

Republic of Moldova

# STATE OF THE COUNTRY REPORT

2019

# Republic of Moldova 2018

## STATE OF THE COUNTRY REPORT

With the  
support of:



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## ABBREVIATIONS:

<b>CEE</b>	Central and Eastern Europe
<b>CEE EU</b>	EU Member States from Central and Eastern Europe
<b>EBRD</b>	European Bank for Reconstruction and Development
<b>EU</b>	European Union
<b>FDI</b>	Foreign Direct Investments
<b>GDP</b>	Gross Domestic Product
<b>HoReCa</b>	Hotels/Restaurants/Cafes
<b>IMF</b>	International Monetary Fund
<b>MDL</b>	Moldovan Leu
<b>PDM</b>	Democratic Party of Moldova
<b>PSRM</b>	Party of Socialists of Moldova
<b>USD</b>	United States Dollar
<b>VAT</b>	Value added tax
<b>Q1</b>	First quarter
<b>y-o-y</b>	Year on year

# Key Messages

*The political transition following the parliamentary elections in 2019 produced a major change of power that created preconditions for boosting the reforms' agenda, but the fundamental weaknesses of the state of the country were not resolved yet.*

The takeover of power by the multi-geopolitical opposition, which entered into a temporary coalition based on joint pro-reform commitments, put an end to the oligarchic governance under the umbrella of the Democratic Party of Moldova (PDM). Most of the reforms were initiated by the parliamentary majority formed of the Party of Socialists of the Republic of Moldova (PSRM) and the ACUM bloc aimed at reviewing and remedying the governance shortcomings of the previous governments, focusing primarily on policies initiated by the PDM. The depoliticization of institutions, judicial reform, and

better use of public money and property are the major reform landmarks, equally appreciated by public and external partners (International Monetary Fund (IMF), World Bank, European Union). However, the PSRM-ACUM government, has hesitated repeatedly to carry out real depoliticization, and the initiated de-oligarchizing is strongly focused on the system previously led by Vladimir Plahotniuc, rather than on establishing a mechanism to prevent and fight the phenomenon of the 'captured state' by de-oligarchizing political power in a systemic and permanent manner.

*The revival of the internal democratic process has resuscitated, as a 'chain reaction', foreign policy with both the West and the East.*

The rapid unfreezing of European Union (EU) budget support has considerably fostered the dialogue with the EU institutions. Thanks to the return to a proportional voting system, more rigorous investigation of the "billion dollar theft" from the banking system, the prioritization of judicial reform and the fight against political corruption etc., the PSRM-ACUM coalition has quickly gained robust credibility among external partners. At the same time, there is a firm stance towards the importance of restoring the relationship with Russia, mainly in commerce, the energy sector, and in relation to

the settlement of the Transnistrian conflict. The Socialists insist on the idea of a 'balanced foreign policy', while the ACUM bloc shows no resistance to this. Intelligent, i.e. flexible, conditionality needs to be strictly applied to the governing parties, to discourage deviation from their commitments. At the same time, rebuilding the relationship with Russia must be free of any elements that might reduce Moldovan security, in particular by encouraging 'hybrid' activities in the informational space or with regard to the Transnistrian conflict resolution, carried out by the Russian authorities in the region.

*On the economic side, Gross domestic product (GDP) annual growth rates have stabilized at around 4 per cent, without any significant structural changes in the national economy.*

Although volatility has decreased, this growth plateauing presents some significant risks. First, this level of GDP growth is insufficient to achieve convergence with Central and Eastern Europe. Moreover, such a rate will push back convergence with these countries in terms of GDP per capita by several decades. At the same time, such a slow rate of growth does not

allow for a qualitative leap towards a new model of economic development. Thus, the growth paradigm remains the same: household consumption accounts for over 80 per cent of GDP and depends strongly on remittances. Such a model can hardly survive in the long-run, and the inability to accelerate and diversify the economy means that the population

will continue to suffer low standards of living. The economic growth above 5% in 2019 is likely to be temporary, being fuelled by

the low comparison base and the effects of the tax cuts from 2018 that will rapidly fade away.

*Some marginal improvements in personal income and welfare have been recorded.*

Real disposable personal income is on an upward trend. Over the past decade, although with periods of stagnation and decline, the personal income grew by about 3 times in nominal terms, representing a 30% growth in real terms. This growth was also reflected in people's perceptions of their standard of living. The share of those reporting a 'bad or very bad' standard of living has fallen to an historical low – 10 per cent of all households. The majority (75 per cent) believe they have a 'satisfactory' standard of living. Despite these positive trends, per capita income and consumption in the Republic of Moldova remain at only 40 per cent of the average in Central and Eastern

Europe, without showing signs of rapid convergence. Further income growth, or accelerating the convergence with such countries, is restricted by the income structure in the Republic of Moldova. An increasing number of Moldovan households receive their main income from activities that are not linked directly to the performance of the national economy and labour productivity. In 2017, over 60 per cent of households were receiving either pensions or remittances from abroad as their income. Thus, the demographic and migration limitations create significant challenges for the sustainable and rapid growth of income for a large part of the population.

*At the same time, there is a worrying level of income inequality, given the sizeable informal economy and narrow tax base that undermine the capacity of the social protection system to address this problem.*

About 40 per cent of total disposable income is held by quintile V (the richest category) of the population, with the Gini coefficient being estimated at a worrying level of 0.35 points. People working in agricultural are the most vulnerable: more than half of them are part of quintiles I and II (the lowest income), revealing issues with income inequality. These trends indicate that farming households are marginalized from the income growth and convergence process. Only those who have given up farming have joined this process and managed to exit the 'poverty trap'. However, over the last few years, the level of inequality has been decreasing. More active involvement of low-income groups in migration is a factor that has narrowed inequalities. The share of remittances in the income of these households is now the same as in the high-income groups. The structural change in the social and economic status of households has been another factor that has contributed to income convergence. The number of farmers and

agricultural employees has decreased, where the concentration of the poor is higher than 50 per cent of households with this status. Despite this dynamic, the level of inequality remains a major concern, poses risks to the state of the country, and calls for economic and tax policies adapted to this challenge. While the level of inequality compares well with other countries in the region, the low capacity of the social protection system to address inequality is an issue going forward. The reasons are mainly related to high fiscal imbalances, coupled with profligate fiscal and budgetary policy before the Parliamentary elections in 2018, which limits the policy space for Government in fighting inequalities with fiscal and budgetary tools. In addition, the demographic aging process could further hinder inequality narrowing efforts, while in the medium and long-term, these processes could further aggravate inequalities due to the diminishing share of the economically active population and the increasing share of pensioners.

*A major challenge for the state of the country and the economic development is related to the deprivation of the main factors that have until recently underpinned economic growth and attracted investments – remittances and cheap labour.*

Remittances are becoming more volatile and uncertain, and tend to shrink in the long-run, and the main factor that has attracted (the low level of) investment so far – cheap labour – is undermined by emigration, an inefficient education system, and wage growth outstripping productivity. As a result, the country's ability to generate added value is diminishing, as revealed by the slowdown in economic growth in recent years, which is expected to worsen in the future. The serious-

ness of the situation is also revealed by decreasing labour productivity and the stagnation of the employment rate (both being the lowest in Europe), with increasing informal employment. Thus, if Moldova does not identify sustainable sources of value added investment and exports in the coming years, the economy will deplete its ability to create jobs, income for the population and revenue for the public budget, with economic growth tending to become lower and less certain.

*The slowdown in economic growth becomes even more problematic against the backdrop of a broadening current account deficit, which reveals structural weaknesses in competitiveness.*

This imbalance is mainly caused by the increasing gap between exports and imports, which ultimately points on competitiveness issues in the Moldovan economy and fuels risks for the long-term macroeconomic stability. It is not the deficit per se that is problematic, but rather the fact that it is determined by imports of energy products, consumption and industrial inputs, and not by machinery, equipment and know-how, which

would boost exports in the long-run and balance the current account. In addition, with stagnating foreign investment and the expected decline in remittances, financing the current account deficit will become an increasingly acute problem, putting pressure on the national currency and foreign debt. In this context, enhancing the competitiveness of the national economy must be the fundamental priority for Government.

*Competitiveness enhancement should be ensured on three interdependent areas: (i) the labour market; (ii) capital and investment markets; and, (iii) foreign markets for exports.*

Labour-force competitiveness must be enhanced by improving its quality and relevance, rather than by decreasing labour costs. In this regard, the educational system needs to be reformed so that, on the one hand, it is more flexible and able to respond to the economy's needs, and, on the other hand, instils a spirit of entrepreneurship, initiative and innovation. These efforts should be also encouraged by tax and economic policy. This will allow the harnessing of people's potential, especially of the younger generation, and will make Moldova more attractive for talent – a fundamental condition for strengthening the state of the country and its long-term competitiveness. At the same time, this should be the main

sustainable factor in terms of increasing the country's competitiveness at the level of the capital and investment market. Fostering a high-skilled labour force, initiative, and openness to innovation and know-how should be the main factors behind the country's investment attractiveness and must be supported by pro-business regulation, a free market economy, transparent and non-corrupt institutions, and a rule of law that protects private property rights. This will boost competitiveness at the level of foreign markets for exports, by augmenting the technological sophistication of exports, diversifying them in terms of products/services and sales markets, and adding more value for the economy and the country as a whole.

*While policies aimed at competitiveness enhancement should be intense and active, these should not compromise on sustainable development objectives related to environment protection, the integrity of investments (transparency), employees' security and human rights in general.*

Given scarce investment, Moldovan governments have traditionally prioritized pro-business policies and marginalized other important objectives related to sustainable development. As a result of this narrow approach to economic policies, Moldova is still lacking investment, while having weak frameworks and institutions dealing with environment protection, employees' rights and money laundering. The government should not attract investment at all costs (e.g. by granting citizenship to investors without proper screening, by capital and tax amnesties, by weakening the environment and labour protection institutions of control and enforcement). Instead, Moldova needs a balanced

economic policy that would stimulate through all possible means (e.g. fiscal, regulatory, financial tools) investments that contribute to the sustainable long-term development of the country. Such investments would meet the following 5 criteria: (i) generate high-value added; (ii) are export-oriented; (iii) create decent jobs; (iv) implement green technologies and contribute to decoupling of economic activity from the use of natural resources; and, (v) comply with the highest standards of transparency and integrity of ownership. The government should deploy a wide range of investment attraction tools for investments meeting all of the above-mentioned criteria.

*All in all, the state of the country can be fostered by empowering three key elements: (i) government; (ii) private sector; and (iii) households.*

In a nutshell, the current state of Moldova is undermined by highly corrupt, inefficient and weak public institutions, which in turn represent the main barriers for doing business and, hence, lead to a fragile private sector, undermining the tax base, employment and the wellbeing of the population. It forms a vicious circle, because weak private sector and high poverty undermine further the public institutions by narrowing the tax base and fueling corruption. In order to turn this vicious circle into a virtuous one, Moldova needs a complex and well-coordinated set of reforms that should be anchored in a well-defined national development strategy for the next 10 years. Policies should target the mentioned three elements that define the state of the country: (i) the government has to become more accountable and efficient, by increasing the transparency of public institutions, fostering the integrity framework, reforming the

justice system and making the public sector attractive for talented professionals; (ii) the private sector should be supported by implementing balanced pro-business fiscal and economic policies (without undermining the sustainable development objectives mentioned above), providing loan guarantees for SMEs and start-ups that implement innovations, generate added value and jobs, developing business infrastructure for start-ups and easing the bureaucratic procedures (e.g. digitalization, tacit approval mechanisms, one stop shops etc.); (iii) households should be empowered by reforming the educational and health systems – top sectors of systemic and strategic importance where reforms stagnated over the last years and which determine the long-term development of the country. Hence, the structure of this edition of the state of the country report is centred around these three key elements.



# EXECUTIVE SUMMARY

Special Subject:

## **Social-Economic Inequalities and their Impact on the State of the Country**

The absolute level of social and economic inequalities in the Republic of Moldova is declining. During the last decade, the Gini coefficient, which measures the inequality in a society, from 0 (perfect equality) to 1 (maximum inequality), has been on a downward trend. The coefficient decreased for both the total disposable personal income to 0.3 in 2017, and for total consumer expenditure to 0.24. The growing emigration of the low-income population groups was an important factor that contributed to the falling level of inequality. During 2006–2017, the share of remittances obtained by households from quintile I (the 20 per cent of the population with the lowest income) doubled to 18 per cent of their total disposable income, at a level comparable to that of households from quintile V (the 20 per cent of the population with the highest income). The signif-

icant decrease in the number of households with a poor socioeconomic status was another important factor fostering personal income convergence. Thanks to the decrease in the share of households with the socioeconomic status of farmer or agricultural employee, over 40 per cent of which were in the quintile I in 2006, income convergence was accelerated at national level. At the same time, the population who remained in rural areas and who are practising agriculture became even more vulnerable to poverty. The share of low-income population with the status of farmer or agricultural employee increased to over 50 per cent of all households with this socioeconomic status. At the same time, despite the positive trend with respect to inequality, its level is most likely underestimated due to the weaker coverage of households with a high level of income.

## **The private sector**

Between 2016 and 2018, annual growth rates stabilized around 4–5 per cent. The business environment worsened in 2016 and 2017, with private investments declining in both years. The trend changed in 2018, when private investment increased by 2.1 per cent. Moreover, private investment increased significantly in Q1:2019 (by 18.7 per cent y-o-y) as a result of the lower social contributions paid by companies. At the same time, the Government played an active role and fostered economic growth. The Government has considerably expanded public investment since 2017, and public sector salaries were increased in Q4:2018 as part of the wage reform. Significant tax cuts were also enacted in Q4:2018, including:

the social contributions rate fell from 23 per cent to 18 per cent of the payroll fund; progressive taxation was replaced by a single income tax rate for individuals; and, the VAT rate in the HoReCa (Hotels/Restaurants/Cafes) sector was reduced from 20 per cent to 10 per cent. The tertiary sector – in particular, trade and construction – benefited the most from these budgetary and tax incentives. The transport sector grew robustly between 2016 and 2018, while the construction sector skyrocketed in 2018 and Q1:2019. In the second half of 2019 economic activity will likely cool. This will be determined by the dissipating effects of tax cuts and by the more austere approach to public finance. The broad tax cuts have affected

the budget balance, which is why in 2019 the budget deficit could touch 3 per cent of GDP. In this context, the new Government must manage the public finances

in a tougher manner by increasing taxes and cutting spending. As a result, aggregate demand will be limited and economic growth will slow.

## Households

Real disposable personal income began to grow again after several years of stagnation. In 2018, disposable income increased by 3.1 per cent y-o-y, which is its average long-term growth rate. During the last decade, real disposable personal income grew by 30 per cent. This long-term trend, although it has fluctuated significantly and stagnated over recent years, was also reflected in people's perceptions of their standard of living. The share of the population who believed themselves to have a 'bad or very bad' standard of living dropped sharply from 25 per cent to 10 per cent of all households, while the share of those who regarded their standard of living as 'satisfactory' increased to 75 per cent in 2017.

Despite these positive trends, the income and consumption levels in the Republic of Moldova are still quite low (only 40 per cent) of the regional average in Central and Eastern Europe. The significant increase in the number of households (pensioners and emigrants) that depend on non-productive income is another concerning trend for the national economy. The share of these households increased from 42.6 per cent to 61.5 per cent of all Moldovan households over the period of 2006-2017. The fact that the main source of income for most households is not related to the performance of the national economy will make it challenging to ensure social equity in the long-run.

## Governance

Moldova witnessed significant political change, both internally and externally, during 2018–2019. The sustainability of the transformation depends on the careful prioritization of public policies, the revival of state institutions, and their dedication to the public interest. The governing parties (the PSRM-ACUM bloc) are committed to a multitude of urgent reforms aiming at restoring both people's trust in the Government and external partners' trust in the Moldovan political class. The speed and quality of reforms, however, depend on the ability of the post-'captured state' government to regenerate the system and overcome political inertia, which pushes the system towards the repetition of the mistakes made by the previous Government. As for foreign policy, the quality of reforms will impact the sustainability of external partners' trust. The support, so quickly offered by EU after the peaceful political transition, will require diligent

compliance with conditionalities, without which it will be impossible to access financial assistance. Making efforts to establish the relationship with Russia on a purely pragmatic footing differs substantially from the blockade maintained in the past by the PDM. However, the Moldovan authorities show limited caution against the nature of the Russian 'hybrid' influence in the region, which must be addressed. Governance reform, at least in the short and medium-term, should focus on: i) developing a permanent mechanism to fight and prevent the risks of oligarchization; ii) controlling better the funds of political parties to ensure genuine multi-party democracy; iii) closing the gaps in the existing approaches to transparency and cooperation with civil society and trade unions; and, iv) building a credible and consistent external image of Moldova, fully harnessing European conditionality and targeting regional 'hybrid' influences.

# SOCIAL and ECONOMIC Inequalities and their Impact on the State of the Country

The state of a country depends not only on the level of people's income, but also on how income is distributed between different population groups. This chapter highlights mostly the evolution of income and expenditure inequality in the Republic of Moldova, which capture to a large extent the material living standards. It analyses the trends over the past decade and the factors underpinning them. The authors have also tried to determine the extent to which the current indicators of inequality reflect the actual situation. Finally, a set of recommendations are presented to address the problems identified.

## Analysis of the Main Trends and Developments

Over the last decade, the absolute level of income inequality in the Republic of Moldova has been on a continuous downward trend.

During the period 2006–2017, the Gini coefficient<sup>1</sup>, which measures inequality from 0 (perfect equality) to 1 (maximum inequality), decreased continuously. The Gini coefficient decreased significantly both for disposable personal income and consumption expenditure (Figure 1). At the same time, there are still large differences in the level of inequality measured for personal income and for con-

sumption expenditure. For example, the Gini coefficients for disposable income are over 0.3 – in particular, for disposable cash income, which indicates a fairly high level of inequality. At the same time, the Gini coefficients for consumption expenditure are below 0.3, reaching 0.25 if total consumption expenditure is taken into account, which indicate a moderate level of inequality.

The significant differences in the Gini coefficient, depending on how they are measured – for income or consumption expenditure – are explained by two important factors.

First, people tend to underestimate their income in the household questionnaires, in relation to their level of consumption expenditure. Also, consumption expenditure measures more properly the long-term income of population, because consumption is often fuelled by savings when recurrent income is insufficient. Second, in-kind income covers a significant share of total consumption for the poorest pop-

ulation. In-kind consumption partially compensates for the lack of cash income for this category of the population. Although declining, the share of in-kind income in total disposable income has stayed at around 10 per cent in recent years, while in quintile I (the 20 per cent of the population with the lowest level of income) the share of in-kind income reaches 18–20 per cent of total disposable income.

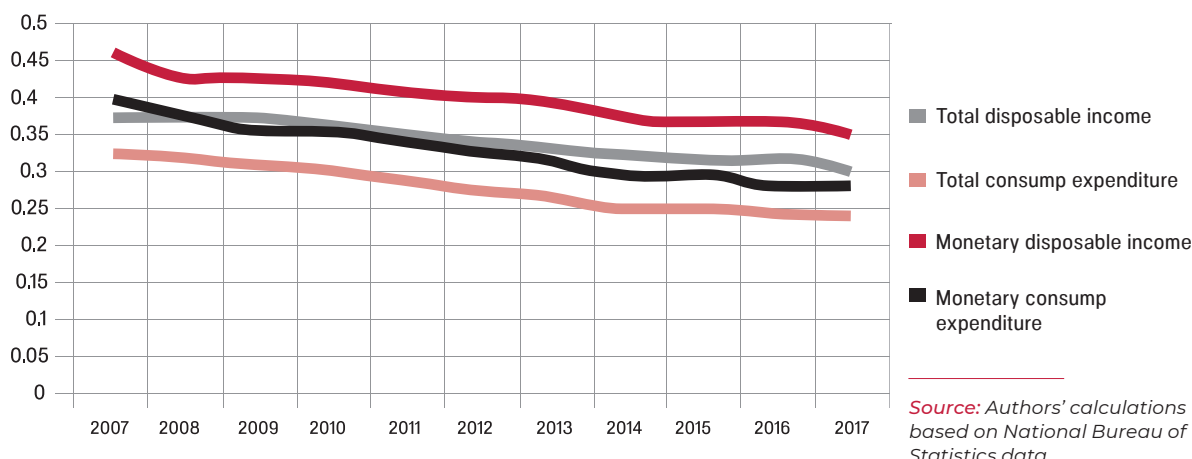
1. The Gini coefficient is the most commonly used measurement of income inequality, representing the income distribution of the population. A Gini coefficient of zero expresses perfect equality (everyone has the same income). A Gini coefficient of 1 (or 100%) expresses maximal inequality (only one person has all the income or consumption, and all others have none). Still, it has some critics. For example, Thomas Piketty (2013) "Capital in the Twenty-First Century" argues that it is difficult to succinctly summarise income inequality in one indicator.

Lower inequality has led to a more symmetrical distribution of income, but the discrepancies remain quite significant.

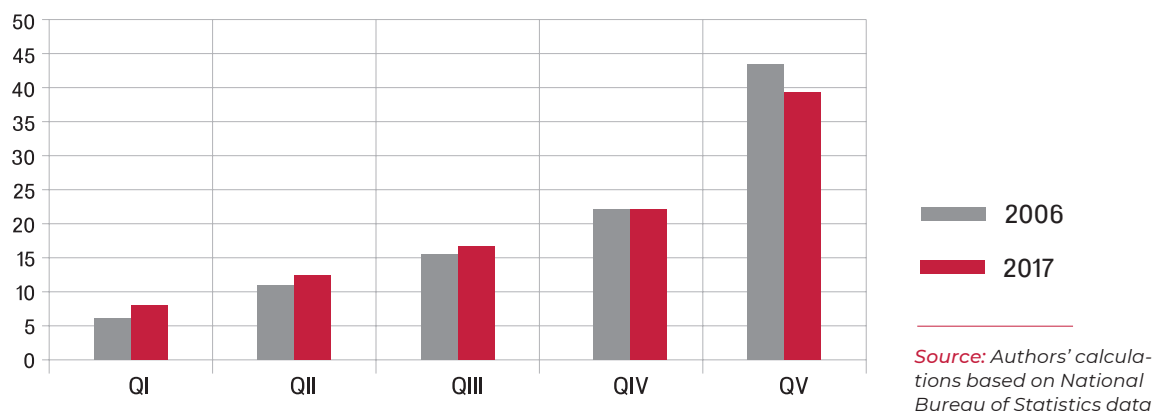
The positive evolution of the Gini coefficient over the last decade is reflected in the fact that the share of income held by the most vulnerable sections of the population has increased. Indeed, during 2006–2017 the share of income held by quintiles I, II and III increased, while the share of quintile IV (the 20 per cent of the population with above average income) stayed the same, and the share of quintile V (the 20 per cent of the population with

the highest level of income) decreased. Thus, the share of quintile V fell from 44 per cent to 40 per cent of total income during the period covered (Figure 2). These trends show that the income share of the poorer population grew and has led to a degree of income convergence. At the same time, the fact that 40 per cent of the total disposable personal income is held by quintile V reveals that the absolute level of inequality is still rather high.

**Figure 1.**  
Evolution of the Gini coefficients, calculated for personal income and consumption expenditure



**Figure 2.**  
Evolution of the distribution of disposable personal income by quintile (per cent of total income)



The level of inequality has fallen in the Republic of Moldova at one of the most impressive rates in Central and Eastern Europe.

Over 2009–2015, the level of inequality remained almost unchanged<sup>2</sup> in most EU member states from Central and Eastern Europe. The Republic of Moldova was the only country in the region which had a sig-

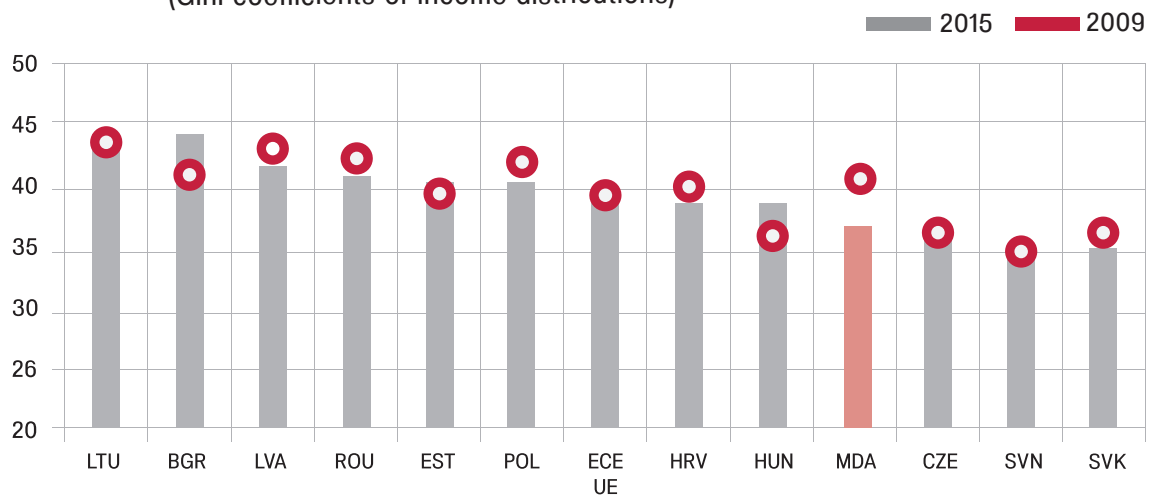
nificant and positive performance in this regard (Figure 3). The Gini coefficient of income in the Republic of Moldova is also one of the lowest, being outpaced only by the Czech Republic, Slovenia and Slovakia.

The increasing emigration of the low-income population was one of the factors that has pushed down inequality in the Republic of Moldova<sup>3</sup>.

During the 2006–2017 period, the share of households that reported remittances as their main source of income almost doubled – from 9.7 per cent to 18 per cent of all households. At the same time, some structural changes occurred in this group of households. Low income (quintiles I and II) and middle-income households (quintiles III and IV) have become increasingly dependent on remittances, while high-income households (quintile V) have decreased their dependence. Consequently, out of all households that depend on remittances, the share of those with a low level of income increased from 27.7 per cent to 31.8 per cent, and of those with middle income from 37 per cent to 39.3 per cent. At the same time, the share for wealthy house-

holds decreased from 35.3 per cent to 28.9 per cent. These structural changes also led to a change in the role of income sources. The share of remittances doubled for the poorest groups of the population. For example, in 2017 remittances accounted for almost 18 per cent of the total disposable income of quintile I, double what it was in 2006, with a slight decrease to 15 per cent in 2018 (Figure 4). Considering that remittances have been increasing for most of the period analysed, the more active involvement of the vulnerable population in migration has also led to income convergence. However, due to demographic limitations, remittances cannot in the longer term be a sustainable way of decreasing income inequalities.

Figure 3. Comparative analysis of the level of inequality in Central and Eastern Europe (Gini coefficients of income distributions)

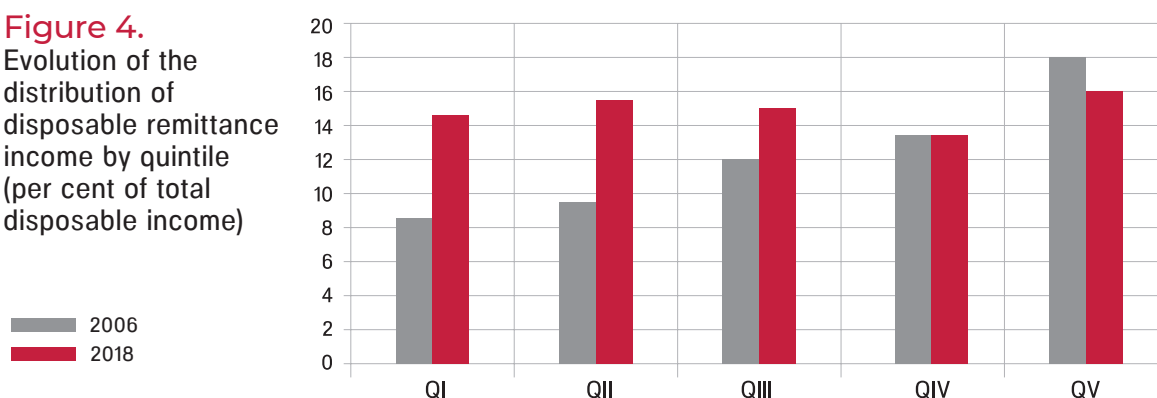


Source: Authors' calculations based on World Bank data

<sup>2</sup> The period between 2009 and 2015 was selected for comparison due to the fact that the World Bank's databases have missing data for some countries for the other years.

<sup>3</sup> <https://www.expert-grup.org/ro/biblioteca/item/1667-inechitatea-sociala-care-este-rolul-coruptiei>

**Figure 4.**  
Evolution of the distribution of disposable remittance income by quintile (per cent of total disposable income)



Source: Authors' calculations based on National Bureau of Statistics data

The positive changes in the structure of the households' socioeconomic status were another important factor that led to lower inequalities.<sup>4</sup>

The number of households with a poor socioeconomic status due to low income decreased between 2006 and 2017 (with a significant concentration of low-income households). Thus, the share of households with the status of farmer or agricultural employee decreased almost three times cumulatively. In each of these categories, the share of households in quintile I and II was over 40 per cent in 2006 (Table 1). The share of the population in households with a more favourable socioeconomic status in terms of income has increased, where the share of the population in quintile I and II is lower (non-agricultural employ-

ees, pensioners and others/migration). These structural changes in households, although they have led to lowered inequality at the aggregate level, have worsened the situation in already vulnerable groups (farmers and agricultural employees). In 2017, the share of quintile I and II households exceeded 50 per cent of all households in these groups, indicating significant inequality. These trends highlight the issue that farming households are the losers in the income growth and convergence process. Only those who gave up farming joined this process and managed to exit the 'poverty trap'.

**Table 1.**  
Structural changes in households by socioeconomic status

Structural changes in households by socioeconomic status	2006		2017	
	Q1 and Q2 (per cent of households in each category)	Category (per cent of households)	Q1 and Q2 (per cent of households in each category)	Category (per cent of households)
Farmers	41,0	20,0	64,5	5,1
Agricultural employees	47,1	8,2	55,5	5,1
Non-agricultural employees	25,7	28,7	19,3	29,3
Pensioners	40,1	32,9	32,0	42,4
Other	37,0	9,7	39,3	17,6

Source: Authors' calculations based on National Bureau of Statistics data

<sup>4</sup> The social-economic status to which the household belongs is defined depending on the main source of income of the household head. According to the classification of NBS, there are the following possible categories – farmers, employees in agricultural sector, employees in non-agricultural sector, self-employed, pensioners and others.

Nevertheless, the level of inequality in the Republic of Moldova, although decreasing, is most likely underestimated due to both the methodology used and the magnitude of the non-observed economy.

The limited coverage of the high-income population and their responses in household surveys is an important methodological issue that can result in an underestimation of inequality in any country. This becomes even more relevant for the Republic of Moldova if we take into account the evolution of households covered that report earning their main income from entrepreneurial activities. The share of these households – which has been always low – has decreased continuously over recent years, from 0.5 per cent in 2006 to 0.1 per cent of all Moldovan households. This concerning trend reveals either a significant decrease in the population engaged in entrepreneurial activities (a decrease of such magnitude, however, is unlikely) or

the fact that respondents avoid or distort their responses for the household survey. Tax evasion has also intensified in recent years, which has resulted in higher income, specifically for households practising entrepreneurial activities.<sup>5</sup> Thus, both aspects (methodology and increased tax evasion) may result in an underestimation of inequality for the Republic of Moldova. If these aspects are taken into account, the Gini coefficient for money income could increase over the current values of 0.35 (already rather high). Finally, the indicators used in this chapter take into account only income, disregarding or underestimating other financial or non-financial assets, which are predominantly owned by households engaged in entrepreneurial activities.

## Policy Recommendations

The indicators relating to inequality have decreased in the Republic of Moldova, but the situation in this area is still ambiguous.

In spite of decreasing inequality, there are some population groups that are not part of the income convergence process. Furthermore, the level of inequality is probably underestimated because of the particular-

ities and shortcomings of the methodology used to calculate these indicators. A series of measures are needed to further reduce the socioeconomic inequalities, as well as to clarify the overall situation:

### *Support measures for vulnerable categories of population.*

Given that the population groups that have remained outside of the convergence process are from rural areas (farmers and agricultural employees), a series of targeted measures are needed to boost their income. Possible measures include: implementing diversification programmes for non-agricultural activities (e.g., tourism); reviewing the agricultural subsidy mechanisms (to make it fairer for small farmers); decreasing informal employment in rural regions (which is

larger than in urban areas); and, making earmarked transfers from the public budget (e.g., for education, health care).

- ***Fiscal measures to reduce inequalities.***

One direction for action would be to reintroduce the progressive tax system – but this should be done only after an impact assessment. Readjusting the tax system shortly after its introduction would be disruptive to the business environment. Fighting tax evasion is therefore a priority for the medium-term, since evasion benefits high-income households and reduces the potential public budget spend for vulnerable groups.

- ***Comprehensive assessment of social and economic inequalities.***

In addition to looking at income, it is important that the level of inequality is also measured by taking into account the ownership of financial and non-financial assets. The structure and extent of these inequalities would provide more options for tax interventions in terms of areas prone to the risk of tax evasion and/or for adjustments to certain taxes and duties (e.g., on real estate). The assessment of these inequalities must be based on accurate information (fiscal, cadastral, etc.), which is not currently available publicly.

**Table 2.**  
The main indicators monitored with regards to inequality

	2016	2017	2018
<b>Gini coefficient (total disposable income), per cent</b>			
<b>Total</b>	32,2	30,8	29,3
<b>Ratio between the income of quintile I and V, per cent</b>			
<b>Total</b>	32,7	33,8	34,9
<b>Rural</b>	36,4	37,2	40,0
<b>Urban</b>	30,7	32,7	33,8

*Source:* Authors' calculations based on National Bureau of Statistics data



# THE PRIVATE SECTOR

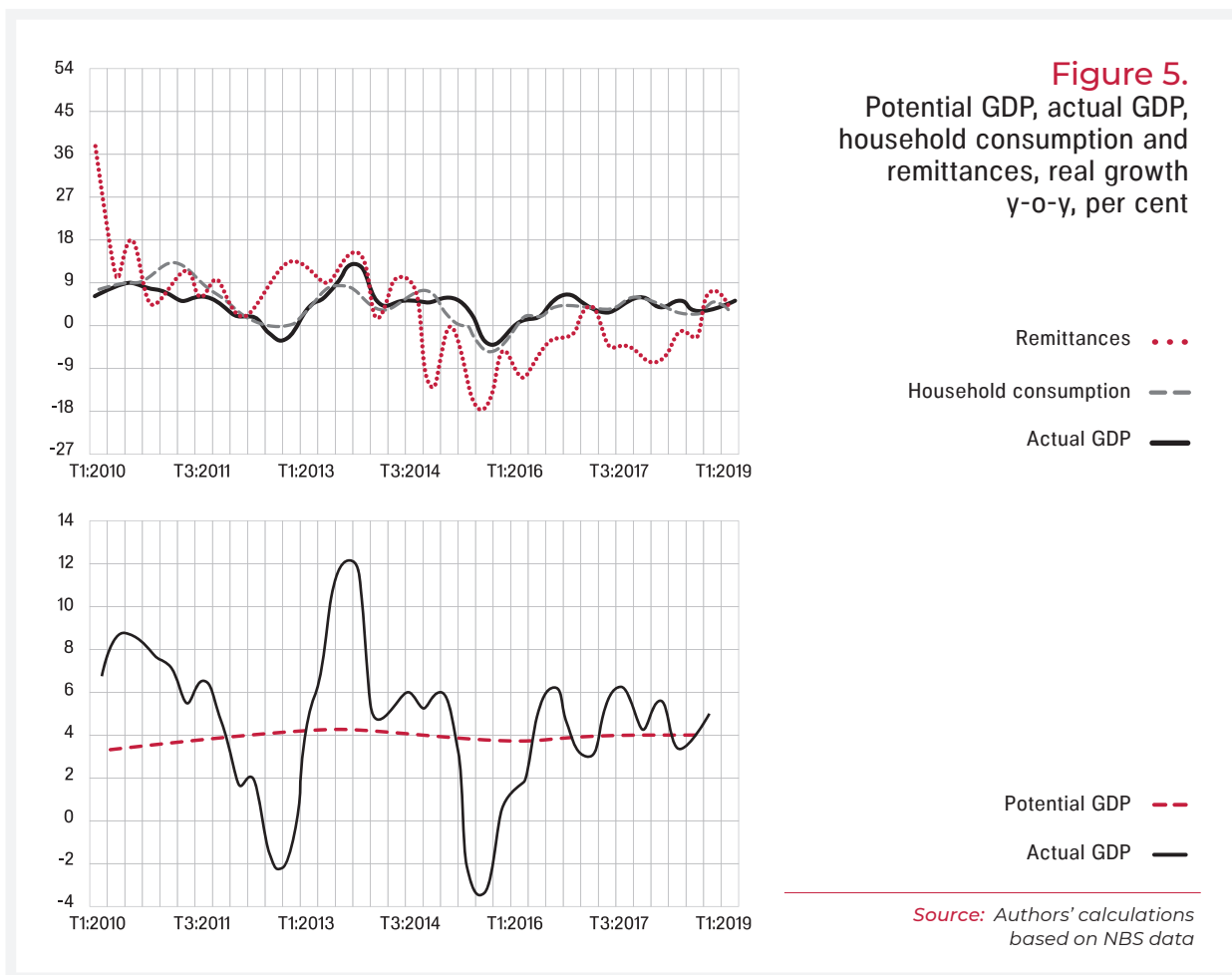
*The state of the country is determined by the development level and competitiveness of companies, human welfare, and the quality and effectiveness of governance. These three defining elements of a state are closely interconnected and are analysed in this State of the Country Report. The chapter below focuses on the first element and evaluates the dynamics of the private sector in the Republic of Moldova, identifying the most significant trends, especially in terms of production volumes and economic growth. The significant tax cuts made in late 2018 should be highlighted as an important factor influencing the business environment. This analysis found that, although the set of fiscal measures fostered private investments, the pace of economic growth did not accelerate. Thus, the positive impact generated by the growth of private investment will be diminished by the need to promote austere fiscal-budgetary policies. The tax cuts undermined the state's budgetary position, and in this context the Government will have to manage public spending in a much more prudent way. The chapter ends with a series of policy recommendations aimed at mitigating the risks that affect the evolution of the business environment.*

## Analysis of the Main Trends and Developments in the Real Sector

**In the period under review, the Moldovan economy stabilized and fluctuated slightly around the natural growth rate.**

From 2010 to the 2015 crisis, however, the economic dynamics were volatile: high growth rates were recorded (5.8 per cent in 2011 and 9 per cent in 2013), as well as falls – in 2012 the economy shrank by 0.6 per cent. After the decline of 2015, quarterly GDP growth was uniform and fluctuated around the potential GDP growth rate, between 3.7 and 3.8 per cent y-o-y (Figure 5). As a result, annual growth rates varied from 4 to 5 per cent. However, such growth levels are insufficient to ensure GDP per capita convergence with Central and Eastern Europe over the next few decades. In order to achieve this convergence, the

Republic of Moldova needs growth rates of 7–8 per cent.<sup>6</sup> Another challenge is that the sustainability of the current model of economic growth is limited in time. Thus, household consumption remains the main driver of GDP growth, and remittances play an important role in financing household spending. The evolution of remittances is particularly volatile and, in the past, has already negatively affected household consumption and GDP (Figure 5). In the long run, these transfers will decrease; there is a risk that, in case of a slow economic development, this loss will not be offset by other sources of income from exports or investments.



Although there is a positive growth trend in agriculture, progress is volatile.

After the 13 per cent decline in 2015, the agricultural sector has been steadily growing, although the growth rates have slowed: 18.8 per cent in 2016; 9.1 per cent in 2017; and 2.5 per cent in 2018. The low growth in 2018 was caused by adverse weather conditions which led to a decline in the yield of several crops, including potatoes, vegetables and sunflower. This trend continued into 2019 with the volume of agricultural production decreasing by 4.5 per cent y-o-y in the first 6 months of 2019. Moreover, the forecast also indicates weak growth for the sector in 2019 of around 2 per cent. The positive developments in agriculture, following the 2015 decline, were due to higher crop production, while the livestock has decreased slightly. In 2018, crop production grew by 49.4 per cent and livestock production decreased by 0.6 per cent, compared with 2015. Despite the upward trend, crop production is still encoun-

tering a range of challenges. Due to the fragmented household structure, economies of scale are difficult to achieve. In addition, low value crops still have a dominant position in agriculture: over half of the processed agricultural land is cultivated with maize, wheat and sunflowers. At the same time, there are some positive developments as a result of deeper relations with the EU, among other factors. Thus, the high EU demand for plums and nuts has favoured the development of these crops. In 2018, record yields were recorded for walnuts (20,000 tons) and plums (133,000 tons). The decrease in livestock production was caused by a fall in the number of animals. For the most part, the number of cattle, pigs and sheep owned by households has decreased, a development caused by the high costs of animal breeding. Poultry is an exception to this trend, with agricultural enterprises representing the largest share of it.

### Although there is a certain rise of industry, its subsectors are experiencing unstable growth.

After initial slow progress in 2016 (0.9 per cent), industrial output increased by 3.4 per cent and 3.7 per cent in 2017 and 2018, respectively. However, progress was insignificant after the 2015 decline. Thus, between 2012 and 2014, industrial production increased by 4.5 per cent on average, while between 2016 and 2018 growth was only 2.7 per cent. Slow progress was also recorded in the first five months of 2019, when growth was only 2.1 per cent y-o-y. Most likely, the sector will make modest progress in 2019 as well, mainly due to the low growth rate in the EU, the slow advancement of agriculture and the significant slow down recorded in construction. The processing industry also progressed slowly – the average annual growth was 3 per cent between 2016 and 2018, and in January-May 2019 growth was 2.1 per cent y-o-y. As for the branches of the processing industry, we can highlight the unstable dynamics of the food industry.

The 2015 fall in agricultural production, and the slow pace growth in 2018, resulted in a shrinking food industry, by 4.8 per cent in 2015 and by 2.9 per cent in 2018. The food industry also decreased in the first 5 months of 2019 – by 3.5 per cent y-o-y. At the same time, the export-oriented branches of the processing industry have in general witnessed positive developments. These include machinery manufacturing (in fact, the activity of this branch is limited to cable assembly). The branch experienced average annual growth of 43 per cent between 2016 and 2018, and between January and May 2019 it grew by 68.7 per cent y-o-y. In the mining and quarrying sectors, the 2015 decrease continued in 2016 and 2017 as well, but in 2018 the trend reversed. Due to the growth of the construction sector, mining and quarrying grew by 9.9 per cent in 2018 and by 27 per cent y-o-y in the first 5 months of 2019.

### Trade and construction have strongly consolidated their positions in the service sector.

Trade grew rapidly after 2015, on average by 7.5 per cent between 2016 and 2018. As a result, compared to 2015, in 2018 the share of trade in GDP increased from 13.8 per cent to 15.5 per cent. The fiscal-budgetary expansion of 2017–2019 (higher public investments and budgetary wages, as well as the tax cuts from the fourth quarter of 2018) stimulated aggregate demand and fostered trade. However, the construction sector benefited the most from the spectacular growth in state-funded investment. After the 2015 stagnation and 2016 decline, this sector expanded

by 5.1 per cent in 2017 and by 16 per cent in 2018. Thanks to this expansion, in 2018 construction reached a share of 7.9 per cent of GDP. Other sectors have also experienced positive developments after 2015. However, in the second half of 2019, with the effects of the relaxed fiscal-budgetary policies falling away and the adoption of a tougher fiscal approach, economic momentum will slow down. This development will be more prominent in the construction sector, while in other areas growth rates will decline more slowly<sup>7</sup>.

### After shrinking for several years, private investment resumed growth in 2018, but at a very slow rate.

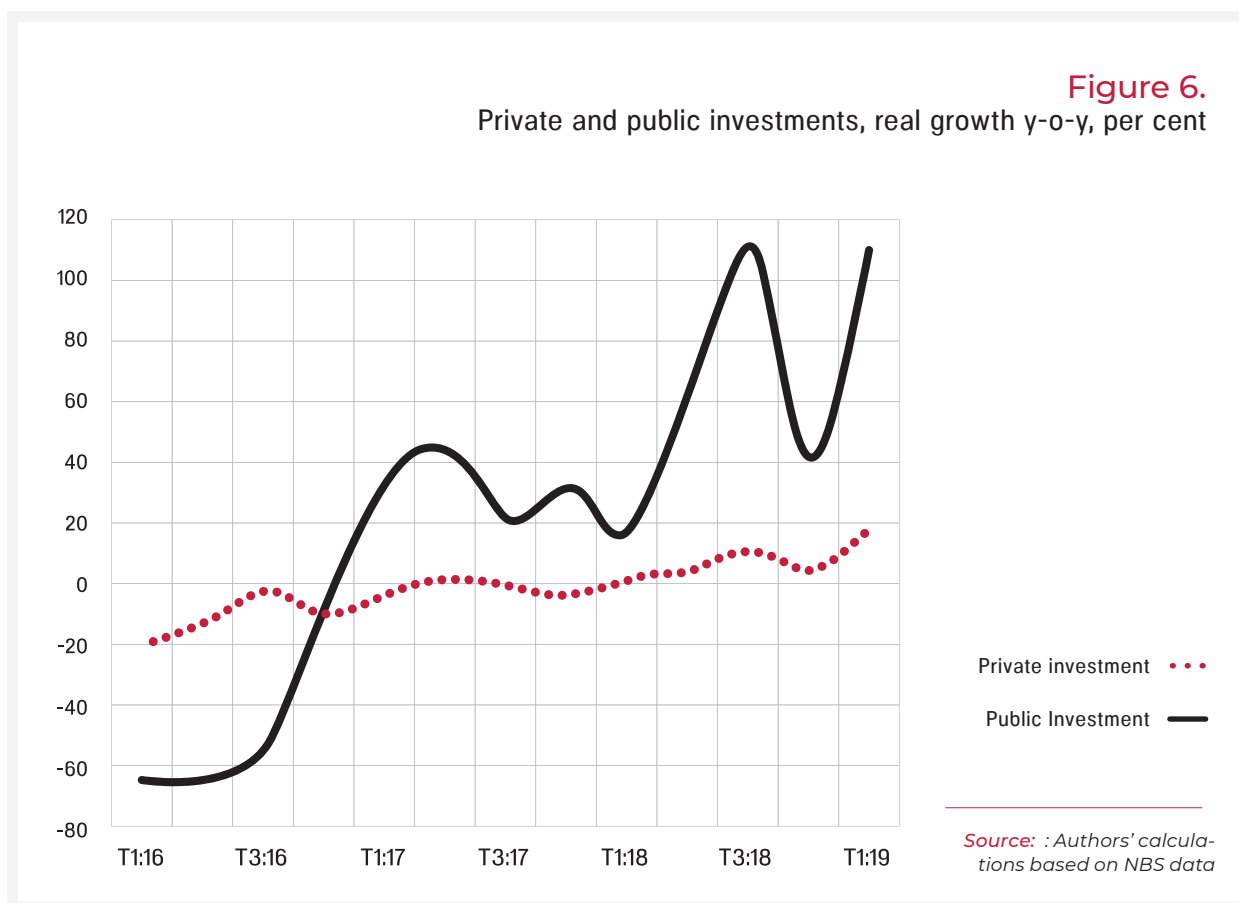
From 2014 to 2017, private investment steadily declined. Thus, its level in 2017 was lower by 24.4 per cent than in 2013. In 2018, thanks to higher domestic demand and the relaunching of bank

lending, private investments grew, but very slowly (by 2.1 per cent). In the first quarter of 2019, private investment grew slightly faster, at 18.7 per cent y-o-y. This expansion was mainly trig-

7. Fala A., Pinteș D., Morcotoș I., Gumeș V., Prohnițchi V., 'Economic challenges following political turbulence. MEGA Quarter III, 2019, #20' Expert-Grup Independent Think-Tank, Chisinau, 2019, p. 18.

gered by cuts in the social contribution (paid by employers) in the final quarter of 2018, from 23 per cent to 18 per cent (a change in the rate of social contributions paid by employers impacts private investments with a delay of one quarter). We therefore expect that the expansion of investment will be maintained during 2019, due to the the ef-

fects generated by the lower rate of social contributions. Note that since 2017 the dynamics of public investment have been much more intense than those of private investments (Figure 6). However, in the second half of 2019, a tougher fiscal-budgetary approach will cause a significant reduction in state-funded investment.



**In the labour market, the improvement of the quantitative indicators is accompanied by a worsening of the qualitative ones.**

In recent years, the trend of increasing total employment has strengthened. In 2018 the employed population was approximately 1.3 million persons – a level equal to that of 2008, before the global crisis. The unemployment rate also reached a historic low of only 3 per cent. However, as employment has increased, informal em-

ployment grew too. In 2018, the share of informal employees in the total employed population reached 38.5 per cent. It is true that tax reform has further curbed the dynamics of informal employment. Thus, due to tax cuts, the informal sector lost 11,500 people in Q4:2018 and 16,900 people in Q1:2019.<sup>8</sup>

8. Fala A., Pinteș D., Morcoteș I., Gumeș V., Prohnițchi V., "Economic challenges following political turbulence. MEGA Quarter III, 2019, #20" Expert-Grup Independent Think-Tank, Chisinau, 2019, p. 14.

## Analysis of the Main Trends and Developments in the Financial Sector

The banking sector's recovery continues and some progress has been made.

In 2018 and 2019, the 'story' of the three commercial banks under special supervision came to an end; this is because the blocks of shares of the respective financial institutions were purchased by strategic foreign investors. A strategic investor (Banca Transilvania) bought 39 per cent of the capital of Victoriabank in January 2018. In October 2018, an international consortium of EBRD, Invalda INVL and Horizon Capital bought 41 per cent of the shares of Moldova-Agroindbank. In March 2019, the Bulgarian company Doverie United-Holding AD purchased 63.9 per cent of Moldindconbank shares. At the same time, in 2019, the French Group Société Générale sold its shareholding in BC Mobiasbanca to the Hungarian Bank OTP Bank. In parallel with these movements, the NBM

continued a series of measures aimed at modernizing the regulation of the banking sector. The implementation of Basel III standards is worth highlighting here, as well as the measures taken to make banks' shareholders more transparent. In general, the banking sector is stable, and prudential indicators are at a comfortable level, within permissible limits. Banks have a high level of capitalization. The total own funds rate exceeds 26 per cent and is well above the 10 per cent minimum. The share of non-performing loans decreased significantly, from 18.5 per cent in November 2017 to 10.6 per cent in June 2019. Banks have excessive short-term liquidity. Thus, the current liquidity level exceeds 50 per cent, provided that the minimum value of the indicator is set at 20 per cent.

Lending has resumed, and the trend has been largely sustained by loans offered to individuals.

After the decline of 2016, new loans granted in MDL increased by about 20 per cent in 2017 and 2018. Individual loans in MDL are growing particularly fast. In 2018, they expanded by 36.5 per cent, and in January-June 2019 by 44.9 per cent y-o-y. Corporate loans in MDL grew by 11.1 per cent in 2018 and by 19.7 per cent y-o-y in January-June 2019. This development may be associated with the launching of the 'Prima Casa' programme, which facilitated

access to real estate loans, but also with very low nominal interest rates in 2018 and in the first half of 2019. However, raising the base rate in the summer of 2019 will slow the lending process. In the case of foreign currency loans, developments have been much slower. In 2018, the increase here constituted 13.2 per cent, but in the first half of 2019 the growth rate slowed to 8.8 per cent y-o-y as a result of the depreciation of the Moldovan leu.

## Analysis of the Main Trends and Developments of the Business Environment

The Republic of Moldova made some progress in improving the business environment, but the fundamental problems are still a limitation on economic growth.

According to the Doing Business Report, in the last three years the Republic of Moldova ranked among the top 50 economies for ease of doing business, ranking forty-fourth in 2017 and 2018, and forty-seventh in 2019. However, this improvement was due to the easier business registration procedure. As for the rest, the economy continues to be affected by fundamental issues related to

justice and corruption, which results in the low attractiveness of the country for doing business for both national and foreign companies. A relevant indicator in this regard is the stock of per capita foreign direct investment (FDI) – a barometer of economic attractiveness. In 2018, this indicator amounted to slightly over USD 1,500 – one of the lowest values in Central and Eastern Europe.

**The fiscal change at the end of 2018 had a beneficial effect on private investments, but negatively affected public finance.**

Significant tax cuts were implemented in late 2018, specifically: a transition from progressive tax system with two rates (7 per cent and 18 per cent) to a single income tax of 12 per cent for individuals; a reduction from 23 per cent to 18 per cent of the compulsory state social insurance contribution paid by employers; and, a reduction of the VAT rate in the HoReCa sector from 20 per cent to 10 per cent. The tax cuts had positive effects on the economy: net salaries increased and private investments expanded. However, following the reform, the Government forewent budget revenues of MDL 1.5 billion.<sup>9</sup> Besides tax cuts, the Government

has significantly increased the salaries of public employees and engaged in a large public investment programme. As a result, the budget deficit increased significantly in the first half of 2019 and could touch 3 per cent of GDP. In this context, the new Government, established after the elections of 24 February 2019, had to increase taxes and decrease spending. The fiscal adjustment measures included returning to the 20 per cent VAT rate in the HoReCa sector and cancelling the preferential tax regime for meal vouchers (employers' allowances for meal vouchers will be taxed like salary income).

## Policy Recommendations

**Under normal economic conditions, public policies for the private sector must be predictable and stable over time.**

The changes made to the tax regime for HoReCa is a noteworthy example in this regard. Neither the decision to decrease the VAT in 2018, nor the decision to increase it again in 2019 were well justified by the executive. At the same time, the rapid amendment of the Government's decision sends out

a negative signal and creates a state of uncertainty for businesses. In an environment with unstable and non-sustainable regulatory measures, it is difficult for companies to develop long-term plans and act accordingly. In this respect, the Government must take into account the following:

9. Fala A., Pinteă D., Morcotilo I., Gumene V., Prohnițchi V., 'Economic challenges following political turbulence. MEGA Quarter III, 2019, #20' Expert-Grup Independent Think-Tank, Chisinau, 2019, p. 27.

- *Policymaking should be based on analysis that takes into account the costs and benefits for all stakeholders.*
- *Public policy making should be consistent and stable over time, at least in the medium-term. (Obviously, there could be deviations from this rule – for example, in the context of extreme events (war or natural cataclysms) or when it is shown that the regulation was developed in bad faith and serves a restricted interest group.)*

**When developing public policies, short-term budgetary gains should not be prioritized to the detriment of human development.**

The change in the tax regime for meal vouchers is an example in this regard. The Government addressed this issue from a strictly fiscal perspective, without paying attention to issues related to the health or productivity of employees. Thus, it was decided that vouchers would no longer benefit from a preferential tax regime, which could lead to the issuers of the respective vouchers exiting the market. This approach can be partially justified, as some employers could try to substitute a part of the salary with vouchers in order to pay less in tax. At the same time, the Government does not have a conceptual

approach to the issue of employee nutrition, which, to a certain extent, has been solved by the deductibility of allowances for employees' meals, as stipulated in Government Decision no. 693 of 11.07.2018 and in the Law on Meal Vouchers of 21.09.2017. Although the system of meal vouchers has its shortcomings, it can ensure the adequate nutrition of workers in urban areas. Without any alternative, the tougher taxation of meal vouchers will result in poorer nutrition for employees in the larger urban localities. This will have an adverse impact on workers' health and productivity.

**The size of the informal economy cannot be reduced only by cutting taxes: institutions also need to be strengthened.**

When it comes to decreasing the size of the informal economy, the standard approach of the Moldovan authorities is de facto limited to cutting taxes. Both the 2007 tax reform (introducing the 'zero' tax on profit) and that from 2018 (cutting the social contributions paid by employers and moving to a single income tax rate for individuals) were supported by the need to reduce the informal economy. Despite the lower tax burden, the

shadow economy has remained large. Therefore, besides fiscal measures, more attention should be paid to strengthening the tax inspectorate, as well as other law enforcement institutions, in order to enhance the capacity to identify and sanction informal economic activities. Detecting and penalizing business entities that use tax evasion schemes will augment the costs of working in the shadow economy.

It is necessary to carry out, and as soon as possible, measures that will make the agricultural sector, as well as the entire economy, more resilient to climate change.

Agriculture is the sector most vulnerable to climate change. Factors such as the degradation of irrigation infrastructure have increased its sensitiveness to climate conditions to an even greater extent. Developing a national afforestation programme is a measure that could increase resilience to climate change. According

to 2017 data, Moldova's forest coverage is 11.2 per cent, which is under the 15 per cent minimum required to ensure ecological balance. Other measures that would strengthen the country's exposure to climate vulnerabilities include promoting 'green' transport, ecological farming and water-saving consumption models.

**Table 3.**  
Main indicators monitored regarding the economy of the Republic of Moldova

	2016	2017	2018
GDP, y-o-y growth, per cent	4,4	4,7	4
Agricultural production, y-o-y growth, per cent	18,8	9,1	2,6
Industrial production, y-o-y growth, per cent	0,9	3,4	3,7
Turnover for provided services, y-o-y growth, per cent	-0,3	2,7	3,9
Volume of construction, y-o-y growth, per cent	-8,1	3,6	17,6
Gross fixed capital formation, y-o-y growth, per cent	-0,9	8	14
FDI inflow, y-o-y growth, per cent	-56,2	69,6	44,2
Consumer price indices, y-o-y growth, per cent	6,4	6,6	3
New loans, y-o-y growth, per cent	-11,6	8,9	17,8
New deposits, y-o-y growth, per cent	5,6	-17,6	-13,9
Own funds ratio, per cent	29,8	31,3	26,6
Share of non-performing loans in total loans, per cent	16,4	18,4	12,5
Current liquidity, per cent	49,3	55,5	54,6
Long-term liquidity, per cent	0,6	0,6	0,7
Export of goods and services, y-o-y growth, per cent	9,8	10,9	4,8
Import of goods and services, y-o-y growth, per cent	2,8	11	8,9
Competitiveness Index, rank	100	100	88
Doing business, rank	52	44	44
Index of economic freedom, score	57,4	49,6	53,5

Source: Authors' calculations based on data taken from: <http://statistica.gov.md>, <http://www.bnm.md>, <https://www.weforum.org/>, <https://www.doingbusiness.org/>, <https://www.heritage.org/index/>



# HOUSEHOLDS

*This chapter analyses the main aspects of people's welfare – another fundamental factor that determines the state of the country. It highlights how disposable personal income evolved and how these trends were reflected in people's perceptions of their standard of living. Factors that can undermine the sustainable and equitable growth of medium and long-term income are also analysed. Based on the limitations identified, a set of systemic proposals are formulated to enhance the growth of household income.*

## Analysis of the Main Trends and Developments

**Disposable personal income is increasing, but this rise has been quite volatile in the last decade.**

In 2018, disposable personal income continued to increase for the second consecutive year, after a period of stagnation and decline in real terms (2014–2016). The actual growth amounted to 3.1 per cent in 2018, returning to the average values for the period prior to 2014. Generally, the dynamics of personal income in the Republic of Moldova have been extremely volatile, mainly due to its sensitivity to the broader

macroeconomic conditions. Therefore, during periods of economic crisis (2009, 2012, 2014–2016), real disposable income decreased, followed by periods of significant rises (*Figure 7*). Despite the observed volatility, the monthly disposable personal income increased about 3 times between 2006 and 2018 – from MDL 840 to MDL 2383 on average per person, which in real terms represented a 30% growth<sup>10</sup>.

**Income grew for all groups of the population, which resulted in poverty reduction.**

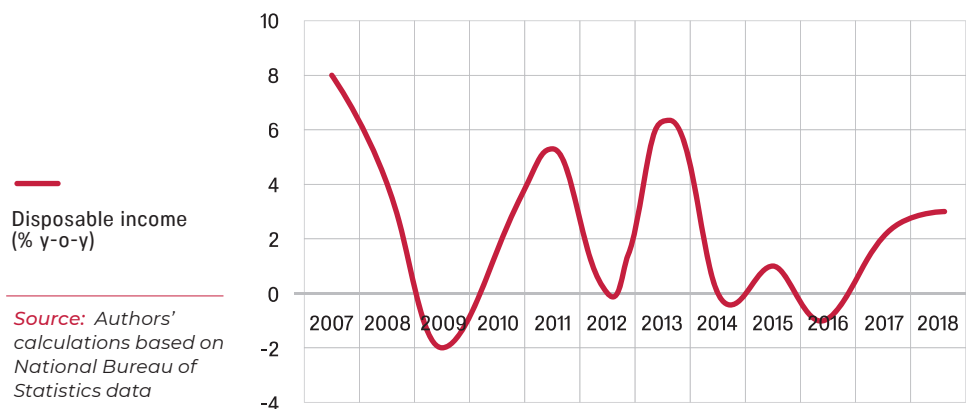
During 2018, as stated in the chapter on inequalities, the income of the poorer sections of the population grew faster than those with a medium and high welfare level. As a result, the share of the poor population (quintiles I–II) fell from 35.3 per cent in 2006 to 31.1 per cent in 2018. During this period, the share of medium-income groups, respectively, increased from 41.9 per cent to 43.3 per

cent, and of those with high income from 22.6 per cent to 25.5 per cent. Following this restructuring, in only a few years (2011–2017), the share of the population with a monthly disposable income below MDL 1,000 actually halved to 20 per cent. At the same time, the share of medium-income groups (MDL 1,000–3,000 per month) increased the most – up to 67 per cent in 2017 (*Figure 8*).

<sup>10</sup> 2006 was chosen as a reference year because the National Bureau of Statistics only began to publish the results of the household budget surveys in this year.

Figure 7.

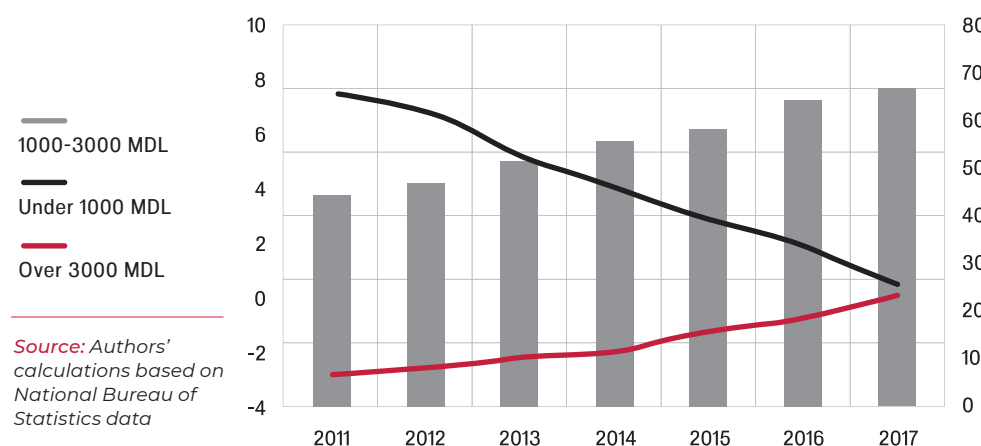
Dynamics of real disposable personal income (% y-o-y)



Source: Authors' calculations based on National Bureau of Statistics data

Figure 8.

Population distribution by average size of disposable income (% of total population; right axis - for income range of MDL 1,000-3,000)<sup>11</sup>



Source: Authors' calculations based on National Bureau of Statistics data

Real income growth was also reflected in people's perceptions of their standard of living.

In 2017, the proportion of those who assessed their standard of living as 'bad or very bad' halved compared to 2006. Also, for the first time, the number of those who believe themselves to have a 'very good or good' standard of living exceeded those who responded 'bad or very bad'. The overwhelming majority of

people (76 per cent in 2017) believe that they have a 'satisfactory' living standard with their share rising over time (Figure 9). In fact, the population who believe that they have a 'satisfactory' standard of living corresponds to those who report a monthly income of MDL 1,000 to 3,000 per person living in the household.

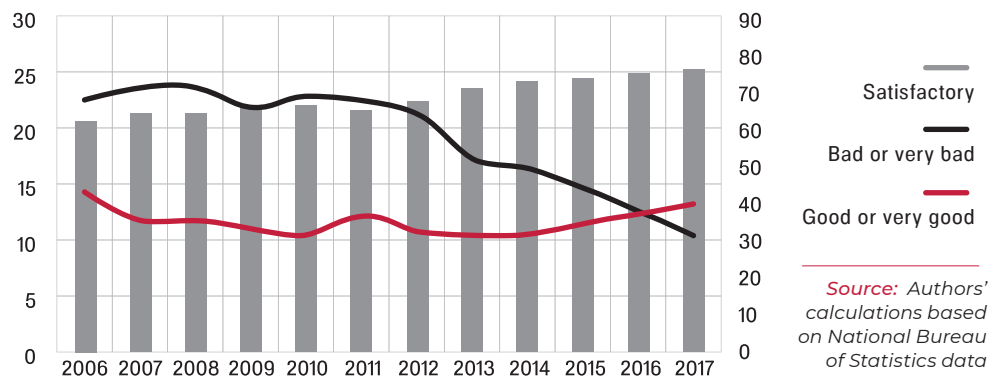
<sup>11</sup> We could analyse the population distribution by average size of income only for the period of 2011-2017, because the income ranges for which the population weights are presented are different in different editions of the publication 'Aspects on the standard of living of the population'. In addition, this publication has not yet been published for 2018.

Nevertheless, income levels remain much lower compared with other countries in the region and do not show a trend towards convergence.

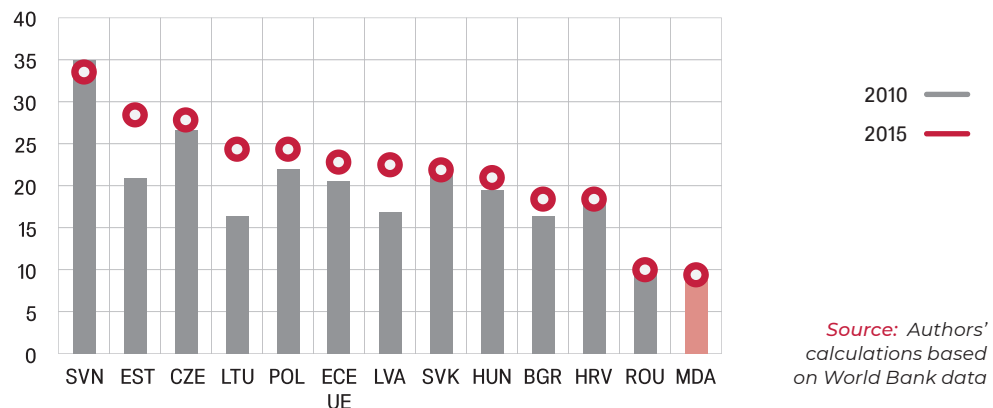
In recent years, the level of disposable personal income in the Republic of Moldova accounted for about 40% of the average level of EU Member States from Central and Eastern Europe (members of the CEE EU). The current level of income, if we are to use household survey data, is comparable only to that of Romania, and lags far behind that of other countries from the CEE EU (Figure 10). The discrepancy is even bigger if data from the national accounts is used instead of household sur-

vey data. Thus, per capita consumption accounted for about 25 per cent of the CEE EU average over the past few years. At the same time, due to the uncertainty regarding the official size of the population, per capita consumption was underestimated for the Republic of Moldova. The household survey data are therefore more accurate. But, even if these data are used, the income level did not converge, in particular due to the fact that real income grew faster in the CEE EU.

**Figure 9.** Self-assessment of people's standard of living (% of the total population; right axis - for 'satisfactory' rating)



**Figure 10.** Comparative analysis of disposable personal income according to the household survey (2011 ppp USD per day)



**The sustainable and equitable growth of personal income is limited by changes in the structure of the source of income.**

Salaries are the main source of household income, accounting for over 40 per cent of total disposable personal income. Between 2006 and 2018, the share of salaries as a source of income increased even more – from 41.6 to 43.7 per cent of total disposable income. Though salaries became a more important source of income for households, other sources of income recorded an even more impressive increase. In particular, we highlight the role of income obtained from social benefits, especially pensions, the share of which almost doubled, touching 25 per cent of total disposable income in 2018 (*Figure 11*). Remittance income (the

‘other income’ category) also retained its importance, constituting 19–20 per cent of disposable personal income. In contrast, the share of income from individual agricultural and non-agricultural activities halved. Thus, the share of income sources that depend on productive economic activities (salaries, income from individual agricultural and non-agricultural activities) decreased from 2006 to 2018 in favour of non-productive ones (pensions, social benefits and remittances). The share of non-productive sources increased during the period mentioned from 32 to 43.5 per cent of total disposable income.

**The negative changes in the structure of income sources are caused by the demographic evolution and socioeconomic changes in household status.**

Pensions have become a more important source of income due to the demographic trend of population ageing. Between 2006 and 2018, the share of households in the Republic of Moldova with a pensioner as the head of household and pensions as the main source of income increased from 33 to 43 per cent. The number of households with income dependent on the overseas employment of the head of household (the ‘others’ category) also almost doubled. Their share touched 19% of all households in 2018 (*Figure 10*). Cumulatively, the share of households

with non-productive socioeconomic status for the national economy (pensioners and emigrants) increased from 42.6% to 61.5% between 2006 and 2018. Respectively, the share of households with productive socioeconomic status (employed in agricultural or non-agricultural sector, and farmers) decreased by 19 percentage points. The share of households with income dependent on agriculture (farmers and agricultural employees) dropped significantly. Their share shrank almost threefold – from 28.2 per cent to 10 per cent of all households.

**The structural changes in households and their sources of income could reverse the recent trends of falling social inequality and absolute poverty.**

In the medium and long-term, the aggregate dynamics of personal income depends on households’ productive activity and income in the national economy (salaries, entrepreneurial revenue, etc.). A lower share of these households in the total population will result in fewer families with higher income, which

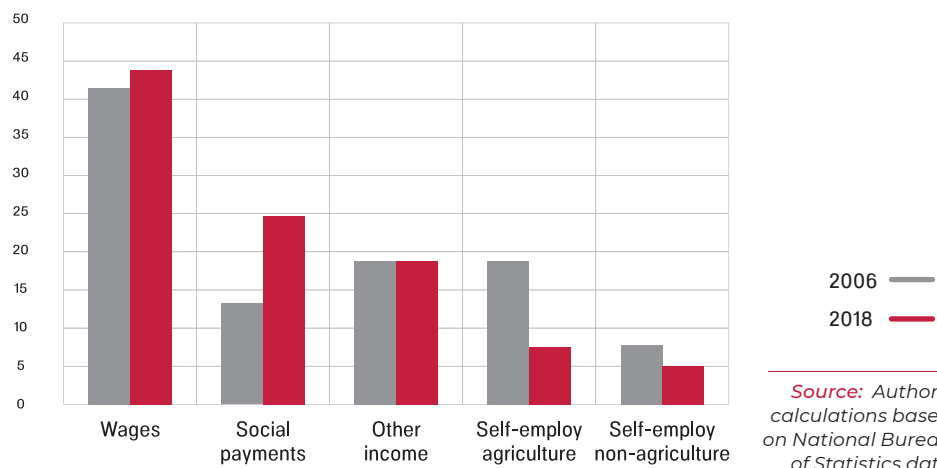
will generate income concentration. Inequality can also worsen in this group of households in the medium and long-term due to scarcer jobs that are better paid and require higher skill levels.<sup>12</sup> In recent years, the share of these jobs has decreased from 48 per cent to 42 per cent of total jobs in the national econ-

<sup>12</sup> [https://www.expert-grup.org/media/k2/attachments/Raport\\_de\\_Stare\\_a\\_Tarii\\_2018.pdf](https://www.expert-grup.org/media/k2/attachments/Raport_de_Stare_a_Tarii_2018.pdf)

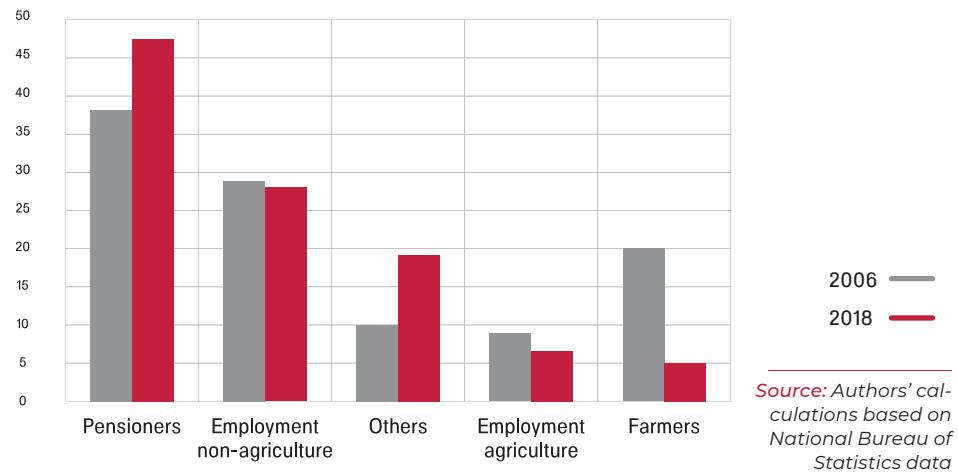
omy. The expansion of employment in agriculture and, at the same time, the lower income earned by households from this activity are further concerning trends. In the last decade, the share of the population engaged in agriculture has increased by more than 10 percentage points, up to 36 per cent of total population employed in 2018, while the number of households that depend on agricultural income has dropped to its historical minimum (Figures 11 and 12).

These trends reveal that the agricultural sector does not ensure sufficient remuneration and that most rural households depend on alternative sources of income (remittances, activity in the non-agricultural sector and social benefits). Thus, the increasing rate of employment in agriculture amplifies the uncertainties regarding the sustainable growth of personal income in rural areas and the convergence with income earned from non-agricultural activities.

**Figure 11.**  
Changes in sources of disposable personal income (per cent of total income)



**Figure 12.**  
Changes in the structure of households by their socioeconomic status (per cent of total households)



**Accelerating growth rates and maintaining the recent convergence trends for personal income depend on addressing demographic and social and economic constraints.**

Personal income needs to grow at higher rates in order to ensure convergence with the Central and Eastern Europe EU countries, in relation to which the Republic of Moldova lags far behind because no significant progress has been made in the last years in this respect. At the same time, convergence with the Central and Eastern Europe EU countries in terms of average income

should not occur on account of social equity, but should keep up with the recent national trends of diminishing inequalities. The issue of inequality is even more important as a result of major tax and structural risks, which amplify inequalities in the medium-term. To achieve these goals, a systemic approach is recommended, including the following activities:

- **MITIGATING NEGATIVE DEMOGRAPHIC TRENDS.**

Due to active population ageing, the share of households (pensioners) that are unproductive for the national economy will increase. It is imperative to continue the reform of the public pension system, by introducing pillars II and III and thereby ensuring a sustainable and steady increase in pensions. Diversifying the pension system by increasing personal responsibility for managing future pension income will ensure convergence of the average pension with the average salary. Active ageing policies would also diminish the cohort of pensioners and increase the share of economically active population in the labour market, which is currently declining. A more active involvement of the elderly in the labour market would, on average, ensure a higher level of income compared to pensions.

- **STIMULATING STRUCTURAL CHANGES IN EMPLOYMENT.**

The increase of the aggregate personal income largely depends on the dynamics of salaries. In their turn, salaries are related to labour productivity and the quality of jobs. To achieve a sustainable medium- and long-term growth of salaries, it is crucially important to stop the concerning trends in the local labour market. First, it is imperative that the share of jobs that require medium and high skills grows. Second, it is important to reduce significantly informal employment (especially in the agricultural sector). Besides the tax measures, a crucial role in achieving these objectives could be played by structural reforms which would stimulate the demand for labour in the manufacturing industry and in some service sub-sectors.

- **ASSESS THE IMPACT OF TAX CHANGES ON SOCIAL INEQUALITY.**

A set of tax changes (e.g., the flat income tax rate for individuals) that could negatively influence social and economic inequality in the medium and long-term was implemented in 2018. In order to address these risks, it is advisable to carry out an impact analysis of the measures in question, which has not been done, and to assess the possibility of returning to a more progressive tax system.

**Table 4.**

The main indicators monitored with regards to people's welfare

	2016	2017	2018
<b>IMPACT OF THE ECONOMIC GROWTH ON PEOPLE'S WELFARE</b>			
- GDP (per cent y-o-y)	4,4	4,7	4,0
- GDP per capita (per cent of the CEE EU average)	15,8	17,2	17,8
- People's perception of their welfare (Public Opinion Barometer). Share of people very and quite satisfied with their standard of living (per cent)	16,7	20,3	18,8
<b>ACCESS TO ECONOMIC OPPORTUNITIES AND INCOME</b>			
- Employment rate (per cent)	40,8	40,5	42,0
- Unemployment rate (per cent)	4,2	4,1	3,0
- Absolute poverty rate (cent, under the threshold of USD 5.50, 2011 ppp)	16,4	16,3	-
- Growth of real salaries (per cent y-o-y)	3,7	5,2	9,9
- People who are looking for a job abroad (% y-o-y)	-2,0	-0,2	10,8
- Remittances from abroad for individuals (% y-o-y, net basis)	-4,4	11,2	5,6
- Gini index (total disposable income)	0,3222	0,3084	0,2931
- Household consumption (% y-o-y)	2,2	3,7	3,8
<b>ACCESS TO PUBLIC SERVICES AND INFRASTRUCTURE</b>			
- Human Development Index	0,697	0,700	-
- Share of expenses for education (% of GDP)	5,3	5,4	5,4
- Share of expenses for health (% of GDP)	4,0	4,1	4,1
- School dropout rate (%)	20,0	19,4	-
- Share of population with access to the public water supply network (%)	65,0	68,5	70,0
- Share of population with access to the public sewerage system (%)	33,9	35,0	35,8

# Governance

*The recent political transition has triggered important governance reforms, which are still fragile. Their sustainability depends on the careful prioritization of public policies, the revival of state institutions and on their ability to pursue the public interest. Progress was registered in both domestic and foreign policy. The governing parties are committed to various urgent reforms aimed at restoring both people's trust in the Government and external partners' trust in the Moldovan political class. The success of the current reforms, however, depends on the ability of the post-'captured state' government to regenerate the state system and overcome political inertia, which may push the system towards the repetition of mistakes made by the previous Government.*

## Analysis of the Main Trends and Developments

**The failure of the previous Government, both internally and externally, set the necessary preconditions for a 'perfect storm', the negative impact of which weakened the resistance of the political regime, represented and led by the PDM.**

The previous Government's drawbacks covered various aspects of public policy – beginning with the electoral system and the management of public finance, and ending with protecting human rights, ensuring the rule of law and conducting foreign affairs. The institutions responsible for judicial fairness and effectiveness (the Constitutional Court, the Superior Council of Magistracy, the Superior Council of Prosecutors and the General Prosecutor's Office), for the impartial implementation of anticor-

ruption policies (the National Anticorruption Centre and the Anticorruption Prosecutor's Office) and for the proper management of electoral processes (the Central Electoral Commission) became the main victims of the informal governance, caused by a 'partially free regime'.<sup>13</sup> The selective, arbitrary or inappropriate implementation of the legal-regulatory framework, depending on the political interest of the governing party, reinforced the perception that state institutions had been 'captured'.<sup>14,15</sup>

**The damage to public institutions' independence resulted in decisions that violated the principles of a democratic state.**

The main decisions in this regard concern the invalidation, by the courts, of the elections in Chisinau municipality, which took place in the summer of 2018, followed by the controversial decisions made by the Constitutional Court one year later, on

7–9 June 2019, regarding the dissolution of the Parliament, the unconstitutionality of the new Government and the organization of early elections. As a result of the disproportionate attempts by the PDM to retain power, the opposition political forc-

<sup>13</sup> Freedom House 2019, <https://freedomhouse.org/report/freedom-world/2018/moldova>

<sup>14</sup> Appeal of the Moldovan Platform of the EaP CSF to the Ninth Eastern Partnership Meeting of Foreign Ministers, October 2018.

<sup>15</sup> European Parliament, Resolution of 14 November 2018 on the implementation of the EU Association Agreement with Moldova, [http://www.europarl.europa.eu/doceo/document/TA-8-2018-0458\\_EN.html](http://www.europarl.europa.eu/doceo/document/TA-8-2018-0458_EN.html)



es formed an unprecedented coalition,<sup>16</sup> which was supported in unison by external stakeholders (the Russian Federation, Romania, the EU and the USA). Following this concerted pressure, the PDM accepted the peaceful transfer of power to a coal-

tion formed by the PSRM, which supports a pro-Russian direction, and the ACUM bloc, belonging to the pro-EU side, whose parliamentary majority (61 out of 101 votes) allows for the adoption of organic laws, but not to amend the Constitution.

**The political monopoly held by the former governing party (PDM) in 2016–2018 allowed it to manipulate the electoral system, although not to the extent necessary to prevent a change of government.**

A drastic reduction in restrictions on electioneering activities, the prohibition of voting using expired passports (allowed during the 2010, 2014 and 2016 elections), the introduction of single-member constituencies for voters from the diaspora and the insufficient number of polling stations opened abroad, as well as the use of administrative resources, distorted the electoral competition (the degree of administrative resources usage: PDM – 58 per cent, PSRM – 21 per cent, ACUM – 6 per cent, PN – 4 per cent, independent candidates – 6 per cent).<sup>17</sup> One of PDM's ideas aimed at attracting votes was to merge the parliamentary elections with a consultative referendum on reducing

the number of MPs from 101 to 61. This affected newer parties that lacked significant representation in the central and local public sectors, and had limited public (subsidies) and private (donations, contributions) revenue. Media power was another factor in forming people's preferences. Four political forces with an electoral chance – the PDM, PSRM, ACUM and the Şor Party enjoyed wide media coverage. Due to the controlled TV channels (seven major TV channels<sup>18</sup>), and thanks to the political positions held (President, Prime Minister), the media presence of the PDM and the PSRM dominated. The ACUM bloc and the Şor Party were also covered by the media, but to a lesser extent.<sup>19</sup>

**The origin of financial resources available to political parties had a major impact on the electoral results.**

The financial advantage of the PDM and Şor Party was significant and no doubt contributed to electoral outcomes in excess of the modest electoral forecasts registered by them in 2018–2019 (Table 5). The institutions responsible for the financial supervision of parties – the CEC and the State Tax Service – ignored cases where the donations for the Şor Party (three cases) and PDM

(one case) reached the threshold of MDL 75,000–1,000,000.<sup>20</sup> The availability of substantial private financial resources intensified the political partisanship by corrupting citizens: some corruption activities targeted the socially vulnerable population (pensioners), who received 'social cards'<sup>21</sup> and access to cheap food products in exchange for joining the Şor Party.

16 On Saturday, 8 June 2019, the Party of Socialists of Moldova (PSRM) and the electoral bloc ACUM, formed of the Action and Solidarity Party and Platforma DA, signed a temporary governance agreement.

17 Promo-Lex, Final Report, Observation Mission of the parliamentary elections of 24 February 2019.

18 The TV channels with national coverage Prime, Canal 2, Canal 3 and Publika TV belong to PDM representatives; the other two stations of regional importance – NTV Moldova and Accent TV – are associated with the PSRM; TV8 and TV Journal – with Platforma DA.

19 IPA, monitoring the media during the election campaign for the 2019 parliamentary elections.

20 Promo-LEX, Report on financing of political parties in the Republic of Moldova. Retrospective of 2018.

21 Ibid

Table 5.

## The revenues and subsidies for 2018 of political parties in the new Parliament

	Votes in the nationwide constituency	Survey, Jan. 2019, %	Survey, Dec. 2018, %	Revenues (donations, contributions) 2018, MDL	Subsidies, 2018, MDL
<b>PARTY OF SOCIALISTS</b>	31,1 % 35 seats the Parliament	20	23	7.164.667	7.516.343
<b>PDM</b>	23,6 % 30 seats the Parliament	9	7,6	41.773.897	7.507.236
<b>ACTION AND SOLIDARITY PARTY</b>	ACUM - 26,8 % 13 seats each in Parliament	11,7	5	1.069.258	-
<b>PLATFORMA DA</b>				285.360	155.414
<b>ŞOR PARTY</b>	8,3 % 7 seats in Parliament	2,7	3	13.534.198	84.144

Source: Promo-LEX, RM Parliament, IPP

To generate more electoral opportunities, the governing party increased public spending, which undermined budget stability.

The range of populist measures launched over March–October 2018 (i.e. during the pre-election year) covered the following: subsidised housing for young people and young families ('Prima Casa');<sup>22</sup> the renovation of regional roads ('Drumuri Bune' – MDL 1.9 billion; 'Drumuri Bune 2' – MDL 2.7 billion); the construction of sports and entertainment sites ('Arena Chisinau' – MDL 44.5 billion, to be paid in instalments until 2029); and an increase in salaries in the public sector.<sup>23</sup> In parallel, the 'capital amnesty' and the 'citizenship in exchange for

investments', which are currently completed or in the process of being cancelled, exposed the public budget and, more broadly, the national economy to transactions involving suspicious money. The rationale for these initiatives caused turmoil among both the opposition and civil society, and blocked foreign funding (IMF, World Bank). The pressure on the Government increased in the autumn of 2018, when the EU suspended budget and macrofinancial support due to the non-validation of the Chisinau municipality elections (July 2018).

The urgency of governance reforms in a fragile coalition creates inconsistencies in the process of change.

In fact, the current Government often acts as a 'fire service'. Thus, by returning to a proportional voting system (August 2019), the government wants to democratize political life. The investigation into unfair competition (the export of nuts, the business of scrap metal, the monopoly on the advertising market, etc.) and of criminal schemes with the participation of state-owned enterprises and institutions (smuggling of prohibited substances, embezzlement of public funds, etc.) can

demonopolize the economy and rebuild public trust in the state and in the justice system. The investigation of programmes for the privatization of state property (the concession of Chisinau International Airport in 2013 for a period of 49 years) and the re-launch of the investigation concerning the 'stolen billion USD' from the country's banking system are aimed at rehabilitating the investment image of the country, although without a clear perspective concerning the recovery of privatized sites.

<sup>22</sup> In March 2018, the Government launched 'Prima Casa', a programme by which the State covers 50 per cent of the cost of a house, the value of which does not exceed MDL 600,000. Between March 2018 and May 2019, 2,282 young people and young families bought apartments under this programme.

<sup>23</sup> On 23 October 2019, the leader of the Democratic Party, Vladimir Plahotniuc, announced salary increases for the public sector. After this announcement, the Government decided to increase the payroll fund in the public sector from about MDL 14 billion in 2018 to MDL 14.9 billion in 2019.

## Nonetheless, the Government faces a series of challenges, which are partially ignored or unrecognized

First of all, efforts to de-oligarchize the country are highly personalized and have a narrow focus (they are directed at the oligarch Vladimir Plahotniuc and his entourage) and do not contain broader mechanisms to counteract and prevent oligarchic interference in the decision-making process, as seen in the 2009–2019 period. Efforts to strengthen the institutional capacity, budget and human resources of the National Integrity Agency, Anti-Corruption Centre (NAC) and the General Prosecutor's Office need to be made in tandem with actions aimed at releasing them from political interference. Deficient de-politization of institutions is the second challenge. Instead of becoming neutral, some structures go through a new stage of politicization,

falling under the influence of the PSRM (Ruslan Flocea, adviser of President Igor Dodon, was appointed as the head of NAC; Alexandru Esaulenco at the Security and Intelligence Service (SIS)). At the same time, due to the shortage of professional and honest human capital, the trend of recycling figures associated with the old regime (Interim General Prosecutor – Dumitru Roibu) persists. The appointment, by the Parliament, of judges at the Constitutional Court and the recent election of Vladimir Turcan, a member of PSRM, as the President of this Court showed the visible trend of the Government to maintain the institutions under political influence. Moreover, these cases illustrate the inability of the ACUM bloc to hinder PSRM's attempts to re-politicize key institutions.

## A lack of communication and cohesion within the ACUM-PSRM coalition, but also within the ACUM bloc itself, is undermining the authority of the Government and popular support.

Dismantling the political influence of the PDM and of its former leader, Vladimir Plahotniuc, in public life is becoming a weaker motivation to govern in the coalition, and the probability of early elections has increased. The lack of engagement with civil society and the private sector in the reform process is a final major challenge. Civil society representatives, who were harassed in different ways by the previous government<sup>24</sup>, actively supported the peaceful transfer

of power<sup>25</sup> and the full resumption of democratic processes. However, the hesitation of the Government regarding key appointments (NAC, Interim General Prosecutor), which led to politicization of the institutions, as well as the decision, taken without prior public consultation, to liquidate the Council for the Prevention of Torture,<sup>26</sup> or the decision to increase the tax rate (VAT for the sector HoReCa) caused the first sceptical reactions in the the local business environment.

## Increasing the role of trade unions in formulating labour policies is essential for the protection of workers' rights.

However, the current format for dialogue between the State and the trade unions is inadequate for a country with such a high rate of labour migration. The previous Government actively collaborated with trade unions and employers' asso-

ciations through the National Commissions for Consultations and Collective Bargaining,<sup>27</sup> whose duties are at best perfunctory, without either exerting any real influence on public policies or promoting the rights of employees.

24. LRCM, according to the analysis of the attacks against non-government organisations in the Republic of Moldova (1 January–31 December 2018), the civil society representatives were incriminated: a) the failure to conduct the reforms (the judicial reform); b) financing the political opposition (PAS, Platforma DA, PLDM); c) 'orchestrated' challenge of Government's initiatives (the citizenship-by-investment programme); d) collaboration with foreign secret services (Russia); e) inadequate treatment of minors (the case of the extradition of seven Turkish teachers); f) political affiliation and promotion of the opposition in the electoral campaign; and g) poor monitoring of elections.

25. Declaration: National Platform of the Civil Society Forum of the Eastern Partnership Regarding the Situation in the Republic of Moldova, 9 June 2019.

26. LRCM, Civil society expresses its concern about the initiative to liquidate the Council for the Prevention of Torture, August 2019.

27. The National Commissions for Consultations and Collective Bargaining has the strict duty to adopt recommendations, and the extent to which these recommendations are accepted by relevant authorities is not monitored at all.

**Improving the living standards of citizens is one of the priorities of the PSRM-ACUM Government Programme of PSRM-ACUM, but it is mainly limited to improving access to higher quality public services (education, health services).<sup>28</sup>**

They promise to support young families, in particular those with low incomes, in order to improve the demographic dynamics. Except for the promise to help young families, particularly the poor, in order to improve the demographic situation of the country, the Government, however, completely neglects the problem of social inequality, which has been falling freely in the last decade.<sup>29</sup> However, for the period 2019–2020, the Government plans to implement a series of social protection measures for vulnerable groups, such as: 1) diversifying the

range of social services ('assisted social housing', 'day care centre for adults with disabilities'); 2) putting in place new financial mechanisms to support those on lower incomes; 3) indexing the guaranteed minimum income; and, 4) reviewing the regulatory framework with respect to the gender dimension.<sup>30</sup> The feasibility of these actions depends on the cooperation of the executive with the legislative, on foreign financial support and on the capacity of implementing institutions, subordinated to the Ministry of Health, Labour and Social Protection.

**Foreign policy is going through a period of rationalization, in which the governing coalition shows geopolitical duality.**

Thus, while the ACUM bloc recognizes a single foreign policy objective – European integration under the Association Agreement – the PSRM is oriented towards a more balanced foreign policy, which mainly aims to develop a strategic dialogue with the Russian Federation. Restoring foreign funding is the main goal of the foreign agenda, which is focused initially on loans from the IMF and financial assistance from EU. By the end of 2019, the Republic of Moldova will have received from the EU budgetary support and macrofinancial assistance of over

EUR 150 million, but only if it meets the outstanding political and sectoral conditions inherited from the previous Government. At the same time, the Government is preparing for a pragmatic dialogue with the Russian Federation on trade flows, natural gas procurement and the Transnistrian issue. The PSRM-ACUM coalition thus aims to avoid the ad hoc and controversial style of the foreign policy pursued by PDM, especially in the 2018–2019 period,<sup>31</sup> and instead, to resort to pragmatism, predictability and strictly strategic relations.

## Policy Recommendations:

**De-oligarchizing the political system by setting up effective governance mechanisms:**

- 1) Developing an inter-institutional mechanism aimed at warning about the future interference of oligarchic interests in order to protect the integrity and independence of the decision-making process and democratic institutions;

<sup>28</sup> Activity Programme of the Government of the Republic of Moldova, June 2019.

<sup>29</sup> According to World Bank data, the inequality index (Gini) constituted 25.9 points in 2018, down from 34.7 points in 2008, and its actual impact of impoverishment of the population is mitigated by money transferred by Moldovan migrants. According to Expert-Grup estimates, the share of remittances in total household income doubled from 8.6 per cent to 18.3 per cent between 2006 and 2017.

<sup>30</sup> Draft Government Decision approving the Government Action Plan for 2019–2020.

<sup>31</sup> On 11 June 2019, in the midst of the political crisis from Chisinau and the duality of power, Prime Minister Pavel Filip decided to transfer the Embassy of the Republic of Moldova from Tel-Aviv to Jerusalem, in order to discourage the USA from recognizing the PSRM-ACUM coalition. Earlier, in September 2018, upon the decision of ISS, seven Turkish teachers from the Orizont High School were extradited one month before the visit of the Turkish President, Recep Tayyip Erdogan.

- 2) Conducting annual monitoring of the areas vulnerable to oligarchic interests on the basis of a joined-up assessment exercise conducted by the National Bank of Moldova (financial transactions with offshore areas), NAC (vulnerability of institutions to corruption) and the Competition Council (concentration of economic power);
- 3) Dismantling permanently existing and previous schemes (such as bank fraud), which weaken the institutions' resilience against the influence of groups with narrow interests, with oligarchic connections.

### **Improving the financial reporting of political parties in order to eliminate the influence of informal groups:**

- 1) Regulating the conditions for conducting internal audit by political parties;
- 2) Involving the Court of Accounts in verifying the internal audit reports of the political parties that receive subsidies from the State Budget (CEC Regulation on the Financing of Political Parties and the Law on the Operation of the Court of Accounts – article 32);
- 3) Cstrengthening the role of the State Tax Service in investigating the donations made by individuals to parties, which exceed the thresholds of MDL 75,000–1,000,000; and,
- 3) Carefully regulating the procedure of offering financial support to parties by the Moldovan citizens who temporarily live abroad in order to eliminate the risk of interference by foreign (non-)Government stakeholders (CEC, NAC, MFAEI, MIA, MoD, ISS).

### **Improving decision-making transparency within Government and Parliament:**

- 1) Systematizing and ensuring the consistency of the annual reporting by the State Chancellery, using a single format to measure participation (the number of individuals and non-governmental organizations involved in consultations), the efficiency (number of recommendations taken per consulted document and field concerned), the share of documents consulted and adopted on the basis of recommendations;
- 2) Incorporating a single, clear and transparent mechanism of public consultations in Parliament by amending the Parliament's Rules of Procedure of 2 April 1996 (Chapter 2, article 49 (1) and Chapter 12 and introducing in the annual report of the Parliament Secretariat a permanent, separate chapter dedicated to detailed data about the level of public consultations.

### **Restoring the credibility of the relationship between central authorities, civil society and trade unions. Establishing a constructive, credible and functional dialogue on the existing collaboration platforms:**

- 1) Reviewing the Government Decision no. 11 of 19 January 2010 on the National Participation Council (Chapter 2 on the duties and Chapter 4 on the operation) in order to ensure an efficient (measurable performance indicators) and transparent mandate (publish the activity reports) concerning the civic surveillance of Government's activity;
- 2) Integrating the National Platform of Eastern Partnership in implementing and monitoring the measures to implement the Association Agreement, stated in the Government's Action Plan for 2019–2020; 3) reviewing the mandate of the National Commissions for Consultations and Collective Bargaining in order to enhance the accountability of trade unions by requesting the Government to report on the implementation of Commission's recommendations and to justify their refusal.

Basing foreign policy on the country's desire to join the EU, strictly observing the conditions set by the EU in exchange for financial assistance and using a cautionary pragmatism towards the Russian Federation:

- 1) EU conditionality has to be applied with strictness, promptness and intelligence (the possibility of redirection), which are a useful additional tools in enhancing the accountability of Moldovan public institutions and in using the alternative reporting of civil society;
- 2) The restructuring of the Moldovan–Russian relationship should not increase, or foster, the 'hybrid' influence of Moscow authorities in the region (propaganda via Russian media, interference in political processes).

**Table 6.**  
Key governance indicators monitored

	2016	2017	2018
Total public spending as part of GDP, %	30,1	30,5	31
Budget deficit, % of GDP	-1,6	-0,6	-0,8
Value of the irregularities and deviations in public finance management (MDL, billion)	20,8 <sup>32,33</sup>	-	-
Global Competitiveness Report, subcomponent 'Institutions'	128 <i>(out of 138 countries)</i>	119 <i>(out of 137 countries)</i>	84 <i>(out of 140 countries)</i>
Corruption Perception Index, Transparency International	128 <i>(out of 176 countries)</i>	128 <i>(out of 180 countries)</i>	117 <i>(out of 180 countries)</i>
Number of corruption-related sentences, % of total	84 <sup>34</sup>	90 <i>(318 cases)</i>	87 <i>(321 cases)</i>
Number of acts (draft laws, regulatory acts) subjected to public consultations, % of total <sup>35</sup>	59,1 <i>(out of 1,645 approved acts)</i>	78,3 <i>(out of 1,295 approved acts)</i>	79,4 <i>(out of 1,434 approved acts)</i>

**Source:** National Bureau of Statistics, Ministry of Finance, NAC, Court of Accounts, State Chancellery, Transparency International, World Economic Forum, authors' calculations

<sup>32</sup> <http://www.ccrm.md/storage/upload/reports/postari/139/pdf/5907c1ba3b2cb54029cc3e54cc61a307.pdf>

<sup>33</sup> The reports of the Court of Accounts for 2017–2018 do not publish any data about the value of the irregularities and deviations in public financial management.

<sup>34</sup> The NAC Report for 2016 does not indicate the number of corruption-related files examined by courts, <https://cna.md/doc.php?l=ro&idc=143&id=1479&t=Studii-si-analize/Rapoarte-de-activitate/Raport-de-activitate-al-CNA-pe-anul-2016>

<sup>35</sup> Data on the share of acts adopted by the Government and by subordinated authorities out of all acts consulted with the public on [www.particip.gov.md](http://www.particip.gov.md) published on <https://cancelaria.gov.md/ro/advanced-page-type/rapoarte-0> and reconciled with the State Chancellery.

# About Expert-Grup

## | WHO WE ARE

Expert-Grup is a think-tank specialized in economic researches and public policy analyses. We are positioning ourselves as a politically and ideologically neutral think-tank, and we do not represent any economic, corporate or political interests. Expert-Grup was established in 1998 and started its research activity in 2006.

## | OUR MISSION

The mission of the organisation is to promote the public interest and to come up with efficient and innovative solutions for the development of the Republic of Moldova. In order to fulfill this noble intention, Expert-Grup provides the necessary creative and institutional environment, encouraging expression of free and non-trivial thinking, which makes us a leading source of unbiased economic analysis.

## | OUR 4 CORE VALUES

1. Independence and objectivity - We encourage creative, non-trivial and critical thinking. We remain independent of any political or ideological influences.
2. Integrity and transparency - We tend to use robust, relevant, and transparent analytical tools. All sources used for research are quoted and all contributors to researches are mentioned.
3. Quality and relevance - We aim to produce high quality analytical products addressing the topical issues for the economic and social development of Moldova in a nontrivial way.
4. Avoiding conflicts of interest - We do not accept activities and partnerships that are contrary to our values or may undermine our independence.

## | OUR 10 PRIORITIES

1. Functional market economy: free competition and property rights protection;
2. Reasoned and rational economic and social policies, developed in the interest of citizens;
3. Free trade based on real competitive advantages;
4. Efficient, transparent and accountable public sector;
5. Business climate that is friendly and appealing for SMEs;
6. Fair labor market conditions for both the employers and employees;
7. Flexible educational system that is connected to the economic, social and demographic realities;
8. Equal access to economic and social opportunities for all citizens;
9. Society that is familiar with the economic trends and basic principles of the economy;
10. Balanced regional development.

# About FES

## | WHO WE ARE

FES is a German political social-democratic foundation, which aims to promote democracy, peace, international understanding and cooperation. FES performs its tasks in the spirit of social democracy and participates in public debates to identify social-democratic solutions to current and future issues in society.

## | FES IN MOLDOVA

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

### Democratisation and political participation .....

The Republic of Moldova faces challenges related to strengthening its democratic institutions and developing a democratic culture that would make the country fully compliant with the standards of the EU. FES contributes to this by promoting political participation in civil society organisations, political parties and local public administration bodies. In this area, FES puts a particular focus on building the capacities of citizens in the regions. Citizens should be trained to follow critically and participate in public debates in order to monitor decision-makers, express their views and act in their own interests. Therefore, through its activities, FES has committed itself to promoting participatory democracy and citizens' civic and political culture at the local level.

### European integration .....

The Republic of Moldova is a part of the European Neighbourhood Policy and the Eastern Partnership. FES aims to support the European integration process of the country. Through a number of tools, such as radio debates, news bulletins, policy papers, publications and conferences, FES focuses on the main challenges related to European integration, facilitating people's access to up-to-date and reliable information on the topic, improving the dialogue between the civil society and decision-makers as regards the requirements for successful European integration, and strengthening, in this way, the efforts of Moldovan authorities to integrate into the EU. Additionally, FES supports non-government organisations in contributing to a peaceful resolution of the Transnistrian conflict, as a precondition for successful European integration in the long run.

### Economic, social and environmental policy .....

FES supports its partners in developing and implementing policies for a sustainable and socially-balanced market economy that is able to address the needs of all citizens. The activity and projects in the area focus on such topics as: reforming social security systems, improving working conditions and labour market opportunities, and fostering sustainable development. Additionally, FES runs programmes that aim to promote social-democratic values.





