

ANTI-CRISIS MEASURES AND POLICY IMPLICATION FOR MOLDOVA

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A*bstract:* The article presents how the Moldovan economy evolved in the post crisis period and how the major policy incentives were implemented. An assessment of the major problems of Moldova after the crisis is undertaken. The authors emphasize the importance of elimination of fiscal burden, administrative burden and access to finance. At the end the authors investigate and propose anti-crisis policy recommendations and solutions for the identified problems.

Keywords: anti-crisis measures, administrative and fiscal burden, economic activity

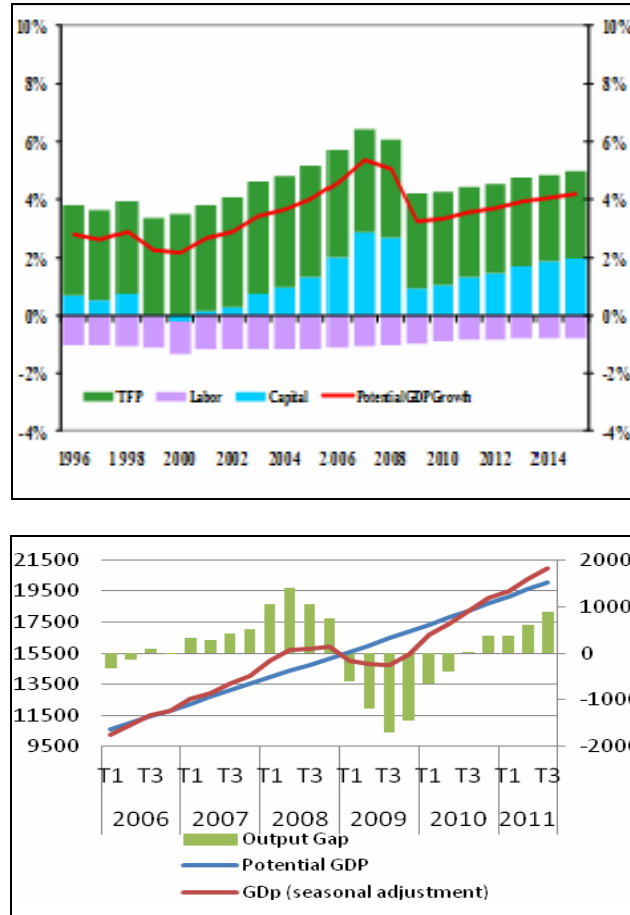
JEL Classification: H00, E60, E61

General overview

The crisis had a negative effect on the potential GDP, and a significant decrease in the capital contribution to the economic growth was attested. At the same time, the contribution of labor to the economic growth increased, but remained negative; the most important contribution is that of the Productivity of Production Factors. In the last year, 2011, the real GDP exceeded the potential GDP, which means a certain overheating of the national economy.

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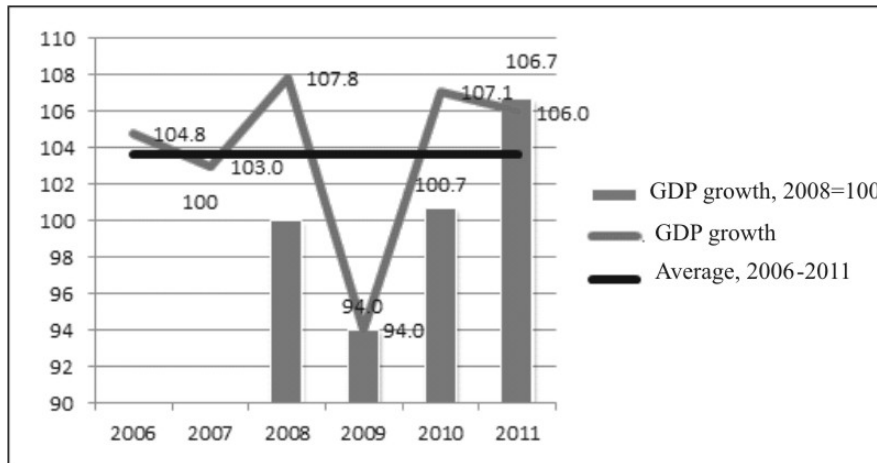
Figure 1. Contribution to GDP growth and potential GDP



Source: World Bank and Moldovan Economic Trends.

The compared analysis of the 2006-2011 period reveals an increase in the economic activity and a re-launch of the national economy after the 2009 crisis for most economic indicators. The economy of the country increased at higher rates, in 2011 being a leader in the region in this respect.

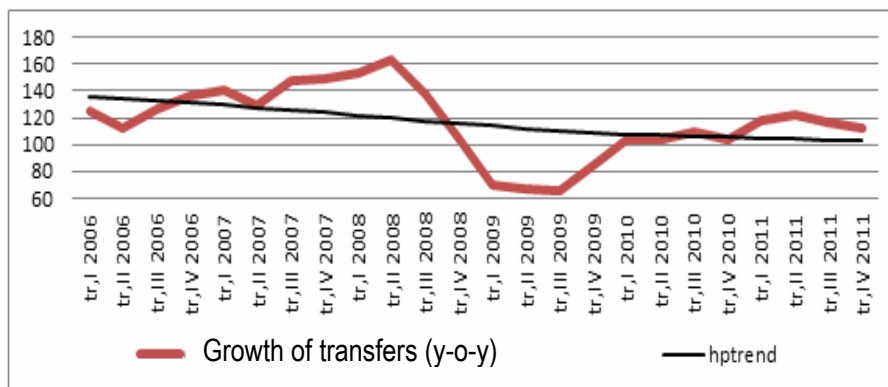
Figure 2. GDP growth in Moldova



Source: According to National Bureau of Statistics.

The current model, although allowing the country to develop and not involving increased efforts to maintain it, represents a long-term challenge. Both the remittance increase rates and the economic growth¹ are slowing down.

Figure 3. Evolution of transfers from abroad to Moldova



Source: According to National Bureau of Statistics.

¹ Trends in the Moldovan Economy, number 2, Policy notes.

Also, the remittance inflow is strongly correlated with the economic dynamics from the outside, especially from the EU and the CIS, and the crisis of the EUR area could have negative consequences for both of the mentioned regions. In case of negative evolutions in the EU economy, we could witness in more modest evolutions of the foreign transfers. In fact, the evolution in the last period of 2011 indicates the tempering of the increase rates of foreign transfers made through the banking system. The total transfers at the end of 2011 represented 87% of the total transfers for 2008.

After the 2009 crisis year, the increase rates of imports decreased in comparison to exports, thus remittances (having a weight of remittances in the GDP of 21%), on which the private consumptions were based and, consequently, which stimulated exports, started to decrease in terms of their influence on national economy. Other factors such as wage increases, investments (FBCF) have roles which are more and more significant, but however with marginal effects which are quite robust. Especially long-term investments have a quick and positive recovery trend. An important factor is that in the last years a correlation was established between the import of cars and equipment and the investments made in national economy. We suppose that they will contribute to the subsequent development of the productive capacities of the country, thus influencing the potential GDP.

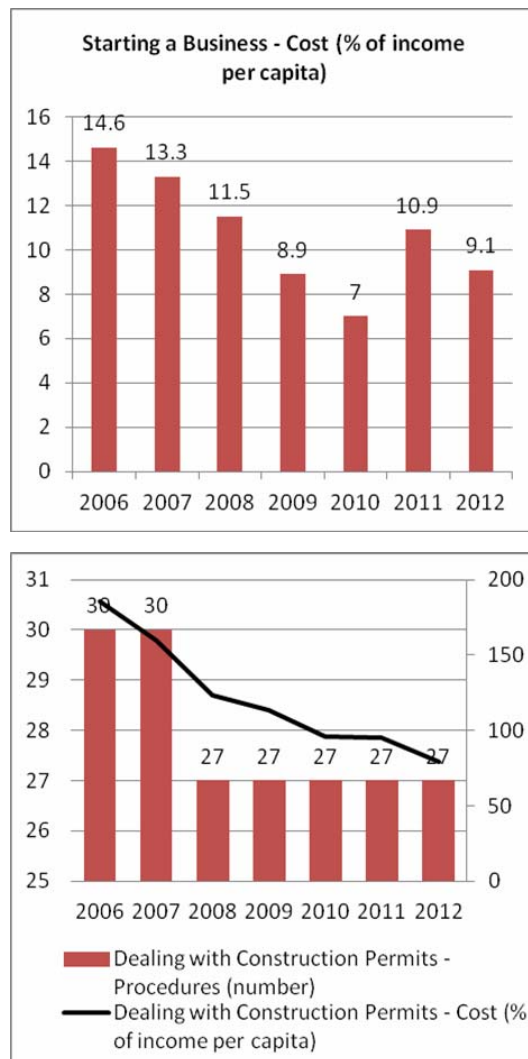
Reduction in the administrative and fiscal burden
for conducting business

Administrative burden. The actions implemented for the purpose of reducing the administrative burden on the business environment were a continuous concern of public policies. However, the measures taken did not lead to very good results. According to the chart below, the quality of public services and the ability of the government to formulate and implement profound public policies stagnate, and little progress is registered in this regard.

Essentially, we should note that in the last years, the rating of the Republic of Moldova in the classifications of the World Bank and other international bodies improved. Thus, the conditions of initiating a business improved, as the number and the cost related to the initiation of the business decreased. Starting in 2006, the number of days necessary to the business initiation decreased dramatically from 30 to 9 days in the 2012 classification. The business initiation cost, as compared both to 2006 and to the year before the crisis, 2008, is lower on the whole.

In the global competitiveness classification, RM evolved more modestly, although the country scoring over the year remained practically unchanged, because of the enlargement by more countries of the coverage area of the index, and the national economy in the classification lost the position held in 2006-2007.

Figure 4. Starting a business and construction permits



Source: World bank, *Doing Business*.

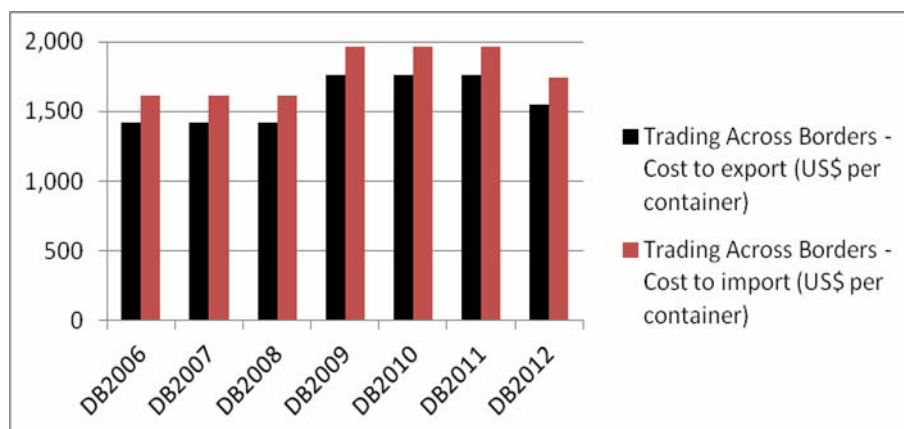
The measures taken in view of improving the situation in the field of building permits stagnate, historically the Republic of Moldova did not make notable progress in this regard. The situation did not change with the economic stabilization and re-launch plan initiation.

This action finalized by the approval and the amendment of certain legislative aspects. According to the Doing Business data, the situation in this field did not essentially change, the number of procedures decreased by 3, and the decrease in related costs was not essential.

The number of activity types diminished from 37 to 32 in the 2008–2011 periods. But the simplification of the licensing procedures did not have a well-defined result, the total number of valid licenses decreased by 7% as compared to 2008.

Despite the efforts made, the international bodies establish that there is no progress in the field regarding the administration of the procedures and costs related to the foreign trade activity. The number of days necessary for export/import remained the same: 32/35 days, and for the number of documents necessary for export/import – 6/7 days. At the same time, the costs related to the export and import of merchandise increased by 9% and 8%, respectively.

Figure 5. Trading across borders

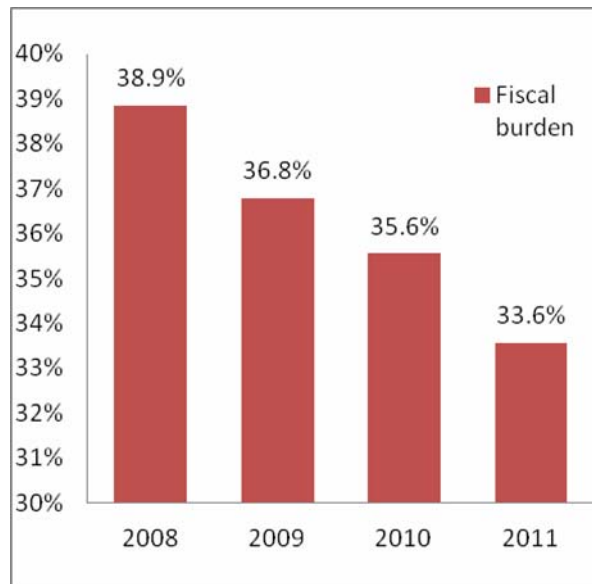
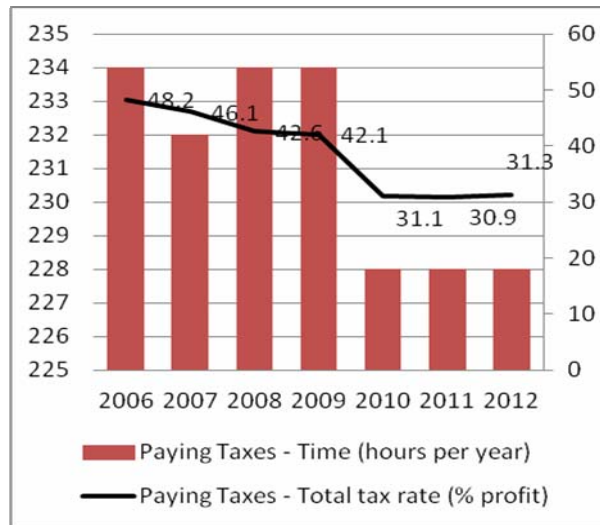


Source: World bank, *Doing Business*.

Fiscal burden. In the period 2009-2011 the fiscal burden diminished both as regards the necessary number of days to fulfil tax obligations and the terms of the total income collected in the national public budget by reference to GDP. In

this regard, the indicators characterizing the national economy are compatible to the region.

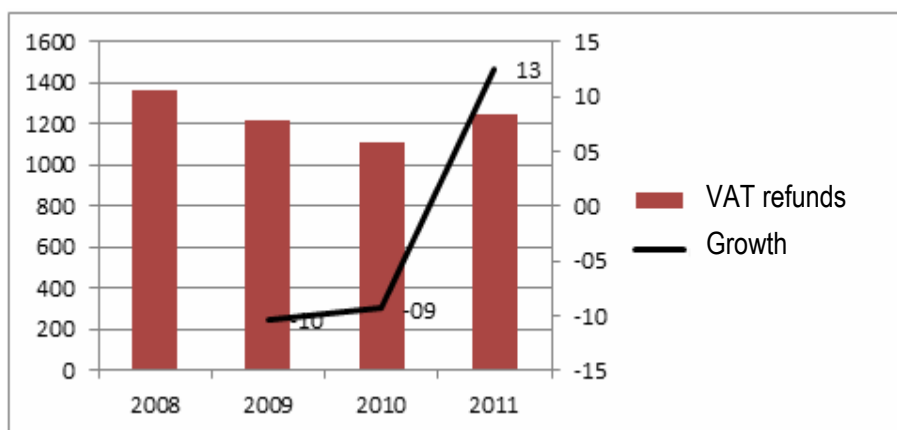
Figure 6. Paying taxes in Moldova and fiscal burden



Source: World bank, *Doing Business*.

The result of VAT restitution measures is ambiguous, although the increase rates of restitutions are higher, the restitutions in absolute values had a downward evolution. As compared to 2008, in 2011 restitutions corresponded to a level of 90%.

Figure 7. VAT refunds in Moldova



Source: According to Main State Tax Inspectorate of Moldova.

Facilitation of entrepreneurs' access to financial means to initiate and develop or re-launch business

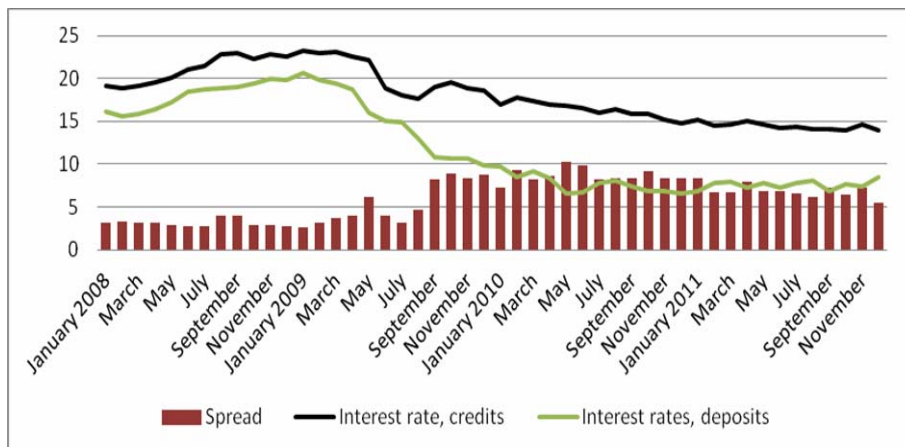
Within the 2009-2011 period a series of measures were taken for the facilitation of the entrepreneurs' access to financial means for the initiation and development or re-launch of business. Among them, the following may be noticed: PNAET and "PARE 1+1" programs; the activity of the Special Fund for the Guarantee of Credits; the Program for the support of the small and medium enterprise sector, financed by the Government of Japan; the creation and functioning of the Business Incubator in the town of Soroca, and other measures.

In the commercial banks of Moldova, crediting lines were opened for SME financing within the implementation of external assistance projects. In 2011 EBRD opened crediting lines for Moldindconbank, the Social Bank, ProCreditBank, and the Black Sea Trade and Development Bank – BC "Moldova Agroindbank" – for crediting small and medium enterprises. Also, among the measures that contributed to the facilitation of the entrepreneurs' access to

financial resources, it is necessary to mention the organization and hosting of certain seminars by the SME Sector Development Organization.

However, at present, most of these measures, aimed at improving access to financing of specific groups of entrepreneurs is quite narrow, so the advantage of the existing possibilities helped only a very small number of beneficiaries. At the same time, with the beginning of the crisis, the risk premiums increased, which reached 9.2% in 2010. At the same time, the partial absence of the demand for credits substantially reduced the interest rates, reaching minimum historical levels in 2011.

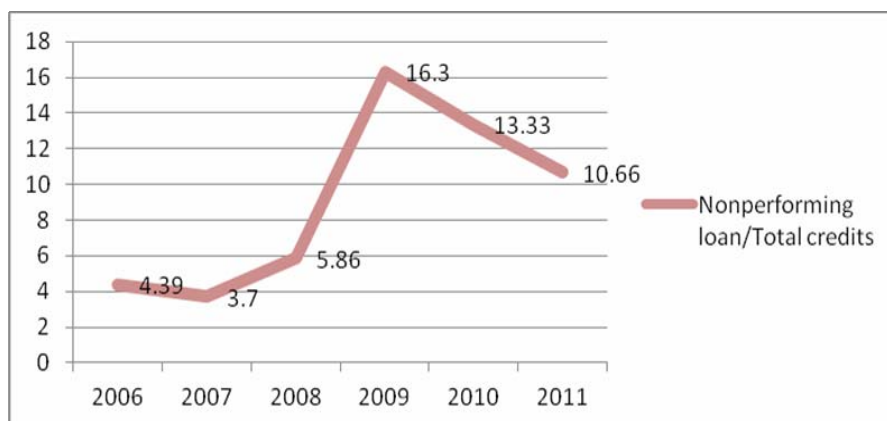
Figure 8. Interest rates and spread



Source: According to National Bank of Moldova and World Bank Indicators.

In particular, due to the slowdown of the activity of exporters and the construction sector, the portfolio of non-performing credits reached alarming levels in 2009, and decreased in the next years, but without reaching the 2006-2008 levels.

Figure 9. The evolution of nonperforming loans in Moldova



Source: According to National Bank of Moldova.

The evolutions of the banking system did not allow however a quick recovery of the existing gaps in the national economy. The weight of the banking credits of the private sector in the GDP is the lowest one in the region (33% in 2010). According to the balance sheets submitted by economic agents, the collections from the receipt of credits and loans only represent 70% of the amounts collected in 2008. The granting of credits and loans to economic agents was not fully recovered.

The complexity of the enterprises' access to financial resources is also confirmed by the low degree of credit penetration in the Republic of Moldova. The rate of the credits granted to the private sector was 36.5% of the GDP in 2008; in 2010 this indicator decreased down to 33.3% (Table 1).

Table 1. The share of bank credits to real sector of the economy, % of GDP

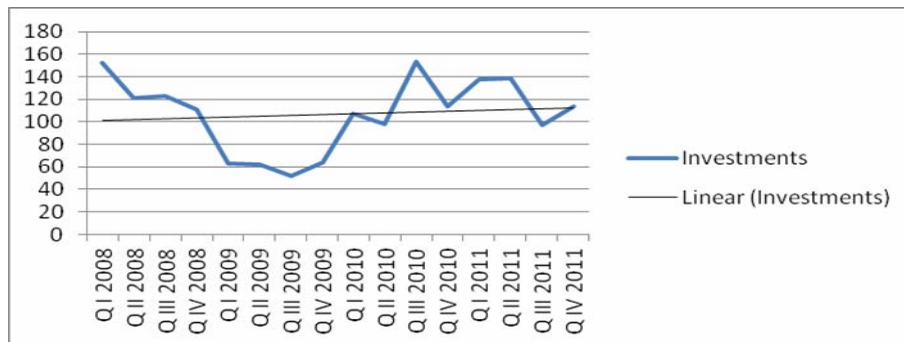
	2007	2008	2009	2010
Moldova	36.9	36.5	36.0	33.3
Russian Fed.	38.8	42.2	46.2	45.1
Romania	35.1	46.0	47.1	46.1
Ukraine	58.2	73.9	73.4	61.7

Source: World Bank indicators <http://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS>.

Stimulation of public and private investments

In total, investments have a positive upward trend. The paces and the values of the years before the crisis were not reached, but signs of quick increase are visible. A negative fact is that most foreign direct investment comes from the re-invested income of the already existing companies. Thus, in 2008 the weight of re-invested income was 19%, and in 2011 it increased up to 35%. The structural change was made in the share capital direct investment account.

Figure 10. The evolution of investments in Moldova



Source: According to National bureau of Statistics.

A positive aspect in the 2009-2011 period refers to the increase in number of new enterprises registered with foreign capital and the increase in their weight in the total number of registered enterprises, which was of 9.1% in 2011, i.e. 1.3 p.p and, accordingly, 2.4 p.p more than in 2008 and 2009. In the last three years, 1,651 new enterprises with foreign capital were registered, with share capital investments amounting to 690 mil. lei.

The inflow of foreign direct investment in national economy had positive trends in the post-crisis period. After a 78.5% decrease in 2009, it increased in 2010 by 35.8%. In the first 9 months of 2011 it amounted to USD 206 million, or 36.4% more as compared to the similar period of last year, after an increase of 27.6% in the January-September period in 2010.

The volume of foreign direct investment in the first three quarters of 2011 exceeded the annual volume of USD 197.4 mil. registered in the previous year. The increase in foreign direct investment registered in the last two years was determined, in particular, by the account of re-invested income which reached in 2011 a record weight in the structure of foreign direct investment.

At the same time, the share capital investments continued to decrease in 2010-2011. In 2010 they decreased by 2.8%, and in the January-September period in 2011 by 8.6%. Their reduction is rather determined by the financial instability in the countries of origin. The main origin of the share capital foreign direct investment flows is represented by EU countries, with a weight of 69.7% as on October 01, 2011.

The most attractive sectors to foreign investors, in terms of increase in the stock of foreign direct investment in the share capital were the financial sector and the real estate transactions. Also, investments increased in other sectors:

- Transports and communications. According to the Global Competitiveness Report in 2011, as compared to 2008, the Republic of Moldova advanced 17 positions, from 113 to 96. Also, such positive trends are registered due to the performances in the telecommunications field, while in terms of the supply of electricity and transport infrastructure, except for the sea transport, a regress was registered;
- Wholesale trade and retail trade;
- Processing industry;
- Agriculture - an indicator of the development of this sector could also be considered the reduction in technical barriers in the trade with such products. An argument in this regard was the registration for the first time of the export of certain agri-food products in the UE, for which quality demands are extremely high;
- Health and social assistance and others.

Summary and policy implications

Moldova was affected by the global crisis through the dramatic decrease in foreign trade, which transposed into decreases of budgetary income and capital inflow (remittances and foreign direct investment). At this time we are in a recovery stage, which is strongly supported by the increase in exports and internal demand propelled by the recovery of remittances and investments.

The role of remittances in the post-crisis period remains essential, but changes in the income structure were noticed, as in 2011 the wage-based activity had the highest weight in the last 6 years. The weight of remittances in the GDP is in a continuous decrease, reaching 21-22% in 2011, as compared to 31% of the GDP in 2008.

Most of the deficiencies faced by the national economy are of a structural nature. The budgetary deficit, which had values close to the balance in the period before the crisis, increased enormously during the crisis, highlighting serious lacks in terms of budgetary income, which were masked until now by the economic boom.

National exports show signs of weak diversification, but which is continuously improving, both through sale markets and through exported products. Four big markets absorb approximately half of national exports – Russia, Romania, Ukraine and Italy. The most important exported products remain agricultural products, wine and alcoholic beverages, tobacco, textiles, all of them totalling on the average around 60% of the national exports. But, lately a quick increase in the basket of exported goods of products with a higher added value – oils and fats, cars, electrical apparatus and equipment, metals is attested.

The national financial market slowly recovers after the dramatic decrease in credits granted to the economy in 2009. The rate of non-performing credits in economy reached the level of 16.3% in 2009, banks set up provisions in order to face this situation, and the decrease in the internal and external economic activity contributed to a low demand for new financial resources.

The credits granted to the economy are insufficient and are at a level lower than in the countries in the region. Although in the report of the World Bank, the Republic of Moldova made progress in terms of crediting conditions, most enterprises consider that access to funds is the most important constraint.

Administrative burden. In the post-crisis period, international bodies and classifications rank the Republic of Moldova relatively better than before. Anyway, in terms of documents/procedures necessary for various operations, the Republic of Moldova registered a modest progress. The quality indicators of institutions do not show major changes in this period. Major progress was made at the level of the granted licenses.

Fiscal burden. In the period of the action of the 2009-2011 Economic Stabilization and Re-launch Plan, the fiscal burden diminished both in terms of the necessary number of days for fulfilling tax obligations and in terms of the total income collected in the national public budget referred to the GDP. Thus, the tax burden decreased by approximately 5 p.p., but the average taxation level increased, especially because of the increase in excise duties on different products. Tax aspects and tax indicators characterizing the national economy are comparable to the region.

Facilitation of entrepreneurs' access to financial means in order to initiate and develop or launch a business. At this time, access to funds represents a major constraint for the national economy. The complexity of the enterprises' access to financial resources is confirmed by the low degree of credit penetration into the Republic of Moldova. The rate of credits granted to the private sector was 36.5% of the GDP in 2008, while in 2010 this indicator decreased to 33.3%. Most of the studies highlight that the situation got worse as compared to 2007, the number of respondents having problems with the access to financial resources increased by 20.7 p.p..

The crisis aggravated the problems of the quality of the domestic business environment, which materialized in a high rate of non-performing credits. The absence of competition in the domestic financial system was counteracted by the decrease in demand, so that the interest rates reached the lowest level ever.

Stimulation of public and private investments. The capital expenses had a low weight in the GDP in the pre-crisis years, the most significant component being wages. In the 2007–2009 period the biggest decline was in terms of new investments – which decreased by 2.2 p.p. in the GDP structure, followed by the purchases of fixed assets, which decreased by 0.6 p.p. in the GDP structure. In the last years, due to international bodies and donors, the structure of expenses has been changing but the implementation process is slow.

Improvement of the investment climate. The 2009-2011 period shows an increase in number of new registered enterprises with foreign capital and an increase in their weight in the total number of registered enterprises, which was 9.1% in 2011, i.e. 1.3 p.p. and, accordingly, 2.4 p.p. more than in 2008 and 2009. During the last 3 years, 1,651 new enterprises with foreign capital were registered, with investments in the share capital amounting to 690 mil. lei.

The inflow of direct foreign investments in the national economy had positive trends in the post-crisis period. After a 78.5% decrease in 2009, they increased in 2010 by 35.8%. In the first 9 months of 2011 they amounted to USD 206 million, or 36.4% more as compared to the similar period of the previous year. In terms of quantity, the 2008 performances were not reached, and in terms of quality, we see a change in the structure of foreign direct investment in the post-crisis period. The increase in foreign direct investment registered in the last two years was determined especially by the re-invested income of foreign companies activating on the territory of the Republic of Moldova. In 2011 their weight reached the record level of 35% the total foreign direct investment (the first 9 months of 2011).

Most of the foreign direct investment is focused on energy, financial institutions and real estate transactions, and few of them are directed to tradable (commercial) sectors of the economy.

The economic stabilization and re-launch program in terms of the investment dimension did not fully achieve its objectives, even if reforms were oriented towards the stimulation of the investment activity, had a limited nature and were implemented quite slowly. Also, the performed measures were not sufficiently focused on the fundamental settlement of imminent constraints: **practically, no measures were taken for combating corruption, counteracting anticompetitive practices or rendering the functioning of state enterprises more efficient.** Consequently, no significant improvement of the investment activity is seen.

Recommendations:

The most important challenge for the Government is combating the inheritance of the crisis without jeopardizing economic growth.

- Measures to create and improve the legal procedures.
- Continuation of the stimulation of competition and openness of the financial sector.
- Simplification of the procedures related to reporting and primary records and the starting of actions to simplify and unify reporting procedures.
- Measures to improve the tax system in view of creating a progressive model of taxes, especially labor taxes and assurance of the sustainability of social payments, especially of pensions.
- Continuation of the reorientation of the capital expenses within the budget to infrastructure.
- Reviewing the progress registered in the implementation of capital projects for increasing the efficiency of project implementation.
- Critical evaluation of public investment projects for the purpose of reducing low priority investments in social institutions and increasing allocations and improving progress in implementing projects, for instance, in the field of road and railway transport, refrigerator storage, irrigation, renewable energy, and energy efficiency sectors.
- The request for technical assistance for accelerating the implementation of capital projects in the infrastructure sectors.

- The continuation of the reform of agrarian incentives for promoting competitiveness in accordance with EU product standards.

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