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FRIEDRICH EBERT STIFTUNG

Republic of Moldova

STATE OF THE COUNTRY REPORT 2024

MACRO

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Republic of Moldova 2024
STATE OF THE COUNTRY REPORT

In partnership with:

FRIEDRICH EBERT STIFTUNG

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Chisinau, 2024

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Abbreviations

ADMA	Agency for the Development and Modernization of Agriculture
AIPA	Agency for Intervention and Payments for Agriculture
APCEE	Anticorruption Prosecutor Central and Eastern Europe
BEI	Bureau for European Integration
CC	Constitutional Court
CGF	Credit Guarantee Fund
CIS	Commonwealth of Independent States
CPI	Consumer Price Index
CPIU-IFAD	Consolidated IFAD Programme Implementation Unit
DCFTA	Deep and Comprehensive Free Trade Area
EU	European Union
EUR	Euro currency
FACEM	Fund for Entrepreneurship and Economic Growth of Moldova
FDI	Foreign Direct Investments
FFs	Family farms
GCEI	Governmental Commission for European Integration
GDP	Gross domestic product
GVA	Gross value added
HORECA	Hotels, restaurants, and cafes
ICT	Information and communication technologies
IFAD	International Fund for Agricultural Development
ILO	International Labour Organization
IMF	International Monetary Fund
INTERPOL	International Criminal Police Organization
IT	Information technology
LCR	Liquidity coverage ratio
MEDD	Ministry of Economic Development and Digitalization
MDL	Moldovan Lei
NAC	National Anticorruption Center
NBM	National Bank of Moldova
NBS	National Bureau of Statistics
NCEI	National Commission for European Integration
NCFM	National Commission for Financial Markets
NEA	National Employment Agency
ODA	Organization for the Development of Entrepreneurship
OMEAP	Office for External Assistance Programs Management
p.p.	Percentage points
PPP	Public-private partnership
PPP $	Current international dollars (at purchasing power parity)
SCM	Superior Council of the Magistracy
SCP	Superior Council of Prosecutors
SMEs	Small and medium-sized enterprises
UCIMPA	Consolidated Unit for the Implementation and Monitoring of Projects in the field of Agriculture
UIP	Programme Implementation Unit
UIPAC	UIP of the World Bank Project for Improving Competitiveness
USD	US dollar
VAT	Value added tax
y-o-y	Year-on-year

Key messages

Moldova remains on the European integration path, but it is undermined by the slow pace of reforms

The historical developments regarding the Republic of Moldova's European integration process, which began in 2022-2023, also marked 2024. This was determined by the validation of the European integration vector through a constitutional referendum, as well as the preparation for the accession negotiations set to begin in 2025. However, the speed of these processes could be jeopardized by a lack of capacity among public institutions, slow progress in bringing about key reforms, and political developments. Obtaining candidate country status in the summer of 2022, and the European Commission's recommendation to begin accession negotiations in December 2023, marked a new stage for the Republic of Moldova's European integration process. Moreover, this was determined by geopolitical factors rather than internal structural improvements. This was, de facto, a credit of confidence granted by Brussels to a vulnerable country, led by a pro-European government, in the context of the Russian military aggression in Ukraine. The major challenge of 2024 was therefore to capitalize on this credit of trust by making a robust start to the preparation procedures for the negotiations, in parallel with pursuing a range of dynamic internal reforms. On the first aspect, the Republic of Moldova did relatively well; on the second, less so. Thus, significant progress was made in terms of bilateral screening before accession negotiations, where the support of civil society was significant. Overall, the preparation processes for the accession negotiations were relatively well coordinated, with the active involvement of the appointed Secretaries of State and the Bureau for European Integration (BEI). On the other side, progress with systemic reforms, especially the most problematic ones, was slow. For example, according to the Shadow Report on the implementation of the European Commission's recommendations regarding the "Fundamentals"[1] cluster, in terms of progress, only 3.2 points were achieved out of a maximum of 5. The slow pace of reforms influenced to a large extent the lower-then-expected pro-EU vector support at the referendum held on October 20, 2024. Thus, to strengthen the Republic of Moldova's credibility when it comes to its ambitions to become a member of the European Union (EU), the pace of reforms needs to be boosted, especially in the areas of justice, the fight against corruption, and public administration.

1 https://www.euromonitor.md/wp-content/uploads/2024/07/Shadow-report_MD-EU-Enlargement_final_RO-IA.pdf

The Moldovan economy is exhausting its potential and should switch its competitiveness model from the one based on cheap labour to a model based on efficiency

The economic recovery previously projected for 2023 has been postponed to 2024. 2023 was marked by economic stagnation, with gross domestic product (GDP) increasing by only 0.7 per cent despite a favourable agricultural year and the small base of comparison (-4.6 per cent in 2022). For 2024, we estimate an economic recovery of around 2 per cent, supported by dynamic domestic consumption and public investments. The main risks stem from several sectors: agriculture, where we anticipate a recession of around 10–15 per cent; industrial production, where we anticipate stagnation or insignificant growth; and the external environment, which is expected to affect export activity and private investment. Broadly speaking, over recent years, we have witnessed a continuous slowdown in economic growth rates, with the country's basic problems remaining unresolved, which undermines the country's investment attractiveness and export potential. Key issues include judicial dysfunctions, political instability, limited access to capital, an almost non-existent capital market, a defective competitive framework, a low level of economic freedom, demographic factors and migration that fuel imbalances in the labour market.

The deceleration of economic growth over recent years and the erosion of its potential, against a background of worsening labour shortages, reveal that the country is gradually exhausting its current competitiveness model based on inputs/resources (mostly cheap labour), while the transition to another model based on efficiency is slow and uncertain. So far, most exports, investments or agricultural and industrial production implied low levels of technological sophistication and value-added. This explains why the country has one of the lowest levels of labour productivity, wages and exports as a share of GDP in the region. Despite its vulnerabilities, this model has survived thanks to the availability and low cost of labour, which attracted a good part of the foreign direct investment (FDI) in sectors such as automotive and textiles (these sectors generate limited value added as they are based on the import of raw material and a minimum level of processing, after which the products are re-exported for further processing in other countries). Along with increased emigration by the working-age population, as well as the rise in wages faster than labour productivity, the deficit in the labour market has become a significant issue for the business environment and enterprises that have built their business models on low labour costs. Therefore, the Republic of Moldova's economy has, de facto, exhausted its competitiveness model based on low-cost labour and is entering a period of low economic growth and uncertainty. In this context, there is still no definite answer to the question of **when** and **if** it will succeed in transitioning to a new model of competitiveness based on efficiency. Also, the talks regarding the potential liberalization of the labour market for unskilled workers are a step backward, and perpetuate the uncertainty associated with the competitiveness model based on low labour costs. If the goal is to maximize the welfare of the entire economy, and not just that of the companies that benefit from low-cost labour, the government's attention must be focused on channelling policies and resources into supporting the private sector that generates added value, by processing local raw materials, streamlining production processes, and implementing technological innovations. Hence, the focus should be on maximizing added value in the economy and streamlining processes that will create sustainable preconditions for increasing wages, net exports, tax incomes, and economic growth as a whole.

The real sector is struggling with high uncertainty, security risks, unfavourable market conditions and instability of the legal and policy framework

Amid high uncertainty stemming from domestic and external sources, the aggregate data from company balance sheets for 2023 suggest further growth in risk aversion and limited investment appetite. Companies' equity increased by 9.6 per cent, while the total debt balance decreased by 0.3 per cent. The apathy and wait-and-see attitude displayed by firms in 2023 have partly continued into 2024 among small and medium-sized enterprises (SMEs), while large businesses have more optimistic expectations.

The real dynamics was undermined by unfavourable market conditions in 2024. In agriculture, farmers faced continued pressure of lower prices combined with last year's reduction in harvests by 10–15 per cent. Industrial production continues to face challenges, and in 2023 its share of GDP fell to historic lows (11.2 per cent), indicating an urgent need for modernization and restructuring. The service sector represents the main source of economic growth for 2024, with the return of retail trade and constructions, along with continued expansion of the information technology (IT) and hotel, restaurants, and cafes (HoReCa) sectors. The new impetus in the residential construction sector, combined with companies' nascent efforts in terms of refurbishment and automatization, allowed for the positive return of investment in 2024. The banking sector remains stable and resilient, but, despite the relaxation of monetary policy, the level of financial intermediation remains mediocre. Banks are attracting deposits at historically low rates and have recorded the largest spreads between the effective rates on loans and deposits in a decade.

The analysis of the business environment reveals continuity in terms of the improvement in perceptions regarding the level of corruption in the country, but also in the worsening of the level of economic freedom. In addition to the security risk generated by Russian aggression in Ukraine, the perception of foreign investors towards the Republic of Moldova has also been shaken by some discretionary and poorly reasoned decisions by the government, as well as by the lack of stability of the rules of the game established by legislation. At the same time, notable progress has been made in the digitization of public services and in the development of online commerce. The authors of the report opt for a strategic approach in all economic areas, including those not covered by strategic planning (internal trade, quality infrastructure, and market surveillance, competition). It is recommended that guarantee instruments be created for exporters to mitigate the financial risks and support liquidity flows. Moreover, it is essential to strengthen active employment measures and accelerate the internationalization of universities to respond better to the needs of the labour market. Improving the predictability and stability of regulations to strengthen business confidence should also remain a priority. Applying the "principle of rarity" in granting agricultural subsidies and prioritizing projects with a high economic impact could contribute to a more efficient and impactful use of budgetary resources for farmers.

The high poverty rate, despite a moderate recovery in incomes and consumption, remains the most pressing social problem

From the second half of 2023, the real incomes of the population in the form of wages and pensions recorded a compensatory increase after the inflationary shock of 2022 had subsided. As a result of the increase in real incomes, but also the decrease in interest rates and the revival of consumer credit, a recovery in household final consumption was recorded. The growth rates were still weak, however. Unlike salaries and pensions, real remittances received by the population continued their downward trend in 2023, and did not recover in 2024. The decrease in real remittances was caused by the decline in nominal remittances in foreign currency as a result of the cost-of-living crisis and of decreasing labour demand in host countries. Since remittances represent an important source of income in household budgets, their negative dynamics were one of the factors that diluted the effect of the increase in other types of income on poverty indicators. Thus, in 2023, the absolute poverty rate remained almost unchanged compared to the previous year and even increased slightly, to 31.6 per cent (+0.5 per cent compared to 2022). Groups that were already disadvantaged were the most affected: people whose main source of income is individual agricultural activity, families with children, and people with disabilities. In order to overcome the problem of persistent poverty, it is necessary to continue social assistance programmes targeted at the most vulnerable, as well as to boost economic growth.

Real wage growth led to the population's more active participation in the labour market, but the labour force continued to decrease, in particular due to emigration. In quarter 2 of 2024 (Q2:2024), the employment rate of the population aged 20–64 increased by 0.7 percentage points (p.p.) compared to Q2:23, reaching 57.3 per cent. In particular, the number of people employed in public administration, education, health and social assistance, transport and storage, information, and communications increased. At the same time, despite the increase in real wages across all industries, the number of people employed in agriculture, forestry and fishing, manufacturing, trade, and HoReCa decreased. In total, the employed population decreased by 34,400 people compared to Q2:23, the number of unemployed decreased by 600 people, while the population outside the labour force (inactive) aged 15 and over decreased by 25,000 people. This phenomenon was in large part caused by emigration, for economic reasons and because of security risks. After the outbreak of the war in Ukraine in 2022, the number of emigrants of working age from the Republic of Moldova increased to 146,000 people annually, and the number of immigrants of working age reached 99,000 people, which resulted in a net migration of -47,000 people. As a policy response, in order to increase productivity and labour remuneration, it is essential to continue reforming the labour market (reducing the mismatch between workers' qualifications and business needs, increasing women's participation in the labour market by developing child and elderly care services), improving the business environment, and stimulating competition.

The transition to an efficiency-based competitiveness model can be achieved with the financial support from the Government. The main condition is to significantly improve the governance and efficiency of government programs and mechanisms to support the economy

Although, in recent years, the state has increased the level of resources allocated to support the private sector and the economy as a whole, these changes have had a limited impact. With regards to the budgetary programmes designed to support SMEs and agriculture alone, in the period of 2022–2023[2] more than four billion Moldovan Lei (MDL) was allocated. However, the respective resources were not managed in the most appropriate way, due to numerous factors including: a lack of coordination between different programmes (e.g. multiple cases of financial support for the same investment project from different programmes), against the background of the lack of a unified register of all support programmes; the allocation of financial support to companies that should not in fact have received preferential financing because they are affiliated to, or de facto part of, large economic groups (the legal framework remains quite permissive in this regard); and, the allocation of financial resources without the establishment of clear priorities for processing activities or activities that bring added value (an eloquent example of this is the subsidies in agriculture, which were also extended to other economic activities such as processing, storage, and the food industry).

2 *According to the State Budget Law for 2023 and 2024.*

In order to support the transition from a competitiveness model based on the cost of resources to one based on efficiency, the state must review the way it plans and allocates financial resources in the economy. Financial support instruments – above all, agricultural subsidies and the programmes of the Organization for the Development of Entrepreneurship (ODA) – must give clear priority to economic activities that generate added value, such as: processing local raw materials, technologizing production processes, implementing innovations at the firm level, and export orientation. At the same time, it is important to establish a coordination mechanism between various programmes, including by creating a register that integrates them to avoid financial support within different programmes being allocated to the same investment projects. It is also important to focus on making the mechanisms for allocating financial resources more efficient. In this sense, it is crucial to move from an approach based on the mechanical and formalistic evaluation of financing files to an evaluation based on risk, added value generated, and the impact of the business on the sector and the economy as a whole. The Competition Council must play a more active role in detecting and penalizing attempts to benefit from state funding programmes through companies that hide their affiliations. More attention must be paid to how financial support is allocated to the private sector to avoid corrupt or crony arrangements. We are talking about some critical elements of governance here, namely: (i) the separation of evaluation, implementation and monitoring functions; (ii) the independence of financing decisions; and, (iii) the quality of management bodies (boards and executive bodies).

Although Moldova has a well-capitalized banking system and increasingly greater financial resources allocated by the government, the funding deficit reported by companies remains a major problem. Lack of equity capital and intermediation problems translate into businesses that stagnate, and the economy ultimately misses out on opportunities for investment and production, gross value added (GVA) growth, job creation, and GDP growth stimulation. In addition, intermediation problems limit the much-needed structural change of the economy to one with higher added value. Therefore, the analysis of financial factors, which prevent the expansion of private investments and the identification of viable solutions to mitigate them, must remain the government's priority. When the financial market cannot self-correct and cannot identify enough incentives to finance the real economy, state intervention is justified because missing economic opportunities can produce losses that are much harder to recover from over time. Externally, the most common example of state intervention in business financing is that of development banks, which allocate volumes of capital to businesses that show promise, but which, under market conditions, could not achieve their full potential. Thus, given the increasingly frequent crises and the permanent need to support the economy, the government needs to decide which mechanism would result in the most efficient allocation of public funds, whether it is from the state budget, the EU, or other external partners.

Even if the government seems to implement programmes and support measures similar to those of other states, including the countries of the EU, their efficiency is in fact much lower. This is confirmed by the modest economic results achieved. Deficiencies of an institutional nature, along with those in the process of developing and implementing programmes, undermine the potential and expected impact of such programmes and measures. Thus, since we are talking about public resources, which come from the account of taxpayers and companies that generate added value, they must be allocated following the principles of efficiency and the greatest impact on beneficiaries and the economy in general. Clearly, the state must give complete freedom to entrepreneurs, so that they can decide for themselves where to invest. Yet when it comes to state financial aid, it must be targeted, both from the perspective of economic activities and from the perspective of the evaluation criteria of investment projects. As for the criteria used to evaluate projects that are to obtain financial aid from the state, criteria related to the creation of Gross Value Added (GVA) the maintenance and launch of new jobs, or the export of processed products and services with high added value must be followed, rather than only compliance-related criteria. The prioritization of resources based on these criteria could lead to the rapid achievement of economic policy objectives or those expressly established by a certain programme.

Special issue:
How to increase Moldova's resilience and economic potential by facilitating access to capital

A functioning market economy is based on strong entrepreneurs who build companies, create jobs, generate taxes and fees for the budget, and cope with various crises. Even if this desired outcome is mentioned in the framework of economic policies implemented by the government, the general state of the business climate is uncertain, with many challenges for economic agents. In addition to the problems mentioned by entrepreneurs, the last crises have further accentuated the chronic deficit of investment. Thus, although Moldova has a well-capitalized banking system, and increasingly greater resources have been allocated by the government for various programmes, access to finance remains a problem. The intermediation of private capital remains low, especially to SMEs, while government business programmes present a series of deficiencies that reduce the expected impact. Therefore, this chapter proposes 10 potential measures to render the support allocated by the government more efficient, increase the impact generated by public money, and mobilize private capital more actively within the national economy.

Access to finance - a constraint that limits development

> The economic model based on the market economy provides that the state must ensure the necessary conditions for economic activities, while private companies carry out the entrepreneurial activity, leading to the generation of goods and services, employment, added value, taxes, and fees.

The economic activities carried out are dictated by the demand and supply of goods and services, as well as by the level of available resources of capital, labour, or technologies. Even if the Republic of Moldova started on the path of the market economy back in the 1990s, it is far from ensuring optimal conditions for: (i) competition; (ii) property rights; (iii) quality infrastructure; (iv) protection of the consumer; and, (v) access to finance. On the one hand, the state still has a significant presence in the economy through state-owned companies, including in sectors where it cannot keep up with private companies or in those that can no longer be considered strategic. While this is not necessarily a negative thing, over time, the state has proven to be a bad manager of these companies, many of which have ended up in a precarious financial situation or even facing bankruptcy (e.g. Air-Moldova, Railway Company from Moldova, Banca de Economii). On the other hand, the state struggles to maintain a business climate favourable to the development, growth, and internationalization of businesses through its institutions, while the problems related to the labour force, competitiveness of local products, and access to capital continue to increase.

> In addition to the many problems encountered by entrepreneurs, the recent crises have further accentuated the chronic lack of investment resources.

Access to finance is frequently cited as one of the major challenges for enhancing economic potential, increasing resilience and strengthening the convergence of the national economy with the European economy.[3] At the same time, despite decision makers acknowledging the importance of the problem – which is among the fundamental priorities of the main development strategies and programmes – firms, especially SMEs, still point to access to finance as one of the main constraints limiting their development.[4] Moreover, although concrete measures have been taken in recent years to strengthen the resilience of the banking sector, and the government has allocated unprecedented financial resources to the financing of businesses, the expected effects are proving somewhat slow to emerge. This is due to the systemic intermediation problems of private capital, as well as existing deficiencies in the process of developing and implementing government programmes.

3 The World Bank, Entreprise survey Moldova, https://microdata.worldbank.org/index.php/catalog/enterprise_surveys/?page=1&sk=moldova&country%5B%5D=141&ps=15&repo=enterprise_surveys

4 Analiza de impact la Regulamentul cu privire la Fondul pentru antreprenoriat și creștere economică a Moldovei - FACEM, https://particip.gov.md/ro/document/stages/proiectul-hotararii-de-guvern-pentru-aprobarea-regulamentului-cu-privire-la-fondul-pentru-antreprenoriat-si-crestere-economica-a-moldovei-facem/9798.

The state of the financial system reflects the quality and capacity of firms

At first glance, the situation in which domestic companies find themselves is atypical – although we have a well-capitalized banking system and consistent financial resources permanently allocated by the government, the funding deficit remains a major problem.

Insufficient self-financing capacities and intermediation problems translate into businesses not growing, and the economy ultimately misses opportunities for investment and production, job creation, and growth stimulation. Moreover, intermediation problems limit the much-needed structural change of the economy to one with higher added value. Therefore, analysing the factors that prevent the expansion of private investments, and identifying viable solutions to mitigate them, remain the government's priorities. Equally, in the event of financial market dysfunction, the authorities need to intervene.

The European Commission has described the financing gap as a situation where companies that deserve financing cannot get it because of market imperfection.[5]

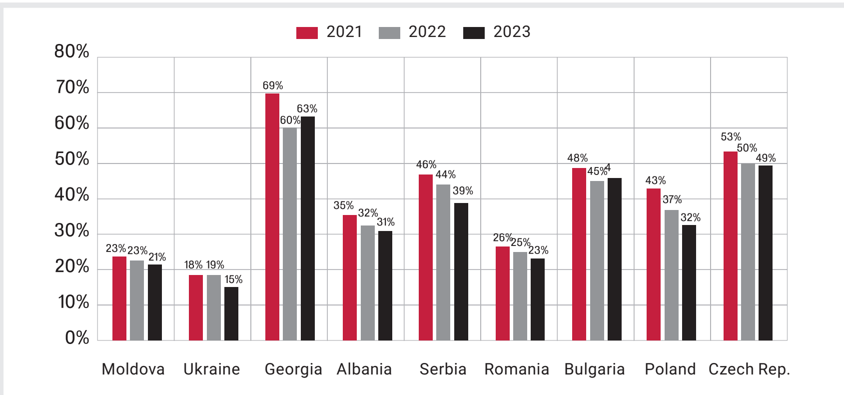
When the financial market cannot self-correct, state intervention is justified, because missing economic opportunities can produce losses that are much harder to recover from over time. Internationally, the most eloquent example of state intervention in the financial system is that of development banks,[6] which mobilize capital from sources other than individual depositors and direct that capital to those businesses that need it most and would not have obtained financing under market conditions. Moreover, the promotion of state policies for the development of the capital market, in addition to the credit market, expands the possibilities of allocating capital by institutional or retail investors directly to companies.

A similar feature for many developing financial systems, including the Republic of Moldova's, is the almost absolute presence of capital available in the banking sector, including for the development of the capital market, as well as lending based on the quality of the collateral rather than the potential of the investment project.

The lack of competition among actors to evaluate the quality of investment projects (pension funds, investment funds, crowdfunding) leads to banks allocating capital to less risky opportunities, such as companies with a solid credit history and sufficient collateral, government securities, and monetary policy instruments. As a result, there is a reduced level of intermediation, as is also confirmed by the data in Chart 1.

Chart 1.

Bank intermediation – the ratio of the balance of bank loans to GDP, per cent



Source: International Monetary Fund data. https://data.imf.org/?sk=E5DCAB7E-A5CA-4892-A6EA-598B5463A34C&sId=1390030341854

5 *Gap analysis for small and medium-sized enterprises financing in the EU, 2020, https://www.fi-compass.eu/library/market-analysis/gap-analysis-small-and-medium-sized-enterprises-financing-european-union*

6 *Development bank - mobilizes money not from individuals, grants loans with lower interest, and implements government projects in a governance framework similar to institutions that assess credit risk.*

The problems of intermediation and access to financing are not only related to the financial system, but also to the quality and ability of companies to generate viable investment projects.

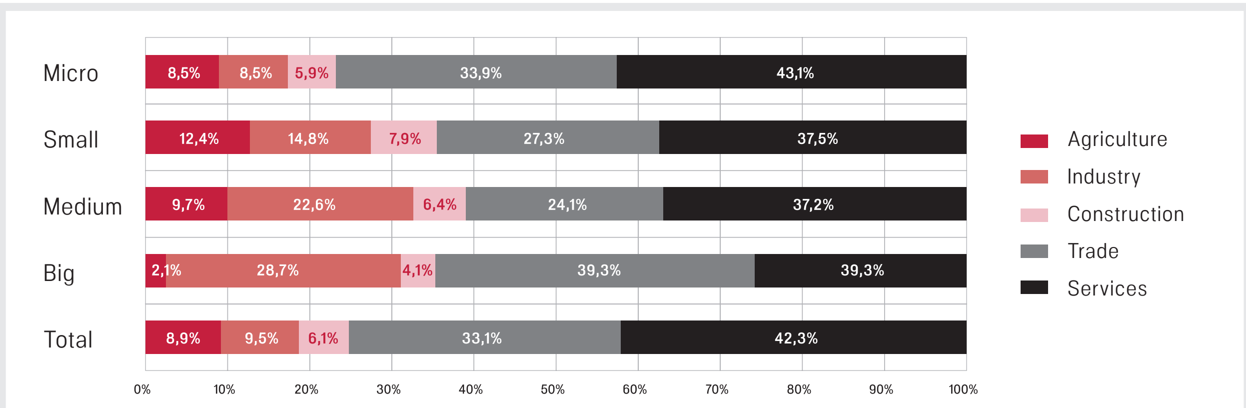
Since the real sector of the national economy is represented by a small number of firms, their number and capacity directly influence the demand for loans. At the end of 2023, 63,800 companies were registered, of which only about 66 per cent, or 42,000 were active companies.[7] Compared to the resident population, i.e. those who actually live in the country, there are about 25 companies per 1,000 inhabitants, which is far below the level of other European states. These numbers are not necessarily due to the entrepreneurial capabilities of the population, but rather represent the effect of massive migration of working-age people and the general state of the business climate.

The number, size and sectoral dispersion of domestic companies also present other realities of the national economy that affect such firms' capacities to finance themselves through bank loans, especially investment ones.

Out of the total number of companies, only 512 are defined as "large" – and it is also important to note here that the turnover ceiling is only 100 million MDL, compared to the EU level of 50 million EUR (if we were to apply the EU ceiling, only about 90 domestic companies could be considered "large"). At the same time, only about 7,300 companies are considered small and medium. The remaining 56,000 – or about 88 per cent –– are micro-companies, with a turnover of up to 18 million MDL and with a number of employees equal to or less than nine people. Additionally, from a sectoral perspective, the enterprises, especially SMEs, are concentrated in sectors affected by a high volatility and high sensitivity to external shocks (e.g. agriculture and industry, with 5,700 and 6,000 companies, respectively). Moreover, the concentration of the economy on sectors such as trade – with 21,100 companies – reveals the narrow specialization of the economy and its orientation towards a consumption economy fuelled by remittances, (see Chart 2).

Chart 2.

The structure of the number of enterprises by groups of economic activities, 2023



Source: *NBS data*
https://statbank.statistica.md/pxweb/pxweb/ro/40%20Statistica%20economica/?rxid=b2ff27d7-0b96-43c9-934b-42e1a2a9a774

Analysis of the situation in the banking sector together with the business environment highlights a series of systemic problems both on the supply side of capital and on the side of demand from companies.

Here, it is the national authorities' responsibility to understand these issues, identify the causes, and propose policy solutions to mitigate their impact.

7 Active companies are considered as those companies that submit financial reports to the National Bureau of Statistics and which report at least one employee and sales revenue.

Systemic problems at the level of capital supply (commercial banks)

- High requirements for collateral - the quality and level of the collateral are elements that cover the credit risk at the expense of the quality of the investment project. It should also be noted here that the rate of non-performing loans remains high in the economic sectors with the highest need for investment and financing, and that many companies are not in a stable financial situation.
- High interest rates - the high volatility of the cost of resources, the high rate of non-performing loans and the profitability objectives of banking activity determine the establishment of high loan spreads.
- Lack of capital to finance long-term loans - the main source of credit financing remains bank deposits, most of which are deposits of up to 12 months. This maturity discrepancy in the lending process reduces the supply of long-term credit or increases the cost of such resources.
- Orientation to other categories of loans and investments - considering that banking activity is a private business, the interest of banks to credit other, less risky types of activities, such as individual consumption, debt or investments in monetary regulatory instruments, increases.

Systemic problems at the level of capital demand (firms)

- Limited number of "bankable" companies - banks register a high rate of refusals for credit. This situation is generated by the fact that the business environment is characterized by the presence of a large number of companies with financial losses, with an instability of economic return and capital, and with limited financial management and planning skills.
- Limited ability to develop business plans - investment loans require the development of long-term business plans and forecasts of financial-economic indicators; these elements are almost missing due to a weak business consulting infrastructure.
- Reluctance to start new businesses - the difficult economic situation witnessed in recent years, which has been characterized by several crises and a war still in its active phase in a neighbouring country, has resulted in a high level of risk aversion on the part of entrepreneurs. Many investment projects have been put on hold or even cancelled, pending more stable financial and security conditions.

What the government is doing to support economic agents

> The government currently makes several support programmes available to companies, through which they allocate public financial resources.

These programmes complement and stimulate other forms of business financing, namely equity and bank credit. At the same time, the range of financing opportunities has grown significantly in recent years, both in terms of the number of products implemented by government institutions and the volume of allocated resources. More than 4 billion MDL was allocated to budgetary programmes to support SMEs and agriculture alone in the period 2022–2023.[8] In addition, the funding from the government was supplemented with financial resources allocated by different external partners, especially the EU, the United States Agency for International Development, and on a bilateral basis.

8 According to the State Budget Law for 2023 and 2024.

At the institutional level, the government allocates financial support to companies through three ministries and their subordinate institutions - the Ministry of Finance, the Ministry of Economic Development and Digitalization, and the Ministry of Agriculture and Food Industry (see Table 1).

Additionally, certain forms of support, such as subsidizing jobs or grants for unemployed people starting businesses, are implemented through the Ministry of Labour and Social Protection. Therefore, four ministries, and no fewer than nine public institutions, support domestic companies in one form or another. This is a rather decentralized and fragmented institutional structure, which cannot but raise questions as to both its efficiency and coordination capacity.

Table 1.
The institutional structure of business financing

Ministry	Subordinate institutions	Abbreviated name
Ministry of Finance	Office for External Assistance Program Management	OMEAP
Ministry of Economic Development and Digitalization	Organization for the Development of Entrepreneurship	ODA
	Implementation Unit of the World Bank Project for Improving Competitiveness	UIPAC
Ministry of Agriculture and Food Industry	Agency for Intervention and Payments for Agriculture	AIPA
	Agency for the Development and Modernization of Agriculture	ADMA
	The “Livada Moldovei” Programme Implementation Unit	UIP “Livada Moldovei”
	Consolidated IFAD Programme Implementation Unit	CPIU-IFAD
	Consolidated Unit for the Implementation and Monitoring of Projects in the field of Agriculture	UCIMPA
Ministry of Labour and Social Protection	National Employment Agency	NEA

Source: Authors’ compilation

In terms of the method of allocation, the nine implementing institutions make about 30 programmes and support measures available to economic agents (Table 2).

Some are implemented continuously, as the financial means accumulate in the state budget, while others, such as compensations, are implemented in exceptional situations, during periods of crisis or natural calamities. At the same time, in terms of the implementation characteristics and financial objectives, these programmes and support measures can be divided into the following three categories:

- Grants - non-refundable financial contributions, given as donations in order to achieve certain public policy objectives, such as the economic empowerment of certain categories of the population, digitization, re-technology, and the internationalization of businesses.
- Subsidies - the financing granted to the agricultural field through the National Fund for the Development of Agriculture and the Rural Area, so that entrepreneurs in the field can maintain their businesses and face the climate changes affecting this sector.
- Financial instruments - support measures in the form of capital, interest compensation, or guarantees, which can be combined with grants and which aim to stimulate access to bank credit. They multiply limited budgetary resources with private ones and align private capital with public policy objectives.

Table 2.

Government programmes and measures to finance the business environment

Support programmes and measures	Destination of funding	Allocation mechanism	Implementing agency
Compensations	• Credit interest compensation	National Fund for the Development of Agriculture and Rural Area Fund for Entrepreneurship and Economic Growth of Moldova	AIPA ODA
	• Reimbursement of expenses for participation in fairs and exhibitions • Reimbursement of expenses in dual education	Annual budget programmes of expenses	ODA
	• Gas consumption compensation • Compensation for damage caused by natural disasters (e.g. drought)	By decision of the Commission for Emergency Situations	MDED MAIA
Grants	• For the launch of new businesses by some categories of the population • For the implementation of thematic investment projects (export, greening, digitization, re-technology, internationalization) • For the realization of investment projects in specific sectors (rural tourism, animal husbandry)	Annual budget programmes of expenses Loan agreement with the World Bank	ODA UIPAC UCIMPA
Subsidies	• Subsidies in agriculture and rural area	National Fund for the Development of Agriculture and Rural Environment	AIPA
	• Subsidizing jobs	Annual budget programmes of expenses	ANOFM
Credit guarantees	• For current assets • For investment projects	The loan guarantee fund	ODA
Preferential loans	• For investment projects in the agrifood sector	Loan agreement with the European Investment Bank	OGPAE UIP Livada Moldovei
	• For small farmers	Refinancing agreements	OGPAE UCIP IFAD
	• With fixed interest	Fund for Entrepreneurship and Economic Growth of Moldova	ODA
Reimbursable capital/ leasing	• For the procurement of agricultural machinery	External financiers	ADMA

Source: Authors' compilation

Even if the government seems to implement programmes and support measures similar to those in other states, including EU countries, they are much less effective – a fact confirmed by the modest economic results. Deficiencies in both programme development and implementation undermine the expected potential and impact. Here, we can highlight the following factors:

- Combining several support programmes for the same investment project reduces the efficiency of public money - the urgent need for financing has led to fierce competition among beneficiaries, meaning that several sources of financing are used for the same investment projects. A clear example of this is the financing of an investment project through a grant, followed by the subsequent subsidization, within the same project, of the entrepreneur's own contribution. Besides the fact that this reduces the entrepreneur's contribution to less than 25 per cent of the investment project – which is implicitly the risk he/she assumes – we may be faced with a situation in which public resources are allocated twice, for the same objectives. In fact, the government should clearly delimitate businesses to be financed through grants from those financed through agricultural subsidies or through other programmes related to bank lending.

- The support given by the government is not always aimed at those who really need it - several programmes with funding from the state budget are based on a compliance assessment of the company or the investment project. This is at the expense of a risk-based assessment of the viability of the business and the impact that the investment can generate in terms of increased sales, taxes, and jobs. Moreover, the risks of certain companies being part of large economic groups, which exceed the SME criteria, are often not taken into account. These situations can also lead to an unfair allocation of resources, from the perspective of competition. When a company is owned, affiliated, or partnered with large enterprises, it may no longer be eligible for SME status (the Law on Subsidies and the Law on Small and Medium Enterprises[9] both refer only to the quantitative criteria for granting SME status).

- The financing programmes are poorly aligned with the public policies established by the government - even if the policies of the executive focus on certain objectives related to economic empowerment, export, and the promotion of domestic products, etc., recently there has been a tendency to allocate public money to supporting projects that do not correspond to the objectives of these policies. Namely, in the process of developing some financing products, too little attention is given to the fact that economic agents present different characteristics in terms of their business model and need for financing. This can be seen at the sectoral level, where a service or trade business requires different resources, investments, and technologies compared to a manufacturing business. Thus, when we talk about support based on the allocation of public money and not on the general conditions of the business climate – taking into account the fact that resources are limited – it is important to establish eligible sectors, types of priority investment projects, and criteria clear evaluations that take into account GVA, jobs, and exports, etc. Therefore, the reasoning should be as follows: subsidies for agricultural businesses, grants for start-up and growing companies, and financial instruments (access to bank loans) for mature companies. At the same time, it is important that the funding programmes remain policy instruments and not political instruments.

- Including some economic activities in agricultural subsidy measures - a clear example of this can be found in agricultural subsidies, which were also extended to some economic activities related to processing, storage, and the food industry. These businesses require other types of financing instruments – particularly those oriented towards bank lending – because we are mostly talking about investment projects here. Moreover, since these concern post-investment subsidies, the decisions to approve the subsidy involve a compliance assessment rather than an assessment of the efficiency and impact of the investment project. For example, last year alone, requests were submitted for post-investment subsidies in the amount of over 1 billion MDL, from which, no project was financed by the resources of the National Fund for the Development of Agriculture and Rural Environment allocated for 2023. As the money was used for other measures, the 2023 requests are to be financed from the resources allocated for 2024. If things continue in this way, small farmers will clearly be disadvantaged because they do not have the investment capacities of larger scale ones.

9 *Law no. 71/2023 on subsidies in agriculture and rural areas, https://www.legis.md/cautare/getResults?doc_id=136602&lang=ro; Law no. 179/2016 on SMEs, https://www.legis.md/cautare/getResults?doc_id=105839&lang=ro*

Ten recommendations for boosting the SME sector

There can be no doubt that the state needs to facilitate greater access to financing for companies.

The stimulation of private investment takes place in many countries and in different forms. The most frequently used mechanism is in the form of a development bank, which has the ability to evaluate investment projects from the perspective of risks and their potential to produce impact. At the same time, the capital market can do better business due diligence than the banking system (as long as it does not have the necessary incentives), which lends more on a collateral basis. The problem is that, in order for businesses to be listed on the stock exchange, they need to be developed.

The state needs to give entrepreneurs full freedom to decide for themselves where to invest.

When it comes to state financial aid, however, attention needs to be given both to economic activities and to the criteria for evaluating investment projects. Even more importantly, the priorities set in relation to public resources must take into account the principle of rarity. Accordingly, state financial support needs to be oriented towards those investment projects that can achieve the objectives of economic policy most quickly or those expressly established by a certain programme.

Under the conditions of the start of the EU accession negotiations, the financial support framework for domestic entrepreneurs is expanding considerably.

The EU provides a great deal of support for companies from candidate states through various structural programmes. However, EU support cannot be allocated in any other way than according to community rules, which are based on the principles of competition, transparency, and efficiency. Incidentally, the rules are similar when it comes to resources from the state budget, because ultimately both sources represent public money.

On this basis, the government needs to closely monitor the way in which financial support is provided for domestic entrepreneurs and maximize the impact of the funds it has available – whether we are talking about resources from the state budget or from external partners.

At the same time, the government needs to create the necessary conditions for the emergence of other private financing instruments. Success, de facto, will not consist in the amount of money allocated, but in the impact on the country's economic growth and development. To this end, we propose 10 recommendations that could bring about more efficiency and a greater impact on the development of the national economy.

1. **Clarification of the "SME" notion** - Internationally, the approach to this type of enterprise is that governments can financially support SMEs because they are the enterprises most vulnerable to crises and face far greater difficulty accessing capital from the financial sector. In recent years, the Moldovan Government and Parliament have created more clarity regarding the financial support mechanisms for SMEs.[10] The amendments to Law no. 179/2016 regarding SMEs have also expanded the group of companies eligible for financing programmes. Additionally, the new Subsidy Law,[11] approved in 2023, refers to the notion of SME when discussing the support extended to the agricultural sector. However, one extremely important aspect that still needs to be clarified is the identification of genuine SMEs. SMEs come in all shapes and sizes, and in today's complex business environment they can have very close financial, operational, or governance relationships, as well as affiliations with other businesses, making it difficult to clearly delineate between an SME and a big company. At the EU level, clear recommendations have been issued for Member States to implement methodologies to identify genuine SMEs, in order to guarantee that financial support measures are granted only to those businesses that really need them.[12] The size of the enterprise (employees, turnover, assets) is no longer the only factor to be considered in determining whether or not a company qualifies as an SME. In fact, according to these criteria, an enterprise may be very small, but if it is owned, affiliated, or partnered with large enterprises, it may no longer be eligible for SME status. The issue of affiliation is quite visible in the national economy, leading to an inequitable allocation of resources from the perspective of competition.

10 Law no. 179/2016 on SMEs, https://www.legis.md/cautare/getResults?doc_id=105839&lang=roonSMEs,https://www.legis.md/cautare/getResults?doc_id=105839&lang=ro
11 Law no. 71/2023 on subsidies in agriculture and rural areas, https://www.legis.md/cautare/getResults?doc_id=136602&lang=ro
12 https://op.europa.eu/ro/publication-detail/-/publication/756d9260-ee54-11ea-991b-01aa75ed71a1

2. **Further revision of the ceilings for the criteria for defining SMEs** - In the context of EU accession and access to a single market without borders, in an increasingly globalized business environment, it is essential that support measures for entrepreneurs are based on common criteria. Currently, the ceilings that define the notion of the SME, transposed in Law no. 179/2016, are 10 times lower than those at the EU level. Thus, in terms of turnover alone, the maximum ceiling is only 5 million EUR in the Republic of Moldova, compared to 50 million EUR at the European level. This difference contributes to a distortion of competition in terms of state aid. However, in Moldova, a company with revenues of over 5 million EUR cannot benefit from support within certain state programmes, while in neighbouring Romania, companies of a similar level can. The differences in question further increase the competitiveness gap of domestic companies when accessing foreign markets and competing with similar goods and services. Obviously, the national economy is extremely small, and the aid that the state can afford to allocate to businesses is limited, which is why any increase in the ceilings for the SME criteria must be carefully evaluated. The most recent change - implemented in 2022, when the ceilings were doubled - only expanded the number of potential eligible companies by about 250. Thus, in a situation in which the national economy registers only 512 large companies, the possibility of further increasing the ceilings to meet the SME criteria needs to be evaluated, so that more companies can benefit from programmes such as the Credit Guarantee Fund, the Fund for Entrepreneurship and Economic Growth of Moldova (FACEM), and agricultural subsidies.
3. **Coordination of the financial support provided by different state institutions** - When almost any form of financial support to entrepreneurs represents a state aid scheme, in order to maintain a normal competitive environment, it is extremely important to strengthen the mechanism for authorizing, monitoring, and reporting state aid granted to beneficiaries from all sectors of the national economy. Currently, the Competition Council does not have a common register containing all forms of financial support received by an economic agent, which increases the risks of illegal aid being obtained according to Law no. 139/2012 regarding state aid.[13] The numerous state support programmes, and especially the large number of implementing institutions, create a relatively fertile ground for breaking the law. Moreover, the possibility of an entrepreneur obtaining financial resources from several institutions for the same investment project amplifies the stated risks. Therefore, it is very important to establish a register for financial aid obtained and to establish clear rules of cooperation between the institutions involved in these processes.
4. **Aligning economic policy objectives with financing programmes** - The government has approved several strategies and activity programmes that specify economic policy priorities. These include the support of industry, high-performance and value-added agriculture, and services in the IT field. Therefore, funding programmes must be developed in order to support and accelerate the implementation of these objectives. Additionally, financial support needs to be allocated based on clear criteria of efficiency and business impact, with an evaluation of indicators related to taxes and jobs, since allocating support based only on compliance criteria risks amplifying the 'free rider' phenomenon.[14] This phenomenon is often observed in agriculture, where the level of the informal economy remains high, or within affiliated companies. Thus, there are businesses that receive subsidies for years in a row without paying any tax and without declaring jobs or businesses that obtain financing for certain machines used within other affiliated companies, which would not have been eligible.
5. **Focusing on credit acceleration instruments** - The state has limited resources to finance a long list of public expenditures. To support entrepreneurs, the state created a financial system whose main role is to finance the real economy. Given that banking intermediation is at a fairly low level, for the various reasons mentioned above, the government needs to intervene with mechanisms dedicated to mitigating or even eliminating these problems. Essentially, from the perspective of entrepreneurs, there are three issues related to bank credit: credit risk, cost of credit, and resource maturity. The most frequent issue concerns credit risk. As a solution, the government must allocate more money to the capitalization of the Credit Guarantee Fund (CGF), whose capacity to multiply is much greater when it comes to stimulating investments than grants or subsidies: one MDL spent by the state through the CGF (when a guarantee is executed and there are no more chance of recovery) supports at least 60 MDL granted in the form of credits.[15] Regarding the cost of credit, this problem usually occurs with investment loans which, being contracted for the long term, are more susceptible to major interest rate fluctuations.
6. **Eliminating fiscal facilities and compensation-based programmes and directing financial support towards targeted investment projects** - Over the past two decades, the most common form of help for entrepreneurs has been in the form of tax breaks for certain economic sectors or compensation to remedy a serious disruption to the economy (e.g. the energy crisis of 2022, when compensations were granted for the natural gas bill, including for non-household consumers). In addition to not targeting those who really need support, these support programmes are an expense that, at some point, will surely recur. On the contrary, supporting investments – that is, those who invest– ensures that certain expenses will no longer be necessary in the future. Obviously, when investments are financed, clear criteria for evaluating investment projects must be established and those initiatives that can have a significant impact on the company and the economy should be selected. Such criteria can be GVA maintaining and/or creating new jobs, with the latter representing one of the most serious problems facing the business environment in recent times. Criteria related to increasing production and exports, reducing costs, or targeting products with high added value can also be established.

13 Law no. 139/2012 on state aid, https://www.legis.md/cautare/getResults?doc_id=144734&lang=ro#
14 In economics, the 'free rider' phenomenon is considered a type of market failure that occurs when those who benefit from public resources and goods do not pay for them or pay much less than others.
15 Calculations based on the CGF multiplier of 1x6 and a Nonperforming Loan ratio of 10 per cent.

7. **Creating an appropriate institutional framework, based on governance specific to financial institutions** - Table 2 shows how dispersed the institutional support framework for domestic entrepreneurs remains. This model raises major problems when it comes to cooperation and coordination of the allocated support and generates risks of political clientelism, given that the governance mechanism remains deficient. More importantly, though this model is not only expensive, but is also quite difficult to sustain in a situation where attracting and maintaining qualified specialists in public institutions is becoming increasingly challenging. The government can no longer afford to create implementation units for each external financier simply because it does not have an institution that meets the criteria put forward by them. It is time for a pragmatic assessment of the existing institutional framework and its optimization in line with economic policy objectives. Additionally, the management of financial instruments requires an approach oriented towards the most modern corporate governance practices, similar to entities that manage activity-specific risks – credit risk, counterparty risk, operational risk, etc. A more appropriate institutional framework would need to take into account: (i) the separation of evaluation, implementation, and monitoring functions; (ii) the independence of funding decisions; and, (iii) the quality of the governing bodies (the Board and the executive body). In addition to the fact that such a structure can increase the quality and efficiency of financed projects, it can also ensure the confidence of various external financiers when they decide to allocate resources to domestic entrepreneurs.
8. **Promoting closer interaction with commercial banks** - With no state-owned commercial bank left, and the creation of a development bank deemed risky (given the quality of governance in state-owned enterprises), the solution is to use the current banking infrastructure to accelerate financing for entrepreneurs. After the reforms in the banking sector, banks today are the entities with the most advanced governance and risk assessment frameworks. Additionally, taking into account the mechanism for supervising and regulating lending activity, they apply a set of strict rules when evaluating a business or investment project. Thus, the government needs to continue to expand the programmes implemented through banks. Moreover, when it comes to offering grants, they also need to be allocated to certain types of loans – loans matched with grants for exporters and other types of investment projects that boost production capabilities. The evaluation of the company and the investment project would thus remain the responsibility of the bank, and the state would intervene with the grant component at a certain stage of the project's implementation. This instrument should not be confused with the programme P373, where the purpose of the state granted allowance is to compensate for the cost of the credit rather than the investment project.
9. **Aligning economic programmes with the monetary policy cycle** - The stimulation of investments and the real economy should not only be seen as an issue concerning the government's economic policy. The coordination of economic policies with the monetary policy promoted by the National Bank of Moldova (NBM) is a premise that can no longer be neglected. Thus, interest rates and exchange rates are two elements that directly affect the economic cycle and the investment process, which need to be taken into account when developing financing products. For example, because the rates on the financial market have currently reached historic lows, the government needs to focus primarily on alleviating the gaps related to the collateral and the capital maturity, rather than on interest compensation. Subsequently, in inflationary periods, when the NBM increases the base rate and reduces the supply of money in the economy to keep inflation within reasonable limits, the government needs to emphasize those instruments that limit the increase in interest on loans. The most suitable instruments in these periods are those that allow for the provision of fixed interest rates for entrepreneurs on investment loans, either by compensating interest up to a certain level (e.g., P373) or by providing capital at a fixed cost to banks (e.g. FACEM). The latter mechanism, even if it has a lower multiplier effect, leads to the simultaneous mitigation of two problems related to investment loans –the cost of loans and their maturity – because banks have access to long-term capital.
10. **Capital market development** - The model of the financial system is also dictated by the policies implemented by the government. The concentration of most of the capital available for business financing in the banking sector is the result of the executive's lack of interest vis-à-vis the capital market. As long as there are no clear political premises for the creation of the second pension pillar, there is no way for institutional investors with an offer of capital to appear. In light of these conditions, but also because the subscription potential from retail investors is quite low, entrepreneurs avoid issuing debt instruments in the form of corporate bonds. The same situation can also be seen, however, in the case of capital instruments, namely shares, whose trading is affected by the extremely low liquidity of the stock exchange. However, this state of affairs cannot continue indefinitely, since external examples regarding the capital market prove that, in most cases, investors can undertake a deeper assessment of a business or an investment project than banking institutions, which tend to limit their ratings to the quality of the collateral. Thus, with the National Commission for Financial Markets having started the process of developing the Capital Market Development Strategy, it is essential to identify those opportunities and mechanisms that could render the circulation of capital in the economy more efficient – private pension funds, investment funds, debt instruments in the form of bonds, and capital in the form of shares.

Firms

The state of the country is determined by the level of development and competitiveness of companies, the well-being of the population, and the efficiency and quality of governance. These three defining elements for a state are closely interconnected, which is why they are analysed as priorities in this State of the Country Report. This chapter focuses on the first of the three elements and evaluates the dynamics of the private sector in the Republic of Moldova, identifying the most significant trends from 2022 to 2024. Increased attention is given to the evolution of economic sectors in the context of recovery after the multiple crises faced by the country, presenting the challenges and structural changes that occurred during this time. The analysis of the business environment reveals, on the one hand, an improvement in perceptions of the level of corruption in the country and, on the other, a worsening of the level of economic freedom. In addition to the security risk generated by the war waged by Russia in Ukraine, the perception of foreign investors towards Moldova has also been shaken not only by some discretionary and poorly argued decisions by the government, but also by the instability of the rules of the game in the legislation. At the same time, during the period concerned, notable progress was made in terms of the digitization of public services and the development of online commerce. The policy recommendations formulated in this chapter advocate both for a strategic approach to all areas of economic development, including those not covered by strategic planning documents, and for the development of guarantee instruments for exporters. Strengthening the role and impact of active employment measures and accelerating the internationalization of universities are recommendations directed at tackling imbalances and shortages in the labour market. This chapter also addresses the need to strengthen business trust in the state as a business partner, by stopping the practices of frequent and non-transparent interventions in the regulatory framework and those of applying the "principle of rarity" in granting subsidies in agriculture, and prioritizing activities and projects with a greater impact.

Analysis of the main trends and developments in the real sector

Entrepreneurship

2023 was marked by a reduction in the general level of indebtedness among companies.

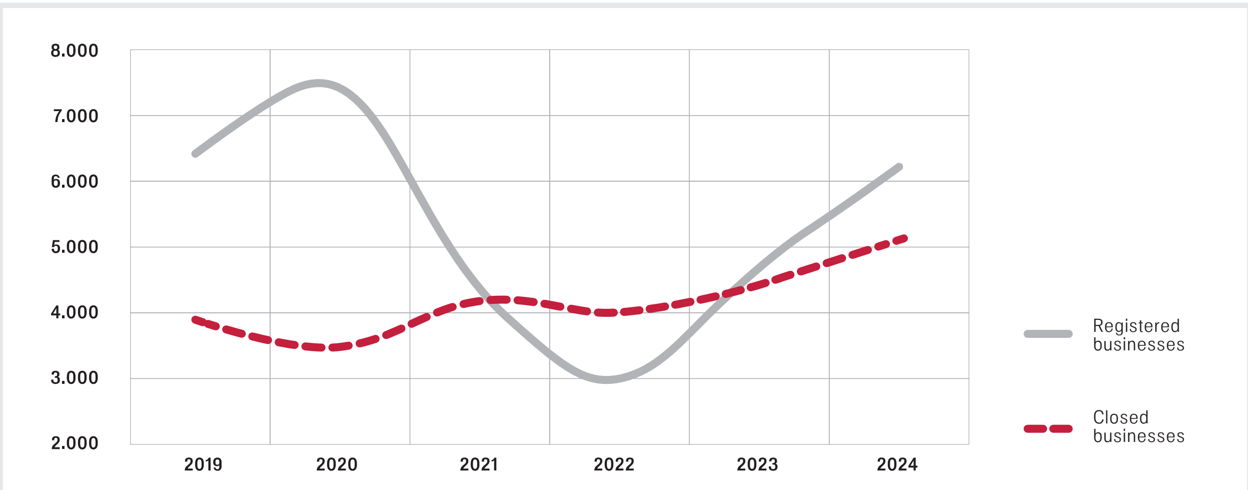
After nominal turnover increases of 25–30 per cent recorded in both 2021 (post-pandemic recovery) and 2022 (28.7 per cent inflation), in 2023 the corporate sector recorded a turnover increase of only 3.9 per cent (while the average annual inflation was 13.4 per cent). This situation is explained both by the reduction in inflation and the drop in international prices for several products, and by the difficulties companies faced in accessing markets. The number of enterprises increased by 1.9 per cent y-o-y (two times slower compared to 2022: 3.8 per cent y-o-y), up to 63,800 units. At the same time, the average number of employees recorded an increase of 1.8 per cent y-o-y, up to 539,000, with the indicator in question being below the parameters before the pandemic, by 2.3 per cent (-13,000 employees compared to 2019). In terms of profitability, in 2023, over half of the companies reported a profit (54.4 per cent), over one third recorded losses (35.6 per cent), while another 10.0 per cent of companies submitted reports on zero (no economic activity recorded) with the given structure being close to that of a year earlier. At the same time, almost every fourth enterprise (22.9 per cent) had no sales in 2023. Aggregate data from firms' balance sheets suggest an even greater increase in risk aversion and limited investment appetite. Thus, in 2023, companies' equity increased by 9.6 per cent, while the total debt balance decreased by 0.3 per cent. At the same time, with regards to assets, tangible fixed assets increased by 7.4 per cent y-o-y, and the value of cash at the end of the year increased by 31.8 per cent. It is worth noting that this trend was even more pronounced among large companies.

> The state of apathy among companies observed in 2023 partly continued in 2024 among SMEs, while large businesses had more optimistic expectations.

In the same context, it is worth noting the National Bureau of Statistics (NBS) research on "Trends in the evolution of economic activity in the third quarter of 2024" here[16] which was carried out by questioning company managers about their expectations concerning future developments in the economy. The research results indicate a relative stability of economic activity, sales revenue, and the number of employees, with anticipated increases of between 0 and 5 per cent. At the same time, perceptions were more optimistic among managers of large enterprises (with more than 250 employees), who expected increases in economic activity and sales revenue, and a moderate increase in the number of employees. The statistics on the number of new businesses registered in the first seven months of 2024 reveal an increase of 13.2 per cent y-o-y, up to 5,000 units (chart 3). This was also the best result for the period 2019–2024. At the same time, the number of closed businesses in the months of January–July 2024 increased by 32 per cent, up to 6,200 units, which resulted in a negative increase in the creation of new businesses. However, the results in 2023, and particularly those in 2024, were also influenced by the fact that, following the legislative changes,[17] family farms (FF) have become subject to the provisions of Law no. 220/2007 on the state registration of legal entities and individual entrepreneurs. At the same time, the amendments in question provide for stricter and clearer rigour regarding the activity of FFs, excluding inactive ones or those that do not correspond to the provisions of the law. For example, out of the 6,200 enterprises closed in January–July 2024, 2,700 were FFs. At the same time, the latest data available[18] show that Moldova continues to have a lower level of entrepreneurial initiative compared with other states in the region. Thus, in the Republic of Moldova, on average, 3.1 enterprises are created per 1,000 inhabitants of working age (15–64 years), which is well below the average of the Central European countries and the Baltic States (5.1).

Chart 3.

Dynamics of the number of newly created and liquidated enterprises, January-July (2019-2024)



Source: Public Services Agency. Note: as a result of legislative changes, starting from 2023, FFs are also included in the statistics on the creation and liquidation of enterprises.

16 https://statistica.gov.md/ro/tendinte-in-evolutia-activitatii-economice-in-trimestrul-iii-2024-9557_61413.html
17 The 2023 amendments to Law no. 1353 on family farms, https://www.legis.md/cautare/getResults?doc_id=135665&lang=ro#
18 https://data.worldbank.org/indicator/IC.BUS.NDNS.ZS

Agriculture

After a largely unfavourable market environment in 2023, in 2024 farmers still need to manage lower price pressures, coupled with lower yields compared to last year.

After a record harvest in 2021, with an increase in the agricultural production index of 58.0 per cent y-o-y, the bad weather in 2022 led to a reduction in the volume of agricultural production by 29.2 per cent y-o-y, while 2023 brought a rebound in agricultural production by 24.5 per cent y-o-y. Based on the agrometeorological forecasts and the data of the sectoral ministry and specialized associations, for 2024 a reduction in the volume of agricultural production of about 10–15 per cent is expected. This decrease will be driven, in particular, by lower harvests of cereals, sunflower, grapes, and apples, but will be slightly mitigated by increased livestock production. The unfavourable market conditions, which began in the second half of 2022, are also reflected in the financial reports of companies in the agricultural sector, which reported a decrease in sales by 8.6 per cent in 2023, in tandem with an increase in the sales cost by 9.6 per cent. Even if farmers benefited from a reduction in the costs of pesticides and fertilizers (by about 30 per cent) and of financing costs during the last year, due to the continuous drop in prices the situation remained complicated in the first half of 2024. For example, the data concerning farmers who manage areas of more than 50 ha show that, in the third quarter of 2024, the average selling prices decreased by 16 per cent for cereals, by 8 per cent for sunflowers and by 33.5 per cent for vegetables, y-o-y. Expectations concerning international markets are more positive regarding an increase in oilseed prices, with more uncertainty when it comes to cereals. Traditionally, also in 2023, fluctuations in agricultural production were higher in the case of agricultural enterprises (+35.3 per cent y-o-y) and lower in the case of the individual sector (+10.7 per cent y-o-y). They were also higher in the case of vegetable production (+36.2 per cent y-o-y) and lower in the case of livestock production, which remained in decline: -1.6 per cent y-o-y. Despite the increasingly frequent climate shocks, the structure of annual crops continues to be dominated by maize, wheat, and sunflower – crops with low added value, which in 2023 accounted for 78.8 per cent of the sown area. This proportion was maintained year after year without any notable deviations. At the same time, crops with a potentially higher added value – such as vegetables, potatoes, or oilseeds – remain underrepresented. This is because these crops largely remain a concern of the individual sector; they are not attractive to the corporate sector due to the greater need for labour as well as the lack of differentiated incentives in relation to other crops. In the case of livestock production, a decrease is noted for the seventh consecutive year. The situation is generated by a reduction in the production base, i.e., the number of animals within the population's households. At the same time, the acceleration of the dynamics of the herd of animals within agricultural enterprises is promising – the situation on July 1, 2024 compared to that of July 1, 2023 is as follows: cattle +8.7 per cent; pigs +13.4 per cent; sheep and goats +34.7 per cent, and; poultry +17.5 per cent.

Industry

Amid growing competitive pressures, the share of GDP contributed by industry has reached historic lows.

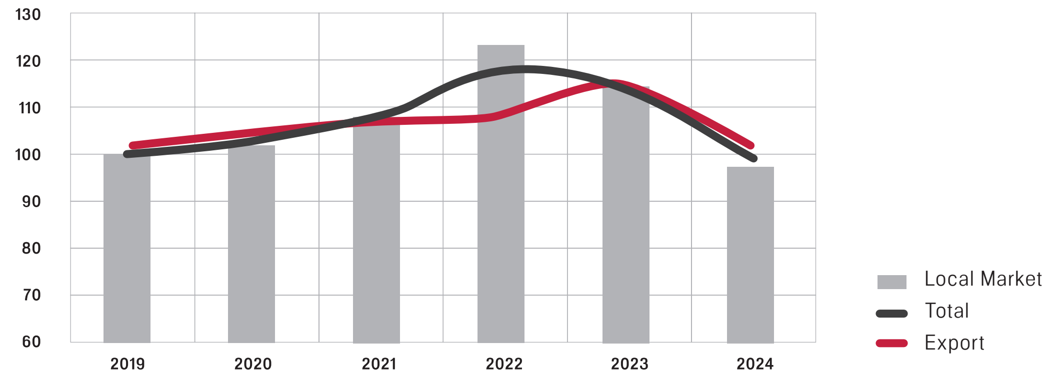
The years 2022 and 2023 were marked by two successive decreases in the volume of industrial production – by -5.1 per cent y-o-y and -3.6 per cent y-o-y, respectively. This decrease in production is the result of a combination of factors, including drought; the contraction of external demand as a result of the reformatting of value chains due to the security crisis, coupled with the growing labour shortage; stagnation in construction and more expensive energy resources. The areas in which production volumes decreased the most in 2023 y-o-y were: manufacturing of clothing (-16.8 per cent); manufacturing of motor vehicles, trailers, and semi-trailers (-13.2 per cent); the food industry (-10.7 per cent); and furniture manufacturing (-9.6 per cent). For 2024, according to the results of the first half of the current year, the volume index of industrial production registered a modest increase of 0.7 per cent y-o-y. This was mainly due to the sectors associated with the construction and infrastructure sector: the metallurgical industry (+45 per cent); the metal construction industry (+28.7 per cent); furniture manufacturing (+26.2 per cent); and the extractive industry (+4.7 per cent). For the second half of the current year, the industrial production volume index is expected to maintain its growth trend, especially thanks to the recovery of the food industry and the low comparison base.

> The general situation in industry is complicated, given that the share of GDP in 2023 reached an historical low of 11.2 per cent, and that in the last two years there were 3,200 fewer jobs in the sector (-3.2 per cent).

The gradual dissipation of the advantage of cheap labour and lower priced energy resources creates the problems of technological underdevelopment and efficient process organization. Factory exit prices of products reveal an average decrease by 0.5 per cent y-o-y in prices in the manufacturing industry in January–July 2024 (chart 4). This occurred due to the 2.4 per cent decrease in prices for domestic deliveries, while export deliveries were, on average, 2.2 per cent more expensive y-o-y. This trend shows an alignment with inflation trends for the most part, as well as an easing of cost pressure on local producers.

Chart 4.

Price indices in the manufacturing industry according to the market in January-July, y-o-y, per cent



Source: Authors' calculations based on NBS data

Services

> The service sector represents the main source of economic growth for 2024 thanks to the return of retail trade and construction and the continued expansion of the IT and HoReCa sectors.

The results for the first half of the current year reveal modest growth in wholesale turnover (+1.7 per cent y-o-y) and robust growth in retail turnover (+16.3 per cent y-o-y). This dynamic exceeds the inflation rate of January–June 2024 (3.9 per cent) by far and shows a recovery of the population's purchasing power. At the same time, in the first six months of the year, the HoReCa sector recorded a nominal increase in sales of 31 per cent for accommodation facilities and 21 per cent for restaurants, after increases of 26 per cent and 31 per cent, respectively, in 2023. Moreover, in 2023, the number of tourists making use of accommodation facilities exceeded the pre-pandemic level, and the share of the hospitality industry in GDP increased from 1 per cent in 2019 to

1.6 per cent in 2023. The sector managed to return after the pandemic, with a higher qualitative leap. In the transport sector, passenger travel in January––June 2024 increased by 9.1 per cent, mainly by air transport. This was mainly thanks to the expansion accessible routes. Meanwhile, the volume and turnover of goods increased by 8.2 per cent and 1.4 per cent, respectively. The railway sector was the most affected, with the transportation of goods seeing a reduction by more than one third. Given that railway infrastructure is in a more than precarious state, reflecting a decades-long a lack of investment, the recovery of this sector will only be possible with government intervention. After two years of decline in the volume of construction work carried out (-15.1 per cent y-o-y in 2022 and -3.0 per cent y-o-y in 2023, in comparable prices), the sector is showing signs of recovery with real growth of 4.2 per cent in the first half of the year y-o-y; this has mainly been generated by an increase in the volume of work carried out in the residential sector (+6.7 per cent). With the changes made to the government programme "Prima Casă", namely, reduced financing costs, it is expected that the demand for apartments will also increase. In this context, the importance of cooperation between the authorities, and the creation of a vision for the development of residential areas in the municipality of Chisinau and adjacent areas, becomes even more critical. This could contribute to the development of the construction sector, but also to an avoidance of excessive housing price increases. The IT sector continues to be a source of growth. Exports of IT services reached 580 million USD in 2023, which is 5.7 times more than the year before the opening of Moldova IT Park (2017). This upward trend will continue in the current year, considering that the turnover of companies in this industry increased by about 12.5 per cent in the months of January–June.

Investment

The return of the residential construction sector, combined with companies' continuous efforts in terms of technology and automation, allowed for a positive return in investment trends in 2024.

This followed a fall in investment by 11.9 per cent (in comparable prices) in 2022, caused by the recession and rampant inflation. The year 2023 marked a near stagnation in investment, with a 1 per cent y-o-y reduction. In 2023, investments in non-residential buildings and engineering constructions (roads, railways, bridges, stadiums, etc.) suffered the most (-28.2 per cent y-o-y and -7.6 per cent y-o-y, respectively). By form of ownership, in 2023, in particular, the investment made by foreign capital companies (-33.6 per cent y-o-y) and local private companies (-3.3 per cent y-o-y) decreased, while public investment increased by 12.8 per cent y-o-y. The results for the first half of 2024 reveal an increase by 1.7 per cent y-o-y. The increase in investment in the first six months of the current year is associated both with the return of the construction sector – investment in residential buildings accounted for +19.7 per cent y-o-y, while investment in land accounted for +12.9 per cent y-o-y – and with companies' continuous efforts to invest in machinery and equipment (+6.4 per cent y-o-y) and in means of transport (+14.7 per cent y-o-y). In terms of financing sources, the increase was ensured mainly by investments made from the companies' own resources (+13.1 per cent y-o-y), which covered about 67.6 per cent of the total investments made. At the same time, except for the resources from the Road Fund account, in the first six months of the year the other sources of investment financing were in the red in comparable prices. These consisted of internal credits and loans (-16.5 per cent y-o-y), external credits and loans (- 56.1 per cent y-o-y), the state budget (-13.6 per cent y-o-y), and local budgets (-10.7 per cent y-o-y). In general, for the second half of the current year, a positive dynamic of investment in fixed assets is anticipated. This will be largely due to the intensification of the investment efforts of the local private sector, including against the background of the continued reduction of financing costs. By contrast, public investment, at best, will stagnate, given that the amount of capital expenditures planned for 2024 in the National Public Budget – 10.5 billion MDL – is lower compared to the executed budget for 2023 (11.9 billion MDL).

Analysis of the main trends and developments in the financial sector

The banking sector remains stable and resilient, but despite the easing of monetary policy, the level of financial intermediation remains mediocre.

As July 31, 2024, the ratio of own funds in the banking sector was 28.3 per cent, a decrease of 1.6 p.p. since the beginning of the year, and well above the minimum limit of 10 per cent provided for in the legislation. This is explained, firstly, by the permission granted to banks to distribute dividends. The liquidity coverage ratio (LCR)[19] requirement exceeds 295 per cent, while its minimum value is set at 100 per cent. As a result of the mitigation of multiple crises, the quality of the credit portfolio in the banking sector has improved. Thus, in 2023, the share of non-performing loans decreased by 0.9 p.p. to 5.55 per cent, and since the beginning of the year it decreased by another 1 p.p., to 4.51 per cent, as recorded in July 2024. At the same time, the increase in financial intermediation expected with the return of inflation to the parameters targeted by the NBM did not occur. Thus, the loan/deposit ratio decreased from 0.65 in 2022 to 0.56 in 2023. Since the beginning of the current year, progress in this regard has been negligible, with an increase up to 0.58 in July 2024. The level of intermediation remains below its potential, including compared to the historical level of 0.81 recorded in 2013, although the parameters to aim for are even higher. The banking sector remains dominant in the architecture of the financial system, with an increased weight of 0.9 p.p., up to 87.8 per cent in 2023. This quasi-total monopoly, and the presence of a business model that brings banks the expected rent, is among the key factors that inhibits the development of other segments of the financial sector. At the same time, the level of penetration of the financial system in the economy slightly increased. Relative to GDP, in 2023 assets were 58.4 per cent, increasing by 2.9 p.p. y-o-y. From a legislative and institutional point of view, the most important events of the period were the full takeover, by the National Financial Market Commission, of the mandate to protect consumers of financial services, and the NBM's submission and signing of the application for the Republic of Moldova's accession to the Single Euro Payments Area.

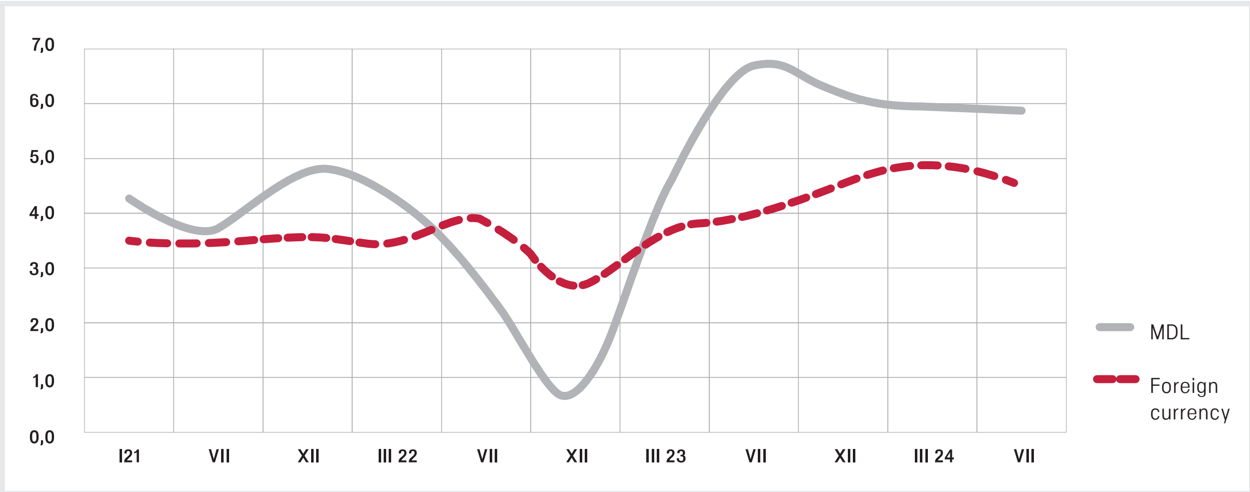
Banks are attracting deposits at record lows and recording the widest spreads between effective rates on loan and deposit balances in at least 10 years.

After a growth of only 5.9 per cent y-o-y in the volume of new loans granted in 2022, 2023 also brought a modest increase of 8.0 per cent. This was largely supported by the recovery in the volume of disbursements to the population, which grew by 30.5 per cent y-o-y. Lending to legal entities almost stagnated in 2023, however, with a marginal growth of 2.9 per cent y-o-y. The results for the first seven months of the current year reveal a 27.6 per cent increase in the volume of new loans granted by the banking sector. Thus, in January–July, lending to businesses in the national currency increased by 43.0 per cent y-o-y, while lending in foreign currency decreased by 3.3 per cent. This was due to the significant reduction in loan rates in MDL and the NBM's maintenance of a greater difference (of 10 p.p.) between the norm of minimum mandatory reserves in the national currency and in foreign currency. At the same time, over the same period of time, lending to the population recorded an increase of 68.6 per cent y-o-y, including +48.6 per cent y-o-y for consumer loans and 2.6 times more for disbursements of real estate loans. Furthermore, the value of new loans granted to companies in January–July 2024 increased by 15.5 per cent. It is important to note that the recent changes made to the "Prima Casă"[20] government programme include, among other things, the increase in the

19 Calculated as the ratio of liquidity reserve/net liquidity outflows during a 30-day crisis period
20 https://www.expert-grup.org/ro/biblioteca/item/2732-prima-cas%C4%83-plus-un-program-social-bancar-imobiliar-sau-electoral?-analiza-oportunit%C4%83%C8%9Bilor-%C8%99i-riscurilor-programului&category=7

ratio between the monthly loan rate (all payments related to the loan) and net income from 50 to 70 per cent, which represents a derogation from the principles of responsible lending imposed by the NBM, where the given rate is 40 per cent, while for those with higher incomes it can reach 55 per cent. This can lead to an even higher increase in house prices, but also to the risk of over-indebtedness of the population, since lending for the purchase of real estate is already experiencing high growth rates (2.6 times in the first seven months of the year, y-o-y). Following the substantial relaxation of the monetary policy by the NBM, banks lowered the interest rates with which they attract deposits to historic lows. In July 2024, the average rate on newly attracted deposits fell below the three per cent threshold (2.99 per cent) for the first time. However, completely different behaviour can be seen in the case of new loans granted. The average rate on new loans granted in the banking sector in July 2024 was 8.82 per cent, which is 2.04 p.p. more than the historical low reported by banks in August 2021. As a result, in June 2024, banks recorded a difference between the weighted average nominal interest rates on loan and deposit balances of 5.59 p.p., which was the largest margin recorded since the start of statistical data for this indicator (January 2013).

Chart 5.
The difference between the average interest rate on new loans granted and new deposits attracted, p.p.



Source: : Authors' calculations based on NBM data

Analysis of the main trends and developments regarding the business environment

International ratings reveal a continuous improvement in perceptions regarding the level of corruption in the country, but also a worsening of the level of economic freedom.

In the latest editions of the Corruption Perceptions Index, conducted by Transparency International,[21] the Republic of Moldova saw an increase of 10 points between 2019 and 2023 and a jump in its ranking from 120th place to 76th place in 2023. Even though Transparency International indicated[22] that "through persistent efforts to strengthen democracy, the fight against corruption and the rule of law, Moldova continues its constant improvement in the ranking", according to the same report, "the country still has a long way to go until it has an extremely effective anticorruption framework, as indicated by the shortcomings of its specialized authorities in combating corruption and problems related to en-

21 https://www.transparency.org/en/cpi/2023/index/mda
22 https://www.transparency.org/en/news/cpi-2023-eastern-europe-central-asia-autocracy-weak-justice-systems-widespread-enabling-corruption

suring the integrity of elected officials". The lobbying influences of various interest groups are also nuanced, and it is noted that "the country needs to better protect the policymaking process from undue influence." At the same time, in the 2023 edition of the Global Innovation Index,[23] which is based on seven pillars – infrastructure, business sophistication, human capital and research, market sophistication, knowledge and technological outputs, creative outputs, and institutions – the Republic of Moldova came 60th out of 132 economies analysed, a fall in ranking of four positions. Data[24] shows that, relative to GDP, Moldova's results were above expectations for its level of development. At the same time, the report emphasizes that Moldova produces more innovative results relative to its level of investment in innovation. Even so, the biggest challenge remains the translation of innovations at the firm level. Research on the results of enterprises' innovation activity in the Republic of Moldova in 2021–2022[25] shows that the share of innovative companies in the total number of companies is only 11.4 per cent. In comparison, at the level of the EU states, more than one out of every two companies fall in that category. Moreover, in the 2024 edition of the Economic Freedom Index, produced by the Heritage Foundation, Republic of Moldova's score is 57.1[26] and its country ranking is 99th worldwide. De facto, in this context, the Republic of Moldova is in decline for the third consecutive year. Compared to last year's edition, it lost another 1.4 points, remaining in the category of "mostly unfree" states. According to the report, "progress in macroeconomic governance and improving the business climate has been uneven", while the weak rule of law undermines the prospects for more meaningful and dynamic economic development in the long term. The study also notes that Moldova has adopted some regulatory reforms, but bureaucracy and the lack of transparency continue to make it difficult for private enterprises to set up and operate. The lower score recorded in the report's 2024 edition was also influenced by the decrease, compared to last year, of 4 of the 12 indicators that make up economic freedom, namely: judicial effectiveness, fiscal resilience, monetary freedom, and public expenditures. At the same time, the Republic of Moldova is performing well in terms of ensuring gender equality, occupying 13th place out of 146 states in the 2024 edition of the Global Gender Equality Index.[27] The index in question is produced annually by the World Economic Forum and analyses the current situation and evolution of gender equality in relation to four key dimensions: i) economic participation and opportunities; ii) educational outcomes; iii) health and survival; and, iv) political empowerment. Out of these four dimensions, Moldova performs best in terms of economic participation and opportunities (occupying fifth place in the ranking). For the other three dimensions, however, it ranks 37–40th. Despite this good position in the ranking, women continue to represent a minority within the business community (on average, one in three businesses are run by women), with significant growth reserves, given that they make up more than half of the country's total resident population. Barriers such as low start-up capital and bank financing, as well as a lack of time, mean that businesses set up by women are on average two times smaller compared to those set up by men. This places women at a disadvantage, which results in a lower level of profitability (by about 60 per cent) and productivity (by about 18 per cent).[28]

In addition to the security risk generated by Russian aggression in Ukraine, the perception of foreign investors towards Moldova has also been shaken by a number of discretionary and poorly reasoned decisions by government, as well as by the lack of stability of the rules of the game set by legislation.

The exit, at the end of 2023, from the state of emergency – as was also recommended in last year's State of the Country Report – is welcome. For, given the major discretionary power available to the government in this context, the sta-

23 https://www.wipo.int/documents/d/global-innovation-index/docs-en-wipo-pub-2000-2023-en-main-report-global-innovation-index-2023-16th-edition.pdf
24 https://www.wipo.int/edocs/pubdocs/en/wipo-pub-2000-2023/md.pdf
25 https://statistica.gov.md/ro/rezultatele-activitatii-de-inovare-a-intreprinderilor-in-republica-moldova-in-an-9794_60858.html
26 https://www.heritage.org/index/pages/country-pages/moldova
27 https://www.weforum.org/publications/global-gender-gap-report-2024/digest/
28 https://ivcmoldova.org/wp-content/uploads/2023/05/4.-Acces-finantare_femei-in-afaceri.pdf

te of emergency generates a higher degree of insecurity in terms of ensuring the right to property. At the same time, the use of the Council for the promotion of investment projects of national importance as a vehicle for countering potential security threats or protecting the information space is certainly questionable, especially if given the limited evidence put forward by this structure to justify its decisions. Another measure that detracts from the principles of a free economy, but also hits the country's food industry, is the provisional licensing of grain and oilseed imports. This measure was initially introduced through the Commission for Exceptional Circumstances under pressure from some farmers' associations,[29] then in July 2024[30] it was legislated in parliament until the end of the current year, with the possibility of extending it for another year. The measure has already produced adverse effects by foregoing exports of value-added products, such as sunflower oil and alcohol, in favour of exports of raw materials. In addition, the measure makes Moldova vulnerable in relation to compliance with the World Trade Organization requirements. During this period, the stability and predictability of normative acts remained problematic. The laws regulating public-private partnership and concessions are clear examples in this regard. Despite the multiple vulnerabilities of the draft amendment to the Law on Public-Private Partnership (PPP) and the Law on Concession of Works and Services, which worsens the existing framework[31] rather than improving it, on July 14, 2023, the Parliament of the Republic of Moldova approved Law no. 193 which amended Law no. 179/2008 (on PPP) and Law 121/2008 (on concessions). At the same time, just five months after the approval of the Law on PPP, the sectoral ministry – the Ministry of Economic Development and Digitalization (MEDD) – publicly announced the initiation of a new draft law to amend this normative act.[32] This was similar to the case off Law no. 121/2018 on Concessions of Works and Services. Just one month after the publication of the law introducing the amendments to this normative act, the MEDD announced its intention to develop a new draft law on the amendment.[33] Such approaches seriously affect the predictability and confidence of the business environment in using public-private partnerships as an investment tool.

During the period concerned, notable progress was made in relation to the digitization of public services and the development of online commerce.

In 2023, the MEDD developed a platform designed to monitor and inform the general public about public services for entrepreneurs in the Republic of Moldova. According to MEDD data, in Moldova there are 463 public services for entrepreneurs, offered by 43 public institutions (ministries, agencies, inspectorates, specialized services, and centres, etc.). Of these, 273 are already digitized, which accounts for 59 per cent of the total number, or about 20 p.p. more than a year and a half ago. At the same time, the launch of the EVO mobile application has improved digital interactions between citizens and the state. Regarding online commerce, the infrastructure has expanded, with the number of electronic trade platforms doubling in the last three years[34] – from 584 in 2021 to 1,199 in 2023. Last but not least, the launch of the Moldova Instant Payments system – which was initially intended for P2P transfers, but will soon also be applicable for businesses – will bring about cost reductions for small entrepreneurs and help expand cashless payments.

29 https://maia.gov.md/sites/default/files/147_11.10.2023.pdf
30 https://www.legis.md/cautare/getResults?doc_id=144100&lang=ro
31 https://www.expert-grup.org/ro/biblioteca/item/2557-parteneriate-cu-bucluc-analiza-proiectului-de-modificare-a-legii-ppp
32 https://particip.gov.md/ro/document/stages/anunt-privind-initierea-elaborarii-proiectului-de-lege-privind-modificarea-legii-nr1792008-cu-privire-la-parteneriatul-public-privat/11958
33 https://particip.gov.md/ro/document/stages/anunt-privind-initierea-procesului-de-elaborarea-a-proiectului-de-lege-privind-modificarea-legii-nr1212018-cu-privire-la-concesiunile-de-lucrari-si-concesiunile-de-servicii/11145
34 A software solution that allows payment cards to be accepted online.

Policy recommendations

A strategic approach to all areas of economic development.

Although the government recently approved the National Strategy for Economic Development 2030,[35] this does not cover some important areas in terms of the responsibility of the MEDD. In particular, this concerns internal trade (although this topic constantly gives rise to numerous debates, such as the topic of ensuring that at least 50 per cent of the space on shelves is reserved for domestic products), quality infrastructure, market surveillance, and consumer protection. As these areas are not covered by other strategic planning documents either, but are of significant importance, including in the context of alignment with European standards, it is critical that they be anchored in a vision of the state, with clear targets.

Development of guarantee instruments for exporters.

The lack of export guarantee and cash flow assurance instruments remain major constraints and missed opportunities for exporters. This situation is due, in particular, to the poorly diversified financial sector, expensive financing, and the deficient legal system which, for example, inhibits the possibility of Moldova joining the international factoring company circuit. After the Russian invasion of Ukraine, which placed our country in a higher risk zone, the pressure on cash flows for exporters increased. On the one hand, suppliers are less willing to sell in instalments, and, on the other, buyers are increasingly demanding to pay for deliveries over a longer period. Fortunately, companies from the light industry, working in Lohn, benefit from the condition that buyers must pay for services provided within 60-90 days. This situation was relatively rare until the war in Ukraine. In this context, it is also worth noting the problem that arose with the adoption of the new Customs Code, which stipulates the need for a guarantee for customs duties and value added tax (VAT) applicable to raw materials imported through inward processing. The parliament later amended the new Customs Code,[36] delaying the application of the provision until 2027. In this light, state support through the development and implementation of guarantee mechanisms is extremely important.

Strengthening the role and impact of active employment measures to mitigate supply-demand imbalances in the labour market.

Over the last three years, the state has sought to focus the labour market support portfolio less on passive measures (for example, making the right to social aid conditional on job-seeking efforts) and more on active measures. For the coming period, it is recommended that a greater focus be placed both on the constant evaluation of the portfolio of active measures, highlighting the most critical employment measures needed, and on the necessary financial coverage.

The acceleration of internationalization of universities in the Republic of Moldova and expansion of dual education.

Balance of payment data from the last decade show an increase in exports of training services – from 34.8 million USD in 2013 to 81.5 million USD in 2023. This increase is mainly generated by the State University of Medicine and Pharmacy. Considering the emigration trends of the population, the accelerated internationalization of Moldovan universities is beneficial both for maintaining the sustainability of the university environment and for miti-

35 https://www.legis.md/cautare/getResults?doc_id=143524&lang=ro
36 https://www.legis.md/cautare/getResults?doc_id=143425&lang=ro

gating the problems associated with the labour market. The issue of higher education and its approach to the needs of the labour market also includes the expansion and institutionalization of dual education for the first cycle of university education. Furthermore, in order to align educational products with the needs of the labour market, it is recommended that the financing of vocational-technical education institutions be more closely aligned with the employment rate of graduates of these institutions.

Strengthening business trust in the state as a business partner, by stopping frequent and non-transparent intervention practices in the regulatory framework.

In recent years, there have been further examples of decisions that impact the business environment being taken in a non-transparent manner and based on questionable evidence. As a result of the opening of accession negotiations with the EU and the need to synchronize the national legislation with the *Acquis Communautaire*, there is an even greater need to involve the business environment in a transparent and comprehensive manner. However, to ensure the successful implementation of various European directives, there needs to be the possibility of adjusting them to the specific conditions of the country in question. Moreover, to minimize adverse effects on companies, effective communication is required, as is investment in competent analyses. Otherwise, there is a risk of perpetuating changes in legislation depending on the situation, of negotiating unfavourable conditions for the country, and of damaging the image of Moldova's European integration.

Applying the "principle of scarcity" in agricultural subsidies and prioritizing activities and projects that have a greater impact.

In recent years, including after the approval of the new law regulating the subsidy framework,[37] the eligibility area of various activities has increased, while funding requests have further exceeded the budgetary resources available. Given that, for many years, it was possible to finance subsidy requests from the following year's budget account, arrears have increased from one year to the next. For example, in 2023, funding requests were submitted for post-investment subsidies in the amount of 1.31 billion MDL, and no project was funded from the state budget resources for that year. Consequently, from the amount of 1.6 billion MDL allocated to the 2024 budget, 1.31 billion MDL (81.8 per cent of the total) will be allocated simply to cover the requests submitted in 2023. Being a derogation from the principles of public finance, this situation also represents a handicap, especially for small farmers, who must wait over a year to receive the subsidy from the state. At the same time, in the public perception, there are increasing doubts about the expected impact of this funding. In this context, in parallel with the reduction in priority activities eligible for funding, it is necessary to return to respecting budgetary requirements. At the same time, especially for the post-investment subsidy measure, a much more rigorous approach is required where, beyond compliance, the emphasis is placed on the economic feasibility of projects.

37 https://www.legis.md/cautare/getResults?doc_id=144143&lang=ro

Table 3.

The main indicators monitored regarding the economy of the Republic of Moldova

	2022	2023	2024 *estimate*
Agricultural production, y-o-y, %	-29.2	24.5	-10
Industrial production, y-o-y, %	-5.1	-3.4	3
GVA from retail and wholesale trade, y-o-y, %	-2.1	-3.5	4
Construction volume, growth y-o-y, %	-15.1	-3.0	5
Gross fixed capital formation, growth y-o-y, %	-8.6	-1.3	5
Foreign direct investment inflows, growth y-o-y, %	51.4	-28.8	n.a.
Consumer price index, growth y-o-y, %	28.7	13.4	5.0
New loans granted, growth y-o-y, %	5.9	8	30
New deposits attracted, growth y-o-y, %	57.5	-5.2	-15
Equity ratio, %	29.5	29.9	n.a.
Share of non-performing loans out of total loans, %	6.4	5.6	n.a.
The liquidity ratio coverage indicator (LCR), %	268	282	n.a.
Long-term liquidity, %	0.67	0.69	n.a.
Share of innovative enterprises, %	11,4	n.a.	n.a.
Export of goods and services, y-o-y, %	37.8	-6.5	-5
Import of goods and services, y-o-y, %	28.5	-5.9	2
Index of economic freedom, score	61.3	58.5	57.1
Global Innovation Index, ranking position	56	60	n.a.
Global Gender Equality Index, ranking position	16	19	13

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

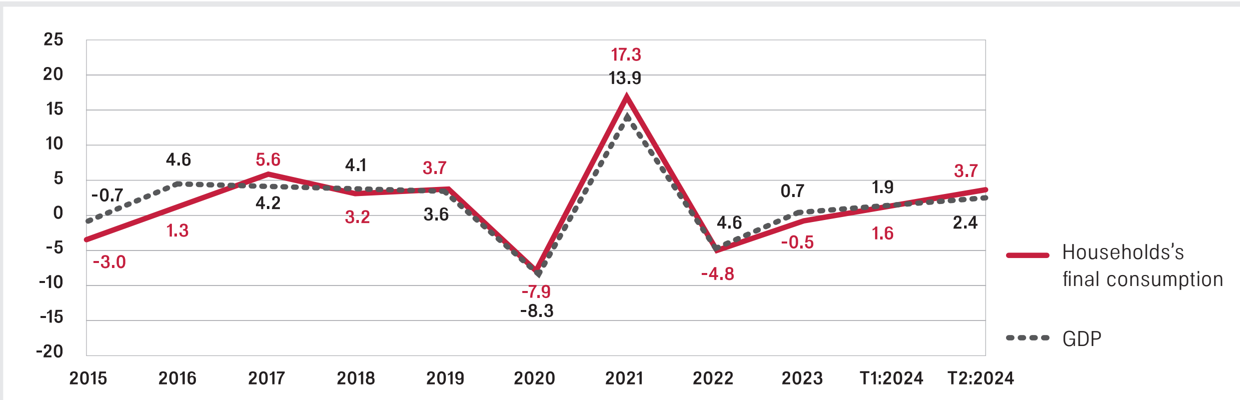
From the second half of 2023, there was an increase in household final consumption as a result of the recovery of real incomes of the population in the form of wages and pensions. Real remittances have continued to decrease, however. The negative dynamics of remittances levelled out the impact of the growth in other types of income on poverty indicators. Thus, in 2023, the absolute poverty rate remained almost unchanged compared to the previous year and even increased slightly: 31.6 per cent (+0.5 per cent compared to 2022). People whose income mainly comes from individual agricultural activity, families with children, and people with disabilities were the most affected. Real wage growth led to the population's more active participation in the labour market, but the labour force continued to shrink, in particular due to emigration.

Analysis of the main trends and developments

From the second half of 2023, an increase in household final consumption was recorded, as a result of the return of inflation rate to normal and the recovery of real incomes of the population.

Household final consumption contracted in 2022 (-4.8 per cent in real terms) and in the first half of 2023 (-0.7 per cent in Q1:23 and -4.4 per cent in Q2:23) as a result of the multiple crises (the sharp increase in consumer prices and resulting increase in interest rates, together with the outbreak of the war in Ukraine, which led to the disruption of traditional supply and payment chains). From the second half of 2023 and the first half of 2024, final household consumption began to increase (+1.3 per cent in Q3:23, +1.1 per cent in Q4:23, +1.6 per cent in Q1:24, and +3.7 per cent in Q2:24) (Chart 6). In the first half of 2024, the increase in household final consumption was due to the procurement of goods (+2.1 per cent, in real terms, y-o-y) against the background of the decrease in interest rates and the revival of consumer lending. The procurement of services by households increased by 4.8 per cent, in real terms, as a result of price dynamics: regulated tariffs for central heating services decreased by 39.5 per cent (June 2024/ June 2023), for natural gas by 36.6 per cent, and for electricity by 21.2 per cent. At the same time, the prices of some services increased rapidly, such as: tourist service packages, +45.6 per cent; recreation and sports services, +27.4 per cent; housing rent, +26.2 per cent; dental services, +19.1 per cent; passenger transport, +13.3 per cent; services for home maintenance and repairs, +11.1 per cent.

Chart 6.
GDP and final consumption of households, indices of physical volume, growth y-o-y, per cent



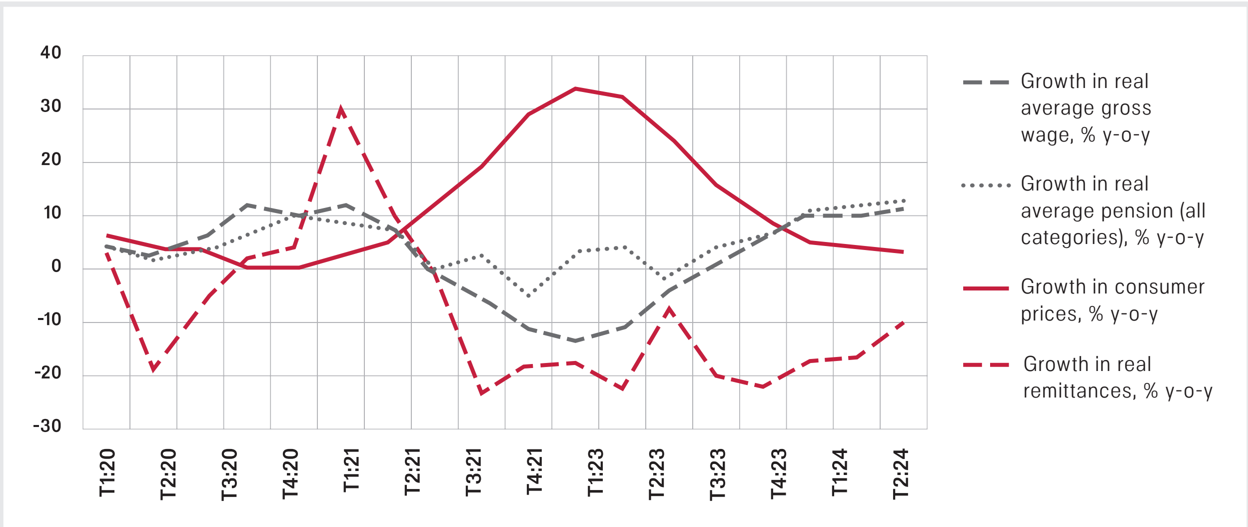
Source: NBS data

Real household income in the form of wages and pensions showed compensatory growth after the inflationary shock subsided, but real remittances received continued to decline.

From Q4:21 through Q1:23 — that is, over the course of one year and a half — real average gross wages fell, with nominal wages rising much more slowly than consumer prices (Chart 7). Thus, in 2022, the real wage index as against 2021 was 90.4 per cent, meaning that the purchasing power of the average wage decreased by 9.6 per cent. In 2023, wages increased in real terms by 3.1 per cent, and in the first half of 2024, real growth continued: +10.0 per cent in Q1:24 and +11.6 per cent in Q2:24. In Q2:24, the nominal average gross wage was 14,069 MDL (EUR 735). Real average social payments (retirement benefits, disability allowances, etc.) stagnated in 2022, then increased by 4.9 per cent in 2023 compared to 2022, by 11.7 per cent in Q1:24, and by 12.3 per cent in Q2:24 compared to the respective quarters of 2023. Unlike wages and pensions, real remittances received by the population decreased in 2022 by 19.7 per cent. The downward trend continued (-17.2 per cent) in 2023 and did not recover in 2024 (-16.0 per cent in Q1:24 and -9.7 per cent in Q2:24). The decrease in real remittances was mainly caused by the inflationary shock in 2022. In the following years, it was attributed to the decrease in nominal remittances in foreign currency, as a result of the cost-of-living crisis and the decrease in the demand for labour in host countries.

Chart 7.

CPI and real incomes of the population, growth y-o-y, per cent



Source: : Authors' calculations based on NBS and NBM data

Although the average retirement benefit has been growing faster than the average wage since 2022, the pension to wage ratio still remains low (below 30 per cent).

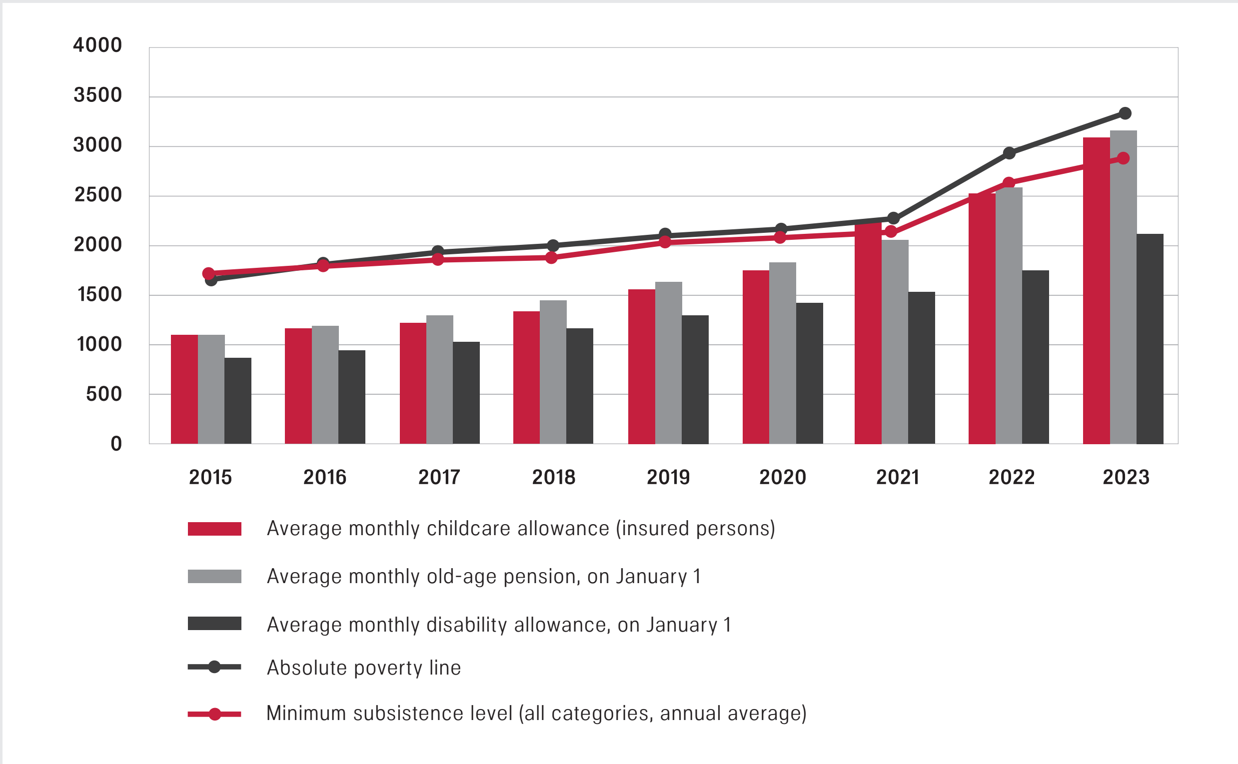
In 2023, the aggregate replacement ratio for pensions in EU-27 was 58 per cent (Bulgaria – 46 per cent, Romania – 48 per cent, Estonia – 46 per cent, Latvia – 50 per cent, Lithuania – 36 per cent, Croatia – 35 per cent).[38] The ratio of the average retirement benefit to the average subsistence minimum improved in 2023 compared to previous years, but the pension only covered slightly more than the subsistence minimum and remained below the absolute poverty line (Chart 8).[39] The same can be said about the average monthly childcare allowance. The average monthly disability allowance did not even cover the subsistence minimum and remained far below the absolute poverty line.

38 https://ec.europa.eu/eurostat/databrowser/view/ILC_PNP3/default/table?lang=en

39 The absolute poverty threshold - the value of the food and non-food basket, calculated as the sum of the cost of food consumption and the expenses for non-food products and services of households that spend on food an amount equal to the cost of the necessary food consumption. For 2023, the absolute poverty threshold was set at 3,336.8 MDL per month.

Chart 8.

The level of the main types of pensions and allowances, MDL (nominal)



Source: NBS data

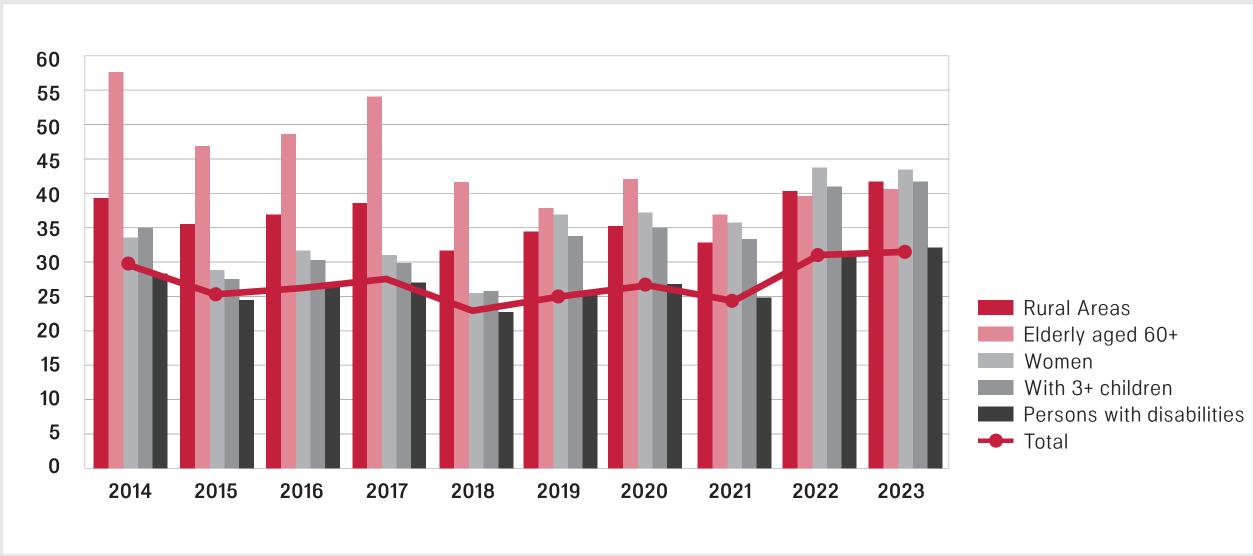
Remittances are an important source of income in household budgets (on average, in 2023, they accounted for 11.1 per cent of income). As a result, their negative dynamic was one of the most important factors blunting the effect of growth in other types of income on poverty indicators.

In 2023, the absolute poverty rate (the share of the population whose consumption expenditures are below the absolute poverty threshold, established for the respective year) remained, in total per country, almost unchanged compared to the previous year: 31.6 per cent (+0.5 per cent compared to 2022). However, the evolution of poverty indicators was uneven for different categories of the population. People whose main source of income is individual agricultural activity were the most affected.[40] While in 2022, 42.5 per cent of people in this group lived below the absolute poverty threshold, in 2023 this share reached 50.9 per cent. Families with children were also disproportionately affected; for this category, the absolute poverty rate increased by 2.3 p.p. to 30.4 per cent. At the same time, the situation of families without children improved, with their absolute poverty rate decreasing by 1.2 p.p. up to 32.7 per cent.[41] For people who had not completed secondary education, the chances of being poor increased by 5.7 p.p., reaching 51.5 per cent. Among people who had completed higher education, on the other hand, the absolute poverty rate increased by 0.9 p.p. to 11.2 per cent. Residents in rural areas were more affected than those in urban areas: in rural areas, the absolute poverty rate increased by 1.7 p.p. to 42.0 per cent, while in urban areas the absolute poverty rate increased by 0.6 p.p., reaching 17.7 per cent. Also, the risk of poverty increased more among people with disabilities (+0.8 p.p. to 42.0 per cent) compared to people without disabilities (+0.6 p.p. to 30.5 per cent) (Chart 9). Women were more affected (+0.6 p.p., 32.0 per cent) than men (+0.3 p.p., 31.1 per cent).

40 *Income from individual agricultural activity represents the net income from the sale of own agricultural production, as well as the counter value of consumption from own, non-commercialized agricultural resources.*

41 *The higher absolute poverty rate among households without children compared to households with children is explained by the fact that the former also includes pensioners with low incomes.*

Chart 9.
Absolute poverty indicators, per cent

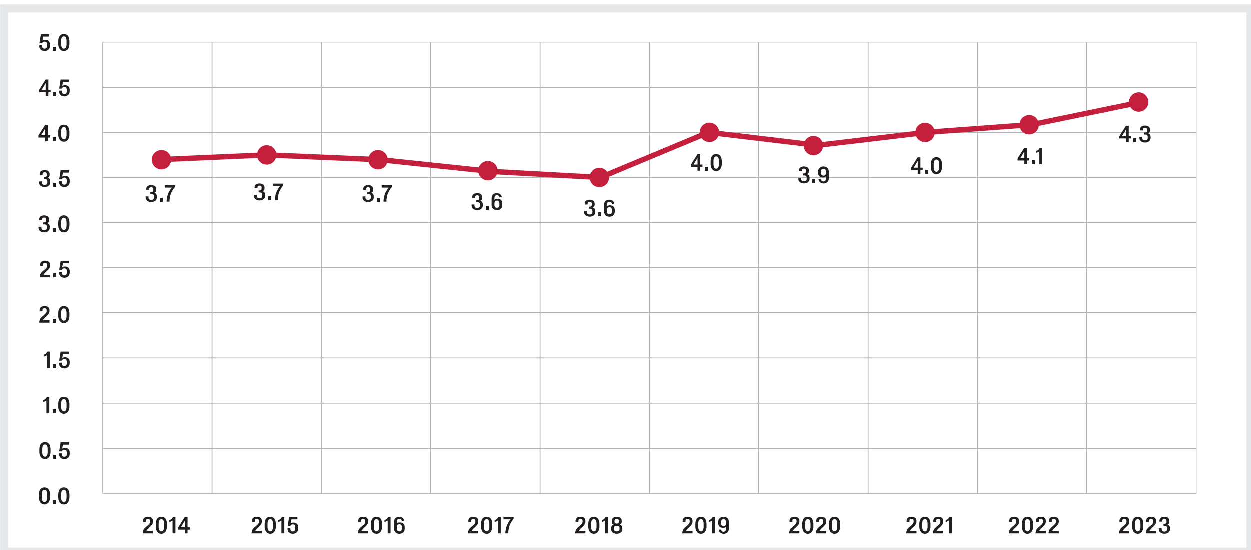


Source: NBS Data

> As can be seen in the chart above, there is a "Matthew effect" in the evolution of poverty indicators, which manifests itself in the fact that poverty rates have increased more strongly for groups that were already disadvantaged, exacerbating existing inequalities.

Indeed, the evolution of the ratio between the expenditures of the population of quintiles I and V[42] shows a continuing increase in the gap between the most vulnerable and the most prosperous. Thus, if in 2022 people from quintile V spent, on average, 4.1 times more than those from quintile I, in 2023 this difference increased to 4.3 times the amount (Chart 10).

Chart 10.
Ratio of the expenditures of the top quintile V to the bottom quintile I of the population



Source: NBS data

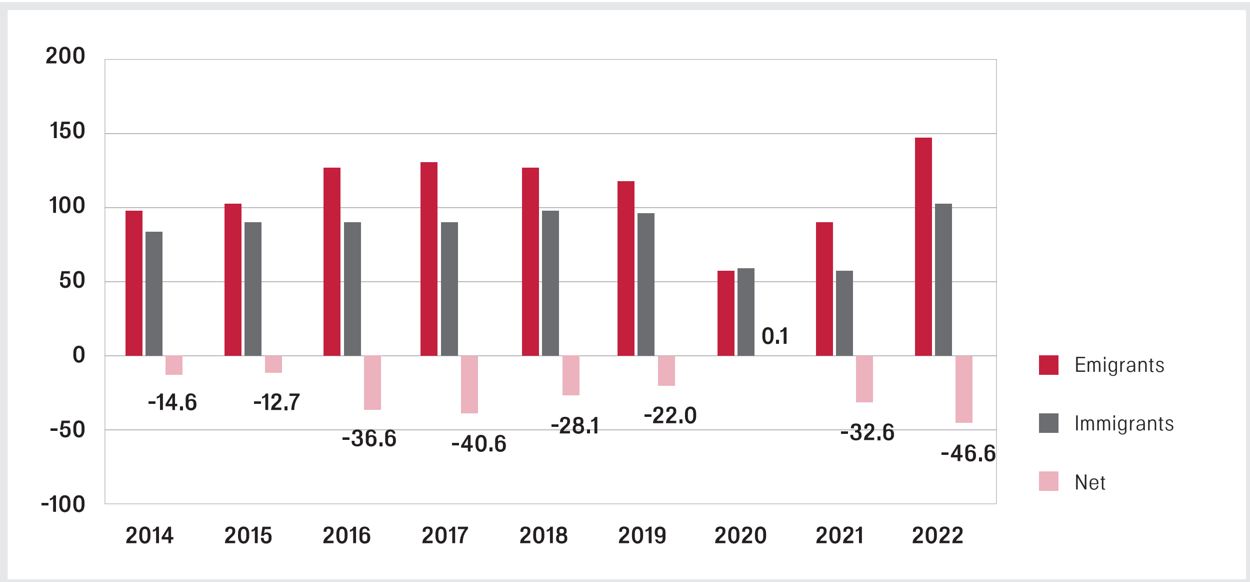
42 Quintile I represents the first 20 per cent of the population with the lowest expenditures, and quintile V represents the last 20 per cent with the highest expenditures.

Real wage growth led to a more active participation of the population in the labour market, but the labour force continued to decline, particularly due to emigration.

According to the results of the Labour Force Survey, in Q2:24, the employment rate of the population aged 20–64 increased by 0.7 p.p. compared to Q2:23, reaching 57.3 per cent. In particular, the number of people employed in public administration, education, health, and social assistance increased (+6.1 per cent compared to Q2:23), as did the number of people employed in transport and storage, information and communications (+12.7 per cent). At the same time, despite the growth of real wages across all sectors, decreases were recorded in the number of people employed in agriculture, forestry, and fishing (-14.9 per cent), manufacturing (-13.3 per cent) and trade, accommodation, and catering activities (-6.8 per cent). In total, the employed population decreased by 34,400 people compared to Q2:23; the number of unemployed people decreased by 600; and the population outside the labour force (inactive) aged 15 and above decreased by 25,000 people. In large part, this phenomenon was due to emigration. Before the Covid-19 pandemic, the Republic of Moldova recorded an annual average of 115,000 people aged 15–64 who emigrated from the country. At the same time, the average annual number of immigrants of working age was about 90,000 (including return migration). Thus, in terms of net figures, Moldova lost approximately 25,000 people of working age every year. During 2020–2021, migration slowed due to health restrictions, before resuming with increased intensity in 2022. After the outbreak of the war in Ukraine, in 2022, the number of emigrants of working age from Moldova increased to 146,000, and the number of immigrants of working age reached 99,000, resulting in a net loss of 47,000 people (Chart 11). Statistics on migration in 2023, disaggregated by age, have not yet been published, but available data on total net migration show a further intensification of net emigration compared to the pre-pandemic years.

Chart 11.

International migrants of working age (15-64 years), thousands



Source: NBS data

Policy recommendations

Although household central heating, electricity, and natural gas service costs have fallen, the risk of them rising again remains.

The electricity sector is still largely dependent on a single supplier, the Cuciurgan power station in the Transnistrian region. The potential expiration of the natural gas transit agreement between Russia and Ukraine, at the end of 2024, could affect gas supply for the Cuciurgan power station, leading to higher electricity prices. Moreover, given the substantial increase in rental costs against the backdrop of rising residential real estate prices, expenses for utilities and housing services remain a challenge for many households. For this reason, it is essential to continue social assistance programmes targeted at the most vulnerable.

The social assistance programmes launched in this context, such as the Energy Vulnerability Reduction Programme, are provisional, limited in scope, and, as a result, unable to provide a systemic counterweight to the problems of persistent poverty.

In order to increase the real incomes of all categories of the population, and reach the EU level in this respect, more accelerated economic growth is needed. In this sense, in order to stimulate productivity, it is necessary to continue reforming the labour market (reducing the mismatch between workers' qualifications and business needs, increasing the participation of women, etc.). At the same time, increasing the efficiency of public investments, improving the business environment, and stimulating competition are essential for economic growth in the medium and long term.

Expanding opportunities for women to join the workforce is particularly important.

Policy measures aimed at facilitating women's participation in the labour market should focus, above all, on providing affordable and high-quality childcare services. Despite the approval both of *Law 367/2022 on alternative childcare services*, which provides the possibility for employers to set up nurseries at the workplace, and *of the National Programme on childcare services for children aged up to three years for 2023-2026*, access to such services remains limited. At the same time, women tend to shoulder most of the care work for the elderly. Given the ageing population trend, this burden is likely to increase, which would negatively affect women's participation in the labour market. In this sense, formal elderly care services also need to be developed. Promoting flexible work schedules and remote work can also help increase women's participation in the labour market. In addition to unlocking the potential for economic growth, increasing women's participation in the workforce could help reduce female poverty and improve opportunities for children from vulnerable families.

The adoption of the necessary legal framework for the transposition and implementation of EU Directive 2022/2041 on adequate minimum wages in the European Union has to be finalized, as well as the ratification and implementation of ILO Convention No. 102 concerning minimum standards in social security.

According to the Directive, to guide the assessment of the adequacy of legal minimum wages, EU states use indicative benchmarks such as 60 per cent of the gross median wage or 50 per cent of the gross average wage. For Moldova, this would mean a minimum wage of at least 7,035 MDL per month (as of Q2:24). In reality, since January 1, 2024, the minimum wage in the country is 5,000 MDL (i.e. only 36 per cent of the average wage). The average pension replacement rate in the Republic of Moldova (28 per cent in Q2:24) also remains well below the 40 per cent minimum level required by the Convention and well below the EU average.

Fiscal policy needs to focus on revenue mobilization.

This will require further reform of the tax administration, combating evasion and abusive tax practices, eliminating unjustified privileges, increasing excise duties on alcohol and tobacco to the EU level, and formalizing the informal economy. Further reform of the State Labour Inspectorate is essential to improve its governance.

Adverse climatic conditions directly influence productivity and working conditions in the agricultural sector and can put pressure on domestic food prices, increasing the risks of poverty.

In this respect, investments are needed not only in adapting agricultural technologies in the face of climate change but also in the diversification of the economy, with an emphasis on the development of the tertiary sector and industries with higher added value.

Table 4.

The main monitored indicators regarding the well-being of the population

	2022	2023	2024 *(estimates)*	2025 *(forecast)*
GDP growth, %	-4,6	0,7	2,6 (IMF)	4,8 (IMF)
GDP per capita (% of the average for Central and Eastern Europe in the EU)	26,6	27,9	29,4 (IMF)	31,3 (IMF)
Employment rate, %	40,5	43,1		
Women	36,8	39,7		
Men	44,7	47,1		
Unemployment rate, %	3,1	4,6	3,5 (IMF)	3,5 (IMF)
Women	2,6	4,2	-	-
Men	3,5	5,0	-	-
Absolute poverty rate, %	31,1	31,6		
Women	31,4	32,0		
Men	30,8	31,1		
Wage growth, % y-o-y	16,3	16,9	7,7 (IMF)	8,7 (IMF)
Net emigration (all ages), % y-o-y	40,0	-6,2		
Remittances, USD, % y-o-y	-3,5	-2,0		
Gini coefficient (by total disposable income)	0,32	0,34		

	2022	2023	2024 *(estimates)*	2025 *(forecast)*
Increase in household consumption in real terms, % y-o-y	-4,8	-0,5	2,7 (IMF)	3,5 (IMF)
Disposable income of the population, monthly average per person, MDL	4 253	4 916		
Women (head of household)	4 039	4 656		
Men (head of household)	4 362	5 051		
Human Development Index in Moldova	0,763	-		
Life expectancy at birth, years	68,6	-		
Anticipated schooling years	14,9	-		
Average schooling years	11,8	-		
Gross National Income per capita (PPP $)	12 964	-		
Public expenditure on education (% of GDP)	5,78	6,25		
Public expenditure on health care (% of GDP)	4,98	5,31		
School dropout rate among students aged 7 to 16, %	0,080	0,078	0,084	
Dwellings connected to the public water supply network, %	74,0	75,5		
Dwellings connected to the public sewerage network, %	31,8	36,5		

Source: NBS, Eurostat, NBM, Ministry of Finance, UNDP, MEDD, authors' calculations

Governance

This chapter analyses developments with respect to political and public governance processes, with an emphasis on fulfilling the conditions for advancing European integration. To this end, the quality of governance is analysed in the light of the opening of accession negotiations with the EU at the end of 2023. The chapter offers a compressed view of Moldova's European integration capabilities, starting from the objectives set by the government.

Analysis of the main trends and developments

The period in question was positively influenced by the termination of the state of emergency at the end of 2023, which was initially introduced in October 2021.

This created favourable conditions for a certain degree of normalization of the governance process. However, the situation in parliament remained unchanged, as the ruling party – the Action and Solidarity Party (PAS) – continued to restrict the opposition's involvement in the legislative process. From August 2022 to August 2023, the opposition proposals accounted for approximately 65 per cent of the total legislative proposals. As their limitation period is the end of 2024, there is a high risk that they will expire.[43] Moreover, there were no meetings dedicated to the opposition, and public consultations were rare (only taking place in 17 per cent of cases, or 78 draft laws).[44] In addition to isolating the opposition from the legislative process, another negative trend concerns the predictability, transparency, and credibility of the parliament due to the high frequency of changes to the agenda at the beginning of the sessions (67 per cent of cases).

The major catalyst for the political and reform process was European integration.

In less than 18 months, Moldova advanced rapidly from becoming a candidate country (in June 2022) to opening accession negotiations (in December 2023). In June 2022, the EU set nine preconditions[45] related to the improvement of the situation in various crucial areas for good governance. These include: justice reform (the "vetting" of judges and prosecutors); fighting corruption; de-oligarchization; combating organized crime; and, public administration reform. Out of a total of nine sets of requirements formulated by the EU in June 2022, six received positive grades from Brussels in November 2023,[46] while deficiencies were found in the other three. A more nuanced analysis shows that the EU has overlooked some problematic aspects in the areas where it has also seen progress. More specifically, this can be seen in the fight against corruption and organized crime and the reform of local public administration. At the same time, signs of stagnation persist in other areas where the EU has requested increased efforts.

43 https://promolex.md/wp-content/uploads/2023/12/Raport-Parlament-2023_web.pdf

44 The parliament carried out public consultations only in approximately 17 per cent of cases (78 draft laws), while the other 83 per cent of the adopted laws were not put forward for public consultations. In addition to the low level of public consultations, anti-corruption expertise was missing in approximately 13 per cent of the draft normative acts approved by the Legal Department of the Parliament (August 2022-August 2023). The anti-corruption expertise of draft laws by the National Anti-Corruption Centre is one of the requirements of the EU):: https://promolex.md/wp-content/uploads/2023/12/Raport-Parlament-2023_web.pdf

45 The requirements against which the EU found deficiencies comprise three blocks of actions. The first block includes justice, with an emphasis on the evaluation of judges at the Supreme Court of Justice, the filling of vacancies in the Prosecutors (SCP). The selection of the new Prosecutor General on a meritocratic basis is also part of the same set of actions. The second block refers to the functionality and efficiency of the Anticorruption Prosecutor's Office. The third block consists of actions related to de-oligarchization, which will involve the regulation of cash payments and financial transactions abroad. https://neighbourhood-enlargement.ec.europa.eu/document/download/d8ef3ca9-2191-46e7-b9b8-946363f6db91_en?filename=SWD_2023_698%20Moldova%20report.pdf

46 https://neighbourhood-enlargement.ec.europa.eu/document/download/d8ef3ca9-2191-46e7-b9b8-946363f6db91_en?filename=SWD_2023_698%20Moldova%20report.pdf

In the field of justice, there was a lack of progress due to multiple image/reputation crises and even tensions.

in the relations between the executive power (the President's office) and the Anticorruption Prosecutor's (AP) Office, in relation to the case of Tatiana Raducan.[47] She is under criminal investigation following accusations of corruption and affiliation (for at least 11 years) with Veaceslav Platon[48] and Ilan Shor, both of whom were involved in banking crimes.[49] This case negatively affected the credibility of the results of the "pre-vetting" procedures in which Tatiana Raducan co-participated from July 2022 to May 2024, when she resigned. Consequently, the integrity of the evaluation process for 67 candidates for the Superior Council of the Magistracy (SCM) and the Superior Council of Prosecutors (SCP) was undermined.[50] Raducan's case has in fact cast a shadow over the appointments to the SCM and SCP.

Although its members are evaluated through a "pre-vetting" process, the decisions of the SCM have generated certain problems, calling into question the effectiveness of this reform, which was requested by the EU.

As it was incomplete, the SCM adopted decisions without a quorum. In July 2024, the Constitutional Court (CC) resolved that the SCM quorum would be made up of 8 votes (two thirds of the total 12 votes).[51] Therefore it sought to clarify the vote within the SCM to avoid the risk of corporatism. The CC's intervention favoured the appointment of the judge Victoria Puica in November 2023, but did not finalize in the case of Victoria Sanduta, even though both magistrates received six positive votes.[52] Another problematic issue concerns political influence within the SCM, whose members undergo a "vetting" process. This is illustrated, for example, by SCM members' monitoring of Victoria Sanduta's comments concerning the country's President on social networks, within the sphere of civil society.[53]

What is more, with deviations from the EU preconditions, the AP's Office did not receive the promised resources to increase its efficiency.[54] This delay lasted more than two years.

The Anti-Corruption Prosecutor Office (AP) also expressed some scepticism about the appropriateness of the "vetting" procedures, which began in July 2024.[55] The reservations invoked by the AP mainly relate to the shortcomings of the "pre-vetting" process of members of the SCM and SCP. Under this pretext, 10 out of the total of 48 anticorruption prosecutors left their jobs at the AP. The remaining prosecutors then had to manage 700 criminal cases between them (18 cases per prosecutor).[56] There were also complications in selecting the Prosecutor General. After a failed attempt,[57] Ion Munteanu, who had been acting as Prosecutor General since October 2022, was appointed to the position in June 2024. Alexandr Stoianoglo's victory at the European Court of Human Rights in October 2023,[58] in the case concerning his suspension from the position of Prosecutor General in 2021, created uncertainty regarding the stability of the Prosecutor General's new mandate.

47 https://radiomoldova.md/p/34643/maia-sandu-cere-pa-probe-concludente-privind-legaturile-tatianei-raducanu-cu-platon-si-sor-precizarile-veronicai-dragalin
48 https://noi.md/md/societate/procuratura-anticoruptie-a-avansat-in-dosarul-raducanu
49 https://radiochisinau.md/sentinta-definitiva-pentru-ilan-sor-curtea-de-apel-la-condamnat-pe-deputatul-fugar-la-15-ani-de-inchisoare---178919.html; https://committees.parliament.uk/writtenevidence/107148/pdf/
50 https://vetting.md/date-preliminare-privind-evaluarea-extraordinara-a-candidatilor-la-csm-si-csp-dupa-ce-comisia-pre-vetting-a-emis-decizii-privind-90-la-suta-dintre-candidati/
51 https://www.zdg.md/stiri/stiri-justitie/curtea-constitutionala-a-declarat-neconstitutionale-unele-modificari-efectuate-de-parlament-privind-sedintele-si-adoptarea-hotararilor-de-catre-csm/
52 https://unimedia.info/ro/news/a07232f9b39909a5/sanduta-cere-demisia-in-corpore-a-csm-cu-6-voturi-a-numit-un-judecator-la-cc-iar-eu-cu-6-voturi-pro-sunt-tinuta-departe-de-examinarea-cauzelor.html
53 https://www.jurnal.md/ro/news/d8e02be3e7aaa9b6/sanduta-respinsa-de-csm-ce-spune-despre-parinti-care-duc-o-viata-grea-dar-detin-bunuri-fantastice.html
54 https://agora.md/2024/08/01/procuratura-anticoruptie-din-nou-fara-sediu-deja-am-inceput-procesul-de-recrutare-a-personalului
55 So far, 22 out of 37 candidates for the Supreme Court of Justice and seven out of 22 candidates for the College for the Selection and Evaluation of Prosecutors have been evaluated. https://www.euromonitor.md/wp-content/uploads/2024/07/Shadow-report_MD-EU-Enlargement_final_RO-IA.pdf
56 https://www.ipn.md/ro/veronica-dragalin-in-ultimii-doi-ani-a-scazut-mult-7965_1105818.html
57 https://www.ipn.md/ro/concursul-pentru-selectarea-procurorului-general-a-esuat-7967_1102998.html
58 https://moldova.europalibera.org/a/decretul-prezidential-de-eliberare-a-lui-stoianoglo-din-functia-de-procuror-general-constitutional/33033771.html

Other issues related to the fulfilment of the EU conditionality concern local public administration reform.

Although the authorities have developed the necessary legal framework for the voluntary amalgamation of the villages, including tools to stimulate the process, the necessary financial resources were reduced five times, by as much as 50 million MDL.[59]

Progress in the fight against organized crime was overshadowed by two serious cases involving actions by foreign criminal groups on the country's territory.

As a result of a corruption scheme in place since 2022,[60] with the involvement of the INTERPOL Office in Chisinau, a series of international alerts ("Red Notices") regarding the names of at least 20 suspects of international crimes were deactivated. Furthermore, the national asylum and migration system failed to extradite an offender to the UK,[61] resulting in his public assassination in Chisinau by foreign criminal forces. Both the INTERPOL case and the case concerning the Office for Migration and Asylum highlight major shortcomings. These could endanger the visa liberalization process with the EU and need to be urgently addressed in the process of the accession negotiations.

Regarding human rights, in addition to frequent verbal attacks against journalists, including by members of the current government, restrictions were reported in relation to media access on the left bank of the Dniester, established by the separatist administration from Tiraspol.

In addition, instead of using the existing legal framework for the regulation of the media sector, in which the key role is played by the Broadcasting Council, the Council for Promotion of Investment Projects of National Importance, composed of members of the government and state agencies, was established. This council can adopt decisions without prior public consultations or other decision-making transparency mechanisms. In this context, the proportionality of the council's decisions regarding the temporary suspension of the licence of six TV stations was a subject of discussion.[62] Some 12 other TV stations were added[63] to this, which had already closed during the state of emergency (2022–2023) following accusations concerning their involvement in disinformation actions and illegal financing by oligarchic groups (Ilan Shor and Vladimir Plahotniuc). Amendments to the Criminal Code, which expand the notion of "state treason", create legal ambiguities regarding actions qualified as "giving aid to a foreign state [...] to carry out hostile activities"[64] against the country, which could negatively impact the right of expression.[65]

Even if Moldova's progress was not linear, and some regression or stagnation was seen with certain preconditions, the EU supported the Republic of Moldova through an accelerated regime.

Its securing of EU candidate country status in June 2022, and the validation of the decision to open accession negotiations in December 2023, were both determined by three factors:

59 https://www.euromonitor.md/wp-content/uploads/2024/07/Shadow-report_MD-EU-Enlargement_final_RO-IA.pdf
60 https://ziar.md/schema-a-intrat-in-vigoare-la-mijlocul-lui-2022-sefa-pa-face-dezvaluiri-despre-dosarul-interpol/
61 https://tv8.md/2024/07/15/examinarea-cererii-de-azil-a-cetateanului-turc-ucis-la-o-terasa-din-chisinau-tergiversata-ancheta-la-biroul-de-migratie-si-azil/261497
62 https://gov.md/sites/default/files/document/attachments/consiliul_174_2021_-_proces-verbal_nr._2_din_27.12.2023.pdf
63 https://www.jurnal.md/ro/news/02e44eb74d667859/recean-despre-soarta-celor-12-posturi-tv-care-au-ramas-fara-licenta-nu-vor-activa-nici-dupa-incheierea-starii-de-urgenta.html
64 https://www.legis.md/cautare/getResults?doc_id=121991&lang=ro
65 https://moldova.europalibera.org/a/pentru-cine-a-fost-extinsa-infractiunea-de-tradare-de-patrie-si-in-ce-conditii-dezinformarea-poate-fi-considerata-o-astfel-de-infractiune/32980595.html

1) the impact of Ukraine-led pro-EU accession diplomacy (2022–2023);

2) reconceptualizing the EU enlargement policy into a geopolitical securitization tool against the Russian threat (2022–present);

3) the results achieved in the field of European integration during the dialogue on visa liberalization (2010–2014) and the implementation of the Association Agreement with the EU (2014–present), including the transposition of the EU energy acquis, resulting in the adoption of the "Energy Package III" in the field of natural gas.[66]

The first EU evaluations show that Moldova's level of preparation for accession is relatively low (see Table 5).

With reference to the issues in Cluster 1 regarding "fundamental issues" (rule of law, justice, human rights, public administration, procurement etc.), it has reached a certain level of preparation. Moreover, part of Cluster 1 concerns the market economy and the ability to withstand competition in the EU market; in this regard, current progress has moved beyond the early stage but efforts are still required to reach an average level of preparedness. Clusters 2–6 include areas related to preparations to fulfil the obligations of an EU Member State. Progress has been achieved in the competition and internal market chapter (Clusters 2–3) thanks to the implementation of the provisions of the Association Agreement with the EU. Regarding the fundamental aspects related to the functioning of democratic institutions (Cluster 1), progress has been made compared to the previous period, such as in relation to the European Neighbourhood Policy, the Moldova–EU Action Plan (2004–2009), and the liberalized visa regime (2010–2014). The lowest level of preparation concerns the "green agenda" and agriculture (Clusters 4–5), where areas of early-stage preparation can be seen. Finally, most progress has been achieved in the political fields (Cluster 6), which does not concern institutional efforts, but only the external alignment of the country with the EU (sanctions, etc.).

Table 5.

Progress in the EU accession process: 3 chapters, 6 clusters in 2023

Cluster 1. Fundamentals - 5 chapters (early stage - 1; some level of preparation - 4)
Cluster 2. Internal market - 9 chapters (early stage - 1; between an early stage and some level of preparation - 2; some level of preparation - 6)
Cluster 3. Competitiveness and inclusive growth - 8 chapters (some level of preparation - 6; between some and moderate level of preparation - 1; moderately prepared - 1)
Cluster 4. Green Agenda - 4 chapters (early stage - 1; some level of preparation - 2; between some and moderate level of preparation - 1)
Cluster 5. Agriculture, Cohesion - 5 chapters (early stage - 4; some level of preparation - 1)
Cluster 6. External relations - 2 chapters (moderate - 1; between moderate and good level of preparation - 1)

Source: The European Commission's report on the EU enlargement policy for 2023

The major risks to maintaining achieving progress across all clusters: 1) internal political stability; 2) the operational capacities of state institutions; 3) the availability of European financial resources, including in terms of the country's reintegration; and, 4) maintaining the interest in enlargement within the EU:

1) According to the New Methodology for Accession to the EU, adopted in 2020,[67] the chapters in Cluster 1 ("Fundamentals") are opened first and closed last, as they include the political and administrative criteria critical to the state's democratic functioning.

66 After 12 years of stagnation, the Republic of Moldova created all the legal conditions to separate the supplier "Moldovagaz" (50 per cent controlled by "Gazprom") from the transport operator "Moldovatransgaz" (whose transport networks are managed by "Vestmoldtrasgaz"" and, indirectly, by the Romanian Company "Transgaz") on the independent operator principle. Also, from April 2024, "Moldovagaz" organizes tenders for gas deliveries through the Romanian Commodity Exchange, and "Energecom" procures gas from European operators.

67 https://ec.europa.eu/commission/presscorner/detail/en/IP_20_181

As a result, the volatility in these areas (justice, the fight against corruption, public administration etc.), which is caused by electoral cycles, can lead to the stagnation of reforms, making it impossible to close chapters. Moreover, the eventual seizure of power by Eurosceptic and/or pro-Russian forces will require a more rigorous assessment by the EU. If a Eurosceptic government in Chisinau implements the precedents set by the current government in 2022-2024, the EU could even resort to freezing the accession dialogue[68] - following the example of Georgia, where abuses are committed against "Fundamentals" (civil society and human rights).

2) Institutional capacities and human resources depend on the speed and quality with which the requirements of Clusters 2-5 are fulfilled; these make up 26 chapters, of which only 15 show a certain level of preparation, while two show moderate progress and the remaining nine are at an early stage. Although the structure of the BEI provides for the employment of approximately 42 people, the institution faces an acute lack of expertise in the technical areas of Clusters 2-5. In addition to frequently requesting assistance from specialized civil society organizations, the BEI makes use of knowledge transfer from Member States (Romania, etc.) and other candidate countries (North Macedonia, etc.). This dependence on secondary actors and the delegation of responsibilities (outsourcing) allows for some acceleration but prevents the transfer and absorption of knowledge within state institutions. The institutional constraints of the BEI create problems for the qualitative fulfilment of the 1,328 measures of the Action Plan for EU accession (2024-2027).[70]

3) In the pre-accession process, Moldova will gain access to European funds, the use of which will be closely monitored by the European Public Prosecutor's Office and other relevant EU institutions. However, most of the funds will be available after 2027 as part of the EU's future multi-annual financial framework. North Macedonia, which in terms of size (approximately two million inhabitants) is close to Moldova, obtained a total of approximately 1.2 billion EUR from European funds in the period 2007-2013 and 2014-2020 respectively.[71] The multiple actions planned by the BEI for the years 2024-2027 will depend on external assistance,[72] which has not yet been confirmed by any European partner. Moreover, the state's resources for the necessary adjustments in the integration process will be under the pressure of budgetary constraints (about 110 billion MDL or 5.6 billion EUR of state debt, in July 2024). The costs for meeting the EU accession criteria exclude the needs for the country's reintegration. In this context, it should be mentioned that the EU is willing to accept the accession of the Republic of Moldova in stages -the first phase will take place without the Transnistrian region, according to the "Cypriot model"[73] adopted during the 2004 EU enlargement process.

4) Maintaining the EU's interest in Moldova will depend on the results of the presidential elections in 2024 and the parliamentary elections in 2025. If power is taken over by Eurosceptic and/or pro-Russian political forces, the dynamics of the dialogue with the EU might bear the consequences of a geopolitical shock. Although the political forces eligible to participate in the vote are not openly opposed to EU accession, they have invoked reservations regarding the content of future accession negotiations (land ownership, agriculture, etc.), and disagree with the delegation of sovereignty in sectoral domains to the EU.

68 https://www.politico.eu/article/georgia-eu-accession-stopped-anti-west-pivot-russian-law-foreign-agent-bill/
69 https://gov.md/ro/content/biroul-pentru-integrare-europeana-preia-atributiile-ce-tin-de-integrarea-europeana
70 https://gov.md/ro/content/planul-national-de-actiuni-pentru-aderarea-republicii-moldova-la-uniunea-europeana-pentru-0
71 https://idscs.org.mk/wp-content/uploads/2021/10/A5_IPA_3_Tilev.pdf
72 https://www.legis.md/UserFiles/Image/RO/2024/mo%2064-69%20md/plan_45md.pdf
73 https://www.eeas.europa.eu/eeas/european-political-community-press-remarks-high-representativevice-president-josep-borrell-upon_en

Policy recommendations

Removing negative precedents for "Fundamentals" and preventing new ones from emerging.

The predictability of the decision-making process, compliance with the principle of inclusion, and full transparency in the EU accession process are essential to ensure the irreversibility of the country's European course. From this point of view, the current parliamentary majority (PAS) and the future one (after the 2025 elections) will need to adopt and implement a package of laws that provide for the opposition's mandatory participation in the legislative process, as well as its representation in various national institutions and platforms – including the Central Election Committee and the People's Advocate to the National Commission for European Integration. Given PAS's current absolute monopoly over legislative and executive power, the current composition of those institutions is dominated exclusively by representatives of, or persons appointed by, this party. Representatives of the Autonomous Territorial Unit of Gagauzia (ATUG) at the level of mayors, credible representatives of civil society in the Transnistrian region, and representatives of the extra-parliamentary opposition and the diaspora need to number among the members of the national platforms dedicated to European integration (the National Commission for European Integration), at least as observers, to give more credibility and representativeness to the process. The inclusive approach adopted in the process of promoting European accession must take into account gender aspects as well as the potential of various social categories. The non-participation of critical voices in society in the European integration discussions could contribute to the spread of disinformation on EU-related subjects. Increased inclusion, on the contrary, will ensure more effective strategic communication with all categories of stakeholders, given the polarized nature of society, where the Eurasian integration vector enjoys the support of at least one third of citizens. An inclusive approach involving the participation of all state actors in the European integration process will also reduce the risk of the politicization of the public service. Thus, inclusiveness emphasizes meritocracy and not the political loyalties or geopolitical vocations of participants in the dialogue, which must include both Euro-optimists and Eurosceptics.

Combining European integration with the country's reintegration according to the "two-speed" principle.

Since the country's territory controlled by constitutional authorities is preparing to begin accession negotiations, the Transnistrian region also needs to be anchored in the process, albeit at a slower speed, through the trade provisions of the Association Agreement with the EU (the Deep and Comprehensive Free Trade Area-DCFTA). Likewise, a conditionality mechanism could be attached to the assistance granted to the Transnistrian region in the context of confidence-building measures between the two banks of the Dniester. In this sense, the EU Border Assistance Mission (EUBAM), together with the Bureau for Reintegration Policies, will play a key role in assessing the degree of implementation of the DCFTA by the Transnistrian region, establishing a "road map" for the expansion of its domains, which will be applicable on the left bank. A trilateral platform between EUBAM and the government Bureaus for European Reintegration and Integration will be needed to coordinate and monitor Moldova's "two-speed" European integration. The focus should be on those DCFTA areas that have a direct relation with the technical chapters with which the Chisinau Government intends to begin the accession negotiations. This will make it possible to achieve accession to the EU at two different speeds for the two banks of the Dniester, without slowing down the progress of Chisinau or abandoning the Transnistrian region.

Absorbing knowledge within the institutions responsible for European integration.

One of the major shortcomings in the country's European path is likely to be the lack of professional staff with experience in the technical areas of the accession process. For this reason, even if the BEI calls for the involvement of civil society and foreign experts, there needs be an internal mechanism for capturing knowledge within the institution. Otherwise, access to knowledge will end when the consulting contract with foreign experts terminates, or when funding for civil society comes to an end. In this sense, the BEI needs a research unit (in addition to the four existing departments) responsible for developing guidelines and other working documents while seeking external assistance. The BEI's capacities also need to be strengthened, with all vacancies being filled (currently, only 22 out of a possible total of 42 positions have been filled). Based on the willingness to provide help in the preparation process for the negotiations shown by the EU Member States, a "database" should be set up with European experts directly involved in the negotiation process, so as to draw on their expertise on specific aspects in the fields concerned. Such a database could be created for all candidate countries in the Western Balkans, Turkey, Ukraine, Georgia, and Moldova, such that the same experts are assessed and appointed to provide additional assistance on a rotational basis. However, given that 10 candidate countries have reached different levels of progress in the accession process, the same expert could be involved in consulting Moldova after activity in Montenegro is completed. This "expert pool" would favour the concentration and consolidation of knowledge, while also encouraging efficiency by sharing advice between countries, depending on their progress made with the negotiations. Such a platform could be created through the College of Europe in Bruges and with the direct financial assistance of the European Commission, which, according to the New Enlargement Methodology, wishes to increase the predictability of the enlargement policy.

Emphasis on the quality of reforms, not their speed.

The political and electoral calendar established by the government, including in relation to the Republic of Moldova's accession to the EU in 2030, creates exaggerated expectations on the part of the population and places pressure on the institutions to deliver "at all costs". Although speed matters, reforms and the country's degree of preparation must correspond to an objective assessment of the progress made and actual capacities. Cost-effective, positive reforms depend both on the people involved and their integrity. The authorities need to adopt and implement strict and rigorous rules vis-à-vis the actors involved in the reforms, including international experts. Otherwise, they risk discrediting and undermining not only the reforms but the EU accession negotiations themselves. Even if external partners provide financial assistance for reforms, the Moldovan Government needs to have the right to refuse certain experts proposed by external donors, if their reputation is compromised.

Ensuring "depoliticized" security for the sustainability of the European vector.

EU membership faces, and will continue to face, geopolitical opposition both from Russia and from pro-Russian actors in the country. For this reason, the role of security agencies will be essential in preventing malicious interference. This must take place, however, under the condition of respecting human rights, which are part of the "Fundamentals" of the EU accession process. In this sense, all policies in the field involve a depoliticization, by law, to redirect state resources away from the party interests of the government and focus them on state national interests. This approach will reduce the risk of shocks to the institutions, whose management has a mandate that is designed not to overlap with the electoral cycles; the lack of depoliticization may result in political conflict following the alternation of power, producing discontinuity in the European integration process.

Table 6.

Main governance indicators

	2021	2022	2023
Global Freedom, Freedom House (ranking position)	61 (out of 100 countries)	62 (out of 100 countries)	61 (out of 100 countries)
Corruption Perception Index, Transparency International (ranking position)	105 (out of 180 countries)	91 (out of 180 countries)	76 (out of 180 countries)
Sentences per corruption case, % of total	62% (out of 376 cases)	–[74]	
Acts (draft laws, normative acts) subject to public consultations, % of the total	44% (out of 786 acts adopted)	–[75] (out of 1,063 acts adopted)	60%[76] (out of 1,248 acts adopted)

Source: The National Anticorruption Center (NAC), State Chancellery, Transparency International, Freedom House

74 The NAC stopped publishing data on the number of sentences per corruption case. This information was last presented in the 2021 Annual Report, https://www.cna.md/public/files/Raport_CNA_2023-1.pdfhttps://www.cna.md/public/files/Raport_CNA_2023-1.pdf; https://www.cna.md/public/files/RAPORT_CNA_2022.pdf

75 The activity report of the State Chancellery for 2022 is integrated into a Report for 2022-2023 which, although it mentions the number of acts approved by the government, does not specify the number of acts passed through public consultations, https://cancelaria.gov.md/sites /default/files/document/attachments/raport_gov_2022-2023_0.pdf., https://cancelaria.gov.md/sites/default/files/document/attachments/raport_gov_2022-2023_0.pdf

76 The State Chancellery's report for 2023 refers to 749 draft acts that were announced in the approval/consultation/expertise procedure, without explicitly stating how many of them de facto went through public consultation procedure https://cancelaria.gov.md/sites/default/files/document/attachments/raport_cs_2023.pdf

WHO WE ARE

Expert-Grup is a think tank that specializes in economic research and public policy analysis. Expert-Grup was established in 1998 and started its research activities in 2006. We position ourselves as a politically and ideologically neutral organization, and we do not represent any economic, corporate or political interests.

OUR MISSION

The mission of the organization is to promote the public interest and to develop efficient and innovative solutions for the development of the Republic of Moldova. In order to fulfil this noble goal, **Expert-Grup** provides a creative and institutional environment and encourages the expression of free thinking, which helps to make us a leading source of unbiased economic analysis.

EXPERT-GRUP'S FOUR CORE VALUES

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

EXPERT-GRUP'S 10 PRIORITIES

1. A functional market economy: free competition and the protection of property rights;
2. Reasoned and rational economic and social policies, developed in the interest of citizens;
3. Free trade based on real competitive advantages;
4. An efficient, transparent and accountable public sector;
5. A business climate that is friendly to, and appealing for, SMEs;
6. Fair labour market conditions for both employers and employees;
7. A 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. A society that is familiar with the economic trends and basic principles of the economy;
10. Balanced regional development.

WHO WE ARE

Friedrich-Ebert-Stiftung (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:

Democratization 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 organizations, 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, having recently been granted EU candidate country status. FES aims to support the country's European integration process. 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 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 NGOs in contributing to a peaceful resolution of the Transnistrian conflict, as a precondition for successful European integration in the long term.

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 activities and projects in this area focus on 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.