

GOVERNMENT OF MOLDOVA

# Rethink Moldova

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Priorities for Medium Term Development



**Report for the Consultative Group Meeting in Brussels**  
**24 March 2010**

## *List of abbreviations*

ANRE	National Agency for Energy Regulation
CCCEC	Centre for Combating Economic Crime and Corruption
CPI	Consumer Price Index
CPT	Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
ESRP	Economic Stabilization and Recovery Program
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
ICT	Information and communications technology
IDC	Initial Detention Centre
IFMIS	Integrated Financial Management Information Systems
IMF	International Monetary Fund
IT	Information Technology
ITES	Information Technology Enabled Services
MCC	Millennium Challenge Corporation
MDG	Millennium Development Goals
MIEPO	Moldovan Investment and Export Promotion Organization
NDS	National Development Strategy
NPEEY	Program for the Economic Empowerment of Youth
ODSME	Organization for Development of Small and Middle Enterprises
PPP	Public-private partnership
RDA	Regional Development Agencies
SIDA	Swedish International Development Agency
SME	Small and medium-sized enterprise
UN	United Nations
USAID	United States Agency for International Development
VET	Vocational Education and Training
WB	World Bank

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# Rethink Moldova

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## *Priorities for Medium Term Development of the Republic of Moldova*

### **I. Introduction**

Consistent with the Government Programme, this document presents the vision of the Government of the Republic of Moldova for achieving its five-pillar reform priorities: European integration, economic recovery, rule of law, administrative and fiscal decentralization and reunification of the country.

In presenting this vision, Rethink Moldova draws from several strategic planning frameworks: the Economic Stabilisation and Recovery Programme, the National Development Strategy, the EU-Moldova Action Plan, the Eastern Partnership and the Partnership and Cooperation Agreement between Moldova and the European Union. These frameworks are still valid and Rethink Moldova is not a substitute for them, nor is it a strategic planning framework in its own right. Rethink Moldova is a call to our partners to assist the Government of the Republic of Moldova in delivering its vision.

The Government of Moldova regards European integration as the most fundamental priority of domestic and foreign policy. In the Government's view the most efficient way to achieve political, economic and social modernization of the country is to implement responsibly the commitments leading the country on the path to European integration. To this end, we are determined to implement an ambitious agenda for European integration. The Government has consulted widely in drafting policies for the development of the Republic of Moldova, and in particular has engaged in an active dialogue with the civil society organizations as partners.

Underlining the paramount importance of its European agenda, the Government of Moldova has restated in a national policy document the provisions of the EU-Moldova Action plan, which technically expired in 2008. Unlike previous Governments, who engaged in the rhetoric of European integration but took little action, this Government is convinced that bringing the Republic of Moldova closer to its strategic goal of full accession to the European Union can only be achieved through swift and tangible change. The Government has already embarked on dynamic, result-oriented talks with its main foreign partners. In turn, our partners are reassessing their relations with Moldova in light of the new political reality which gives new impetus to our ties.

Moldova is committed to carrying out fundamental reforms which continue our transition to a European democracy, including ensuring a separation of powers, independence of the judiciary, respect for human rights and freedom of the media. We have already taken specific actions. The Joint Statement of the EU - Republic of Moldova Cooperation Council of 21 December 2009 set the tone for an intensified dialogue. On 12 January 2010 Moldova and the EU launched negotiations on an Association Agreement which will raise the bilateral relationship to a new level. This Agreement is a framework to bring Moldova closer to the EU through political association and economic integration. Both the EU and Moldova have reaffirmed their desire to start talks on the creation of a

Deep and Comprehensive Free Trade Area. In addition, the two parties have agreed to establish dialogue on visa liberalization for the citizens of Moldova.

The new political reality in Moldova and the Government's vision of European integration for Moldova, including through an efficient and result-oriented activity within the Eastern Partnership, provide solid grounds for Moldova's development partners to RETHINK MOLDOVA. Based on the changes in Chisinau, now is the time to "reinvent" relations with Moldova. At the same time, Moldovans should reinvent Moldova, making it an attractive place for investment. The Government of Moldova is ready to take up this challenge and make things work in Moldova. Yet, this effort, in order to be successful, needs the support of our partners and friends.

The world financial crisis hit the Moldovan economy hard, and represents the first hurdle the country faces on its path towards the European Union. The situation is further complicated by the political motivation of the previous administration, which continued with business as usual through the end of their mandate rather than addressing the crisis. A substantial response was proposed by the current Government through its Economic Stabilization and Recovery Programme. The Programme, recently backed by the IMF, focuses on public expenditure rationalization, enhancement and targeting of safety nets, and liberalization of the highly regulated economy.

The Economic Stabilization and Recovery Programme will put Moldova back on a sustainable macroeconomic path but it cannot in and of itself bring the livelihood of Moldovans closer to the level enjoyed by citizens of nearby EU countries. This can only be achieved through dramatic improvements in public service provision, massive investments in infrastructure, a shift towards an export-focused economy, and deep reforms of the judiciary and education systems. These transformations require a level of resources and expertise that can only be put together in partnership with Moldova's development partners, including the private sector.

Notwithstanding these immediate priorities, the Government stands behind its ongoing commitments to the protection of human rights and democracy. Moreover, the Republic of Moldova is keen to achieve the Millennium Development Goals set for 2015 as assumed by its signing of the Millennium Declaration and reflected in the National Development Strategy for 2008-11.

## II. Recent economic developments

The Republic of Moldova's economic performance over the last several years was built on poor foundations. On the surface, the country was quite successful, with its GDP growing at an average rate of 5% between 2006 and 2008, reaching 7.2% in 2008 itself, while monetary and fiscal positions were kept in check. The overall fiscal balance had a deficit of only 1% in 2008 and efforts have been made to bring inflation down. But vulnerabilities existed: economic growth was a function of consumption, mostly of imported goods, and was fuelled by remittances from abroad which grew at an alarming rate: remittances accounted for 30% of GDP in 2008, ranking among the highest in the world.

Having originally been seen as a problem that could be tackled later, the global economic crisis had a major and abrupt impact on the economy of the Republic of Moldova. After registering double-digit growth rates for most of the decade, in 2009 remittances fell 27%, reflecting plunging economic activity in countries with large numbers of temporary Moldovan workers. Foreign Direct Investment fell abruptly to 2% of GDP from a pre-crisis level of 11.4%. Exports of goods and services decreased by a hefty 22%, although the decrease of imports was even higher – 35%, meaning no overall negative impact on GDP performance.

The combination of these factors brought a decline in GDP performance of 9% in real terms. At the end of the fourth quarter of 2009 the number of unemployed reached 73,900, almost double the comparable period in 2008. Reduced disposable incomes, especially for the 40% of Moldovans living in households that receive remittances, as well as an overall decrease in consumer confidence resulted in deflationary pressures. The CPI at the end of 2009 was only 0.4% after several months of deflation. Deposits held with domestic banks decreased by 3.7% in comparison with the end of 2008, while credit to the real economy shrunk by 4.9% in the same period. Lending conditions also worsened in real terms despite expansionary monetary policy followed by the National Bank of Moldova (NBM).

Despite managing to avoid a financial crisis, the recession has taken its toll on credit quality. Stress tests conducted by the NBM confirm that most banks' portfolios are robust to various risks. However, the share of nonperforming loans of total loans increased by 10 p.p. from the beginning of the year, amounting to 16.3% in December 2009, and one medium-size bank became insolvent in June 2009.

Worse still, throughout most of 2009 the Republic of Moldova did not respond with adequate, if any, anti-crisis measures. Disputed elections in April 2009 brought democracy issues to the fore. Early elections were held in July 2009, bringing the current Government to power on September 25th, 2009. Both the crisis and pre-election spending hikes resulted in a large fiscal gap. Over the first nine months of 2009, budget revenue dropped over 10% relative to 2008 due mainly to a drop in VAT receipts, nontax revenue, and import duties. Despite the budgetary implications a number of wage and pension increases were enacted by the former Government, draining limited budget resources even further. The fiscal deficit increased from 1% of GDP in 2008 to about 6% of GDP between January and September 2009, financed mainly by a drawdown of previously accumulated balances in budget accounts and heavy domestic borrowing.

### III. Reform agenda

The Economic Stabilization and Recovery Plan (ESRP), which the new Government approved during its first 50 days in office, aims to re-launch economic growth within two years. Already being implemented, the ESRP intends to achieve the following objectives:

- Stabilize public finances and optimize allocation of scarce resources according to policy priorities;
- Stimulate economic recovery through market reforms, access to credit and public investment in infrastructure;
- Alleviate the impact of the economic downturn on the most vulnerable.

While providing a much-needed focus on actions that have to be undertaken in the immediate future, the ESRP is no substitute for a medium to long term reform agenda of the Government. The National Development Strategy 2008-2011 remains at the heart of the Government's vision. Macroeconomic stability and an efficient public administration are still prerequisites for meeting the NDS objectives of (1) Strengthening democracy, rule of law and human rights; (2) Resolving the Transnistria conflict and reintegration of the country; (3) Improving competitiveness of the national economy; (4) Development of human capital, employment and inclusion; and (5) Regional development.

The Government fully realizes that there is need for a new National Development Strategy following the current one. In this regard, the Government is keen to use information and communication technology (ICT), as a tool to rethink and transform the current development paradigm and to enable the transition of Moldova to the next generation of economy, society and government. The Government sees ICT as a new engine of sustained growth, and citizen-centric government transformation.

The development of a new National Development Strategy will be undertaken in full partnership with civil society along with our development partners, including private investors. Progress towards negotiating a new European Union – Republic of Moldova Association Agreement will provide a stronger framework for a future NDS. For now though, the focus is on crisis management and implementation of reforms.

Below are the Government's priorities for which we seek the assistance of all our development partners. They are centred on responsible governance; economic recovery; and human capital. This does not limit Government intervention to these areas alone – more is being done in the fields of education, the judiciary, health etc., including on-going reforms funded from the general budget with support from development partners. However, provided we can secure additional financing, the reforms noted below will take Moldova further and more swiftly to a position of economic stabilisation and along the path to European integration.

The reform programme presented in this document reflects the Government's priorities and the significant investment financing needs of Moldova. However, it must be noted that not all financing

needs are expected to be addressed through official development assistance. In this regard, the present report highlights public-private partnerships (PPP) as an option for Government intervention.

In the period ahead, the Government will seek support from donors as well as the private sector in meeting financing needs. Meanwhile, agreements on external assistance will be guided by the principles of maintaining debt sustainability and macroeconomic stability, as well as the Moldovan economy's absorptive capacity. The Government will ensure that new external support will be consistent with the macroeconomic framework under Moldova's programme with the IMF.



## **A. Responsible Governance**

Our strategic objective is to create an efficient, professional, honest and transparent public administration aligned with democratic principles and enabled to provide high value services to Moldova's people. Better institutions are also of paramount importance in tackling the economic crisis and moving ahead towards European integration. The Government is keen to use information and communication technology (ICT) to help strengthen governance and public service delivery.

Previous Governments, in cooperation with development partners, have taken steps to advance public administration reform, anti-corruption measures, funding of the judiciary and public finance management. However, lack of political commitment resulted in incomplete reforms that did not provide the benefit that the Moldovan people expected. Now, the new Government is fully committed to improving the quality of administrative performance and public services delivered to its citizens.

## Effective civil service

Public Administration Reform is an ongoing effort in the Republic of Moldova. In 2005 it began as a result of a functional review of all central government authorities and a review of the decision making process, but has delivered mixed results. The initial target of downsizing the civil service was compromised by the transfer of a large number of civil servant functions to sub-ministerial agencies. The separation of policy making functions from administrative functions was only partial. It was not until September 2009 that the recommendations of the functional review became fully reflected in the structure of the new Government.

The Law regarding the civil service was approved in July 2008 providing clear roles for civil servants and rules for their hiring, promotion and dismissal. In November 2008 the Law regarding the transparency of the decision making process was passed by Parliament, establishing rules for the participation of civil society in the governance process.

A new remuneration system intended to motivate civil servants is in the pipeline. An audit and classification of the civil service is currently being finalized and will become the foundation for a new wage system based on merit and professional performance. Its governing principle – equal pay for equal work – provides incentives for civil servants to undertake responsibilities and hard work irrespective of age or any other kind of favouritism. Unfortunately, the full scale implementation of the new system has been delayed by the budgetary implications of the economic crisis.

The costs associated with the implementation of this policy are estimated at around €100 million. This includes the costs of deploying an electronic human resource management system that will strengthen public payroll management. To manage effectively the transition to the new system, a topping-up scheme for officials with top qualifications is deemed necessary. In this regard, the Government will set up a Capacity Building Fund in partnership with our development partners. This will provide a bridge to the new pay system for civil servants that will become effective in 2012 as a sustainable and forward-looking solution to ensure a motivated civil service.

### Challenge

Enhance quality and motivation of civil servants through the implementation of the new remuneration system for civil servants

### Policy instruments

Topping-up scheme for officials with top qualifications;

Electronic human resource management system;

Implementation of new law regarding the civil service pay.

## Anti-corruption

Corruption has become systemic in numerous areas of Moldova's economic activity. Uncertainty associated with economic transition, unstable social safety nets, widespread state capture by various interest groups, and a large shadow economy have created an environment for corrupt practices. Key challenges to achieving economic growth, accountable governance, and improved social conditions for Moldovan citizens are to reduce the incidence of corruption and reverse society's acceptance of it.

As of 2009 the Republic of Moldova ranks 89 in the Corruption Perception Index produced by Transparency International for 180 countries. Clear progress in the control of corruption can be attributed to the implementation of Threshold Country Program with the assistance of the MCC, as well as through the support of other development partners in this issue. More has to be done.

Opaque regulation limits competition and favours a small number of interest groups. Invisible to the broad public, these groups have benefited from extracting high rents from their business activity at the cost of impoverished Moldovans. Immediately after taking office our Government lifted numerous trade restrictions, providing space for fair competition. We also plan to expand e-Governance programmes, detailed below, as a crosscutting mechanism to simplify workflows and make resource allocation, public services, and information provision more transparent. This will help to minimize opportunities for corruption.

Much has been invested in the institutional capacity of the Centre for Combating Economic Crime and Corruption. However, public oversight of the anti-corruption body must be strengthened, enabling it to control corruption within government as effectively as it does outside. To this end the Government will develop a new strategy which takes a systemic approach to the control of corruption.

In parallel, the Government will set up automated systems for road traffic surveillance on national highways serving international routes and on road segments with high rates of traffic accidents. This will have a decisive impact on road safety, in which the Republic of Moldova performs much worse than its peers, but will also reduce incentives for corruption.

<b>Challenge</b>	Improve control of corruption
<b>Policy instruments</b>	Approval and implementation of the new Anti-corruption Strategy Unified information system of CCCEC Anti-corruption campaign Setting up automated systems for road traffic surveillance on the national highways

## Fiscal and administrative decentralization

Similar to many countries in transition, administrative decentralization in the Republic of Moldova was not mirrored by fiscal decentralization. As a result, local public authorities became dependent on transfers from the central budget and lacked ownership for policy implementation at local level. Removal of the corporate income tax in 2008 furthered the deterioration of local public finances. Moreover, the mechanism for budgetary transfers from central to local governments provided space for political manoeuvre, awarding those raions (districts) which were more loyal to the central Government and penalising those in opposition.

With support from the UN and SIDA, the Government has launched a programme of Decentralization Reform which takes a rights based and gender responsive approach to advance administrative and fiscal decentralization and to ensure real local autonomy. Decentralization will advance in sequence, expanding the areas of responsibility for local and municipal governments and separate the different tiers of government. In the first stage this includes design, policy-planning implementation and horizontal coordination of the components for a national strategy.

As a second stage, decentralization will consist of a revised assignment of responsibilities to local and sub-national governments, based on the criteria of exclusive, shared and delegated functions, compatible with criteria of allocation efficiency. At this stage the decentralization strategy will clarify the functions and role of regional government agencies and decentralized local governments, phased through the transfer of exclusive responsibilities (communal service, public transport, water and sewerage, garbage collection, transport and landfill administration), with some shared functions (primary and secondary education, primary health services, social services, community based services and residential institutions).

Alongside the redesign of competencies, decentralisation will include the reengineering of the current local government revenue system: assigned (own revenues) and transfers (shared revenues, equalization grants, earmarked and non-earmarked grants). Assigned revenues include property tax (on buildings, land and vehicles, for citizens and companies), taxes on using public property, notary taxes, and non-fiscal revenues (in general rents on using public property – land and buildings). Decentralisation will address both vertical and horizontal imbalances of the current system. Imbalances related to local economic underdevelopment ‘pockets’ will be equalised through non-earmarked and earmarked grants.

Finally, decentralisation will increase the fiscal and institutional capacity of local government via process learning and pilot projects, the introduction of monitoring systems, and quality-standards in the delivery of local public services. We will provide local authorities with a better financial footing, while at the same time setting up a clear mechanism for inter-budgetary transfers. There is an opportunity to use Integrated Financial Management Information Systems (IFMIS) as part of the larger e-Government agenda to support improved financial management alongside transparency building measures such as posting online of public information related to intergovernmental transfers or tax revenue collections.

**Challenge**

Fiscal and administrative decentralization

**Policy instruments**

Redesign of the current inter-budgetary system in Moldova to the emerging needs and demands of the local governments

Coordination and Implementation of the strategy on decentralisation of education, and adjustment of functions to local capacities

Enhance current equalization policies of resources and grant-allocation, at the national and regional level

Capacity building of local and sub-national governments

Expand fiscal base for the local governments and increase institutional budgetary capacities

Expand municipal-level public private partnerships in setting and maintaining public services and adjust existing framework to the existing opportunities at the local and sub-national level

## Funding of Judiciary

Moldova's courts receive inadequate funding: Moldova allocates the smallest share of the national budget to funding the judiciary of any country in Europe. This includes budgets for the operation of the courts as well as funding allocated to pay for capital repairs.

In 2007, the Council of Europe found that funds allocated to the judicial system in Moldova are inadequate for the efficient conduct of the courts and recommended that between 1.5% and 2% of the state budget should be allocated to the judiciary for operating expenditures and for capital repairs. Nonetheless, in 2007, Moldova allocated only 0.7% of the state budget for funding the courts, 0.74% in 2008, 0.61% in 2009, and the judicial budget for 2010 represents 0.52% of the state budget. This downward trend is dangerous and can only aggravate the situation of the Moldovan judiciary.

Inadequate funding of court operations has resulted in low salaries for judges, unfilled vacancies, insufficient staffing and increased caseloads. The national average ratio of court staff to judges in District Courts in Moldova (taking into account total court staff in all categories) is about 2 staff members per approved judge position. A typical European court would have a minimum of 7-12 staff members per judge.

Reforms are needed to establish more objective, transparent and accountable budgeting processes and to ensure that court staff are properly trained in financial management, financial reporting, auditing and procurement.

In addition, funding of the judiciary should also support the transfer of responsibility for people remanded in custody from the Ministry of Internal Affairs to the Ministry of Justice. The Report of the European Committee for the Prevention of Torture and Inhuman or Degrading Treatment or Punishment (CPT) called upon the Moldovan authorities to give the highest priority to implementing this measure. However, during the Committee's 2009 visit, the Minister of Justice indicated that the responsibility for the police Initial Detention Centres (IDCs) could not be taken over by his Ministry because conditions in these facilities were substandard.

In its 2009 Report, the CPT shared the view that IDCs do not offer suitable conditions for holding people remanded in custody. The official occupancy levels in the cells is high (e.g. 4 places in a 10 m<sup>2</sup> cell in Chisinau), there is poor lighting and ventilation, no showers, and limited access to water. Moreover, the Committee's findings from the 2009 visit indicate that the problem of ill-treatment persists in everyday police practice, in particular during initial questioning. The same is true for prisons which do not offer suitable conditions despite the fact that the UN Human Rights Committee sets forth minimal conditions of detention that must be met irrespective of the state of development or budgetary constraints.

While the 2008-2011 National Development Strategy Action Plan includes provision for building 7 houses of arrest (pre-trial detention centres), none has been built so far. Additionally, one prison was to be built and another six were to be reconstructed. Only one prison was reconstructed in 2009.

**Challenge**

Independent judiciary

**Policy instruments**

Increase financing of the judiciary

Introduce performance based budgeting for judiciary

Transfer of the pre-trial detention responsibilities from the Ministry of Interior to the Ministry of Justice

Building of pre-trial detention centres

Ensure safe and humane conditions of confinement

## E-Governance

The Electronic Governance (e-Governance) concept was floated by the former Government, but it yielded few visible results. This is unfortunate because e-Governance could help to reduce the costs of doing business and of public service provision for citizens. Inefficient agency coordination and fragmented databases have multiplied application procedures and other requirements for beneficiaries of public services, leading to higher overall costs for the Government, businesses, and citizens. This Government is committed to a full-fledged digital transformation of governance to enable more efficient and improved service provision to citizens and businesses.

Our short-term objective is to conduct an audit of all state agencies providing paid services to business and citizens with the aim of identifying quick efficiency gains by reengineering processes using ICT. In the medium term, we intend to use the internet for various public registries and secured intranet for registries containing private data. Data about licenses, authorizations, public procurement, court decisions, and state information must be open to the public, while individuals should have secured access to private information. There is also significant scope for improved coordination among Government agencies at various levels – central, district, and local. Documents provided by public authorities to businesses and citizens should be available within minutes, minimizing long queues, trips to Government offices, and opportunities for bribery and corruption.

To this end, our Government undertakes to:

- Design a unified Public Sector ICT organization and governance structure to mainstream the use of ICT within Government agencies
- Design and implement Government to business (G2B) and to Government to citizen (G2C) service portals by integrating workflows and dual use of systems
- Expand online and mobile service delivery to citizens and businesses, including the 20 basic e-services in EU classification

### Challenge

Efficiency and quality of public services provision to citizens and businesses

### Policy instruments

Assessment of citizen- and business-facing public services

Design and institutionalize a unified Public Sector ICT organization and governance structure

Design and implement Government service portal by integrating the workflows and minimizing duplication of systems

Alleviate the reporting burden for business by implementing e-reporting (including e-statistics)

Expand online and mobile service delivery to citizens and businesses



## B. Foster Economic Recovery

The Republic of Moldova needs growth for development. Achieving policy objectives in education, public health, social protection and other sectors depend upon how well the country is performing in economic terms. In light of the economic downturn, the model through which growth is a function of high consumption rates in turn fuelled by remittances from abroad has proven unsustainable.

This model relies on imports of goods and services as the major, if not only, driver of government revenue. During recession the concomitant fall of consumption rates and government revenues reduces the fiscal space for government intervention. Even during economic booms, this model generates growth rates limited to the comparative advantage in labour productivity and does not enable faster convergence with our European neighbours. Business sophistication is minimal and overall economic growth is factor-driven.

The vision of our Government is to re-establish a growth path and at the same time, ensure export and investment led growth. To do this, we need to facilitate a transition to a knowledge-based economy, where ICT plays a major role in integrating Moldova into the global information economy and knowledge pool, while offering a foundation for long-term job creation and economic growth. At the same time, reducing the footprint of the state in the economy by removing barriers to competition is a key priority of this Government.

Despite the fact that infrastructure is a major determinant of economic growth it was largely underfunded by former governments. In light of the current economic downturn, the volume of public spending on infrastructure dropped to 5.3% of GDP in 2009 from 7.5% of GDP in 2007. To counterbalance this reduction, we stand ready to employ various forms of public-private partnership (PPP) and other collaborative solutions. However, as there are limitations to these solutions, we seek additional support from our international development partners to rebuild critical infrastructure.

Economic growth is the key factor that enables us to fight poverty and promote human development in a sustainable manner. In this regard, we are also concerned with the quality of growth to ensure that it provides equal employment opportunities across regions and does not discriminate on the basis of gender, race or disability.

## Improve business conditions

There is a fine balance between the costs of business regulation and its benefits for society. This balance is not always obvious. For instance, there are numerous public services, such as licenses, authorizations, permits, and reports which are not justified. A clear signal that licensing of business activity does not serve a regulatory function is that there are thousands of licensed companies active in the market. Instead of safeguarding public interests, the state is often in the position of extracting rents disproportionate to the market it intends to regulate. Worse still, such behaviour of the state restricts competition and yields high prices for final consumers. Our Government will scrutinise the need for all permits, authorizations, licenses issued by public authorities at central and local level.

In 2009, the Republic of Moldova climbed 14 places in the World Bank's Doing Business survey and now ranks 94<sup>th</sup> in the world. This is much too low in comparison with our regional peers and there is clear potential to make a quick jump in the ranking by engaging in concerted cross-sector reform. To this end the Government has approved an Action Plan for the Removal of Business Constraints which *inter alia* addresses the deficiencies revealed by the Doing Business Reports and Cost of Doing Business Surveys.

Specifically, the Government has committed to:

- Implement effectively the principles of good regulations as defined by Law 235 on Basic Principles of Regulation of Entrepreneurial Activity;
- Reduce significantly the number of categories of goods subject to mandatory compliance certification and licensing requirements and other types of authorizations imposed on business activities;
- Enforce a one-stop shop policy to streamline relations between companies and government without the need to interact with other government agencies;
- Modernize the legal framework for construction authorization to reduce the duration and number of procedures related to obtaining construction permits;
- Improve investor protection by amending the legislation on joint stock companies to bring it in line with best practice and make adequate enforcement mechanisms.;
- Reduce the tax reporting burden by promoting the use of electronic reporting;
- Simplify procedures for business registration and liquidation;
- Eliminate duplication of information requirements imposed by public agencies;
- Substantially improve the regulatory framework of sanitary and veterinary services.

E-Governance programs focused on Government to Business service delivery could also help in cutting the costs and improving the efficiency of the business environment. From one-stop shop facilities, to online business registration solutions and secure electronic signature, re-engineering existing processes using ICT will simplify services and ensure significant savings in the public sector.

Complementary to the above, we plan to expand the mandate of the Moldovan Investment and Export Promotion Organization (MIEPO) transforming it into a functional front office for all interested investors, facilitating their interaction with various regulatory institutions.

**Challenge**

Improve environment for doing business

**Policy instruments**

Eliminate red-tape and promote deregulation of markets

Create one-stop shops

Streamline procedures in the fields of construction, investor protection, business registration and liquidation

Redesign of MIEPO into an investors' one-stop shop consulting agency

## Stimulus for business development

Access to credit by start-ups and SMEs has always been difficult. Lack of credit history, proper collateral or both makes borrowing from commercial banks highly problematic. These problems have exacerbated recently due to the credit crunch. At the end of 2009, the total stock of lending to the real economy decreased by 16% compared with the end of the previous year.

Interest rates are very high for start-ups and SMEs and there is no alternative to borrowing from commercial banks. Lending rates have been in the range of 18-25% for more than a year and despite deflation, lending rates did not follow the downward trend established by the easing of reference rates by the National Bank of Moldova. This is because the risk premium charges by commercial banks increased due to the economic crisis. As a consequence lending rates doubled in real terms.

Acknowledging that absorption is the main constraint, the Government responded with a variety of policy instruments to increase access to finance for start-ups and SMEs.

- *Interest rate subsidy or partial guarantee for credits provided to SMEs through the state Guarantee Fund managed by the Organization for Development of Small and Medium Enterprises.* At the end of 2009 the ODSME was managing a portfolio of €335,000 in guarantees issued in favour of 25 SMEs and triggering investment of €1 million. The Government's plan is to increase the capital of ODSME to €6 million in three years, reaching 100 new enterprises and triggering investments of €18 million.
- *Concessional loans through the National Programme for the Economic Empowerment of Youth (NPEEY).* Around 300 projects received access to concessional credit amounting to €5.7 million by the end of 2009. This lending was backed by World Bank financing. The objective is to continue funding 400 new private projects of young beneficiaries, gender balanced, on concessional terms.
- *Matching grants for invested remittances (PARE 1+1).* According to research, less than 5% of remittances are invested. In order to boost this figure, the Government started a national programme that includes information, communication, research, training, consulting, and financing of businesses created with the help of invested remittances. Through this programme, the state will match each invested Lei with a granted Lei for investments up to 200,000 Lei (€11,300). It is planned to support the creation of 240 new enterprises in rural areas of Moldova over the next 2 years.
- *Matching grants for implementation of ISO certification.* Access to export markets is crucial for SMEs that target economies of scale. The Government's objective is to enable businesses to receive internationally recognized certification. The Competitiveness Enhancement Project of the World Bank has successfully done this in the past. Our objective is to reach 100 new enterprises annually.

In addition, the Government wants to set up a network of business incubators and strengthen existing ones to provide SME support infrastructure, to improve SME viability and to encourage more innovation and the introduction of new technologies and know-how which should result in growing budget revenues. The Government will also step-up procurement of equipment for creation

of small industries in rural areas (pursuant to the mechanism used by the Implementation Unit of the grant provided by the Government of Japan). We will also provide matching grants for consulting services for restructuring private and state-owned enterprises, including export marketing, studies, plans and activities.

Increasing the financial allocations provided through these programmes is expected to boost entrepreneurial activity but is also seen as a social measure to increase occupation through self-employment and reduce emigration of the labour force. The Government will implement policies and services to promote women's employability, especially targeting poorer women in rural and suburban areas.

**Challenge**

Stimulus for business development

**Policy instruments**

Increased portfolio of guarantees for start-ups and SMEs

Concessional lending for youth and women's empowerment

Launch the program of matching grants for returning migrants willing to start-up a business (PARE 1+1)

Establishment of business incubators

Leasing of equipment for creation of small industries in rural areas

Matching grants for implementation of the ISO certification

Matching grants scheme for restructuring plans and export marketing, studies, plans, activities

Introduce programme budgeting for business development

## Industrial parks

In addition to a better business environment and access to financial resources, businesses need proper infrastructure. This is of even greater importance in the context of regional development in Moldova. In the Republic of Moldova, industry only just survived the transition period and suffered significantly in the recent economic crisis: in 2009 industrial production dropped by 22%.

Appropriate infrastructure includes the physical infrastructure for business operations such as utility networks and other facilities. The Government will promote the development of industrial parks by providing a range of incentives including conversion of agricultural land for industrial purposes free of charge; offering assets, such as facilities and land owned by local and central governments; and building appropriate infrastructure and public utility networks for industrial parks. At the moment the Government is revising these incentives in cooperation with the private sector, in order to simplify application and granting procedures and include additional incentives. For this purpose the Law on industrial parks will be amended.

Through European Union technical assistance, a group of experts carried-out a feasibility study on the creation of industrial parks in the Republic of Moldova. The study revealed five potential locations for industrial parks and estimated the necessary investment at €73 million. If established, the industrial parks will provide up to 25 thousand new jobs. The regions where the parks will be established will also benefit in terms of increased revenues to local budgets, improved infrastructure, import of advanced technology and management capacity, and new business opportunities for SMEs. The Government will work to link these parks to educational institutions to enable two-way interactions (improved training opportunities for educational institutions and access to skilled youth & technical knowledge for firms).

One area of focus in the Industrial Parks programme could be to focus on Information Technology (IT) and Information Technology Enabled Services (ITES) to harness Moldova's growing potential to become a service centre for the EU and CIS countries. Such "IT parks" could host specialized business incubators, ICT skills development facilities, and offer world-class facilities to global or regional IT/ITES firms to attract them to locate there. This will attract investments, develop the local IT/ITES industries, and facilitate venture capital and inward investment while opening the doors to increased service exports.

Moreover, the creation of industrial parks fits well with the Government's vision of making the growth model more sustainable by inviting export oriented companies to locate their investments in these industrial parks. Six local governments have expressed interest in allotting space for the creation of the industrial parks on their premises. Partnership with the private sector is required through which the Government will commit to ensuring the necessary infrastructure for job creation and export efficiency.

**Challenge**

Promote export-led growth model

**Policy instruments**

Streamline legislative framework for the establishment of industrial parks

Setting up industrial parks and providing them with access to infrastructure, educational and research institutions, and human resources

## High value agriculture

One third of Moldovan labour is engaged in agriculture, where the wages are low. The sector is characterised by poor access by local producers to markets, lack of storage capacities, limited access to credit, and low investment. The economic recession has hit Moldovan agriculture as with other sectors of the economy; however the budgetary constraints provide little fiscal space for agricultural subsidies.

To ensure sustainability, we need to raise efficiency in the agricultural sector. To this end, the Government has secured financing from the Millennium Challenge Corporation (MCC) to support, *inter alia*, the development of high value agriculture. This will help to increase agricultural incomes of rural Moldovans by stimulating the production and improved marketing of high-value agricultural products, including fruits and vegetables. The project includes plans to provide reliable water for agriculture by repairing up to 11 large irrigation systems servicing 15,500 hectares. Our estimates indicate that there is scope for repairing 4 additional irrigation systems.

Improving access to credit for agricultural projects and a technical assistance package co-financed by the United States Agency for International Development will support related investments by farmers and entrepreneurs in the shift to higher value agricultural production, post-harvest processing, storage, and marketing.

In addition, compliance to international/EU standards and food safety requirements is key to access export markets. To this end, we see benefit in setting up a new project that will provide financing with a grant element to farmers for the acquisition of agricultural equipment (similar to the SAPARD project in neighbouring Romania). Also servicing this goal, the testing laboratories in the phyto-sanitary field need to be re-equipped and modernized in order to receive international accreditation.

Higher productivity in agriculture will require human resources for other sectors. Therefore, this Government undertakes to liberalize land transactions by transferring the power to change the destination of land from central to local governments. Integrating ICT into agricultural communities has the potential to improve access to markets, knowledge about prices and farming techniques, and create new economic opportunities for rural communities. The implementation of an accessible geographic information system (GIS), developed through a public-private partnership, can simplify land record management and resource planning. Further to this the implementation of the automated data management system enabling risk monitoring and analysis, searchable databases of agro-industrial companies, tracking of animal origins, and sanitary surveillance, will support increased productivity in the agricultural sector.

Overall, we shall consider the development of high value agriculture in the broader sense of Moldova's regional development and social assistance.



**Challenge**

High value agriculture

**Policy instruments**

Conduct agricultural census

Ensure easy market access to farmers, both to local and export markets

Equipment of the laboratories

Restore irrigation systems

Provide access to credit for farmers

Liberalize land transactions

Design and implement data management systems

Promote agricultural research

## **Infrastructure investment**

Since Moldova's independence, with the exception of telecommunications, investment in infrastructure has been inadequate and infrastructure maintenance has been neglected. According to the Global Competitiveness Index, infrastructure is one of the pillars in which the Republic of Moldova scores worst. This assessment is particularly true for the road infrastructure and to some extent true for the water supply and electric power infrastructure.

Taking the ground transportation system as a whole, it should be noted that railroad infrastructure does not serve well the needs of the economy. In this regard, we must work out a strategic vision targeting the modernization of the railroads and their connection to European networks.

Public-private partnerships are part of the solution in the field of infrastructure investment. A law setting up the principles of such collaboration was approved in 2008. Another part of the solution is public finance for infrastructure which the Government will step up as soon as the impact of the economic crisis recedes.

### ***Road infrastructure***

The roads in the Republic of Moldova are perceived to be among the worst in the group of countries in transition, and the worst in Europe. According to the Global Competitiveness Index we are ranked 133 out of 134 countries in terms of road quality. Over 90% of the road network of the Republic of Moldova requires immediate rehabilitation. Poor quality roads leads to transportation costs which are 30% higher than in peer countries, and to direct losses to local business. The poor quality of roads in the Republic of Moldova deters international traffic, excluding the country from the pan-European network. The bad state of national roads hampers people's access to medical infrastructure and education facilities.

To this end, the Government has secured MCC funding for 93 km of roads to be rehabilitated in the north-eastern part of the country, as well as joint EU, EBRD and EIB funding for the second phase of the Road Rehabilitation Project. However, this only covers a small portion of Moldova's 3,600km of national roads that require immediate attention. To address the issue the Government has recently announced a feasibility study for the rehabilitation of another 750 km of national roads, which need financing either in the form of public investment or through a PPP.

Urban roads, which bear the highest traffic, are in very poor condition. High post-rehabilitation costs associated with road maintenance have prevented donors from engaging in support in this area. In the medium term, sustainability in this sector will be restored through fiscal decentralization through which local governments will have a stronger financial footing.

Unfortunately, the economic crisis has constrained Government intervention in the immediate future and, once again, we count on our development partners, including the private sector for support.

To ensure sustainability, the Government undertakes to:

- Amending the Road Fund Law, providing a more reliable mechanism for adequate road maintenance funding;
- Implementing a truck axle weight limit control system to prevent heavily loaded and overweight trucks from further deteriorating national roads;
- Stepping up public investment for roads infrastructure as soon as the impact of the economic crisis alleviates;
- Adopting PPPs for national roads where applicable.

**Challenge**

Improve quality of roads

**Policy instruments**

Amendment of the Road Fund Law

Public investment in road repairs and maintenance

Public-private partnership for road rehabilitation

Rehabilitation of main urban roads

***Drinking water and sanitation infrastructure***

The state of water supply and sewerage infrastructure is extremely poor and has been for some time. Revenue does not reflect the real cost of service provision, leaving service providers carrying high levels of debt. Water supply and sewerage facilities are underutilised by around 25 – 30%; at the same time, water losses are significant, caused by worn equipment and poor maintenance of the water supply network. Sewerage facilities are absent in many parts of the country. Limited financing and under-investment over the last fifteen years has meant that maintenance has not been carried out and infrastructure has not been adequately developed.

Half of Moldova’s population, particularly in rural areas, does not have access to safe water sources and to an improved sewerage system. Almost 90% of rural households do not have basic water and sanitation facilities in their homes. Living in the rural areas has become synonymous with tough living conditions and lack of infrastructure. Poor access to sanitary infrastructure has a negative impact on the population’s health. In this context, the Government considers the development of water supply and sewerage facilities among its top priorities, and will ensure adequate support for this and to increase the proportion of the population having access to improved sources of water supply and sewerage.

In line with this priority, investments will be made to reduce risks to public health, including through reducing excessive levels of nitrates and microbial contamination in rural drinking water supplies through fencing of well zones, removal of rubbish heaps, public information campaigns and by protecting groundwater in rural areas, e.g. through simple latrine improvement programmes. Substantial investments will also be made in improving sanitation in rural educational institutions

including through the installation of mini stations for water treatment and improved sanitary standards in lyceums and gymnasiums.

**Challenge**

Access to safe water sources and improved sewerage systems

**Policy instruments**

Public investment in water supply and sewerage infrastructure

Modernisation of the rural areas through infrastructure projects in sewerage, garbage collection, and sanitation units in schools, hospitals, other public institutions

*Energy*

Up to 98% of primary energy resources in Moldova are imported, the country being highly dependent on supplies from Russia and Ukraine. Until recently national tariffs for energy were regulated by public authorities which limited increases in tariffs because of concerns about the impact of price rises on the population. Tariff increases are required to fund improvements in equipment, 60% of which has been in use for over 30 years and 40% for more than 40 years. This situation leads to reduced quality of electric power supply services as well as to increased losses during energy transportation and distribution, and ultimately to low sector efficiency and accumulation of debt along the energy sector value chain (starting with import and ending with final consumption).

From the beginning of 2010 the independent regulator ANRE has been responsible for establishing tariffs for all energy companies along the value chain. This will allow for proper adjustment of tariffs for energy resources but cannot solve the problem of inefficiencies in state enterprises.

In order to reduce further accumulation of debt and/or increases in tariffs for energy, the government is planning to assess the efficiency of energy companies and invest in restructuring their operation, making them more efficient. This will require the modernization and extension of the generation capacity of the national Combined Heating Plants and energy distribution networks, as well as construction of new energy interconnections with neighbouring countries. Undertaking this modernisation will make the sector more attractive to private sector investors. Bearing in mind the Government's objective to optimize energy tariffs by improving efficiency, diversifying sources of primary energy and promoting energy conservation, we will compliment the measures above through the development of the thermal-energy sector.

**Challenge**

Development of energy infrastructure

**Policy instruments**

Restructuring of the energy sector

Modernize production equipment and energy distribution network

Extension the generation capacity of national CHP's

Build connections to international gas pipelines  
Restructuring of the heating sector  
Implementation of the programme for the thermal rehabilitation of buildings  
Setting up the Energy Efficiency Fund

### *Information & communication technology (ICT)*

Our Government is keen to transform Moldova into a knowledge based society. However, the development of the ICT sector lags regional peers. Market penetration of broadband internet is less than 2 percent, most of it concentrated in Chisinau. The development of the IT sector is held back because of limited skilled labour, the presence of a dominant state-owned company which crowds out private firms, and the absence of a coherent industry development and promotion strategy. Moldova lags behind all its Eastern European peers in the adoption of e-services because of a weak information society strategy, unequal distribution of access throughout the country, and limited mainstreaming of ICT in other sectors.

Our Government is keen to unlock ICT sector growth, creating the conditions to increase job creation, diversify the economy, and enable trade. This will lay the foundations for the transformation of Moldova into a knowledge based society. To achieve this, our Government is planning to review the strategic and policy framework and (1) promote competition and strengthen the regulatory environment in the telecommunications sector, (2) expand the information technology (IT) sector, and (3) enhance e-government services, including mobile services.

Even though liberalization of the telecommunications sector led to growth, Moldova still lags behind its regional peers because of limited competition and a weak regulatory environment. The dominance of Moldtelecom has limited the growth of competitive fixed line telephony and internet service providers. Further, the mobile telephony market remains highly concentrated despite having four service providers. A weak regulatory regime has been unable to mitigate the effects of dominance and an uneven playing field.

To promote competition now will require strengthening the regulatory framework and restructuring Moldtelecom. A strong regulator can mitigate the effects of market dominance and create a level competitive playing field. Restructuring, or even privatizing Moldtelecom with adequate competition safeguards, will invite investment and enhance the incumbent's performance, enabling it better to face the competitive environment and technological evolution.

Promoting the information technology (IT) sector will diversify the economy and create jobs. The strategy must address the existing skills gap, which is compounded by the stagnating quality of technical education and the emigration of young professionals. Further, the government can improve firms' access to finance, develop shared infrastructure such as technology parks, and promote the sector internationally. It can also leverage its role as a major user of IT to generate business, supporting local firms through their initial growth.

Expanding e-Governance programmes will improve the delivery of public services to citizens, reduce corruption, and increase trust between citizens and the state. However, the Government will have to move beyond simple automation towards business process re-engineering that improves the effectiveness of such programs. This issue is addressed in the section on e-Governance (page A.13).

**Challenge**

Development of the ICT sector to lay the foundation for Moldova's transformation into a knowledge based society

**Policy instruments**

Develop a coherent and unified ICT sector strategy

Improve competition and strengthen the regulatory framework in telecommunications

Expand ICT skills development programmes through stronger private sector links

Development of national optical fibre infrastructure for electronic communications

Development of an on-ground digital television network

Enabling access of the population to broadband internet and advanced ICT solutions

## Regional Development

Regional disparities in economic growth are a major source of concern for our Government. The two-speed development between Chisinau and the rest of the country has resulted in a number of raions being deprived of adequate access to healthcare, education and basic infrastructure. We aim to address these issues through targeted policy measures. However, the lack of economic power outside the capital city is still the root of regional imbalances. To this end, the Government has approved the National Strategy for Regional Development.

Through this Strategy the authorities have committed to:

- Establishing a National Fund for Regional Development (NFRD) comprising at least 1% of the State Budget, an amount to be determined annually by the State Budget Law, plus contributions from donors, to be administered by the Ministry of Construction and Regional Development;
- Creating the institutional framework to enable the creation of the National Development Council and Regional Development Councils;
- Creating six Regional Development Agencies and establishing Regional Development Councils formed by local government in partnership with civil society representatives residing in these regions. The councils will take strategic decisions regarding funding of various regional projects, while the agencies will have an operational role.

As of now, public funding has been provided to the three RDAs which are established, but they still lack the capacity to become fully operational.

### Challenge

Balanced economic growth across regions

### Policy instruments

Budgetary allocations for the National Fund for Regional Development

Capacity building of the Regional Development Agencies

## C. Human capital

The economic crisis has had adverse effects not only on the country's economy and Government's ability to respond adequately, but also on the country's most vulnerable people. The shrinking economy led to an increase in the unemployment rate through returning migrants, limited job creation, payroll cuts or fewer working hours imposed by employers, with Government having sparse leverage to support those affected. The drop in remittances which previously provided decent living conditions for people and kept households out of poverty is a critical factor increasing the vulnerability of households today.

The MDG agenda which seemed to be within arm's reach in 2007 is currently at risk due to the economic turnaround. Out of 28 national targets set by the Republic of Moldova 6 are likely to be missed by 2015. These are:

- Increase the gross enrolment rate for general secondary education from 94.1% in 2002 to 95% in 2010 and 98% in 2015;
- Increase the enrolment rate for pre-school programmes for 3-6 year-old children from 41.3% in 2002 to 75% in 2010 and 78% in 2015, and for 6-7 year-old children from 66.5% in 2002 to 95% in 2010 and 98% in 2015, as well as reduce by at least 5% the discrepancies between rural and urban areas, and between disadvantaged and middle-income groups;
- Stabilize the spread of HIV/AIDS by 2015. Reduce HIV/AIDS incidence to 9.6 cases per 100,000 people by 2010 and 8 cases by 2015;
- Increase the share of the population with permanent access to safe water sources from 38.5% in 2002 to 59% in 2010 and 65% in 2015;
- Increase the share of the population with permanent access to improved sewerage systems from 31.1% in 2002 up to 50.3% in 2010 and 65% in 2015;
- Increase the share of the population with permanent access to improved sanitation systems from 41.7% in 2002 to 51.3% in 2010 and 65% in 2015.

The economic crisis is not an excuse for reducing investment in human development. According to the Human Development Index, the Republic of Moldova's ranking of 117<sup>th</sup> out of 158 countries means it is outperformed by many of the country's peers. Of course, low GDP per capita is still the origin of these problems, therefore the Government will make efforts to find a balance between growth and social spending, while making public spending available to the neediest, to avoid social exclusion and reduce the risk of poverty.

Education, Public Health and Social Protection are the sectors that consume most public spending. Unfortunately, the spending of taxpayers' money across these sectors is far from optimal. Efficiency gains in education spending would arise from school optimization. Similarly, there are savings to be produced through healthcare reform but the initial costs for the modernisation of the hospital



system are high. With regard to social protection, the challenge is to direct social assistance to the neediest and away from the outdated system of 13 different social assistance programmes.

## Education

In the Republic of Moldova budgetary allocations for education are quite high by regional standards – in excess of 8% of the country’s GDP. In addition, the allocation was increased in 2009 as a result of salary increases enacted by the former government and motivated by the election campaign. However, despite the level of public spending, the education system fails to produce quality at all stages of education, with particularly poor outcomes in primary education and vocational education. Limited access to qualified labour, supplemented by a significant brain drain is constraining investment and entrepreneurial activity. As Moldova develops its foundations to become a knowledge-based globally competitive economy, it should consider linking ICT and education, both as a subject matter (ICT skills development) and as a tool for the delivery of education in all areas and at all levels (educational technology).

Comprehensive reform of the education sector is clearly needed.

### *Optimize school network*

One of the basic problems in the education sector is the inefficient use of public finances. During the past decade there has been a demographic decline due to low fertility rates and massive outward migration. The drastic reduction in student numbers was not accompanied by reductions in teaching and non-teaching staff. Outdated norms, dating from Soviet times, meant unnecessary increases in the number of teachers and non-teaching staff. The decrease in the number of students means that many rural areas have under-utilized schools with incomplete classes. During the 2007-2008 school year, the student/teacher ratio in such areas was as low as 13 (the European average is 18). At the same time, the non-teaching staff/total staff ratio was as high as 37% (the European average is 27%). As a result only 30%–60% of capacity is used, and the expenditure per student is 3–5 times higher in rural areas than in district schools.

In the medium term, the Government will optimize the school network to use more efficiently the existing technical and material assets and financial resources. Optimization will be achieved through the creation of district schools, development of school transport, implementation of a new school financing formula, and decentralization of financial management to the level of the institution providing educational services.

Optimization will lead to reductions in teaching and non-teaching staff, will reduce the cost of running schools, and improve the teacher/student ratio, bringing it closer to international norms. Savings could be used to increase the salaries of the remaining teachers, as well as to improve water, sewerage and heating systems.

#### **Challenge**

Efficiency of public finances for education

#### **Policy instruments**

Introduction of an adequate financing formula to ensure a more equitable and efficient distribution of public finances for education

Implement nationwide school optimization reform

### *Vocational education and training*

Although formal sector employment in the Republic of Moldova is low by international standards, even now, against the background of the crisis, access to qualified labour is a constraint for development. The labour force is characterized by high rigidity and migration is often the preferred option instead of requalification. Provision of vocational education and training (VET) is highly centralized, understaffed and underequipped. Adult education and continuous vocational training is underdeveloped. It should be organized based on students' previous education background and specialization, and taking into account job requirements and future career opportunities. In reality, there is no systematised information regarding the degree of worker participation in vocational training, although anecdotal evidence suggests that large companies do provide some training to their employees.

Over the medium-term the Government undertakes to apply its best efforts to rehabilitation of vocational education and consolidation of vocational training institutions. In addition, emphasis in professional training will be placed on those professions with high demand in the labour market, and on specialities and professions with which students will be easily integrated to the labour market. One area of focus would be the IT and IT-enabled services (ITES) sectors. Improving links between higher education and private firms in dynamic sectors such as these will lead to better training and increased employment opportunities, especially for youth, and has the potential to reverse the existing brain drain.

A Strategy for the Development of the Vocational Education and Training System has been drafted with support of development partners but, despite being recognized as a priority in the National Development Strategy, did not receive support from the former Government. It has the following specific objectives:

- To modernize the network of vocational education and training institutions and to increase their efficiency;
- To improve the quality and the aims of courses and services provided within the VET system, using occupational standards as a basis for curriculum development;
- To enhance the access of vulnerable groups to vocational education and training;
- To ensure equal gender representation in vocational education and training;
- To modernize the system of information and analysis and to establish an independent evaluation and certification system of VET graduates to facilitate the process of finding employment;
- To implement and apply new information and communication technologies to make the teaching-learning process more efficient and to develop self-learning skills.

We plan to do a quick update of the Strategy and have it approved by the Government.

**Challenge**

Development of demand-driven vocational education and training

**Policy instruments**

Approve and implement the Strategy for the Development of the Vocational Education Training System

***Reform residential child care***

Moldova's education system includes 62 boarding schools, where close to 9,000 children live and are educated. Although the finances allocated to boarding schools have increased in recent years, these have not been sufficient for full coverage of children's needs. Upkeep and functioning of these boarding schools is significantly more expensive than that of regular schools; the salary scale for staff is higher, while the quality of education is often lower than mainstream schools. Most children schooled in boarding schools are there due to poverty and lack of appropriate parental care. Data indicates that graduates from boarding schools have poorer adult outcomes than those from general schools making their social integration particularly challenging.

From the financial standpoint, residential care is an expensive and inefficient form of schooling as compared with systems based on family support and community services. Furthermore, the place of boarding schools in the system of child protection is unclear, with the boarding schools identified as either a form of educational services (subordinate to the Ministry of Education) or of medical assistance (subordinate to the Ministry of Health) instead of coming under the remit of the Ministry of Social Protection .

It is necessary to implement a deep reorganization of residential institutions, through development of an efficient and flexible financial mechanism involving the redirection of financial resources from a residential system to community and family services, by advancing professionalism of human resources and through consolidation of capacity for monitoring, evaluation and supervision at all levels of child and family protection.

**Challenge**

Reform the residential care system

**Policy instruments**

Moratorium on new admissions to several boarding schools with appalling conditions

Speed up the implementation of the Strategy for Reform of the Residential Care System

## Health

Reforms implemented in recent years in Moldova's health system to strengthen primary health care and launch compulsory health insurance have enabled progress towards achieving the Millennium Development Goals. Basic health indicators such as infant mortality, vaccination rates, deaths caused by acute diseases, and others have all shown improvements. In spite of this progress, average life expectancy at birth remains 10 years less than that of the European Union member states, and one of the lowest in Europe. Currently the most common cause of death is chronic non-communicable diseases. High morbidity and mortality rates call for new approaches to addressing public health issues, involving all social sectors in tackling the root of health problems. Furthermore, there is clear benefit from redirecting the healthcare system towards illness prevention.

### *Public Health*

Strengthening health systems and protecting public health are priorities for the ongoing health reforms and a subject of the future Association Agreement between the Republic of Moldova and the European Union. The alignment to international and European community norms implies the adjustment of the public health system particularly to the International Health Regulations (2005).

The State Service for Public Health Surveillance was traditionally oriented towards communicable disease prevention and control, regulation over exposure to risk factors, surveillance and law enforcement; the Service needed to be adapted to address public health challenges. In order to achieve this goal and ensure accessibility, equity, quality and provision of efficient health services, the State Service for Public Health Surveillance underwent reorganization.

However an effective State Service for Public Health Surveillance requires appropriate and coordinated supporting actions if it is to respond to new challenges that affect the population's health status. These actions include surveillance, prevention and control over communicable and non communicable diseases, health promotion, information and health education, and assessment of the social determinants of health. The main proposed actions include a) rehabilitation and modernization of diagnostic and laboratory services; (b) strengthening implementation capacity for public health programmes, disease prevention and control; (c) mainstreaming ICT into the provision and management of healthcare to extend its reach, to improve health outcomes, and enhance efficiency; (d) health promotion and training of specialists involved in public health; and (e) promotion of gender sensitive preventive, biomedical, behavioural, epidemiological and health-service research, including the testing of new and emerging drugs and medical technologies, benefiting women and men equally.

#### **Challenge**

Protection of public health in line with international and EU standards

#### **Policy instruments**

Development and enforcement of public health service standards in line with EU recommendations

Modernization of diagnostic and laboratory services

### *Restructuring of the hospital sector*

The slow transition to a market economy accompanied by a significant economic crisis has had a major negative impact on the health system in general and on the hospital sector in particular. Having inherited the Soviet principles of organization, the hospital sector remains the consumer of approximately half of the resources allocated to the health care system.

Hospital system reform started in 1996 and the number of hospital beds has halved since then to reach the European average. Over the last two decades no significant investments have been made in hospital infrastructure, and conditions in hospitals now are dire. Medical equipment is outdated or does not work, and sometimes can be dangerous for both patients and medical staff. Where modern and expensive equipment exists it is not used optimally, often having been purchased and placed in hospitals without any analysis of specific needs and cost-effectiveness.

Hospital reorganization was identified as a health system priority and is stipulated within the national policy and strategic planning documents including the National Development Strategy for 2008-2011, the National Health Policy for 2007-2021 and the Health System Development Strategy for 2008-2017. In order to manage effectively the investments needed for the hospital sector, modernization will take place in accordance with the National General Plan for the Hospital Sector developed by an international consulting company with the financial support of the World Bank. While primary health care reform is being financially supported by the European Commission through a Sector Policy Support Programme of €46.6 million, financial sources for the implementation of the General Hospital Plan have yet to be identified. A partial financing commitment of about €15 million has been obtained from the European Commission, the World Bank and Council of Europe Development Bank but this is insufficient for the implementation of the Plan.

The objective of the Plan is to create a cost effective hospital system capable of providing higher-quality, safer and more accessible health care services. In this regard the changes have been designed in three steps: short-term (phase 1), medium term (phase 2 and 3) and long term (phase 4 and 5). Medium term investments needed for 2010-2013 constitute €637 million.

The consolidation and restructuring of hospitals under the National General Plan for the Hospital Sector will enable the achievement of a fundamental change by accelerating the development, re-equipping and modernizing of the whole system, adjusting it to European Union standards, able to contribute more effectively to increasing public accessibility to quality health care and ultimately leading to improved health status. Referring the most difficult cases to tertiary level hospitals and upgrading their infrastructure will ensure a safe environment for the delivery of high quality medical services. This will generate savings through decreased rates of intra-hospital infection, complications and medical errors.

Consolidation and restructuring will minimise duplication of services and end the waste of available resources in the hospital sector. According to studies conducted in 2002 and 2006, by optimizing specialized services, about 135 million lei (€7-8 million) will be saved annually. There may be opportunities to improve efficiency and generate further savings by using Health Information

Systems to link various hospitals to transfer patient information quickly, allow consultation among medical personnel, and to manage resources such as medical supplies.

Appropriate hospitalization of patients will improve the bed occupancy rate by 25% and will reduce the average length of hospitalization by about one day (10%). Hospital sector reform will create conditions for the treatment of about 25% of cases in outpatient facilities, where costs are 30% lower than inpatient care. These reforms will increase patient satisfaction with and confidence in physicians, medical institutions and the health system as a whole. Hospital modernization should also increase the motivation of health professionals. The total costs of the Plan for the next three years are estimated to be up to €475 million, including €183 million for the Northern region, €223 million for Centre and Chisinau, and €69 million for the Southern region of the country.

**Challenge**

Hospital sector reform and adjustment to European Union standards

**Policy instruments**

Development of outpatient facilities and optimization of the hospital network

Rehabilitation of Hospital Centres, including their refurbishment with adequate medical equipment

Quality management (use of standardized treatment guidelines; and reference guidelines between levels of care)

## Social Protection

As the economic crisis has worsened, the vulnerability of Moldova's population to the risk of social exclusion has increased. The Government is committed to protecting those in need through provision of adequate social benefits and the development of an integrated system of social services. A programme for reform of the system of social assistance was launched in 2008 with the adoption of the Law on social assistance. The gradual substitution of nominative compensation and certain benefits which are category based with means-tested social assistance for vulnerable households is indispensable for directing support to the most vulnerable. A particular medium-term emphasis will be put on support for persons with disability, the most vulnerable group in the context of social exclusion. Comprehensive reforms are necessary for sustained social inclusion in society.

### *Implement targeted social assistance*

Until recently social assistance was provided through allowances (nominative compensation) paid to eleven categories of people who are not necessarily the poorest. Social assistance therefore did not always reach the neediest. Nominative compensations for payment for utility services and for electric power represent the most significant social allowances, both in terms of budgetary allocations (around €20 million) and in terms of the number of beneficiaries (about 256, 000).

Phasing out nominative compensations creates social distress and therefore a gradual approach has been adopted to avoid undue stress on vulnerable households. However, to minimize overlap of payments, we have discontinued registration of new beneficiaries for nominal compensations, and frozen the amount of nominal compensation benefits paid from January 1, 2010.

The targeting mechanism for means tested benefits under the Social Support Law adopted in 2008 is currently being piloted, allowing social assistance to be directed to those with incomes below a minimal threshold. Beneficiaries have been identified and transfers have begun. Our objective is to encompass two thirds of eligible recipients by end of 2010. An intensive communication campaign is already underway to promote enrolment of eligible households into the new system. In the longer term the guaranteed minimum income should be increased to the level of the absolute poverty line.

Ensuring that government benefits reach the right people in a secure and cost-effective manner is a high priority. Implementing existing ICT applications for identity management, such as e-ID solutions, will be a major asset to address many of these challenges and alleviate difficulties faced by citizens and government alike, such as identity fraud and expensive, time-consuming paper processes.

Alongside cash benefits, social assistance encompasses social services grounded in community needs, sustainability, and the principle of access. These have to be provided for different social groups (families in need, persons with disability, the elderly and children) according to a mapping of needs for such services. To this end, gender balanced community based services must be developed, including through the implementation of a public private mechanism for procurement of social services at the local level.



**Challenge**

Provision of social assistance to the neediest

**Policy instruments**

Institutional capacity development in the field of modelling / forecasting policy adjustments relating to cash benefits

Developing a social inspection model for effective provision of the targeted cash benefit mechanism

Development of integrated community-based social services provision

***Protect persons with disabilities***

Statistics show that there are over 170,000 people with disabilities in Moldova. Social protection for persons with disabilities is provided through a range of policy instruments: pensions, social allowances, social services, medical services, educational services, job placement, and fiscal facilities for employers. Unfortunately, the current approach is centred on the medical aspects of disability, overlooking inclusion issues. Comprehensive reforms are envisaged in order to ensure that persons with disabilities are not excluded from society.

The human rights of people with disabilities are challenged by inadequate government interventions, for example in education the lack of appropriate facilities and rigid curriculum prevent children with disabilities from attending regular schools; social services provided to people with disabilities are sub-optimal, while professional orientation and training for social workers on this issue is limited. Labour legislation discourages discrimination against persons with disabilities and provides some incentives for employers to hire disabled employees, but in practice these are rarely used.

The Republic of Moldova's signing of the UN Convention on the Rights of Persons with Disabilities on 30 March 2007 marked the beginning of the reform process in this field, reflected in the National Development Strategy. To this end, the Ministry of Labour, Social Protection and Family has drafted a Strategy on the Social Inclusion of Persons with Disabilities. In 2010, the Government will finalise and approve this Strategy.

**Challenge**

Protection and social inclusion of persons with disabilities

**Policy instruments**

Approval and implementation of the National Strategy for Social Inclusion of Persons with Disability

Development of social rehabilitation services (3 regional centres)

Establishing an information system for evidence of persons with disability.