Republic of Moldova
Policy Priorities for Private Sector Development

June 2013

ECSPF
EUROPE AND CENTRAL ASIA
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# List of Acronyms

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>ANB</td>
<td>National Business Agenda (Agenda Nationala de Business)</td>
</tr>
<tr>
<td>ASYCUDA</td>
<td>Automated System for Customs Data</td>
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<tr>
<td>BRITE</td>
<td>Business Regulatory, Investment, and Trade Environment</td>
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<tr>
<td>BuDDy</td>
<td>Business Diagnostics and Dynamics Database</td>
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<tr>
<td>CEE</td>
<td>Central and Eastern Europe</td>
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<td>CIS</td>
<td>Commonwealth of Independent States</td>
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<td>CODB</td>
<td>Cost of Doing Business Survey</td>
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<tr>
<td>DCFTA</td>
<td>Deep and Comprehensive Free Trade Area</td>
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<tr>
<td>ECA</td>
<td>Europe and Central Asia</td>
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<td>EU</td>
<td>European Union</td>
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<td>EUBAM</td>
<td>EU Border Assistance Mission</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<tr>
<td>GCR</td>
<td>Global Competitiveness Report</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>IFC</td>
<td>International Finance Corporation</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<tr>
<td>LOC</td>
<td>Lines of Credit</td>
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<tr>
<td>NBS</td>
<td>National Bureau of Statistics</td>
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<td>NCFM</td>
<td>National Commission for Financial Markets</td>
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<td>MCS</td>
<td>Moldovan Customs Service</td>
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<td>MOF</td>
<td>Ministry of Finance</td>
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<td>MFI</td>
<td>Microfinance Institutions</td>
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<td>MSE</td>
<td>Moldova Stock Exchange</td>
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<td>MSTI</td>
<td>Main State Tax Inspectorate</td>
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<td>NAPC</td>
<td>National Agency for the Protection of Competition</td>
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<td>PPD</td>
<td>Public/Private Dialogue</td>
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<td>RIA</td>
<td>Regulatory Impact Assessment</td>
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<td>RRS</td>
<td>Regulatory Reform Strategy</td>
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<td>SCA</td>
<td>Savings and Credit Associations</td>
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<td>SOE</td>
<td>State-owned Enterprises</td>
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<td>STI</td>
<td>State Tax Inspectorate</td>
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<td>STS</td>
<td>State Tax Service</td>
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<tr>
<td>TLS</td>
<td>Transport and Logistics Strategy</td>
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<tr>
<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
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<td>WBG</td>
<td>World Bank Group</td>
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<td>WEF</td>
<td>World Economic Forum</td>
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EXECUTIVE SUMMARY

1. The Government of Moldova is seeking to change the country’s development paradigm and build an export-oriented economy characterized by investment, innovation, and competitiveness, following a decade of “jobless growth”. The Moldova 2020 national development strategy aims to move from a remittance- and consumption-driven model of growth to an export-driven model in order to reduce the economy’s vulnerabilities and spur job creation. Improving the business environment and facilitating access to finance are two of the strategy’s central pillars. The government’s efforts to promote European integration are also a key component of the shift in the development paradigm.

2. The success of the Moldova 2020 national development strategy hinges upon improved performance of the private sector, which has been fairly weak in the last ten years. Barring some modest gains and individual success stories, firm-level data shows that enhancement in firm efficiency has been relatively unimpressive. Only 23 percent of enterprises classified as inefficient in 2003/04, which made investments, became efficient by 2008/09, and 33 percent of enterprises that were efficient and invested became inefficient by 2008/09. Moreover, Moldova’s exports have shown little dynamism. They exhibited strong growth in 2000-2004, but in 2004-2008—before the crisis—they expanded at less than 5 percent per annum in real terms. This pace was slower than Moldovan GDP growth and slower than the Commonwealth of Independent States (CIS) average growth. Even more importantly, growth in exports to European and other high-value markets came from further processing of goods using raw materials and design specifications produced elsewhere, i.e. re-exports, rather than Moldovan firms’ own production, which did not manage to expand in countries outside the realm of the CIS. Exports helped the Moldovan economy after the crisis, with strong growth in 2010 and 2011; however, their growth slowed to just over 2 percent in 2012, in the context of a negative shock in the agriculture sector.

3. This report focuses on improvements that will be needed to move Moldova to the next stage of development as envisioned in the Moldova 2020 strategy; however, reforms over the past decade also deserve acknowledgment. Regulatory reforms implemented in 2001-2012, as Moldova was deepening its market economy, brought slow but steady progress. On the Doing Business “Distance to the Frontier” measure, which measures how far a country is from global best practice, Moldova has risen from 55.9 (in 2006, earliest available) to 63.5 (in 2013).

1 In this report, “business environment” refers to the overall business enabling environment: the policies, regulations, and availability of cross-cutting inputs (such as finance and infrastructure), which have an impact on companies’ productivity. “Business environment” does not refer to the business community itself, as the term is sometimes used in Moldova. The term can be used interchangeably with “business enabling environment” and is also very similar to “investment climate”.
2 As determined by an analysis conducted by the World Bank team using the Business Diagnostics and Dynamics database. This database was developed by the World Bank and populated with firm-level data from firms’ financial statements and the Annual Enterprise Survey, provided by the National Bureau of Statistics, for 2003/04, 2008/09, and 2010/11. “Inefficient” firms are those with lower-than-average total factor productivity (TFP), while “efficient” firms have higher-than-average TFP. TFP is calculated using a Solow residual. See more detailed analysis starting in paragraph 36.
3 World Bank staff estimates based on UN COMTRADE data. See World Bank 2011, p. 33.
4 World Bank 2011
5 World Bank 2011
6 This measure shows the distance of each economy to the “frontier,” which represents the highest performance observed on each of the indicators across all economies included in Doing Business since each indicator was included in Doing Business. An economy’s distance to the frontier is indicated on a scale from 0 to 100, where 0 represents the lowest performance and 100 the frontier. For example, a score of 75 in DB 2012 means an economy was 25 percentage points away from the frontier constructed from the best performances across all economies and across time. An increase in the score over time would
Reforms have reduced the percent of time spent by management on meeting regulatory requirements from 17 percent in 2005 to 10 percent in 2012, as reported by the domestic Cost of Doing Business survey.7

4. Despite this progress, the competitiveness of Moldovan firms remains limited by a business environment characterized by uncertainty and high transaction costs. Moldova now ranks 83rd out of 185 economies (55th percentile) in the 2013 edition of the Doing Business report, and 87th out of 144 economies (40th percentile) in the World Economic Forum's 2012-13 Global Competitiveness Report. Companies cite substantial barriers related to many aspects of the business environment, from obtaining authorizations for certain activities, to importing goods, getting credit, and competing on a level playing field with other companies.

5. Improving the business environment is an especially important task, given Moldova’s low levels of natural resources and small internal market. Unlike many other countries of the former Soviet Union, Moldova has relatively few options on which to base a sustainable growth model. Although it has rich agricultural soil, there are few natural resources that can be easily exploited to provide an engine of growth. And with an internal market of 3.6 million people and USD 7 billion, Moldova also has a relatively small base of consumers and investors. Thus, in order to grow sustainably, the need to improve the business environment in order to help domestic companies increase their productivity, and to attract foreign investment, is even more acute.

6. This study aims to identify the most pressing problems in the business environment that are adversely affecting Moldovan companies’ productivity and competitiveness, and to present recommendations that would help remove these obstacles. The analysis is based on a review of existing reports; interviews with government officials, private sector associations, a sample of businesses, and some subject matter experts; as well as original research on access to finance. The findings indicate that Moldovan businesses face considerable uncertainty and/or high costs in their interactions with the government, which reduces real returns and the appropriability of these returns. The problems are further compounded by difficulties with accessing finance. This study has identified that the following aspects of doing business are the most problematic: customs administration; tax administration; business regulation, consisting of licenses, authorizations, permits, and inspections; the competition framework; and access to finance. The report's findings are supported by international assessments and rankings of Moldova’s business environment.

7. In international trade administration, Moldovan companies' performance is adversely affected by delays, unpredictable requirements and valuation practices, burdensome inspections, and corruption. These issues understandably introduce uncertainty and increase transaction costs for enterprises across the whole economy: as an illustration of the importance of trade, in 2011, imports equaled to approximately 74 percent of GDP. The problems are caused – and sustained – by unclear rules, complicated procedures, a lack of transparency, a high degree

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of discretion and insufficient accountability of customs officers, and a heavy reliance on customs for government revenue. To address these concerns, there should be a comprehensive reform effort to shift away from a control-based approach to a modern, enabling one that would give more weight to trade facilitation as an important aspect of customs administration. Over the past couple of years, the Moldovan Customs Service (MCS) has made a number of efforts in these areas, which must be expanded and strengthened.

8. **In tax administration, companies are stalled by the tax authorities’ rigid approach, based on strict controls and inconsistencies in normative acts.** The lack of consistency in awarding fines and penalties, which are often excessive or disproportionate given the severity of the violation, is a common barrier to doing business. It diminishes the companies’ capacity to plan, because their tax-related costs are uncertain, based on experience, and likely to be higher than expected. Businesses also struggle with inefficiencies in the tax dispute resolution system and in the administration of VAT refund claims, as well as frequent allegations of corruption. These problems are symptomatic of an unclear, and at times contradictory, regulatory framework; pressure placed on the State Tax Service (STS) as one of the primary sources of government revenue to generate the direly needed income; and the lack of a mechanism through which the STS can provide advance or binding rulings. There is also a notable lack of public-private dialogue (PPD) on tax matters. The STS has made some progress in key areas, but more is needed. The newly-appointed head of the Main State Tax Inspectorate is committed to continuing and strengthening reforms.

9. **Companies also have to handle multiple and overlapping requirements related to licenses, permits, authorizations, and inspections, which elevate the cost of doing business.** Managers spend a reported 10 percent of their time complying with government regulations on behalf of their firms.\(^8\) Insufficient clarity of requirements as well as the need to get approval from multiple agencies for licenses, permits, and authorizations contributes to this problem. The 2001 Licensing Law attempted to reform this aspect of doing business. However, by restricting its definition of licenses to documents issued by “a licensing authority,” it failed to address a large number of other authorizations, certificates, permits, and detailed operational requirements that are required by government agencies. In addition, the myriad of licenses and permits required by the authorities provides officials with opportunities to restrict market access for reasons other than risk management and consumer protection: for instance, to protect certain economic interests. In inspections, a risk-based approach is rarely applied, and about 40 percent of inspections are duplicates lacking clear criteria, shared principles, and transparent procedures. The government, especially through the Ministry of Economy, has made a substantial effort to pass legislation addressing these issues, and these laws must be fully implemented. The laws include: “Guillotine 2+” (Law 160 of 2011) and prior “guillotine” reforms, as well as the new Inspection Law (Law 131 of 2012), among others. Implementing the 2013-2020 Regulatory Reform Strategy will also be an important next step.

10. **Insufficient competition in Moldova’s domestic market also limits firms’ growth and productivity.** In numerous industries, there are indications of a high concentration of firms, abuses of dominant positions, monopolistic profits, collusion, and other horizontal and cartel agreements. This is problematic because the degree of competition in an economy has a direct

\(^8\) World Bank, Ministry of Economy of Moldova, and Centrul de Dezvoltare Economică Rurală Promo Terra, CODB 2012
impact on productivity, growth, and consumer welfare. Competition problems stem from barriers to market entry, commonly created by government policies (including the overly complex requirements discussed above), and discretion by officials in licensing, authorizations, and inspections, as well as from structural weaknesses in the economy-wide competition policy framework. Political economy considerations tied to linkages between economic interests and public administration also play a constraining role. The government has made progress by enacting a new Law on Competition and Law on State Aid, which aim to address a number of the weaknesses identified. These laws must now be fully implemented. Implementation of the reforms on business regulation, mentioned in the previous paragraph, is also crucial for improving conditions for market entry, another key determinant of market competition.

11. While Moldova’s core indicators of financial depth have improved markedly over the last few years, access to finance continues to pose significant obstacles to private sector development. Smaller companies, in particular, face difficulties, as banks generally continue to focus on lending to a few larger clients, and savings and credit associations, and microfinance institutions only tend to offer small and short-term loans. Moldovan enterprises also highlight the elevated costs of borrowing, high collateral requirements, and limited availability of longer loan maturities as key barriers to doing business. The underlying bottlenecks that were identified in this report were closely linked to Moldova’s current unsustainable model of remittance- and consumption-driven growth. On the demand side, while interest rates and spreads are in line with regional comparators, enterprises’ eligibility for loans and risk profiles are adversely affected by their low and inconsistent profitability, the poor quality of the financial information presented to banks, and insufficient integration into strategic alliances that would help overcome existing information asymmetries. On the supply side, problems arise from a low level of competition between banks and elevated costs of attracting term funding. Banks tend to lack suitable products and credit evaluation techniques for loans to smaller companies, and they face general deficiencies in risk management. Some steps to remove these obstacles have already been taken, as documented in chapter 0 of this report. In addition to recommendations made to address both the demand and the supply side of access to finance, improvements in the business environment will also have positive spillovers into these areas.

12. In sum, the need for reform across the five priority areas is dire. Moldova needs productive, competitive, and efficient firms that create jobs, in order to outgrow the remittance-based, consumption-driven model of economic development. It also needs to work harder than other countries with larger internal markets or more natural resources. Moldovan companies need the government to create an enabling business environment at home by reducing the burden of regulation and compliance, improving access to finance, and enhancing competition in the domestic market.

13. The reforms recommended do not require large amounts of investment, and they can result in substantial – even transformational – benefits. Short-term priority reform recommendations are presented in Table 1 on page 6. Detailed reform recommendations are presented in each chapter and summarized in Annex A. The reforms focus on legal, regulatory, and policy changes. The most important aspect will be to ensure full implementation of these

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9 Weaknesses on the demand/enterprise side of access to finance include: deficiencies in financial management, business, and investment planning; a strong reliance on a few export markets; and low-quality production and poorly organized value chains; as well as deficiencies in the business enabling environment and macroeconomic uncertainty.
changes by the respective government authorities. Once the reforms to remove the priority constraints facing businesses are implemented, Moldova can capitalize on its comparative advantages, such as geographical proximity to high-value markets, access to diverse export markets, low labor costs, and a multi-lingual labor force to expand exports. If it harnesses its potential, the country could benefit immensely from the upcoming Deep and Comprehensive Free Trade Area (DCFTA) and the Association Agreement (AA) with the European Union. Further opening of the EU’s €13 trillion and 500-million-strong consumer market could boost exports and attract FDI. The DCFTA will also expose Moldova’s markets to fiercer competition from European firms and products. This will benefit Moldovan companies and consumers through improved access to lower-cost and higher-quality inputs, and will also increase competition in Moldova’s internal markets. Moldovan companies need an improved business environment to take advantage of these benefits, and remain competitive when the domestic markets open further.

14. **The Moldovan authorities have expressed their commitment to addressing the above-mentioned challenges; the major task ahead is to implement existing laws and strategies well.** The draft Regulatory Reform Strategy 2013-2020 seeks to facilitate improvements in some of the most problematic aspects of doing business, including customs administration, tax administration, and business regulation. Furthermore, the Moldovan Customs Service plans to address several issue areas where upgrades are required. The tax authorities have a reform plan, the legal framework for competition and state aid has recently been improved, the competition authority is being reformed, and infrastructure to support access to finance is being improved. Furthermore, the Ministry of Economy has been diligently working on transforming business regulation since 2004.

15. **This report presents short-term (2013-2014) and longer-term (2015-2017 recommendations in each of the five priority areas.** These recommendations are specific and actionable. They reflect ongoing strategies and priorities, and also bring in some additional areas for reform, based on a sound knowledge of successful approaches and the Moldovan context.
Table 1: Key Recommendations for Improving the Business Enabling Environment in Moldova

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<tr>
<th>Immediate</th>
<th>Short-term</th>
<th>Short-medium term</th>
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<tr>
<td><strong>Customs Administration</strong></td>
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<td>Articulate the ongoing efforts in a comprehensive reform strategy focused on risk management and trade facilitation.</td>
<td>Improve public-private dialogue by forming a Standing Working Group in the area of international trade administration, with the participation of the private sector and cooperation with the Working Group for Regulation of Entrepreneurial Activity.</td>
<td>Draft a new Customs Code that is consistent with the International Convention on the Simplification and Harmonization of Customs Procedures (Revised Kyoto Convention) and EU legislation.</td>
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<tr>
<td>Prepare and enact modifications to Law 235 and Cabinet Decision No. 1240 of 2006 that establishes the Regulatory Impact Analysis (RIA) methodology, to clarify that customs- and tax-related legislation and regulations that affect companies (including Customs Orders and other documents that impose requirements on companies) must be accompanied by a RIA that is analyzed by the RIA Secretariat and publicly discussed with the Working Group for Regulation of Entrepreneurial Activity, and must be published.</td>
<td>Begin to implement the human resource management reform concept.</td>
<td>Fully develop and implement the risk-based approach to customs controls/inspections.</td>
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<tr>
<td>Send to the RIA Secretariat/discuss with the Working Group, and adopt, the recently-drafted legal amendments and Customs Orders that remove the requirement for exports to be processed at the inland customs depot closest to where the company is registered, eliminate the transit declaration for exports, and other improvements.</td>
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<td>Implement a “guillotine” exercise of customs orders and other documents that impose requirements on companies.</td>
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<td>Hire an international customs valuation expert to analyze valuation practices and ensure that they are aligned with all applicable international rules.</td>
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<td>Adopt a concept for human resource management reform (including training) based on the EU Customs Blueprint</td>
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<td><strong>Tax Administration</strong></td>
<td><strong>Prepare and enact modifications to Law 235 and Cabinet Decision No. 1240 of 2006 that establishes the Regulatory Impact Analysis (RIA) methodology, to clarify that customs-and tax-related legislation and regulations that affect companies (including Government Decisions and other documents that impose requirements on companies) must be accompanied by a RIA that is analyzed by the RIA Secretariat and publicly discussed with the Working Group for Regulation of Entrepreneurial Activity. Require these acts to be published as well.</strong></td>
<td><strong>Conduct an inventory of regulations, normative acts, decrees, letters, and other acts that have an impact on tax administration and policy.</strong></td>
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<td><strong>Fully implement efforts initiated by the new Director of the Main State Tax Inspectorate to improve public-private dialogue and promote taxpayer compliance.</strong></td>
<td><strong>Enforce a risk-based assessment system to determine the need for audit in line with international good practice.</strong></td>
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<td><strong>Draft and promote to Government and Parliament legal amendments to revise the system of fines and penalties.</strong></td>
<td><strong>Design and begin to implement institutional and human resource management reforms.</strong></td>
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<td><strong>Adjust State Tax Service performance indicators to focus on compliance and not sanctions.</strong></td>
<td><strong>Improve public-private dialogue by forming a Standing Working Group in the area of tax administration, with participation of the private sector and cooperation with the Working Group for Regulation of Entrepreneurial Activity.</strong></td>
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<tr>
<td><strong>Licenses, Authorizations and Inspections</strong></td>
<td><strong>Adopt the Regulatory Reform Strategy 2013-2020 and its accompanying Action Plan 2013-2015.</strong></td>
<td><strong>Update the inventory of existing licenses and authorizations, review them, and remove overlaps and duplicates through amendments to the relevant laws and regulations.</strong></td>
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<td><strong>Government adopts the risk-based inspection methodology, which establishes the platform, types of risks, methodology for calculating risks, and methodology for undertaking inspections.</strong></td>
<td><strong>Streamline laws and regulations related to inspections, as per the requirements of the Inspection Law. Review the relevant legislation and propose modifications to be adopted by the Government and/or Parliament.</strong></td>
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Ministry of Economy promotes to Government and Parliament draft modifications to legislation that aim to improve a range of other areas related to doing business, including: permits, construction permits, inspections, voluntary liquidation, one-stop shops, and other areas.

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<tr>
<th><strong>Competition</strong></th>
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<td><strong>Market Entry</strong></td>
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<tr>
<td>See in “licenses, authorizations, and inspections” above</td>
<td>Reduce existing export licensing regimes and price controls, and do not issue any new ones.</td>
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<td><strong>Competition and State Aid Framework</strong></td>
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<td>Fully implement the new structure of the Competition Council, by appointing the remaining members of the council and enacting legislation that establishes the positions required to staff the Council.</td>
<td>Adopt and publish all secondary legislation required to implement the new Law on Competition and Law on State Aid.</td>
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<td>Conduct a full inventory of existing state aid schemes, building on and verifying information collected to date.</td>
<td>Review sector-specific constraints affecting market competition, using the OECD’s Product Market Regulation approach, to identify priority sectors and actions.</td>
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<td><strong>Access to Finance</strong></td>
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<td>Fully enforce the amendments to the Law on Financial Institutions to improve ownership/shareholder transparency in the financial sector (enacted in April 2013).</td>
<td>A national body takes responsibility for monitoring efforts to enhance enterprise access to financial services.</td>
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<td>Develop and enact further legal amendments to facilitate disclosure of the ultimate beneficiary owners in the financial sector.</td>
<td>Improve the skills and capacity of enterprises to improve business planning and financial management.</td>
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<td>Begin efforts to improve the functioning of the deposit guarantee fund and increase the amount guaranteed.</td>
<td>Improve banks’ risk assessment methodologies for lending to small and medium-sized companies.</td>
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<td><strong>Cross-cutting</strong></td>
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<td>Continue implementation of the Justice Sector Reform Strategy 2011-2016.</td>
<td>Improve financial literacy of individuals, companies, and investors, as part of a strategy to develop longer-term funding sources.</td>
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*Note: Immediate reforms should be initiated now and completed as soon as possible. Short-term refers to the period from 2013 through 2014. Short-medium term refers to actions that should be initiated in the short term but will likely extend into 2015.*
I. Introduction

16. This study aims to identify the most pressing constraints to enterprise productivity and competitiveness posed by Moldova’s business enabling environment\(^\text{10}\), and to present recommendations on reforms that will remove these obstacles. The Government of the Republic of Moldova is committed to continuing to implement reforms that address the substantial challenges to private sector development. Its commitment to reform in the short and medium term has been documented in the passage of several important laws, the Moldova 2020 national development strategy, the draft Regulatory Reform Strategy for 2013-2020, and the draft Transport and Logistics strategy (both of which are expected to be adopted soon), as well as in the formation of working groups under the Moldova 2020 umbrella. The government, through the Ministry of Economy, requested additional assistance from the World Bank to support the reform agenda, through the preparation of this note, as well as through future investment lending activities and technical assistance. This study will also serve to inform these future activities.

17. The study focuses on the business environment, including policies and regulations that affect companies throughout their whole lifecycle, from starting a business, through ongoing operations, to closing a business. It does not examine sector-specific constraints or labor force constraints in depth (although managerial and technical skills do arise as one of the underlying causes of difficulties in access to finance, and are discussed briefly in chapter II).

18. Challenges are analyzed from the point of view of private sector companies, and the analysis draws substantially on existing reports and key informant interviews. The study is based on: i) a review of existing reports commissioned and conducted by Moldovan government agencies, private sector associations, other donors, and prior studies done by the World Bank; ii) original research by the team on access to finance, which is presented in an accompanying background note; iii) interviews with business associations\(^\text{11}\), government officials\(^\text{12}\), and other donors\(^\text{13}\); and iv) in-depth “case study” interviews with a sample of 13 companies.\(^\text{14}\) This information was supplemented by a survey of 25 companies conducted by the European Business Association with the aim of obtaining additional illustrative examples.\(^\text{15}\) The study was also informed by the knowledge accumulated by the World Bank of good practices and experience in other countries, and by consultations with individual subject matter experts on some specific topics.\(^\text{16}\)

19. To select the priority areas, and understand how they impact economic growth, the “Growth Diagnostics” framework from Hausmann, Rodrik and Velasco (2005) was used. This framework demonstrates that creating dynamic economic growth requires business

\(^{10}\) See footnote 1 for a definition of “business enabling environment” and “business environment” as used in this report.

\(^{11}\) European Business Association, American Chamber of Commerce in Moldova, Chamber of Commerce and Industry, and Timpul Business Club

\(^{12}\) Including, but not limited to: Ministry of Economy, Moldovan Customs Service, State Tax Service, Credit Line Directorate, Competition Council, National Bank of Moldova, and National Commission of Financial Markets.

\(^{13}\) European Commission, EBRD, USAID, and the USAID-funded BRITE project, ACED project, and CEED II project.

\(^{14}\) The sample was fairly representative of the size and sector distribution, geographical location, and ownership distribution (foreign/domestic) of Moldovan companies.

\(^{15}\) The respondents to this survey were medium to large, foreign and domestic companies. The sample is not representative, and the survey served only to gather examples in order to understand in depth the types of problems that companies face. Because the sample was not representative, the results were not used to determine the priority areas.

\(^{16}\) Including other World Bank staff, an international customs expert, and a Moldovan tax lawyer, among others.
opportunities with strong returns alongside a reasonable cost of finance. The framework divides the drivers of economic growth into two components: returns to economic activity, and the cost of finance. Returns are further divided into the real returns to investing, and the appropriability of those returns to the owner of capital. Finance is divided into the international cost of finance and local factors affect the cost of finance.

20. Once the priority areas were identified, they were analyzed using the following approach: First, the specific problems faced by businesses were identified. Then, the underlying causes of those problems were explored. Finally, recommendations to address the causes – and therefore alleviate the problems in a significant and sustained way – were formulated.

21. The rest of this report is structured as follows. Chapter II presents an overview of the macro-economic context, international assessments of the business environment, data on firm performance, and a brief discussion of labor force skills. Chapter III presents the priority policy areas, which were identified using the framework described in paragraph 19. Chapters IV through VIII present the problems, the underlying causes of the problems, and the recommendations for each of the priority policy areas in turn. Chapter IX briefly discusses the role that the justice sector plays as a cross-cutting institution. Chapter X concludes.
II. Private Sector Development Opportunities and Challenges

A. Current Economic Performance and the Need for a New Model of Growth

22. Moldova’s recent macroeconomic performance has been volatile, reflecting exposure to global economic and climatic conditions. After a 6-percent contraction of the economy in 2009 due to sharp decreases in remittances and export earnings during the global crisis, growth increased to 7.1 percent in 2010 and 6.4 percent in 2011. Recovery was fueled by favorable external conditions, including a resumption of remittance flows and external demand, which drove strong growth in private consumption and exports. Moldova’s economy recovered more quickly than its neighbors Romania, Russia, and Ukraine, and GDP returned to above its pre-crisis level by the end of 2011. However, in 2012, real GDP dropped by 0.8 percent as the economy suffered two shocks: first, the Eurozone crisis crippled demand for exports and lowered remittances from Europe; and second, the agriculture sector was hit by a drought that halved the grain harvest, and decreased value added by 23 percent.

Figure 1: Sectoral Contribution to GDP Growth, 2008-2012

Source: World Bank calculations based on official statistical data. Notes: based on gross value added; scale is in percentage growth.

23. Over the past five years, Moldova’s economy has gone through significant sectoral changes. The service sector has been the largest contributor to economic growth, and tradeable sectors, namely agriculture and manufacturing, have stagnated. As shown in Figure 1 above, the main drivers of growth have been retail and wholesale trade and other services, including the financial sector. The transport and communications sector has also been strong. Agriculture and industry as a share of GDP have been on a steady decline, falling from 56 percent in 1995 to a mere 25 percent in 2012.

24. There has been little job creation, and economic growth has relied strongly on remittances. As the labor force steadily declined, Moldova's GDP expansion in the last decade has to be attributed to “jobless” growth (see Figure 2 below). Overall, labor productivity increased due to labor outflows from low-productivity sectors, especially from agriculture. Comparatively low salaries triggered massive outflows of migrants to the two main regional markets, the EU and the Russian Federation. In 2000-2012, Moldova's employment rate decreased from 60 percent to only 40 percent, while unemployment fell from 8.5 percent to 5.6
percent. Therefore, it can be concluded that migration must have led to the apparent lack of correlation between unemployment and general economic conditions in Moldova. In the meantime, Moldova became one of the countries in the world with the highest proportion of remittances relative to GDP.

**Figure 2: Employment, Unemployment, and Remittances, 2000-2012**

![Graph showing employment, unemployment, and remittances from 2000 to 2012.]

*Source:* authors’ calculations based on official statistical data.

*Note:* RHS indicates the series uses the right-hand side scale.

25. **Excessive dependence on remittances and insufficient job creation exposes the Moldovan economy to several vulnerabilities.** High reliance on remittances, mostly from southern Europe and Russia, increases the risk of high-impact external shocks, for instance those related to the current debt crisis in Eurozone countries and, potentially, to shocks that would slow Russia’s growth (such as a drop in global oil prices). Additionally, a large structural current account deficit makes Moldova vulnerable to changes in donor and investor sentiment. At the same time, lack of progress on the job creation front and migration of younger segments of the workforce abroad are reducing the economy’s tax base, and risk putting increased pressure on public social services as the elderly continue to retire at home. Lastly, the agriculture sector remains exposed to extreme weather conditions. The Moldova 2020 strategy posits that, “...without a concerted effort to change the development paradigm, the potential for growth over the next ten years [in an optimistic scenario] is limited to a maximum of 4.5 to 5 percent of GDP”.

26. **Although exports have grown substantially in aggregate since 2000, they have also shown little dynamism.** Exports exhibited strong growth from 2000 through 2004. In 2004 to 2008, they continued growing, but slowed to an average annual growth rate of less than 5 percent. This pace was slower than overall GDP growth, and slower than the growth of exports in many other CIS countries and average export growth in other regions of the developing world. Much of the export growth that Moldova did experience in 2004-2008 was driven by re-exports, i.e. additional processing of goods using raw materials and design specifications.

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17 Government of the Republic of Moldova. 2012a
18 World Bank staff estimates based on UN COMTRADE data. See World Bank 2011, p. 33
19 World Bank 2011
produced elsewhere. The 2011 Moldova Country Economic Memorandum (CEM) produced by the World Bank showed that re-exports do not create jobs, but direct exports do. Crucially, there has been little expansion of direct exports to countries outside the CIS region in the past several years. Exports have also remained relatively concentrated in a few industries.20 Exports helped the Moldovan economy after the crisis, with strong growth in 2010 and 2011, but growth slowed to 2.3 percent in 2012, in the context of a negative shock in the agriculture sector.

27. In response to the vulnerabilities inherent in the remittance-driven model, the Government of Moldova has made a welcome, committed decision to pursue a strategy of export-oriented economic growth. The national development strategy, Moldova 2020, is centered around the need to transition to a dynamic economic model based on investment and the development of goods- and services-exporting industries.21 Putting this model in place requires substantial increases in domestic investment and FDI, and enhancing knowledge and innovation, in order to increase efficiency and competitiveness. The Moldova 2020 strategy is built around seven priorities: the business environment, access to finance, education, and infrastructure, which are defined as critical areas; the judicial sector as an issue area that underpins all others; and energy consumption and the pension system, which disproportionately affect the poor.

B. Opportunities and Challenges

28. If Moldova can make the necessary policy and regulatory improvements, firms will be able to capitalize on some of the country’s comparative advantages. First, Moldova’s geography is both a curse and a blessing: the landlocked position and the contested border have certainly presented drawbacks in the past. But the strategic location between Europe and Russia, and proximity to other CIS states give Moldovan firms the potential to respond quickly to customers in high-value markets and, at the same time, diversify exports between regions with different economic drivers as a way of managing the risk of external shocks. Second, of the markets in and close to the European Union, Moldova has the lowest labor costs. This provides the country with an additional competitive edge over manufacturers that also enjoy the benefit of geographical closeness, but offer more expensive labor. Third, Moldova’s labor force is bilingual – Russian- and Romanian-speaking – and knowledge of the latter language has been conducive to the learning of other Romance languages, such as French and Italian, equipping the labor force with skills relevant to the EU market and export services (e.g. call centers). Finally, given Moldova’s fertile agricultural soil, climate, and the highest share of cultivated land vis-à-vis the total land area in the world, it has a comparative advantage in agricultural products.22

29. Improving the business enabling environment, a key pillar of the national development strategy, must remain a top priority if Moldovan firms are to harness the latent potential of these opportunities. A good-quality regulatory framework is essential for a healthy business environment and a competitive economy to thrive. This is even more important in Moldova, which depends on export competitiveness and FDI as engines of growth, given its relatively limited endowment of natural resources and small domestic market. The experiences of other small and open economies, such as Georgia and Latvia, demonstrate the tangible

20 World Bank 2011. The industries include wine, fresh fruit and nuts, food products, and textiles.
21 Government of the Republic of Moldova 2012a
22 World Bank 2011
benefits that can come from a concerted effort to dramatically improve the business environment (see Box 1).

**Box 1: Business Environment Reforms in Two Small and Open Economies**

According to the World Bank Group’s Doing Business report, the Government of Georgia has implemented 35 major institutional and regulatory reforms since 2005, in a comprehensive effort to reform the business environment. The government has introduced a credit information bureau and a new and more efficient property registry, and it currently allows for the majority of the business registration procedures to be completed online. The number of taxes decreased from 21 to 6, and the country significantly simplified its labor legislation. The authorities recently created “one-stop-shop” custom clearance zones in major cities, which are open every day.

Georgia has been the top reformer since 2005 in the ECA region and worldwide in the Doing Business report, and has advanced from ranking 112th out of 145 countries in 2005 to 9th out of 185 countries in 2013. Concurrent with this impressive improvement, the annual volume of net FDI net inflows increased four-fold, from USD 453 million in 2005 to USD 1,878 million in 2007. Average annual GDP growth in this period was 10.4 percent, and in 2007, Georgia was among the top 20 countries in the world in terms of FDI as a share of GDP. FDI flows slowed during the global crisis, but rebounded in 2010 and 2011. In 2011, net inflows of FDI represented more than 8 percent of GDP, placing Georgia ahead of most regional and European comparators. GDP growth was strong in both years, at 6-7 percent.

Likewise, Latvia made substantial progress over the same time frame. The costs of obtaining construction permits were reduced, the number of tax payments per year was reduced from 29 to 6, an electronic customs service was introduced, the time required to obtain electricity connection was reduced from 6 to 3 months, registering property can now largely be done electronically, and the time required to transfer property was reduced from 55 to 18 days. In addition, in order to address some of the effects of the recent economic crisis, Latvia streamlined the process of resolving insolvency, and expanded the availability of credit information.

Much like Georgia, Latvia experienced strong rates of GDP growth, FDI net inflows, and FDI as a share of GDP in 2004-2007, while significant regulatory reforms were being implemented. FDI grew from USD 637 million in 2004 to USD 2,713 million in 2007. In the same period, GDP growth averaged 10.2 percent per year. Although Latvia has been severely affected by the economic crisis, it has been recovering at a sustained pace since 2009, and the government has made additional efforts to improve the business environment in order to support this process. FDI inflows were once again strong in 2011 (USD 1,502 million), and GDP growth was 5.5 percent.

*Sources: Doing Business 2012 and 2013, World Development Indicators*

30. Notwithstanding its reform achievements since 2004 (see paragraph 129), Moldova still ranks relatively low in global and regional comparisons of competitiveness and the quality of the business environment. Since productivity is highly correlated with growth, the government needs to prioritize those aspects of the business environment that have the largest impacts on productivity. Analysis conducted for the 2011 CEM came to the conclusion that business regulation and inspections are two of the areas that have the largest impact on firm-level
productivity. As many companies have excess capacity\textsuperscript{23}, their response to rapid improvements in the business environment could be swift.

31. The following sections examine Moldova’s business environment in more detail, presenting relevant conclusions from firm-level analysis, and consider the importance of managerial and technical skills. The chapter concludes with observations on the need for reform.

\textit{Moldova’s Performance in Cross-Country Assessments of the Business Environment}\textsuperscript{24}

32. Moldova has made substantial progress since transitioning to a market economy two decades ago. During the 1990s, the fundamentals of a market economy were introduced, through the liberalization of most price controls and the privatization of many enterprises. More recently, attention has turned toward streamlining and improving interactions with businesses, including through regulatory reforms, furthering the use of information technology in government services, improving financial infrastructure, and others. Figure 3 below shows how Moldova has compared to global best practice on the various World Bank Group Doing Business indicators over time.\textsuperscript{25} The figure indicates that the areas in which Moldova has made the most progress include starting a business and registering property. However, protecting property through contract enforcement has become slightly more difficult, and progress in many other areas has been slow or stagnant. Financial infrastructure has improved, but as will be shown later in this report, getting credit still presents many difficulties for companies.

\textbf{Figure 3: Moldova’s Distance to the Frontier on Doing Business Indicators, 2013}

\textit{Source: World Bank 2013e}

\textsuperscript{23} According to the World Bank 2011 Country Economic Memorandum, average capacity utilization is around 54 percent, and around 76 percent of firms are operating below 80 percent capacity, which is the “optimal” capacity for the US economy.

\textsuperscript{24} For a more detailed analysis of Moldova’s performance in cross-country assessments of the business environment, as well as the supporting data for the major rankings cited here, please see Annex B.

\textsuperscript{25} See definition of this indicator in the footnote to paragraph 3.
33. **Turning to measures of current competitiveness, in the World Economic Forum’s 2012-13 Global Competitiveness Index, Moldova ranks 87th out of 144 economies.** This index, which forms part of the Global Competitiveness Report (GCR), offers a glance at the competitiveness of 144 countries, providing insight into the drivers of their productivity growth and their long-term prosperity. Moldova’s ranking in the 40th percentile suggests that there is notable room for improvement. Moldova performs especially poorly on: innovation, business sophistication, institutions, financial market development, and the efficiency of markets (including competition); it ranks in the bottom 100 countries in the world on these indicators. Moldova ranks best on technological readiness (65th in the world). Moldova is also at the low end of the spectrum in terms of the sophistication of its economy. The GCR also places Moldova among Stage 1 factor-driven economies, alongside two other countries in the CIS region: Tajikistan and the Kyrgyz Republic. In the meantime, Moldova’s peers such as Macedonia FYR and Montenegro, are at Stage 2, classified as efficiency-driven economies, while the three Baltic countries have already transitioned to Stage 3, becoming innovation-driven economies.

34. **Most international surveys find that Moldovan firms suffer due to burdensome interactions with government agencies.** The GCR computes data for 12 diverse aspects of competitiveness, from institutions, and education and health, to infrastructure and innovation. The 2012-13 report concludes that the three most problematic factors for the development of Moldovan businesses are corruption, frequently shifting policies, and inefficient government bureaucracy. This is consistent with feedback gathered from other sources, which indicate that the main problem is not the lack of quality legislation, but rather the public administration’s struggle to implement it effectively.

35. **Cross-country surveys confirm that Moldova faces significant challenges in its business environment.** Moldova ranks 83rd out of 185 economies in the World Bank Group’s 2013 Doing Business report. While this marks an improvement from the 86th place that Moldova occupied last year, the country still hovers below the average ECA rank of 73, and stands at the 55th percentile. The GCR found that the fourth-most problematic factor for businesses (along with those listed in paragraph 34) is access to finance, which is necessary for firms to make investments that increase their productivity and competitiveness. According to the 2009 Business Enterprise Survey, Moldovan exporters consider that the greatest barriers to doing business are underdeveloped labor force skills, insufficient access to finance, corruption, and problems in customs administration. Expanding the sample to all firms, access to finance and labor force skills are the top two constraints.

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**Performance and Productivity of Moldovan Firms**

36. **An assessment of firm performance from panel data provides some indications that the poor business environment is having a negative impact on sales and productivity.** Evidence of this trend could already be detected before the financial crisis, in the period

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This section is based on an assessment conducted by the World Bank team using the Business Diagnostics and Dynamics (BuDDy) database. This database was developed by the World Bank and populated with firm-level data from firms’ financial statements and the Annual Enterprise Survey, provided by the National Bureau of Statistics, for 2003/04, 2008/09, and 2010/11. The analysis presented here follows a panel of more than 3,600 firms in these periods. The panel is broadly representative of the size, sectors, and geographical location of Moldovan firms, although by location, Balti is slightly over-represented and Chisinau under-represented. The results are intended to be illustrative only. More in-depth analysis is needed to explore causality and the determinants of the observations presented here.
2003/04-2008/09. Although GDP growth was solid at six percent on average per year, Moldovan companies in the formal sector were not experiencing increases in real sales volumes (the value of sales after correcting for inflation). The three main sectors – agriculture and mining, industry, and services – all saw aggregate contractions in real sales. The proportional decline between pre- and post-crisis levels was slightly more pronounced in industry, which saw a real sales decline of 17 percent between 2008/09 and 2010/11. In services, real sales fluctuated close to the 2003/04 levels until the onset of the crisis in 2008/09. Disaggregated data by sector and efficiency levels shows that only firms with higher than average total factor productivity in 2010/11 in the service and agriculture sectors managed to increase real sales throughout the crisis. To understand the relationship between growing GDP but declining sales, analysis of the data shows that many businesses had operating losses, but were making up for these with other sources of income, to arrive at a positive net income. This other income may have included: financial investments, subsidies and other transfer payments, and informal sector revenue.

37. **The 2008-10 global financial crisis had an uneven impact on productivity in different sectors of the Moldovan economy.** The service sector proved most robust, with average total factor productivity (TFP) increasing from 0.04 pre-crisis to 0.05 post-crisis. Services also saw a lower percentage drop in sales and employment than the other two sectors. In the meantime, agriculture's TFP remained negative, while industry's TFP went from positive to negative.

38. **Even before the crisis, Moldovan companies generally were not hiring, and while half of them were investing, on the whole, they did not seem to become more efficient.** The enterprise panel data shows that the number of full-time, formal sector jobs decreased by 27 percent between 2003/04 and 2009/09. Fifty-five percent of Moldovan firms invested in that period, but of these, only 23 percent of investing firms that were inefficient in 2003/04 became efficient by 2008/09. On the other hand, 33 percent of investing firms that were efficient in 2003/04 became inefficient in 2008/09, and these firms saw their real sales fall by 28 percent on average. These counter-intuitive findings suggest that firms may have been suffering adverse effects of various micro-economic factors, even though the GDP was growing. This points to problems in the business enabling environment.

39. **Given low investment returns, the main path to increased efficiency for Moldovan businesses pre-crisis was shedding labor.** Some 47 percent of firms that were inefficient in 2003/04 became efficient by 2008/09. Following the outbreak of the crisis, a further 33 percent of firms that were inefficient in 2003/04 became inefficient in 2008/09, and these firms saw their real sales fall by 28 percent on average. Overall, full-time formal sector employment fell by 27 percent in the 2003/04-2008/09 period. It declined further during the crisis to 60 percent of the 2003/04 level in 2010/11.

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27 A firm is considered efficient if it has higher-than-average total factor productivity (TFP) for the given period. 49, 43 and 52 percent of firms were above the average TFP in each period. Only 19 percent of firms were in the efficient firm category throughout the period, compared with 23 percent that were inefficient throughout. There is no clear sector pattern to inefficiency or efficiency, although manufacturing firms make up a proportionately higher share of inefficient firms. Nearly all of the firms deemed efficient in all periods were private firms, whereas 13 percent of the inefficient firms had municipal or public ownership (compared with just 7 percent for the panel sample as a whole).

28 Estimated to equal 42 percent of GDP (World Bank 2012a).

29 This refers to equity investment. Data on gross fixed capital formation is not available at the enterprise level.
40. Thus, the overall findings show that greater efficiency does not seem to be positively correlated with investment, that companies reduce employment whether or not they are investing, and that companies which increased their TFP did so mostly by shedding labor. This trend highlights the need to upgrade the business environment in order to reverse the systematic trend of declining employment.

41. The combination of declining productivity and rising real wages is reducing the competitiveness of Moldovan enterprises. Prior to the global crisis (in 2003/04-2008/09), real wages in formal businesses rose by 39 percent, while the reported average real value added per worker fell by 15 percent. In addition, firms that become inefficient over time are paying significantly higher real wages. The disconnect between wages and value added per worker may point to inefficiencies in the labor market and/or a skills mismatch, in which employees are not able to perform as well as it was expected when their wages were determined (see the section below for more detail). The role of public sector wage increases in setting wages throughout the economy also should not be ruled out.

42. Firm performance and efficiency have important implications for job creation and the overall resilience of the economy in the face of a crisis. More efficient companies across the three main sectors survived the crisis in better shape, and recovered faster. After the onset of the crisis, efficient firms in the primary (agriculture and mining) and service sectors reported 3-4 percentage increases in sales, while their inefficient counterparts saw their sales fall by 46 percent on average. In the manufacturing sector, sales experienced a steep decline overall, but efficient firms saw an average 30 percent decline, while inefficient firms lost more than double, 68 percent. As for jobs, higher firm efficiency is also associated with better average real pay for the workers retained. Therefore, one can reason that if the business environment is improved, companies that invest will be more likely to increase their efficiency, create well-paid jobs, and be well-positioned to weather macro-economic downturns.

Managerial and Technical Skills of the Moldovan Labor Force

43. A better business environment is a necessary but insufficient prerequisite of improvement in firm-level productivity and competitiveness: Moldova must also improve the managerial and technical skills of its labor force. A more predictable and enabling business environment can decrease costs, thereby increasing profitability. However, in order to achieve longer-term, transformational effects, it is the quality of management and skills of the employees that will be able to translate these improvements into greater productivity, competitiveness, and faster job creation. For instance, a reduction in the cost of exporting can increase a producer’s margin, but capitalizing on this to reach new markets requires skills in business planning and market analysis.

44. Moldovan managers need to upgrade their business skills in financial management, business planning, market entry strategies, and general administration. Although indicators measuring management capacity directly are few, evidence of these needs is found in: (i) deficiencies in business planning and internal financial management, which are having a negative impact on firms’ eligibility for loans, as documented in the access to finance assessment (chapter 01); (ii) the low quality of documentation supporting business loan applications at commercial banks; (iii) the heavy reliance of company managers on the administrators of the Competitiveness Enhancement Project matching grant facility in order to prepare documentation.
for obtaining business development services; and (iv) small companies’ complaints about their inability to comply with the documentation requirements imposed by banks.

45. **An inadequately-educated workforce is also holding back companies’ growth.** The 2009 Enterprise Survey showed that this was the second most important constraint to firms in Moldova. In 2012-13, the GCR still identified it as the fifth-most important obstacle to doing business in the country. Interviews with companies and private sector associations suggest that the curricula of technical courses at vocational schools and universities, as well as the equipment used in the course of study, need to be updated as they are largely out of touch with market needs. These findings are also supported by the 2011 Moldova Country Economic Memorandum, produced by the World Bank. This deficiency of the Moldovan labor market is a particular challenge for foreign investors.

46. **While skills development is crucial, it is outside the scope of this study.** The study focuses on legal and regulatory aspects of the business environment that need to be reformed to create the conditions for improved firm performance. However, managerial and technical skills should receive more attention through other efforts.
III. Priority Policy Areas for Private Sector Development

47. Moldovan companies are held back by uncertainty and high costs of compliance with regulatory frameworks, which reduce real returns and their appropriability, as well as by difficulties with accessing finance. Real returns are reduced due to a lack of clarity in legislation and regulations, their uneven application in practice, and the existence of time-consuming procedures. Uncertainty in the application of the regulatory and policy framework means that it is difficult for companies to estimate the costs of complying in advance. Deficiencies in the competition framework and the judicial sector reduce the appropriability of returns. The difficulties with obtaining finance also have an adverse effect on company performance.

48. The figure below illustrates how the analytical framework described in the introduction to this study was applied to Moldova’s economy in order to identify the priority policy areas. The policy priorities are: customs administration; tax administration; business regulation, defined as licenses, permits, authorizations, and inspections; competition; and access to finance. Their linkages to the analytical framework are described in the paragraphs following the figure.

Figure 4: Growth Diagnostics Framework Applied to Moldova

Note: Framework adapted from Hausmann, Rodrik and Velasco “Growth Diagnostics” (2005).
49. **Uncertain and high costs wield the greatest adverse impact on companies in international trade and tax administration.** Firms that wish to trade abroad are subject to numerous and changing documentation requirements, burdensome inspections, a lack of consistency in the application of customs rules, and corruption. All these elements combined create delays and inevitably elevate costs of import and export operations. In tax administration, companies likewise face rules that are unclear, or seem to be applied inconsistently; intrusive tax inspections and audits; penalties/fines that seem excessive compared to the damage caused to the state budget; and corruption.

50. **Inefficiencies in business regulation, including licensing, authorizations, and inspections, also increase costs and uncertainty.** Companies have to cope with multiple and overlapping requirements when seeking authorizations and licenses, as well as with parallel or duplicate inspections. At times, administrative decisions regarding licenses and authorizations may be made to protect specific economic interests, rather than safeguard consumer well-being (which is the ultimate objective of business regulation). Hence, even if a company has obtained the requisite licenses and authorizations, there is a risk that the authorities will make a decision that will impede its ability to continue doing business as usual. These issues both increase costs and reduce the appropriability of returns to companies.

51. **There are also weaknesses in the identification of, and action against, anti-competitive behavior.** Decisions on licensing, permits, and authorizations at times are used to restrict market entry or present difficulties for firms currently operating in a market. In these cases, the companies are not able to appropriate the returns they generated. Collusion, cartels, and other horizontal agreements, as well as companies abusing dominant positions in a market, restrict the ability of all market players to compete, generate returns, and appropriate them. Granting state aid to some enterprises also puts them on an uneven playing field vis-à-vis their competitors. While the legal framework for competition and state aid in Moldova has recently been improved, it needs to be properly implemented.

52. **Difficulties with accessing finance limit Moldovan companies’ ability to invest.** Given the weaknesses in generating and appropriating real returns, it is often difficult for companies to make their projects financially viable. High collateral requirements significantly reduce the firms’ ability to leverage their assets for loans, and firms find that it is difficult to access long-term financing (at terms of three years or more).

53. **Moldova also lacks another key element that supports the business environment in more competitive economies: a judicial system that arbitrates and resolves disputes fairly.** Although it is outside the scope of this study, this is another priority area that can bring across-the-board improvements in the business environment. A sound judicial system and rule of law will reduce uncertainty by providing recourse for companies in situations in which the rules of doing business are applied incorrectly or unfairly. The ability to receive a fair ruling from an impartial judiciary helps reduce the uncertainties in returns and their appropriability, as discussed above. The certainty that banks will be able to take control of collateral when a borrower defaults on a loan reduces the banks’ perceived risk, and by extension, the cost of finance.
IV. Customs Administration

A. Evidence of Problems

54. Virtually every company in Moldova is affected by the customs administration’s ability to facilitate trade; it is a key element determining the competitiveness of Moldovan enterprises. The link between efficient customs administration and exports is obvious: delays and impediments at the border have a direct impact on the cost and delivery times of goods in their destination markets. Price and timeliness are crucial for the ability of Moldovan exporters to compete in high-value markets, such as European Union. Customs administration related to import procedures also has a significant impact on companies that produce goods for export and for sale in the domestic market. In 2011, imports were equal to approximately 74 percent of GDP, and in 2009 (latest data available), 69 percent of manufacturers used inputs of foreign origin. Inefficiencies in customs administration that increase the time and cost of imports, and reduce the reliability of deliveries also affect competitiveness, predictability, and price structures of many Moldovan enterprises.

55. Inefficiencies and a lack of transparency in border management agencies, including the customs administration, are currently retracting value from the economy. Moldova ranks 142nd out of 185 economies on the Doing Business “Trading Across Borders” indicator, and 16th out of 24 countries in the Europe and Central Asia (ECA) region (see Figure 5 below). In interviews conducted by the World Bank in 2012 and 2013, government officials (with the sole exception of Customs Service officials), representatives of private sector associations, and companies singled out international trade administration as the most important barrier to doing business in Moldova. A recent report by the USAID-funded BRITE project highlights the severity of the problem: “inefficient trade regulation, more than any other factor, is responsible for Moldova’s failure to reach its potential for greater competitiveness in new markets, despite its relative geographic and workforce advantages”.

Figure 5: Moldova’s Rank on the Trading Across Borders Indicator, Compared to Other ECA Countries, 2013

Source: World Bank Group 2013b

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30 USAID 2012, page 10
56. **The challenge is for the Customs Service to improve trade facilitation, while continuing to deliver its other statutory obligations as well.** Customs authorities are responsible for ensuring that revenue on cross-border transactions is collected appropriately, prohibiting unauthorized goods from entering the country, and safeguarding consumer safety. In 2011, the Customs Service collected MDL 11.9 billion (approximately USD 1 billion), equivalent to 39.4 percent of total government revenue.\(^{31}\) In 2012, collections grew to MDL 12.6 billion, and represented 37.6 percent of government revenue. It is estimated that revenue lost to under-invoicing or reporting of fraudulent value could be as high as 30-40 percent of the amounts currently collected.\(^{32}\) Therefore, the challenge is to help the Customs Service minimize the burden on traders while still complying with its statutory obligations.

57. **This chapter presents problems related to customs administration from the viewpoint of the private sector, and also acknowledges recent progress by the Customs Service.** The Customs Service has been working to address a number of the constraints that will be highlighted in this chapter. Efforts began in 2011, intensified in 2012, and continued in 2013. Nevertheless, it is important to understand the constraints that have affected companies in recent years in order to determine how enterprise competitiveness has been affected, where additional effort is needed, or where companies are not yet feeling the benefits of the changes. This chapter aims to identify constraints and to recommend priority reforms, taking into account information from both perspectives.

58. **Trade-related services are of a poor quality, and processes are burdensome.** On the World Bank’s 2012 Logistics Performance Index, Moldova ranks second worst in the ECA region (only topping Tajikistan\(^{33}\)), and 132nd out of 155 countries in the world. Moldova’s rank on the various components is as follows: efficiency of customs and border management clearance 129th, quality of trade and transport infrastructure 98th, ease of arranging competitively-priced international shipments 145th, quality and competence of logistics services 142nd, ability to track and trace consignments 116th, and timeliness 126th. Thus, there is notable room for improvement. Moldova’s low ranking in the ECA region suggests that difficulties encountered at and within its borders are the major constraints, and that if Moldova can lift these constraints, the improvements would benefit the whole supply chain.

59. **The Government of Moldova’s Transport and Logistics Strategy offers useful self-critical insight in this respect,** stating that: “unwieldy and sluggish export and customs procedures hinder trade and exporting companies, and discourage transit traffic.”\(^{34}\) The strategy also acknowledges that customs procedures at border crossings are complicated. In the same vein, the National Business Agenda 2012-13,\(^{35}\) prepared by more than 30 business associations and regional Chambers of Commerce, highlights customs administration and tax administration as the two most critical problem areas in doing business.

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\(^{32}\) World Bank and Government of the Republic of Moldova 2012

\(^{33}\) Turkmenistan is not included in the ranking due to lack of data.

\(^{34}\) The draft strategy (Government of the Republic of Moldova 2012b) was prepared with assistance from the World Bank. The government has finalized the strategy in Romanian, and this quotation has been checked against the final version available here: [http://www.mtid.gov.md/img/proiecte/MoldovaTLS_Romanian_Dec2012-prelim.pdf](http://www.mtid.gov.md/img/proiecte/MoldovaTLS_Romanian_Dec2012-prelim.pdf)

\(^{35}\) ANB for its Romanian initials
60. **Exporting and importing in Moldova is time-consuming.** Out of the aspects measured by the Doing Business “Trading across Borders” indicator, Moldova performs worst when it comes to the amount of time that it takes to export or import goods and services. On average, it takes 32 days to export a 20-foot container, and 35 days to import it. The ECA averages are 26 and 29 days, respectively. Document preparation takes longest, requiring 20 days for an export and 21 days for an import.\(^{36}\) Once documents are ready, the Doing Business indicators suggest that it takes on average 6 days to complete an import process, and 3 days to complete an export process (see Table 2 below.) When transporting the goods, waiting time at the border can also add to processing time and uncertainty of delivery times.\(^{37}\) Although the processing itself can take as little time as the average 20 minutes reported by the Customs Service based on their IT system, waiting time before arriving at the border point is not factored in to this measure.\(^{38}\)

**Table 2: Moldova’s Performance on the Components of the Doing Business Trading Across Borders Indicator, 2013**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Moldova</th>
<th>Eastern Europe &amp; Central Asia</th>
<th>OECD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of Documents to Export</td>
<td>7</td>
<td>7</td>
<td>4</td>
</tr>
<tr>
<td>Days to Comply with Export Procedures</td>
<td>32</td>
<td>26</td>
<td>10</td>
</tr>
<tr>
<td>Cost to Export (USD per Container)</td>
<td>1,545</td>
<td>2,134</td>
<td>1,028</td>
</tr>
<tr>
<td>Number of Documents to Import</td>
<td>7</td>
<td>8</td>
<td>5</td>
</tr>
<tr>
<td>Days to Comply with Import Procedures</td>
<td>35</td>
<td>29</td>
<td>10</td>
</tr>
<tr>
<td>Cost to Import (USD per Container)</td>
<td>1,870</td>
<td>2,349</td>
<td>1,080</td>
</tr>
</tbody>
</table>

*Source: World Bank Group 2013b*

61. **Companies commonly face overly complex or unpredictable documentation and regulatory requirements.** The Transport and Logistics Strategy and other analyses (including the BRITE project’s assessment) indicate that Moldovan importers and exporters must collect a large number of documents from multiple offices to obtain the required approvals. The ANB observes that there is a need for the Customs Service to improve transparency and predictability of customs procedures so that economic agents know beforehand what documents they need to submit, how long the procedures are expected to take, and what the sequence of the procedures is. Different customs officers tell companies that different documents are required, which duplicates paperwork, and causes delays.

62. **The Customs Service can impose documentation and other requirements at will, usually by issuing Customs Orders or other documents.** The Customs Service began to publish Customs Orders in late 2012. The practice of imposing requirements through unpublished documents has been one of the underlying causes of the unpredictable requirements and delays observed in international trade. Economic agents frequently learn about new requirements only at the border point or at the customs office. Until the customs orders affecting companies began to be published, gradually, starting in late 2012, many companies commonly

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\(^{36}\) This includes the time required to prepare all documents, including those that may be required by authorities other than the Customs Service.

\(^{37}\) Government of the Republic of Moldova and World Bank 2012

\(^{38}\) The Customs Service reports substantial progress in reducing the average border crossing time, from 55 minutes in 2008 to 20 minutes in 2012, as stated in written comments provided to the World Bank team. However, this represents only a fraction of the time that companies spend on international trade procedures.
did not have advance notice of changes in the rules. Additionally, without access to the documents, companies had no way of knowing if requirements for a given shipment were the result of an internal order or other official document, or the determination of an individual customs officer. Analysis conducted for the TLS found that final clearance of imports can be delayed due to factors including missing support documents and appeals against a customs decision. The unpredictability of documentation requirements adds to delays in international shipments.

63. The Customs Service began publishing some of its orders in late 2012, and made an effort to re-initiate public-private dialogue starting in December 2012. Given that the latest feedback from the private sector for this study was gathered in March 2013, it is too early to gauge the impacts of this effort. In any case, this is a laudable effort, and is in line with two of the important recommendations of this study.

64. Despite automated declaration processing capabilities, customs procedures heavily rely on paper-based documents. This requires additional time, effort, and money on the part of Moldovan companies, and it makes customs processing less efficient.

65. Customs valuation practices appear inconsistent, and commonly present difficulties for importers. The methods for determining tariff classification can also be unclear. Customs valuation legislation largely reflects the provisions of the WTO valuation agreement (GATT Article 7), which requires a hierarchical order of rules. The first method, where appropriate, is to accept the price as declared on the invoice as the transaction value. Yet analysis conducted for the Transport and Logistics Strategy suggests that the Customs Service does not consistently follow the WTO rules, and often rejects the invoice price without first seeking further evidence to verify its validity. The ANB states that the methods of determining the amounts of customs payments are not transparent. This creates uncertainty for companies. Interviews with representatives of international organizations that have assessed Moldovan customs support these findings. Analysis conducted for the TLS found that final clearance of imports can be delayed due to problems with tariff classification and valuation.

66. The Customs Service has been working to improve customs valuation practices, as listed in its 2013 Activity Plan and in a progress report of its work with EUBAM. Representatives of the Customs Service state that their practices are in line with the World Customs Organization's risk analysis methods, and consistent with guidance and training received from EUBAM. Guidelines for customs officers based on the WTO Handbook were drafted with EUBAM assistance. A recent EUBAM report also noted positive developments in this area. Given discrepancies in information about the degree to which valuation practices have

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39 The 2012-13 ANB characterizes the problem as follows: “Within the Customs Service there are internal normative acts (regulations, instructions, letters, etc.), which are not available to economic agents. That causes companies to incur unforeseen expenses in the form of money (additional payments, penalties and fines), time, and effort.” (IDIS “Viitorul” 2011)

40 Government of Moldova and World Bank 2012

41 They are: 1) transaction value, 2) transaction value of identical goods, 3) transaction value of similar goods, 4) deductive method, 5) computed method, and 6) fallback method (including indicative prices only as a last resort).

42 Assessment of the Progress made by MDCS and UASCS in Implementation of Recommendations on Improvement of Inland Customs Processes at Regional and Local Levels Action Plan Phase 8 Activity # 4.1.2 and 4.1.4
been improved, actual practices at the border should be examined in more detail. There is also a need to communicate more clearly with the private sector regarding valuation methods.

67. **There are also indications of inconsistencies in the application of tariff classifications, although the Customs Service has made recent progress in this area.** As stated in the paragraph above, this was one of the reasons for delays that were identified in the analysis conducted for the TLS. There are indications that difficulties with customs valuation and tariff classification go hand in hand. In May 2012, the Customs Service began issuing tariff rulings. Tariff rulings or explanatory notes for approximately 66 HS codes have been issued and published on the Customs Service’s website.\(^{43}\) This is progress in the right direction, and more progress is needed.

68. **Customs inspections can be unnecessarily burdensome, and a risk-based approach is not fully applied.** The burdensome inspections contribute to delays and extend delivery times for both importers and exporters. Although the Customs Code provides for selective examination of imports based on risk management practices, in practice, there is an over-reliance on physical inspection regardless of the ASYCUDA selectivity channel. Analysis conducted for the TLS states that it is common for customs officers to conduct thorough controls of all import shipments regardless of their risk channel categorization (even if they are designated as “green channel”).\(^{44}\) The analysis also states that the Customs Service uses selectivity criteria that are too broad, and that it also uses too many risk criteria.

69. **The Customs Service confirmed that the risk management process still requires further development** in order to reduce the number of physical inspections, and stated that the number of physical controls decreased by 17 percent during 2012. The Customs Service provided the following data on the percentage of shipments going through each risk channel.

<table>
<thead>
<tr>
<th></th>
<th>Green Channel</th>
<th>Yellow Channel</th>
<th>Red Channel</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Import</strong></td>
<td>48%</td>
<td>19%</td>
<td>32%</td>
</tr>
<tr>
<td><strong>Export</strong></td>
<td>73%</td>
<td>11%</td>
<td>17%</td>
</tr>
</tbody>
</table>

*Source: Data provided by the Customs Service directly to the World Bank team, May 28, 2013*

70. **In addition, there are indications that all export documents are checked at border crossing points** in spite of having been processed and verified by Customs Service staff at the inland customs depot (ICD) before the truck was allowed to proceed to the border. Companies must open a transit declaration at the ICD and then close it at the border; this increases the time required to make a shipment. Problems related to examination of export documents at the border were observed in the analysis conducted for the preparation of the TLS, and by other donors working on customs administration in Moldova. The Customs Service states that customs officers verify only the existence of the documents, but do not carry out double control of the documents. The evolution of these practices, and their effect on companies, should be monitored.

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\(^{43}\) The Customs Service states that they have issued 100 rulings, but only 66 distinct entries were found in the published list. The list is available here: http://customs.gov.md/index.php?id=3485

\(^{44}\) World Bank and Government of Moldova 2012 p. 7
71. **The post-clearance audit has also been described as using strict controls.** According to the analysis prepared for the TLS, the performance of the Customs Service’s Post Clearance Audit Department is measured by the increase in customs revenue collection. In 2006, the department collected MDL 1.25 million from 144 audits, while by 2011, it raised many multiples of this amount, with MDL 35.7 million from 382 audits. The TLS analysis states that the Customs Service, “does not carry out post clearance audits with the intention of identifying low risk compliant and legitimate exporters.”

72. **Some simplified procedures have been introduced, but companies have not felt many tangible benefits from these procedures.** Several categories of “simplified” procedures are available to businesses certified as authorized (or trusted) economic operators.

<table>
<thead>
<tr>
<th>Year Implemented</th>
<th>Name of Procedure</th>
<th>Description</th>
<th>Number of Companies Benefitting</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 2010</td>
<td>Reliable Economic Operator</td>
<td>Automatically assigned to “green channel” in ASYCUDA</td>
<td>2010: 25 2012: 37</td>
</tr>
<tr>
<td>August 2011</td>
<td>Local Clearance</td>
<td>Imported goods can be transported directly to a company’s premises (rather than to a customs control house for clearance), be declared electronically via electronic signature, and released for free circulation</td>
<td>2011: 4</td>
</tr>
</tbody>
</table>
| January 2013      | Simplified Customs Procedures | - Reduced number of documentation requirements, and documentation and physical customs controls  
- Priority in implementing controls.  
- Customs clearance at the destination by submitting an electronic customs declaration, under the framework of “local clearance procedure”  
- Possibility of customs clearance outside of working hours and during holidays  
- An appointed customs contact person. | 2013: 55 companies 10 percent of customs declarations |

*Note: This combines the two benefits above and the “reliable transport operator” designation discussed below into a fourth designation - “trustworthy economic operator”*

*Source: Data provided by the Customs Service directly to the World Bank team, May 28, 2013*

Although the “Reliable Economic Operator” designation was introduced in 2010, only 0.4 percent of customs declarations used this benefit in 2011. The Customs Service states that this has since increased substantially. In addition, in June 2012, a “Reliable Transport Operator” designation was introduced. Shipments by these transporters can use a dedicated, “reliable operator” lane for border crossing. Four companies were authorized to use this designation.

73. **There seems to be a disconnect between the simplified procedures implemented by the Customs Service and the experiences of companies.** As listed in the table above, few

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45 World Bank and Government of Moldova 2012, p. 9
companies currently benefit from these procedures. Those that are eligible have not yet felt substantial savings in terms of time or costs. Simplified customs clearance procedures, following EU norms, need to be introduced. As stated earlier in this chapter, the Customs Service still has work to do to further develop risk and selectivity criteria for more shipments to use the “green channel”, and have more streamlined controls.

74. **In recent years, it has been difficult for companies to get basic trade-related information.** During the first nine months of 2011, it took the Customs Service an average of 15 working days to reply to requests for information. According to analysis conducted for the TLS, Customs planned to reduce the time to 10 working days by 2014.\(^\text{46}\) However, even this processing time would still be too long, especially when dealing with simple requests such as Harmonized Schedule (HS) codes.

75. **Other benefits that the Customs Service states are in place but remain unrecognized by companies include:** (i) the ability to submit customs declarations on weekends, (ii) no restriction on where the goods can be declared, and (iii) an expedited process for issuing certificates of origin.

76. **Additional areas in which international trade administration negatively impacts businesses include:**

- **Non-recognition of foreign certificates and restrictions on advanced products:** Foods that have conformity and other certificates issued abroad must be re-certified in Moldova, which causes delays and increases costs for companies. Furthermore, some advanced products are not recognized by Moldovan standards, and therefore are not allowed to enter Moldova until the corresponding standard is developed. This restricts companies’ access to some advanced technologies that could improve their productivity.

- **Restrictions on foreign agricultural inputs:** There are barriers to the import of foreign agricultural inputs, even when the inputs are not produced locally (such as concentrated grape juice). Farmers that want to use foreign inputs must get them tested and certified according to Moldovan standards, which is a costly process that deters many farmers.

- **Transit time:** Although the Customs Code allows for up to 4-8 days, the ANB cites that the Customs Service routinely allows time frames that are much shorter than this. This causes problems for transporters, and often results in penalties for late arrival at the customs transit destination point, even if transporters make the best possible effort to meet the deadline. Customs has recently issued an order that allows for the use of longer transit times based on a company’s needs. Its implementation should be monitored.

77. **Finally, an underlying current in companies’ interactions with Customs is the presence of corruption.** The problems listed above – non-transparent requirements, requests for additional documentation, non-transparent valuation, and strict controls – present broad opportunities for bribery in exchange for relaxing requirements, and reducing delays. Analysis carried out during the preparation of the TLS analysis confirms that corruption remains an issue, and undermines efforts to improve customs administration practices. The Customs Service’s 2013 Action Plan recognizes and attempts to address the issue of

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\(^{46}\) World Bank and Government of Moldova 2012, p. 14
corruption by vowing to establish, “a control mechanism over the observance of ethical norms and prevention of professional misbehavior”.  

78. To summarize, the most common trade-related problems faced by companies are: delays, caused by inefficient processes and unpredictable requirements, such as unpublished customs orders and discretion by customs officers; inconsistencies in the approach to customs valuation; burdensome inspections that do not take advantage of the risk-based approach; a lack of options for simplified procedures in practice; and corruption. All of these issues introduce uncertainty, and increase costs of international trade.

B. Underlying Causes of the Problems

79. The problems faced by companies are driven mainly by unclear rules, overly complex processes that have not been modernized, lack of transparency, excessive use of discretionary powers and physical interventions, exemption of customs rules from the principles of good regulation, lack of accountability of customs officers, and heavy reliance on customs for government revenue. Areas of the Customs Code are vague, leaving room for interpretation through internal customs orders and by border officers themselves. Even when the rules are clear, they often prescribe unnecessary, time-consuming procedures. The principle of transparency was violated by the practice of not publishing customs orders that affect businesses. This creates uncertainty and opportunities for customs officers to disguise attempts to extract bribes as requirements of internal orders. Moreover, as customs collects a substantial portion of government revenue, there is pressure to maximize collections, which directly contradicts the goal of facilitating trade. Finally, existing human resource policies need to be reformed in order to enforce the application of existing rules. These underlying causes of the problems faced by companies are described in more detail below.

80. Parts of the Customs Code are confusing and unclear, and leave room for discretion. The Customs Code is not aligned with the World Customs Organization’s Revised Kyoto Convention or EU Customs legislation. A 2010-11 review of the Customs Code against these benchmark documents found the following weaknesses, among others: (i) the requirements for goods crossing the border are fragmented into multiple sections, and there is no comprehensive list; ii) the terms for “release” and “clearance” are interchanged when compared to their use in international documents, which can be confusing; iii) the Customs Code frequently states that requirements “shall be implemented in line with relevant legislation,” which leaves room for interpretation and discretion, especially since there is no reference to specific pieces of legislation; iv) some technical provisions are unclear in Romanian and Russian; and v) the Customs Code does not incorporate some modern concepts. Firms cannot submit a declaration in advance, and electronic signatures are not accepted. Customs declarations are submitted to ASYCUDA, but they must be printed out, and multiple copies must be presented at border points.

81. A number of time-consuming processes still exist for imports. The process of gathering all required documents, including those which the importer may not be aware of in advance, is long, as documented above. Then, when processing an import, the Customs Service does not separate release from clearance procedures, and it does not release goods until all issues

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47 Government of the Republic of Moldova 2013c
related to the transaction are resolved.\textsuperscript{48} A customs process mapping exercise, currently underway, will identify specific processes that should be streamlined and optimized.

82. **Time-consuming processes also exist for exports.** First, exporters are required to process their shipment at the inland customs depot (ICD) closest to the location in which the company is registered, even though this might not be the most efficient option. ICDs are open from 8:00am until 5:00pm. Second, once exporters file their declaration, pay a processing fee and open their transit declaration at an inland customs post, they must subsequently stop again at the border to close the transit declaration, and have their documents double-checked. Trucks may wait for up to four hours on approach roads leading to the border point. This adds to the time and cost. While the Customs Service states that an option to take goods directly to the border and process them there exists, feedback from the private sector indicates that companies are not using it. Analysis conducted for the TLS also found that the Customs Service lacks equipment that would allow it to conduct less intrusive inspections.

83. **The risk-based approach to customs controls requires further development before it can be fully applied.** According to the TLS, the Customs Service’s lack of modern risk management approaches is driven by the legal and regulatory framework that gives it a traditional control approach. This includes the 2010 Customs Code, which has not been modernized or aligned with the Kyoto Protocol or EU regulations, and it does not incorporate cooperation with the private sector. Moreover, the Customs Service currently lacks the tools to fully apply a modern risk-based approach. Selection criteria must be clarified, risk criteria systematized, information exchange between stakeholders improved, and institutional capacity significantly raised. TLS also notes the need for additional equipment to support the implementation of a risk-based approach.

84. **Additionally, after passing through the border points, mobile customs and anti-fraud teams are allowed to conduct roadside examinations.** They may gather evidence in cases of expected fraud, and may also take action against customs officers that have previously processed the import. This practice provides an additional incentive for customs border guards to conduct overly thorough inspections, even of shipments that were identified as low risk. This practice also provides an opportunity for officials to extract additional payments from importers and transporters. The Customs Service has developed a new concept on mobile teams, and is developing an associated action plan, with the support of EUBAM.

85. **The principles of good regulation are not routinely applied to customs requirements, although there has been progress in late 2012 and early 2013.** Several laws on business regulation have been passed to improve and simplify regulations affecting businesses. In some instances, documents issued by the Customs Service have been excluded from the scope of the law, and in other cases, the laws are not fully applied. The laws, and the degree to which they have been applied to the area of customs, are as follows:

\textsuperscript{48} Government of Moldova and World Bank 2012
### Table 5: Laws on Business Regulation as Applied to Customs

<table>
<thead>
<tr>
<th>Law Number</th>
<th>Description of the Law</th>
<th>Applicability to Customs</th>
<th>Gaps in Implementation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Law 235 of 2006 (Guillotine 2)</td>
<td>This law makes draft laws and regulations affecting businesses, and any proposed modifications to them, subject to Regulatory Impact Analysis, which is to be reviewed by the Working Group of the State Commission for Regulation of Entrepreneurial Activity, assisted by the RIA Secretariat.</td>
<td>This law has not been applied to documents issued by the Customs Service in practice. The Customs Service did send one customs order to the RIA Secretariat for their review in 2013. This is a good first step.</td>
<td>The applicability of the law to customs legislation and requirements imposed on companies by the Customs Service is still unclear. Customs orders issued prior to 2013 have not been reviewed.</td>
</tr>
<tr>
<td>Law 160 of 2011 (Guillotine 2+)</td>
<td>This law states that a permissive act may be invoked or applied only after its inclusion in the Nomenclature of Permissive Acts.</td>
<td>Nine permissive acts – authorizations and certificates – issued by the Customs Service are listed in the Nomenclature of Permissive Acts.</td>
<td>In practice, other requirements issued by customs have the character of permissive acts, but are not included in the Nomenclature.</td>
</tr>
<tr>
<td>Law 239 of 2008</td>
<td>This law partly incorporates the provisions of Article X of the GATT on the publication and application of regulations to international trade.</td>
<td>The Customs Service began to publish customs orders in late 2012. Customs orders are sent to the Ministry of Justice for endorsement and guidance on whether they should be published. This is a good first step.</td>
<td>Need to ensure that all customs orders that currently affect businesses have been published.</td>
</tr>
</tbody>
</table>

In addition to the recent progress listed in the table, during 2012, the Customs Service reviewed the Customs Orders issued in 2012, published 5 and canceled 13 (the proportion of the total number of orders that this represents is unavailable). The Customs Service states that all of the orders that have an impact on businesses are being registered with the Ministry of Justice and published. These developments, and those listed in the table, are welcome and should be continued.

Notwithstanding recent progress, the gaps in following the principles of good regulation have significantly affected companies – and their export competitiveness – in previous and recent years. When the principles of good regulation are not followed, the Customs Service has full autonomy over matters that have a substantial impact on businesses and their overall competitiveness, and allows for the implementation of requirements that may not be justified.

86. **There is evidence of a lack of communication with the private sector.** There is a disconnect between the practice that the Customs Service claims it follows, and the experience of the companies with customs valuation, inspections, the use of the “green channel”, and simplified procedures. A Customs Consultative Committee was established in 2007 to consult and obtain feedback from the private sector, but the Customs Service did not schedule any
meetings after spring 2010. The Consultative Committee was re-activated in December 2012, welcomed five new members, and now has a secretariat that rotates among members. The USAID BRITE project is assuming the role of secretariat during the first six months. In addition, the Customs Service states that the seven customs houses have been holding meetings with private sector representatives, including brokers and traders, and that customs orders are available to companies at the customs houses. These recent initiatives are welcome, and more effort should be placed on this issue.

87. Numerous weaknesses have been identified in Moldovan Customs’ organization and human resource policies. The disconnect between reported and actual practices indicates that there may possibly be a lack of leadership to ensure that existing rules are implemented, deficiencies in the human resource policies that incentivize officials to adhere to the frameworks in place, or both. The following weaknesses have been identified in various reports reviewed for this study:

- **Customs officials are not incentivized to provide efficient services.** As the government depends on customs revenues for an important part of its budget, there is pressure within the organization to meet revenue targets by collecting more fees and penalties from companies and applying stricter controls.
- **Low salaries feed the trend of petty corruption.** Acceptance of unofficial payments and gifts has become a norm.
- **Unclear division of roles and tasks within the organization blurs responsibilities and increases inefficiency.** A regulatory reform evaluation study funded by the World Bank noted a disconnect between the central and regional levels of customs administration, and noted overlaps in competencies and duties. The evaluation identified a need to organize customs administration more efficiently, distribute functions and duties clearly among the various levels of the Customs Service, and eliminate duplications and omissions in functions.
- **Lack of capacity and training sustains inefficient practices.** The TLS assessment carried out a Skills Survey of Customs Service staff and management. The results indicate that both groups currently lack the range of skills needed to complete daily operational tasks in a professional manner. Most staff reported that they learned their skills “on the job”, and did not receive specialist training. In the past, training offerings have depended heavily on ad-hoc offerings by donors. More recently, training programs are being developed and additional training courses are being offered with the support of EUBAM, the World Customs Organization, the USAID-funded BRITE project, and others.
- **Staff rotation policies do not build capacity.** Overly-frequent rotations replace experienced officers with staff who need to learn on the job, and have not developed the capacity to perform the new duties effectively.

88. Inadequate hardware supporting the ASYCUDA system, and restricted hours of operation also contribute to delays. The capacity of the ASYCUDA server is inadequate, which leads to routine delays on Mondays and Fridays due to increased volumes of declarations to be processed before and after weekends. There can also be delays or service outages at unpredictable times. The Customs Service plans to upgrade the ASYCUDA system in June 2013 by bringing a second server online. Chambers of Commerce, which issue certificates of origin,
do not operate on the weekends, and the Phytosanitary Service offices are only open from 8:00am to 5:00pm, which creates further delays at inland customs depots.

89. **All of these elements contribute to delays and higher costs in cross-border shipments.** The extent of delays was noted in the first section of this chapter. Delays in international trade increase costs directly, through the cost of transport as cargo is stopped at the border, penalties that may be charged by the client receiving the goods, and other charges applied by Moldovan authorities, such as the fine for transit shipments not arriving at the outgoing border crossing in time. Delays also decrease Moldovan companies’ competitiveness in export markets. Timeliness and responsiveness to the customer can make or break a company’s success in high-value markets such as the EU.

**C. Policy Recommendations**

90. **If Moldova reduces the processing time for imports and exports to the ECA average, its trade volumes and GDP could increase substantially.** This would have a strong, positive impact on the competitiveness of Moldovan companies.

91. **Reforms addressing the problems identified will require a comprehensive approach focused on risk management and trade facilitation, while still allowing the Customs Service to pursue the parallel goals of ensuring safety and collecting revenue.** Short-term and longer-term policy recommendations are listed below. Current reform plans of the Moldovan government, including the draft Regulatory Reform Strategy and Transport and Logistics Strategy, as well as the 2013 Customs Service Activity Plan, incorporate many of the policy recommendations listed here. The Customs Service is receiving expert assistance from donors including EUBAM, as well as technical assistance from the USAID BRITE project. Although progress is being made in many areas, as highlighted above, and in the references to reform plans below, the impact on the private sector must be monitored to ensure that these efforts are being implemented well and are having their desired effect.

The status of the various recommendations is also included below. Recommendations that appear to be fully covered by existing plans are denoted by the acronyms for the plans: CSAP refers to the 2013 Customs Service Activity Plan, and RRS refers to the 2013-15 Regulatory Reform Strategy Action Plan. The recommendation (below) that the Customs Service cooperates with the Ministry of Economy (MoE) is not intended to suggest that MoE has technical responsibilities related to customs, but rather it reflects the MoE’s role in overseeing the RRS.

**Short-term Recommendations (through 2014)**

a. Articulate the ongoing efforts in a comprehensive reform plan focused on risk management and trade facilitation. Consider including language on trade enhancement in the Customs Service’s Development Objectives. (Consistent with RRS. Responsibility: Customs Service.)

c. The Government adopts the Transport and Logistics Strategy developed with support from the World Bank, and the Customs Service and its partners begin to implement it. (Expected by July 15, 2013.)

d. The Government ratifies the Revised Kyoto Convention (i.e. the International Convention on the Simplification and Harmonization of Customs Procedures).

e. The Customs Service continues to implement its Activity Plan for 2013, and develops future Activity Plans consistent with the Regulatory Reform Strategy 2013-2020 and the Transport and Logistics Strategy. (Responsibility: Customs Service, in cooperation with the Ministry of Economy and Ministry of Transport as the entities overseeing the respective strategies.)

f. The Ministry of Finance and Customs Service work together to draft a new Customs Code in accordance with these global good practices, capitalizing on the 2010-11 article-by-article review of the Customs Code. (RRS. Responsibilities: The Customs Service should take the lead on the technical components of the Customs Code for which the Ministry of Finance does not have expertise.)

g. Prepare and enact modifications to Law 235 and Cabinet Decision No. 1240 of 2006 that establishes the Regulatory Impact Analysis (RIA) methodology, to clarify that customs-and tax-related legislation and regulations that affect companies (including Customs Orders and other documents that impose requirements on companies) must be accompanied by a RIA that is analyzed by the RIA Secretariat and publicly discussed with the Working Group for Regulation of Entrepreneurial Activity.

h. Carry out a “guillotine” exercise of customs orders and other documents from the Customs Service that impose requirements on companies. Customs and government agencies should work together to subject internal customs orders affecting businesses to the same good regulatory practices as other pieces of legislation, and make them available online (RRS. Responsibility: Customs Service, in cooperation with the Ministry of Economy.) The steps include:

i. Carry out an inventory of all internal normative acts of the Customs Service related to import-export procedures. Eliminate those that are not justified for economic or safety/security reasons.

ii. Create two distinct categories of normative acts: those that directly affect businesses, and those that do not.

iii. For acts that affect businesses, post them on the web site of the Customs Service.

iv. For acts that are truly internal in nature, and should not be published, create a different designation than those that affect businesses, and create clear rules on their treatment.

v. Bring the acts that affect businesses to a quality level that allows companies to estimate cost, time, and documentation requirements in advance, quickly and efficiently. Clearly state the legal basis for the requirements.

vi. Translate relevant legislation and regulations into English.

49 Note: This recommendation will also help support improvements in several of the other areas covered below.
As described in the text above, the Customs Service took some steps in this area during 2012. This effort should be expanded to be a comprehensive one; and the authorities should ensure that all Customs Service acts that are still in force should be put through this procedure.

i. Send to the RIA Secretariat/discuss with the Working Group, and adopt, the recently-drafted legal amendments and Customs Orders that remove the requirement for exports to be processed at the customs post closest to where the company is registered, eliminate the transit declaration for exports, and other improvements.

j. Continue the import and export process mapping currently being supported by the BRITE project. (Consistent with RRS. Responsibility: Customs Service) The process should:
   
   i. Identify all procedures (completed).

   ii. Identify the legal basis for all procedures, and the time and costs required to complete them. For the time study, use the World Customs Organization Time Release Study method.

   iii. Identify where processes can be streamlined and optimized, in line with EU-recommended good practice.

k. Fully implement a Standing Working Group in the area of international trade administration, with participation of the private sector and cooperation with the Working Group for Regulation of Entrepreneurial Activity (RRS. Responsibility: Customs Service, in cooperation with the Ministry of Economy.)

l. Hire an international customs valuation expert to analyze valuation practices and ensure that they are aligned with all applicable international rules; develop clear procedures making customs valuation transparent, objective, and verifiable. Implementation of modern techniques for customs valuation is included in the Customs Service’s 2013 Activity Plan; however, the specified actions relate only to disseminating information to companies and providing additional training to customs officers. In addition to these planned activities, an assessment by an international expert, possibly in cooperation with EUBAM, is also needed. (Responsibility: Customs Service.)

m. Introduce electronic declarations (paperless processing). (Responsibility: Customs Service.)

n. Fully develop the risk-based approach to customs controls/inspections and implement it. Improve selection criteria, systematize risk criteria and profiles, improve information exchange between stakeholders, and develop institutional capacity. The Customs Service is working on this area, and plans to revise the concept on risk management during 2013 with support from the EU High-Level Policy Advice Mission expert assigned to Customs. (CSAP, RRS. Responsibility: Customs Service.)

o. Analyze sanctions applied to traders and rationalize them according to the degree of harm caused to the state budget. Differentiate between minor infringements and gross negligence. (RRS. Responsibility: Customs Service.)

p. Implement electronic procedures in the ASYCUDA system and improve electronic information exchange with trading partners. (Responsibility: Customs Service.)
q. Improve tariff classification procedures:
   i. Assess the process of issuing binding tariff rulings, identify any improvements required, and implement them. (Responsibility: Customs Service.)
   ii. Establish uniform and clear procedures for tariff classification (RRS) (Responsibility: Customs Service in cooperation with the Ministry of Economy.)

r. Extend the operating hours for customs declarations and those of other agencies issuing documents required for international trade. (Responsibility: multiple agencies.)
s. Increase the time that customs officers authorize for transit shipments to cross the country. (Responsibility: Customs Service.)
t. Make a serious commitment at the highest level of government to eliminate customs and trader corruption. (Indications of this are included in the Customs Service 2013 Activity Plan, but a higher, and more public, degree of commitment would be very useful. Responsibility: Government, Ministry of Finance, and Customs Service.)
u. Begin human resource management and training reform (CSAP, RRS. Responsibility: Customs Service. EUBAM is currently supporting the Customs Service in this area.):
   i. Approve and begin implementing a concept for human resource management reform based on the EU Customs Blueprint \(^{50}\). (The “Concept for Reforming the Personnel Management at the Customs Service” was prepared with EUBAM support.)\(^{51}\)
   ii. Revise the Code of Conduct for customs employees based on the Revised Arusha Declaration and the WCO Model Code of Ethics and Conduct (CSAP).
   iii. Develop and disseminate a long-term anti-corruption strategy, based on all of the above (partially included in CSAP, but should be strengthened).
   iv. Establish a training plan that will allow the Customs Service to provide ongoing training to its employees, and will not be dependent on ad hoc offerings by donors (partially included in CSAP, but a longer-term training plan should be developed).


a. Continue implementing reforms initiated in the short term:
   i. The Regulatory Reform Strategy and Transport and Logistics Strategy, and harmonization of Customs Activity Plans with these two strategies.
   ii. Process improvements identified as part of the mapping above.
   iii. Human resource management reform, training reform, and anti-corruption policy.

b. Expand work on risk management (CSAP. Responsibility: Customs Service.):
   i. Further develop and implement the concept of authorized economic operators.

\(^{50}\) The following chapters of the EU Customs Blueprint are applicable: Education and Training, Ethics and Anti-Corruption, Human Resources Management, Organization and Management, and Internal and External Communication.

\(^{51}\) This is consistent with the EU Customs Blueprint and covers: (i) personnel management, (ii) professional ethics, and (iii) professional training.
ii. Introduce and implement additional simplified procedures, including simplified declarations and local clearances in line with EU regulations.

c. Ensure that veterinary and phyto-sanitary requirements handled by the new Food Safety Agency are interfaced with ASYCUDA, and that the information is accessible to the tariff code. (Responsibility: Food Safety Agency prepares the information; Customs Service includes it in ASYCUDA.)

d. Improve post-clearance control and audit procedures. (CSAP. Responsibility: Customs Service.)

e. Improve information exchange, and introduce Joint Customs Controls with neighboring countries. (This is partially covered in the Integrated State Border Management Action Plan 2011-2013. Responsibility: Customs Service.)

f. Accept systemically recognized foreign certificates, especially when they meet Moldovan standards. Work with international trade partners to increase recognition of sanitary and veterinary certificates, phyto-sanitary certificates, certificates of conformity, and any other permissive acts relevant to imports and exports. (Responsibility: multiple agencies.)
V. Tax Administration

A. Evidence of Problems

92. A sensible corporate tax system is not only about attractive tax rates, but also tax administration rules and procedures that are transparent, simple, and easy to comply with. Efficient tax administration can help encourage businesses to become formally registered and the economy to grow, thus expanding the tax base and increasing tax revenues. Unpredictable and unfair tax administration can have the opposite effect, pushing companies into the informal sector, where they pay no taxes at all. Tax compliance is increased when the rules are as clear and simple as possible. In fact, investors identify the tax system – including both tax rates and compliance costs from the way in which taxes are administered – as one of the most important parameters in making an investment decision. The Doing Business team of the World Bank Group has found that companies worldwide consider tax administration to be among the top eight constraints to doing business. This chapter will focus on problems related to tax administration and will suggest short- and medium-term solutions for Moldovan authorities.

93. According to the 2012 Cost of Doing Business (CODB) survey, one of the top two problems faced by Moldovan companies, both small and large, is tax administration. On the 2013 Doing Business “Paying Taxes” indicator, Moldova ranks 109th out of 185 countries worldwide, and 15th out of 24 countries in the ECA region. Moldova performs much worse than the ECA average on the number of payments per year (48 compared to 28), and although the amount of time spent on dealing with tax administration is lower than the ECA average, it is still substantial at 220 hours per year. This equals to 5½ work weeks, or more than 10 percent of work weeks in a year for one employee. In addition, the CODB survey reveals that in 2012 businesses reported a considerable increase in the time needed to submit tax reports.

52 This data and other concepts from this paragraph draw on World Bank Group 2013d: “Paying Taxes: Why it Matters,” from the Doing Business methodology.
53 World Bank, Ministry of Economy of Moldova, and Centrul de Dezvoltare Economică Rurală Promo-Terra 2012 (Cost of Doing Business analysis). The analysis is based on surveys of a representative sample of 621 private Moldovan companies.
54 World Bank Group 2013c
Figure 6: Moldova’s Rank on the Paying Taxes Indicator Compared to other ECA Countries, 2013

Source: World Bank Group 2013b

94. The most common tax administration problems cited by companies, as documented in CODB 2012, are severe sanctions for errors and unclear procedures. Data on firms’ perceptions of various aspects of tax administration is presented in Figure 7 below. The severity of the problems identified was confirmed in interviews with businesses, representatives of private sector associations, think tanks, and government officials conducted by the World Bank team in September 2012 and January-February 2013. The paragraphs below provide more detail on the areas that warrant special attention from the authorities, and are in dire need of reform.

Figure 7: Tax Administration Problems in Moldova, as Stated by Companies


Notes: The figure shows the companies’ perceptions on a 1-5 point scale, with 5 being the worst one.

95. Importantly, the Government of Moldova has highlighted strengthening the tax administration system as a top priority. To that end, the government has approved the State
Tax Service’s Development Plan for 2011-2015. It includes a detailed Action Plan, which addresses many of the tax administration problems raised in this study. Below, we provide more details on problems that companies face in this respect.

96. **Fines and/or penalties that are disproportionate relative to the violations are a common complaint raised by businesses in the CODB 2012 survey.** According to Figure 7 above, it is the second-largest tax-related problem cited by companies (high tax rates is the first-ranked problem, but is not included because tax policy is outside the scope of this study). The behavior of tax inspectors who levy sanctions is also perceived as problematic by firms. While the legally-applicable fines and penalties are standard, many businesses believe that there is an unequal application of these fines and penalties based on favors, corruption or a need to extract additional revenue. These issues have been raised in reports including the National Business Agenda 2012-2013, a 2013 survey of companies by the European Business Association (EBA), and a 2012 report produced by the USAID-funded BRITE project.

97. **The recently (May 2013) appointed new Director of the Main State Tax Inspectorate (MSTI), Mr. Ion Prisacaru, confirmed the existence of the challenge and the intention to tackle it.** In an interview for the “Capital Market” weekly he mentioned: “We should initiate legislation on downward revision of monetary penalties for minor tax violations. And if a violation did not result in a decrease of taxes or charges paid by the company, the economic entity should not be punished at all. In exchange, penalties for bad-faith contraventions should increase markedly.”

98. **Table 6 below shows that the penalties collected were higher than the amount of additional taxes collected following controls by the State Tax Inspectorate (STI) in 2012.** Penalties represented 53 percent of total revenue from all control visits and 62 percent of revenue from planned control visits. A number of factors may account for the high amount collected in penalties, including: (i) penalties applied to more than one tax year; (ii) actual mistakes, inaccuracies, or misreporting by companies; and (iii) misapplication of fines by the tax inspector. A more detailed analysis would be necessary to establish which of these explanations predominates; however, the data, which is consistent with information given by companies, suggests that penalties are large.

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55 Approved by Government Decision Nr. 1141 dated 16 December 2010
56 The National Business Agenda is a document produced yearly by representatives of more than 30 business associations, think-tanks, as well as regional Chambers of Commerce.
57 European Business Association (EBA) is an independent, non-government organization set up by some of the biggest investors in the Republic of Moldova, under the auspices of the EU Delegation, aimed at aligning the national economy and business legislation to the EU standards, and promoting European values and best business management practices in the Moldovan business community.
58 USAID 2012
59 CAPITAL Market, Issue 20 (491), 29 May 2013
Table 6: Taxes and Penalties from Comprehensive Control Visits, 2012 (MDL million)

<table>
<thead>
<tr>
<th>Revenues from:</th>
<th>Total Visits</th>
<th>Planned Visits</th>
<th>Unplanned Visits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxes</td>
<td>159</td>
<td>70</td>
<td>89</td>
</tr>
<tr>
<td>Penalties</td>
<td>180</td>
<td>116</td>
<td>64</td>
</tr>
<tr>
<td>Total</td>
<td>339</td>
<td>186</td>
<td>153</td>
</tr>
</tbody>
</table>

Source: STI

99. **Substantial fines and penalties increase costs, and may incentivize companies and individual entrepreneurs to resort to bribes or conduct their activities in the shadow economy.** The National Business Agenda, put together by a large cross-section of the private sector, including over 30 business associations, think-tanks and chambers of commerce, comments on the issue this way:

>“The practice according to which the state tax authorities apply penalties and sanctions, even for a potential or virtual damage, even when no damage to the public budget was confirmed, is widespread. Also, sanctions are applied in cases when it is clear that the economic agent did not have the intention of fraud, but made a mistake caused by the human or technical factor. Because of the application of sanctions in such situations, the resources that could be invested in business development are removed from the business circuit that consequently leads to the reduction of future collections to the state budget. In addition, this situation creates a climate of nervousness and distrust between business and the state authorities, which in turn stimulates the growth of the shadow economy.”

100. **A recent study performed by the pre-eminent economist in the field of sizing the shadow economy, Professor Friedrich Schneider, estimates that the size of the Moldovan shadow economy in 2010 was 41.8 percent of GDP.**

Regional comparisons using 2007 data (the most recent comparable data available) show that in that year, Moldova had the 5th largest shadow economy in Europe, and a larger shadow economy than any country in the EU27. Certainly, this situation presents both a huge challenge to the tax authorities, as well as ample opportunities for corruption and collusion. The 2009 Enterprise Survey indicates that 35.5 percent of firms in Moldova identify practices of competitors in the informal sector as a major constraint, compared to 27.5 percent in ECA and 30.5 percent worldwide.

101. **CODB 2012 data clearly shows that the share of companies verified by the tax authority and the duration of such control visits is significantly higher compared to any other state controlling body.** The average numbers based on a sample of 621 companies indicate that 74 percent of all companies have been visited by tax auditors in 2012, with a frequency of 1.7 control visits per year and an average duration of 2.9 days per visit (remotely followed by the National Anticorruption Center at 1.1 days per control visit). See Table 7 below for more details:

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60 IDIS “Viitorul” 2011
61 World Bank 2012a
62 World Bank 2012a. The EU27 countries are: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden.
Table 7: Data on the Number, Duration, and Fines from Control Visits\textsuperscript{63}

<table>
<thead>
<tr>
<th>State Control Body</th>
<th>Share of Companies Inspected, % 2011</th>
<th>Frequency 2011</th>
<th>2012</th>
<th>Number of Days per Visit 2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax Inspectorate</td>
<td>67</td>
<td>1.5</td>
<td>1.7</td>
<td>2</td>
<td>2.9</td>
</tr>
<tr>
<td>Fire Service</td>
<td>54</td>
<td>1.2</td>
<td>1.3</td>
<td>1.2</td>
<td>0.6</td>
</tr>
<tr>
<td>Sanitary-Epidemiological Service</td>
<td>23</td>
<td>1.5</td>
<td>1.6</td>
<td>1.7</td>
<td>0.6</td>
</tr>
<tr>
<td>Police</td>
<td>23</td>
<td>1.9</td>
<td>1.7</td>
<td>1.3</td>
<td>0.5</td>
</tr>
<tr>
<td>Traffic Police</td>
<td>20</td>
<td>3</td>
<td>2.8</td>
<td>0.7</td>
<td>0.5</td>
</tr>
<tr>
<td>Price Monitoring Bodies</td>
<td>7</td>
<td>1.8</td>
<td>1.2</td>
<td>1.6</td>
<td>0.7</td>
</tr>
<tr>
<td>Standards Monitoring Bodies</td>
<td>9</td>
<td>1.5</td>
<td>1.1</td>
<td>1.5</td>
<td>0.8</td>
</tr>
<tr>
<td>Environmental Monitoring Bodies</td>
<td>6</td>
<td>1.3</td>
<td>1.2</td>
<td>1.3</td>
<td>0.4</td>
</tr>
<tr>
<td>Licensing Bodies</td>
<td>27</td>
<td>1.3</td>
<td>1.1</td>
<td>1.2</td>
<td>0.7</td>
</tr>
<tr>
<td>National Anti-corruption Center</td>
<td>14</td>
<td>1.3</td>
<td>1.3</td>
<td>1.7</td>
<td>1.1</td>
</tr>
<tr>
<td>Other Ministries and Departments</td>
<td>13</td>
<td>1.5</td>
<td>1.4</td>
<td>1.5</td>
<td>1</td>
</tr>
<tr>
<td>Local Authorities</td>
<td>14</td>
<td>1.7</td>
<td>1.5</td>
<td>1.3</td>
<td>0.5</td>
</tr>
<tr>
<td>Labor Inspection</td>
<td>35</td>
<td>1.4</td>
<td>1.4</td>
<td>1.5</td>
<td>0.7</td>
</tr>
</tbody>
</table>

Source: CODB 2012

102. \textit{At the same time, according to official STS data for 2012, the average duration of a control visit was 1.3 days.} It should also be noted that the maximum duration of fiscal control visits is established in the Tax Code. It stipulates that such control visits can last up to 2 calendar months, and may be extended for another period of up to 3 months. In this context, the STS is currently working on enhancing the results and quality of tax control visits, including by applying new approaches in its complex analysis. Even though this could ultimately result in a further increase in the average duration of control visits, it is expected that this reform will reduce their number.

103. \textit{Official data from STS also shows that an overwhelming 68.7 percent of control visits identified violations of the tax legislation, triggering a penalty or sanction.} Overall, 55,113 companies were verified during 2012, and 15 percent of companies had more than one control visit.

104. \textit{The official statistics is well reflected in companies’ perception with regards to fines and penalties, as documented in the 2012 CODB Survey.} The survey, which is based on a representative sample, found that a visit by the tax inspectorate is 17 times more likely to generate a fine or penalty than a visit by any other control body. Direct feedback from companies confirms that they do view tax inspections as a problem, citing that tax inspectors take an intrusive or intimidating approach.

\footnote{\textsuperscript{63} World Bank, Ministry of Economy of Moldova, and Centrul de Dezvoltare Economică Rurală Promo-Terra 2012}
105. Notwithstanding the measures taken in 2008 to simplify and accelerate value-added tax (VAT) refunds, companies still face difficulties in the administration of VAT refund claims. These include delays and excessive bureaucracy in the processing of VAT refunds, based on a VAT credit carry-forward system. This is particularly problematic for exporters. In addition, the STI’s refund system requires that all companies requesting VAT refunds are subject to a control visit, except a few large taxpayers that meet the criteria for a simplified procedure. Indeed, a company surveyed for this report confirmed that applications for VAT refunds can trigger long tax inspections. Many of the problems associated with VAT refunds are documented in a 2013 IMF report. The report finds that the current approach to the administration of VAT refunds is not effective or aligned with global good practice. It highlights the following issues:

- The current VAT system only partially allows for direct payments of VAT refund claims.
- The current VAT refund system facilitates unfair competition. Delays or refusals to refund VAT credits convert the VAT from a tax on consumption to a tax on both consumption and production.
- Issuing refunds or providing for a prompt recovery of VAT credits is important for the integrity of the VAT system.
- Transitioning from a VAT credit carry-forward system to a full VAT refund system could have a positive influence on economic activities, especially those of exporters.
- Denying VAT refunds does not necessarily protect the authorities from revenue leakage.

106. The current tax dispute resolution system shows inefficiencies. Taxpayers wishing to contest a tax assessment issued by the STI must first appeal to the tax authorities at the administrative level, and then can elevate the dispute to the judicial level, as shown in Table 8 below. The administrative appeal is filed with the same tax body that made the disputed decision. Companies have even reported cases in which the appeal was examined by the same tax audit officer. Under these circumstances it is highly unlikely that appeals at the administrative level will be successful. Data provided by the STS supports this view: out of a total of 430 appeals submitted to the tax authorities in 2011, only 45, or 10.5 percent, were won by businesses. The situation was similar in 2010, although the number of disputes lodged was much lower. Businesses won 28 out of 230 appeals, or 12 percent.65

<table>
<thead>
<tr>
<th>Level</th>
<th>Review Body</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administrative</td>
<td>State Tax Inspectorate (STI) at municipal or territorial (rayon) level</td>
</tr>
<tr>
<td></td>
<td>Main State Tax Inspectorate (MSTI)</td>
</tr>
<tr>
<td>Judicial</td>
<td>Court of First Instance</td>
</tr>
<tr>
<td></td>
<td>Court of Appeals</td>
</tr>
<tr>
<td></td>
<td>Supreme Court of Justice</td>
</tr>
</tbody>
</table>

107. Data on judicial rulings in tax-related cases show an uneven record in appeals. In 2011, the court system issued 292 decisions in tax-related cases filed by businesses against the

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64 Jensen et.al. 2012
65 Information on administrative and judicial appeals provided by the State Tax Service
STI. Of these, 173, or 59 percent, were won by the taxpayers. This is similar to 2010, when 177 out of 325 decisions, or 55 percent, favored the taxpayers. However, the situation is quite different when it comes to decisions issued on cases filed by the STI against taxpayers. In 2011, out of 444 such decisions, an overwhelming 424, or 95 percent, were won by the tax authority.\footnote{Information on administrative and judicial appeals provided by the State Tax Service}

108. **Other difficulties in resolving tax disputes through the courts include:**

- Although court decisions are available online, the current format makes it difficult to identify and retrieve cases addressing specific tax issues.
- Tax rulings often suffer long delays in the court system. Companies report that it usually lasts at least one year, and often up to 3-4 years, before a final court decision is issued.
- Judges deciding on tax related cases brought before them would benefit from specialized training in tax legislation.

109. **Corruption has also been cited by enterprises as a major issue that taxpayers face in their relationship with the tax authorities.** Whether instigated by the tax authorities or by companies, bribes may take the form of a business transaction that yields a lower tax or penalty payment for the company and unofficial, “tax-free” income for the tax official. These transactions come at the expense of overall tax revenue. Such collusive corruption is at the heart of many problems related to tax administration in Moldova. Several companies interviewed for this study reported that the practice of presenting small gifts and facilitation payments to tax service employees was customary and important for avoiding unexpected control visits and maintaining a “friendly relationship” with the local tax office. The STS is one of the government agencies most commonly perceived as corrupt.

110. **All of the above-mentioned problems have a major impact on the cost of doing business and on investment decisions by local and foreign companies.** Foreign investors may consider investing in other countries in the region to avoid these costs. Local investors may consider relocating to countries with a more stable and predictable tax environment. Investors may also opt to move their operations partly or entirely into the shadow economy. According to a recent World Bank-sponsored study the size of the shadow economy in Moldova is estimated at approximately 42 percent of GDP.\footnote{World Bank 2012a}

**B. Underlying Causes of the Problems**

111. **Difficulties with applying tax legislation are in part caused by the ambiguity and contradictions in the fiscal regulations.** The Tax Code, which is the primary piece of legislation governing taxes in Moldova, became effective in 1998, and it has been amended frequently over the last decade. The customary practice has been that the proposed draft amendments to the Tax Code and the accompanying Explanatory Note have not been subject to a Regulatory Impact Assessment (RIA), which is compulsory for all laws and regulations affecting business, to help ensure that the changes are justified.

112. **The major problem seems to be that certain provisions of the Tax Code have been distorted by regulatory acts** approved by the government, the Ministry of Finance, other line
ministries, or local authorities, after the adoption of the Tax Code. These regulatory acts were
often introduced with the aim of enforcing and/or completing the Tax Code, but in reality that
was not always the case. A tax lawyer consulted for this study confirmed that numerous letters
from government agencies, Government Decisions, decrees, and other normative documents
introduce complexity and inconsistencies into the application of tax rules. While many of these
documents attempt to clarify the tax code, according to the lawyer, they commonly introduce
more confusion, and make matters worse. The World Bank’s forthcoming Auditing and
Accounting Report on Standards and Codes (ROSC) in Moldova offers a concrete example: The
Tax Code was amended such that any income and expenses resulting from the transition from
National Accounting Standards to International Financial Reporting Standards would not be
recognized for tax purposes – a sensible and welcome decision. However, there is no guidance
on how to apply this amendment.

113. This lack of clarity, according to the ROSC, has significant implications for both the
public and private sectors in terms of predictability of tax revenues and charges, tax
collections and payments, as well as corruption. Regarding the overall lack of clarity in tax
rules, the National Business Agenda (ANB, for its initials in Romanian), which reflects the views
of a broad range of private sector stakeholders, states that, “the high number of regulatory acts
and unclear, vaguely described procedures favor their misinterpretation or abusive interpretation
by tax officials. Under such conditions, the cost of business administration is increasing, both
relating to the time spent to solve these problems and to the informal payments involved”.

114. The National Business Agenda, CODB, BRITE, and EBA surveys all suggest that
gaps in legislation and unclear or conflicting norms are at the root of Moldova’s problems
with taxation. As shown in Figure 7, the second, third and fourth-ranking problems with tax
administration identified by businesses relate to the lack of certainty and predictability in tax
rules and their application. The ANB lists multiple examples of inconsistencies between the Tax
Code and other Government Decisions or letters from MSTI, including:

- Government Decision No. 77 of 30.01.08 specifies a limited list of expenses that are
deductible; however, the Tax Code (Art. 24) allows enterprises to decide which expenses
are ordinary and necessary for their business and to deduct them accordingly.
- MSTI’s “Letter on the Terms of the Fiscal Obligation for VAT on Imported Services”
(No. 26-08/2-02/1/2539 of April 27, 2011), establishes additional taxable obligations and
terms for VAT payments on imported services that are inconsistent with what the Tax
Code requires when it comes to import of services.
- VAT payments on advances received by businesses are not made in accordance with the
provisions of the Tax Code, but rather in accordance with unofficial practices and
relevant letters from the MSTI.
- Order of the Ministry of Finance No. 87 of 23.12.2004 on Record-keeping of Tires and
Accumulators obliges companies to deviate from the standard accounting rules of record-
keeping of tangible assets. It also establishes, indirectly, a tax rule providing for
deductions of expenses for tires and accumulators for fiscal purposes.

68 ‘Idis Vitorul 2012
69 IDIS “Viitorul” 2011

45
115. Other studies reviewed for this report, as well as the overwhelming majority of companies interviewed by the team, have the view that inconsistencies in primary and secondary legislation contribute to high compliance costs and encourage corruption. Such inconsistencies in legislation and regulations contribute to high compliance costs and encourage corruption. They affect the companies’ ability to follow relevant laws and regulations as well as the tax auditors’ ability to apply them. This then has an impact on the approach of the tax auditors and the fines and penalties charged. Inconsistencies in the rules also leave room for discretion by individual tax officials and invite opportunities for corruption.

116. The head of MSTI, Mr. Ion Prisacaru, largely agreed with these challenges, as quoted by the Capital Market newspaper: “First of all, it is the deficient tax legislation. More specifically, ambiguity and vague nature of many articles in the Tax Code and some implementing regulations create conflicts between business people and tax authorities’ representatives.” Furthermore, he added that, “first and foremost, I deem it unacceptable that documents issued by the MSTI involve fiscal traps for economic entities. It is necessary to help develop the businesses, rather than impede them.”

117. Interviews with businesses, the ANB report, and reports by international donors indicate that the pressure to satisfy budget revenue targets may also be leading tax authorities to focus on compliant taxpayers. It is widely believed that the practice of placing excessive pressure on companies in the formal sector to extract additional revenue in taxes and penalties has been used as a short-cut at the expense of efforts to reduce the “tax gap” by pursuing companies that operate in the “shadow” economy. The vast majority of interviewed companies operate in the formal sector. The end of year 2012, when budget revenues were falling short of expectations, proved to be a particularly difficult period for many transparent businesses. However, the long-term impact of inaction on the informal economy is likely to bear a higher cost than the short-term gains from additional revenue generated by companies that are compliant with tax legislation. Bringing informal firms into the formal economy would increase the tax base, and improve the government’s ability to meet revenue targets.

118. The new Director of MSTI has signaled several positive and welcome developments. The organization intends to draft legislation to revise the system of sanctions and fines, and to revise the institution’s performance indicators to focus on compliance and not sanctions.

119. Changes to tax legislation currently make limited use of a public-private dialogue (PPD) mechanism. Although the authorities have established one committee to discuss and examine possible legislative changes and another committee to discuss compliance issues with the private sector, research conducted for this study did not indicate that either of these bodies was serving as an effective PPD mechanism. As previously mentioned, RIAs, which are reviewed by a public-private body, are not routinely performed for proposed tax legislation and regulations. A review by World Bank tax specialists in November 2011 also found that taxpayer education is weak. The general absence of meaningful interaction between the public and private sectors in the legislative process may result in inappropriate, or at least sub-optimal, tax policies.

70 CAPITAL Market, Issue 20 (491), 29 May 2013
71 Tax gap is the difference between taxes owed and taxes paid
72 Consultative Committee, approved by Ministry of Finance Order Nr. 19 from 14.02.2011
73 Committee for Compliance, approved by MSTI Order Nr. 1078 from 10.10.2012
and procedures, and likely have an adverse impact on taxpayer compliance and resulting tax revenues. On the contrary, an effective PPD mechanism could improve the process of formulating, drafting, and enacting legislation and normative acts (including regulations and government decrees). It could also make companies more aware of changes in tax legislation so that they are better able to plan for and comply with it. This would reduce the costs and uncertainty faced by companies when dealing with tax administration. The new Director of MSTI has taken some steps to improve PPD and intends to continue and strengthen these efforts.

120. **The STI is not empowered to provide advance rulings or other forms of binding rulings, which features in many modern tax administration systems.** The major reason for that is that the concept of “advance rulings” does not exist in the current Tax Code. Legislative amendments on advance rulings have been presented, and are awaiting a decision, in the Parliament. In addition to approving these amendments to the tax legislation, in order to implement this reform, the STI’s capacity to administer advanced rulings regime would need to be built. Advance rulings are an important part of ensuring transparency and certainty in the taxpaying community. Advance rulings would also help improve the current process of administrative appeals.

121. **Risk management has been initiated as a tool to select companies for audits, but covers only a fraction of total audits.** During their visit to Moldova in November 2011, World Bank public sector specialists found that the capacity for risk analysis is weak. Access to third party information, a critical aspect for the success of technology-based compliance management, is limited by legislative restrictions. As a result, there is very little automated information matching, and these key components of a risk management system are missing. In addition, audit techniques are not well standardized or specialized by industry. The new Director of MSTI has expressed his intention to separate responsibility for planning and implementing controls, which is a positive step.

122. **Human resource management and the organizational structure of the State Tax Service also exhibit weaknesses.** Additionally, the November 2011 World Bank mission found that human resource functions including recruitment, promotion, and disciplinary action are localized, and there is almost no inter-rayon rotation of staff. This facilitates favoritism, collusion, and corruption, as companies and tax officials can build relationships that can foster collusion. The mission also found that the organizational structure of the State Tax Service (STS), with 35 local inspectorates, results in inefficiencies. Training also requires significant improvement; most local recruits are trained only through a local mentor within the inspectorate. The mission concluded that “improving voluntary compliance through application of modern technology will only be beneficial if there are corresponding reforms in the organizational structure, human resource management, business processes of the State Tax Service, and investment in training. Many of these reforms will require significant changes to the legislative framework as it exists today”.

123. **Despite the tax inspectors’ stated goal of uncovering wrongdoing by taxpayers and cracking down on the informal economy, taxpayer services and taxpayer education are weak.** The World Bank mission did not detect any organized effort to facilitate taxpayer compliance, and reduce taxpayer compliance costs. Though it is a key objective in the STS’s development plan, as of the November 2011 no evidence was found that this was being pursued
in practice. There is a clear need for a functional area of the STS to be charged with ensuring that taxpayers can execute their self-assessment responsibilities efficiently and effectively.

124. **Business processes are also outdated and duplicative, and information technology is outdated** according to the findings of the World Bank mission. Regarding business processes, many routine functions, such as monthly submission of returns, are done locally. Even though declarations are entered into the database centrally by Fiscservinform, these are first collected and checked locally, and then sent in batches for central processing. Regarding IT infrastructure, the STS today operates about 40 different application systems that cover key aspects of its operations. These systems are often not able to communicate with each other, which creates many inefficiencies, and can make some policies ineffective. The World Bank mission noted that “obtaining consolidated information for STS management or taxpayers within the current IT infrastructure is impossible”. While these internal inefficiencies do not affect taxpayers directly, they can clearly contribute to some of the problems faced by companies, including those stemming from delays in communications with the tax service and the lack of a risk-based approach.

125. **Another example of inefficiency imposed on taxpayers is the multiple filing of information on payroll deductions.** The World Bank team found that as of late 2011, separate declarations are filed with the tax administration, health insurance, and pension insurance agents. Delays in data exchange and discrepancies in the data provided to different institutions make STS auditing of payroll deductions inefficient and not as effective as it should be. This is another example in favor of electronic filing and distribution of information to the government agencies with a need to know.

**C. Policy Recommendations**

126. **In 2011, the government stated that strengthening tax administration was a top priority.** A comprehensive tax administration reform initiative was announced by the Moldovan Prime Minister in April 2011. In December 2010, the Government approved the STS’s Development Plan for 2011-2015, including a detailed Action Plan. Prior to approval, it went through a broad-based consultation process with the involvement of all relevant stakeholders. It therefore represents a solid base for advancing with tax administration reform in Moldova. Strong commitment to enact changes in this issue area was confirmed to the World Bank Vice President and Country Director and reiterated by the Finance Minister during discussions with the Country Manager and the World Bank team in 2011. This level of commitment should be sustained in the future.

127. **Short-term and medium-term policy recommendations are listed below.** The recommendations that already form parts of reform plans are classified as such, using the acronyms of the relevant plan(s).

**Short-term Recommendations (through 2014)**

b. Eliminate inconsistencies and ambiguity in tax legislation (STS\textsuperscript{74}, RRS\textsuperscript{75}). Conduct an inventory of regulations, normative acts, decrees, letters, and other acts that impact tax administration and policy. Consider developing a new Tax Code and follow up by developing an official Explanatory Note to the Tax Code, that would give detailed interpretations in order to improve clarity of the tax code. (Responsibility: Ministry of Finance, STS.)

c. Fully implement efforts initiated by the new Director of the Main State Tax Inspectorate to improve public-private dialogue and promote taxpayer compliance. (Responsibility: STS)

d. Draft and promote to Government and Parliament legislation to revise the system of fines and penalties. The new Director of MSTI has signaled his intention to do this. (Responsibility: STS)

e. Adjust State Tax Service performance indicators to focus on compliance and not sanctions. The new Director of MSTI has signaled his intention to do this. (Responsibility: STS)

f. Increase the State Tax Service’s independence from political influence. (Responsibility: Government.)

\begin{itemize}
\item \textbf{g.} Approve the Regulatory Reform Strategy 2013-2020 (RRS), and direct the State Tax Service to implement the tax-related recommendations of the 2013-2015 RRS Action Plan. (Responsibility: Government, STS)
\item \textbf{h.} Enforce the compulsory RIA processes for all tax legislation, including but not limited to laws, amendments to laws, governmental and ministerial decisions, decrees and letters (RRS). (Responsibility: Government, Ministry of Finance, STS)
\item \textbf{i.} Create a formal Private Public Dialogue (PPD) mechanism that allows the private sector to interact with the Parliament, MOF, and the STS throughout the process of designing tax policies and procedures, as well as their ultimate implementation (STS, RRS). This may take the form of a standing working group on taxes that would cooperate with the Working Group for Regulation of Entrepreneurial Activity. Enhanced PPD will help the STS facilitate taxpayer compliance and reduce compliance costs. (Responsibility: Government, Ministry of Finance, STS)
\item \textbf{j.} Enforce a risk-based assessment system to determine the need for audit in line with international good practice. Restrict tax control visits to businesses with a good history of tax compliance. (Responsibility: STS)
\item \textbf{k.} Implement more effective processes of VAT refunding and reclaim systems by following specific recommendations provided in the IMF report.\textsuperscript{76} (Responsibility: Ministry of Finance, STS)
\item \textbf{l.} Design and begin to introduce institutional and human resource management reforms (STS, RRS). (Responsibility: Government, Ministry of Finance, STS.) These include:
\end{itemize}

\textsuperscript{75}The recommendation is part of the Regulatory Reform Strategy Action Plan 2013 - 2015
\textsuperscript{76}Jensen et.al. 2012 (IMF). The contents of this report constitute technical advice provided by the staff of the International Monetary Fund to the authorities of Moldova in response to their request for technical assistance.
i. Conducting a detailed functional analysis and providing recommendations for a modern, region-based organizational structure

ii. Establishment of a permanent tax training institute with a proper complement of training staff; development of e-learning

iii. Human resources development including centralized recruitment

iv. Support for redeployment and retraining


m. Design and begin to introduce operational reforms. Internationally (particularly EU) proven business processes should be adopted, and this should be linked with the effort to upgrade information technology and automation. (Responsibility: STS) Operational reforms include:

i. Enhanced analytical and strategic planning capacity

ii. Enhanced capacity for applying risk management techniques

iii. Modernization of excise administration

iv. Improving the effectiveness of VAT administration

v. Modernization of information technology

vi. Others as listed in the World Bank November 2011 Aide Memoire.

n. Improve the legislative framework to support these and the institutional reforms above (Responsibility: STS, Ministry of Finance, government where appropriate.)

o. Provide tax training to judges, possibly jointly with STI staff. It could start with a limited number of judges who will be designated to handle tax cases, in order to improve the dispute resolution mechanism. (Responsibility: STS.)

p. Create a user-friendly electronic web-based registry of all decisions and clarifications issued by the tax authority, as well as tax-related court decisions (precedent cases). This would order to increase transparency of decisions and raise awareness of taxpayers, and help make sure that legislation is applied in a uniform and consistent manner. (Responsibility: STS.)

q. Improve external communication and transparency. Implement a “Taxpayer Rights” information campaign via TV, radio, Internet, information booklets at tax office locations. (Responsibility: STS.)


a. Extensively use the Public Private Dialogue to facilitate the process of improving tax-related legislation and regulations, and keep a wide range of stakeholders informed and involved in legislative changes. (Responsibility: government, Ministry of Finance, STS.)

b. Institutionalize a streamlined and transparent Tax Dispute Resolution System through: (Responsibility: Government, STS.)
i. Creating a mediation system for tax cases.\textsuperscript{77}

ii. Establishing the office of the Tax Ombudsman.\textsuperscript{78}

c. Further promote and encourage e-filing and automation within the STS. This will enable businesses to quickly and easily file returns and pay taxes, thus reducing compliance costs. In addition, international experience demonstrates that reducing the interface between the tax officials and the taxpayers limits opportunities for corruption. (Responsibility: STS.)

d. Implement an advanced rulings regime. It should be phased in over a period of time to allow for extensive training of staff in good practice in administering advance rulings. More extensive use and publication of rulings would provide greater certainty to taxpayers, allowing them to undertake, restructure, or forego transactions based on the ruling. This mechanism could also help reduce the number of appeals. (Responsibility: STS, Ministry of Finance, government.)

e. Continue implementation of institutional, human resource management, and operational reforms. As part of this, implement the region-based organizational structure and centralize human resource management. (Responsibility: STS, government.)

\textsuperscript{77} Georgia’s Revenue Service implemented mediation procedures with IFC assistance. The adoption of this reform resulted in businesses winning approximately 47 percent of cases, compared to approximately 10 percent (identical to the current situation in Moldova) won before the reform. (Source: IFC Investment Climate department.)

\textsuperscript{78} Georgia and Armenia have introduced the Taxpayers’ Ombudsman as an independent institution advising taxpayers on their rights, and providing them with recourse against the tax authorities on service matters such as undue delays, unfair conduct, and corrupt practices. (Source: IFC Investment Climate department.)
VI. Licenses, Authorizations\textsuperscript{79}, and Inspections

A. Evidence of Problems

128. Licenses, authorizations, and inspections seek to reduce information asymmetries between consumers and firms regarding the quality of goods and services. Extending licenses and authorizations to qualified businesses is a risk management tool. Inspections are part of the mechanism through which government agencies ensure that companies comply with the requirements of the licenses and inspections over time. Thus, the existence of licenses, authorizations, and inspections is not incompatible with a good regulatory environment. However, it is important for the public authorities to administer them in a transparent and predictable way, in order to impose minimal costs on businesses and allow businesses to calculate and plan for the associated expected costs. As emphasized in the 2005 World Development Report: A Better Investment Climate for Everyone (World Bank, 2004), a good business regulatory environment has an impact on the productivity of investments, and hence is key to sustained growth and poverty reduction. Licenses, authorizations (which includes permits), and inspections are the key ingredients of the regulatory framework.

129. Moldova has been pursuing reforms to reduce interventionism, and eradicate corruption in the regulatory environment, but the reforms so far have not produced all of the expected benefits. The 2012 Cost of Doing Business (CODB)\textsuperscript{80} survey indicates that the businesses’ perception of the regulatory environment worsened in 2012 compared to the previous years. The share of firms that considered the regulatory environment less favorable increased from 33 percent to 36 percent from 2011 to 2012, while the share of those who reported improvements decreased from 25 percent to 18 percent. The various reforms enacted, and their degree of implementation, will be discussed in the next section of this chapter.

Figure 8: Assessment of Changes in the Regulatory Environment

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure8.png}
\caption{Assessment of Changes in the Regulatory Environment}
\end{figure}


\textsuperscript{79} This Report reviews “licenses” and “authorizations” separately. The former category is regulated by Law on Regulating Entrepreneurial Activity by Licenses # 451 (License Law); while the latter type is regulated by the Law on Regulating Entrepreneurial Activity by Authorization # 160 (Authorization Law). In a large number of cases these two categories of permissive acts overlap, and are duplicative (see some examples in this chapter).

\textsuperscript{80} Enterprise survey-based study conducted yearly since 2002.
130. As per the 2012 CODB Survey, authorizations and inspections are the second and third-most difficult areas for businesses. The graph below shows how businesses rate the difficulty of various components of the business environment over the past four years, on a 5 point scale.\(^{81}\)

**Figure 9: Major Difficulties Faced by Businesses**

![Graph showing major difficulties faced by businesses over the past four years.](image)

*Source: CODB 2012*

131. The findings on enterprises’ negative perceptions of the regulatory framework are supported by various benchmarking studies. In the World Bank's Doing Business report, Moldova ranks 83rd in the world, below the ECA regional average of 73rd. Moldova ranks far below the ECA and OECD averages on indicators such as Dealing with Construction Permits (168th) and Trading Across Borders (142nd). These two areas require a high number of licenses and authorizations. Likewise, the 2013 Index of Economic Freedom ranks Moldova 113th out of 177 economies.\(^{82}\)

**Problems Related to Licenses and Authorizations**

132. The large number of license and authorization requirements elevates compliance costs for Moldovan companies. Businesses find it difficult to navigate the multi-layered system, as obtaining a license from one authority often requires permits and certificates issued by other government agencies. At times, the license merely confirms that these other documents have already been duly obtained. See Box 2 below for examples of some of these overlapping requirements.

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\(^{81}\) Scale from 1 to 5, where 1 – do not face difficulties, 5 – face serious difficulties.

\(^{82}\) Heritage Foundation 2013
Licenses can grant as well as restrict market entry, and in Moldova, the latter is a concern. Market entry can be restricted through changing requirements and lack of transparency in the process of issuing and renewing licenses. Examples of non-competitive behavior by government authorities, documented by the National Agency for the Protection of Competition (NAPC), and discussed in chapter VII (see paragraph 164) show instances in which government agencies have made it difficult for companies to obtain relevant authorizations and other permissions. Market access can also be indirectly restricted by regulatory requirements, such as the one barring pharmacies from being located within 500 meters of each other, as stipulated by the Law on Pharmaceutical Activity (No. 1456).

Licensing may also pose a constraint to innovation and thereby reduce firm competitiveness. In prescribing the skills and equipment that are required for a license, the system reflects assumptions about technology that may have become obsolete. For instance, focus groups with entrepreneurs in Moldova’s rural areas revealed that applicants for licenses to import or produce alcoholic beverages, or sell them wholesale, were obliged to supply evidence that they owned a 500m² warehouse, as required by the Law on Fabrication and Circulation of Ethylic Alcohol and Alcoholic Products. This size is clearly excessive for smaller volumes.

Imposing license requirements can also restrict entry for otherwise qualified businesses that may not be able to afford the cost of applying. Recent estimates put the average cost of obtaining a license in Moldova at around USD 266, which amounts to 13 percent of GNI per capita. That cost is likely to constitute a barrier for some businesses, especially small and medium-sized enterprises. This then affects patterns of competition in the market.

The 2012 CODB identifies authorizations as the second greatest difficulty faced by firms participating in the survey, after tax inspections. The Authorization Law defines the term “authorization” to cover a broad range of requirements for doing business, including: authorization, permit, certificate, endorsement, approval, coordination, patent, and qualification certificate issued by public administration authorities or institutions which were given regulatory

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83 World Bank, Ministry of Economy of Moldova, and Centrul de Dezvoltare Economică Rurală Promo-Terra 2012 (CODB)
84 CODB is limited because it defines “Authorizations” to include only permits related to business activities, and it tackles Construction, Sanitary Certification, and Certification of Goods and Services separately.
85 See Figure 7 of this Chapter.
and control functions by law. Authorizations apply to a range of areas: food safety, health and pharmacology, consumer protection, MSTQ, telecommunications, energy, finance (banking and non-banking), environment etc.

137. **The large number of authorizations**, as well as overlaps in legal and institutional structure for their issuance and renewal, impose high compliance costs. The large number and variety of authorizations required tends to confuse business operators, and complicate entrepreneurial activity. For instance, grain exporters have to collect six authorizations: a grain inspection certificate, a phytosanitary certificate, a veterinary certificate, a certificate of origin, a certificate of conformity, and a certificate of quality for the grain elevator, which are all, issued by different authorities with different geographical locations. The collection of all of these authorizations, which are required for each shipment, requires 3-4 days. The problem of overlaps is discussed under “Underlying Causes of Problems” further on in this chapter.

**Problems Related to Construction Permits**

138. **Businesses seeking construction permits are faced with high costs and extensive delays.** The most recent Doing Business report ranks Moldova as 168th and 165th in the world in Dealing with Construction Permits for 2013 and 2012, respectively. Figure 10, depicting Moldova alongside other CIS countries and Romania, shows that the country is lagging behind its regional peers. Figure 11, in turn, presents the main difficulties perceived by Moldovan companies when dealing with construction permits, according to the 2012 CODB survey. Negative numbers (in orange) indicate the percentage of firms that finds overall procedures, their duration, or their cost to be a serious or critical problem. Positive numbers (in green) indicate the percentage of firms that state that these problems are insignificant or that no problems exist. Similarly the 2009 Enterprise Survey shows that 48.9 days are required to obtain a construction permit in Moldova, comparing to, 26.3 days in Armenia, 29.9 days in Estonia, 44.3 days in Georgia, and 46.5 days in Azerbaijan.

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86 Despite a 30 percent reduction in authorizations through the “Guillotine 2+” law, which will be discussed further on in this chapter, a large number of authorizations are still required.

87 This permit is discussed separately as an illustrative case on which good data at the national level and across countries is available (through Doing Business).

88 Enterprise Survey 2009.
Figure 10: Moldova’s Rank on Dealing with Construction Permits, Compared to other ECA Countries, 2013

Source: World Bank Group 2013b

Figure 11: Problems Related to Receiving Authorizations for Construction and Repairs (Construction Permits)

Source: CODB 2012

Problems Related to Inspections

139. Duplicate inspections and lack of coordination between regulators with identical or similar inspection objectives are major hurdles faced by enterprises. IFC mapping of laws/regulations in 2012 indicates that about 40 percent of inspections tend to overlap, and they lack clear criteria and straightforward procedures. For instance, despite a one-stop-shop and electronic issuance of authorizations, inspectors still request original certificates issued by government agencies. The 2009 Foreign Investors Association (FIA) White Book underlines the

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89 IFC 2011.
need for deeper reform, recommending to, “streamline the functions of inspection bodies, in order to prevent duplication of check-ups.”

**Figure 12: Inspection Authorities by Type**

![Bar chart showing inspection authorities by type](chart_image)


*Note: Red denotes a large number of inspection authorities, blue medium, and green low.*

140. **Firms’ evaluations of inspections indicate that compliance costs are high.** The 2012 CODB survey reveals that entrepreneurs find inspections excessive: the average number of inspection visits per year increased from 4.2 times in 2011 to 5.2 times in the 2012 report. Nearly a quarter of the companies interviewed for the 2012 CODB stated that their experience with inspectors was worse than the previous year. Moreover, the share of respondents with negative perceptions increased year on year, which is a worrisome trend. Moreover, a third of the businesses interviewed for the survey also suggested that the law on inspections is applied selectively, depending on the attitude of public officers. Only 17 percent of respondents said that all companies were equal before the law (see Table 9 below).

**Figure 13: Evolution of Inspection-related Procedures**

![Bar chart showing evolution of inspection-related procedures](chart_image)

*Note: 22% worse, 64% the same, 14% better.*

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90 Foreign Investors Association of Moldova 2009
91 CODB 2012
Table 9: Companies’ Responses to Questions on the Objectivity of Public Officers

<table>
<thead>
<tr>
<th></th>
<th>Yes</th>
<th>Partially</th>
<th>No</th>
<th>Don’t Know</th>
</tr>
</thead>
<tbody>
<tr>
<td>All companies are treated</td>
<td>17%</td>
<td>33%</td>
<td>36%</td>
<td>14%</td>
</tr>
<tr>
<td>equally before the law</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The law is selectively</td>
<td>38%</td>
<td>29%</td>
<td>10%</td>
<td>23%</td>
</tr>
<tr>
<td>applied</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

Source: CODB 2012

B. Underlying Causes of the Problems

Underlying Causes of Problems Related to Licenses and Authorizations

141. Moldova has been pursuing reforms to streamline and eradicate corruption in the regulatory environment, but the reforms so far have not produced all of the expected benefits. There has been a concerted effort for over a decade to reform licensing and other regulatory acts. This included the Licensing Law of 2001, which attempted to simplify the licensing framework, and reduce discretionary powers of the ministries involved, as well as regulatory reform implemented through Law 424 of 2004 (“Guillotine 1”), Law 235 of 2006 (“Guillotine 2,” which also introduced the requirement for Regulatory Impact Assessments), and Law 160 of 2011 (“Guillotine 2+”). However, progress implementing these reforms has not yielded all of the benefits expected, as will be explained in this section. Reform efforts have been more recent, and modest, in the area of inspections. A law has been passed enabling the creation of one-stop shops, including for issuing construction permits, but none have been implemented.

142. Although the 2001 Licensing Law created the legal and institutional framework for a single Licensing Chamber that is meant to serve as a one-stop shop, this reform was too narrow to result in major improvements. The Licensing Chamber was meant to absorb most of the line ministries’ functions to authorize certain activities. A total of 55 types of activities fell under the newly-established licenses regime, and this was reduced over time to the current level of 44 types of licenses (see footnote 92). However, by defining licenses too narrowly as documents issued by a “licensing authority”, with certain characteristics, the Licensing Law effectively failed to transfer responsibility for a myriad of authorizations, certificates, and

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92 Moldova implemented a licenses reform back in 2001 by enacting the License Law, which created an institutional and legal framework based on a single Licensing Chamber, which embraced most of the line ministries’ functions to authorize certain activities. A total of 55 types of activities fell under newly established licenses regime. At that stage, the License Law did not cover licenses issued by independent regulators. Over the period of more than 10 years the License Law has been several times modified and its actual version lists 44 licenses, including those issued by independent regulators.

93 Law 424 of 2004 requires that all regulatory action affecting business be implemented through either laws or other normative acts. Law 235 of 2006 streamlined 82 laws and abrogated 2 laws. It also makes draft laws and regulations affecting businesses, and any proposed modifications to them, subject to Regulatory Impact Analysis, which is to be reviewed by the Working Group of the State Commission for Regulation of Entrepreneurial Activity, assisted by the RIA Secretariat. Another outcome of the Law 235 was the Law 160 (Guillotine 2+) states that a permissive act may be invoked or applied only after its inclusion in the Nomenclature of Permissive Acts, and reduced the number of authorizations from 400 to 277.

94 The License Law did not cover licenses issued by independent regulators.

95 Licenses are defined as official acts, issued by a licensing authority, which certifies the right of the holder to conduct the type of activity specified by the license over a fixed period of time.
permits that firms have to obtain at different points in time from other government agencies. In most instances, the role of the agencies that issue authorizations is to ensure compliance with the terms of the licenses. This creates duplications, increases the procedures the companies must go through – at times duplicating them – and also creates confusion among businesses as to which authority to contact in case of any problems.

143. **Reforms to reduce the number of authorizations were also limited in their scope, and the reforms have not been fully implemented.** Despite the three “guillotine” exercises, which made some progress in this respect, requirements for permissive documents are excessive and overlaps are still abundant. For instance, Guillotine 2+ reviewed 400 authorizations but left 277 of them in place, including them in the Law on Regulating Entrepreneurial Activity by Authorization #160 of 2011. Although the reduction in authorizations seemed substantial at 30 percent, the yielded annual impact on the private sector was not significant, as direct and indirect costs were only reduced by USD 2.4 million. In addition, the 400 authorizations reviewed did not include the whole universe, and many of the authorizations that remain overlap with licenses. Furthermore, many public authorities did not fully implement Law #160 in practice, and have not modified their line (sector-specific) laws and regulations to reflect the modifications made by Law #160. Additionally, although Law #161 requires all public authorities to implement one-stop shops in their interactions with businesses, no one-stop shops have been created. Many authorities have not yet reviewed their sector-specific legislation and proposed modifications in order to implement these one-stop shops, as directed by the law.

144. **Difficulties obtaining licenses and authorizations can also be caused by government authorities that wish to use their discretion over them to restrict market access.** As discussed in paragraph 133, administrative decisions on permissive documents can be unpredictable and subject to outside influence. Interviews with entrepreneurs suggest that regulatory bodies can – and do, at times – withhold or remove licenses without an explanation.

**Underlying Causes of Problems Related to Construction Permits**

145. **In contrast to licenses and authorizations, there has been no major effort to reform construction permits in Moldova.** As stated above, Law # 163 as well as Law # 161 on Implementing the One-Stop Shop in Entrepreneurial Activity directed the authorities to implement one-stop shops, including for construction permits, but this has not been implemented. A recent IFC report underlines additional bottlenecks in the area of construction permits. These include:

- Multiple authorities are involved in the procedure for obtaining a construction permit, which makes the process very complicated.
- The design documentation required is too detailed.
- The procedure for getting an occupancy permit is very complicated.
- Some special laws are not consistent with the Law on Construction Permits.
- Some authorities request a fee, although it is not prescribed by law.
- There is no risk-related categorization of buildings.

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96 Based on calculations by IFC using the Standard Cost Model.
97 Adopted in June 22, 2011.
98 IFC 2011
• The technical requirements for buildings are spread over hundreds of documents.
• Urban plans exist only for very few communities.
• State owned land is often not covered by the cadaster.

Only the first issue listed here was addressed by the Law on Construction Permits; there have been no attempts to reform the other areas listed here.

**Underlying Causes of Problems Related to Inspections**

146. Many systemic issues contribute to the high costs and uncertainty imposed on businesses by the authorities’ approach to inspections. A risk-based approach is not used for inspections. There is a lack of horizontal interaction between regulators even when their mandates overlap or are complementary. No substantial public administration reform related to inspections has been undertaken. As a result, inspections are excessive and costly. The complex system also creates ample opportunities for corruption. Moldovan authorities have not made substantial progress in this area: until 2012, none of the reforms in the area of business regulation attempted to streamline inspections.

147. The authorities are making a solid attempt to address the underlying causes of the problems, through a new law and Government Decision. The 2012 Law on State Control of Entrepreneurial Activity No. 131 (Inspection Law) and the Decision No. 147 on Inspection Registry Regulation are the first steps in the right direction. The Inspections Law introduces principles of state inspection, institutionalizes a system of supervision and monitoring of inspection entities, and sets clear rules for on-site inspections. The decision on the registry could mark a breakthrough in transparency, as it creates a basis for a government portal of inspections, [www.controale.gov.md](http://www.controale.gov.md), linked to the e-government services platform, [www.servicii.gov.md](http://www.servicii.gov.md). However, in order for these laws to have an impact, they must be implemented well, including by harmonizing line (sector-specific) laws and regulations with the laws mentioned here.

148. However, because the law omits customs and tax authorities, it is also likely to result in only a partial reform, as with the licensing and authorization reforms discussed in the section above. Eight out of the 33 inspection bodies are effectively excluded from complying with the Inspection Law. Four of them are exempt, because the legislation does not apply to fiscal, customs and tax control. The remaining four are only bound by the provisions of the law that do not contradict special laws governing their activity. Hence, though the law requires 25 regulators to implement risk-based system, it does not cover customs and taxes, cited as major problem areas for companies (see chapters IV and V).

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100 February 27, 2013.
C. Policy Recommendations

149. The government has already made a commitment to reform the system of business regulation in several key policy documents. The 2011-2014 Government Program, “European Integration: Freedom, Democracy, Welfare”, underlines the need to, “speed up the regulatory reform; revise, unify and optimize the licensing requirements and criteria; identify possibilities to optimize the number of types of activities subject to licensing; increase transparency of the business authorization system; clearly define authorization procedures and requirements; and reduce the number of areas subject to authorization.” It also pledges to reduce the number of groundless and/or abusive inspections, and design a single inspection and control management system. In the same vein, the Moldova 2020 national development strategy vows to uphold the principle of doing business with “clear rules of the game.”

150. The strategic vision outlined in these two documents has informed the draft Regulatory Reform Strategy (RRS), and the accompanying 2013-2015 Action Plan. The Action Plan, if implemented properly, should create a better investment climate, reduce administrative barriers and compliance costs, and increase competitiveness. Short-term and longer-term policy recommendations listed below. These recommendations aim to substantially reduce the red tape that increases compliance costs for business operation, and increase transparency and predictability. Recommendations that are included in the RRS are noted with this acronym.

Short-term Recommendations (through 2014)

a. Adopt the Regulatory Reform Strategy 2013-2020. Monitor its implementation through its accompanying Action Plan. This plan will help to ensure that the 2004-2012 reforms to streamline and clarify government regulation of business activity are fully implemented. For instance, as discussed in chapters IV and V, regulatory impact analysis (RIA), required by Law #235, is currently not applied for legislation related to tax and customs (RRS. Responsibility: Ministry of Economy, MoE.)

b. Update the inventory of existing licenses and authorizations, review them, and remove overlaps and duplicates to ensure that the principles of good regulation and the Regulatory Reform Strategy are followed. Doing this inventory would allow for the Guillotine 2+ reforms to be completed and would include the entire universe of permissive acts, including those that were not covered under Guillotine 2+. (RRS. Responsibility: MoE and central public authorities.)

c. Ministry of Economy promotes to Government and Parliament draft modifications to legislation that aim to improve a range of other areas related to doing business, including: permits, construction permits, inspections, voluntary liquidation, one-stop shops, and other areas. (Responsibility: MoE)

103 Government of the Republic of Moldova 2011a
104 Government of the Republic of Moldova 2012a
105 These include: Law # 235 of 2006, which makes draft laws and regulations affecting businesses, and any proposed modifications to them, subject to Regulatory Impact Analysis, to be reviewed by the Working Group of the State Commission for Regulation of Entrepreneurial Activity; Law # 160 of 2011 (Guillotine 2+), which requires that all permissive acts may be invoked, or applied only after their inclusion in the Nomenclature of Permissive Acts.
d. Improve the draft Construction Code and adopt it, to reforms the framework for construction permits. Components of the Code will allow for full implementation of Laws #160 and #161 in this sector. Work on the Construction Code is ongoing. (Responsibility: Ministry of Regional Development and Construction, MoE.)

e. Implement a monitoring mechanism to ensure that public authorities move forward to implement one-stop shops for their interactions with business, as required by Law #161. (Responsibility: MoE and central public authorities.)

f. Streamline laws and regulations, as per the requirements of the Inspection Law. Each of the authorities with an inspection function must review the relevant legislation, and propose modifications to be adopted by the Government and/or Parliament for complete institutional reform of inspections. (RRS. Responsibility: MoE and central public authorities that have a control function.)

g. Adopt the Framework Risk Based Inspection (RBI) Methodology, in order to comply with the requirements of the Inspection Law, which identified RBI as a core requirement. The RBI Methodology establishes the platform, types of risks, methodology for calculating risks, and methodology for undertaking inspections. Adopting this is also a pre-condition for line agencies to elaborate sectoral RBI methodologies. (RRS. Responsibility: MoE.)

h. Develop and secure government approval of sectoral RBI methodologies for the authorities that undertake inspections. (RRS. Responsibility: MoE and central public authorities that have a control function.)

i. Upgrade the e-government portal to allow entrepreneurs to access all necessary information about licensing and authorizations: documentation to present, procedures to be followed and overall costs. Make it an offense for officials to deviate from these requirements. (Related to RRS. Responsibility: State Chancellery, MoE, Center for Electronic Governance, public authorities.)

j. Create a similar online portal for inspections to ensure that companies are well-informed about the provisions of inspections, penalties that they may face, and appeals/disputes related to inspections that involve them or other firms. (Related to RRS. Responsibility: State Chancellery, MoE, Center for Electronic Governance, public authorities that have a control function.)


a. Extend the e-government portal (servicii.gov.md) to all government agencies, so that it serves as the only interface of government-to-business. (Center for Electronic Governance, public authorities. MoE to monitor progress.)

b. Adopt a voluntary compliance framework for inspections. A voluntary compliance framework involves enterprise codes of conduct, standards, and voluntary disclosure policies. Voluntary disclosure policies are official guidelines issued by the state as an incentive for companies to undertake effective self-regulation. The guidelines usually provide that if an entity discovers violations of the regulation through the operation of its own internal compliance or self-regulatory system, and reports to the inspection authority
those violations and the corrective action taken, the entity will not be liable for fines and penalties. (Responsibility: Public authorities that have a control function, MoE.)

c. Ensure that all changes optimizing the licensing and authorization regimes and fee regulation are fully implemented. (Responsibility: Licensing Chamber, and public authorities that issue authorizations. MoE to monitor progress.)

d. Enforce the requirement for government authorities to follow the principles and procedures outlined in the online portal of business regulation. (Responsibility: multiple agencies, MoE to monitor progress.)

e. Streamline local government regulations with the Construction Code. (Responsibility: local public authorities. Ministry of Regional Development and Construction to monitor progress.)

f. Extend the e-government portal to the Municipality of Chisinau and rayon centers. (Responsibility: Local public authorities, Center for Electronic Governance.)
VII. Competition

A. Evidence of Problems

151. Competition in domestic markets is critical to ensure increased productivity, innovation, and economic growth, and ultimately international competitiveness. Firms facing more intense competitive pressures are more likely to introduce new products and upgrade existing product lines. Firms acquire many of their inputs (such as transportation, energy, construction, and professional services) in local markets. If these upstream markets lack competition, goods and services necessary for production will not be provided at competitive prices. As a result, firms may be less competitive than their foreign rivals and less able to compete globally.

152. Empirical evidence shows that improved competition has tangible effects on productivity, growth, and consumer welfare. Examples are plentiful. A study of 22 industries in 12 OECD countries showed that an improvement of 20 percentage points on a competition policy index – roughly equivalent to moving from the level of enforcement in the Czech Republic to that in the United Kingdom – increases total factor productivity growth by one percent. In Australia, competition policy reforms in the 1990s increased GDP by 2.5 percent, or USD 20 billion. In 24 transition economies, as they moved from an economic system without competition to a market economy over a period of three years, firms that remained as monopolies saw their real sales decline by one percent, while firms that faced between one and three competitors experienced sales growth of almost 11 percent over the same period. An analysis of nearly 2000 retail stores in 41 Indian cities found that pro-competition reforms can boost labor productivity by about 87 percent. In Kenya, eliminating controls on prices and private trade in maize facilitated consumer savings of nearly USD 10.1 million a year. An analysis of 40 international cartels in the 1990s found that prices fell by 20-40 percent after the cartels were broken up. A study of 20 OECD countries showed that reforms reducing state controls would increase long-term employment rates by 2.5-5.0 percentage points. Research on state aid indicated that sectors where subsidies and state aid are concentrated in only a few firms have lower productivity growth, and the effect is particularly strong in developing countries.

153. A healthy level of competition in domestic markets can also help firms cope with competitive shocks. In Moldova’s case, such shocks could be related to new market entrants once the DCFTA with the European Union comes into effect. Conversely, the existence of distorted and uncompetitive markets reduces investment opportunities; increases business risks, raises the costs of inputs, and reduces progress on economic development and the private sector’s contribution to poverty reduction.

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This section is based on the approach developed by the World Bank Group Competition Policy Team. In particular, please refer to “Competition Policy: Encouraging Thriving Markets for Development”, ViewPoint Note 331, September 2012, and Competition Policy Approach, 2012 (Competition Policy Practice, Investment Climate, World Bank Group).


This paragraph summarizes findings from the World Bank literature review cited in footnote 79.

However, this boost to sales through competition tapered off as more competitors entered the market. These findings are from Carlin, Schaffer, and Seabright 2004, which explores why sales growth is stronger when facing a larger set of competitors. The paper concludes that the transition to at least some rivalry in the market (when firms face 1-3 competitors) incentivizes firm managers to use resources more efficiently. The paper also finds indications that more intense competition increases productivity growth.
154. *Competition policies are defined as laws and regulations that ensure that competition in the market is not restricted in a way that reduces economic welfare.*\(^{110}\) In practical terms, competition policy usually involves the enforcement of anti-trust legislation – typically rules against anti-competitive business conduct and on control of mergers – and the promotion of measures enabling firm entry and rivalry, through the elimination of restrictive product market regulation and the opening of markets to competition – typically referred to as competition advocacy.\(^{111}\) Successful implementation of competition policy includes: (i) eliminating anti-competitive product market regulation limiting market entry or affecting firms’ competition capacity; and (ii) tackling anti-competitive business practices by effective enforcement of anti-trust legislation.

155. *In Moldova, evidence indicates that competition in markets for goods and services is hampered by a concentrated market structure, low enforcement, regulation, state aid, and the presence of strong state-owned companies.* Evidence points to a low level of competition in domestic markets, a high concentration of firms, the existence of monopolistic profits, cases of collusion, and other horizontal/cartel agreements. These issues are explored below.

156. *Moldova ranks 108\(^{th}\) out of 144 economies on intensity of local competition and 130\(^{th}\) on the extent of market dominance,* according to the 2012-13 Global Competitiveness Report (GCR). On the global scale, Moldova lingers in the 25\(^{th}\) percentile on intensity of local competition, and in the 10\(^{th}\) percentile on market dominance. While the presence of dominant players is not a problem in isolation, low competition alongside strong market dominance indicates that Moldova’s competitive environment is weak. Moldova also ranks 120\(^{th}\) (16\(^{th}\) percentile) on the extent of foreign ownership, which is another indicator that exposure of domestic markets to competition and innovative practices from abroad is limited.

**Figure 14: Moldova’s Performance on Competition Elements of the GCR, 2010-2013**

![Graph showing Moldova's performance on competition elements](image)

*Source: Global Competitiveness Reports for the years indicated.*

*Note: Score scale is 1-7, with 1 being worst. Percentile is calculated using Moldova’s rank out of the total number of economies included in the ranking for that year, in order to make it comparable across time periods.*

\(^{110}\) Motta 2004

\(^{111}\) For more details, see International Competition Network (ICN) Report on Assessment of ICN Members’ Requirements and Recommendations on Further ICN Work on Competition Advocacy, 2009.
157. **Moldova performs worse on these indicators than comparator countries**, as shown in the figure below.

**Figure 15: Indicators of Market Competition and Competition Policy**

![Graph showing indicators of market competition and competition policy](image)

*Source: Global Competitiveness Report 2012-13.*

*Note: Height of bar corresponds to score. Number shown corresponds to rank (out of 144 economies).*

158. **Output and employment tend to be concentrated in larger enterprises.** In 2011, the 1,204 large firms – 2.5 percent of the total number of enterprises – accounted for 42 percent of employment and 65 percent of formal sector revenue. The 36,641 micro-enterprises employed 17 percent of the labor force, and generated only 5 percent of formal sector revenue. Data from the World Bank’s 2009 Enterprise Survey shows that Moldova has a greater share of monopolies than other economies in the region, and that markets exhibit higher levels of concentration overall. Fifteen percent of manufactured goods markets in Moldova are dominated by monopolies, compared to an average of 6 percent elsewhere in the region, and moreover, 20 percent of Moldovan manufactured goods markets have an oligopolistic or monopolistic market structure. Furthermore, 2006 data suggested that the top quintile of firms accounted for over 70 percent of exports and 50-100 percent of sales in 24 major industries. Although the data is now dated, it indicates that economic concentration is not a new phenomenon in Moldova.

**Figure 16: Market Structure in Manufacturing Sectors, 2009**

![Bar chart showing market structure in manufacturing sectors](image)

*Source: World Bank Group Enterprise Surveys, 2009*

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112 Government of the Republic of Moldova, Ministry of Finance. 2012f
159. **Key sectors of the Moldovan economy are controlled by a limited number of firms.** Market structure – the number of firms and the size of the firms compared to their competitors – affects the degree of competition that can be attained. In Moldova, sectors with key inputs into other economic activities that hold untapped potential for strong competition — especially telecommunications and transport — only consist of a few firms or merely one firm.

160. **Dominant firms seem to be extracting monopolistic profits.** A World Bank analysis of data from Moldova’s Annual Financial Statement Survey shows that the proportion of a firm’s sales to total industry sales is the single most important driver of firms’ profitability in the country. The estimates show that a one percent increase in the market share raises profits by 0.55 percent. Furthermore, the data suggests that only firms with market shares in the fourth and fifth quintiles have been consistently profitable since 2005. Firms with lower market shares usually make a loss.\(^{113}\)

161. **The authorities sometimes seem to be favoring certain firms by applying discriminatory policies.** In certain sectors, oligopolies have historically been created through various licensing regimes, and some industries are controlled by politically-connected individuals. A political economy analysis commissioned by the World Bank did a high-level mapping of political and business interests, and found that members of political parties have economic interests in sectors including hotels, sale of oil products, banking, media, insurance, transportation, advertising, construction, and sugar production. The analysis states that “economic interests of high-profile members of [political parties] cover a broad spectrum of economic sectors and companies, both in Moldova and abroad”.\(^{114}\) Data from the Competition Council provides additional examples of “uncompetitive actions” by public authorities.

162. **Pricing in the agricultural sector also points to problems linked with market dominance.** The 2011 Country Economic Memorandum found that there is a large gap between the farm-gate price and the consumer price for numerous agricultural and food products. Hence, intermediaries are extracting high margins. Moreover, farmers that export their produce receive much lower unit prices than their counterparts in neighboring countries and food trading partners. The price gap is greater than the productivity gap, which, once again, suggests that intermediaries are asserting their market power.

163. **Examples of companies or groups of companies seeking to manipulate markets through price fixing and market sharing agreements are not uncommon in Moldova, and they have been noted in transport, telecommunications, energy, and other services sectors.** The Competition Council recently investigated the procurement of insulin for the government program “MoldDiab”. The Council found that during the 2009-2010 period, two winning bidders colluded on the price and volume offered in their bids, offering to supply the medicine at the same exact price. The procuring agency ended up purchasing half of the insulin from one company and the other half from the other, though this provision did not appear in the bids. The case went to court, and as of May 2013, proceedings had already gone on for over 1.5 years. Additional cases of cartel behavior are listed below.


\(^{114}\) Political economy analysis commissioned by the World Bank (unpublished).
The precursor to the Competition Council, the National Agency for the Protection of Competition (NAPC), has detected numerous violations of competition law across sectors. The 2007-2011 NAPC Activity Report lists violations of competition legislation related to abuse of dominant positions, cartels, and anti-competitive behavior of public authorities. More detail is provided below:

- **Abuse of a dominant position:** Seventeen instances of abuse of a dominant position were found over the five years. Seven instances were found in the utilities (energy, oil and water)\(^{115}\) sector, four in the transportation and communications sector, and two in financial services. Three instances were found in other sectors, including one in cigarette imports.

- **Cartels/horizontal agreements:** Seven instances of cartel agreements were found, in: transportation services, a shopping center, automobile insurance, insulin supply, gasoline retail, and cable television services.

- **Anticompetitive acts of public authorities:** Nine instances were found, including in: municipal contracts for solid waste disposal, issuance of a technical authorization, restrictions on international transport operations, and refusal to properly register food supplements.

- **Unfair competition/advertising:** NAPC found 42 violations of legislation on advertising and on fair competition. See paragraph 181 below for more detail.

- **Mergers:** NAPC/the Competition Council analyzes proposed merger transactions, and no mergers were found to have a detrimental effect on competition.

**Figure 17: Investigations and Violations Found by NAPC, 2007-2011**

![Figure 17: Investigations and Violations Found by NAPC, 2007-2011](image)

*Source: NAPC (attachment to the 2007-2011 Activity Report; data as of July 2011 is the latest available).*

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\(^{115}\) The cases of abuse by utilities companies that have a natural monopoly may signal inadequate functioning of the relevant regulatory authority.
165. **Companies also face unfair competition from counterparts that evade taxes, especially VAT.** It is not uncommon for firms to evade paying the 20 percent VAT on at least some of their sales. This provides companies with room to decrease their prices without affecting their margins. As a result, the market price is pushed down to reduce the margins of tax-abiding companies, threatening to squeeze them out of the market. Further unfair competition is also caused by firms that pay salaries “under the table”. In the 2009 Enterprise Survey, 35.5 percent of Moldovan firms reported practices of competitors in the informal sector as a major constraint; this was well above the ECA regional average of 27.5 percent, and placed Moldova 5th out of 29 countries with respect to the degree of this problem. Although companies relate this behavior to competition, it is a tax administration issue that should be addressed by the tax authorities.

**B. Underlying Causes of the Problems**

166. **Competition problems stem from:** (i) barriers to market entry, commonly created by legislation and government policies; (ii) weaknesses in the competition policy framework; and (iii) political economy factors, which can also affect barriers to market entry.

**Barriers to the Development of Competitive Markets: Market Entry and Expansion**

167. **The ease with which companies can enter and exit markets affects competitive dynamics in those markets, even in the absence of deliberate anti-competitive behavior.** This area includes not only starting and closing a business, but also policies and regulations that govern market access, restrict the number and type of firms, and control prices. Markets will have freer competition when investors can enter them relatively easy, operate in a relatively stable and predictable regulatory environment, and exit the business if they identify a market in which their capital can be employed more productively.

168. **Though registering a business in Moldova is fairly simple,** data on business market entry indicate that the rate of new business creation remains low. Moldova has a business entry density rate of 1.3, lagging behind regional peers Georgia, Romania and Macedonia with rates of 4.0-4.5. The top performer in Europe, Cyprus, has a rate of 24.7, and it is followed by Latvia (11.2), Montenegro (10.4), and Bulgaria (7.2). Moldova ranks 12th out of 24 countries.

169. **Government authorities at times restrict market access.** Administrative decisions on licenses and permits can be unpredictable and subject to outside influence. The cases identified by NAPC in paragraph 164 above include examples in which a regulatory body refused to issue a permit or license that a company needed to operate in a certain market. Anecdotal evidence from company interviews also supports the conclusion that this is a problem. Market entry rules should allow firms to become players in a certain market based on their competitive abilities, not based on policies that favor specific companies.

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116 Since 2004, Moldova has introduced some reforms in this area that have reduced the time to start a business from 42 days to 9 days, reduced the cost from 24.5 percent of per-capita income to 5.7 percent (DB 2013). More recently, in 2012 the government implemented a one-stop shop for business registration, which seems to be working well. Of the companies surveyed as part of a 2012 assessment carried out by the USAID-funded BRITE project, only 8.1 percent of respondents said that registering a business was either difficult or very difficult.

117 The number of newly registered limited liability companies per 1,000 working-age people (ages 15-64) per calendar year; data from the World Bank Doing Business/Entrepreneurship database.
170. **A particularly instructive example of a government policy limiting market entry can be found in export and import licensing.** Since 2007, under requirements established by the Government of Russia, the Government of Moldova has kept lists of companies eligible to export apples, wine, and meat to Russia. In the case of apple exports, in 2012, Russian authorities requested that the list be shortened: only nine out of 130 companies remained. This had a substantial impact on the private sector; Russia accounts for 94 percent of Moldova's overall apple exports. Licensing rules also apply to other sectors – for instance, exports of scrap metal, for which a single license has been awarded to the state-owned company Metal-Feros. Licensing restrictions complicating market entry are also applied in the realm of imports (see chapter IV).

171. **Exiting a market is fairly difficult in Moldova.** The most burdensome aspects of voluntary liquidation are: i) proving that the company does not owe debts to creditors or the state, and ii) waiting for 12 months after publicizing the notice of the intention to liquidate to distribute company assets to shareholders.\(^{118}\) Difficulty of closing a business increases entrepreneurs’ perception of the risk of entering a market, ties up investors’ capital in non-productive firms for a substantial amount of time, and therefore may deter entry.

**Discriminatory Treatment of Market Players and State Aid**

172. **State-owned enterprises (SOEs) also still play an important role in the economy.** SOEs’ access to government resources and policy-makers can put them in a privileged position, even when there is no direct intention of interfering with private market participants. As of January 2012, there were 274 fully state-owned companies in Moldova, and an additional 116 companies in which the state was a majority shareholder. Together, these firms represent about 10 percent of the assets in Moldova’s corporate sector and 19 percent of GDP.\(^{119}\) Data from 2009 (latest available) suggests the state’s presence is strong in real estate and business services, transport and communications, and health and social work. SOEs in these sectors account for more than 30 percent of sales. SOEs also have a substantial presence in the manufacturing of machinery and equipment, non-metallic mineral products, and paper, holding between 6 and 13 percent of sales.\(^{120}\)

173. **State aid to enterprises could also be putting some of them in a preferential position.** NAPC made rough estimates of aid disbursed based on official documents and reports on public funds. State aid is granted to all SOEs without exception. The effects of state aid on competition have not been properly assessed, but state aid could potentially be serving to favor some firms.

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\(^{118}\) As identified by analyses conducted by the World Bank Group in the context of the new Insolvency Law (enacted and Insolvency Administrators Law (not yet enacted), and also by USAID 2012.

\(^{119}\) Government of the Republic of Moldova, Ministry of Finance. 2012d and 2012f

\(^{120}\) Government of the Republic of Moldova, Ministry of Finance. 2012d and 2012f
Figure 18: NAPC Estimates of State Aid Granted in Moldova

![Graph showing State Aid Granted in Moldova]


Note: The initial State Aid Inventory is an initial approximation.

174. **A level playing field needs to be guaranteed for all market players.** Competitive neutrality requires that no entity operating in a market should be subject to undue competitive advantages or disadvantages. The rationale for pursuing competitive neutrality is both political and economic. The main economic rationale is that it enhances allocative efficiency throughout the economy – in the absence of competitive neutrality, where economic agents (whether state-owned or private) are put at an undue disadvantage, goods and services are no longer produced by those who can do it most efficiently. The political rationale is linked to governments’ role as universal regulators, ensuring that economic actors are “playing fair” (whether state-owned or private), while also ensuring that public service obligations are being met.\(^\text{121}\)

**Controls on Prices and other Market Variables**

175. **Some prices are still regulated.** The state holds the right to regulate prices for “socially-important” domestic products; margins on these products cannot exceed 20 percent, with a few exceptions. In the 2012 domestic Cost of Doing Business survey, 24 percent of companies reported that their prices were regulated, and the regulations affected on average 8 percent of their sales volume. Of the companies that reported price regulation, 57 percent reported that margins were regulated, 24 percent reported that prices were regulated directly, and 19 percent reported that profitability was regulated.\(^\text{122}\)

176. **While price controls might be effective in lowering and stabilizing prices in the very short run, their final effect on consumer welfare in competitive markets is generally negative.** Experiences in a number of countries have shown that the adverse effects are considerable. Effects include inefficient allocation of government resources, fiscal losses, shortages and smuggling, reduction of product quality, low productivity of firms with controlled prices, cartel formation, facilitation of market control by favored entrepreneurs, lapses in good governance, corruption, and arbitrary pricing.

\(^{121}\) OECD 2012

\(^{122}\) CODB 2012
177. **Deficiencies in the legal framework for, and implementation of, competition policy allowed competition problems to persist in Moldova’s economy.** In the 2012-13 GCR, Moldova ranks 130th on effectiveness of anti-monopoly policy (see Figure 14). A 2009 EU-funded review of competition law and policy, published before the 2012 Law on Competition and Law on State Aid were drafted and approved, concluded that Moldova’s competition legislation was not compatible with EU standards. The legislation as of that time was based on bills passed in 1992 and 2000, and the National Agency for the Protection of Competition was not established until 2007. According to the EU assessment, this legislation “[did] not encourage a market economy, [did] not contain the relevant basic principles of due process and [did] not adequately reflect EU law and practice”\(^{123}\). Weaknesses in the laws also created deficiencies in implementation. For instance, the laws had too strong of an emphasis on the existence of a dominant position independent of its abuse, required NAPC to analyze all mergers—not just those above a certain threshold, and combined elements of competition policy and consumer protection.

178. **In 2012, two key laws were passed two that aim to improve the country’s legal framework for competition and begin to address state aid.** Beginning in 2008, NAPC received technical assistance through an EU twinning project to harmonize Moldova’s legal framework with EU regulations, draft regulations and guidelines consistent with EU rules, and deliver training. Consequently, a new Law on Competition and the country's first Law on State Aid were drafted, following EU rules and *acquis* closely. They were adopted in July and June 2012, respectively. The Competition Law elaborates on the anti-competitive actions that are qualified and sanctioned by the competition agency, the rules for evaluating and investigating anti-competitive behavior as well as identifying the relevant market, and exemptions. The law also created a new Competition Council to replace the NAPC, with an expanded structure to implement the activities prescribed in the laws.

179. **To ensure that the new legislation is successfully implemented, challenges that limited the capacity of the competition agency in the past will need to be overcome.** The 2009 EU assessment concluded that although the NAPC was doing a good job given the constraints faced, the quality and implementation of competition policy in Moldova were weak. The limiting factors included low quality legislation, weak enforcement power, resource and capacity constraints, and limited political will. NAPC had difficulty recruiting and retaining qualified and experienced personnel, as it offered wages below the public sector average. The EU assessment also indicates that it did not have a sufficient number of professional staff.

180. **Tools addressing these bottlenecks are being put in place.** By approximating the Law on Competition and Law on State Aid to EU rules, most of the shortcomings identified in the previous legal framework have been removed. Sanctions have been strengthened. To overcome resource and capacity constraints, a new Competition Council was formed, and draft legislation amending relevant civil service legislation to allow the Council to increase its staff from 41 to approximately 127, \(^{124}\) introduce new categories for its positions, and adjust salaries, is now in

\(^{123}\) Stuart and Mateus 2009  
\(^{124}\) The final number will be determined in the final legislative amendments that operationalize the new structure.
Parliament. Political will to comply with EU rules is receiving a boost from the DCFTA and Association Agreement negotiations with the EU.

181. **The competition authority will also need to adjust to new approaches under the new laws.** The changes will make the competition framework more effective, but they will also require increased capacity. The Competition Council’s focus is expected to change as follows:

- *Less emphasis on market dominance:* Many of the prescribed actions of NAPC in the 2000 Law on Protection of Competition related to determining if a dominant position existed in a market. NAPC directed a lot of its efforts to this end. Dominance was also a pre-condition for abuses of other competition rules, such as those on horizontal agreements. This approach is inconsistent with international jurisprudence and EU law. It is not illegal to be in a dominant position; it is only if such a position is abused that a violation of the law occurs. Additionally, dominance should not be a pre-condition for other violations.

- *Fewer merger cases to investigate:* The new law establishes a threshold for examination of mergers. Only mergers with potential effects on competition are to be analyzed ex ante. Although there may be fewer cases, the cases that the Competition Council needs to investigate may be more complex.

- *Less emphasis on advertising and unfair competition:* Previous legislation gave NAPC substantial power in this area. It was expected, for instance, to address companies’ dissemination of false information about another economic entity; deception of buyers about characteristics of goods; unauthorized use or imitation of a brand; and illegal acquisition of commercial secrets. While these activities are generally related with competition, they are more closely related to consumer protection and implementation of intellectual property rights. Under the new law, responsibilities related to interactions between companies remain with the Competition Council, and responsibilities related to interactions between companies and individual consumers have been transferred to the Agency for Consumer Protection.

- *More emphasis on cartels/horizontal agreements:* The new law places more emphasis on cartels, as experience shows that globally, the need to fight hard-core cartels is at least as important as dealing with abuses of market dominant positions.

182. **The Law on State Aid introduces rules on government assistance to companies for the first time in Moldova’s history.** The logic behind rules on state aid is that governments can distort competition by providing subsidies, incentives, and other benefits to firms. Thus, there is a need to ensure that government interventions do not distort competition and trade inside the EU. State aid is generally considered to be incompatible with the EU common market. However, there are exceptions in some cases of regional and development, e.g. SME development, employment, environment, research and development, some sectoral aid, and others. The EU rules provide guidelines on what type of aid is acceptable, and how it should be treated. The process for granting incentives to firms needs to be clear, transparent, and competitive. Some types of state aid schemes require notification of EU authorities.
183. **In Moldova, there is not a full understanding of the extent to which state aid is used.** To implement the new law, it will be key to develop an accurate inventory of the entities receiving state aid. The Competition Council received some assistance from the EU twinning project to begin an inventory. The Council now needs to work with local authorities to deepen their understanding of state aid, and gather and verify relevant information before the law becomes effective in August 2013.

184. **Although progress has been made recently, it will take time to create a culture of competition in Moldova’s economy.** NAPC only began operations in 2007. While its investigations raised awareness of competition abuses, general knowledge of competition policy remains fairly weak. The Competition Council has held press conferences on the new Law on Competition and Law on State Aid, and has undertaken substantial work with public authorities regarding the Law on State Aid. As work continues on the state aid inventory and secondary legislation for the two laws is adopted, public information campaigns to business and the general public should be continued.

*Political Economy*

185. **Competition problems in Moldova are exacerbated by political economy considerations.** NAPC confirmed the existence of cartels and horizontal agreements in some sectors. A political economy analysis commissioned by the World Bank found that large businesses and influential individuals control many important sectors, such as the import of food and medicine, import of fuel, banking, some transportation services, some construction materials, meat, fish, sugar, children’s clothes, and electronic communications. Through their political connections, some of these individuals have access to the government regulatory bodies that make decisions, and can either unleash or constrain competition, e.g. through licenses, permits, and import restrictions, as well through the justice sector (see chapter IX).

186. **Although political economy issues are by their nature difficult to capture through data, the 2012-13 Global Competitiveness Report offers some valuable insight.** The top three constraints to doing business cited by Moldovan firms in this report are corruption (17.9 percent), policy instability (12.6 percent), and inefficient government bureaucracy (10.3 percent). These responses indicate that the government is unable to maintain a consistent playing field for companies. The paragraph above then suggests that changing rules and corruption may be motivated by a wish to protect certain economic interests.

*C. Policy Recommendations*

187. **Policy recommendations for improved competition aim to:** (i) reduce barriers to the development of competitive markets; and (ii) make competition and antitrust policies more effective. The ultimate goal is to unlock investment opportunities, and ensure that Moldovan companies and consumers enjoy the benefits of increased competition.

188. **The government has expressed its interest in improving market competition in several key laws and policy documents.** As part of the economic and financial policies presented in the 2009 Government Program “European Integration: Freedom, Democracy, Welfare”, Moldovan authorities set a strategic objective to de-monopolize the internal market excitement.
and eliminate anti-competitive practices. Priority actions include: strengthening the institutional capacity of the competition agency, ensuring fair competition and encouraging the entry of new companies in markets where firms are monopolistic or have a market dominant position, and reducing the state’s presence in competitive sectors. In the Moldova 2020 strategy, fair competition is an important element within the objective of improving the business environment through clearer rules of the game. The document notes the need to remove unjustified regulations that create favorable conditions for some economic groups, as well as the need to minimize ambiguity and contradictions in regulations (which permit discretionary enforcement of the provisions), in order to promote competition and innovation throughout the economy. Competition is also included as an element of improved public procurement in the roads sector, improved access to finance, and improved performance in the energy sector. The enactment of the Competition Law and State Aid Law shows that the government is acting on its commitments in these areas.

189. **Improving competition will require efforts to reduce barriers to market entry, and to implement the new Competition Law and State Aid Law effectively.** Short-term and medium- to long-term policy recommendations are listed below. The market entry recommendations directly related to licenses and authorizations have been included in that chapter (VI), and are referred to here as well. The Competition Council expects to receive some technical assistance from the EU to implement the Law on Competition, train judges, and conduct seminars with staff. However, this assistance has not been committed yet. Recommendations that are consistent with the Regulatory Reform Strategy (RRS) and other plans are noted in the list below.

*Short-term Recommendations (through 2014)*

**Market Entry**

a. Eliminate any remaining barriers that restrict market entry based on criteria that are not justified by economic or safety concerns. This includes many of the market entry recommendations in chapter VI, as well as the following:

i. Create an inventory of existing price regulations (including those affecting prices indirectly, through the regulation of margins or profitability), analyze them, and remove those that are not economically justified. (Responsibility: Ministry of Economy, government.)

ii. Do not create any new export licensing regimes or price controls. (Consistent with RRS. Responsibility: Ministry of Economy, Licensing Chamber.)

b. Advance the privatization process in competitive sectors. If market-dominant SOEs are to be privatized, implement the privatization in a way that allows for multiple new entrants where possible. (Responsibility: Ministry of Finance, Public Property Agency.)

c. Simplify the process of closing a business:

i. Support the efforts of the Ministry of Economy and parliament to enact legal amendments that would streamline the process of voluntary liquidation. (Responsibility: Ministry of Economy, government.)
ii. Effectively apply the new Insolvency Law, and approve the Insolvency Administrators Law. (Responsibility: Ministry of Economy, Ministry of Justice.)

**Competition and State Aid Framework**

d. The Competition Council should continue its efforts to inform the public about its commitment to effective implementation of competition policy based on the new competition and state aid laws. It should state how its enforcement practices will change and how it will implement the new legal framework, e.g. by continuing to hold press conferences when secondary legislation is adopted, and other actions to create a competition culture (below).

e. Appoint and secure parliamentary approval of the remaining four members of the Competition Council’s Administrative Council (this is expected by July 15, 2013). (Responsibility: government and parliament.)

f. Adopt and publish all required secondary legislation.125 (Responsibility: Competition Council.)

g. Review sector-specific constraints affecting market competition, using the OECD’s Product Market Regulation approach, to identify priority sectors and actions. Then, eliminate or amend the current normative regulations that run contrary to the Competition Law and continue to restrict competition. (Responsibility: Competition Council and public authorities that have issued these regulations.)

h. Draft, finalize and adopt all relevant guidelines and internal regulations for the Competition Council to effectively implement the two new laws.126 (Responsibility: Competition Council.)

i. Implement the new structure of the Competition Council. Secure parliamentary approval of the required amendments to civil service laws. (Responsibility: government/parliament.) Select personnel in a competitive process; and ensure that staff is clearly informed of its duties under the new laws. (Responsibility: Competition Council.)

j. Begin to build the capacity of the Competition Council to implement the new laws, based on the new concepts, methods and approaches introduced. The Competition Council’s Program of Strategic Development for 2012-2014 provides a good blueprint. (Responsibility: Competition Council.)

k. Conduct a full inventory of existing state aid schemes.127 (Responsibility: Competition Council.)

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125 Seven regulations linked with the Law on Competition have been drafted and publicly consulted, and they are expected to be published in the Official Gazette in the summer of 2013. Twelve regulations related to the Law on State Aid are now going through the process of public consultation. The regulations must be published before the laws come into effect, in August 2013.

126 The EU twinning project helped the Council draft eleven competition policy guidelines, as well as internal procedures on state aid monitoring and investigation. Additional approaches, guidelines, regulations, templates, forms, and manuals are needed. For instance, a leniency program needs to be fully developed. The Competition Council should continue to receive support from international experts to craft these instruments, which it needs to carry out its duties.

127 This includes: i) validate the information on state aid that the twinning project helped the Competition Council collect; ii) implement the Competition Council’s plan to visit and engage in further dialogue with rayons and municipalities across the country, and with each relevant national ministry or authority; and iii) finalize the process of collecting and validating all information.
1. Create and implement a mechanism of collecting information and monitoring all state aid granted in Moldova on an ongoing basis. Carry out an analysis of the impact of existing state aid schemes on markets and trade. (Responsibility: Competition Council.)

m. Establish and begin to implement a program to train judges handling cases related to competition, so that they develop a better understanding of the spirit of the Competition Law and the State Aid Law, and relevant economic concepts. (Responsibility: to be determined by Competition Council, government, and the justice sector.)

n. Hold joint training programs for staff of the Competition Council, the public procurement agency on bid rigging detection, and the public procurement framework. (Responsibility: Competition Council and Ministry of Finance.)

o. Step up efforts to promote a competitive culture and awareness in Moldova, through public outreach, seminars, trainings, press conferences, publications, etc. (Responsibility: Competition Council.)

p. Conduct an in-depth study of the legal, judicial, and regulatory system, to better understand the political economy incentives faced by decision-makers, and identify reforms that would align these incentives more closely with a transparent and effective economic system. (Responsibility: To be conducted by an independent entity and recommendations made to government.)


Market Entry

a. Continue implementation of the reforms listed above.

b. Examine how the State Tax Inspectorate and Registration Chamber can use their taxpayer and company information to further simplify voluntary liquidation and bankruptcy procedures. (Responsibility: Ministry of Economy.)

Competition and State Aid Framework

c. Assess progress on the following activities during 2013-2014, update the plan, and implement/intensify them: (i) capacity-building inside the Competition Council; (ii) training provided to judges; and (iii) promotion of a competition culture. (Responsibility: Competition Council.)

d. Limit the number of goods and services for which the government determines prices or retail margins. Subject them to competition in order to offer goods and services at the most competitive price, and broaden the choice available to consumers. (Responsibility: Ministry of Economy.)

e. Apply any improvements that might be needed to the mechanism for monitoring state aid. (Responsibility: Competition Council.)

f. In the longer term, consider giving the Agency for Consumer Protection responsibility for issues related to unfair competition and advertising (see paragraph 181), and relying on the courts to enforce intellectual property rights. Do this via legal amendments (Responsibility: Government).
g. Continue to pursue justice sector reform, and promote increased transparency in order to address political economy concerns affecting competition. (Responsibility: Ministry of Justice.)

h. Guarantee that the principles of competitive neutrality are followed by SOEs and public authorities. The government should ensure that SOEs operate under the same legal framework as private enterprises. Furthermore, any aid to enterprises by public authorities must be governed by the state aid framework. (Responsibility: Ministry of Finance, all public authorities, and Competition Council.)
VIII. Enterprise Access to Finance

A. Evidence of Problems

190. **Access to finance is a key facilitator of economic growth and competitiveness.** Most enterprises need financing options with a reasonable cost in order to be able to invest in equipment and other assets that will help them improve their productivity, cover short-term needs throughout the business cycle (for instance, to bridge the gap between issuing an invoice and being paid), and adjust to changing market requirements.

191. **Moldova’s core financial depth indicators improved markedly over the years, and they are now broadly in line with those in countries with similar levels of development.** Credit to the private sector as a share of GDP increased from 24 percent to 38 percent between 2005 and 2012. Deposits also rose significantly over the same period, and they now account for 41 percent of GDP, up from 30 percent. Both ratios are roughly aligned with average ratios for countries at similar stages of development, but still lag behind other countries in Central and Eastern Europe. There are currently 14 banks operating in Moldova, along with 361 member-owned savings and credit associations, as well as 73 micro-finance institutions. The number of financial service points and deposit accounts in the system has also increased markedly in the past couple of years.

![Figure 19: Financial Sector Depth](image)

**Source:** International Monetary Fund

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128 This chapter summarizes the findings of the World Bank study “Moldova: Enterprise Access to Finance”, which is available under separate cover as a background note to this report. We encourage interested audiences to read the full report.

129 These numbers in the text are based on IMF data, and are comparable with data on other countries that are used as benchmarks in this report.

130 CEE countries include: Albania, Montenegro, Macedonia, Estonia, Latvia, Lithuania, Poland, Czech Republic, Slovakia, Hungary, Romania, Bulgaria, Slovenia, Croatia, Bosnia-Herzegovina, Serbia, and Kosovo. CIS countries include: Russia, Belarus, Ukraine, Armenia, Azerbaijan, Kazakhstan, Kyrgyz Republic, Moldova, Tajikistan, and Uzbekistan.
192. **Nevertheless, access to finance remains a pressing issue for enterprise development in Moldova.**131 Available surveys and market feedback suggests that businesses strongly depend on retained earnings and bank loans for funding. According to the 2009 Enterprise Survey132, only 30 percent of all enterprises interviewed in Moldova reported not needing a loan, compared to 40 percent in the region and worldwide. However, only 39 percent of enterprises in Moldova have a loan or line of credit. The average capacity to finance investment internally stood at 56 percent of the funding needed, compared to 60 and 69 percent in the region and worldwide. The dependency leaves enterprises more vulnerable to the drying up of bank credit. On the supply side, the vast majority of bank credit tends to finance a few larger clients. Eighty percent of the loan volume is concentrated in only three percent of borrowers. The average loan size for the remaining 97 percent of borrowers is only USD 5,000.133

193. **The availability of long term finance continues to be limited.** Only 37 percent of the loans (by volume) in the commercial banking system have a maturity of three years and above.134 Companies reported during interviews that maturities of five years and above, needed for long-term investment projects, are not sufficiently available. Even maturities in the range of 3-5 years are difficult to secure. Lines of credit provided to Moldova’s banking sector by international institutions have helped bridge this gap in the last few years. Six percent of the banks’ long-term (three years and above) credit portfolio currently consists of these on-lending resources. Nonetheless, available credit volumes are still insufficient.

194. **Although not a constraint for all enterprises, medium-sized and small firms face a challenge to fulfill banks’ collateral requirements.** According to the Enterprise Survey, collateral requirements stood around 140 percent of the loan value. In addition, the National Bank of Moldova (NBM) and company interviews conducted for this study found that banks can require collateral of up to double the value of the loan size. This particularly affects start-ups and small enterprises, which do not have much to pledge, and thus often get denied a loan due to these prohibitive collateral requirements. As for larger enterprises, which in general are already banked, the collateral value mostly affects the amount of credit that they can obtain.

195. **Moldovan enterprises still perceive that total loan costs are high, although interest rates are in line with those in comparator countries,** and have fallen below the CIS and low-income country averages in recent years. Spreads have also fallen after a brief surge in 2009-2010 (see figure below). Yet, companies state that nominal lending rates – currently at 12 percent in local currency and 7 percent in USD – continue to limit loan affordability. Loan interest rates are usually variable, and they have fluctuated due to inflation, risk perception and market competition. This has introduced uncertainty as a factor into the finance decision-making process of Moldovan enterprises. Furthermore, firms face a number of additional costs, such as: bank commissions, costs for collateral evaluation and registration, costs related to the documentation that must be supplied, and early repayment fees.135 This further lowers loan affordability. Uncertainties with regards to revenue and profitability (see paragraph 202) also

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132 World Bank Group 2009
133 This average includes both individual loans and legal entities, as disaggregated data is not available.
134 A more detailed breakdown of maturities is not available.
135 More details on hidden fees and costs can be found in the background report prepared for the study.
play a substantial role in making finance seem unaffordable for companies even if interest rates seem low compared to other benchmarks.

**Figure 20: Interest Rate Spread and Nominal Lending Rates - A Comparison**

![Graph showing Interest Rate Spread and Lending Rates](image)

Source: own computation based on World Bank World Development Indicators.

**B. Underlying Causes of the Problems**

**Enterprises and the Demand for Loans**

196. **A number of exogenous and endogenous factors continue to constrain companies’ access to loans from banks and non-bank credit institutions.** The exogenous factors are tied to the difficult economic situation and business environment. The endogenous factors are related to the performance of Moldovan companies: (i) insufficient profitability, (ii) gaps in skills and the capacity to prepare a business plan, and (iii) lack of adequate financial statements and accounting standards.

**Macro-Economic Environment and Business Enabling Environment**

197. **A volatile economic environment has led to reduced investment activity and correspondingly lower demand for loans.** The profitability of Moldovan enterprises strongly correlates with the developments in its remittance and export markets. Fluctuations in remittance income, which accounts for roughly 30 percent of GDP, tend to have a large impact on both local demand and imports. Exports depend on a few core export markets, namely the EU and Russia. This dependency was particularly visible after the global financial crisis, which led to a sharp drop in remittance income (by 40 percent in 2009) and exports (from 47 percent of GDP in 2007 to 35 percent of GDP in 2010) due to diminished external demand. Investment and FDI activities have since remained subdued despite a return to economic growth rates of approximately six percent. The overall level of gross capital formation falls short of the levels attained in other low- and middle-income countries, and it continues to delay the country’s transformation into a more advanced economy.
The business environment in the country is complex, and doing business in Moldova remains costly. Moldova’s performance on the World Bank’s Doing Business indicators\textsuperscript{136} indicates overly lengthy procedures and high costs, especially in the area of taxation and customs. In addition, the excessive number of procedures needed for licenses, permits, and authorizations reduces transparency throughout the handling process, and opens doors for petty corruption. Moreover, the poor competition environment reduces real returns as well as their appropriability. All of these factors increase the cost of doing business, and lower enterprises’ profit margins. The introduction to this report (chapter II) provided an overview of Moldova’s rankings in international assessments of the business environment, as well as evidence from firm-level data, which both demonstrate that the poor business environment is adversely affecting Moldovan companies’ productivity, sales, and employment. Other chapters of this report have addressed the other priority areas in more detail.

Lack of Value Chain Integration

Moldovan enterprises are not well-integrated in global value chains, and gaps in technology adoption are taking a toll on productivity. A World Bank and two recent USAID studies on value chains in Moldova suggest that agricultural production in Moldova continues to suffer from low quality and efficiency due to the absence of vertical collaboration between farmers, as well as insufficient investment in post-harvest infrastructure. As a result, high-value buyers are encountering difficulties with finding the needed quantities and quality in the Moldovan market, and farmers are only receiving a low price for their produce. Similar gaps in integration and production quality were also reported by stakeholders in other sectors of the economy. Entrepreneurs appear to have a limited understanding of the benefits of collaboration with partners, and little trust in cooperation with peers who are perceived as competitors. The lack of collaborative culture inhibits scale, and the usage of inefficient production techniques lowers enterprise profitability, turning producers into price takers.

Limited Skills and Management Practices

200. **Gaps in financial management and investment planning capacity have a negative impact on profitability, contributing to elevated lending costs.** Banks’ loan rejection rates for companies range between 40-80 percent in rural areas, and around 20 percent in urban areas. The investment projects presented by enterprises are often not well thought out, or are deemed unprofitable. Careful planning and mapping of cash flows is rare, leading firms to seek unnecessarily large loan sizes that then involve costly surprises when repayments of principal are due. Stakeholders reported that some companies were charged late fees after struggling to stay current after a grace period, as they had already spent the funds elsewhere. In cases where not all credit funds were needed, or the credit could be repaid earlier, enterprises shouldered an additional 1-2 percent in fees for early repayments. Other entrepreneurs mentioned that donor-supported credit lines are utilized so that companies can benefit from the grant grace period, not because the underlying expense is needed in the context of the broader business strategy.

201. **The lack of financial management capacity in Moldovan enterprises has an adverse effect on the quality of their financial statements and loan applications.** Banks expect to see a business plan as part of a loan application, and interviews conducted for this study revealed that enterprises frequently complete these plans only to comply with the banks’ requirements, and not to develop a long-term vision for the enterprise or assess viability, risks and cash flow generated by the investment. Furthermore, within the group of companies required to conduct annual audits, the quality of the audits remains low. According to the Global Competitiveness Report, Moldova ranks 98th out of 144 countries when it comes to auditing and accounting standards.

**Inconsistent Profitability**

202. **The above-mentioned factors combined reduce enterprise profitability, or, at a minimum, make it unpredictable.** National Bureau of Statistics (NBS) data shows that roughly half of the companies that submit financial statements report net losses annually. According to other NBS data, presented in chapter II, many enterprises continue to suffer net operating losses, although they exhibit positive net incomes. The experience of the Competitiveness Enhancement Project’s matching grant facility indicates that, out of a sample of 49 enterprises, only 15 were able to exceed the sales volume that they had projected they would attain with the aid of the matching grant. Nine businesses in the sample generated less than 50 percent of the expected sales volume. Although the companies may have had some incentive to overestimate the expected increase in sales as a result of the grant, sales were quite far below the expected levels, and this is illustrative of problems faced by and less-developed companies.

**Financial Institutions and the Supply of Finance**

**Relatively Low Competition in the Banking Sector**

203. **Despite an increased number of entrants and upmarket saturation, competition in the financial sector remains limited.** Standard concentration ratios for the volume of assets,
deposits, and credit are at 50 and 70 percent, respectively, for the largest three and five banks, which suggests that the system is moderately competitive. However, 75 and 90 percent of the borrowers and depositors are accounted for by the largest three and five banks, respectively. Of the 14 banks operating in Moldova, only five have more than 3,000 borrowers, while the rest cater to a limited number of borrowers, and maintain large exposure to a few select clients, for whom intensive market competition has ensued. Small enterprises and micro-enterprises only have limited access to bank credit, and they mostly rely on savings and credit associations and micro-finance institutions for funding.

Lack of Adequate Sources of Funding and the Maturity Mismatch

204. **Shortage of financial products, in particular the availability of long-term funding and access to capital markets, is restricting the deepening of the financial sector.** Similarly to other banking systems in developing countries, in Moldova, deposits currently constitute the majority of bank liabilities, accounting for 82 percent of the total (down from over 91 percent in 2005). In order to satisfy some of the demand for longer-term credit, banks offer their clients interest rates at 7-10 percent for term deposits of over six months. The average interest rates for term deposits have fluctuated in recent years, reflecting changes in supply and demand for term financing. Deposits as a source of term funding have remained costly for banks, and as the average maturity of deposits is around one year, financial institutions are limited in the amount of longer-term loans that they can provide. As a result, funds from international institutions – mainly donors and the banks’ own capital continue to be the primary sources of long-term funding. There is no official data that differentiates between the remaining liabilities, but banks repeatedly stress that they rely on their own capital and donor funding to satisfy the demand for long-term credit of over three years. As these funds usually come in a foreign currency, banks continue to depend on capital and deposits for local currency loans.

205. **The capital market in Moldova is not yet well-developed, and the vast majority of local companies in Moldova remain too small to enter it.** Based on a recent World Bank study on capital market development, the country’s capital market is illiquid, with only 12 companies formally listed and traded at the Moldova Stock Exchange (MSE), and with corporate bonds not issued. The local stock market is generally only used to purchase controlling stakes in local companies, or to consolidate the shareholdings of strategic investors. Equity fund options are available, but stakeholders report that entrepreneurs prefer bank loans to equity investments, as they have previously had negative experiences with joint ventures and collaboration with business partners. Moreover, given the current interest rates, larger companies also tend to favor bank loans over the capital market, de facto “crowding out” SMEs from the market.

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139 In addition, the Herfindahl-Hirschman Index for the three variables (assets, deposits and credits) is between 1200 – 1350, which also reflects a moderately competitive banking system.

140 Individual banks have direct loans from the EBRD, IFC, the Black Sea Trade and Development Bank and other bilateral donors, which provide an important source of long-term funds. The World Bank provided a line of credit that is disbursed through the Credit Line Directorate to five commercial banks, and then on-lent to companies.

141 The NBM does not differentiate for liabilities to foreign and domestic financial institutions, but instead only uses debt securities issued, and other financial liabilities.

142 Capital adequacy ratio –CAR– in the banking system stands currently at 25%.

143 Technical Note on Capital Market Development, April 2012, the World Bank
206. **Financial intermediation in loans** remains restrained in the banking sector, as banks have a strong preference for maintaining liquidity due to the uncertain macro outlook and the recent history of banking sector instability. 90 percent of bank deposits are transformed into loans, but there is substantial deviation between banks in this respect. Some banks, mostly the smaller ones, only channel 50 percent of their deposits into loans, and report over 20 percent non-performing loans. On the other hand, three of Moldova’s four foreign banks as well as two of the large domestic banks have loan-to-deposit ratios (LTD) of 1 and above, and report non-performing loans below 7 percent. This divergence stems partly from differences in market strategy, but mainly from differences in credit evaluation and risk management capacity, as well as from issues pertaining to connected lending.

**Figure 22: Selected Financial Indicators in the Moldovan Banking System**

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<th>Financial Intermediation in the Banking Sector</th>
<th>Financial Intermediation in the Banking Sector (in each of 14 banks, 2012)</th>
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<th>Portfolio Quality and Provisioning</th>
<th>Portfolio Quality and Provisioning (in each of 14 banks, 2012)</th>
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*Source: NBM data*

**Limitations in Banks’ Lending Methodologies**

207. **Lending methodologies in most banks are not sufficiently refined to overcome information asymmetries of smaller and informal enterprises in a cost-effective way.** Only a small number of banks uses differentiated credit appraisal practices, and can ease the burden for
smaller enterprises. The majority of lending decisions are taken at the banks’ headquarters, mainly due to the perceived inexperience of branch officers. This also reduces cost-effectiveness. In loan evaluations, financial institutions verify the collateral, assets and cash flow on site, but require the enterprises to present preliminary balance sheets and business and investment plans. Since many businesses do not have these readily available, they have to put them together for this purpose or get external support in order to apply for a loan. This adds to the compliance costs and the administrative burden related to loans. Moreover, the credit evaluation and the decision-making process can take weeks, depending on the availability of the supporting documents that are requested, and the process maintains a strong focus on the availability of collateral, as the business and cash flow assessment capacity in banks is still reportedly weak. Loan officers frequently overestimate the loan amount that a client can afford and the cash flow that the business can generate when servicing that debt on time.

**The Regulatory Framework and Financial Infrastructure**

208. While considerable improvements have been made in the legal and regulatory framework of the financial sector, further effort should be invested in creating a development path for financial entities, strengthening consumer protection, and balancing requirements for stability and financial deepening. Since 2008, NBM has been further strengthening the regulatory framework through introducing tighter exposure limits, strengthening transparency (in particular on ownership and pricing) and risk management in banks, and revising prudential regulations to increase banks’ resilience to the volatile economic environment. While the reforms have undoubtedly strengthened the banking sector, further steps need to be taken to encourage financial intermediation and to further enhance market competition. Reserve and liquidity requirement should be calibrated to reflect the risk outlook in the banking sector.

209. Non-bank financial institutions are supervised by the National Commission of Financial Market (NCFM), created in 2007 through a merger of various non-bank supervisory agencies. The capacity of the NCFM to supervise savings and credit associations (SCA) and monitor other entities has been considerably strengthened over the years, contributing to the overall consolidation of the SCA sector. However, microfinance institutions only have to report their financial data to NCFM, which currently lacks the legal power to monitor them in more depth. Leasing entities do not have to provide any information to NCFM and are thus not monitored. As both microfinance and leasing institutions are playing an increasingly important role in the provision of financial services, strengthening of non-prudential supervision would be warranted to safeguard their sound development and promote a better understanding of cross-linkages between the various financial institutions in the Moldovan market. Furthermore, it would be helpful to create an over-arching development path for the financial entities to facilitate upward mobility. Finally, further progress is needed in the area of consumer protection to enhance transparency in terms of access to information, and to improve the ease of placing a complaint.

210. A privately owned Credit Bureau is operational since 2011, and it already provides comprehensive information on most bank borrowers. While some gaps are noted in the coverage of loans to legal entities, the information on bank loans appears to be sufficient overall. Loans from leasing companies, microfinance institutions, and savings and loans associations are
not yet reported, but there are plans to include this data in order to offer a holistic evaluation of a client’s level of debt and increase the range of borrowers in the database.

211. **A broad range of collateral can legally be used, but pledge registration is costly and time-consuming, and repossessing and sale of collateral has been deemed problematic in the past.** Banks and micro-finance institutions continue to request a relatively high amount of collateral for lending, which adversely affects in particular start-ups and small enterprises that do not have much to pledge. Most forms of collateral are legally permissible, but the registration process is burdensome, with the borrower required to pay for collateral registration, asset evaluation and notarization. These additional costs decrease the possibility of accessing a bank loan for smaller companies. As for repossession and sale of the collateral, until recently, it had to be sold “at market price” within 12 months, a high compliance cost in the absence of a functional market for used goods. The World Bank is currently working with NBM on improving the framework for secured lending.

212. **The legal framework for creditor rights, as well as auditing and accounting, has also undergone sufficient reform, and now a stronger focus needs to be placed on implementation and enforcement.** Moldova has so far performed poorly with regards to insolvency procedures, ranking 91st worldwide on the corresponding Doing Business indicator in 2013. In particular, the 2.8 years needed for insolvency proceedings and the 32-percent recovery rate of the underlying value are considered substandard. Some progress has been made. A new insolvency law was approved in 2012, which introduced additional options for the initiation of bankruptcy procedures by creditors and allowing for out-of-court settlements. This should help reduce some of the bottlenecks, but actual implementation will hinge on providing further guidance to companies on individual procedures and steps, and setting precedents. Moreover, a number of valuable reforms in auditing has also upgraded the legal framework, set quality standards and created an oversight structure. There are ongoing efforts to revise national accounting standards: in this respect, the authorities should focus on balancing the need to strengthen the overall accounting framework with the equally important interest in keeping compliance costs manageable for smaller enterprises.

**C. Policy Recommendations**

213. **The Moldova 2020 national development strategy identifies improved access to finance as one of the primary pillars that will allow the country to transition to an economic paradigm based on export-oriented growth.** The government has committed to establishing a working group under the Moldova 2020 framework to address these issues.

214. **Although many individual reform initiatives and programs to support access to finance support programs have been undertaken, there is not yet a comprehensive view of the extent of the problem or a structure in place to monitor progress.** Availability of detailed data on enterprise access to finance is lacking. The reform efforts to date, which have been supported by donors including the World Bank Group, include capital market development, the establishment of a credit bureau, financial supervision and regulation. Donor-supported lines of credit have been disbursed to companies through commercial banks, and donors have also helped to support the emergence of savings and credit associations.
This section contains a summary of short-term and longer-term recommendations that should continue to enhance enterprise access to finance in Moldova. These recommendations appear in more detail in the “Access to Finance” background paper, which is an accompanying piece to this study, available under separate cover. The recommendations below cover a range of activities on both the supply and demand sides of access to finance, and many entities, in both the public and private sectors, will need to be involved in their implementation.

**Short-term Recommendations (through 2014)**

a. **Institutional setup:** Improve the coordination of the various ongoing reform efforts. To maximize the efficiency and effectiveness of the reforms, a national body should be given responsibility for monitoring efforts to enhance enterprise access to financial services. This could be a unit at the level of the Deputy Prime Minister that is responsible for economic issues (a position which is also currently shared with the position of Minister of Economy), or another level that is able to effectively foster collaboration between different entities in government. The unit should use an existing structure if at all possible. Some of the measures to monitor include:
   i. Assessing data gaps and coordinating initiating data collection, including a baseline survey.
   ii. Developing a national policy for access to financing of enterprises.
   iii. Bringing the various stakeholders and donors together to coordinate and consolidate the ongoing reform efforts into larger and well-communicated initiatives.
   iv. Monitoring reform results and revising reforms as needed.
   v. Identifying gaps and bringing stakeholders (including donors and the private sector) together to fill them.

b. **Financial infrastructure:** Continue to increase the coverage of the credit bureau for both enterprises and individuals. (Responsibility: Credit Bureau) This will involve:
   i. Mandating the reporting of credit of legal persons to the Credit Bureau to further enhance the coverage and reliability of the database.
   ii. Incorporating data from microfinance institutions, savings and credit associations, and leasing companies.
   iii. Exploring the possibility of adding information from utility and other relevant providers to expand the database and the credit history of both companies and individuals.

c. **Improve ownership transparency to foster competition:** There are still information gaps regarding the ownership of banks and selected enterprises in Moldova. This makes it more difficult to identify related parties, which is a problem that has repeatedly contributed to bank vulnerabilities and failures in the past. This weakness also hinders
consolidated supervision of related groups.\textsuperscript{144}(Responsibility: NBM) The specific recommendations are:

i. The amendments to the Law on Financial Institutions enacted in April 2013, that aim to increase shareholder transparency\textsuperscript{145} should be fully enforced.

ii. Further legal amendments to enhance ownership/shareholder transparency and facilitate disclosure of the ultimate beneficiary owners in the financial sector should be developed and enacted. This will help improve competition in the sector and mitigate systemic risks related to the possible high concentration of ownership in multiple financial institutions by related parties.

d. \textit{Appropriate prudential regulation of non-bank financial institutions:} Regulation of these institutions needs to be strengthened, but commensurate to the risks that the different institutions pose, and the types of services that they provide. (Responsibility: NCFM.) Specific recommendations are as follows:

i. Prudential oversight for microfinance institutions and leasing entities can be kept at a minimum, as they are not taking deposits. The focus would have to be on eliminating room for arbitrage, creating an adequate framework for growth of the various financial players, and facilitating the upward transition for those institutions that wish to become banks.

ii. Regulations pertaining to information, transparency, corporate governance, financial management, and reporting should be developed; and they should be proportionate to the risks that these institutions pose.

e. \textit{Increase access to longer-term funding sources:} Further efforts should be made to develop alternative and innovative products, and access of banks and enterprises to a regional or local capital market should be increased. (Responsibility: multiple entities.) In the short term, efforts should be advanced in the following areas (from the 2012 World Bank Technical Note on Capital Market Development 2012):

i. Further develop the government bond market and issue bonds of longer maturities to develop a full yield curve.

ii. Continue to enhance the legal and regulatory framework.

iii. Revise taxation to create a level playing field among various sources of finance.

iv. Improve financial literacy among possible institutional and private investors.

f. \textit{Improve banks’ procedures and risk assessment methodologies:} Banks should improve their risk assessment methodologies, and cater to new corporate segments. This will help expand the companies that are eligible for bank financing, and reduce collateral

\textsuperscript{144} This not only pertains to the ownership structure of banks per se, but also to their participation and involvement in unregulated leasing companies, MFIs, and other financial intermediaries.

\textsuperscript{145} The Law on Modification and Supplementing Certain Legislative Acts no. 31, dated 7 March 2013, Monitorul Oficialno. 69-74/223 as of 05.04.2013,
requirements somewhat as banks are able to more accurately assess credit risk. (Responsibility: banks, banking association, others.) In the short term, the following should be implemented:

i. Assess capacity and interest among banks.

ii. Develop and implement technical assistance programs.

iii. Consider linking these programs with existing government and donor programs.

g. *Improve the skills and capacity needed by enterprises to increase their profitability and eligibility to borrow*: A more coordinated and holistic effort should focus on building companies’ financial management and business planning capacity. (Responsibility: MoE, business support infrastructure providers, others.) Short-term measures include:

   i. Based on the forthcoming OECD report on business support infrastructure (BSI), identify gaps in BSI availability and quality. Design a program to fill these gaps. One option would be to creating regional business development centers that provide access to services such as business and investment planning and training for financial management. Particular attention must be paid to direct involvement of enterprises in the investment planning process. The goal should be for these services to become self-sustainable in the future (based on market demand from companies).

   ii. Improve the framework for accounting and auditing, per the recommendations of the forthcoming World Bank Report on Standards and Codes in this area.

   iii. Foster collaboration between businesses along the value chain (some work in this area has already been done[^146]).

   iv. Improve access to government contracts (procurement) for SMEs. This would require clear bidding procedures – including quality standards – and could help the government reduce its own expenditures, while providing important opportunities for companies to grow. (Note: this is also included in the government’s SME development strategy.)

   v. Strengthen efforts to attract increased foreign direct investment (FDI). There is evidence that FDI has positive spillovers that help improve management practices and quality standards in national enterprises.

   vi. Improve provision of information on business opportunities with foreign partners. Market information – on trends, opportunities, and requirements for entering priority markets for priority products – is a critical input into companies’ business planning processes. The function of providing this information to Moldovan companies could be taken up and expanded by the Moldovan Investment and Export Promotion Organization (MIEPO), or another appropriate entity. The work should start with a strategic identification of priority products and priority markets for those products, based on Moldova’s comparative and competitive advantages.

[^146]: For instance, [www.businessportal.md](http://www.businessportal.md) provides information on companies active in certain areas and indicates available government programs.
This can be conducted in conjunction with the sector-specific value chain analyses that are planned under the Regulatory Reform Strategy Action Plan.

vii. It is crucial to improve the technical skills of the labor force, as the availability of workers with appropriate technical skills is a major concern for foreign investors and national companies. General recommendations in this area were made in the World Bank 2011 Country Economic Memorandum for Moldova. These recommendations should begin to be implemented.

h. Improve financial literacy: Efforts should be made to improve financial literacy of individuals, in order to increase the base of long-term savings that banks can use to lengthen the tenors of their loans; financial literacy of companies, so that they are better able to understand and evaluate different financing options; and financial literacy of potential institutional investors, to contribute to further development of the capital market and long-term finance, as described above. Short-term recommendations include:

i. Assess the consumer protection and financial literacy framework to identify legal, institutional, and outreach gaps. The assessment should aim to uncover viable ways of pooling ongoing initiatives by public and private stakeholders, enhance their efficiency, and evaluate opportunities and constraints within the legal framework for various players in the system.

ii. Launch financial literacy campaigns to promote a culture of long-term savings. Education campaigns should cover a broader spectrum of investment alternatives, and support the development of institutional investors, providing information on prices, available resources, and “what to look for”. Public and private sector stakeholders should collaborate more closely to be able to offer finance education in a cost-effective way.


The implementation of the following recommendations should be initiated as soon as possible, but as the implementation process is likely to take longer, the recommendations are labeled as medium- and long-term reforms. The same entities identified as responsible above should also be responsible for ensuring implementation in the longer term.

a. Closely monitor progress and continue efforts in order to enhance the ownership/shareholder transparency and facilitate disclosure of the ultimate beneficiary owners in the financial sector.

b. Monitor the performance of the coordination body, and make corrections in its structure, scope and responsibilities as needed.

c. The authorities should continue efforts to increase access to longer-term funding sources. In the long run, sustainable alternative funds from the private sector (for instance, from institutional investors) will be needed. Recommendations in this area, based on the World Bank Technical Note on Capital Market Development, include:

i. Broaden equity and bond financing options for the private sector, especially for banks.
ii. Develop the institutional investor base to create demand.

iii. Continue to work to strengthen financial literacy among investors.

d. Work to improve banks’ procedures and risk assessment methodologies can be broadened to include targeted programs with government funds, risk-sharing facilities, and partial credit guarantees.

e. To continue to improve skills and capacity of enterprises:

i. Monitor and evaluate the work on BDS and the provision of market information to ensure that it is meeting companies’ needs, and that services are becoming more sustainable. Make any necessary adjustments.

ii. Monitor and evaluate efforts to improve the competitiveness of companies along the whole value chain. Make any necessary adjustments. Once work on the initially-selected value chains has been completed, bring additional value chains into these programs.

iii. Monitor and evaluate progress on increasing SME access to government procurement, FDI attraction, and technical skills. Make any necessary adjustments.

f. Monitor and evaluate progress on financial literacy, and make necessary adjustments – including adjusting the approach to the support for the development of institutional investors – as progress is made in this area.
IX. The Justice Sector

216. **Weaknesses in Moldova’s justice sector** continue to impede private sector development. Previous chapters have provided some evidence that courts are limited in their ability to fulfill their role as arbiters and effectively enforce the rules of the game. This undermines the predictability and effectiveness of the legal and regulatory frameworks, as neither the government nor enterprises are consistently held accountable for non-compliance with the rule of law. Hence, addressing the lack of well-functioning, accessible, and affordable dispute resolution mechanisms needs to be a priority. Strengthening the rule of law will bring benefits that cut across the priority areas presented in this report: business regulation, tax, customs, competition, and access to finance.

217. **Improving the performance of the justice sector will at the same time be a key priority for Moldova’s path toward EU accession.** Future membership is likely to depend on considerable progress in this area.

*Legal Certainty and Predictability*

218. **Despite the recent headway in legal and regulatory reform, the rules on the books need to be enforced by efficient institutions:** in this respect, Moldova’s justice sector lags behind. An impartial and effective judiciary would act as a “second line of defense” for companies facing problems with licenses, authorizations, and inspections; with taxes, customs, and competition; in dealings with banks executing collateral; and in other aspects of doing business. However, the efficiency of Moldova’s judiciary in resolving dispute ranks 120th out of 144 countries in the World Economic Forum’s Global Competitiveness Report (GCR). Other rankings cited in this chapter also indicate that the justice system is currently under-performing.

219. **An impartial judiciary would enforce the rules when they are not followed, be it by the authorities or companies.** However, Moldova currently ranks 121st out of 144 on favoritism in decisions of government officials and 138th on judicial independence, per the GCR. Comprehensive justice reform ensuring effective future implementation of the *acquis communautaire* will therefore be a key requirement for EU accession.

220. **Limited capacity of the Moldovan judiciary, already alluded to in previous chapters, is an important part of the challenge.** Judges do not seem to be receiving the training that they need to adjudicate tax or competition cases related to cartels. Overall, politicization of appointments and corruption fundamentally undermine the system’s impartiality. The Justice

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147 The Justice Sector Reform Strategy for 2011-2016 defines the “justice sector” as comprising “the institutions and structures that contribute directly or indirectly to the organization and the administration of justice... [including]... primarily the judiciary and the entire set of authorities and relations between such authorities that contribute to the execution of justice, and namely criminal investigation bodies, legal professions related to the justice sector (lawyers, notaries mediators, bailiffs, legal experts, administrators of insolvency proceedings, translators/interpreters), the probation system, system for enforcing court decisions, prison system, Ministry of Justice, ombudsman, Constitutional Court.”

148 In the Global Integrity Report Scorecard 2010, Moldova earned a relatively strong score of 89 out of 100 for its legal framework, but a much weaker one of 59 out of 100 for implementation. (http://www.globalintegrity.org/report/Moldova/2010/)

149 World Economic Forum 2013

150 World Economic Forum 2013

151 Freedom House 2012, p. 388
Sector Reform Strategy\textsuperscript{152} quotes surveys conducted between 2005 and 2011, which indicate that confidence in judges is extremely low: “in 2011, only 1 percent of the respondents said that they have complete confidence in justice, while 42 percent of respondents said they had no confidence at all in justice.”\textsuperscript{153} In a 2009 resolution, Moldova’s parliament acknowledged that “the justice sector in Moldova is seriously affected by corruption.”\textsuperscript{154} This assessment is in line with the findings of Transparency International’s latest Global Corruption Barometer, which has identified police (4.1) and justice (3.9) as the most corrupt areas, on a scale of 1 to 5. In 2010-2011, 30 percent of the respondents reported that a member of their household paid a bribe to the judiciary in the last 12 months.\textsuperscript{155}

221. **The lack of legal certainty translates into real costs for businesses.** If banks, for example, had more confidence in the judiciary, they would have more faith in the process of execution of loan collateral. This would reduce the risks that they perceive, and it could, by extension, reduce the cost of finance, and thus increase firms’ access to finance. In multiple areas, effective and predictable enforcement of the rules of the game would reduce the high costs and the uncertainty that currently constrain the competitiveness of Moldova’s economy (see discussion in chapter III).

222. **Along with petty corruption, vested interests present a formidable challenge to legal certainty and the protection of property rights.** Some of them seem to exert control over judges, using them to maintain or upgrade their market position, orchestrate corporate raids to consolidate and expand their holdings, or extract rents. These profits then enable them to influence court rulings, perpetuating the system.\textsuperscript{156} Overall, Moldova ranks 122\textsuperscript{nd} out of 144 countries in terms of protection of property rights.\textsuperscript{157}

*Ineffective Dispute Resolution Mechanisms*

223. **Ineffective dispute resolution mechanisms deprive companies of need of fair solutions within a reasonable time frame.** Overall, the complex and lengthy adjudication procedures generate unreasonable costs to businesses. The current tax dispute resolution system, for example, is largely inefficient, as described in chapter V. While many countries have established administrative dispute resolution procedures to allow for speedy and inexpensive redress with benefits for citizens as well as the state, the likelihood that a Moldovan taxpayer will successfully contest a case filed by the STI in the judiciary is remote: approximately 95 percent of cases filed by the STI are resolved in favor of the STI.\textsuperscript{158} Thus, in many instances, the current system delays the resolution of tax cases. Moreover, Moldova is among the countries with the greatest delays in the execution of the legally-binding decisions of the European Court of Human Rights.\textsuperscript{159}

\textsuperscript{153} Government of the Republic of Moldova 2011b, p. 9.
\textsuperscript{154} Parliament Resolution no. 53 of October 2009, as quoted by the Justice Sector Reform Strategy, p. 7.
\textsuperscript{155} Transparency International 2012
\textsuperscript{156} Freedom House 2012, p. 388
\textsuperscript{157} World Economic Forum 2013
\textsuperscript{158} Appeals by businesses have a better record. See chapter V.
\textsuperscript{159} Freedom House 2012, p. 387
The Justice Sector Reform Strategy (2011-2016)

224. Moldova recently adopted a Justice Sector Reform Strategy for 2011-2016 with the aim of promoting transparency and impartiality, and reducing corruption. The strategy identifies the following priority areas: the court system, criminal justice, access to justice and enforcement, fighting corruption and enhancing ethics and integrity, the role of the judiciary in economic growth, observance of human rights, and judicial management. In order to implement these priorities, the Government has adopted an Action Plan.

225. Effective implementation of these reforms over the next few years can help increase legal certainty, and strengthen the ability of the justice system to resolve disputes. This could have a profound positive impact on the business environment. However, in order for that to happen, Moldovan authorities must come to understand that implementation of the reforms goes beyond changes to the legal and regulatory framework, and aim for observable and measurable results on the ground. Only then will the impact of the reforms on companies and the economy’s overall competitiveness be maximized.
X. Conclusion

226. **This paper has presented policy recommendations to address what the World Bank considers to be the most pressing problems related to the business environment in Moldova.** If the government is able to improve the business environment by revamping customs administration, tax administration, business regulation (licenses, authorizations, and inspections), the competition framework, and the aspects of access to finance that it can influence, Moldovan companies of all sizes and across sectors will benefit from greater competitiveness. Businesses would also be in a better position to capture the opportunities presented by the upcoming DCFTA with the European Union, increase sales, and create jobs. Then, Moldova’s economy could undergo the desired paradigm shift towards an export-oriented model characterized by investment, innovation, and competitiveness.

227. **Many of the reforms do not require new policies or strategies to be developed, but rather, they depend on sound implementation of existing laws, strategies, and action plans.** The reforms presented here do not require a large degree of investment, but they do require substantial political will on the part of the authorities to ensure sound implementation. The reforms focus on legal, regulatory, and policy changes that will clarify the rules of doing business, and align the incentives of government agencies to soundly implement these rules. Existing efforts that must be fully implemented include: Regulatory Reform Strategy 2013-2020 (must be adopted and implemented); Transport and Logistics Strategy (expected to be adopted very soon); State Tax Service Development Plan 2011-2015; Customs 2013 Activity Plan, the human resource reform concept, and other activities ongoing with EUBAM and USAID-BRITE support; Law 160 of 2011 (Guillotine 2+), Law 161 of 2011 (One-Stop Shop Law), and Law 131 of 2012 (Inspections Law); Law on Competition and Law on State Aid; and Judicial Sector Reform Strategy 2011-2016. The new head of the Main State Tax Inspectorate has also recently announced a number of improvements that he expects to implement. Access to finance is one area in which it would be useful to elaborate a guiding strategy, and work with financial institutions and private companies to bring about improvements.

228. **The reform process outlined in this report should be complemented by additional efforts to increase management and technical capacity in Moldovan enterprises.** This way, executives, entrepreneurs, and workers would be more prepared to take full advantage of the improved business environment, and to translate the reforms into increased export competitiveness, revenue, and job creation. Evidence of skills constraints have been presented in the access to finance analysis that accompanies this report, as well as in the Country Economic Memorandum and the 2009 Enterprise Survey.

229. **Moldovan authorities have demonstrated their willingness to reform key areas – including by the enactment of laws and the development of strategies mentioned in paragraph 227 – and donors are also supporting these efforts.** Going forward, it will be important for the government and the donor community to work together to identify gaps in technical knowledge, capacity, and investment resources, where further donor assistance would be necessary. Government coordination with donors and coordination among donors themselves will help harmonize efforts around a core set of shared objectives, ensure that the required changes are designed and implemented as parts of a holistic, sequenced program (not as ad hoc interventions), and ensure that the limited resources of all parties are spent well. A coordinated
and comprehensive approach will deliver better results, and multiply the benefits of ongoing and future reforms for Moldovan businesses and the economy as a whole.
### ANNEX A. Table of Summary Recommendations in the Priority Areas

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<tr>
<td>Prepare and enact modifications to Law 235 and Cabinet Decision No. 1240 of 2006 that establishes the Regulatory Impact Analysis (RIA) methodology, to clarify that customs- and tax-related legislation and regulations that affect companies (including Customs Orders and other documents that impose requirements on companies) must be accompanied by a RIA that is analyzed by the RIA Secretariat and publicly discussed with the Working Group for Regulation of Entrepreneurial Activity.</td>
<td>Expand work on risk management, including authorized economic operators and simplified procedures.</td>
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<td>Carry out a “guillotine” exercise of customs orders and other documents from the Customs Service that impose requirements on companies.</td>
<td>Improve post-clearance control and audit procedures.</td>
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<td>Send to the RIA Secretariat/discuss with the Working Group, and adopt, the recently-drafted legal amendments and Customs Orders that remove the requirement for exports to be processed at the customs post closest to where the company is registered, eliminate the transit declaration for exports, and other improvements.</td>
<td>Improve information exchange, and introduce Joint Customs Controls with neighboring countries.</td>
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<td>Draft a new Customs Code based on Kyoto and EU rules.</td>
<td>Improve international recognition of certificates.</td>
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<td>Customs Service develops future Activity Plans consistent with the RRS and TLS.</td>
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<td>Introduce electronic declarations (paperless processing).</td>
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<td>Improve public-private dialogue by forming a Standing Working Group in the area of international trade administration, with participation of the private sector and cooperation with the Working Group for Regulation of Entrepreneurial Activity</td>
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<tr>
<td>Continue process mapping, conduct a time study, make processes more efficient in line with good international practices (Kyoto and EU).</td>
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<td>Hire a customs valuation expert to analyze valuation practices.</td>
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<td>Analyze and rationalize sanctions applied to traders.</td>
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<td>Fully implement the capacity to issue binding tariff rulings.</td>
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<td>Fully develop the risk-based approach to inspections and implement it.</td>
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<td>Implement electronic procedures in the ASYCUDA system, improve electronic information exchange with trading partners, extend the hours of operation of ASYCUDA.</td>
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<td>Begin human resource management and training reform based on the EU Customs Blueprint.</td>
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<td>Tax Administration</td>
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<tr>
<td>Adopt and implement the tax-related components of the Regulatory Reform Strategy.</td>
<td>Further promote and encourage e-filing and automation within the STS.</td>
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<tr>
<td>Fully implement efforts initiated by the new Director of the Main State Tax Inspectorate to improve public-private dialogue and promote taxpayer compliance.</td>
<td>Implement an advanced rulings regime.</td>
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<tr>
<td>Draft and promote to Government and Parliament legal amendments to revise the system of fines and penalties.</td>
<td>Implement modern and transparent human resources management policy and systems, as a continuation of the shorter-term reforms.</td>
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<tr>
<td>Adjust State Tax Service performance indicators to focus on compliance and not sanctions.</td>
<td>Institutionalize a streamlined and transparent Tax Dispute Resolution System.</td>
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<td>Conduct an inventory of regulations, normative acts, decrees, letters, and other acts that impact tax administration and policy. Clarify the existing rules by drafting a new Tax Code, and follow up with an official Explanatory Note.</td>
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<td>Increase political independence of the tax authority.</td>
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<td>Enforce the compulsory RIA processes for all tax legislation.</td>
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<tr>
<td>Create and implement a formal Private Public Dialogue mechanism.</td>
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<td>Enforce a risk-based assessment system to determine the need for audit in line with international good practice.</td>
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<tr>
<td>Implement more effective policies for VAT refunds.</td>
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<tr>
<td>Design and begin to introduce modern and transparent human resource management policy and systems.</td>
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<td>Design and begin to introduce institutional reforms, including a modern, region-based organizational structure.</td>
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<tr>
<td>Design and begin to introduce operational reforms. Internationally (esp. EU)-proven business processes should be adopted, and this should be linked with an effort to upgrade information technology and automation.</td>
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<td>Conduct a training needs assessment of judges for tax matters, and provide training.</td>
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<td>Improve communications and transparency, including through: A user-friendly electronic web-based registry of all decisions and clarifications issued by the tax authority, as well as of tax-related court decisions. A “Taxpayer Rights” information campaign.</td>
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<tr>
<td><strong>Licenses, Authorizations, and Inspections</strong></td>
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<tr>
<td>Ensure that the 2004-2012 reforms to streamline and clarify government regulation of business activity are fully implemented (including Law #235, Law #160, and Law #161).</td>
<td>Extend the e-government portal to serve as the only interface of government-to-business. Also extend it to the Municipality of Chisinau and rayon centers.</td>
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<tr>
<td>Adopt the Regulatory Reform Strategy 2013-2020, and monitor implementa-</td>
<td>Adopt a voluntary compliance framework for inspections.</td>
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<tr>
<td>Action Plan</td>
<td>Description</td>
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<tr>
<td>Ministry of Economy promotes to Government and Parliament draft modifications to legislation that aim to improve a range of other areas related to doing business, including: permits, construction permits, inspections, voluntary liquidation, one-stop shops, and other areas.</td>
<td>Streamline local government regulations with the Construction Code.</td>
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<tr>
<td>Update the inventory of existing licenses and authorizations, review them, and remove overlaps and duplicates.</td>
<td>Ensure that all changes optimizing the licensing and authorization regimes, and fee regulation, are fully implemented.</td>
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<tr>
<td>Improve, then adopt, the Construction Code, which reforms the framework for construction permits.</td>
<td>Enforce the requirement for government authorities to follow the principles and procedures outlined in the online portal of business regulation.</td>
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<tr>
<td>Streamline laws and regulations in line with the new Inspection Law.</td>
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<tr>
<td>Adopt the Framework Risk Based Inspection (RBI) Methodology.</td>
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<td>Develop and secure government approval of sectoral RBI methodologies for the authorities that undertake inspections.</td>
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<tr>
<td>Enhance transparency and accountability by including comprehensive information about licenses, authorizations, and inspections on the e-government portal, and make it an offense for government officials to deviate from the requirements listed.</td>
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### Competition

#### Market Entry

Eliminate any remaining barriers that restrict market entry based on criteria that are not justified by economic or safety concerns (see recommendations on licenses, authorizations, and inspections). | Continue implementation of the short-term recommendations. |
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<tbody>
<tr>
<td>Advance the privatization process in competitive sectors, and allow for multiple new entrants where possible.</td>
<td>Examine how the State Tax Inspectorate and Registration Chamber can use their information to simplify the process of closing a business.</td>
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<tr>
<td>Simplify the process of closing a business.</td>
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#### Competition and State Aid Framework

Continue to disseminate information about the new legislation on competition and state aid, and its enforcement, to the public | Assess progress on short-term recommendations, update plans in these areas, and implement/intensify them. |
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<tr>
<td>Fully implement the new structure of the Competition Council (approve relevant laws, appoint directors, and recruit personnel).</td>
<td>Limit the number of goods and services for which the government determines prices or retail margins.</td>
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<tr>
<td>Adopt and publish all required secondary legislation. Draft, finalize and adopt all relevant guidelines and internal regulations.</td>
<td>Continue to pursue justice sector reform, and promote increased transparency, in order to address political economy concerns that affect competition.</td>
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<tr>
<td>Review sector-specific constraints affecting market competition, using the Product Market Regulation approach. Eliminate/amend regulations that restrict competition.</td>
<td>Guarantee that the principles of competitive neutrality are followed for SOEs.</td>
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<tr>
<td>Begin to build the capacity of the Competition Council.</td>
<td>In the longer term, consider giving the Agency for Consumer Protection responsibility for issues related to unfair competition and advertising, and relying on the courts to enforce intellectual property rights.</td>
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<td>Conduct a full inventory of existing state aid schemes; create a monitoring</td>
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<td>Mechanism</td>
<td>Increase efforts to build a “competition culture”.</td>
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<tr>
<td>Mechanism</td>
<td>Increase efforts to build a “competition culture”.</td>
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<td>Mechanism</td>
<td>Provide training to related agencies, including judges, the public procurement agency, etc.</td>
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<tr>
<td>Mechanism</td>
<td>Conduct a political economy analysis to better understand the incentives faced by public and private decision-makers.</td>
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### Access to Finance

To improve targeting, coordination, and sustainability of reforms, a national body should be given responsibility for monitoring efforts to enhance enterprise access to financial services. A baseline survey should be conducted.

- Continue to increase the coverage of the private credit bureau, focusing first on microfinance institutions, savings and credit associations, and leasing companies. Explore the possibility of adding information from utilities and others.
- Improve ownership transparency to foster competition. Fully enforce the recent amendments to the Law on Financial Institutions that aim to increase ownership/shareholder transparency. Develop and enact further legal amendments to facilitate disclosure of the ultimate beneficiary owners in the financial sector.
- Strengthen regulation of non-bank financial institutions, commensurate to the risks that the different institutions pose and the types of services that they provide.
- Begin efforts to improve the functioning of the deposit guarantee fund for the banking sector.

#### Access to Finance: To increase access to longer-term funding sources step up/initiate efforts to:

- Further develop the government bond market.
- Continue to enhance the legal and regulatory framework.
- Revise taxation to create a level playing field among various sources of finance.
- Improve financial literacy among possible institutional and private investors.

- Improve banks’ procedures and risk assessment methodologies. In the short term:
  - Assess capacity and interest among banks.
  - Develop and implement technical assistance programs.
  - Consider linking these programs with the existing government and donor programs.

- Improve the skills and capacity needed by enterprises to increase their profitability and help them qualify for the type of financing they need:
  - Improve financial management and business planning skills of entrepreneurs and managers.
  - Foster business linkages.

- Monitor the performance of the coordination body, and make corrections in its structure, scope and responsibilities as needed.
- Continue to increase the coverage of the credit bureau along the lines of the short-term recommendations presented.
- Monitor to ensure compliance with the transparency laws.
- Monitor and evaluate progress, and adjust as needed.

#### Access to Finance: Begin efforts to improve the functioning of the deposit guarantee fund for the banking sector.

- Continue reform efforts and increase the amount guaranteed.

- To increase access to longer-term funding sources step up/initiate efforts to:
  - Broader equity and bond financing options for the private sector.
  - Develop the institutional investor base to create demand.
  - Continue to work to strengthen financial literacy among investors.

- Broaden work to improve banks’ procedures and risk assessment methodologies to include targeted programs with government funds, risk-sharing facilities, and partial credit guarantees.

- Monitor and evaluate the efforts listed in the short term. Make any necessary adjustments. “Graduate” firms and value chains, bring new firms and value chains into the programs, and in the long run, work to make programs that provide services to businesses or sectors self-sustaining.
- Increase small and medium-sized enterprise (SME) access to government contracts (procurement).
- Strengthen efforts to attract increased foreign direct investment (FDI).
- Continue efforts to improve the business environment, as recommended in other chapters of this report.
- Improve provision of information on business opportunities with foreign partners.
- Design and begin to implement a strategy to improve the technical skills of the labor force.

**Improve financial literacy:**
- Assess the consumer protection and financial literacy framework to identify legal, institutional, and outreach gaps.
- Launch financial literacy campaigns for individuals, companies, and investors.

| Monitor and evaluate progress on financial literacy, and make necessary adjustments. Further support financial literacy of institutional investors as progress is made in this area. |  |
ANNEX B. Moldova’s Performance on International Assessments of the Business Environment

230. **On the World Economic Forum’s 2012-13 Global Competitiveness Index, Moldova ranks 87th out of 144 economies.** This index assesses the competitiveness landscape of 144 economies, providing insight into the drivers of their productivity and prosperity. Moldova’s performance, at the 40th percentile of economies worldwide, demonstrates that there is much scope for improving its competitiveness. Moldova is also at the low end of the spectrum in terms of the sophistication of its economy. The WEF’s Global Competitiveness Report (GCR) continues to place Moldova among Stage 1 factor-driven economies, together with only two other countries in the region: Tajikistan and Kyrgyz Republic. Countries such as Macedonia FYR and Montenegro are at Stage 2 of development, efficiency-driven economies, while the three Baltic countries are already transitioning to Stage 3, innovation-driven economies.

231. **Interactions with the government are particularly burdensome for Moldovan firms.** The GCR computes data on 12 different areas, looking at very diverse aspects that build up economic competitiveness, from institutions, to education and health, to infrastructure and innovation. The 2012-13 report found that the three most problematic factors for Moldovan businesses are corruption, policy instability, and inefficient government bureaucracy. This is consistent with feedback gathered from other sources, which also agree that one of the most important problems faced by Moldova’s public administration is not the lack of qualitative legislation, but rather the challenge of implementing the legislation effectively.

232. **Examining the business environment in more depth, international rankings confirm the existence of many weaknesses.** The World Bank Group’s Doing Business report measures the quality of the business enabling environment in economies worldwide, examining the regulations and procedures applying to small and medium-sized companies throughout their life cycle. Moldova ranks 83rd out 185 countries on the 2013 Doing Business report. This is an improvement from the previous year when it ranked 86th, but the report still places Moldova below the regional ECA average rank of 73rd. See the figures below for a comparison of Moldova’s rankings with those of other countries in ECA, on Doing Business and the Global Competitiveness Index.
The paragraphs below briefly review how Moldova performs on international rankings evaluating aspects of the business lifecycle.\textsuperscript{160} We have compared Moldova to countries in the region of a similar size, with varying degrees of development, which the Government of Moldova has in the past considered to be relevant benchmarks, using countries of similar size and resources: Georgia (the best in the region on Doing Business, and also a former Soviet country), Macedonia FYR (the most comparable country from the Balkans), and Latvia (former Soviet country and the most comparable country from the Baltic region).

\textsuperscript{160} This does not include the domestic Cost of Doing Business survey, which is not comparable across countries.
234. **The procedures to start a business have improved, but the reform still needs to be fully implemented.** Since 2008, reforms were undertaken to create a one-stop shop for business registration; according to the Doing Business Starting a Business indicators, these reforms reduced the number of procedures from 11 to 7 and decreased the number of days to start a business from 42 to 9. However, the one-stop shop is not yet fully functional; companies still visit several agencies during the registration process (Tax Inspectorate, Social Security Fund and the National Medical Insurance Company), even though some of these procedures have been removed on paper. This is reflected in Moldova’s rank on “Starting a Business”, on which it is 92nd in the world, below both neighboring countries: Ukraine (50th) and Romania (68th).

**Business Life-Cycle Component 2: Business Regulation and Inspections**

235. **Licenses, inspections and construction permits are the three areas in which Moldova performs poorly as a result of complicated bureaucratic procedures coupled with corruption**, as documented in the World Bank Group’s Enterprise Surveys and Doing Business.

236. **The burden of government regulation is higher in Moldova than in other small countries in the ECA region.** On this indicator in the 2012-13 GCR, Moldova ranks 105th out of 144 economies, below Georgia (9th), Macedonia FYR (54th) and Latvia (67th). The GCR also shows that Moldova ranks poorly on the existence and efficiency of government services for improved business performance, coming in at 113th place, and thus unfavorably compared to Macedonia FYR (55th) and Latvia (94th). The Enterprise Survey captures the percentage of senior management time spent dealing with government regulations. In Moldova, this indicator is 7.0 percent, better than the regional ECA average of 10.4 percent, Latvia (9.7 percent) and Macedonia FYR (14.5 percent), but worse than Georgia (2.1 percent).

237. **The 2009 Enterprise Survey (latest available) shows that 20 percent of Moldovan firms consider business licensing and permits as a major constraint**, below the regional average of 15.8 percent and below the rest of the benchmark countries: Macedonia FYR (14.7 percent), Latvia (14.4 percent), and Georgia (10.7 percent).

238. **The surveys also document problems in the area of construction permits.** In the 2009 Enterprise Survey, 29.3 percent of Moldovan firms perceive that corruption is an obstacle when dealing with construction permits, and this is the public service with the highest perceived levels of corruption. Moldova compares unfavorably with the ECA average of 23.7 percent, and performs worse than Macedonia FYR (17.3 percent), Latvia (13.2 percent), and Georgia (3.9 percent, the lowest in the region). The Doing Business rankings also give Moldova a low score in this area; it ranks 168th in the world on construction permits, and 17th out of the 24 countries in ECA.

239. **The Enterprise Survey found that inspections are also more burdensome for Moldovan firms than for others in the regions.** Corruption is perceived as a problem; 15.5 percent of firms state that it is expected that companies give gifts to tax inspectors, above the regional average of 12.8 percent and also above the benchmark countries: Georgia (8.4 percent),

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Macedonia FYR (8.1 percent), and Latvia (4.4 percent). Inspections coming from the Tax Department are only part of the problem. Firms are likely to be inspected up to several times a year by multiple authorities, as discussed in the chapter on this topic.

Business Life-Cycle Component 3: Access to Finance

Access to finance also ranks as atop problem for businesses in Moldova, but the Doing Business survey indicates that progress is being made. In the 2009 Enterprise Survey (latest available), 19.5 percent of companies state that it is a top problem. Access to finance also appears as the 4th constraint to Moldovan enterprises in the 2012-13 Global Competitiveness Report. Thus, despite recent reform efforts that include improving the functioning of the private credit bureau, companies are still having difficulty getting access to loans. The credit bureau reforms have helped Moldova improve to 40th place on the world Doing Business Getting Credit indicator, and 10th place out of the 24 ECA countries. However, Moldova is still below the comparator countries Georgia and Latvia (4th), Romania (12th), and Macedonia and Ukraine (23rd).

Business Lifecycle Component 4: Trading Across Borders

Moldova performs quite poorly on the efficiency with which goods can be traded across borders. In the 2013 Doing Business report, Moldova ranks 140th out of 185 economies in terms of costs and time to import and export. This places Moldova in the bottom quarter of economies on this indicator (“Trading Across Borders”, 24th percentile). Moldova performs substantially worse than Georgia (38th), Romania (72nd), and Macedonia FYR (76th), and it is 16th overall in the ECA region. The Heritage Foundation’s Index of Economic Freedom includes an indicator on trade freedom, as a measure of tariff and non-tariff barriers that affect trade in goods and services. As part of the trade freedom indicator, with 80.0 Moldova scores fairly well; however, it performs worse than the benchmark sample countries: Georgia (89.2), Macedonia FYR (84.6), and Latvia (86.8). The World Bank Logistics Performance Index examines trade-related aspects in more technical terms, looking at customs efficiency, infrastructure, costs, logistics competence, timeliness, and the ability to track shipments. In 2012, Moldova ranked 132nd out of the 155 countries in this index, in the 15th percentile, and with the second-lowest score in the ECA region (above Tajikistan; Turkmenistan is not included due to lack of data).

Data Tables

The tables below present a brief description of the sources used in the analysis above, as well as the relevant data and rankings.

World Bank Group Doing Business 2013

The Doing Business report measures the quality of the business environment in economies worldwide, by evaluating the regulatory requirements faced by small and medium-sized firms. For each economy the ranking is calculated as the simple average of the percentile rankings on each of the ten components included in the index (listed below).

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<table>
<thead>
<tr>
<th>Doing Business (2013)</th>
<th>Moldova’s Rank(out of 185 countries)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall Rank</td>
<td>83</td>
</tr>
<tr>
<td>Starting a Business</td>
<td>92</td>
</tr>
<tr>
<td>Dealing with Construction Permits</td>
<td>168</td>
</tr>
<tr>
<td>Getting Electricity</td>
<td>161</td>
</tr>
<tr>
<td>Registering Property</td>
<td>16</td>
</tr>
<tr>
<td>Getting Credit</td>
<td>40</td>
</tr>
<tr>
<td>Protecting Investors</td>
<td>82</td>
</tr>
<tr>
<td>Paying Taxes</td>
<td>109</td>
</tr>
<tr>
<td>Trading Across Borders</td>
<td>142</td>
</tr>
<tr>
<td>Enforcing Contracts</td>
<td>26</td>
</tr>
<tr>
<td>Resolving Insolvency</td>
<td>91</td>
</tr>
</tbody>
</table>

*World Economic Forum Global Competitiveness Index 2012 – 2013*

The Global Competitiveness Index assesses country-level competitiveness, and represents a weighted average of a set of the microeconomic and macroeconomic indicators of competitiveness grouped in 12 policy areas. The indicators are assigned a score ranging from 1 to 7, where 7 represents the best possible outcome.

<table>
<thead>
<tr>
<th>Global Competitiveness Index (2012 – 2013)</th>
<th>Moldova’s Rank (out of 144 countries)</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall Rank</td>
<td>87</td>
<td>3.9</td>
</tr>
<tr>
<td>Institutions</td>
<td>110</td>
<td>3.4</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>92</td>
<td>3.5</td>
</tr>
<tr>
<td>Macroeconomic Environment</td>
<td>93</td>
<td>4.4</td>
</tr>
<tr>
<td>Health and Primary Education</td>
<td>86</td>
<td>5.4</td>
</tr>
<tr>
<td>Higher Education and Training</td>
<td>88</td>
<td>4.0</td>
</tr>
<tr>
<td>Goods Market Efficiency</td>
<td>100</td>
<td>4.0</td>
</tr>
<tr>
<td>Labor Market Efficiency</td>
<td>81</td>
<td>4.3</td>
</tr>
<tr>
<td>Financial Market Development</td>
<td>104</td>
<td>3.6</td>
</tr>
<tr>
<td>Technological Readiness</td>
<td>65</td>
<td>3.9</td>
</tr>
<tr>
<td>Market Size</td>
<td>121</td>
<td>2.5</td>
</tr>
<tr>
<td>Business Sophistication</td>
<td>120</td>
<td>3.3</td>
</tr>
<tr>
<td>Innovation</td>
<td>135</td>
<td>2.4</td>
</tr>
</tbody>
</table>
World Bank Group Logistics Performance Index 2012

The Logistics Performance Index, published by the World Bank, compares the trade logistics profiles of 155 countries and rates them on a scale of 1 (worst) to 5 (best). These ratings are based on individual country assessments by nearly international freight forwarders. The LPI’s six components include: (i) efficiency of the clearance process (speed, simplicity, and predictability of formalities) by border control agencies, including customs; (ii) quality of trade- and transport-related infrastructure (ports, railroads, roads, information technology); (iii) ease of arranging competitively priced shipments; (iv) competence and quality of logistics services (transport operators, customs brokers); (v) ability to track and trace consignments; (vi) frequency with which shipments reach the consignee within the scheduled or expected delivery time.

<table>
<thead>
<tr>
<th>Logistics Performance Index (2012)</th>
<th>Moldova’s Rank (out of 155 countries)</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>World Rank</td>
<td>132</td>
<td>2.3</td>
</tr>
<tr>
<td>Customs</td>
<td>129</td>
<td>2.2</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>98</td>
<td>2.4</td>
</tr>
<tr>
<td>International Shipments</td>
<td>145</td>
<td>2.1</td>
</tr>
<tr>
<td>Logistics Competence</td>
<td>142</td>
<td>2.2</td>
</tr>
<tr>
<td>Tracking &amp; Tracing</td>
<td>116</td>
<td>2.4</td>
</tr>
<tr>
<td>Timeliness</td>
<td>126</td>
<td>2.7</td>
</tr>
</tbody>
</table>

Heritage Foundation Index of Economic Freedom 2013

The Index of Economic Freedom, published by The Heritage Foundation, covers four policy areas (rule of law, limited government, regulatory efficiency, open markets), and encompasses ten specific components (economic freedoms). Each component is assigned a grade using a scale from 0 to 100, where 100 represents the maximum freedom, and all ten indicators are weighted equally in determining country scores.

<table>
<thead>
<tr>
<th>Index of Economic Freedom (2013)</th>
<th>Moldova’s Rank (out of 177 countries)</th>
<th>Trend</th>
</tr>
</thead>
<tbody>
<tr>
<td>World Rank</td>
<td>115</td>
<td></td>
</tr>
<tr>
<td>Score</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Rule of Law</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property rights</td>
<td>40</td>
<td>Stable</td>
</tr>
<tr>
<td>Freedom from Corruption</td>
<td>29</td>
<td>Stable</td>
</tr>
<tr>
<td><strong>Limited Government</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government Spending</td>
<td>50.1</td>
<td>Improving</td>
</tr>
<tr>
<td>Fiscal Freedom</td>
<td>87.2</td>
<td>Improving</td>
</tr>
<tr>
<td><strong>Regulatory Efficiency</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business freedom</td>
<td>69.7</td>
<td>Worsening</td>
</tr>
<tr>
<td>Labor freedom</td>
<td>40.9</td>
<td>Worsening</td>
</tr>
<tr>
<td>Freedom</td>
<td>Score</td>
<td>Status</td>
</tr>
<tr>
<td>---------------------</td>
<td>-------</td>
<td>--------------</td>
</tr>
<tr>
<td>Monetary freedom</td>
<td>73.4</td>
<td>Worsening</td>
</tr>
<tr>
<td><strong>Open Markets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade freedom</td>
<td>80</td>
<td>Improving</td>
</tr>
<tr>
<td>Investment freedom</td>
<td>35</td>
<td>Worsening</td>
</tr>
<tr>
<td>Financial freedom</td>
<td>50</td>
<td>Worsening</td>
</tr>
</tbody>
</table>
ANNEX C: References


World Bank. 2012e. Logistics Performance Index 2012. Available at: http://go.worldbank.org/7TEVSUEAR0


