

## Moldova: Partnership for Change

Moldova's commitment to a shared vision for sustainable growth and poverty reduction has buoyed the country's economic recovery and spurred progress towards integration with the European Union (EU). Although it is still the poorest country in Europe, Moldova has greatly reduced its overall poverty rate from a high of 70 percent in 1999 to about 30 percent today. Moldova's economy has expanded by more than 45 percent since 2000. Successfully managing debt and maintaining a prudent fiscal stance have allowed the country to improve its prospects for donor assistance, and the coordination of international aid has, in turn, played a critical role in helping the country achieve its development objectives.

| Country Indicators                                       | 1995 | 2000  | 2006  |
|--|------|-------|-------|
| GNI per capita (Atlas method, current US\$)              | 480  | 370   | 1080  |
| GDP (current US\$ billions)                              | 1.7  | 1.3   | 3.4   |
| Inflation, GDP deflator (annual %)                       | 39   | 27    | 13    |
| External debt (DOD, current US\$ billions)               | 0.7  | 1.7   | 2.4   |
| FDI net inflows (US\$ millions)                          | 25.9 | 127.5 | 241.9 |
| Population (millions)                                    | 4.4  | 4.1   | 3.8   |
| Poverty incidence (%)                                    | --   | 68    | 30    |
| Primary school completion rate (% of relevant age group) | 94   | 90    | 90    |
| Under-five child mortality (per 1,000)                   | 30   | 24    | 19    |
| Maternal mortality (per 100,000 live births)             | 41   | 27    | 16    |

Sources: World Development Indicators database, Household Budget Survey data (Ministry of Economy and Trade)

In 1994, Moldova joined the International Development Association (IDA), the World Bank's fund for the world's poorest countries. IDA's contributions have included analytic and advisory services, financing for investment projects, and—starting in 2007—budget support via a Poverty Reduction Support Credit (PRSC) program. To date, IDA commitments for Moldova have totaled US\$387 million, with US\$279 million disbursed so far.

### COUNTRY ACHIEVEMENTS

*Moldova has established a stable, growing economy by pursuing incremental reforms and strengthening partnerships.*

**Development efforts have reversed a decade of economic decline and rising poverty that followed Moldova's independence in 1991.**

As a small landlocked country, Moldova's economy was highly dependent on the rest of the former Soviet Union for energy and raw materials. The country suffered from the breakdown in trade that followed the dissolution of the Soviet Union, and these difficulties were exacerbated by drought and civil conflict. The Russian ruble devaluation of 1998 further buffeted Moldova's economy, and between independence and 1999, GDP plummeted more than 60 percent.

An additional complication in Moldova's transition is that limited economic opportunities and rising poverty have precipitated widespread emigration. Some 25 percent of Moldova's working population now lives abroad, and workers' remittances—payments sent back home—account for about one-third of GDP. These migrants are typically young, educated, and skilled.

### **Moldova's political environment has gained stability.**

After the country adopted a parliamentary system of government, the Party of Communists of the Republic of Moldova gained control of parliament and the presidency in 2001 in internationally sanctioned democratic elections. This incumbent party retained control in the 2005 elections, and President Voronin was reelected. The intervening period has seen steady improvement in economic performance, poverty reduction, and the management of public finances.

### **Prudent fiscal policy and debt rescheduling have paid off.**

Moldova was the last country among former Soviet republics to see a return to positive growth. Important structural reforms, rising demand from Moldova's trading partners, and a sizable inflow of workers' remittances have supported ongoing economic recovery. Authorities have harnessed this momentum by limiting budget deficits and restructuring debt. In fact, public debt was reduced from roughly 65 percent of GDP in 2001 to around 23 percent in 2007.

Improved debt sustainability has been an important factor for establishing partnerships with international donors and collectively pursuing development objectives. In 2004, Moldova adopted its Economic Growth and Poverty Reduction Strategy Paper (EGPRSP)—the first full poverty reduction strategy developed for the country in consultation with broad-based stakeholders and civil society. Moldova further strengthened its links with the EU through the EU-Moldova Action Plan (EMAP) signed in 2005, and together, the EGPRSP and EMAP provided a framework for increased donor harmonization. In early 2008, Moldova approved the National Development Strategy for 2008 to 2011 in close consultation with development partners.

### **Moldova's economy has proven resilient.**

The country experienced strong economic growth from 2001 through 2005, with GDP growth averaging 7 percent. Since 2006, natural gas prices have more than doubled, imports of Moldovan wine were banned by Russia in 2006 and 2007, and the Moldova agricultural sector was hit by a severe drought. Although these shocks slowed GDP growth to 5 percent in 2006 and 4 percent in 2007, a rebound is expected in 2008 and 2009.

## **IDA CONTRIBUTIONS**

Much of IDA's assistance in Moldova has focused on the infrastructure and human development sectors. Given the country's difficult transition and political instability in the 1990's, a community driven development approach was used to direct IDA support to mainly local interventions in areas with the highest concentration of poverty. This approach has allowed IDA to help Moldova improve the quality of and access to social services and strengthen community infrastructure. IDA has also aided the government in efforts to improve public sector governance and to eliminate bottlenecks to growth, particularly through improvements to the business environment.

Through IDA involvement, Moldova has maintained an active dialogue with the World Bank and demonstrated its commitment to reform. This has resulted in not only increased IDA assistance but also greater support from and involvement by other donors.

*Promoting a stable macroeconomic framework and a competitive market environment to fuel pro-poor growth have been key development priorities.*

**Guiding sustainable change through analysis and policy advice.** IDA has strategically complemented financial assistance with analytic and advisory activities (AAA). A recent example is the role of the Country Economic Memorandum, poverty update, advisory work on agriculture, and business environment surveys for informing the development of the PRSC program. Similarly, AAA work has informed and supported investment operations; for example, a Trade Diagnostic Study highlighted how to mitigate inefficient and costly border procedures, and the Pension Policy Dialogue aided efforts for reforming the pension system.

IDA's analytic work in Moldova has illuminated a path for sustainable development. The Public Expenditure Review in 2007 was closely linked to policy notes in health and education to ensure a comprehensive review and adequate sector input. This cross-sectoral approach continues to be critical for identifying constraints that impede competitiveness and refining public services and social assistance.

**Facilitating trade and reducing the cost of doing business.** IDA resources have been instrumental for improving the conditions needed to increase domestic and foreign investment. With the help of an IDA investment project, the Moldovan Customs Service has improved its performance and implemented an automated system for customs data to expedite processing. This enhanced capacity promotes export competitiveness and allows domestic firms to export directly and to act as suppliers to international firms.

Two notable ways that IDA has helped to strengthen the private sector include simplifying business registration and licensing procedures and creating a sound basis for financial reporting and auditing in the corporate sector. A 2006 law has mandated a review of all existing legislation and developed the capacity for applying regulatory impact assessment methodology to new legislation. After IDA supported various follow-up activities to the Report on the Observance of Standards and Codes for accounting and auditing in 2005, Moldova passed new accounting and auditing laws in 2007 that are aligned to EU law and international practices.

#### **Removing Barriers to Trade**

Major improvements in customs services occurred after the Automated SYstem for CUstoms Data, or ASYCUDA World, was put into operation at all 15 Moldovan customs offices with support from IDA.

Says Vasile Danu, the manager of a Moldovan export company, "I no longer have to wait for an interminable amount of time to register merchandise, as clearance procedures are now completed in less than two hours."

Together, IDA-supported efforts are bolstering the investment climate. Private investment has risen from about 14 percent of GDP in 2003 to over 22 percent of GDP in 2007. Foreign direct investment has increased sharply during the same period, up to 7 percent of GDP in 2006 and 10 percent of GDP in 2007.

**Strengthening property rights and increasing access to finance, knowledge, and technology.**

The security of tenure and ownership rights has increased with the establishment of a unified national real estate cadastre system for urban and rural land. To date, 75 percent of rural property in private hands has been fully registered. Investment projects focused on providing credit and technical assistance in rural areas have promoted a surge in new businesses and boosted the income of existing ones.

***A focus on public administration reform has increased the capacity of the public sector.***

**Public financial management.** Efficient governments allocate public resources to policy priorities to attain decisive impact with government programs. IDA has been helping Moldova do just that through gradual development of a Medium-Term Expenditure Framework (MTEF) budgeting process to improve fiscal discipline and strategic resource allocation. The MTEF now covers all the national public budget resources, including not only the state budget but also local budgets, the state social insurance budget, national health insurance budget, and donor funded investment projects.

Analytical work, investment lending, and budget support from IDA have guided and enabled Moldova to increase transparency and accountability in managing public finances. A government internal financial control and audit system based on EU standards has been developed and is being implemented. Other important developments include the establishment of a single treasury account system, an integrated financial management system, and a strategic plan for the institutional development of the Court of Accounts.

**Civil service reform.** A key step in building public sector capacity is establishing a transparent and uniform remuneration system for civil servants. IDA has facilitated ongoing improvements to Moldova’s public administration by supporting important analytic work—such as a public expenditure review—and administering a multi-donor Public Administration Reform Trust Fund. With the support of IDA’s policy-based lending, Moldova has recently adopted a Civil Service law to classify and grade positions and link pay with professional development and performance.

***IDA’s targeted approach has reaped benefits in various sectors.***

**Energy.** Sharp increases in the prices of oil and natural gas have heightened Moldova’s energy vulnerability. An IDA energy project has yielded important benefits in this context: upgraded metering and transmission of electricity to reduce outages by 35 percent; more energy efficient heating to achieve significant savings; and increased access to heating and hot water. Meanwhile, policy lending has supported Moldova in developing and adopting a new Energy Strategy in 2007 to establish a reform path for legal, regulatory, and technical harmonization of the Moldova energy sector with the EU internal energy market and the Energy Community Treaty.

**Health.** With IDA’s support, Moldova’s projects are building on the experience of health sector reforms and successful HIV prevention strategies throughout the Europe

**Providing Heat and Hot Water for Better Health**

As many as 170 public buildings — with over 1.2 million visits per year — are benefiting from the heating component of the Energy II project. Most of the sites (schools, kindergartens, district hospitals) are in small towns.

Ms. Lydia Hangan, Head Physician of the District Hospital in Ialoveni, reported, “We have been operating in comfortable conditions for two years now, which has resulted in a two-fold drop in the rate of morbidity owing to respiratory conditions among health workers.”

and Central Asia region. Health investment projects have defined a minimum package of health services offered by the government at no charge, provided basic medical equipment to 84 percent of rural health centers, provided portable medical kits to all general practitioners, and renovated 22 percent of all health centers. Training has been provided for 750 doctors, 1,500 nurses, and 300 healthcare managers.

An AIDS Control project has supported Moldova's implementation of the National Program for Prevention and Control of HIV/AIDS and STIs. Among other benefits, full coverage has been established for screening pregnant women for HIV and providing prophylactic treatment and free milk formula for those who are infected. Transmission of HIV from mother to child has fallen from 20 percent to 2 percent as a result.

In combination, IDA-supported initiatives have helped Moldova improve rural access to health care and slow the spread of AIDS. Since 2000, maternal mortality has decreased more than 40 percent and under-five child mortality has decreased more than 20 percent. In collaboration with IDA and other international donors, Moldova has developed a new Health Sector Development Strategy 2007-2017 to continue the health reform process.

**Education.** IDA has focused steadily on improvements to Moldova's education system. Social Investment Fund resources have supported the construction and rehabilitation of schools. A completed investment project provided 186 new curricula and more than 100 textbooks (by title). More than 3,500 training courses were held for teachers to improve the quality of education services. A current project aims to increase access to quality education for children in poor families, particularly in rural areas. These efforts have included components to strengthen the government's capacity for education planning and monitoring, and they are coupled with a broader program for education reform supported through policy-based lending. This reform will promote a more efficient use of public resources—decreasing the share of non-teaching staff, lowering overhead costs, and bring pupil-teacher ratios closer to international norms.

**Water and sanitation.** IDA is helping Moldova improve water supply and wastewater treatment systems, which have seriously deteriorated after almost two decades of deferred maintenance. A pilot project has benefited five Moldovan towns with a total population of about 250,000—providing a steady supply of water free of pathogens, improving energy efficiency, and increasing the financial viability of utilities. A new national water supply and sanitation project is expected to increase the coverage, quality, efficiency, and sustainability of these services more broadly.

**Increasing Access to Clean Water**

"Today, tap water is available 19 hours per day, and at the same time, energy is being conserved at the pumping stations."

*Vasile Zagaevski, Head of the Municipal Water Enterprise in Cahul*

"As of December 2006, for the first time, the entire town of Orhei enjoys a 24-hour supply of quality potable water."

*Ion Stratulat, General Mayor of Orhei*

*IDA has played a pivotal role in catalyzing and coordinating donor support.*

**Combining resources for sustainable solutions.** Nearly all of IDA's lending operations and analytical work in Moldova involve partnerships with other donors. In 2006, a Development Partnership Framework was agreed upon by Moldova, IDA, Netherlands, United Kingdom,

Sweden, United Nations, International Monetary Fund, and the EU to harmonize development efforts. With increasing resources for Moldova flowing from other donors and agencies, IDA is no longer the largest provider of external financial support. But the World Bank's country team in Chisinau continues to serve an important function in convening donors, facilitating the development dialogue with the government, and lending its expertise and systems for the efficient and transparent administration of development aid.

In promoting sustainable outcomes, IDA often leverages support from other donors and streamlines the implementation of multi-donor initiatives to minimize the administrative burden for the government. One example is in the transport sector, where IDA has been engaged with government counterparts and other development partners in designing a Land Transport Infrastructure Strategy. In response to the government's request, IDA is helping the government prepare a large-scale Road Sector Program, which is to be financed jointly by Moldova and at least five external partners.

**Responding to immediate development needs.** IDA's collaborative relationship with Moldovan authorities and with other donors allows for a flexible and informed approach to addressing urgent needs as they arise. To minimize the threat of the avian flu, IDA combined resources with Moldova, Japan, the European Commission (EC), and the United States Agency for International Development to boost the country's preparedness and capacity to respond. In 2006, IDA's leadership in convening donors was exemplified by the Consultative Group meeting in Brussels. This meeting, hosted jointly by IDA and the EC, brought together the government of Moldova and international partners to confirm commitment to the country's reform program and to identify more than US\$1.2 billion additional external financing in response to recent external shocks.

## **CHALLENGES AHEAD**

With IDA assistance, Moldova is successfully implementing an ambitious set of reforms and experiencing increased economic stability and steady growth. Moldova's per capita income recently exceeded the IDA eligibility threshold for the first time, and the country is entering a new transition period—possibly graduating from IDA support altogether in the not-so-distant future.

There remains much to be done to build on this substantial progress. The economy is still vulnerable, as demonstrated by responses to rising energy prices, the wine embargo, and the devastating drought. Remittances from Moldovans working abroad still account for too large a share of the GDP given that relying on such inflows might not be sustainable in the long run. Too many Moldovans, especially the rural poor, still struggle for access to food, clean water, basic healthcare, heat, and education. Furthermore, the country faces a time of political uncertainty, with the current president finishing out the maximum allowable length of service in early 2009.

***Moldova's successful transition to a competitive market economy will require continued support with a comprehensive strategy that includes and helps the rural poor.***

### **Enhancing competitiveness is necessary to achieve sustainable growth.**

Moldova has not yet achieved its vision of private sector-led growth, and the country's standing in global *Doing Business* ratings remains low relative to its neighbors. Further attention is needed to address remaining barriers related to trade across borders, licensing, access to credit, and tax payments.

Enhancing the economy's global competitiveness is essential for achieving long-term growth in a small, open economy like Moldova. This will require the continuation of structural reforms, improvement of public institutions, promotion of a market-friendly business environment, a more sophisticated financial system, and better infrastructure.

### **Persistent rural poverty signals a need for further reforms in the agricultural sector.**

Agriculture continues to be one of the largest real sectors of the economy, but the sector has underperformed overall economic growth. Moldovan farmers are generally receiving less for their harvests and paying more for their inputs than they should, and this trend appears to explain in part why poverty reduction has stalled in rural areas. Public spending and agricultural policy still disproportionately support large corporate farms even though 40 percent of Moldovan land is cultivated by individual farmers.

Developing the agricultural sector will require further deregulation of input and output markets, improved access to finance, implementation of standards and food safety regulations aligned to international practice, and better access to new technologies. In addition, as demonstrated by the severe drought in 2007, Moldova needs better measures for reducing farmers' vulnerability to natural hazards.

### **Lessons from IDA's contributions**

In October 2004, the Bank's Independent Evaluation Group (IEG) completed a 10-year assessment of IDA's involvement in Moldova. It highlighted the difficulty of Moldova's transition and the varying success of efforts supported first by the International Bank for Reconstruction and Development (lending for creditworthy countries) and later by IDA (assistance for the world's poorest countries). At that time, IEG found that the institutional impact of the World Bank's program for Moldova was only modest, that the sustainability of the recent economic recovery was unlikely, and that the overall development effort must be defined as unsatisfactory. However, the review also emphasized that development must be a long-term effort: the experience of other former Soviet Union economies has shown that the transition process will likely take more than a generation.

IEG's findings provided important guidance for IDA in pursuing effective changes and strengthening the development dialogue with Moldova and with other donors. Country assistance was driven more by analytical work such as a Country Economic Memorandum, and lending decisions were more closely linked to performance and to demonstrated commitment by the government for reform. These strategies have been successful. IEG ratings and other internal

measures of quality indicate that IDA products and services in Moldova have been improving, and no projects have been at risk since 2004.

Achieving development outcomes is contingent on providing the right level of support to build capacity and complete reforms. With more than a decade of experience in Moldova, IDA has established an effective, collaborative relationship with government authorities that honors this dynamic.

In the end, all attempts to improve the business environment, spur domestic productivity, and reduce poverty will count on the presence of an effective, efficient, and transparent public sector.

Strong national agencies are needed to sustain desirable development outcomes over the longer term. Moldova has made great strides in pursuing a reform agenda, engaging the donor community in an ongoing development dialogue, and launching its new National Development Strategy (2008-2011). IDA's experience has demonstrated the value of strategic support—channeling resources, evaluating outcomes, and coordinating aid in partnership with the government.

**Coordinating Development Assistance**

"World Bank procedures and mechanisms for monitoring the portfolio are well-established. The World Bank IDA team is open to working with us on aid harmonization, trying to use our national systems and improving them. This builds our capacity to work better and gives opportunities to our workers."

*Lucretia Ciurea, Head of the Coordination Section for External Technical Assistance, Government of Moldova*