44,9	43,6
<b>Domestic credit to private sector</b>	12,6	14,7	17,1	20,3	21,2	23,6	27,4	36,8	36,4	36,0	33,2	33,5	38,0
<b>Public and Private together:</b>													



- Gross savings of GDP (%)		18,3	17,6	16,1	22,33	21,56	21,75	25,86	23,39	14,53	15,38	14,57	12,8
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Source: National Bank of Moldova (bnm.md) – FDI; OECD (aidflows.org)- data about ODA; amb.md – personal remittances; World Development Indicators - tax revenues, gross savings, export

As we may observe, global flows are building up the biggest part of the GDP. The economy of Moldova is very internationally integrated.

## 3.2. Public finance

### 3.2.1. Domestic (tax revenues)

Table 5 demonstrates that tax revenues are relatively stable in the envisaged period, which is good and not. Good because despite economic crisis, political disturbances and other fluctuations, taxes contributed to GDP in a normal proportion. However, despite fiscal administration reforms and adjustments, the revenues did not grow significantly.

We shall look on income tax and some other taxes evolution in the period 2005-2012 for further comments.

Table 6. Taxes and fees applied in Moldova in 2005-2014

Type of Tax	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Income tax rate, corporate	18	15	15	0	0	0	0	12	12	12
Personal income tax	20	20	15	18	18	18	18	18	18	18
Social contributions	27	26	25	27	29	29	29	29	29	29
Medical fund contribution (both from company and worker)	4	4	4	5	6	7	7	7	7	8

Source: www.fisc.md

In a period 2008-2011 the 0%-rate income tax was applied. The Government adopted this tax intended to attract FDI and accumulate more fiscal revenues through reduction of gray economy. The effects were discussed widely. We may look at table 5 to compare FDI in those years when income tax was at 0% rate with other years. Of course, a correlation does

not imply causality, and other factors, such as economic crisis should be considered. One thing is clear – in 2013 the FDI contribution to GDP is lower than in other years. However, fiscal conditions are important for investors and 0% rate income tax was seen as a good sign for investors and a comparative advantage. *Therefore, in some manner the scope of the state to accumulate internal resources conducted to reduction of foreign sources flows.*

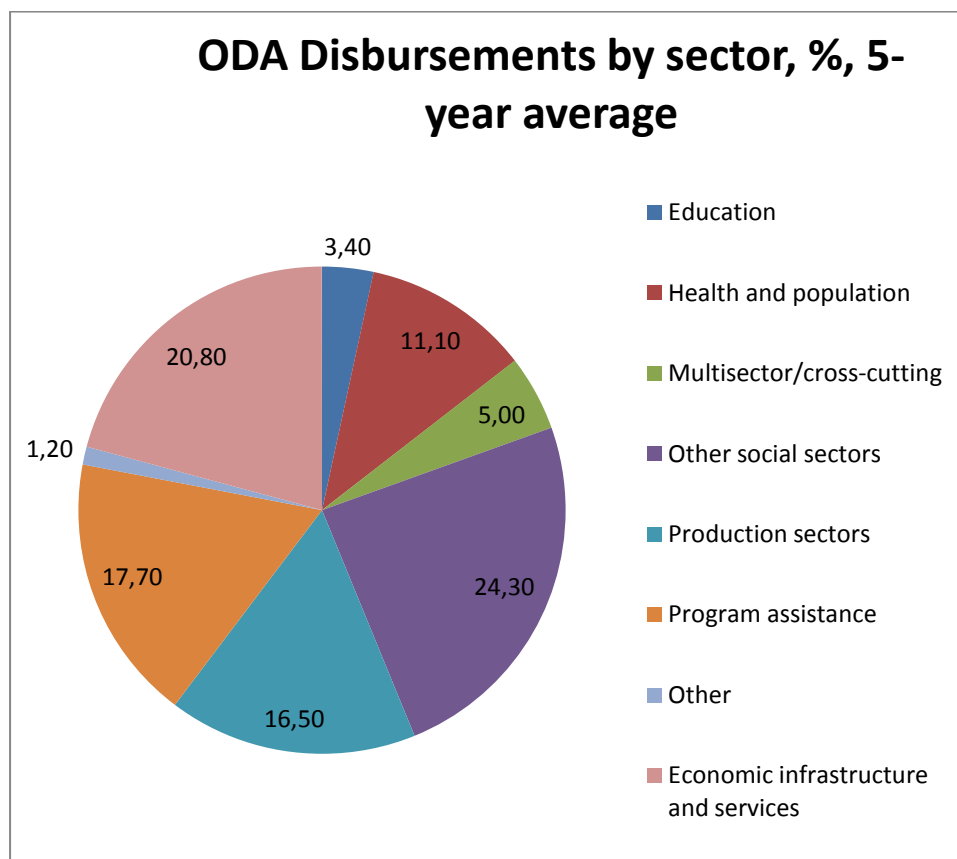
We may also observe that social contributions and contributions to medical insurance fund also increased. This fact indicates that the state was not able to generate enough contributions from available tax basis. Salaries, declared revenue were very low. At the same time, in we look again on data from table 5, we will observe that tax revenues did not increase as GDP contribution, consequently tax administration has worsened. In 2010 a new approach to fiscal administration was proposed, the one, which to be based on collaboration between entities and fiscal body. The Strategic Plan for Development of Fiscal Service for 2011-2015 relies on voluntary contribution of companies towards tax payment and modern and progressive services offered by the Fiscal Service. The IMF, USAID/BIZTAR project in 2010-2011 and more recently in 2013 the Swedish International Development Aid developed some project in order to support positive transformations. However, fiscal administration still remains the major problem for internal resource generation. Corruption (there has been several corruption scandals during the last years in regard to fiscal officers and even the head of the Fiscal Service), lack of competence of fiscal officers, typical “Soviet” attitude of Fiscal Service collaborators (the entity has to primarily satisfy their need, not the owner’s requirements) are the major obstacles to fiscal administration reform.

### **3.2.2. Global (ODA)**

ODA’s impact on social transformation is undisputable. The analysis of statistical data supports this idea.

The picture below shows ODA’s disbursements by sector in % for 5-year average (2008-2012).

Figure 7. ODA disbursements in Moldova by sector, %, 5-year average



Source: aidflows.org

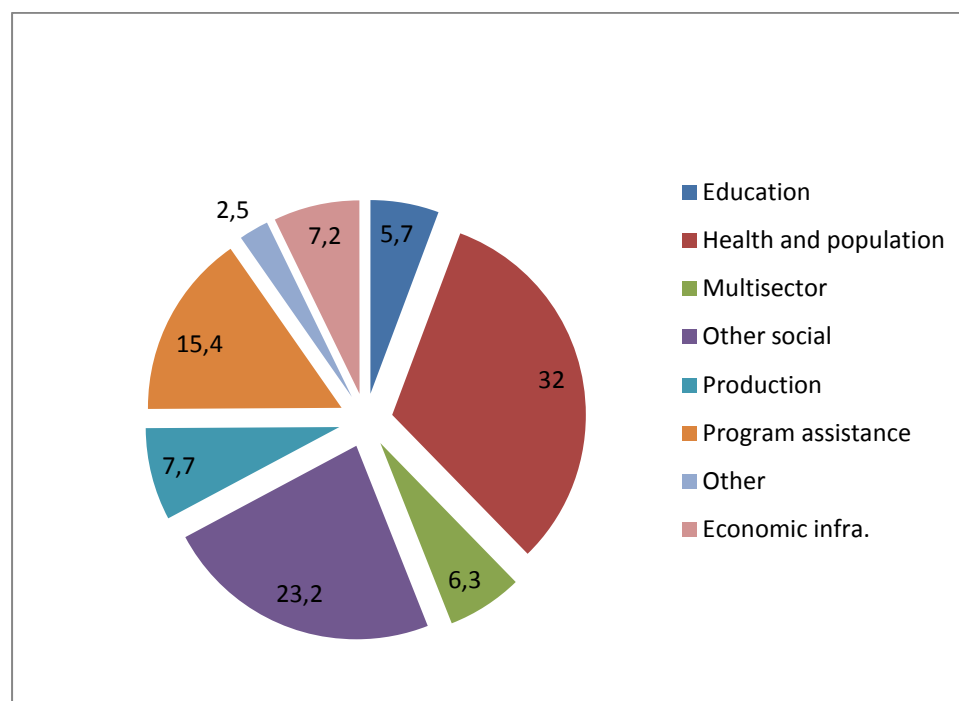
Table 7. ODA disbursements by sector, 2008-2012

	2008	2009	2010	2011	2012
Education	5,9	6,7	3,1	3,8	3,8
Health and population	6,3	17,4	11,6	8,8	7,5
Multisector	19,0	6,4	9,5	7,7	7,5
Other social	25,7	46,5	18,6	20,4	20,4
Production	9,0	7,1	6,1	6,0	11,7
Program assistance	24,6	---	39,6	27,5	18,5
Economic infra.	6,7	14,5	9,7	23,8	28,5
Other	2,8	1,4	1,7	2,0	2,2

We may observe that ODA dedicated in 2008-2012 more than 38.8% of its sources to social sector development (education – 3.4%, health and population – 11.1%, other social sectors – 24.3%). It is about 200 mil. USD - almost 15 times more than contribution to GDP from FDI and two times less than the contribution to GDP from gross savings.

However, in order to be more convincing about the importance of ODA for social transformations, we propose to look on ODA disbursements only some years ago, in 2008. The change is not radical, however, well observable and potentially important.

*Figure 8. ODA disbursements in Moldova by sector in 2008*



Source: aidflows.org

We may observe that social sector received more than 50% of total assistance.

There is no secret that such an approach of ODA has been criticised by some experts (Lozovanu, Girbu, 2010), because it was not sustainable and was not based on creation of a business environment, which would contribute to long-lasting growth and, therefore, development. However, budget support for social assistance has also been reduced in the last years. Our main concern is if this concomitant decision to follow the economic path of

development would not affect the poorest and contribute to change in social transformations' positive trends.

ODA is important for development of poor countries. Moldova is the poorest country in Europe, and, definitely, ODA contributed to certain transformations, primarily in those sectors where ODA's financing was significant (health, education). However, a question which persists in the world and is applied to Moldova is on aid efficiency, and more than that, if it is efficiently and fairly distributed.

There is a well argued concern among the population and experts that the biggest part of ODA is not directed towards declared destinations, but remains in hands of responsible officials. Corruption compromises ODA's role and sometime, makes an opposite contribution. In Moldova 63 % of population consider that public money remain in the pockets of officials (TRM, 2013)<sup>5</sup>. Corruption in the public sector, especially in justice and police, and in the political parties remains one of the major challenges in Moldova, which in 2013 scored a Corruption Perception Index (CPI) of 35 points (0 means that a country is perceived as highly corrupt and 100 means it is perceived as very clean) and was placed 102nd of 177 countries in the rankings released by Transparency International. There were some very mediatised cases of misappropriation of donor's allocations: case of the center for children with disabilities, Costesti, Ialoveni<sup>6</sup>, expenditures at City major office Echimauti, Rezina<sup>7</sup> etc. In all these cases money from foreign grants and subsidies were spent very dubiously, and, probably, on personal consumption of responsible persons, as media declared.

It is obvious, that ODA is aimed to influence certain social or economic transformations through different chains, of them being support of consumption, development of services and demand for services or goods, however, it is important that this consumption not to contribute to inequality growth through support of responsible officials who become

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<sup>5</sup> <http://trm.md/ro/social/63-din-moldoveni-considera-ca-banii-publici-sunt-inghititi-de-buzunarele-functionarilor/>

<sup>6</sup> <http://apropomagazin.md/2013/12/13/luxul-alesilor-pe-banii-copiilor-nevoiasi/>

<sup>7</sup> <http://www.cuvintul.md/article/26/>

extremely rich and wealthy, however, other purposes of ODA distribution are not reached. In this case ODA is contributing to ineffective and sometimes, destructive consumption.

The role of ODA is important also for the improvement of general economic and investment climate in Moldova. The 2005 World Development Report found that “assistance provided by major bilateral and multilateral development agencies for investment climate improvements averaged USD 21 billion per year between 1998 and 2002 — or about 26% of all development assistance. The bulk of that assistance went to infrastructure development.” Much is already known about what should help promote private investment. To flourish, the private sector requires a stable and predictable investment climate that comes from macro-economic stability, transparent and accountable government, rigorous enforcement of the rule of law, functioning markets and institutions, a skilled and productive labour force, a strong commitment to fighting bribe solicitation and corruption, affordable and accessible infrastructure, intellectual property right protection and political and social stability. It is, therefore, clear what to do. The key questions remains – how? The OECDs 2006 Report suggests some important steps towards this solution:

- Donor coordination. On 19 January, 2010, the Moldovan government approved Regulation no. 12 on setting up institutional framework and mechanisms for the coordination of foreign assistance and invited individual ministers to set up sectoral committees to deal with foreign aid. A Coordination Department was subsequently established at the Prime Minister’s office to coordinate all foreign aid and to maintain relations between the government and international and bilateral donors. Besides the Coordination Department, sector-specific donor coordination committees also exist and are led by representatives of UN agencies and the applicable departments of the Moldovan government.

In 2010, donor coordination following the above system focused on:

- Education;
- Water and sanitation (Water and Sanitation Coordination Group);
- Social protection (Social Protection Coordination Group);
- Transport infrastructure (Roads Sector Investment Programme).

In March 2010, the Moldova government and all relevant donors in Moldova, including the European Commission, World Bank and United Nations agreed on Development Partnership Principles. The document lays down the rules for coordination and harmonization between the Moldovan government and the donors. The principles are expected to improve effectiveness of foreign assistance<sup>8</sup>.

- Developing the capacity of people.
- Public-private dialogue.
- Demand-driven initiatives to support firms.

ODA has contributed to all of these directions. The point, however, is how effective was this support. Although the ultimate impact of successful reforms will be a rise in the levels of private investment and a reduction in poverty, all development partners should be rigorous in their efforts to measure the impact that programmes are having on the capacity of governments to design, enforce and review their policy, legal and regulatory framework, as well as on the private sector's ability to participate in on-going reform efforts in an informed and strategic way. Since important improvements to the investment climate will take considerable time, development agencies can draw out a small number of critical components of a programme and track progress with these over time.

ODA can also be potentially important for productivity. The relationship between aid and productivity has not been much developed in the scientific literature. What we found interesting is that different aid, its purposes has different impact on productivity (Menard, Weill, 2013). Therefore, it depends much on quality of ODA in terms of arguing about its impact on productivity.

Aid works well in a good policy environment, a well-designed aid plan can support knowledge and transferring technology and skills. These non-money effects can be even more important and viable than the money value of aid. However, some studies found that aid is normally more effective when it facilitates efficiently and timely reforms triggered by the local authority (World Bank, 1998). Also, different types of aid have different impacts on growth and productivity. In a country analysis of Cote d'Ivoire from 1975 to 1999, Ouattara

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<sup>8</sup> Development Partnership Principles – Coordination and Harmonization of Government and Partner Practices for Enhanced Effectiveness of Foreign Assistance to the Republic of Moldova - March 18 2010, Chisinau)

(2003) categorizes foreign aid into project aid, program aid, technical assistance and food aid. Using a disaggregation approach with auto regressive techniques, he finds that project aid displaces public savings; impact of program aid is almost neutral while technical assistance and food aid increase public savings, and project aid and to a lesser extent, program aid, worsen the foreign dependence of Cote d'Ivoire while technical assistance and food aid reduce the gap.

The conclusion for each country (and Moldovan case is not an exception) can be made on extensive empirical analysis and measurement of relationship between aid and productivity (without or through technology transfer).

### **3.3. Private finance**

#### **3.3.1. Domestic (domestic credit to private sector)**

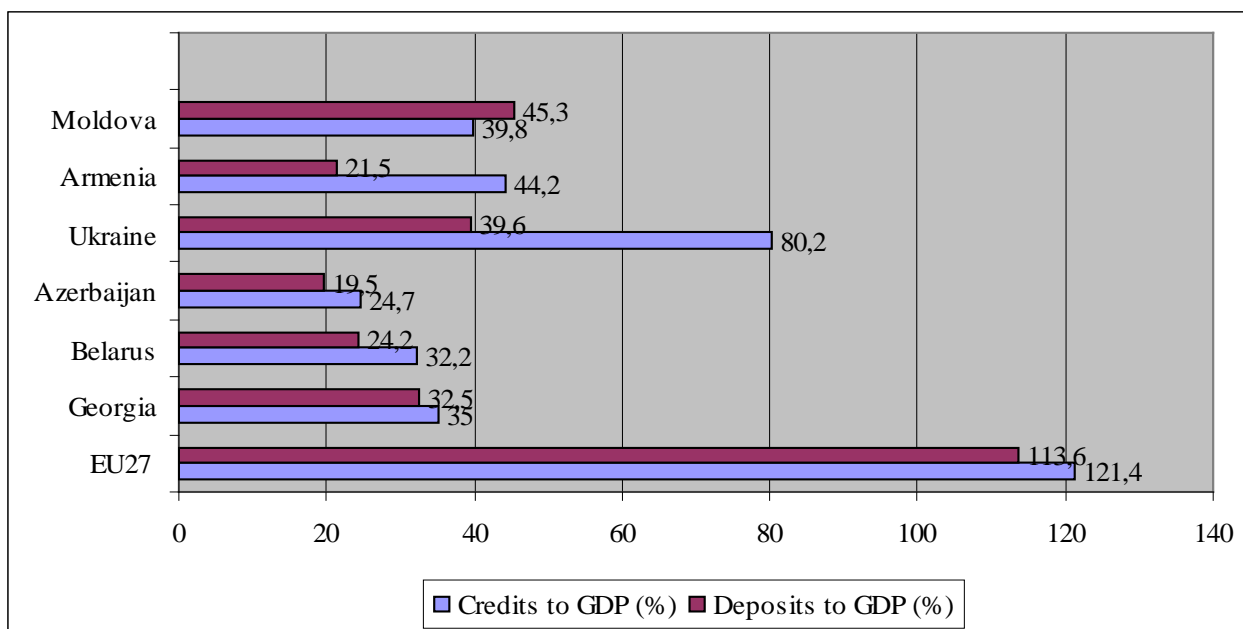
When speaking about the evolution and role of the domestic credit to private sector, a special attention should be paid to the financial sector in Moldova, which is relatively developed compared with other economic areas of the country, but is behind financial sectors from most of countries in Central and Eastern Europe. The financial intermediation level in Moldova is very low, compared with other countries. In particular, this is the situation of non-bank financial services, with insurance services including pensions being the most problematical subsector because of bad condition and demographic perspectives. However, as it is clear from the table 5, domestic credit to private companies increased its contribution to GDP from 12,6% in 2000 to 38% in 2012.

The financial sector is regulated by the National Bank of Moldova (for banking) and the National Commission of Financial Market (for non-banking). The EU adopted the Financial Services Actions Plan (FSAP) for financial services sector, which stipulates a series of legislative actions aimed to develop a single service market. However, the fundamental challenge in the financial services sector is that besides EU standards, a series of international standards issued by IMF, the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors, the International Organisation of Securities Commissions, and others, shall be implemented in this sector. Implementing these standards is feasible for Moldova, given their complexity and major economic implications. A comparative analysis of financial intermediation shows that Moldova is



currently situating at the level of regional countries with similar stages of development (surpassing countries such as Georgia, Belarus, Armenia), but below EU average.

Figure 9. Level of financial intermediation in Moldova and countries of the region, 2012



Source: Country Illustration Workshop presentation by D. Clichici, 15 May, 2014, Chisinau

Moldovan financial sector is dominated by the banking system which accounted for 93% of total financial assets provided by the financial sector at the end of 2012 and 96% of total loans provided by the financial sector at the end of 2012. However, access to bank resources is limited due to:

- ✓ Limited availability of longer loan maturities for funding capital investments,
- ✓ Inflation and high credit rate risks,
- ✓ Risk of doing business in Moldova,
- ✓ High collateral requirements,
- ✓ Relatively high levels of interest rates and commissions on borrowing,
- ✓ Moldovan banks have a strong preference for maintaining liquidity.

Table 9 is proposed for some indicators of banking activity in 2004-2012.

*Table 8: Indicators of banking activities evolution, 2004-2012*

Indicator	2004	2005	2006	2007	2008	2009	2010	2011	2012
Borrowers from commercial banks, per 1000 adults	15,6	27,9	37,5	60,13	63,9	43,4	38,03	37,12	41,5
Depositors for commercial banks, per 1000 adults	788,6	847,5	903,8	1015,6	1096,7	1134,1	1208,4	1166,3	1235,9
Domestic credits by financial sector (% GDP)	29,5	31,5	34,5	40,2	39,7	41,4	37,2	39,4	42,2

Source: World Development Indicators

We observe that credit contribution to GDP, however is increasing, primarily comparing with the beginning of 00's. Significantly increased (comparing with beginning of 00's) the number of borrowers from commercial banks (however, with some decline over the last years). This increases can be explained by policy measures, provided by the National Bank, such as: creating conditions for encouraging both loan supply and demand in order to stimulate sustainable economic growth; Central Bank actions by debtor position with the banking system, continuing the sterilization operations; Central Bank has taken measures that were oriented more towards offer contraction due to excess liquidity recorded in recent years in the banking system. Thus, domestic finance provided by local banks represents a relatively stable source of finance, even taking into consideration difficulties and limited access. There is, nevertheless, room for improvement, but this depends not only on banking sector per se, but on general macroeconomic conditions, lack of external shocks and other factors.

One of the major factors, indeed, is quality of regulation in terms of protection of competition and combating corruption. According to some unofficial estimation, more than 70% of the Moldovan financial sector is concentrated within the same group of people. In fact, officially, 70% of banking sector assets belong to the biggest 5 commercial banks<sup>9</sup>. There are strange situations when one bank is holding shares in another one<sup>10</sup>. These and other issues must be addressed in order to improve the financial and particularly banking sector in Moldova.

### 3.3.2. Global

#### - Remittances (REM's)

REM's impact on social transformations in Moldova is hard to overestimate. The data presented at MIRPAL conference in March 2014<sup>11</sup> shows that the number of low skill migrants is increasing. In 2000 they made 18% of the total number of migrants; in 2012 this indicator was 27%. The same study shows that usually, people cannot keep their profession when working abroad and therefore, many young people prefer to migrate before graduating from college or university. The number of unskilled migrants is increased primarily by this category of persons.

According to the study<sup>12</sup> developed by the World Bank, all remittances to Moldova can be divided into 3 groups:

1. The first group and the biggest part of REMs go to satisfy primarily necessities of family members of those working abroad. What is interesting in this case is that transfers for spouses are almost twice bigger than transfers for parents, living in Moldova. Therefore, in case of family reunification the amount of remittances will decrease significantly.

<sup>9</sup> <http://particip.gov.md/categoryview.php?cat=202&l=ro>

<sup>10</sup> Ghedrovici O. Potential implications of EU-Moldova Association Agreement for Moldovan Banking Sector Stability, Proceeding of the International Conference, Iasi, April 2014, <http://mbf-eu.info/home>

<sup>11</sup> <http://vocea.md/profilul-migratiei-de-munca-din-republica-moldova/>

<sup>12</sup> Consolidation of relationship between migration and development in Moldova, CIVIS, IASCI, <http://siteresources.worldbank.org/INTMOLDOVA/Resources/ConsolidareaLegaturiiDintreMigratieDezvoltare.pdf>

2. The second group is referred to migrants, who send their money from abroad in order to make some savings. Money is deposited in banks and contributes to the banking system liquidity.
3. The smallest group, who send their money in order to invest.

The same study suggests that revenues of families who receive money from abroad are twice bigger than revenues of those families who do not receive money from remittances.

The purposes of remittances are the following:

*Table 9. The main purposes of remittances to Moldova*

<b>Purpose</b>	<b>% of REMs</b>
Support family, children	34%
Support parents	22%
Construction, repair of house	11%
Savings	10%
Urgent needs	4%
Purchase of house	7%
Medical treatment	5%
Help to other relatives	4%
Invest in business	1%
Other	2%

Source: Consolidation of relationship between migration and development in Moldova, CIVIS, IASCI

In this order of ideas, it is clear that REMs contribute a lot to increase of sources for living for the Moldovan households, and thus, contribute to poverty reduction.

However, we cannot omit the negative impact of REMs, or, more precisely, migration as a root of REMs. According to some estimations, 66% of children in Moldova have only one parent living in Moldova, the another one being a migrant. 34% of children are missing both

parents. Of course, there are also other negative sides of migration, like exodus of medical and teaching personnel, and others.

REMs and migration in general are also important for productivity growth. In countries like Moldova, where agriculture is a significant part of economic and small farmers do not have control over the climatic, economic, and social environments in which they live, productivity and its growth can become an efficient solution. Natural and social constraints significantly restrain people choices over land use, output mix, and farm investment. Labor migration is the most prevailing approach for small farm households in Moldova to improve their livelihood. As it was mentioned above, 27% of migrants are low skill migrants. Therefore, Moldova experienced a dramatic decline in its rural population due to continuing out-migration. Small farmers do not reinvest to agriculture because cultivation is not a good investment. Poor environmental quality, low-returns make agriculture a risky activity for small farmers in Moldova.

Several academic papers which examined the role of migration and especially remittances on agricultural productivity show different results. Lucas (1987), Taylor et al. (2003) demonstrate that migration increases productivity, Brown & Jimenes (2008) argues that there is no significant effect from migration and remittances for productivity.

For Moldovan case it could be a subject to detailed research in order to make reasonable estimation, however, some evidence show that REMs at least somehow contributed to productivity in agriculture. During the program PARE 1+1 some interesting investments, bringing new technologies, also able to increase productivity were made by those came back home from abroad, such as<sup>13</sup>:

1. Factory for production of pellets "ARIN ALB". The products are used by those entities which get heating from systems based on pellets.
2. Honey packaging line (ecologically safe and modern packaging).
3. Purchase of new agricultural equipment for already existing farms.
4. Opening new farms, based on modern technologies.
5. Other business projects, based on modern applications with high productivity.

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<sup>13</sup> [http://odimm.md/files/ro/pdf/pare/Istorie\\_de\\_succes\\_2012.pdf](http://odimm.md/files/ro/pdf/pare/Istorie_de_succes_2012.pdf)

There is no doubt, therefore, that in some manner REMs contributed to productivity in agricultural sector.

Same new technologies were implemented in other domains, such as services (cleaning, auto services etc.) through PARE 1+1 program.

### **Program on Attracting Remittances into the Economy "PARE 1 +1"**

Program on Attracting Remittances into the Economy "PARE 1+1" has been approved by the Government Decision no. 972 of 18.10.2010.

The program is oriented towards migrant workers and/or their first-degree relatives who want to invest in starting and/or development of a personal business. For each Moldovan lei invested, the Government is giving another 1 lei as grant.

#### **TARGET GROUP:**

Migrant workers or first-degree relatives who prepare to start a business or intend to develop an existing one with full private capital, registered under one of the following legal forms:

1. Individual enterprise/ individual entrepreneur;
2. Limited liability company;
3. Farmer;
4. Production cooperative;
5. Entrepreneurial cooperative.

**PARE 1 +1 Program is developed in four components:**

**COMPONENT I - "Information and Communication"**

**COMPONENT II - "Training and Entrepreneurial Support"**

**COMPONENT III - "Business Financing/1+1 Rule"**

**COMPONENT IV - "Post-financing Monitoring and Program Evaluation"**

#### **PRIORITIES of Program "PARE 1+1"**

1. Creation of new jobs;
2. Export orientation;
3. Import substitution;
4. Implementation of energy efficiency projects;
5. Application of modern technologies, know-how transfer, innovation.

As demonstrated in the table 5, remittances represent an important source of GDP formation and a very significant source of existence for many families. Moldova is still on the front place among countries of the region in export of the working force. Many experts consider that during the last decades REMs were the main engine of Moldovan economy. There is no doubt, that REMs enlarged the household revenues, consumption, and thus, indirect taxes paid for goods purchased. The consumption nature of REMs is explained by some objective factors, persisted during the analyzed years, such as:

1. The influx of REMs is composed of big in number, however small in value amount of money sent by those family members who work abroad. It is hard to speak in numbers in case of remittances to Moldova, because, according to some estimation, about 40% of total remittances<sup>14</sup> are transferred via informal channels (persons coming from other countries, bus drivers etc.),
2. Low interest to invest in the country (because of corruption, lack of support for SMEs etc.).

This fact, i.e. consumption target of REMs led to some other undesired consequences for Moldovan economy:

3. Inflation pressure due to increased demand for goods, which are predominantly imported,
4. Trade balance deficit,
5. Excessive demand on real estate market and growth of prices for apartments and houses, which stimulated the construction sector, from one side, but inflated domestic prices, making them comparable to the European real estate prices,

Remittances play a significant role for investments through direct implication on money from abroad and indirectly through creation of demand for products and goods. If speaking about the PARE 1+1 program, which can somehow demonstrate the direction of investments from REMs, it is supposed to offer (in 2014 and 2015) cumulative investments of 48 mil. MDL (about 2.5 mil. EURO) with about 11 mil. MDL of grants (0,7 mil. EURO). Each MDL offered through PARE 1+1 will bring 4,35 MDL of investments. 54% of investments are for agricultural businesses, 22% - production/manufacturing, 21% - services and also public

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<sup>14</sup> <http://capital.market.md/ro/content/exper%C5%A3i-remiten%C5%A3ele-ar-putea-cre%C5%9Fte-%C3%AEn-urm%C4%83torii-doi-ani>

catering. In 2014 of total 59 projects 36 represent start-ups; the biggest part of beneficiaries are young people up to 35 years and 20% are women. From the beginning of the program in 2011 until now more than 300 persons received financing from this program<sup>15</sup>.

#### - **Foreign Direct Investments (FDI)**

Foreign direct investments are not playing important role in GDP formations in the latest years. More than that, this source of finance is very volatile and tends to decrease as a result of risks and shocks. Being accounted as 12% of the GDP in 2008, as a result of the financial crisis in 2009, the FDI went down dramatically to 2,4 %. However, FDI are associated with positive impact on economic transformation and growth for many countries. The analysis developed by Moldovan expert (Melnicenco, 2010) demonstrated that FDI positively influenced not only economic performance, but also social changes<sup>16</sup>. It has been mentioned in the study that for Moldova is important not only to attract investments, but also to provide conditions for growth of sustainable investments, which will not bring ecological or social harm and will be relatively stable in case of crises.

#### **3.4. Other important considerations about finance and resource distribution**

For many emerging economies, as Moldova is, it is considered that foreign resources, such as FDI, ODA or export revenues are extremely important for development. It is true in many circumstances, because lack of internal resources can be compensated only from abroad.

In 2006 in Moldova was adopted a Government decree nr. 1288 of 09.11.2006 "About the approval of Strategy of attraction of investments and export promotion for 2006-2015". This document indicates the major problems of Moldovan producers in their export extension: reduced competitiveness of Moldovan products, high costs of production, not harmonized certificates and other export documents. It is stated that investments are necessary to overcome this shortages. And it is true that export activities brought significant investments into Moldovan economy, which could mitigate these obstacles.

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<sup>15</sup> Ministry of Economy via <http://www.contabilsef.md/libview.php?l=ro&id=9341&idc=13>

<sup>16</sup> Teza de doctor O. Melnicenco:

[http://s3.amazonaws.com/zanran\\_storage/www.cnaa.md/ContentPages/136028513.pdf](http://s3.amazonaws.com/zanran_storage/www.cnaa.md/ContentPages/136028513.pdf)



There is a direct correlation between development of a certain activity (export, for example) and investments oriented on this direction. The case of Moldova confirms this rule. Leading types of activities, supported by investments in Moldova are: commerce, industrial production, financial services (according to NBS data). If commerce and financial services are oriented primarily on local market, than industrial production (including wine production, textiles, processing and preserving fruits and vegetables) is counting the biggest part of total export and major investments were made for launching local production for export. Examples of such entities are: Draxlmeier Automotive Ltd. (electrical cables for automotive industry – BMW, MiNi) with total investment of 30 mil. USD; GG Cables and Wires EE (electrical cables for electronic equipment) with total investment of 28 mil. USD and others.

While resources mobilization and attraction is vitally necessary, their distribution is also an important factor for the direction of transformation. Governmental spending is very expressive in this context, as show priorities and potential trends of evolution. In case of Moldova, foreign assistance, in turn, is crucial for governmental spending because of two factors:

- It constitutes about 10% of budget expenditures<sup>17</sup>,
- Usually foreign allocations (primarily those coming from the IMF) dictate the direction of spending and, more important, other social and economic policies.

These affirmations lead for understanding the fact that growing economy, which could involve greater social spending and institutional reforms was not supported, more than that, governmental spending was not targeted on social development.

This is demonstrated in the following table.

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<sup>17</sup> [http://pasos.org/wp-content/archive/Policy\\_Statewatch11\\_en.pdf](http://pasos.org/wp-content/archive/Policy_Statewatch11_en.pdf)

Figure 10. Selected budgetary expenditures in Moldova, 2003-2014, % of GDP

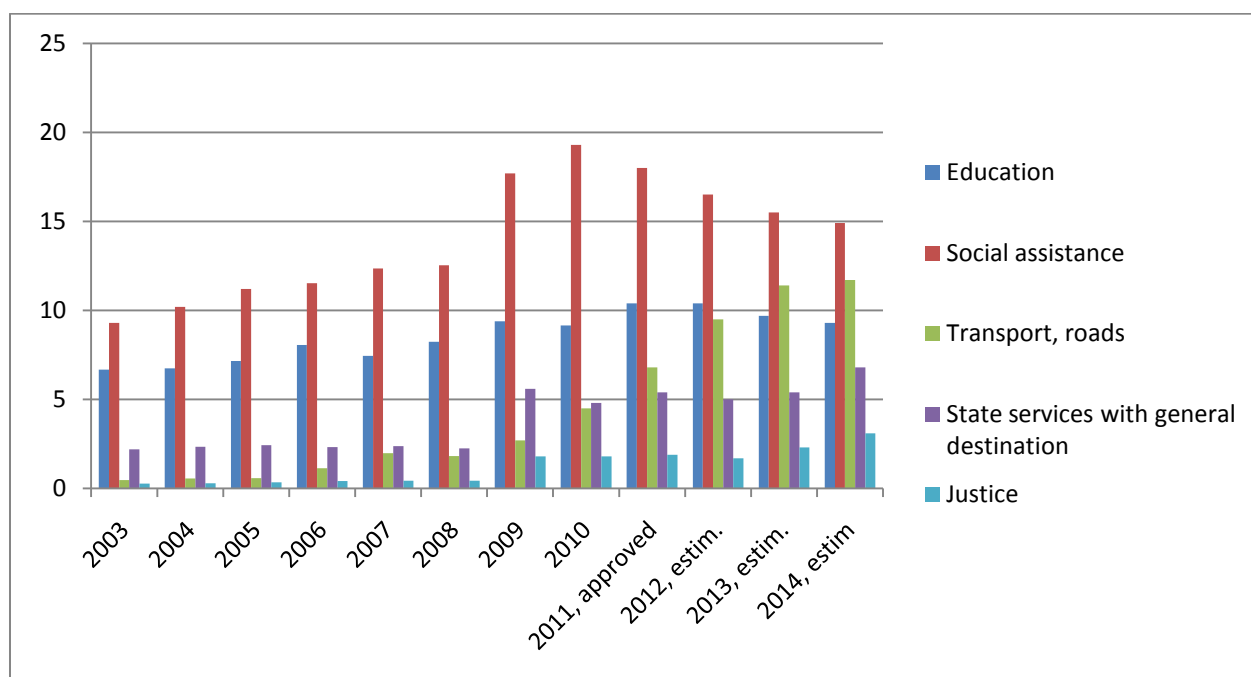


Table 10. Selected budgetary expenditures in Moldova, 2003-2014, % of GDP

Expenses	2003	2004	2005	2006	2007	2008	2009	2010	2011, approved	2012, estim.	2013, estim.	2014, estim.
Education	6,67	6,75	7,16	8,06	7,45	8,23	9,38	9,15	10,4	10,4	9,7	9,3
Social assistance	9,3	10,2	11,2	11,52	12,35	12,54	17,7	19,3	18,0	16,5	15,5	14,9
Transport, roads	0,47	0,57	0,58	1,13	1,99	1,82	2,7	4,5	6,8	9,5	11,4	11,7
State services with general destination	2,2	2,34	2,44	2,32	2,37	2,25	5,6	4,8	5,4	5,0	5,4	6,8
Justice	0,28	0,29	0,34	0,42	0,43	0,44	1,8	1,8	1,9	1,7	2,3	3,1

Data for the picture.

Source: [http://www.mf.gov.md/common/files/CCTM%202012-2014/Anexa\\_2\\_2\\_BPN.pdf](http://www.mf.gov.md/common/files/CCTM%202012-2014/Anexa_2_2_BPN.pdf),  
<http://www.mf.gov.md/node/7778>

The main observations include:

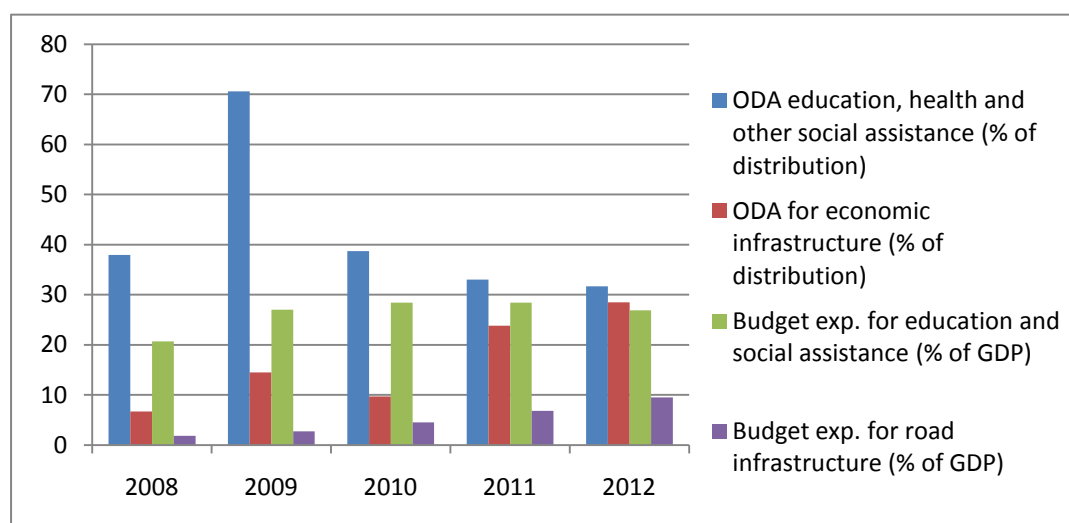
- In a period before 2010-2011 the state was concerned with social needs of the population. Education, social assistance received the biggest part of the support. However, the state was not focusing on certain economic problems, such as infrastructure, and thus, productivity etc.
- Budgetary expenditures for road increased substantially during the last years, infrastructure gained a special role.
- Justice was selected as important target for budget support.
- Education and social assistance is losing the “battle” for budget finance.

The current situation is directly explained by ODA impact and foreign non-finance pressure. In 2011 there was a big discussion about the IMF memorandum for Moldova and its social costs. IMF solicited to retain the salaries growth for certain groups of budgetary workers, to close schools with insufficient children, to hoof about 2000 teachers. The correctness of these measures is very controversial, as one may understand. However, the main reasons argued by the IMF and the respective Moldovan ministries were related to urgent need of optimization and reduction of expenses in conditions of deficit of budget sources.

Moldovan relations with the EU also influence governmental decisions about spending. As EU officials usually suggest to focus on fighting corruption, reforms in juridical system, expenditures for justice are very significantly increased in 2014 comparing with 2003.

Our concern, thus, is related to the fact that concomitantly ODA and budget expenditures have been redirected to economic transformations, social support being placed as second priority (see picture 13).

*Figure 11. ODA and Budget distribution shift from social to economic needs in 2008-2012*



The report findings as very beginning demonstrated that social transformations were very significant and important during 2000-2012 period, however, the shift to economic priorities may negatively influence this trend.

#### ***PROBLEM WITH TRANSNITRIAN REGION***

We consider relevant to point a special attention the problem related to situation in the Eastern region of Moldova – so-called, Transnistria. Transnistria became one of the "unrecognized republics" that appeared throughout the USSR, when on 2 September 1990, the Pridnestrovian Moldavian Soviet Socialist Republic was proclaimed. After military conflict of 1992 the region is still maintaining the unclear status. For EU, it represents threats of the "frozen conflict" closest to its borders. For Moldova, it means the dismembered country's impairment. The situation in Transnistrian zone is very contradictory and is far from normalizing. "Grey schemes" of traffics are used often, fuelled by interests of administrative-economic conglomerations from Ukraine (Odessa – Illyichevsk, Vinnitsa, Kherson), Transnistria and Moldova. Entities are registered in Transnistria and pay taxes to Transnistria budget, which is absolutely uncontrolled by Moldovan authorities. Smuggling is a main source of revenues for many pseudo-businessmen in Transnistria. All these factors cause official export reduction and decline of budget revenues in Moldova. It is to mention that the leading Moldovan industries – steel, textile and others during the Soviet times were predominantly situated in Transnitrian region. Therefore, the scale of the problem for Moldovan budget is really huge and its solution may be crucial for economic and social development of the country.

## 4. The role of complementary policies

There are a range of specific and common factors behind the mobilisation of finance. In the Road Map towards the implementation of the UN Millennium Declaration, it is clearly pointed out that the mobilization of domestic resources is the foundation for self-sustaining development. Domestic resources finance internal investments and social programmes which are essential for economic growth and poverty reduction. In this context, a balanced fiscal policy, responsible social spending and a well functioning and competitive financial system are the elements of good governance that are crucial to economic and social development.

The UN's study <sup>18</sup> argued that "the primary responsibility for achieving stable growth and equitable development lies with the developing countries themselves... The generation of domestic resources to save and invest productively is the essential foundation of sustained development." Therefore, balanced and well analyzed economic policy, monetary strategy for the country serve as basis for stability in economic and social development.

However, many emerging economies face serious problems in adoption of respective policy measure. This happens because of lack of political initiative, lack of knowledge, other social and economic factors.

In this context, support of foreign donors in terms of technical assistance, political transformations and other aspects is crucial.

Therefore, further our emphasis will be placed on those MOI and factors, which helped Moldova in two directions:

- Domestic resources mobilization,
- Optimization and making more efficient foreign sources of finance.

Domestic resources are primarily important for government. The last can mobilize available sources through three channels:

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<sup>18</sup> IMPROVING FINANCIAL RESOURCES MOBILIZATION IN DEVELOPING COUNTRIES AND ECONOMIES IN TRANSITION, UN, 2002, <http://unpan1.un.org/intradoc/groups/public/documents/un/unpan006729.pdf>

- Taxes,
- Non-tax revenues,
- Borrowings.

The following programmes and measures are related to resource mobilization:

### ***I. Of domestic origin***

1. **Measures for SMEs development.** Internal finance sources from taxes are primarily accumulated from SMEs in developing countries. In Moldova the Strategy to Develop the SME Sector for the years 2012-2020 was approved in 2012.<sup>19</sup> According to the Ministry of Economy, the Strategy to Develop the SME Sector for the years 2012-2020 and the Action Plan to Implement this Strategy for the years 2012-2014 provide the long-term and mid-term policy framework as regards the development of the micro, small and medium enterprises in the Republic of Moldova in the context of transition from the economic development model, based on consume, to the new paradigm, which is oriented towards exports, investments and innovations, the political goal of European integration and global economic trends.

A series of national programmes to support the SME sector are underway or implemented already. Among them: the Credit Guarantee Fund (FGC), the Programme to Attract Remittances to the Economy - PARE 1 +1, the National Programme of Youth Economic Empowerment (PNAET), the "Supporting the Implementation of the Migration and Development Component of the EU-Moldova Partnership for Mobility", "Effective Business Management" Continuous Training Programme (GEA), Programme to support the small and medium enterprises sector, funded by the Government of Japan etc.

### **2. Increasing budget revenues from privatization.**

A series of laws on the public-private partnerships, including Government Decision No. 438 of 19.06.2012 on Initiating Public-Private Partnership Project for the Concession of the S.E. "Chisinau International Airport"<sup>20</sup>, Government Decision No. 419 of 18.06.2012 on Approving the List of Assets that are State Property and the List of Works and Services of National

<sup>19</sup>Government Decision No. 685 of 13.09.2012 on approving the Strategy to Develop the SME Sector for the years 2012-2020. OJNo.198-204/740 of 21.09.2012.

<sup>20</sup>OJ 126-129/466, 22.06.2012.

Public Interest that Are Proposed to the Public-Private Partnership<sup>21</sup>, Government Decision No. 245 of 19.04.2012 on the National Council for the Public-Private Partnership<sup>22</sup>, Government Decision No. 91/13.02.2012 on the Public-Private Partnership for Building Homes and Buildings for Social-Cultural Activities<sup>23</sup> etc. were approved.

The Action Plan to streamline the process of management and privatization of the state assets was approved<sup>24</sup>.

Great efforts have been made in order to successfully implement privatization. This approach was largely supported by IMF. Despite serious resistance and mediatised negative attitude to privatization, mostly from the non-ruling political forces, the most important objects were privatized. Many economists still consider that long-term effects of this privatizations are incomparably smaller than amounts received in the state budget.

The following programmes and measures are related to making resources more efficient:

***I. Of domestic origin***

3. **Additional National policy context.** There has been developed some national plans and programs, aiming to canalize the available resources for national priorities and to make them more effective. These are:

➤ Strategy “Moldova 2020”, which is based on 7 pilons:

1. Aligning the education system to labor market needs in order to enhance labor productivity and increase employment in the economy. The new Education Code was approved on June 28<sup>th</sup> by the Government. This document proposes significant changes in educational system of Moldova: mandatory study of two foreign languages, entrepreneurial skills development, consolidation of high education institutions autonomy etc. All these measures will make the Moldovan educational system more competitive and results oriented.

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<sup>21</sup>OJ 126-129/457, 22.06.2012.

<sup>22</sup>OJ 82-84/281, 27.04.2012.

<sup>23</sup>OJ 34-37/116, 17.02.2012.

<sup>24</sup>Government Decision No. 586 of 29.07.2011 on measures related to streamlining the process of management and privatization of the state public goods. OJNo.128-130/656 of 05.08.2011.

2. Increasing public investment in the national and local road infrastructure, in order to reduce transportation costs and increase the speed of access.
3. Reducing financing costs by increasing competition in the financial sector and developing risk management tools.
4. Improving the business climate, promoting competition policies, streamlining the regulatory framework and applying information technologies in public services for businesses and citizens.
5. Reducing energy consumption by increasing energy efficiency and using renewable energy sources.
6. Ensuring financial sustainability of the pension system in order to secure an appropriate rate of wage replacement. The pension system reform is much discussed. In the National Development Strategy “Moldova 2020”, this reform represents one of the most important strategic objectives. However, political conjuncture is not favourable for painful, but necessary reforms. Elections and re-elections, which took place during the last years imposed political elites to retain this issue for later times.
7. Increasing the quality and efficiency of justice and fighting corruption in order to ensure an equitable access to public goods for all citizens.

- National Sector Strategies,
- National Action Plan on Open Government 2012-2013. The Open Government Action Plan for Moldova embraces the idea of working proactively to advance a culture of Open Government through:

Objective 1: Strengthening public integrity by ensuring a participative decision-making process that encourages citizen participation and increasing transparency in governance;

Objective 2: Efficient management of public resources **by increasing transparency in public spending**;

Objective 3: Improving the quality of public services delivery.

- Agreements with development partners:
  - Partnership Principles and their Implementation Plan
  - ENPI National Indicative Programme 2011-2013
  - IMF Programme 2010-2012



– UN – Moldova Partnership Framework 2013-2017.

## ***II. Of global origin***

4. **Donor coordination measures.** In 2009 the World Bank started an initiative of creation of the Joint Assistant Strategy for foreign donors active in the Republic of Moldova in order to make the aid more affective, well distributed, coordinated and monitorized. All partners – the Government, NGOs, civil society, development partners were implicated in the process of coordination principles development. In March 2010 the Development Partnership principles were signed, which presumes the following:

- National Ownership (increasingly nationally led development programmes),
- Alignment (work in support of national priorities),
- Harmonization (donors are better coordinated),
- Results-Based Management (results count)
- Mutual Accountability (donors and recipient equally responsible)
- Predictability (know available support well in advance)

This policy coherence for development should ensure that different policies in different sectors work in synergy with development cooperation.

Today the coordination among donors is realized through:

- Partnership Principles and their Implementation Plan,,
- Donor Coordination Meetings,
- Joint donor missions, analytic works ,
- Joint feedback on “Moldova 2020”,
- Other common activities.

## 5. **International policy context.**

Republic of Moldova is a partner of the European Union within the framework of the European Neighbourhood Policy (ENP). In the ENP framework the European Union – Republic of Moldova Action Plan (EUMAP) was signed in 2005, a signally political document designing strategic objectives of cooperation between the two parties, with the No.1

purpose being to bring Moldova closer to the European Union. EUMAP was signed for a three-year term and was based on the Partnership and Cooperation Agreement (PCA).

On January 12, 2010, the Republic of Moldova and the European Union pledged to negotiate an ambitious document, an Association Agreement to replace the PCA. In parallel, EU authorities negotiated and completed in late 2010 with the Moldovan Government the Visa Liberalisation Action Plan, which contained 4 important blocs: security of documents; illegal immigration; rule of law and security; foreign relations and fundamental rights. Before the signing of the new legal document on EU-Moldova relations, following priorities and reform commitments needed to meet political criteria of implementation of EU standards and principles are in force: human rights; democratic standards; independent and efficient justice; probity of governance, administrative capacities and anti-corruption fight etc.

***On April 28<sup>th</sup>, 2014 the visa regime for Moldovan citizens was liberalized. The EU initialled the Association Agreement with Moldova on 29 November 2013. It is expected that Moldova will sign it in June 2014.***

One part of the Association Agreement is addressing an eventual Deep and Comprehensive Free Trade Area (DCFTA). DCFTA is crucial for the development of Moldova. The EU is Moldova's first trading partner with 54% of Moldova's total trade - followed by Ukraine (15%) and Russia (12%). EU exports to Moldova (€ 2 billion in 2012) are dominated by machinery, transport equipment, chemicals, fuels, mining products and agricultural products. Over half of Foreign Direct Investment came from the EU Member States and more than 10% from the Commonwealth of Independent States member countries. Moldova's exports to the EU are already liberalised to a large extent under the EU Autonomous Trade Preferences. However, **the free trade agreement between Moldova and EU** involves gradual liberalization (up to 10 years from the date of signing) of trade in goods and services, free movement of labor, reduction of customs duties and non-tariff technical barriers, abolition of quantitative restrictions and harmonization of RM legislation to the EU acquis.

This two steps – visa liberalization for the European Union and signing the Association Agreement will definitely change the economic conditions of Moldova (see next paragraph). There is no doubt that legal and policy approximation with EU, which Moldova is experiencing during the last years significantly contributed to both – finance accumulation and finance distribution. And, probably, this aspect is the most powerful for both as well. EU

is assisting Moldova in policies development and by offering financial sources for transformations. Normally, this assistance is supported by a range of conditions. This conditions impacted Moldova is the following directions:

- ✓ Budget distribution. Necessity to conform with rule of law and fair justice principles, imposed by the EU determined reprioritization of budget expenditures (see table 7).
- ✓ Capacity building through program support from the EU:
  - Support to Government of Moldova on capacity building of the forensic laboratories of the Ministry of Interior,
  - EUBAM (EU border assistance mission) for developing tactical, operational, administrative and institutional capacity in Moldova to ensure effective controls and surveillance related to border management,
  - other programs.
- ✓ Institutional changes.

## **5. Future prospects and conclusions**

The economic history of other countries shows, that the so-called “pre-access” effect is important and visible. Countries which have clear perspective to become a EU member (and Moldova is such a country) experienced a FDI boom, productivity growth and general growth of wellbeing. In terms of financing options the following should be considered:

1. There is still room for improvement in social sphere both in terms of poverty eradication and reducing inequality. Because of massive migration, many children remained without one or both parents. Because of the educational reform, approved in 2011, in 2012 57 schools were closed and 110 were reorganized. School abandons became very frequent<sup>25</sup>. ODA will still play an important role not via direct financial support, but also through guidance and support distribution conditioning, taking into consideration reduced possibilities and increasing necessities of the state budget.
2. Due to fiscal administration reforms and new attitude, expressed by actual fiscal authorities, fiscal revenues will increase, or, at least, won't decrease. In the first

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<sup>25</sup> <http://www.investigatii.md/index.php?art=300>

quarter of 2014 revenues from taxes increased by 0,9% comparing to the same period of 2013<sup>26</sup>.

3. FDI will increase also, as result of pre-EU access effects (EU-Moldova Association Agreement). However, for Moldova is important to create specific infrastructural conditions for specific investors in time when general infrastructural improvements still requires time.
4. Personal remittances will be less important as source of finance in a long perspective, as many Moldovans move to live abroad with their families. Only in 2013 more than 2500 Moldovan moved officially to live in other countries. The majority of migrants are young people up to 39 years.<sup>27</sup> As they remain to live in other countries with children and their old parents will be excluded as destination for remittances in a long term, the amount of money transferred will decline.
5. The signing of EU-Moldova Association agreement as a global enabler will change the structure of finance options. Exports will increase as a result of DCFTA and free movement of goods.
6. Visa liberalization will conduct to increase in average work remuneration. In present, FDI are coming to Moldova, taking into consideration cheap working force as a strong point. As this advantage will disappear, Moldovan Government should give something in exchange to investors.
7. Many social transformations will become visible as result of free movement of people (free EU visa access since April 2014). Here we mean transposition of way of life, for example, housekeeping, consumption, etc. It is probable, that poverty will decrease as a result of ability for free movement, seasonal revenues available and growth of salaries because of labor opportunities, available in other EU countries and less labor force remained in Moldova. This happened in other countries after EU approximation (membership): in Romania minimal salary in 2006 (81.79 Euro) almost doubled in 2011 (122.71). Same situation is observable in Estonia, Poland and other relatively recent EU members<sup>28</sup>. In the ERD2013 similar case study on Nepal showed

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<sup>26</sup> Data of the National Bureau of Statistics, [www.statistica.md](http://www.statistica.md)

<sup>27</sup> <http://www.statistica.md/newsview.php?l=ro&idc=168&id=4415>

<sup>28</sup> EUROSTAT data

large scale outmigration of unskilled workers from rural areas actually meant that agricultural wages increased, because the labor supply decreased.

8. Ability of the government to increase its spending depends primarily on budget revenues. The mid-term budgetary framework for 2012-2014 is based on a forecast of economic growth of av. 5% annually. This growth is supported by:
- Structural reforms,
  - Attraction of investments,
  - Private sector support,
  - Optimization of imports,
  - Growth of population revenues.

All these measures are important, but should be correlated with permanently changing conditions. This shift modifies initial factors and thus, cannot be ignored.

Certain concerns, however, also have to be mentioned, such as:

1. Impact of ODA and budget expenditures' reduction for social assistance. The successes of Moldova in this area over the last decades can be mitigated.
2. Ability of the state to generate revenues from taxes, in order to compensate remittances' reduction is very reluctant. There is a need to revise not only fiscal administration issues, but also tax rates, declaration obligations etc. The "Doing Business" report of the World Bank<sup>29</sup> indicates excessive number of fiscal payment in Moldova in comparison with other OECD countries, as well as more significant labor taxes and contributions.
3. Escalation of Transnistrian conflict and all related consequences of military interventions within the country.
4. Increasing shortage of qualified working force because of visa liberalization and consequent increasing opportunities for "brain drain".

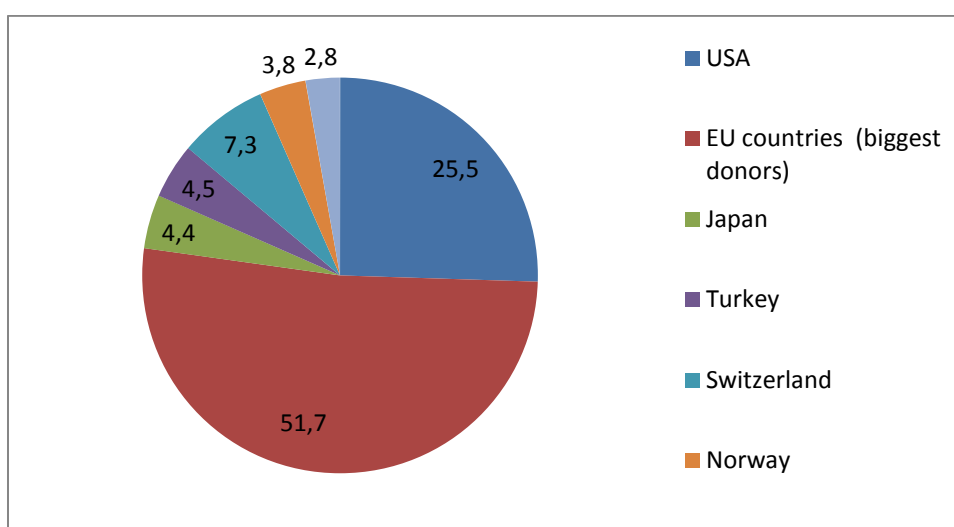
National context (political forces, civil participation) and international framework (relationship with main partners – EU, USA, Russia) are very fast changing in Moldova. The shift of initial "factors basket" is, therefore, another important factor, which should not be omitted. In regard to the finance options, the perspectives of ODA and remittances

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<sup>29</sup> <http://www.doingbusiness.org/data/exploreeconomies/moldova#paying-taxes>

reduction are mostly possible. Currently Moldova is a lower middle income country<sup>30</sup>, which according to the EU 2006 European Consensus on Development is a priority for finance aid. However, future transformations (visa liberalization, growing influx of FDI) will, probably, bring the country to upper middle-income classification. It will be necessary to bring convincing arguments that ODA is needed in the same amounts. The EU Agenda for Change proposes a new paradigm for development assistance; the one that can “demonstrate the impact it has had<sup>31</sup>”. The EU is the world’s largest aid donor and also the most important development partner for Moldova (picture), therefore changes in EU donor’s policies will undoubtedly affect Moldova.

Figure 12. Sources of ODA, top donors for Moldova, 2008-2012 (average)



Source: aidflows.org

Remittances will also decrease as a result of family establishments abroad and less transfers to parents.

Thus, the focus should be moved to other main sources of transformations – tax revenues, export growth etc. or combined finance mechanisms, better reflecting the rapidly changing realities.

Financial aid is not synonymous with development support, but is just one of a range of possible interventions of developing partners. ODA will inevitably be a less relevant feature of the more developed and independent economy of Moldova. Other forms of international

<sup>30</sup> <http://data.worldbank.org/country/moldova>

<sup>31</sup> Agenda for Change Impact Assessment,

support can come instead of ODA, including architectural and regulatory issues such as ensuring a better context for trade and improving the intellectual property rights regime, enhancing dialogue and sharing between countries and support in better management of other finance mechanisms.

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