



REPUBLIC OF MOLDOVA

POVERTY REDUCTION STRATEGY PAPER

August 2013

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NATIONAL DEVELOPMENT STRATEGY: 7 SOLUTIONS FOR ECONOMIC
GROWTH AND POVERTY REDUCTION

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INTRODUCTION

STRATEGIC VISION FOR THE DEVELOPMENT OF THE REPUBLIC OF MOLDOVA

FEATURES OF CURRENT ECONOMIC GROWTH

Economic growth and the poverty reduction trend is closely correlated in Republic of Moldova with the flow of remittances and consumption generated by the latter. Revenues from Moldovans' work abroad have fuelled the disposable income of households, thus leading to an increased aggregate demand for consumption. Constrained by the limited capacity of domestic production, this demand was largely met by imports of goods and services. The national public budget has benefited from this, but the trade balance has turned into an alarming trade deficit.

Economic growth based on consumption and on remittances exposes the economy to a number of vulnerabilities, but there is a greater danger associated with this model of economic growth, i.e. that remittances, at one point in time, will start to decline. Currently, migration breaks families of Moldovan citizens. This in itself is bad enough, but following the evolution of migration in countries faced with this phenomenon, we anticipate that Moldovan families will reunite. Unfortunately, if it will not be acted firmly to create adequate working and living conditions in Moldova, migrant family reunification will occur outside the country, which will trigger a decline in remittances.

Two conclusions emerge from the aforementioned:

- **first conclusion** is that it will be difficult to maintain the pace of economic growth, which, in the absence of a structural change of national economy, proves to be unacceptable from the perspective of Republic of Moldova's development agenda;
- **second conclusion** refers to the actual change of the growth model, namely: the need to replace the inertial growth model based on consumption fueled by remittances in favor of a dynamic model based on investment and on development of goods- and services-exporting industries.

In this context, the National Development Strategy "Moldova 2020" comes to present a vision of cohesive long-term sustainable economic development based on a diagnostic study of constraints to economic development. In this sense, it will consolidate and will guide the sectoral approach characteristic for the governance program, the objectives of which are outlined for the entire mandate period.

Also, before changing the development paradigm of Republic of Moldova's economy, we will continue to count on development partners' support. Areas such as health, culture, social protection, and environmental protection are crucial for the country's sustainable development. The focus of the National Development Strategy is to increase the budget coverage of adequate policies in these sectors as a result of accelerated economic development. Such a focus also requires the sustainability of foreign assistance currently provided to the country.

CHANGING THE DEVELOPMENT PARADIGM

Economic development, wherever it occurs, is based on 3 factors, namely accumulation of capital, labor force and its productivity level, which includes and other parameters, such as: technologies, efficient governance,

skills, etc. The Government has made an attempt to shape the historic and future development of Republic of Moldova in the context of the National Development Strategy „Moldova 2020”.

An analysis of economic development factors in Republic of Moldova reveals a very alarming conclusion - without a concerted effort to change the development paradigm, the potential of growth over the next ten years is limited to a maximum of 4.5% to 5% annually. Even this relatively moderate growth scenario is based on rigid assumptions, that labor outflow will be stopped and remittances will remain at current levels at the least, fact which is not guaranteed at all. Certainly, this increase is insufficient to ensure a convergence trend with comparable countries, and even less with European standards. According to the IMF estimates (Table 1), the Republic of Moldova is the penultimate country, ranked in comparison with countries in the region, ahead only of Kirgizstan in terms of GDP per capita at purchasing power parity. With an annual growth rate of 5%, this position in the regional rankings will continue until 2016.

As per results of the analysis, growth in Republic of Moldova during 2000-2010 can be firstly attributed to an increase in capital – productive stock of fixed capital. It had increased on average by 8.2% annually, which is a pretty high rate, but still insufficient. Secondly, GDP growth was also conditioned by an increase in productivity of labor and capital (4.7% annually). Therefore, the nature of growth was more extensive rather than intensive. Switching economic activity in the area of agricultural production, characterized by low productivity, to the area of industry and services, where productivity is higher, explains this relative performance. By contrast, labor dynamics has adversely affected economic development. Migration trends that emerged during this period have determined a lower rate of activity in the national economy, from 60% down to 44%. Actual labor as a factor of production decreased during the last decade, from 1.514 million to only 1.143 million in 2010 or, on average, by 2.8% annually. This reduction undermines the positive influence of capital and productivity growth and, as a result, erodes the recorded GDP growth. Therefore, given labor "erosion", the quite positive statistics of the last decade in terms of capital and productivity growth were not high enough to ensure a convergent growth path with the European average.

Overall, it took place a jobless economic growth, without a massive re-equipment of production. In other words, the capital has increased, accompanied by a slightly enhanced efficiency of production factor utilization, but at absolutely insufficient rates to ensure sustainable economic development. But even modest growth rates of capital and efficiency of factors of production recorded during 2000-2010 should not be perceived as a guarantee for the next ten years. These have actually been achieved under circumstances when the Government and entrepreneurs had a wide range of so-called "easy targets" or reform and technological opportunities as a result of transition. Any investment in fixed capital under any type of reforms narrows this field of maneuvers. Once the “easy” reforms and structural adjustments have worn out their beneficial effects, the development potential based on multi-factor productivity is minimal. The physical volume of labor is in turn a very rigid economic variable that will never meet elastically medium-term rational efforts of the Government to enhance it, especially under circumstances of mobility offered by European integration.

A change in the development paradigm can only occur through a concerted effort by both Government and society. This effort is meant to identify, as quickly as possible, and address those gaps that still impede an economic development model focused on raising investments in fixed capital and its increased utilization, including by increasing labor force productivity.

As a way to increase the productive stock of capital and the knowledge regarding its use, the economic development paradigm would imply attracting investment, developing export industries, promoting a

knowledge-based society, including strengthening research and development activities, innovations and technological transfer geared towards efficiency and competitiveness. Changing the development paradigm of the Republic of Moldova will be achieved by ensuring equitable distribution of economic development benefits for all strata of society. On the other hand, the speed, scale and consistent approach to the broad spectrum of proposed reforms are also important. A shift in paradigm cannot be achieved through a set of instant reforms only. Promoted reforms will serve only as a first step in establishing a new working method and approach towards issues by the Government and entire society. If we learn to work together at this pace, Moldova will become a competitive country in Europe in terms of its ability to reform and innovate, but economic development will accelerate to a rate that will reduce, in the near future, the gap between our country and developed European economies.

DEVELOPMENT PRIORITIES

A diagnostic analysis of the constraints to economic development highlights the critical issues, i.e. domains in terms of which Republic of Moldova is largely surpassed by comparable countries. This approach¹ has been applied successfully in several countries, such as Brazil, Egypt, Bolivia, and Mongolia. Essentially, as long as the critical issues remain unresolved, the investment potential of the national economy cannot be fully realized. It is necessary to remove these investment-suppressing barriers as a matter of priority in order to change the country's development paradigm.

On these lines, four critical issues were identified: education, roads, access to finance, and business environment. Following a consultative process, the Government established major problems that, once solved, will contribute greatly to ensuring economic growth and poverty reduction. Hence, the experience of an inefficient judicial system endangers the development of all areas, affecting seriously both the business environment in the country and the investment process. Other two priorities, solutions to which can be found during the implementation timeframe of present Strategy and which have direct impact on the poor, are: consumption of energy resources and pension system. Health was identified as one of critical problems which leads to reduction of labor force and to a decrease in labor productivity, but its solving is possible by including health aspects in all long-term development priorities. As long-term strategic objectives, the National Development Strategy "Moldova 2020" is focused on the following development priorities:

1. Aligning the education system to labor market needs in order to enhance labor productivity and increase employment in the economy;
2. Increasing public investment in the national and local road infrastructure, in order to reduce transportation costs and increase the speed of access;
3. Reducing financing costs by increasing competition in the financial sector and developing risk management tools;
4. Improving the business climate, promoting competition policies, streamlining the regulatory framework and applying information technologies in public services for businesses and citizens;
5. Reducing energy consumption by increasing energy efficiency and using renewable energy sources;

¹ "Growth Diagnostics" (2005), Ricardo Hausmann, Dani Rodrik, Andrés Velasco.

6. Ensuring financial sustainability of the pension system in order to secure an appropriate rate of wage replacement;
7. Increasing the quality and efficiency of justice and fighting corruption in order to ensure an equitable access to public goods for all citizens.

The focus of this Strategy is to produce a social and economic impact on each of the above-mentioned dimensions. The cumulative effect of solving the addressed problems lies in removing the critical barriers that prevent the optimal use of resources. This approach makes it possible to prioritize areas of state intervention and subject them to a clearly defined objective of the Strategy: **ensuring qualitative economic development and, implicitly, poverty reduction.**

The Republic of Moldova will undertake all the necessary efforts to ensure the transition to a green economic development, which promotes sustainable development principles and contributes to poverty reduction, including by ensuring a better governance in the sustainable development domain, by integrating and strengthening environmental protection aspects in all social-economic development domains of the country.

A determining factor in the successful accomplishment of identified priorities and achievement of the main objective is the existence of efficient and modern state institutions. Acceleration of institutional reforms and strengthening of capacity of public authorities will address each identified priority. Increased quality of public services through modernization and greater transparency and accessibility are inherent during Strategy implementation process.

IMPACT ON ECONOMIC DEVELOPMENT

GDP grew on average by 5.1% annually during 2000-2010. Certainly, some successful years generated better growth rates (7.1% during 2000-2004, 5.2% during 2005-2008), but there are crisis phenomena and the phenomenon of long economic waves, the frequency of which can be estimated at around ten years. Indeed, regional and global economic crises occurred in 1998 and 2008. High growth rates in the most favorable years are, in fact, correction, recovery from the crisis, or crisis-preceding boom effects.

This Strategy's economic growth forecast for 2012-2020 uses *average rates* of economic growth. Certainly, higher annual rates will be registered by case, specifically over short term, and lower annual rates will be registered during correction periods or eventual crises.

The *base case scenario*, which regards a continuation of trends of the last decade, implies that we develop as we did so far, with the same economic, social, political phenomena, with rising remittances and the same pace of reforms. The base case scenario estimates an average annual GDP growth of 4.7% during 2012-2020. But what happens if we succeed in changing the paradigm of economic development?

The implementation of the present Strategy's priorities, considering the direct and quantifiable effects of each priority, supplements this annual growth rate by more than 1.2% annually, forming thus an *alternative scenario*. The annual supplement to the additional GDP growth will emerge gradually, but will accelerate rapidly and sustainably, from 1.1% (2015) to 2.1% (by 2020), continuing after the expiry of the used planning schedule (Figure 1). The difference is small at a first glance, but in developed economies an annual GDP growth difference of 2% is sometimes the difference between stagnation and growth, or the difference between normal growth and economic boom.

Hence, the alternative scenario assumes that, due to effects only, in 2020 the GDP will be 12% higher compared to the base case scenario and, with each year beyond 2020, this difference will grow significantly (Figure 2).

IMPACT ON INCOME AND POVERTY

Along with the implementation of these priorities, the annual income per capita by 2020 will be on average 12% higher compared to the base case scenario and 79% higher compared to 2011. Assuming at least a proportional distribution of welfare, we can estimate the reduction effect from an average income increase.

There is an intrinsic relation between the poverty rate (share of population living below the *poverty line*) and the economic growth rate, which can be expressed through the elasticity coefficient. Thus, the coefficient was minus 0.7 during 2000-2010, which means that each annual supplementary percentage of GDP growth reduces the poverty rate that year by 0.7%. An estimation of the benefits of implementing these priorities can be made by using the elasticity coefficient and the average GDP growth rates in the base case scenario – 4.7% and in the scenario which assume the implementation of seven priorities – 6.7% by 2020. In addition, the direct effect on poverty of pension reform implementation is estimated at about 2%. It should be mentioned that these two effects will cumulate.

In 2010, the poverty rate was 21.9%. If we use the poverty level (or line) of 2010, the poverty rate will also be reduced in the base case scenario to approximately 16% by 2020. But, along with the implementation of priorities, it will be reduced significantly, to 12.7%, or by 3.3 percentage points over the base case scenario, which accounts for 149,000 people out of poverty (Figure 3).

SUSTAINABILITY OF ECONOMIC GROWTH

By contrast, it is worth noting that ensuring a qualitative economic growth through elimination of critical constraints and poverty reduction has a short-term effect. Over medium- and long-term, the main concern of authorities is to promote welfare – a concept that incorporates various development aspects, among which public health, personal security, access to culture, and, last but not least, clean environment.

It is known that, without a sustained effort, economic growth has a negative impact on the environment as a result of greater industrial pollution and increased consumption. Regulations that are designed to counter this effect are treated by businesses as an excessive burden. However, at national policy level, the sustainable nature of economic growth is equally important.

In this context, the Government's strategic vision over medium and long term is the reconciliation between the need for accelerated economic development and environmental protection in conformity with European standards. This will materialize through: (i) achievement of a rate of economic development that would allow an increasing financing of environmental protection measures, and (ii) balanced regulation of the business environment, both in terms of economic impact and environmental impact.

Health also is an integral part of social welfare of the population, but good health conditions facilitate economic development, competitiveness and productivity. Improvement in the health of the population will have a decisive impact on economic development and social prosperity only by achieving equity in health, by real progresses in ensuring the right to health for all people and by making the entire society accountable for health care measures that can contribute to human development, to social and economic welfare. Awareness-raising activities on health determinants and promotion of provisions on health issues in all policies will maximize results in health domain.

Thus, health will presume that economic and social security, harmonious social and interpersonal relationships, a safe and healthy working and living environment, adequate quality of drinking water, air and soil, an adequate and reasonable nutrition are necessary conditions, all of which being complemented with healthy lifestyle and access to quality health services. Increasing health system efficiency will also contribute to increased productivity, social inclusion and will reduce poverty, due to the positive impact on reducing morbidity, premature mortality and increase healthy life expectancy.

TABLES AND FIGURES

TABLE 1. IMF ESTIMATES OF GDP PER CAPITA AT PURCHASING POWER PARITY IN 2010 AND 2016, USD

	2010	2016
Albania	7 454	10 067
Armenia	5 110	6 712
Georgia	5 114	7 386
Kirgizstan	2 249	3 181
Macedonia	9 728	13 136
Moldova	3 083	4 424
Bulgaria	12 851	18 010
Romania	11 860	16 335
Ukraine	6 712	9 739
Estonia	18 519	25 145
Latvia	14 460	20 213
Lithuania	17 185	24 262

FIGURE 1. GDP ANNUAL GROWTH FORECAST

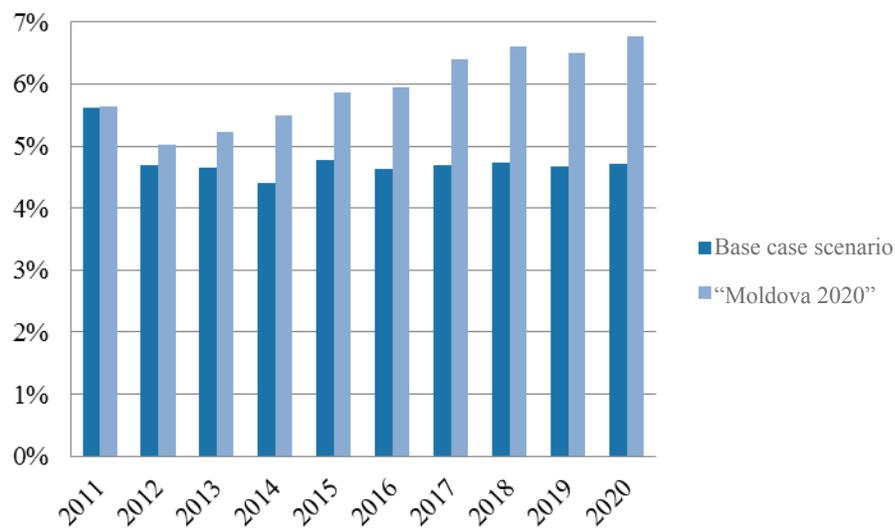


FIGURE 2. GDP GROWTH WITH AND WITHOUT IMPLEMENTATION OF DEVELOPMENT PRIORITIES, MDL MILLION AT 2000 PRICES

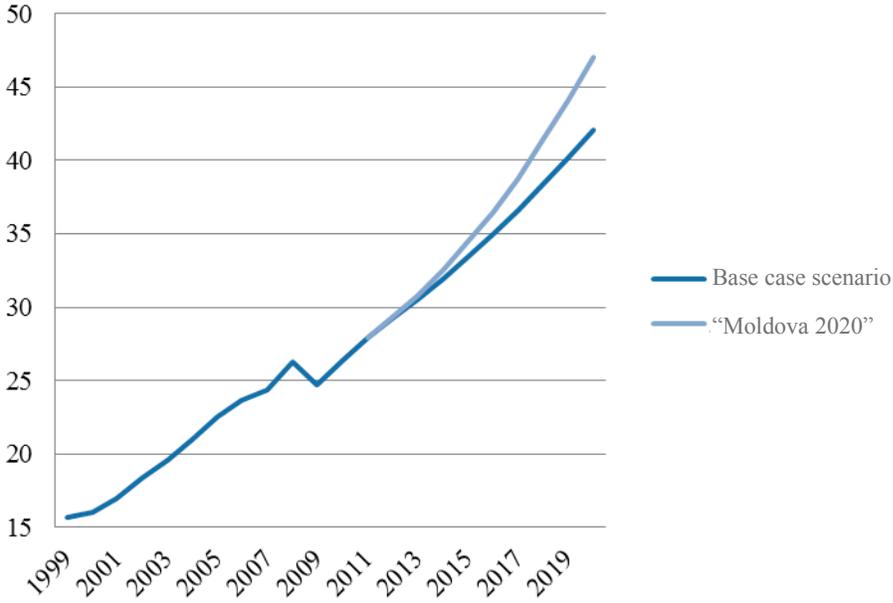
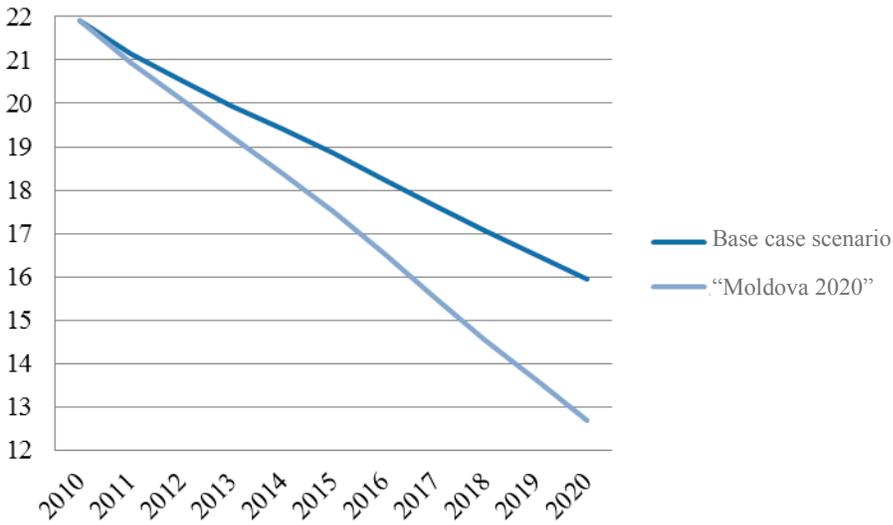


FIGURE 3. REDUCTION OF POVERTY RATE, %



EDUCATION: RELEVANT FOR A CAREER

Human capital is one of the few resources that can offer to the Republic of Moldova a comparative advantage. However, if labor is not specialized in fields required by potential investors – job providers – human capital remains an untapped resource.

SITUATION ANALYSIS

In recent years, an increasingly characteristic phenomenon for the education system in Republic of Moldova is preference for higher education. The last two decades have been marked by a doubled number of students enrolled in higher education to the detriment of secondary vocational education and general specialized education (Figure 4). Overall, university education is becoming increasingly accessible and age limitations were excluded. Similarly, the high number of students in higher education compared to the much smaller number of people in secondary vocational and general specialized (vocational/technical) education shows that university education is a priority for Moldovan citizens. The popularity of higher education is increasing, although 71.3% of students are enrolled on a contractual basis and pay a tuition fee.

Spending on education in Republic of Moldova reached a record 9.2% of GDP (the European average being 5.5% of GDP), without producing a significant economic and social impact. In 2009, financial allocations per pupil in secondary vocational education accounted for MDL 10,224, which is higher by 15% than in general specialized education (MDL 8,709/student/year) and by 33.5% than in higher education (MDL 6,802/student/year)². Although secondary vocational education is the most expensive, the biggest problems appear on this particular segment. In 2010, according to International Labor Organization methodology, the number of unemployed with secondary vocational education was 22,800 people, or 24.8% of the total number of 92 thousand unemployed, being higher than the number of unemployed with higher education (18.3 thousand), general specialized education (12 thousand), lyceum, general secondary education (22 thousand) and secondary education (16.8 thousand), recording the highest drop-out level (24.5%).

In terms of labor market in Republic of Moldova, 970 thousand people of 15-29 years old or 27.2% of the total population were registered in 2010. The unemployment rate among this age group is 13.9%, being 1.9 times higher than the nationwide unemployment rate (7.4%). According to the National Bureau of Statistics data, only 22% of young people found a job immediately after graduation in 2010. A quarter left their first jobs because of low wages, and 17.7% went to work abroad. Young people in cities succeed in higher proportions to find a permanent job than those in rural areas (75% versus 54%).

Consequences are felt directly on the economic front. They show a relatively small proportion of graduates employed as per qualification obtained in education institutions, and the absence of monitoring mechanisms for their careers makes the issue less visible. About 30% of graduates do not work according to professional qualifications obtained in vocational schools, colleges and universities, which show the necessity to diversify the educational routes by promoting the lifelong learning concept. This phenomenon is deepened by the informational asymmetry between labor force demand of potential employers and the wrong perception of students regarding employing opportunities, which tends to perpetuate this phenomenon.

The business environment in Moldova, especially exporters, complains about low quality of job candidates education and about lack of qualifications. 85% of companies mention lack of qualified labor force³, with

² Vocational Education at a Crossroads: An analysis of policy decisions in the secondary and specialized education system, Sergiu Lipceanu, IDIS Viitorul, 2010.

³ „Work relations in Republic of Moldova from companies' perspective”, UNDP and Government of Belgium.

companies requiring a higher level of professionalism and specific skills from workers. Most often, economic agents mention that they are faced with a significant gap between their needs and professional skill mix of vocational/technical education institutions' graduates. The quality of curricula also determines the reduced adaptability of young workers to company conditions. This most often leads to an increased turnover of staff. On the one hand, the worker is unsatisfied because he/she cannot meet the requirements and, on the other hand, the employer does not receive the expected performance from the employed human resources. It is also alarming that young workers do not show devotion to work, as confirmed by 52.2% of respondent companies⁴.

The low productivity of young employees and poor quality of products/services form a vicious circle, which in turn determines modest salaries. Non-competitive salaries are another reason for lack of business attractiveness. For graduates of secondary vocational education unemployment is more acute than for those who graduated from general specialized or higher education facilities. Their share in the structure of unemployment reached 28% in 2009. In this context, labor migration is an increasingly pressing problem, which imposes a more efficient correlation between education policies and migration and employment policies.

If the Government will not intervene, unwanted effects of the problem will deepen. This situation, combined with unfavorable demographic forecasts and with the precarious state of health, challenges the myth that Republic of Moldova has plenty of labor force, which is skilled and cheap. Consequently, the labor market will face a deepening substantial imbalance between supply and demand and shortage of skilled labor. Attracting investment, given the lack of required human capital, will become increasingly difficult, and the lines of emigrants will be further fuelled by fresh graduates of the education system, with the purpose of both searching for a well-paid job and materializing quality education without tapping the potential to create domestic jobs.

Aligning the education system to the requirements of the labor market is imperative. A perpetuation of this situation is a major risk for the education system because, with extending opportunities to access education in Europe, potential students will prefer other educational destinations.

STRATEGIC VISION

The correlation between labor market demand and education supply will have a significant impact on economic development. Modernization of the vocational education system and improvement of continuous labor force training will allow citizens to adapt to new labor market conditions. Partnerships between education and labor market will lead to a generation of educational offerings that will meet the quantitative, qualitative and structural labor force needs. This in turn will help reduce unemployment and the flow of citizens who leave the country and the rate of population at risk of poverty or social exclusion.

To the effect of achieving the strategic vision, education policy will be targeted to ensure the quality of studies. Enacting new legislation on education, adjusted to the European experience, will facilitate structural and institutional reform in the field, taking into account the principle of efficiency and quality. Reform of research and innovation system, by de-monopolization of its financing, by applying consistent and relevant rules supporting excellence in education and in science, will boost the quality of career education. Establishment of the National Agency for Higher Education and Research Quality Assurance is crucial for

⁴ Idem.

evaluation and accreditation of institutional and professional training/development programs for labor market specialists. The National Framework for employment qualifications and standards will guide the educational process towards development of competencies required on the labor market. Meanwhile, labor forecasting capacity will be strengthened, with a focus on creating lifetime professional training opportunities. Curricula will be geared towards professionalization of research and innovation capacities, as well as towards their development in universities.

The quality of academic processes will be ensured inclusively by redefining the assessing principles and criteria of higher education institutions intellectual potential, by restructuring teaching and research tasks, by refocusing institutional services, which will be made available to students, in the benefit of accurate and more adapted choice of educational routes by them. As a quality requirement toward the intellectual staff of an institution will be the share of 75% of professors with teaching and research titles.

A precondition for increasing the quality of education is to eliminate corruption factors in the education system. The optimal solution in this regard is to rely on market mechanisms. In order to stimulate a real competition among higher education institutions, the financing formula for universities will be modified, taking their performance as a fundamental criterion, offering to them in return broader financial autonomy.

EXPECTED IMPACT

The process of enhancing education quality will allow creating a good investment climate due to skilled, responsible, flexible labor, thus contributing to greater labor productivity. This will result in an increased quality of products/services in the national economy. Promoting the transfer of knowledge must be conducted in a way that would translate innovative ideas into new products and services, which generate growth, quality jobs and contribute to solving society problems with a view to consolidating economic and social cohesion. Training of qualified labor force will be ensured through promoting career guidance, starting with general education, and offering lifetime continuous training possibilities.

In accordance with the inter-generational model (Mayer, 2004), current investments in nutrition, health and education have a significant positive impact on employment, on professional skills and on knowledge, and these in turn contribute to increased economic development.

A work force that is better educated and connected to the needs of the economy affects the gross national production through multiple paths, called channels of influence. First, the volume of physical labor as a direct factor of production increases. Second, the efficiency of using a unit of labor (production factor productivity) increases. These two parameters can be quantified and estimated until 2020. Additionally, there are other ways in which better education will serve the national economy, such as: encouraging domestic investments at the national level and new jobs creation due to manifested managerial skills and personal initiative of the graduates; greater attractiveness to foreign investors; reduced employers' costs to re-shape and enhance the current workforce skills by developing new skills and competencies generated by an economy based on knowledge; innovation and modern technologies.

Estimating the effects of achieving the proposed objectives on annual GDP growth was based on several additional conditions, the main being: (i) migration of young graduates will be reduced by at least 50%, and (ii) in the medium and long run, graduates who were able to fully benefit from the reform will be at an aggregate level by 20% more productive. Under such circumstances, the annual growth rate of GDP over the medium term may be 0.6-0.9% higher compared to the scenario "without reforms".

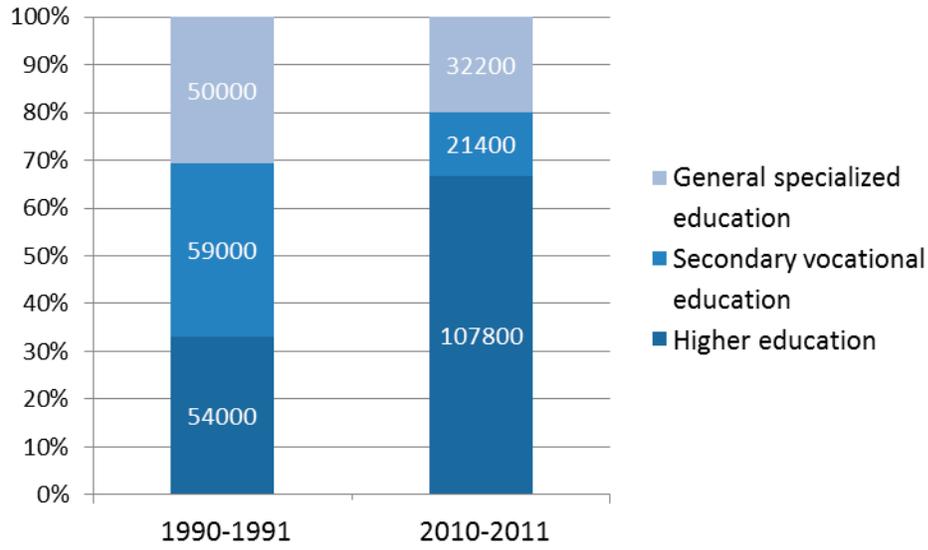
Even if the labor force is an inert economic variable, and by 2020 due to lower replacement rates the new graduates will form only a small share of the total employed population, the improvement of the career education quality will have a greater effect in the long run.

SPECIFIC OBJECTIVES

Monitoring indicator	2010	2015	2020
Unemployment rate, %	7.4	6	5
Outflow of young labor force, %	17.7	15	10
Share of employers satisfied with labor force quality, %	15 (2011)	40	60
Share of employed graduates that claim to need additional training after graduation, %	40	20	10

TABLES AND FIGURES

FIGURE 4. SHARE OF STUDENTS ENROLLED IN HIGHER EDUCATION VERSUS SECONDARY VOCATIONAL EDUCATION AND GENERAL SPECIALIZED EDUCATION



ROADS: IN GOOD CONDITION, ANYWHERE

Transport costs of economic agents and road traffic safety are closely related to road infrastructure quality. The poor condition of roads is seen as a major constraint hindering economic development and requiring substantial public investment. Moreover, an adequate road infrastructure is a precondition for a harmonious regional development and access of population to public services. The prospect of establishing a Deep and Comprehensive Free Trade Zone between Republic of Moldova and European Union makes road infrastructure indispensable for the utilization of local producers' export potential.

SITUATION ANALYSIS

Republic of Moldova is affected by an intensive process of road degradation. About two thirds of the length of national roads was in good condition in 1992, then less than half of them were in good condition in 1998, and only 7% in 2006 (Figure 5). Although the condition of local roads was less examined, a study of 1,500 km (out of 6,000 km) of local roads conducted in 2006 found a bad and very bad condition of about 96% of their length.

Intensive degradation of public roads in Republic of Moldova occurred because of insufficient funding for maintenance and repairs (Figure 6). During 1998-2006, road funding covered less than 10% of needs. Allocated funds allowed only the execution of routine maintenance (winter maintenance, filling potholes, profiling, etc.). Because of failure to conduct average and capital repairs, over 80% of road length exceeded the established operating framework.

A relative improvement in the condition of roads has occurred in the years 2010-2011, conditioned by increased contributions to the road fund (from MDL 241 million in 2009 up to MDL 788 million in 2011). However, these contributions are not sufficient to restore the entire road network to an appropriate state.

The effects conditioned by insufficient funding of road maintenance and repair works were exacerbated by systemic issues. Technical norms and standards used in roads are outdated and do not match current requirements, and the institutional structure of the road maintenance system is inefficient.

In Republic of Moldova (except the left-side region of Nistru) there are 39 road maintenance companies, of which one is private, 35 are joint stock companies with state participation, and three are state companies. The study conducted during the development of the Land Transport Infrastructure Strategy for 2008-2017 demonstrated the need to reform the road maintenance system in order to enhance the efficiency of this transport. Administration costs exceed 25-30% of total spending, with a law-prescribed ceiling of 14.5%. To the effect of making the road maintenance system more efficient it is necessary to ensure a healthy competition and encourage new investment in the field through transparent public procurement friendly to bids involving advanced technologies, ensure transparency in the operation of specialized companies, their privatization and merger, optimize the maintained road network length, and implement a maintenance method through multi-annual contracts (3-5 years) and road differentiation by level of required maintenance.

The adverse effects generated by the poor condition of roads in Republic of Moldova have a significant negative impact on the country's social-economic activity. One of the factors offering the possibility to achieve sustainable economic development, examined in the Global Competitiveness Report 2010-2011, published by the World Economic Forum, i.e. „quality of infrastructure”, ranks Republic of Moldova 94th out of 139

countries, the lowest being road quality infrastructure (139), followed by port infrastructure (124), air infrastructure (109), and only railway infrastructure is ranked higher (67).

The quality of transport infrastructure is largely perceived as an important component of competitiveness and business environment in general and, as a consequence, is an important factor in attracting investment and ensuring export competitiveness. Compared to countries in the region, Republic of Moldova got the lowest positions in the World Bank's ranking on 2010 Logistics Performance, being ranked 104th out of 155 countries, 132nd for logistics competency, 124th for customs procedures, and 123rd for infrastructure aspects (Table 2).

However, Moldova cannot fully capitalize on the economic and investment potential because of poor roads that limit accessibility to objects of production, to markets and to cultural and tourist centers. Moldova is often avoided because of these reasons as a transit country for cargo and passengers.

Because of poor road network, households, especially those in rural areas, incur significant additional costs to access social and administrative services and markets. According to estimates, the unsatisfactory state of roads implies additional costs for users of approximately MDL 2.5 billion annually.

The poor quality of roads also has a negative effect on road safety. The total number of reported deaths per million vehicles is about 1,120 (6-9 times higher compared to European Union countries) and the number of deaths per one million population is about 120 (Figure 7).

The poor condition of roads has a negative environmental impact. Fuel consumption on roads in bad shape condition increases by 20%, generating additional emissions of harmful substances into the atmosphere. Besides, bad roads are an additional source of noise and of vibration. Gravel roads cause formation of dust clouds, which negatively influence the development of agricultural crops in the roads influence area.

STRATEGIC VISION

The implementation of the new qualitative economic development model based on exports, on investment and innovation will be accelerated by the development of both road infrastructure and logistics sectors related to transport services.

Essentially, road infrastructure durability is contingent upon ensuring the necessary minimum of financial resources for national and local road infrastructure maintenance, but also upon substantial public investments in construction and rehabilitation of national public roads, so as to have 80% of roads in good and very good condition by the end of this Strategy due date (Figure 8).

Estimates show that approximately MDL 4.2 billion is required annually for national and local road maintenance and current repairs (Table 3). At the same time, a capital reconstruction of over 400 km of roads was planned for 2011-2014 with funding from external sources, reaching an amount of EUR 334 million. Thus, to the effect of attaining the established objective by the end of this Strategy due date, it is necessary to mobilize additional domestic and foreign funding of EUR 1.1 billion.

Measures beyond the mere allocation of public funding are required in order to accomplish this vision. It is necessary to explore the public-private partnership potential in the area of road infrastructure and logistics services related to transport and road infrastructure services. The road network management is also followed closely by the Government. A reduction of administrative costs to a standard prescribed by legislation is a source of savings that can contribute to more adequate maintenance works. Hence, a greater efficiency of the

maintenance system will be achieved through an effective competition based on: (i) transparent public procurement friendly to bids involving advanced technologies; (ii) ensuring a more efficient control of work quality; (iii) reorganization and modernization of road maintenance companies by the year 2013; and (iv) implementation of the road maintenance method through multi-annual contracts by the year 2015.

EXPECTED IMPACT

Adequate road rehabilitation and maintenance in Republic of Moldova will have a number of beneficial effects, contributing to the country's economic development. With a strategic location, Moldova plays an increasingly important role as a border country between the European Union and Eastern Europe and could become a commercial hub of transportation in the region, where roads will be rehabilitated and logistics costs will be lower than in neighboring countries. Transport services can be developed but their costs are very high in the absence of a quality road infrastructure.

It is important that in the future the design and development of road infrastructure be done in line with social and economic needs of citizens. Given that Republic of Moldova aims at increasing the dynamics of industrial and agricultural sector's development, a solid road infrastructure, functioning road transport and some multi-modal logistics centers will facilitate significantly the access of farmers to local and foreign markets. Rehabilitation of roads in the country by using advanced technologies will have an impact on the labor market through both creating new jobs and involving more adequate professional training. Last but not least, a modern road infrastructure will contribute to the development of some sectors providing non-traditional services such as tourism and logistics services. The imperative to implement environmental protection measures will be taken into account while designing, constructing and operating the roads, including by applying environmental impact assessment procedures, by promoting construction and operational standards under climate change conditions, by maintaining, restoring and expanding road plantations areas (green protective strips along roads etc.).

Also, road infrastructure development has a beneficial social impact. The current state of roads is a major impediment in rural population's access to quality social services. For example, school network optimization through establishment of hub schools is directly posing the problem of access to these institutions. Auto transport services can be developed, but their maintenance costs are very high in the absence of a well-developed road infrastructure. Hence, road rehabilitation will increase the population's access to health services, especially to emergency and hospital services. In the context of hospital reform and public hospital network restructuring based on the National Master Plan for Hospitals, the distance between hospitals will increase and the state of roads is crucial for the rapid access of patients to health facilities. Simultaneously, transition to universal coverage and access to an efficient primary care, as the closest nursing provider to the individuals and of good quality is a priority for the Republic of Moldova. Thus, further road construction, urban and rural planning will be coordinated closely with medical institutions planning (hospitals, primary care and emergency institutions). Also, it is a fact that the inclusion of effective road safety measures in the road construction helps to prevent personal injury and loss of human capital and productivity as a result of road accidents. Building new, safer roads is also an opportunity to promote a healthier lifestyle by creating conditions for physical activities such as walking and cycling in public spaces.

Another important aspect is environmental protection. First, better roads reduce significantly fuel consumption per each kilometer, thus reducing harmful gas emissions, noise and other pollutants. Vehicles will require less consumable, such as oil and tires, which are also a great pollutant. Last but not least, the road

rehabilitation and reconstruction process must be conducted in strict compliance with the requirements of national legislation in the areas of environment and good international practices (environmental impact assessment, action plans for environmental protection during reconstruction, etc.).

Apart from these beneficial implications, better roads affect directly economic growth and development through more channels. Both in the international practice and in the Moldovan context, mathematical models are well-calibrated to appreciate exactly the effect of one kilometer of road rehabilitated on expenditures, population and business incomes, time saved, and accidents. The main benefits, displayed in descending order, are:

- reduced vehicle operating costs, including saved fuel and avoided repairs;
- less time spent on roads, which can be further used for productive or recreational purposes;
- reduced number of accidents;
- intensify additionally attracted traffic of goods and of passengers, including international transit;
- increased investments, regional development, extended tourism as a result of enhancing country attractiveness, these representing tertiary, less distinguishable effects.

The first of these is the most tangible benefit. Estimates suggest that MDL 2.5 billion is wasted annually on additional repairs and on fuel on road segments planned for rehabilitation. Starting with the assumption that at least a moderate part of saved money can be invested for productive purposes, increasing thus the stock of fixed capital, calculations suggest that over short and medium term regular annual GDP growth will be additionally increased by 0.3% due to fuel savings and repairs avoiding only. But the overall effect will be probably even greater.

SPECIFIC OBJECTIVES

Monitoring indicator	2010	2015	2020
Rehabilitation of national public roads, km		900 (2014)	1900
Repairs of local public roads, km		700 (2014)	4900
Share of national public roads in:			
<i>very good condition, %</i>			38
<i>good condition, %</i>			42
Reduction in the number of deaths caused by road accidents per million population	120		60
Logistics Performance Index)	2.57	2.67	2.87
<i>infrastructure</i>	2.05	2.35	2.65
<i>logistics competency</i>	2.17	2.37	2.77

TABLES AND FIGURES

FIGURE 5. EVOLUTION OF THE CONDITION OF NATIONAL ROADS DURING 1992-2010

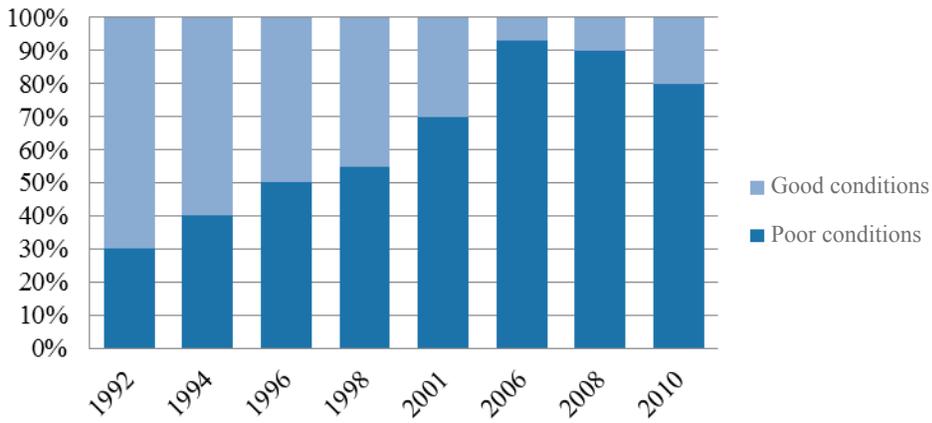


FIGURE 6. FUNDING IN THE ROAD SECTOR DURING 1990-2011, MDL MILLION

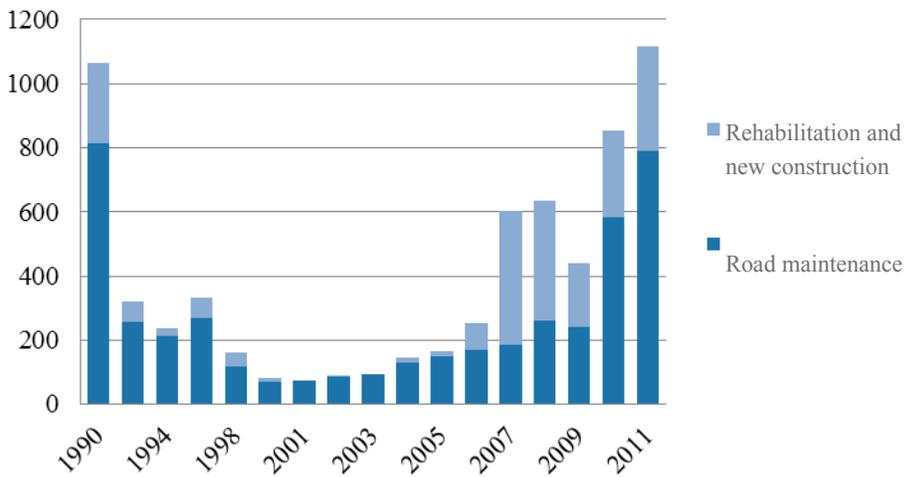


TABLE 2. LOGISTICS PERFORMANCE INDEX (LPI) FOR SOME COUNTRIES IN THE REGION

Country	LPI	Customs	Infrastructure	Transportation across borders	Logistics competency	Tracking of shipments	Costs
Ukraine	2.57	2.02	2.44	2.79	2.59	2.49	3.06
Croatia	2.77	2.62	2.36	2.97	2.53	2.82	3.22
Bulgaria	2.83	2.50	2.30	3.07	2.85	2.96	3.18
Romania	2.84	2.36	2.25	3.24	2.68	2.90	3.45
Albania	2.46	2.07	2.14	2.64	2.39	2.39	3.01
Moldova	2.57	2.11	2.05	2.83	2.17	3.00	3.17

FIGURE 7. STATISTICS OF ROAD ACCIDENTS FOR 1990-2010

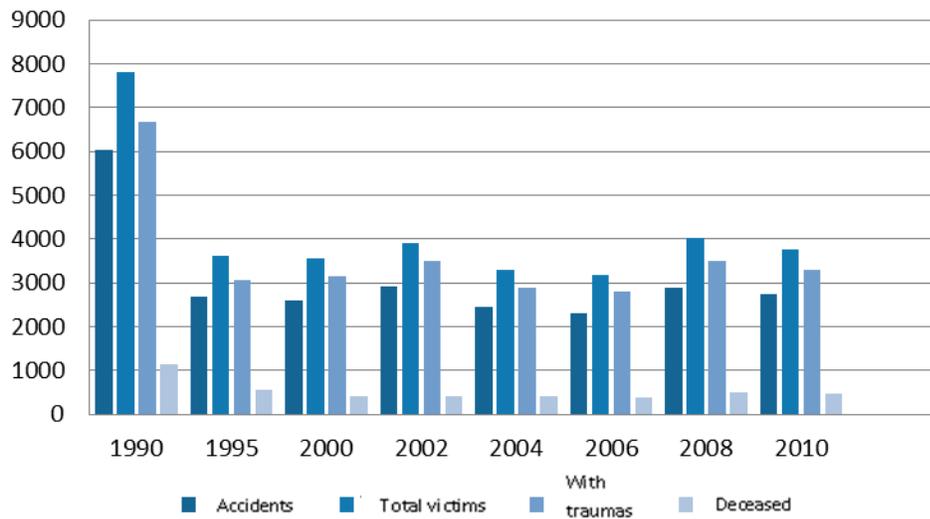


FIGURE 8. FORECAST OF EVOLUTION OF THE CONDITION OF NATIONAL ROADS DURING 2011-2020

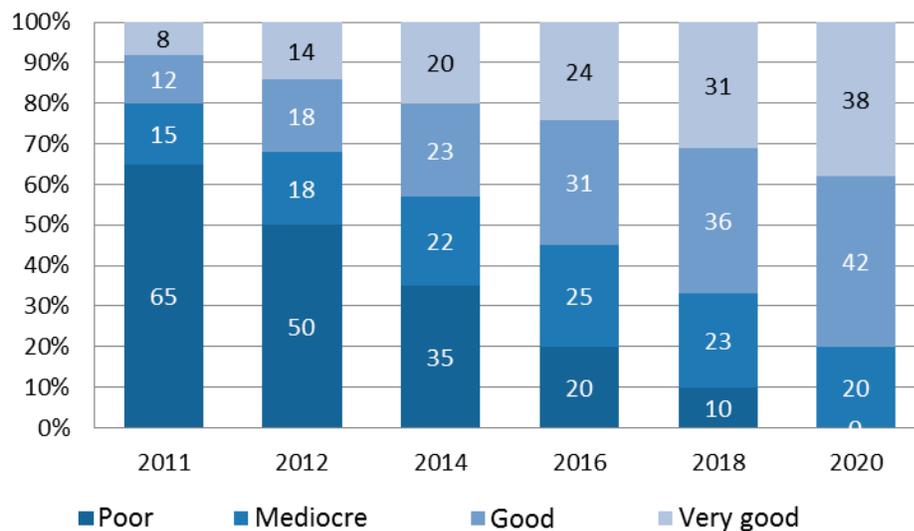


TABLE 3. ESTIMATES OF MEANS REQUIRED TO REPAIR AND MAINTAIN PUBLIC ROADS

Name of Works	Total Volume	Periodicity	Annual Volume	Estimated Cost, MDL thousand	
	km	years	km	la 1 km	total
a. National Roads					
Capital repairs (rehabilitation)					
<i>cement concrete coverage</i>	287	30	10	4800	45920
<i>asphalt concrete coverage</i>	2797	16	175	7500	1311094
<i>gravel coverage</i>	252	9	28	450	12600
Total	3336				1369614
Medium repairs (periodic maintenance)					
<i>asphalt concrete layer</i>	1150	6	192	2450	469583
<i>bituminous treatment</i>	1592	4	398	450	179100
<i>profiling with added material</i>	252	3	84	220	18480
Total	2994				667163
b. Local Roads					
Capital repairs (rehabilitation)					
<i>cement concrete coverage</i>	42	25	2	3600	6048
<i>asphalt concrete coverage</i>	2717	13	209	3500	731500
<i>gravel coverage</i>	3016	9	335	450	150800
Total	5775				888348
Medium repairs (periodic maintenance)					
<i>asphalt concrete layer</i>	1350	6	225	1450	326250
<i>bituminous treatment</i>	1367	5	273	350	95690
<i>profiling with added material</i>	3016	3	1005	220	221173
Total	5733				643113
c. Capital repairs of bridges	1131 units /24681 m	16	1554	34	52830
d. Routine maintenance of national and local roads	9344	continuously	9344	64,2	598016
ÎN TOTAL					4219084

FINANCE: AFFORDABLE AND CHEAP

The financial system in Republic of Moldova is largely dominated by the banking sector. This in turn proved to be sufficiently stable and held on relatively with no losses in the global financial crisis of 2008-2009. Economic recession has affected the credibility of economic agents, announcing the deterioration of the loan portfolio. Still, these were short-term effects, the situation getting back to normal with the economic recovery. Despite the stability of the banking sector, economic agents signal limited access to finance, and the level of financial intermediation is among the lowest in the region.

SITUATION ANALYSIS

The fundamental feature of the banking sector in Republic of Moldova is weak financial intermediation. The average GDP share of banking loans during 2004-2010 accounted for 31.5%, Republic of Moldova being surpassed by countries in Central and Eastern Europe, except only Albania and Georgia. Leaders in the region – Latvia, Slovenia and Estonia provide credits, the average GDP share of which varies between 80% and 115%⁵.

Although the situation is slightly better in terms of bank deposits as a share of GDP – the main source of lending, however the Republic of Moldova, characterized by an average GDP share of bank deposits of 32.9%, is ranked lower on this than countries such as Lithuania, Serbia, Romania, Belarus, and Georgia, remaining below the region's average. Lack of confidence in banks by population and companies is the main obstacle determining the relatively low rate of deposits as a share of GDP.

Hence, the main function of the banking system, namely concentration of citizens' savings and their channeling towards those who need additional liquidity, is performed deficiently.

Growth reserves for the lending volume to the real sector of economy, accompanied by a higher savings rate, are gains from Moldovans' work abroad. Empirical studies show that about half of the work gains are transferred to Republic of Moldova as remittances. Preference to place savings in foreign banks, also conditioned by the fact that the amount of guaranteed deposits in EU countries is considerably higher, does not lead to a full tapping of this potential. On the other hand, state policies targeting the channeling of remittance funds towards small businesses (PARE 1 +1) were not supported by sufficient financial means.

Another aspect relevant to the situation analysis in the banking/financial sector relates to the use of available resources and risk management efficiency. On the one hand, banks in Republic of Moldova have liquidity in excess of prudential norms prescribed by international good practices. Hence, the average share of liquid reserves in total banking assets was 27.3% during 2004-2009. In case of an efficient intermediation the liquidity excess would determine banks to intensify lending efforts, which would imply a reduction of the risk premium. In reality, economic agents in Republic of Moldova invoke limited access to finance, indicating high interest rates as one of the biggest problems encountered in their operation (14.2% of respondents to the questionnaire that laid the foundation for the 2010-11 Global Competitiveness Report indicated access to finance as the biggest obstacle to doing business⁶).

⁵ "Diagnostic of the Moldovan banking system in the context of signing the Deep and Comprehensive Free Trade Agreement with the EU", Expert-Grup, 2011.

⁶ "The Global Competitiveness Report 2010-2011", World Economic Forum, 2010

The same is confirmed by the risk premiums applied in Republic of Moldova, which are the highest in the region⁷. The fact that risk premiums in Republic of Moldova represented 8.6% during 2004-10 shows lack of confidence by commercial banks in potential debtors and determines their preference for liquid assets.

The confidence crisis could be partially overcome by improving the information on debtor credibility. A recent reform in this area aims at establishing in Republic of Moldova credit history bureaus that collect information on timely loan payments, which would allow commercial banks to adjust interest rates based on debtors' profiles. As a result of this reform's implementation, Republic of Moldova jumped considerably in the World Bank's *Doing Business 2012* ranking, from 96 to 40⁸. At the same time, some problems remain unsolved, i.e. rights over security if the debtor becomes insolvent.

The inefficient use of resources and inadequate risk management are conditioned by lack of a true competition in the banking segment of the financial market and, generally, lack of viable financing alternatives through the non-banking financial sector. At the end of 2011, the assets of the largest five banks in Republic of Moldova as a share of total banking sector assets accounted for 70.12%⁹. In 2011, although approximately 3/4 of banks' capital was represented by foreign investments, only four banks out of those 15 active banks in the Republic of Moldova were branches of Western banks. Another factor reducing the efficiency of resources utilization is the state's share in the banking capital of one of the largest five banks in Republic of Moldova.

Referring to the capital market, it is worth noting that the volume of securities traded during 2004-2010 as a share of GDP is among the lowest in the region – 1.28%, recording in the last years a downward trend. For purposes of comparison, the regional average during this period was 5.32%, while the European Union average was 92.4%.

STRATEGIC VISION

The strategic vision for increasing access to finance is based on the following pillars: (i) developing financial intermediation; (ii) streamlining the costs of financial resources; and (iii) streamlining the guarantee terms for credits and loans.

The objective of authorities for the year 2020 is to have a financial system channeling efficiently financial resources to households which produce savings to businesses that are looking for ways to finance their business ideas, creating a true competition in the banking market to attract funds from depositors. Selling of the state's share in the banking capital and entrance of new strategic investors in the market will boost the competition spirit and will optimize financing costs. It is also imperative to develop as many options as possible to place the savings of the population outside the banking system, which leads to the development of financial intermediation.

The reforms promoted in support of the business environment will be targeted towards the optimal utilization of remittances to stimulate economic development, which will maximize development advantages offered by migration. The confidence in the financial system of households, including migrant workers, will be subject to increased guaranteed amounts of deposits and effective monitoring of financial services. The issuance of long-term securities accessible to migrant workers (such as *Diaspora Bonds*) can be an efficient tool to use the

⁷ Risk premiums are expressed as the difference (in percentage points) between the interest rate on loans provided by banks and interest rate on state bonds. World Development Indicators, <http://data.worldbank.org/indicator/FR.INR.RISK>

⁸ Doing Business 2012, <http://doingbusiness.org/data/exploreconomies/moldova>

⁹ Financial indicators for the banking system of Republic of Moldova, <http://www.bnm.md>

remittance potential. Also, an important objective is to improve the financial tools that are already applied, together with their diversification, to the effect of supporting the re-equipment of industry and innovation (*business angels*).

Mobilization of new funding through existing models and new innovative investment schemes will generate changes in the consumption and production manner and will increase export product competitiveness.

Adapting to good European practices of the financial market regulation and supervision mechanism will increase its level of efficiency, will create favorable conditions to access capital on the local financial market, which will generate an increased entrepreneurial activity in the field and will boost the level of protection of consumer services offered on the financial market.

Current weaknesses in collateral management will be removed, and hedging instruments will be developed so that excessive liquidity in the financial system be targeted in an effective way to crediting the real sector of national economy. Developing risk management capabilities, including expanding information coverage through credit history bureaus, will lead to lower risk premiums.

EXPECTED IMPACT

Facilitating access to finance will lead to a significant increase in financing volumes through the banking and non-banking sectors as a percentage of GDP (up to 50% by 2020). Achieving the planned level of growth of economy financing is in itself an ambitious task, sensible to global economic and financial risks, as well as to local ones. But, being reached, such an increase will have a direct impact on gross domestic production and income by converting loans into new investment.

Assessing the impact that would have easier access to finance was based on the assumption that, out of each modest additional MDL provided to the real sector as a loan, at least 30 bani will be invested in productive capital. The supposed average maturity of loans is three years. Under such circumstances, additional investment will be reflected in an annual GDP growth of up to 0.5-0.7% higher compared to the scenario without the implementation of this priority. This beneficial effect appears gradually, but tends to accelerate rapidly, and will continue after the expiry of the forecasted term of this Strategy.

SPECIFIC OBJECTIVES

Monitoring indicator	2010	2015	2020
Increasing the GDP share of deposits, %	35.8	40	45
Increasing the GDP share of loans, %	37.2	45	50
Reducing the risk premium, percentage points	10.1	9	7
Increasing the volume of exchange transactions with securities as a share of GDP, %	0.4	2	5

TABLES AND FIGURES

FIGURE 9. RISK PREMIUMS IN COUNTRIES IN THE REGION, PERCENTAGE POINTS

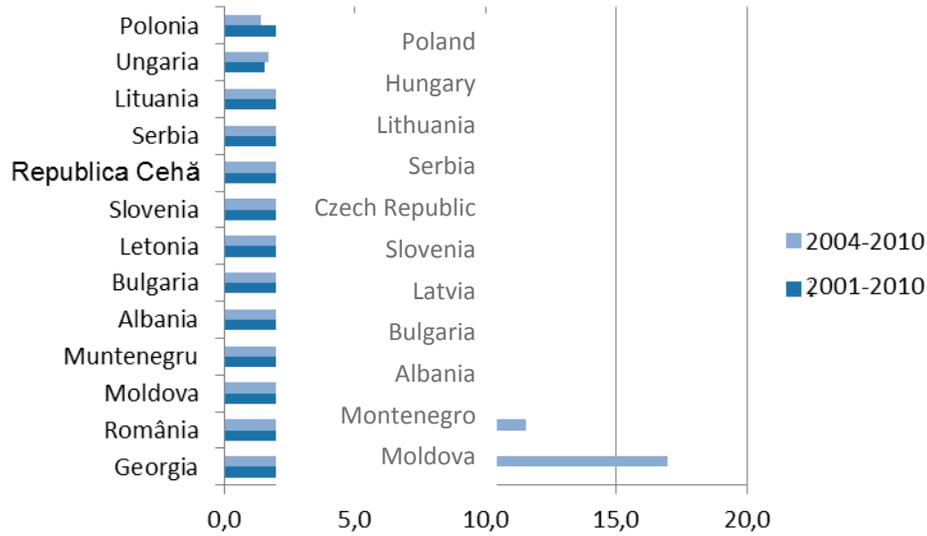
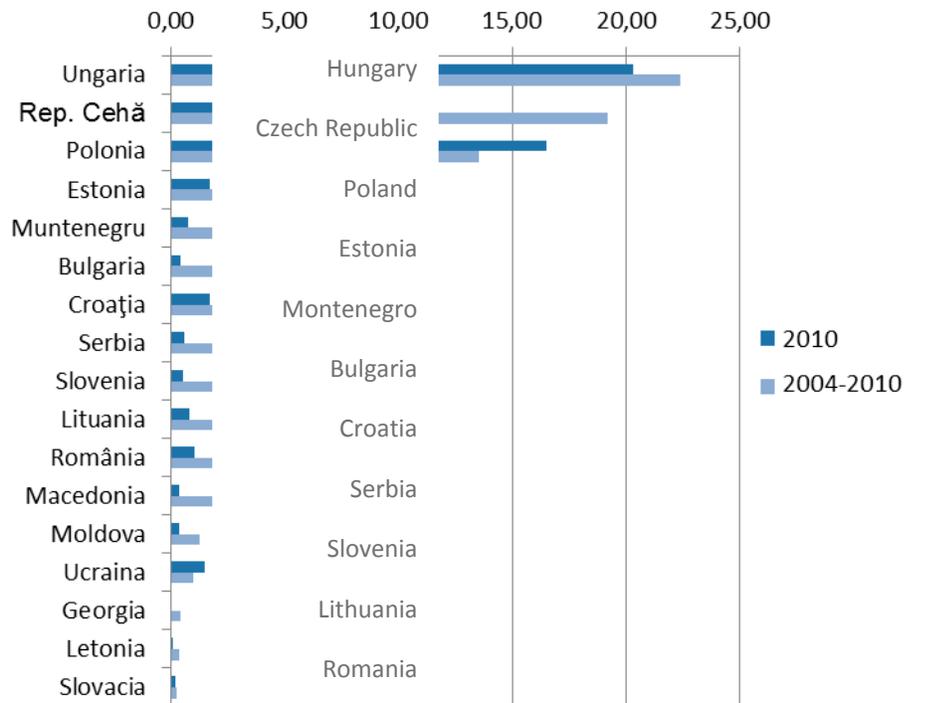


FIGURE 10. VOLUME OF STOCK TRANSACTIONS TO GDP, %



BUSINESS: WITH CLEAR RULES OF THE GAME

An efficient market economy is characterized by the capacity to promote innovation based on fair competition for resources and clients. Ultimately, the winners are consumers that benefit from goods and services purchased for a fair price and a quality commensurate with the price. A favorable business environment is attractive to foreign investment and creation of new enterprises.

SITUATION ANALYSIS

Foreign direct investment is mobilized by economic development prospects, as well as by a series of external and domestic factors. Externally, the global economic expansion favors investment from emerging countries, while domestically the implementation of privatization programs is able to generate a targeted interest of potential investors. In Republic of Moldova direct foreign investment has reached a maximum level of USD 713 million in 2008, having declined dramatically as a result of the world economic crisis. In 2010, the growth rates of foreign direct investment were recovered but not entirely (Figure 6). Creation of new enterprises is also influenced by the country's economic prospects, albeit clear rules of the game have a determining role in taking a business start-up decision. The number of enterprises increases annually in Republic of Moldova by over 2,000 (figure 12). This growth could be intensified provided there are regulations favorable to doing business.

The perception of investors and enterprises regarding business environment attractiveness in Republic of Moldova is guided by international rankings.

- Republic of Moldova's ranking in the **Doing Business 2012**¹⁰ survey of the World Bank was 81st out of 183 countries, being surpassed significantly by the majority of countries in the region and in the CIS.
- In the **Global Competitiveness Index 2011-2012**¹¹ Republic of Moldova ranked 93^d out of 142 countries, also being surpassed by the majority of countries in the region and in the CIS. According to the aggregate indicator "Institutions", which reflects the regulation framework under the Global Competitiveness Index, the Republic of Moldova ranks 106th. According to the same ranking, entrepreneurs highlighted the following factors as being key problems to businesses, in order of priority: (i) political instability; (ii) corruption; (iii) limited access to finance; (iv) inefficient public administration; and (v) Government instability.
- **Index of Economic Freedom 2011**¹² is an important reference indicator internationally, which evaluates the degree of state interference in economic activity based on 10 sub-indicators: business freedom, trade freedom, fiscal freedom, Government spending, monetary freedom, investment freedom, financial freedom, property rights, freedom from corruption and labor freedom. Republic of Moldova is ranked only 120th on this indicator out of 179 countries.
- Another indicator is the **Logistics Performance Index**, which shows the capacity of countries to ensure the goods movement and to interconnect producers with consumers and with international markets. Moldova ranked 104th out of 155 countries in 2010. On the same indicator, the Republic of Moldova is situated among the last in the rank: the 124th in customs administration and the 132nd in the area of logistics competency and performance.

¹⁰ „Doing Business Survey 2012”, World Bank, <http://doingbusiness.org/>

¹¹ „Global Competitiveness Index 2011-2012”, World Economic Forum, <http://www.weforum.org/reports>

¹² „Index of Economic Freedom 2011”, Heritage Foundation, <http://www.heritage.org/>

As a conclusion to the aforementioned, the business environment in Republic of Moldova is characterized by unjustified financial costs and time, which exceed essentially the levels in developed countries. Consequently, the country's rate of economic development is affected negatively and the investment and export potential for added-value production is not fully utilized. The excessive administrative burden creates barriers for starting, doing and closing businesses, being a de-motivating factor in promoting fair competition geared towards productivity and innovation.

Indicated problems are encountered at all stages of the business cycle: (i) starting a business; (ii) doing business, and (iii) closing a business.

STARTING A BUSINESS

Moldova ranks 88th out of 183 countries in the international ranking „*Doing Business*” 2012 on „*Starting a business*”.

The main problems at this stage of a company's business cycle are the large number of procedures and high costs associated with these. However, the „Starting a business” indicator described above covers only the procedures related to business registration. For many types of activities, before starting a business, companies must get a number of permits (trade operating permits, sanitary permits, veterinary permits, licenses, authorizations for anti-fire protection etc.), the issuance procedures often being burdensome, non-transparent and unclear, including time-consuming, costly and involving human resources.

DOING BUSINESS

At the stage of doing business, entrepreneurs encounter a number of mandatory conditions imposed for different types of activity and administrative barriers and costs related to:

- big number of state inspections;
- frequency and manner of submission of compulsory reports and information;
- tax payment manner and, respectively, time consumption ;
- getting a huge number of permits for constructions, installations, equipment, raw materials, products and services, including for imported and exported ones;
- burdensome and non-transparent formalities, procedures and rules in customs administration and in ensuring customs declaration for import and for export of goods and services;
- non-familiarization by importing countries with conformity evaluation results, conducted by national entities for exported goods.

An inventory of the list of permits, except those related to financial markets (banking and non-banking), licenses and documents issued by local authorities, conducted in 2011, revealed the existence of over 400 papers. Of these, only 272 papers were considered justified, which were included in the Nomenclature of permits issued by authorities to individuals and businesses for entrepreneurial practice¹³. Permits other than the ones included in the Nomenclature do not represent a legal norm. Also, it is important to mention that several public authorities are mandated with control functions, performing numerous inspection visits that bring significant costs and risks to the business environment. A combination of these with the requirements and procedures related to import-export operations, associated with high costs for goods' border crossing,

¹³ Approved by Law regarding regulation through authorization of entrepreneurial activity No.160 of July 22, 2011

affects primarily investments in export-oriented businesses, which are intense from technology and innovation perspectives, or which have the highest potential for growth.

Aside from conformity requirements and administrative barriers, a critical constraint to doing business is the low level of quality infrastructure development, specifically of conformity assessment capacity, which affects significantly the country's export potential.

Ensuring a sustainable export-based economic growth requires a reduction in the high costs associated with goods' border crossing, service delivery and mobility of persons related to these businesses. A better business infrastructure, an efficient customs administration, targeted to facilitate trade with goods and services represent priorities to ensure an economic development based on business cost optimization and export promotion.

CLOSING A BUSINESS

Moldova ranks 91st out of 183 countries in the international ranking „*Doing Business*” 2012 on “Closing a business”. Problems at this chapter are associated with the cost and with the length of insolvency procedures, as well as low asset recovery rate by creditors.

Generally, financial and time costs incurred by companies at different stages of the business cycle are comparatively higher than average costs in the reforming countries from the region, such as Georgia (Figure 13). The sequential implementation of the regulatory reform, the unequivocal interpretation of regulatory acts corroborated in conjunction with biased attitude towards entrepreneurs by public authorities and institutions mandated with state control functions have diminished to some extent the expected effects of reforms meant to improve the business environment.

Regulations that lead to an excessive increase in the administrative burden fall by their nature under the following two categories:

- **Unjustified regulations**, which generate administrative costs often exceeding public benefits. Such regulations are the result of low competencies of public bodies or institutional and personal interests. Interests relate to the preservation and expansion of institutional functions that allow greater influence and importance, and creation of favorable conditions for corruption and encouragement of economic groups, generating thus unfair competition in the economy and inhibiting innovational activities;
- **Ambiguous and contradictory regulations**, which can be interpreted and applied in a discretionary manner and, thus can lead consequently to the discretionary enforcement of regulatory provisions, to a reduced regulation predictability and transparency, to corruption and unfair competition.

Although a large number of regulations and of permits were reviewed and amended during the reform, it has not answered fully the expectations in this regard. Thus, compared to Georgia, which inherited from the Soviet period a similar regulatory framework, Republic of Moldova failed to utilize sufficiently the potential for reduction of administrative barriers (Table 4).

This situation reveals another major problem that lies in poor compliance by public authorities to the principles of good regulation prescribed by previous reforms, such as predictability and transparency in business activity regulation; material and procedural regulation through legislative acts; regulatory impact assessment; equity in relationships between state and businesses; tacit approval of starting and/or doing

business; one-stop shop, etc. This situation creates favorable grounds for corruption and regulatory discrimination.

STRATEGIC VISION

Republic of Moldova aims at improving the business environment so that by 2020 the risks and costs associated with each stage of the business life cycle are lower compared to countries in the region, this being governed by the principle of free competition. The impact of improved business environment will be expressed through increased investment and exports, higher number of reliable companies motivated to implement innovations, capable of creating quality jobs, ensure high productivity and competitive export-oriented production, which is supported by Republic of Moldova's advancement in the international rankings *Doing Business*, *Global Competitiveness*, *Economic Freedom* and *Logistics Performance*, exceeding the average in the region.

Optimization of procedures and timeframe required for an economic agent to start, do and close a business, by applying innovational approaches in business regulation, such as digitization of public service delivery, and changing the focus from inspections to counseling, with inspections being conducted based on the perceived risk principle, will improve significantly the business environment and will also reduce useless administrative costs and will ensure implicitly economic development. Aside from direct stimulation of businesses, investment and foreign trade, optimization by means of innovational approaches in public service delivery will create a foundation and substantial boost for innovations and for new jobs, including in the private sector.

The reform solutions for the regulatory system will be efficient and sustainable if supported by enforcement and implementation mechanisms. In this regard, work will be done on involving more actively the private sector in initiating, developing and revising regulations. Other important players in this process are the courts, which will have to answer promptly and correctly to citizens' and entrepreneurs' signals of violations of their rights by public institutions, particularly in relation to the timely issuance of permits, ensure a transparent system for the submission of complaints regarding all institutions involved in business regulation and foreign trade, non-involvement by public institutions in business activity, if there are no obvious reasons, and recovery of damage caused by these within a short period of time.

Competition is an essential factor in boosting the national economy, in improving the business environment and raising its attractiveness for both launching new businesses and their development. To ensure effective and fair competition, the Republic of Moldova intends to develop and implement a national program in the field of competition and state aid by undertaking the best European practices to prevent, suppress and limit the anticompetitive activities of economic agents and of public administration authorities.

Creation of new enterprises will be also encouraged through sharing of business success stories, through support to entrepreneurial spirit, among women in particular, whose share is currently only 27.5% among entrepreneurs. The existing mechanisms through which small and medium enterprises benefit from trainings, as well as financial and logistics support, will be expanded and diversified.

In addition, efforts will be concentrated to develop the quality infrastructure capacity meant to facilitate exports and encourage implementation of advanced technologies in local companies, including in agriculture, so that to ensure the consumption security. Also, the implementation of reforms in the health regulation and administration domain can optimally improve the productivity and efficiency in the Republic of Moldova.

The economic activity of companies has a direct environmental impact. At the same time, rigid regulations addressing environmental protection impose certain compliance costs for doing business. Although from the perspective of sustainable development such costs are justified, there is a risk that the business environment perceives them as excessive. In this regard, new regulations will address environmental impact assessment so as to distribute evenly the administrative burden on economic entities without distorting market mechanisms and without creating grounds for unfair competition.

Broadly, the quality of the business environment affects investment activity and economic development through administrative and compliance costs and through risks associated with the opacity of regulations and discretionary enforcement of sanctions. Promoting intelligent regulation and a horizontal approach and establishing interoperable standards in the field will create conditions to use all business development opportunities.

EXPECTED IMPACT

Eliminating regulatory constraints and unjustified costs would create grounds for a more dynamic, intelligent and sustainable economic development, encouraging investment in the productive sector of national economy, creating new products and broader access to foreign markets.

Direct effects from regulatory framework improvement will be a reinvestment of savings from the reduction in doing business and job creation costs. Savings from reduction of administrative costs can be estimated relatively easily and are smaller than the costs of compliance with regulatory provisions. Compared to these, savings from reduction of compliance costs cannot be estimated with sufficient precision but can be reckoned by increased trade volumes, including exports as a share of GDP, which have an impact directly proportional with economic development and poverty reduction.

Indirect effects would be enhanced investor confidence in the business environment in Republic of Moldova and, as a result, increased investment flows, including foreign. Since local investors' resources are limited, foreign investment could be a major factor in changing the country's development paradigm. Moreover, an improvement in the business environment, aside from the quantitative impact on investment, will also enhance their quality, with a particular bias towards businesses that are technology- and innovation-intensive. Since this effect depends on several factors, including the quality of business environment in Republic of Moldova compared to business environment from other countries, it is not possible its quantification.

SPECIFIC OBJECTIVES

Monitoring indicator	2015	2020
Starting a business		
Time required to start a business, hours	24	1
Reducing the cost of starting a business	by 50%	by 80%
Dealing with construction permits		
Time required to obtain construction permits, days	180	100
Reducing the costs of dealing with construction permits	by 20%	by 40%
Paying taxes		
Reducing the number of payments in paying taxes, fees and contributions	down to 35	down to 25
Time dedicated to paying taxes, hours	215	190
Trading across borders		
Reducing the number of documents required for export/import operations	down to 5	down to 4
Reducing the time required to obtain documents relevant for export/import operations, days	down to 25	down to 10
Reducing the costs of export/import operations (per container)	by 5%	by 10%
Logistics Performance Index (LPI) (customs operation)	2.33	2.55
Logistics Performance Index (LPI) (logistics competency)	2.30	2.50
Closing a business		
Increasing the investment recovery rate	by 50%	by 100%
Time required for business closing, years	2	1.5
Reducing the number of state inspections	by 20%	by 40%
Reducing the number of mandatory reports	by 10%	by 20%
Reducing the number of permits	by 20%	by 40%
Reducing the cost of dealing with permits	by 20%	by 40%
Digitalizing public services for the business environment (no. of services)	20	All

TABLES AND FIGURES

FIGURE 11. FOREIGN DIRECT INVESTMENT FLOW, USD MILLION

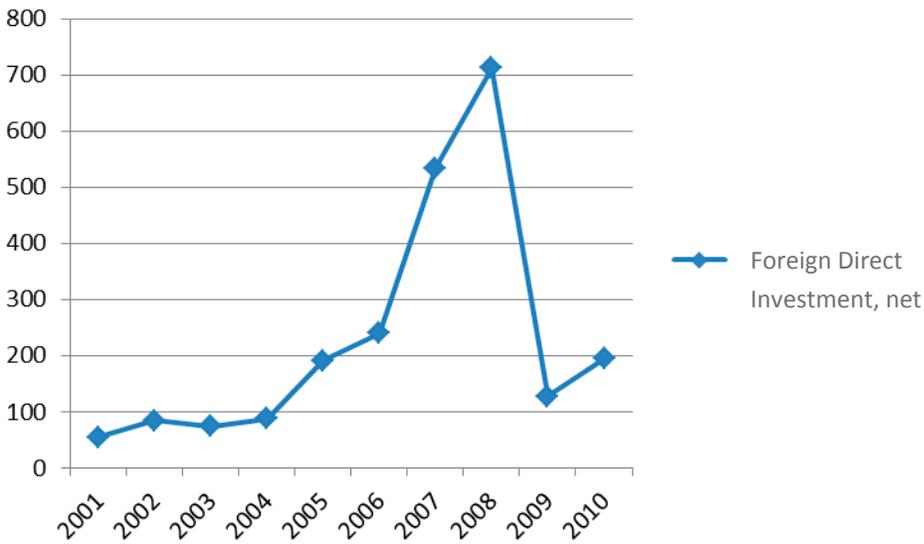


FIGURE 12. NUMBER OF ENTERPRISES IN REPUBLIC OF MOLDOVA

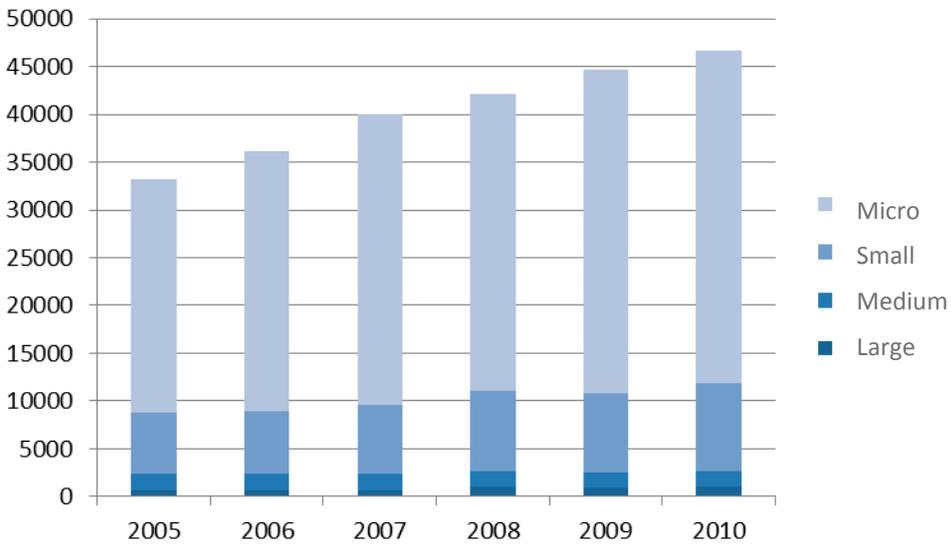
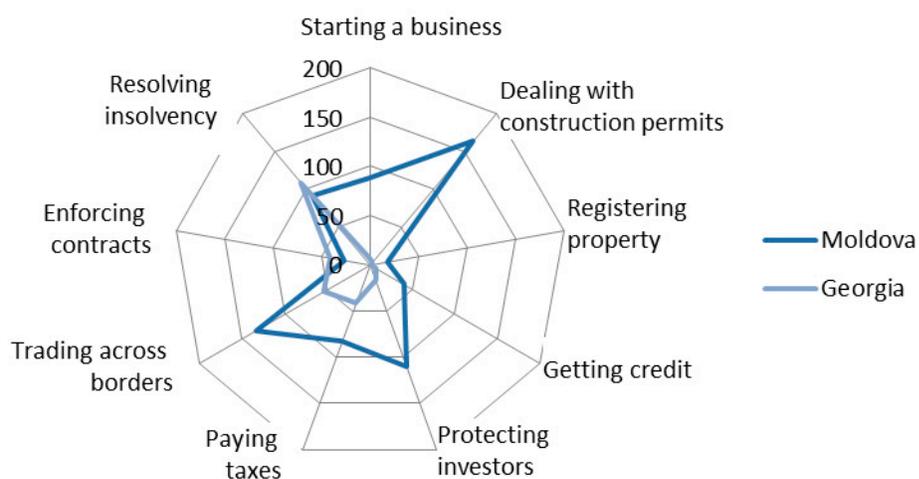


TABLE 4. REPUBLIC OF MOLDOVA VERSUS GEORGIA IN THE GENERAL *DOING BUSINESS 2012* RANKING

	Moldova	Georgia
Doing Business 2012 ranking	81	16
Starting a business	88	7
<i>Procedures, number</i>	7	2
<i>Time, days</i>	9	2
<i>Cost, % of GDP per capita</i>	9.1	4.3
<i>Minimum capital, % of GDP per capita</i>	9.9	0
Dealing with construction permits	164	4
<i>Procedures, number</i>	27	9
<i>Time, days</i>	291	74
<i>Cost, % of GDP per capita</i>	79.2	20.2
Getting electricity	160	89
<i>Procedures, number</i>	7	5
<i>Time, days</i>	140	97
<i>Cost, % of GDP per capita</i>	660.6	751.3
Registering property	18	1
<i>Procedures, number</i>	5	1
<i>Time, days</i>	5	2
<i>Cost, % of property value</i>	0.9	0.1
Getting credit	40	8
<i>Strength of legal rights, 0-10</i>	8	8
<i>Depth of credit information, 0-6</i>	4	6
<i>Public credit registry coverage, % of adult population</i>	0	0
<i>Private credit bureau coverage, % of adult population</i>	0.3	29.6
Protecting investors	111	17
<i>Extent of disclosure, 0-10</i>	7	9
<i>Extent of director liability, 0-10</i>	1	6
<i>Ease of shareholder suits, 0-10</i>	6	6
<i>Strength of investor protection, 0-10</i>	4.7	7
Paying taxes	83	42
<i>Payments, number per annum</i>	48	4
<i>Time, hours per annum</i>	228	387
<i>Total tax rate, % of profit before all taxes</i>	31.3	16.5
Cross borders trading	134	54
<i>Documents required to export, number</i>	6	4
<i>Time required to export, days</i>	32	10
<i>Cost required to export, USD per container</i>	1545	1595
<i>Documents required to import, number</i>	7	4
<i>Time required to import, days</i>	35	13
<i>Cost required to import, USD per container</i>	1740	1715
Enforcing contracts	26	41

<i>Procedures, number</i>	30	36
<i>Time, days</i>	352	285
<i>Cost, % of contract value</i>	28.6	29.9
Resolving insolvency	91	109
<i>Time, years</i>	2.8	3.3
<i>Cost, % of property value</i>	9	4
<i>Recovery rate, cents per dollar</i>	31.3	25.5

FIGURE 13. REPUBLIC OF MOLDOVA VERSUS GEORGIA IN THE *DOING BUSINESS 2012* RANKING



ENERGY: DELIVERED SAFELY, USED EFFICIENTLY

Energy efficiency and security have a direct impact on economic development and poverty reduction. At the moment, however, the energy system in Republic of Moldova faces a number of problems. Energy infrastructure is in a state of advanced usage, and prices of energy resources, which are 95% imported, are increasing. Power generation capacities are insufficient on the right bank of Nistru. Similarly, there are insufficient physical network interconnections with neighboring countries in the sectors of natural gas and of electricity. Losses in the electricity and heating sectors are high, as well as the debt to the natural gas supplier accumulated in the heating sector. Energy consumption is inefficient and the use of renewable energy resources is limited (table 5).

SITUATION ANALYSIS

Although a series of trends are common for all sectors, further are reflected the particularities of the situation in electricity, heating, natural gas and renewable energy resources sectors.

ELECTRICITY

The level of electricity production decreased by 15% in 2010 compared to 2001, the largest share of electricity production belonging to the Central Heating-and-Power Plant nr.2 (CHP-2) - 70-80%. Procurement of imported and of produced by the Moldovan Thermo-Electrical Power Plant electricity is declining. Thus, in 2010, this indicator fell by about 21% compared to 2009 and, respectively, by about 6% compared to 2001 (see Figure 14). This shows the dependence on energy imports and procurement from one supplier - the Moldovan Thermo-Electrical Power Plant, which affects our country's energy security.

Also, albeit losses recorded by electricity distribution grids in Republic of Moldova are declining, their level is higher level compared to developed countries (up to 10%), which affects negatively the energy efficiency of Republic of Moldova (figure 14).

HEATING

Production of heating is fluctuating (Figure 16). Thus, in 2010, production increased by about 9% compared to 2009, but fell by 12.8% compared to 2001. The largest share of heating is produced by the central heating-and-power plants – 60-65%. The reduction of thermal load is conditioned, inter alia, by massive consumer disconnections from the district heating system.

A serious problem of the heating sector in Republic of Moldova is the large historic debt accumulated by the JSC “Termocom” to the central heating-and-power plants (table 6).

Following an analysis of the JSC “Termocom” debts, one can see that the greatest debts are registered to the JSC “CHP-2”. The reviewed period recorded 2-fold increase of debts, and their average payment rate was 40-60%. It should be noted that the debts of the JSC “Termocom” to the JSC “CHP-1” are 3 times lower compared to the JSC “CHP-2”, which is due to the different capacities of the plants. This is caused by increasing population and economic agents’ arrears for heating and by non-adjustment of tariffs on time.

Another deficiency of the heating sector is the high level of heat losses, which accounted for 22% in 2010. This indicator registered in the period 2001-2010 a general growth trend of about 7.2 percentage points (Figure 17).

Buildings consume most of the energy (40%) and contribute most to greenhouse gas emissions. Buildings in the residential sector show the highest energy consumption (65% of all buildings). Reduced energy performance of existing buildings also has a strong social impact, affecting in particular the socially vulnerable population. The average share of spending for heating ranges from 15% up to 50% of the total spending of a household.

The experience of European countries and the local one gained as a result of implementing projects meant to increase the energy efficiency of existing buildings (building envelope renovation, upgrading heating systems, etc.) demonstrate that the potential for reducing energy consumption in existing buildings is about 30-50% and may even reach 70% in some cases.

NATURAL GAS

Republic of Moldova is dependent on natural gas imported from a single source. This dependence enhances the vulnerability of national economy to natural gas price increases.

Procurement of natural gas to Republic of Moldova is declining (table 7). Thus, in 2010, natural gas procurements decreased by approximately 16.3% compared to 2005. However, gas procurements in terms of value increased by approximately 2.7 times in the reviewed period due to higher average import prices for natural gas. Similarly, the volume of natural gas supplies fell as a natural expression, and in monetary terms these registered an upward trend because of increased average prices of gas delivered. Higher natural gas import prices have a negative impact on the economy and vulnerable categories of the population.

RENEWABLE ENERGY RESOURCES AND ENERGY EFFICIENCY

It is clear that ensuring energy efficiency and using of renewable energy sources in Republic of Moldova is a strategic priority in the absence of energy resources and growing dependence on imported energy resources.

Energy efficiency in Republic of Moldova is very low, about 3 times lower compared to European countries, which leads to a substantial increase in the costs of energy resources. The main constraints for energy efficiency growth in Republic of Moldova are: i) high energy consumption leading to increased energy intensity; ii) increasing energy prices, morally and physically outdated technology and equipment; and iii) lack of knowledge and skills in the area of energy efficiency and use of renewable energy resources (Table 8).

STRATEGIC VISION

The Government aims to create by 2020 a competitive and efficient energy sector that will provide consumers with quality energy resources, on affordable and reliable terms, will respond to the challenges of energy price increases, dependency on imports of energy resources, and energy sector impact on climate change. The strategic vision will be accomplished based on the principle of competitiveness and liberalized energy market.

The specific situation in the energy sector, with continuously growing consumer requirements for quality and energy security, meeting the mutual obligations „energy services provider – consumer”, have an overall significant impact on Republic of Moldova’s sustainable development, on viable supply of energy and fuel to the country and population, in adequate quantities and at reasonable prices. Hence, an active energy policy

and a well-developed and efficient legislative-regulatory framework will contribute to changing the paradigm of economic development.

The strategic vision for the development of the energy sector is based on the following pillars: (i) ensuring the country's energy security, and (ii) increasing energy efficiency.

Strengthening the country's energy security will be achieved through energy market liberalization in compliance with provisions of the Energy Community Treaty, through integration of the Republic of Moldova with the European energy market and development of energy resources' transport interconnections. Also, special emphasis will be placed on optimizing the energy mix, on diversifying energy resources and on creating new energy generation capacity.

Ensuring energy efficiency will materialize through: reduction of energy intensity in residential, industrial, transport and agriculture sectors; modernization of the energy system; implementation of efficient energy technologies; involvement of own energy resources, including renewable ones, in the consumption balance. Major importance will be given to raising public awareness regarding the need to save energy, including by encouraging the population to buy utility services, construction materials, housing, home appliances, and products with an impact on energy. Energy savings thus obtained will also have a favorable environmental impact.

Also, innovations in all aspects of hospital sector modernization regarding energetic assurance and raising energetic efficiency will be supported. The role and value of building low-cost technologies for medical facilities operation will be most appreciated. An emerging need will be to ensure low-cost biosafety and biorisk management, closely connected with the introduction of environmental friendly technologies within medical institutions, in accordance with modern European standards or with other modern standards.

Attracted investments are essential in order to develop and modernize the energy sector in line with the strategic vision. This implies: (i) creating and strengthening mechanisms to attract and use efficiently funding for energy projects; (ii) use rationally state investment and private investment in energy development projects; (iii) developing an information base and a database for energy project funding.

To the effect of accomplishing the proposed strategic directions, the Government will channel its efforts to: (i) strengthen sector reform, including by adopting new energy legislation harmonized with EU requirements; (ii) implement measures promoting energy efficiency; (iii) attract investment in the sector; (iv) strengthen institutional capacity in this area.

EXPECTED IMPACT

Development of the energy sector in line with the strategic vision will contribute to materializing the concept of sustainable development of national economy. Envisaged actions will boost the implementation of a new economic paradigm based on „investment-exports” relying on the country's industrial development process, will result in a reduced poverty level as a consequence of increasing population access to energy resources, as well as a reduction of dependency on imports of energy resources and strengthened energy security.

Increasing energy efficiency will have a direct influence on many sectors of national economy, especially those directly related to utilization of energy in production, as well as to consumption in households and public institutions. Currently, the intermediate production in the energy and transport sectors amounts over MDL 17 billion.

The planned gradual increase of energy efficiency by up to 10% would mean that more goods could be produced with the same amount of energy, or that the same domestic product could be obtained with less energy, which equals fewer costs. Annual savings by 2020 will account for approximately MDL 830 million in current prices.

These savings can be channeled towards new investment in different proportions, depending on the sector. A modest estimate suggests that, as a result of new investment, the annual GDP growth rate over medium and long term will be higher by at least 0.2% compared to the base case scenario, only on account of savings achieved.

SPECIFIC OBJECTIVES

Monitoring indicator	2015	2020
Energy Security		
Energy interconnections <i>electricity lines, km</i>		139
<i>natural gas pipelines, km</i>		40
Stimulating the use of energy produced from renewable energy sources in the total domestic consumption, %	10	20
Ensuring the share of bio-fuels in the total of fuels used, %	4	10
Increasing the domestic production capacity for electricity, MW		800
Ensuring the share of annual electricity production from renewable energy sources, %		10
Energy Efficiency		
Reducing energy intensity, %		10
Reducing electricity losses in transport and distribution networks, %	13	11
Reducing natural gas losses in transport and distribution networks, %	20	39
Reducing heating losses in transport and distribution networks, %	2	5
Reducing greenhouse gas emissions (compared to 1990), %		25
Reducing energy consumption in buildings, %		10
Share of renovated public buildings, %		10

TABLES AND FIGURES

FIGURE 14. DYNAMICS OF ELECTRICITY GENERATION AND PROCUREMENT IN REPUBLIC OF MOLDOVA (RIGHT BANK OF NISTRU), KW MILLION

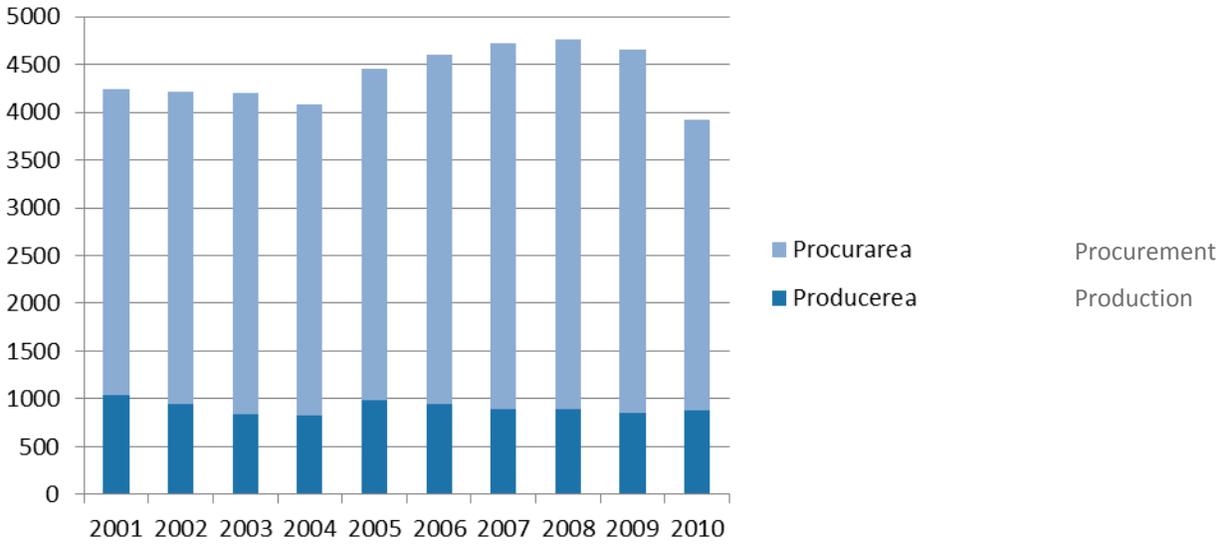


FIGURE 15. DYNAMICS OF LOSSES RECORDED BY ELECTRICITY DISTRIBUTORS IN REPUBLIC OF MOLDOVA

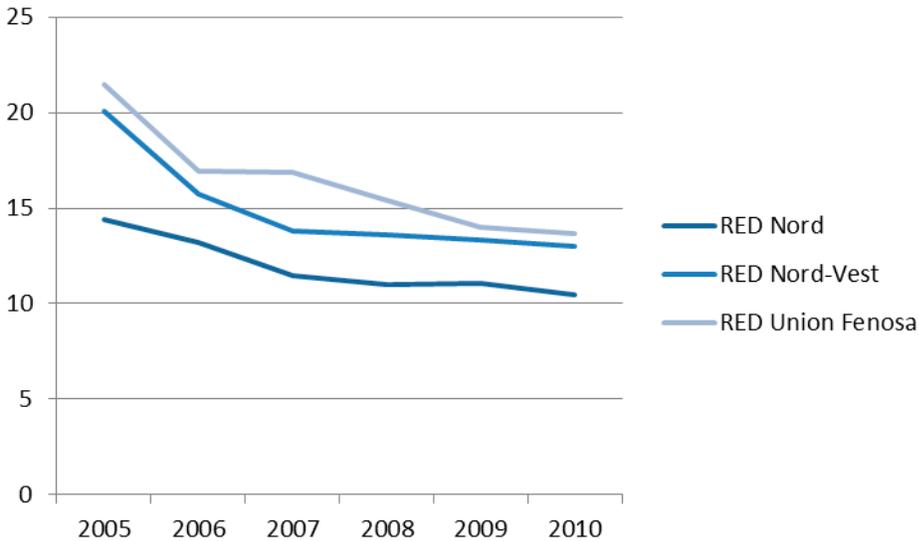


FIGURE 16. DYNAMICS OF HEATING PRODUCTION IN REPUBLIC OF MOLDOVA, GCAL THOUSAND

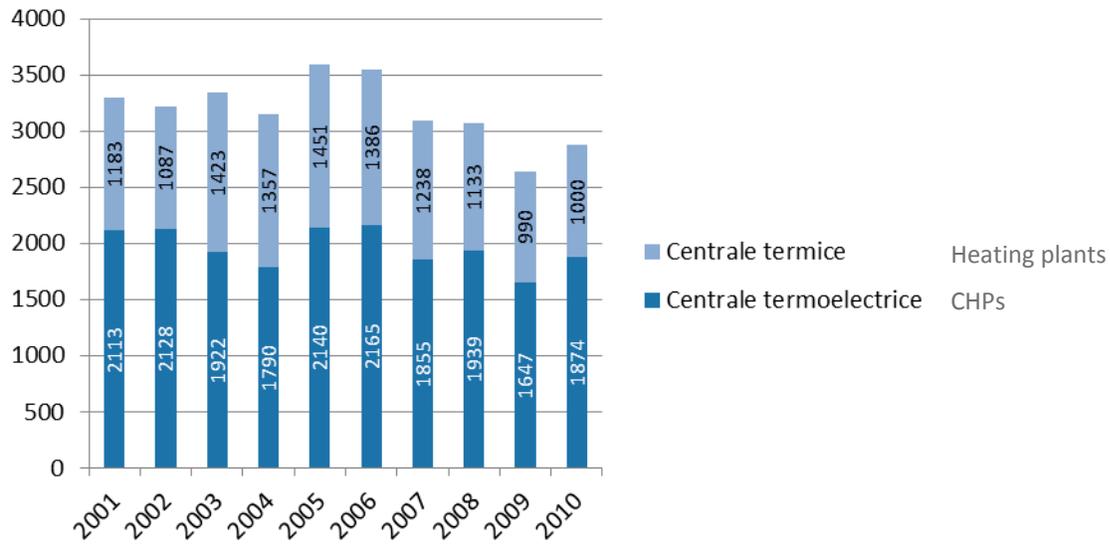


FIGURE 17. DYNAMICS OF HEATING LOSSES IN REPUBLIC OF MOLDOVA

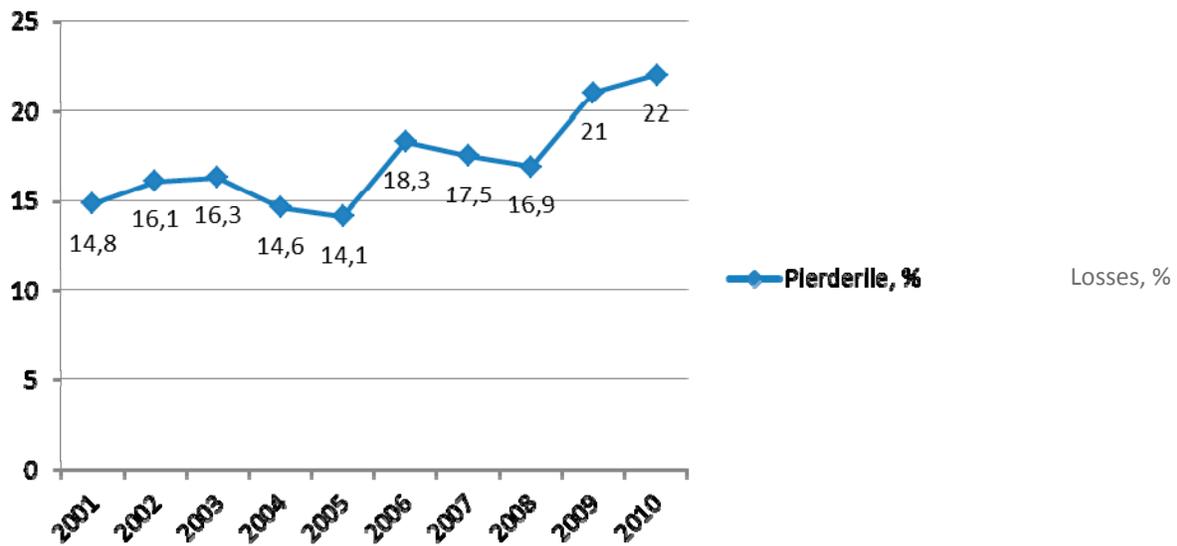


TABLE 5. INDICATORS ON ENERGY RESOURCE CONSUMPTION AND ENERGY INTENSITY

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Domestic consumption of energy resources, thousand tons coal equivalent (c.e.)	2479	2701	2826	3065	3257	3242	3090	3128	2960	3157
Electricity consumption - total, million kWh	2206	2449	2527	2634	2921	3215	3364	3428	3378	3488
Energy intensity of industrial production, tons e.c./MDL 1000	0.238	0.214	0.177	0.174	0.157	0.145	0.118	0.104	0.131	0.112
Electricity intensity of industrial production , kWh/MDL 1	0.325	0.300	0.290	0.249	0.202	0.182	0.154	0.135	0.175	0.146
Average annual energy consumption per capita, tons e.c./person	0.683	0.746	0.782	0.851	0.905	0.904	0.864	0.876	0.831	0.886
Average annual electricity consumption per capita , kWh/person	934	1044	1282	1216	1166	1136	1127	1137	1115	1152
GDP per 1 kg e.c. domestic consumption, MDL	7.69	8.35	9.77	10.45	11.56	13.80	17.29	20.12	20.42	22.76
GDP per 1 kWh electricity consumption, MDL	8.64	9.21	10.93	12.16	12.89	13.92	15.88	18.36	17.89	20.60
GDP energy intensity, tons e.c./1000 lei PIB	-	0.12	0.10	0.10	0.09	0.07	0.06	0.05	0.05	0.04

TABLE 6. DYNAMICS OF TERMOCOM JSC DEBTS

Compan	Debt frozen as per Plan Procedure, MDL million	Current debt, MDL million / % payments										Total
		2003	2004	2005	2006	2007	2008	2009	2010			
S.A. CET-1	MDL mil. 158.1 %	0 100	0 100	0 100	0 100	0 100	60 100	130 100	140 100	370 100	370 100	374 7
S.A. CET-2	MDL mil. 458.7 %	125 7	106 17.0	80 29.1	97 29.1	80 41	70 61	150 60	200 48	267 47.1	125 47.1	125 3.3

TABLE 7. DYNAMICS OF NATURAL GAS VOLUME PROCURED AND DELIVERED TO CONSUMERS IN REPUBLIC OF MOLDOVA

Indicator	2005	2006	2007	2008	2009	2010
Volume of natural gas procured, million m ³ /MDL million	1418.6	1418.2	1305.4	1226.9	1126.3	1187.8
	1364.9	2473.3	2727.3	3007.6	3288.1	3674.0
Average price of natural gas, USD/1000 m ³ / MDL/1000 m ³	76.1	133.4	172.9	232.3	263.9	250.1
	962	1744	2089	2451	2920	3093
Volume of delivered gas – total, million m ³ /MDL million	1315.0	1322.0	1208.8	1130.8	1030.0	1089.8
	1555.2	2440.5	3148.3	3603.4	3622.3	4362.4
Average price of delivered natural gas, MDL/1000 m ³	1183	1846	2604	3187	3517	4003

TABLE 8. AVAILABLE TECHNICAL POTENTIAL OF THE MAIN TYPES OF RENEWABLE ENERGY SOURCES (RES)

Type of RES	Technical potential	
	PJ	Million tons equivalent of petroleum
Solar	50.4	1.2
Wind	29.4	0.7
Hydro	12.1	0.3
Biomass	Agricultural waste	7.5
	Firewood	4.3
	Waste from wood processing, rape	4.7
	Biogas	2.9
	Bio-fuel	2.1
	Total biomass	21.5
Total RES potential	113.4	2.7
<i>Sources of energy with low heating, including geothermal, potential</i>		<i>> 80.0</i>
		<i>> 1.9</i>

PENSION SYSTEM: EQUITABLE AND SUSTAINABLE

Ensuring an equitable pension system based on a wage replacement rate that ensures a decent living for citizens is the main focus of this priority and the reason for having it in the vision of the authorities of Republic of Moldova in 2020. At the same time, the fiscal burden associated with the contributions to the state social insurance budget the gap between pension amounts for different categories of pensioners, influence of demographic trends – population migration and ageing – all of them have a sizeable impact on national economy and on its development rates.

SITUATION ANALYSIS

The public social insurance system is an integral part of the state social protection system, with the main objective of providing cash benefits to insured persons who are unable to obtain wage revenues due to certain risks (ageing, temporary or permanent lack of working capacity, maternity, unemployment, etc.) and is based on the collection of social insurance contributions from employers and from insured persons and distribution of benefits to beneficiaries.

The pension system in Republic of Moldova operates based on the pay-as-you-go scheme, which consumes 8.8% of GDP. In 2010, 69.6% of the working population was contributing to the social security system, and pensions were paid for 84.7% of citizens who have reached the retirement age, i.e. a total of 460,500 people, or 13% of the total population. Thus, the pension system has a significant role in ensuring a decent standard of living for the population. In 2011, expenditures for payment of pensions were 67.8% of the total social security budget.

The pension system currently faces the following challenges:

SMALL QUANTUM OF BENEFITS AND LOW REPLACEMENT RATE

The quantum of the average pension for retirement age was only 70.6% of the subsistence minimum for pensioners in 2010. Over 92% of the total retirement-age pensioners received pension amounts lower than the subsistence minimum for pensioners. The replacement rate or, in other words, the ratio between the average retirement-age pension and average salary recorded in the economy, is only 28.2%, while the European Code of Social Security establishes its recommended value at 40%. Moreover, a modeling of the local pension system over long term shows that, under current conditions of the system, the replacement rate will decline further to 23% in 2020, down to a low level of 14% around late 2040. Under these circumstances, the pressure on state to increase pensions grows dramatically, which will lead to a destabilization of the pension system. A reduction in the replacement rate is caused by two factors: (i) pension indexation method and (ii) non-updating (non-indexation) of income insured in the past to determine the initial pension.

The pension indexation coefficient is the average of annual growth of the consumer price index and annual growth of the average wage for the previous year. CPI growth usually records lower growth rates than the average wage, which leads to a reduction of the replacement rate. This method of indexation is in line with international practices, while the non-indexation of income insured in the past is a practice without precedent.

The amount of pensions in the local pension system is calculated differently for periods before and after 1999. The pension part for the period of activity until 1999 is calculated so that nominal wages are updated together

with wage growth until the year preceding the year of retirement. The pension part after 1999 is calculated based on the average insured income without updates, based on wage/price evolution in this period. Non-indexation of insured income reduces replacement rates, resulting in major differences between pensioners. The unbalanced pension formula in itself creates differences between pensioners whose pension amount was calculated "on old manner" and those whose amount was calculated "on new manner".

SMALL NUMBER OF CONTRIBUTORS AND REDUCTION OF THE RATIO BETWEEN THE NUMBER OF CONTRIBUTORS AND PENSIONERS

The coverage of the pension system and the number of insured persons is decreasing. The number of active population fell during 2011-2010 from 1.6167 million to 1.2354 million, and the number of employed persons from 1,499,000 thousand to 1,143,400. Thus, the number of taxpayers in the public social insurance system has fallen to about 860,000 in 2010. This is mainly due to population emigration. According to statistics, 311,000 people work outside Republic of Moldova. In this context, we could mention the informal employment phenomenon. According to estimates, in the second quarter of 2011 the number of informally employed people was 406,900 persons.

On the other hand, the number of pensioners of all categories has remained relatively stable, falling by about 4.1% compared to 2001, accounting 627,100 persons on January 1, 2011. Thus, the ratio between active population and pensioners of all categories is 2:1, and the ratio between working population and pensioners is 1.8:1. It should be noted in this context that it is necessary to maintain the ratio between number of contributors and number of pensioners at around 4:1 - 5:1 for the stable operation of the pay-as-you-go pension systems.

POPULATION AGEING

Further development of the public pension system will worsen due to demographic trends. The ratio of population aged over 60 years to the total population was 14.4% in 2010 compared to 13.6% in 2000. Among the persons 60 years of age and beyond women prevail, with a share of 16.8% of the total population, the share of men being 11.8%. The ageing process is more pronounced in rural areas, where the share of the elderly over 60 years is 15.2% of the total population compared to 13.2% in urban areas. According to international practice, a population is considered "ageing" when the ratio of elderly exceeds 12%.

According to the pessimistic scenarios of demographic projections, the number of population could shrink by up to one million inhabitants by 2050. Simultaneously with declining birth rates, working-age population (15-59 years) will decrease steadily and population ageing will aggravate. Thus, by 2050, the share of working-age population will decrease, depending on the scenario, by about 11 to 16 percentage points from current indicators, from 69.2% down to 57.9%.

However, it is not the decrease in the number of population that is the most worrying development, it's the developments associated with the continuous decline of the age structure, largely due to the process of population ageing. Compared to 2001, the share of young population in 2010 was lower (corresponding to 0-15 years of age), from 24.8% to 17.8% of the total population, and the share of population over 57/62 years of age from 14.4% to 15.5% of the total number of population.

The share of people over the current retirement age will increase from 15.2% to 31.5% in 2050. The increase in the share of elderly population will create an increasing pressure on social insurance systems.

DIFFERENT RETIREMENT AGE

The current pension system sets the retirement age at 57 years for women and 62 years for men. The minimum insurance period, i.e. the mandatory payment of social insurance contributions, is at least 15 years for a partial pension or at least 30 years for women and 30.5 years for men for a full pension. According to current legislation, the total number of work history required for an old-age pension will be extended to 35 years by 2020.

Compared to other countries in Central and Eastern Europe, the retirement age in Republic of Moldova is at the lower limit for men and below the minimum limit for women. On the other hand, life expectancy in Republic of Moldova is also lower compared to those countries. However, most countries in Central and Eastern Europe plan to increase the retirement age in the next ten years, specifically by equalizing the retirement age for women and men. Life expectancy is higher for women than men in all countries of Central and Eastern Europe, including Moldova.

Because of this reason, as well as fact that the retirement age in the Republic of Moldova for women is lower than for men, we find significant differences in the national retirement system between the number of women and of men benefitting from pensions and between the size of their pensions. Thus, in 2010, the average number of years worked registered for retirement pay was 32.5 years for women and 37.5 for men, and the average old-age pension for women was MDL 797.1 and MDL 937.8 for men because the size of the pension depends directly on the number of years worked and the level of state social insurance contributions.

LOW LEVEL OF INSURED INCOME OF CONTRIBUTORS

The size of the pension depends directly on the incomes of active and working population through paid social insurance contributions. According to the National Social Insurance House, the average monthly insured salary of people employed through individual contracts was about MDL 2,133 in 2010. Another Moldovan reality is provision of salaries under the table. Thus, reported wages of insured persons being small, low level of pensions is a direct consequence of this fact.

At the same time, there are some discrepancies in relation to salaries by gender (in 2010, the average salary of women was 76% of men's salary). In the end, existing salary discrepancies contribute to a conservation of the low level of pension savings, which influences further directly their quantum, which affects the welfare of women and of men.

FINANCIAL NON-SUSTAINABILITY OF THE PENSION SYSTEM

The social insurance system has been facing a budget deficit since 2005, which has increased gradually from MDL 1.74 million to MDL 87.33 million in 2007. After a period of three years, 2008 the state social insurance budget reports showed a surplus of MDL 47.7 million. However, the situation changed in 2009 and 2010, when the state social insurance budget recorded again a budget deficit of MDL 25.55 million and MDL 213.3 million respectively. The deficit in previous years was covered from the balance of funds on National Social Insurance House bank accounts. In 2009, the budget deficit was covered from means in the reserve fund of the state social insurance budget and partially from state budget means. Starting in 2010, the budget deficit is covered from the state budget. Long-term modeling indicates that, if current conditions remain, the system will register a deficit in the next ten years and a surplus in the long run. The pension fund surplus in the long run is caused only by the considerable reduction of the replacement rate.

UNFAIR REDISTRIBUTION OF FUNDS

Moldovan legislation stipulates privileged pension terms for certain categories of citizens: judges, prosecutors, civil servants, MPs, members of government, locally elected officials, and customs employees. The difference between these terms and general conditions for old-age pensions consists in lower retirement age and lower required number of years worked. The stated objective of such privileges is for the state to reward the special merits of these categories. But in the transition process to a market economy these principles lose their relevance. The average pension for these categories, in the case of Government members, about 8 times higher than the average old-age pension set under general terms, but in the case of civil servants - 2.3 times higher.

In order to respect the basic principles of the public social insurance system, currently first steps are being undertaken to unify the pension system, which seek to ensure that all contributors to the social insurance system benefit from the right to receive an old-age pension based on general conditions. The total number of privileged pension beneficiaries was 7,311 persons in 2010 or approximately 1.1% of the total number of pension beneficiaries. The pension expenditure for these categories reached MDL 116.49 million or 2% of total expenditure for payment of pensions in 2010.

However, out of the total number of beneficiaries of social insurance and state pensions, only about 152,400 are employed in the national economy. Current legislation does not provide for a re-calculation of pensions for people who continue to work. So, although they continue to pay social insurance contributions, this does not influence the amount of their pension in any way, the means being used to cover other social risks, such as benefits for temporary loss of working capacity.

LOW ATTRACTIVENESS OF THE PENSION SYSTEM

The social insurance system faces a credibility problem of population, mainly due to the low level of pensions and insufficient information provided to the population on the retirement system. As a result, people continue to avoid paying contributions based on their real wages, which further jeopardizes the proper operation of the pension system.

UNDERDEVELOPED OPTIONAL PRIVATE PENSION FUNDS AND NON-EXISTENCE OF MANDATORY PRIVATE PENSION FUNDS

The social insurance system is the only way to protect an individual in case of social insurance risks, including for age limit. In 1999, Moldova adopted the legislative framework on non-state pension funds, which represents the 3rd pillar of a multi-pillar pension system or optional pension systems according to the World Bank's classification. However, the private pension system in Republic of Moldova is virtually non-existent – two private pension funds are registered, but they do not have any significant activity. The factors behind this stagnation are, on the one hand, lack of interest shown by the population (low level of incomes that do not allow to allocate a part of wages to these private funds) and, on the other hand, insufficient incentives for employers and for individuals contributing to these funds. In addition, the legal framework required for the operation of mandatory private pension funds, or second pillar, is non-existent so far.

SOCIAL SECURITY GUARANTEES FOR MIGRANT WORKERS

Given the increase in labor mobility between countries and the migration of working-age population, the optimization of social insurance systems has become an important component of the social policy promoted by the state. The negative effects of migration are long-term and usually are felt either when migrant workers and their families who worked a period abroad are returning back or are displaced in other states, in both cases these persons having no social insurance entitlements. Under these conditions, migrant workers and their family members are often disadvantaged economically and socially in comparison with the citizens of that country, being deprived of the right to social security, including right to pension. Hence, the migration processes have led to the urgent need to conclude bilateral social insurance agreements with the main host countries for migrant workers.

STRATEGIC VISION

A fair and sustainable pension system, ensuring a decent living after retirement to all categories of population, men and women alike, is indispensable for social cohesion. The current inadequate level of pensions in Republic of Moldova and its further downward trend generate an alarming growth of pressure for ad hoc pension increases, threatening the viability of the pension system and, implicitly, even the economic development potential in the "without reforms" scenario.. The funding of any pension increases from outside the pension system reduces the chances of success of other reforms, including those of other development priorities. Thus, the pension reform will primarily minimize the risk of these adverse effects.

The reform of the current pension system implies:

- A. Modernization of the existing pay-as-you-go pension system (pillar 1) by:
 - adjusting the pension system to principles of organization and operation of the public social insurance system and existing international standards;
 - improving the financial sustainability of the system by increasing and unifying conditions regarding the contribution period and retirement age, and accumulating financial means in the reserve fund of the state social insurance budget;
 - ensuring a closer link between paid state social insurance contributions and amount of pension set for insured persons;
 - undertaking complex measures to develop the labor market, increasing labor remuneration and improving the demographic situation.
- B. Reviewing timeliness for cumulative pension system implementation (pillar 2), within which social insurance contributions are invested instead of being spent immediately for payment of benefits to current pensioners. An opportunity study will be developed by the end of 2015.

At the same time, the introduction of a cumulative pension system implies preparation measures, including for the modernization of the existing pay-as-you-go pension system (pillar 1) and development of the financial market.

EXPECTED IMPACT

The reform of the pension system will contribute to a reduction in poverty rate. Although poverty rate evolution is influenced by a multitude of factors, we can say that a more rapid growth of the pension quantum due to pension system reform will reduce the absolute poverty rate of pensioners in a higher proportion than under current conditions of the pension system. Hence, the net impact of the reform estimates that by 2020

the share of pensioners below the absolute poverty line will decrease by 2 p.p. over the scenario "without reforms".

At the same time, a sustainable and attractive pension system will have positive repercussions on the national economy, reducing the extent of unwanted phenomena, such as salaries paid under the table, shadow economy, etc.

SPECIFIC OBJECTIVES

Monitoring indicator	2010	2015	2020
Minimum level of rate of replacement of salaries with pensions, %			25
Increasing the ratio between average retirement pension and subsistence minimum for pensioners, %	70.6	75	85
Reducing the absolute poverty rate of pensioners, %	28.1	26	23
Reducing the ratio between the number of retired pensioners with pensions under the subsistence minimum for pensioners and the total number of retired pensioners, %	92	89	84
Reducing the state social insurance budget deficit, % (compared to an average of 1% during 2006-2010)		0.5	0
Increasing the number of states that have concluded social security agreements with Republic of Moldova	4	8	12

JUSTICE: RESPONSIBLE AND INCORRUPTIBLE

Demand for justice is a priority for the country's economic and social development. An eloquent indicator that qualifies as alarming the situation in this sector is the increasing trend in citizens' lack of trust in justice. According to the Public Opinion Barometer, 2/3 of citizens do not trust the justice system and their number is increasing. This has serious spillovers for the business environment, affecting implicitly economic development prospects and country citizens, whose rights must be ultimately safeguarded by the judiciary. Protection of human rights and fighting against corruption are global commitments that are in the permanent focus of authorities. Also, considering that the accomplishment of these commitments depends on a well-functioning justice system, this Strategy is focused on the reform of the court system.

SITUATION ANALYSIS

The perception of population regarding the performance of the judiciary is not a favorable one. According to the International Survey of Enterprises, carried out by the International Finance Corporation, only 31.9% of economic agents from Republic of Moldova consider that courts are reasonable, impartial and incorrupt, as compared to 38.9% of economic agents from Eastern Europe.¹⁴ The same source specifies that about 70% of economic agents from Republic of Moldova do not believe that courts would protect their property rights, and this affects negatively their intentions to invest.

In the same vein, the satisfaction level with court services related to the organization of court trials reveals the following assessment: the courts got 3.91 points, courts of appeal – 3.76, and the Supreme Court of Justice – 3.62 out of maximum 5 points¹⁵. Normally, the superior bodies should be more efficient in order to serve as an example for the lower-level bodies, situation which is not registered at the moment in the Republic of Moldova.

From a statistical point of view, things do not look better. The productivity and efficiency of courts is falling: the number of remaining cases by the end of the year is increasing by 20% for criminal cases, by 50% for civil cases and by 150% for economic cases, while the total number of cases entering the system is decreasing (2009 versus 2007). In the same context, the number of judges increased from 380 in 2007 to 420 in 2009, but their monthly load decreased, accordingly, from 66.6 down to 58.6. The case settlement rate - an international efficiency indicator used to measure courts' performance, is also decreasing. The majority of unsolved cases is in economic courts (it actually doubled from 2,000 in 2007 to 5,200 in 2009), thus implying greater attention to changing the economic jurisdiction under the planned reform.

This situation has following causes:

PROCEDURES AND OPERATIONAL EFFICIENCY

The delays and postponements of court procedures became a rule in courts, registering an upward trend during 2006-2008. Thus, 61% of monitored court trials were postponed by courts in Chisinau and 85% in the Southern-Eastern region of Republic of Moldova¹⁶. The postponed court trials imply damage for the economic

¹⁴ <http://www.enterprisesurveys.org/documents/EnterpriseSurveys/Reports/Moldova-2009.pdf>

¹⁵ Decision of the Superior Council of Magistrates regarding the results of the survey on satisfaction level of the court services' beneficiaries, no. 271/12 dated September 17, 2009. Survey funded by USAID.

¹⁶ Report on OSCE Program on monitoring judiciary processes in the Republic of Moldova, 2009.

agents and country economy, expressed in lost gross national revenue due to absence from work of about MDL 390 million annually (Table 9).

Only 60% of courts use audio-video recording technologies for court trials (although all courts have been equipped with such devices) and about 25% publish court decisions on their web pages. Hence, a study conducted, in June 2011, by the USAID Good Governance Program found that 30 courts (of the total number of 52 courts) do not post entirely court decisions and lists of court trials – which is important information for the public.

Different court decisions continue to be issued for similar cases, thus disturbing business environment security and generating unequal opportunities. Economic agents consider the lack of judicial security and predictability, as well as that of public policies, a critical constraint to development.

The issue of judicial unpredictability will get exacerbated along the advancement of the EU legislation absorption process – commitment assumed in the context of European integration, as shown by the experiences of other countries that have recently joined the EU. The principles of market economy inspired by the EU law, substance of the free exchange and internal market of the EU are not familiar to the professionals in the area, thus affecting de facto implementation of the EU legislation.

The impact of judicial remedies' duration and lack of uniformity for national jurisprudence are reflected in the number of cases with systematic property rights' breach solved by the European Court of Human Rights. Hence, during 1995-2010, 40% of the total number of breaches found by the European Court of Human Rights refers to property rights in Republic of Moldova.

INTEGRITY OF THE JUDICIARY SYSTEM

Disciplinary procedures in the judicial system are rather formal and with no visible impact on its performance. During 2001-2008, a number of 44 disciplinary sanctions were applied to judges. In 2010, disciplinary sanctions were applied to 10 judges. Although a certain functioning of the disciplinary system may be attested, the number of sanctions is immeasurable in relation to breaches reported by the national and international reports in the area.¹⁷ A similar situation is perceived in relation to ethics and discipline among all legal professions.

Corruption erodes the rule of law and affects the state's reputation and trust. Over 20 thousand persons confessed that they bribed judges in 2009; every judge has requested or accepted on average about 4 bribes per month¹⁸. Approximately 40% of population states that it is very likely for a person to solve a problem by bribing the judge.

A comparative analysis with other countries in the region, based on the relative number of people that were asked for a bribe, ranked in 2008 the Republic of Moldova among the countries with populations most vulnerable to corruption¹⁹ (Figure 1). The corruptible nature of the judicial system is implicitly confirmed by the Justice Independency Indicator determined by Freedom House at 4.5 (1 being the highest independency level, 7- being the lowest one). In the same context, almost 30% of practitioners attest to know situations when decisions were taken based on attempts of direct and deliberate influence²⁰. At the same time, it is also

¹⁷ E.g., reports of the OSCE Mission in the Republic of Moldova. Trial Monitoring Reports, 2006, 2007 and Final Report 2009.

¹⁸ Analytical Report on Victimization. Soros Foundation Moldova, 2010

¹⁹ "Human Development Report", PNUD, 2010

²⁰ "Judiciary Integrity and Resistance to Corruption", Transparency International, 2010.

alarming that 69% of judges consider that their legal status does not ensure their independence, and 47% of judges perceive performance indicators to be useful in ensuring the system's independence.

One in five persons in Republic of Moldova admits that he/she was asked to offer a bribe. 23% said they offered bribes in social activity areas: health, police, customs, education, local public administration, and private sector. The role of justice in fighting corruption is illustrated by the share of cases solved in court out of the total number of persons under accusation²¹ (Figure 19).

Corruption affects severely the vulnerable segments. Being harshly influenced by the economic crisis, people with small incomes are most dependent on public services and least able to pay additional costs related to bribes and frauds. Affecting property rights, corruption leaves investors without any compensation for assumed risks and increases the uncertainty regarding potential dividends. Thus, their motivation to invest reduces, being reflected in the country's economic development.

PROTECTION OF HUMAN RIGHTS IN CRIMINAL COURT AND PROTECTION OF VULNERABLE POPULATION

Observance of human rights, especially in criminal justice, remains to be an aspiration. Detention conditions (re-socialization system, subculture, lack of jobs when getting out of penitentiaries) generates an increasing number of relapses (60% in 2010), exposing communities to insecurity and tax payers to triple costs, in cases when the claims regarding detention conditions go to the European Court of Human Rights. At the same time, according to experts' opinion²², the justice system services for vulnerable persons (children, elderly, minorities, victims) needs systemic interventions.

The manner of collecting specific data on vulnerable groups and informing the decision making process, promptness of reaction of authorities, including the judiciary, specialization of interventions for vulnerable persons through specific training, restorative role of justice – all these remain to be just recommendations. The situation attested in the justice sector explains the extremely low reporting rate from women-victims and, as a consequence, the small number of investigated cases, when one in three women is subjected to domestic violence, and Moldovan women are more susceptible than men to become victims of offences.

STRATEGIC VISION

Justice to serve the citizen – this vision is shared by all actors in the area and represents the qualitative change needed for the reform approach in the justice sector. As a result of reforms to be implemented in the sector, justice seekers will benefit from impartial, qualitative, accountable and timely justice, with zero tolerance to corruption, for the country's sustainable development, and the justice system will offer efficient remedies for an inclusive economic development, for social justice and human security.

In the context of these priorities, the vision of authorities for 2020 is in line with the specific objectives reflected in the Justice Sector Reform Strategy for 2011-2016:

- strengthening the independence, accountability, impartiality, efficiency, and transparency of the court system;
- increasing the efficiency of the pre-judicial investigation process to the effect of guaranteeing the observance of human rights, ensuring the security of each person, and reducing the level of crime;

²¹ Evaluation Report, GRECO, 2010

²² Victimization Study, Soros Foundation, 2010

- improving the institutional framework and processes that ensure an effective access to justice: effective legal counseling, examination of cases and execution of judicial decisions within a reasonable timeframe, modernization of the statute of some legal professions related to the justice system;
- promoting and implementing the principle of zero tolerance for corruption phenomena in justice;
- implementing certain measures, whereby the justice sector would contribute to creating a favorable environment for sustainable economic development;
- ensuring the effective observance of human rights in legal practices and policies;
- coordinating, establishing and delimitating responsibilities and tasks of main actors in the justice sector, as well as ensuring cross-sectoral dialogue.

The plenary implementation of justice sector reform is crucial with a view to implementing the vision of authorities. The broader horizon provided for by present Strategy assumes that the effects of this reform's implementation will be felt by the entire society.

EXPECTED IMPACT

It is difficult to quantify the manner in which more efficient justice may influence economic development, because it is composed of multiple individual benefits, which complement each other and contribute to a generalized perception about justice, which may favor or may disfavor investment. When referring only to a reduction in corruption, very modest estimates for 2011 assess the volume of bribes paid from the enterprises' revenues to be about MDL 390 million. The lower level of corruption would result in investing a part of this money for productive purposes, thus generating an annual GDP growth by at least 0.1%. Aside from the purely numerical effect on domestic investment, the country's attractiveness will increase for foreign investment and associated new technologies, thus inducing important collateral effects.

The reduced number of postponed court trials will have similar effects on the costs incurred by citizens and by business environment, as well as indirectly on the investment climate and country's attractiveness.

SPECIFIC OBJECTIVES

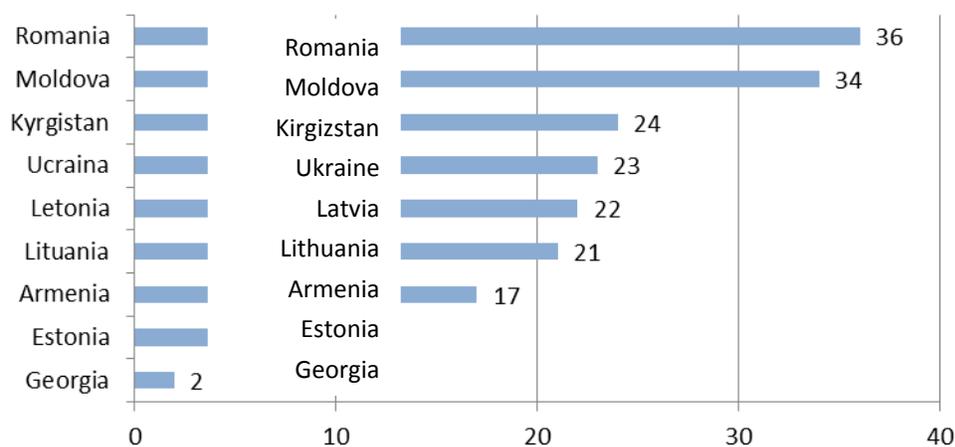
Monitoring indicators	2010	2015	2020
Share of citizens that show lack of trust in justice, %	67	60	40
Improved justice independence index Freedom House	4.5	4	3
Share of judicial cases examined with delays, %	60	30	10
Share of courts that observe norms and decisional transparency (publish court decisions and have audio-video records of court sessions), %	60	100	100
Share of litigations solved via alternative ways (extra-judicial)	0	10	25
Number of corruption victims, %	20	15	10
Share of economic agents which believe that courts are reasonable, impartial and non-corrupt, %	31.9	40	60

TABLES AND FIGURES

TABLE 9. ESTIMATED ECONOMIC IMPACT OF DELAYS AND POSTPONEMENTS IN COURTS

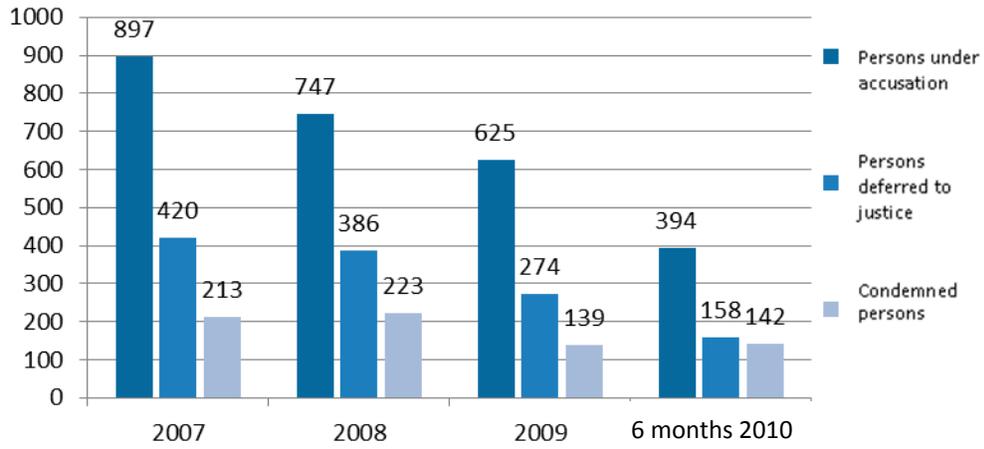
Statistical Indicator		Economic calculations	
Number of delays per year in the system ²³	576,213		
Average number of people participating in a session	7	Average monthly salary in the economy per working hour, MDL	20
Time spent by a participant during the day when the case was postponed, hours	4	Total "lost" economic effect by a participant per day, MDL	95
Average monthly salary in the economy (2010), lei	3,500	Total economic effect per delayed session, MDL	668
Average transport expenses of a participant (2010), MDL	15	Total losses in the system without intervention, MDL	385,036,338

FIGURE 18. VICTIMS OF CORRUPTION, % POPULATION IN BRIBE SITUATIONS, 2008



²³ Estimates were made based on the rate of postponed sessions, identified by the OSCE report "Monitoring of court sessions", 2009, which concluded that 61% of 7037 monitored court sessions in Chişinău were postponed. Estimates include all courts and appeal courts and the total number of cases examined by these in 2009.

FIGURE 19. SHARE OF CASES SOLVED IN COURT OF THE TOTAL NUMBER OF PERSONS UNDER ACCUSATION

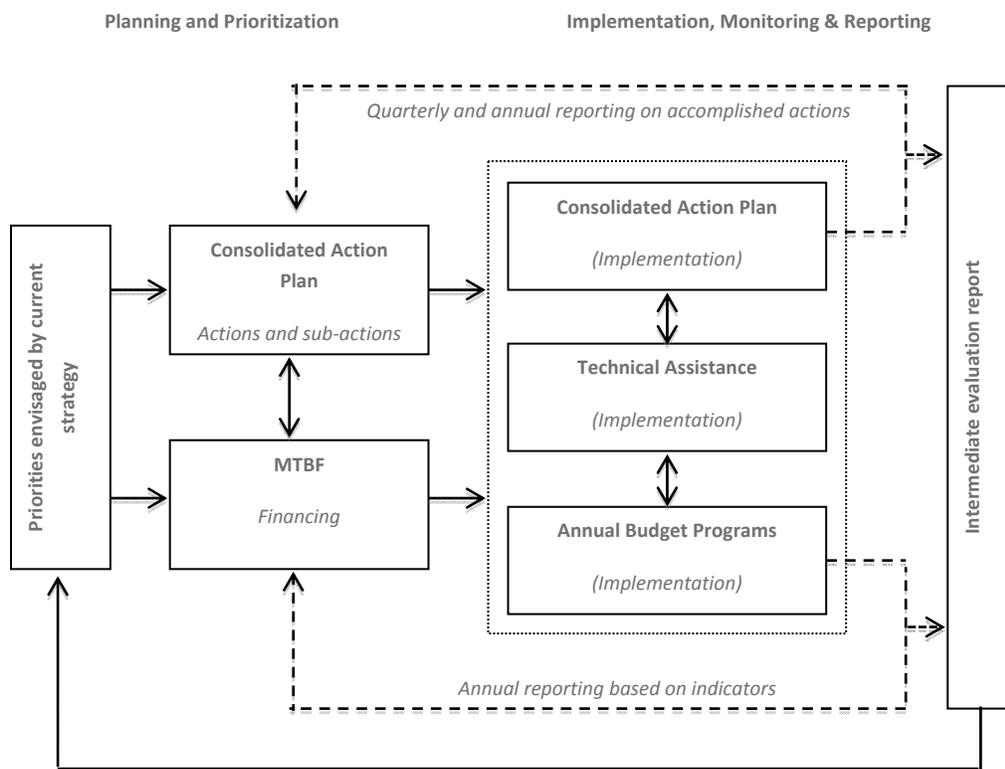


COORDINATION OF IMPLEMENTATION, MONITORING AND EVALUATION

This strategy will lay the foundation for Republic of Moldova’s long-term development and will ensure a platform for the management and coordination of reforms in seven priority areas that, alongside the Government’s strategic documents and donor initiatives, cover the activity of all ministries and autonomous administrative authorities. Strategy coordination, monitoring and evaluation, as well as stakeholder functions are described below.

INTEGRATED CYCLE OF PLANNING, MONITORING AND EVALUATION

Republic of Moldova passes through a dynamic development process, during which development priorities are defined, with necessary actions planned for their implementation. Further, after accomplishment of established actions, the evaluation process of established tasks will be undertaken. Although the document envisages a period of nine years, starting in 2012 until 2020, the planning, allocation of resources, monitoring and reporting on accomplished actions will be performed annually. The scheme below describes this cycle:



Thus, according to the scheme above, the management system of the National Development Strategy „Moldova 2020” will have the following main features:

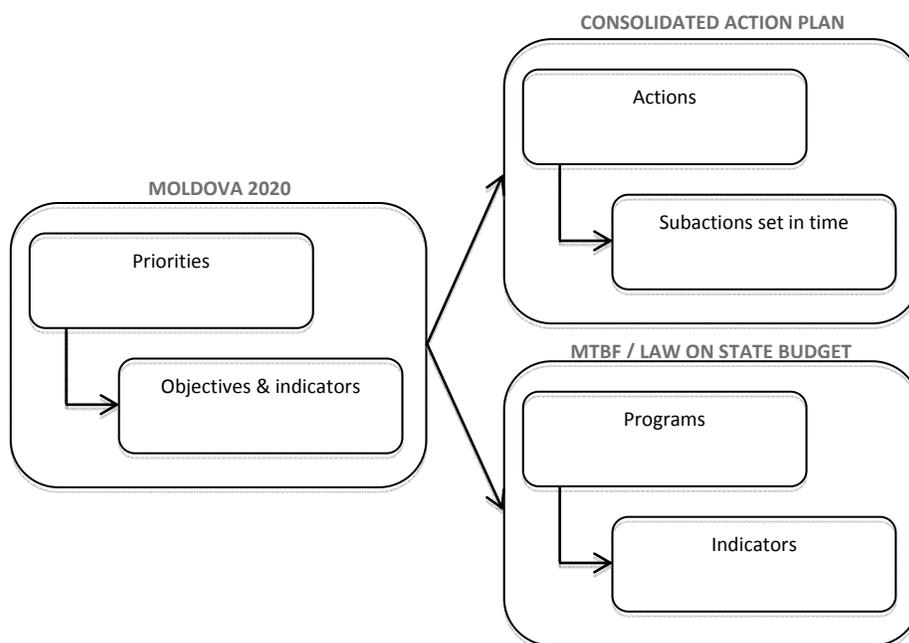
- The Strategy will be implemented through an update of the existing Consolidated Action Plan, which includes in itself actions from the Government’s Activity Program and other national and strategic planning documents. Consolidated Action Plan is a single framework for planning, monitoring and

reporting for all central public administration institutions. Similarly, reporting on implementation of actions from the National Development Strategy „Moldova 2020” will be conducted based on the Consolidated Action Plan. To this effect, the State Chancellery has already implemented an online monitoring system of the Consolidated Action Plan;

- The annual planning and reporting cycle will not only allow a permanent monitoring of Strategy implementation progress, but also the correction, when the case, of planned measures and activities. This is important because the Strategy is a long-term one, when changes can occur in the domestic and foreign environment, thus requiring some adjustments, but also in the context of implementing current and future European integration commitments, which have a direct link to Strategy priorities;
- The implementation of many actions in the strategy will be impossible without amending the structure and level of funding. The Medium Term Budgetary Framework (MTBF) will be the framework through which Strategy actions requiring financing will be prioritized and financed. The general establishment of priorities in the Medium Term Budgetary Framework, development of sectoral expenditure plans and program-based budget planning – all these will have to take into account the priorities envisaged by the National Development Strategy „Moldova 2020”. These documents will be progress assessment tools, since the main Strategy indicators will be reflected in program-based budgets and in sectoral expenditure plans. It will be the responsibility of the Ministry of Finance in collaboration with the State Chancellery to ensure this synchronization;
- In order to know the Strategy implementation progress and to determine the necessity to adjust some established actions, the State Chancellery will conduct a mid-term evaluation of Strategy implementation. Depending on circumstances and on progress achieved, such an evaluation could be holistic, to include for example all seven priorities, or thematic – cover certain priorities or aspects. Such an approach is in line with the monitoring and evaluation mechanism of the „Europe 2020” Strategy.

OPERATIONALIZATION PROCESS

The ministerial subdivisions for analysis, monitoring and evaluation of public policies will have an important role in the Strategy's operationalization, ensuring that actions for its implementation are integrated in the annual strategic planning cycle. The results of activities were taken into account during the development, at the beginning of 2012, of the Medium Term Budgetary Framework for 2013-2015. This process will be repeated annually and will offer to all stakeholders the possibility to express their views at any time of the implementation process. This approach is reflected in the diagram below:



As in the case of all actions from Consolidated Action Plan, activities identified for the implementation of this Strategy will be specific, set in time, with an indication of public administration institutions responsible for their implementation.

In the context of the Medium Term Budgetary Framework for 2013-2015, both the State Chancellery and the Ministry of Finance will introduce a mechanism for comment analysis and formulation to the effect of ensuring the conformity of ministerial proposals for sectoral expenditure plans and program-based budgets with priorities revised in the Strategy and actions specified in the Consolidated Action Plan. An important aspect is to ensure the harmonization of indicators in the National Development Strategy „Moldova 2020”, sectoral expenditure plans and program-based budgets.

INTERRELATED ASPECTS

Special attention will be paid during the operationalization and implementation process to interrelated aspects, namely gender, human rights, social inclusion, environmental dimensions, etc. In this sense, the mechanisms will be applied at three levels:

- In the process of action formulation for the implementation of Strategy priorities the ministries will be instructed to use already existing techniques and methodologies with a view to ensuring that interrelated aspects and proposed measures and actions are reflected. If necessary, consultations with different support groups will be encouraged;

- The State Chancellery will facilitate the active use of the methodology for ex-ante evaluation of public policy impact in the formulation of actions for Strategy implementation. This methodology includes already the most relevant interrelated aspects. At the same time, public policy proposals developed with ex-ante methodology are useful instruments for the dialogue with the civil society;
- Actions included for Strategy implementation will be directed not only at the primary removal of the barriers that suppress investment activity, but also to ensuring that these measures do not adversely affect many areas of public policy – health care, environmental protection, employment, social protection etc., but, on the contrary, to help maximize performance in these areas;
- Upon submission of annual reports on implementation and in the intermediate evaluation process in particular, the State Chancellery will ensure the integration of interrelated aspects in reports.

IMPLEMENTATION REPORTS

Consultations regarding implementation at Government, at Parliament, at donor community, and at civil society levels will cross the entire Strategy implementation process as a red line. Monitoring and evaluation reports developed in the process will not only highlight the successful outcomes but will also identify challenges and obstacles, suggesting corrective actions.

Hence, the reporting framework will not be static. The framework of indicators and measurement techniques will evolve depending on how the analysis of each of those seven priorities will evolve. These modifications will be considered regularly and will be integrated in the general monitoring and reporting framework.

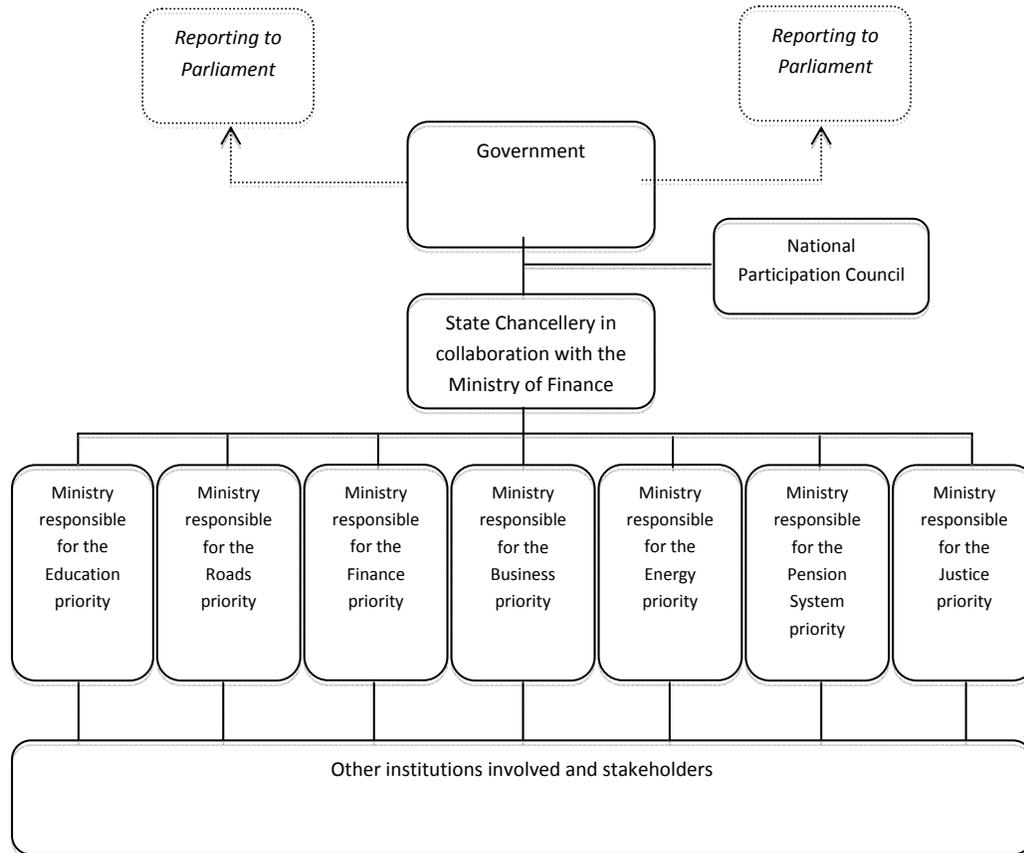
Strategy implementation will be accompanied by the development of reports specified below:

- **Quarterly progress reports** – based on an online Consolidated Action Plan monitoring system managed by the State Chancellery. The ministries will submit quarterly information regarding progress in implementation of Consolidated Action Plan actions. Performance criteria for action accomplishment will be used to observe progress, such as: *initiated, under implementation, completed, completed with delays*, etc. Comparisons between ministries and priorities will also be possible. If necessary, the State Chancellery will develop narrative reports with presentations of main accomplishments and obstacles;
- **Annual implementation report** – results of permanent (quarterly) monitoring will be presented in the annual report on Strategy implementation. Compared to quarterly reports that will reflect statistical data, the annual report will have an analytic nature. It will serve as a base in planning the next Consolidated Action Plan cycle and modeling the next Medium Term Budgetary Framework cycle. The reports will also include comments regarding indicators of each of the seven priorities envisaged in the Strategy;
- **Thematic evaluation reports** – developed on a needs basis. Very often unexpected challenges emerge, also caused by a constantly changing operating environment of the Government. Given the above, the State Chancellery will conduct thematic evaluations during implementation. The concrete aspects to be evaluated and time of evaluation will be identified during Strategy implementation;
- **Intermediate implementation report** – upon completion of the first stage of Strategy implementation, after 2015, the State Chancellery will develop an intermediate evaluation report, which will include the results and impact of implementation, as well as an adjustment of final objectives based on progress made;

- **Final implementation report** – upon completion of Strategy implementation, the State Chancellery will develop a final report on implementation results and impact. It will reflect the main accomplishments, as well as issues and future needs. If necessary, the State Chancellery will use the results of external evaluations in preparing the final report.

INSTITUTIONAL FRAMEWORK

The following stakeholders will be involved in Strategy implementation:



Government will have a supervision role in the Strategy implementation process, will review the progress made on its implementation, will guide the State Chancellery and line ministries, and will approve reports before submitting them to the Parliament and stakeholders. The Government will ensure a maximum reflection of Strategy priorities in the future financing framework.

State Chancellery is the main institution responsible for Strategy coordination, monitoring and evaluation. It will ensure the translation of priorities envisaged in the Strategy in the Consolidated Action Plan, regular submission by all line ministries and other institutions of information for the online monitoring system, and timely submission of progress reports to Parliament, Government, Strategic Planning Committee and National Participation Council, as well as to external stakeholders.

Ministries responsible for priorities will ensure coordination and reporting in their areas of competency. Ministries will ensure the coordination of actions for accomplishment of priorities envisaged in the Consolidated Action Plan and their comprehensive nature, as well as presentation of financing needs in sectoral expenditure plans and in annual budgets of public authorities. Ministries will ensure that information

regarding implementation progress and needs for assistance is presented to donor sector coordination groups.

Parliament will review the Strategy implementation evaluation reports. The purpose of this reporting is to inform the legislative power of the progress made and existing issues. A permanent interaction between Government and Parliament is essential, particularly in the budget process.

National Participation Council is an important platform in Strategy implementation, formed out of civil society representatives. It will also be consulted at the implementation stage through a review of monitoring and evaluation reports and through formulation of recommendations. Special importance will be attributed to the opinions and contributions of organizations working in interrelated areas, such as gender equality, human rights, environment protection and other.