Investment Climate Assessment

Moldova Investment Climate Assessment

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TABLES AND FIGURES

WHAT IS AN INVESTMENT CLIMATE ASSESSMENT?

Investment climate assessments systematically analyze the conditions for private investment and enterprise growth in a country, drawing on the experience of local firms to pinpoint the areas where reform is most needed to improve the private sector's productivity and competitiveness. By providing a practical foundation for policy recommendations and involving local partners throughout the process, the assessments are designed to give greater impetus to policy reforms that can speed the private sector's growth, leading to faster economic growth and poverty reduction.

Produced by the World Bank Group in close partnership with a public or private institution in each country, the investment climate assessments are based on a survey of private enterprises to find out what difficulties they encounter in starting and running a business—and, if the business fails, in exiting. The survey captures firms' experience in a range of areas—financing, governance, regulation, tax policy, labor relations, conflict resolution, infrastructure services, supplies and marketing, technology, and training. All these are areas where difficulties can add substantially to the costs of doing business. The survey attempts to quantify these costs. Using a standard methodology, the assessment then compares the survey findings with those in similar countries to evaluate how the country's private sector is faring and how well it can compete.

The findings of the survey, combined with other relevant information from other sources, provide a practical basis for identifying the most important areas for reform aimed at improving the investment climate. The assessments look in detail at policy, regulatory, and institutional factors that hamper the provision of good-quality infrastructure services and the functioning of product, financial, and other markets, linking the constraints to firms' costs and productivity.

In each country the investment climate assessments draw on the guidance and expertise of local partners in government and the business community. The findings and policy recommendations emerging from the assessments are discussed extensively with the private sector and other stakeholders in the country. This broad dissemination of the findings is aimed at engaging not only policymakers but also business leaders, investors, nongovernmental organizations, and the donor community in shaping the national private sector development strategy, forging consensus on the priorities for reform of the investment climate, and laying the groundwork for concrete responses to the problems identified. Updates of the assessment can help track progress in improving the investment climate.

After a nine-year 60% plunge in GDP since independence in 1991, the Moldovan economy began to recover in 2000. Cumulative growth of more than 20 percent has been recorded since. Growth has largely been demand driven with consumer spending fueled by a marked increase in real wages and sizeable inflow of workers' remittances, that have benefited sectors such as services and construction. This growth has been coupled with recovery of demand from Moldova's main trading partners—Russia and Ukraine—which has allowed Moldova to recapture markets in industry and exports lost after the 1998 regional financial crisis.

The recent growth has helped reduce poverty. The poverty headcount has declined to 48 percent today—roughly equal to pre-Russia crisis levels—after peaking at 71 percent in 1999. More than 80 percent of the poor, however, are living in extreme poverty.

The recent economic growth in Moldova is largely a recovery from the collapse of the 1990s. According to the IMF estimates, total factor productivity (TFP) growth between 1998–2002 for Moldova negative.[1] The key for sustainable growth over the medium-term and for continued or even accelerated advancement in poverty alleviation will be reversing Moldova's declining economic productivity. A country with productivity gains encourages domestic and foreign firms to invest further, hire workers, and expand, and thus over the long-run generate more and higher paying jobs and opportunities to start-up new businesses that in turn enhance living standards and reduces poverty. Raising productivity of Moldova's economy will require a competitive market environment in which the entry of new firms is unfettered by excessive regulation, existing firms have the incentive to be productive and innovative, and unproductive economic activities are halted without excessive delay.

This is a tall order. As discussed in more detail below, opportunities available to firms in Moldova remain constrained—by slow progress on structural reforms and by discretionary control over private business. The risks and costs of doing business also remain unnecessarily high. Administrative burdens of all kinds are excessive. Access to finance is low, reducing the productivity of enterprises. And workers are often unproductive, with workweeks of 28 hours and most of the workforce out of the country or in the informal sector.

This analysis is largely consistent with survey reports on the perception of firms of the key constraints to doing business in Moldova. Of 18 potential business constraints, Moldovan firms indicate that policy instability, legal and regulatory burdens, corruption, and crime are relatively important constraints to business. Rounding out the top constraints are access to finance (collateral) and customs and trade regulation, each identified by roughly half the sample as moderate or major constraints. Of less concern for these existing firms are issues of labor costs and infrastructure.

A weak investment climate takes a toll on businesses. The Cost of Doing Business report concludes that Moldova has the highest regulatory compliance costs in the region. For examples, managers spent an average of 17 percent of their time in 2002 meeting regulatory requirements, and 40 and 50 percent of firms report paying bribes for building permits. Alarming is the finding from the Early Warning System[2] study that there is a noticeable deterioration of the business environment for small firms in Moldova over the last three years, as they are becoming increasingly burdened by inspections and overall regulatory compliance requirements. This trend is alarming given that a dynamic small enterprise sector is key to bring in new competition and jobs into an economy.

Clearly, the impact of improving the investment climate would be significant—both for improving productivity of existing firms, and opening the way for easy entry of new firms. Consider this: If Moldova's investment climate were to match Poland's, the productivity of food and garment firms would get a first-order jolt of 9 percent. Note that those firms are among Moldova's more productive—and that the productivity boost could thus be substantially higher if productivity gains were realized in other economic sectors.

The Moldovan Government has a responsibility to create an investment climate that increases opportunities available to firms—and to reduce the risks and costs of doing business. The Government acknowledges this responsibility in its Strategy of Socio-Economic Development Through Year 2005 which lists the "creation of favorable conditions for entrepreneurial activity, promotion and attraction of foreign and domestic investment, and the creation of competitive business climate adequate for a market economy" among its priority objectives. Indeed, there have been advancements made—particularly on the legal framework and improvement of infrastructure services. However, much remains to be done.

The "Nuts and Bolts" of the Reform Agenda

Administrative and Legal Constraints

Quantitative indicators of regulatory constraints that are benchmarked against neighboring countries and competitors are largely consistent with more qualitative reports on perceptions of firms. Taken together, it becomes clear that administrative barriers are a major constraint to private sector growth. Despite certain improvements, registering a new business is still cumbersome, and licensing remains one of the most restrictive among transition economies. Certifying compliance with standards is getting more time-consuming and costly, not less. The frequency of inspections increased, and while duration and cost of inspections have come down, they still remain greater than in most neighboring countries. Smaller businesses may be finding things more complex, keeping them in the informal sector. Recent surveys show that Moldovan managers spend a sixth of their time meeting regulatory requirements.

Another major constraint: customs and trade regulations. Two-thirds of Moldovan entrepreneurs believe the conditions for import transactions are getting worse, mainly because of the many documents required. Seen as particularly pernicious are customs clearances. Paying bribes to get things done is pervasive, even more so for smaller firms. Moldovan businesses spend on average more than 2 percent of their revenues on side payments. In the case of building permits, between 40 and 50 percent of firms report paying bribes.

Court efficiency and contract enforcement, worse than the average for transition countries, are also important. Low confidence in the system leaves enterprises wary of dealings with suppliers and customers they do not know well, limiting their business opportunities and productivity growth.

Labor, Finance, and Land

The workforce is well educated and wages are low, two pluses for investment. Yet the labor market is depressed. The workweek is short, at about 28 hours. High entry barriers particularly for small businesses, encourage Moldova workers to either stay in the informal sector or seek work abroad. About 300,000 Moldovans, a quarter of the labor force, are working outside the country. Of key concern is the highly restrictive labor laws governing firing of workers.

For finance, delays in the development of the technical infrastructure for payments, banking sector inefficiencies, and excessive regulations are reflected in high interest margins and intermediation costs. Lack of financial products and services diversification, poor banking skills, and inadequate lending policies prevent banks from servicing private sector needs efficiently. As a result, businesses are reluctant to borrow, and they rely predominantly on their own funds. There are few other options available due to underdevelopment of alternative forms of financing, such as leasing.

For land, Moldova has a sound cadastre and registration system, and the real estate market is getting stronger. But cadastre mapping needs to be upgraded in most areas, and the legal environment needs to be strengthened, especially for the licensing of notaries, valuers, surveyors, and realtors. Obtaining building permits has become complex, requiring authorizations by at least 15 governmental bodies. Particularly alarming is the share of businesses paying bribes to obtain permits—at least 40 percent.

Infrastructure—Not Seen as a Major Constraint, But It Is Deteriorating

Moldovan firms generally do not see infrastructure as a major constraint, and indeed the proportion of firms surveyed perceiving it as a minor (or no) constraint rose from about half in 1999 to more than 85 percent in 2002. Telecommunications services have been expanding and improving, though fixed lines can be unreliable and Internet services are a long way from being a business tool.

Transportation services are fairly well developed, but the road and rail infrastructure has been poorly maintained, with few additions to accommodate changing patterns of commerce and trade. Electricity services have also improved in recent years, with the privatized distribution companies cutting power outages from nearly 5,000 hours a year to 50. But again, the infrastructure is deteriorating, and reforms have to be pushed through to get the sector on a sound footing.

Policy Uncertainty

An investment climate entails not only policy and institutional dimensions, but also behavioral environment, both present and expected, formal and informal. From the investor's perspective, all aspects count. There is strong anecdotal and focus group survey results that point to the selective enforcement of laws and regulations for political gains and economic benefits. Additionally, the power of the state is perceived as being used as a means of unfair competition. There is also the perception that the court system—which should be a check against executive abuses of the system—is also inadequate.

Key Recommendations

Overall the regulatory burdens tend to be greater in Moldova than in other CIS countries at similar incomes. Both the real and financial sectors suffer from excessive government interference and a high degree of policy uncertainty, which affects large and small firms, domestic and foreign companies, and exporters as well as firms oriented toward domestic production. This makes the deregulation agenda a top priority for Moldovan policymakers.

This agenda is large. To facilitate and monitor implementation, the Government should develop a strategy and institutional framework for deregulation. It should introduce regulatory impact analyses of government regulations affecting the investment climate. The goal would be to analyze the impact of new regulations on the economy—and to ensure that new regulatory acts do not contradict existing legislation. Donor assistance could be requested to create an assessment unit within the Government, train regulators, and provide other technical support.

In the short- and medium-term the Government should focus its reform efforts on the following key areas:

- Creating legislative and institutional framework for deregulation, defining the strategy and priority actions.
- Reducing the documentation and limiting the involvement of government ministries in certification, standardization, inspections, and customs regulations.
- Further streamlining procedures for business registration and reducing the number of steps, docu-

ments, and authorizations businesses must get to obtain licenses.

- Eliminating restrictions on lending, transferring, and holding foreign currencies and removing the regulatory impediments to leasing operations.
- Reducing operating costs of the banking system by improving the payment system infrastructure and stimulating consolidation of the banking sector.
- Improving the services of the cadastre system.
- Implementing procedures for out-of-court mediation and for the resolution of small claims.

Notes

1 Unpublished IMF estimates from "Growth in the CIS-7: Recent Developments and Prospects" October 2003 an unpublished working paper by Elena Loukoianova.

2 The Early Warning System study surveys 150 primarily small businesses and focuses mainly on three areas: licensing, inspections, and construction permits. The aim is to provide a more accurate picture of market entry and quality of business environment.

INVESTMENT CLIMATE AT-A-GLANCE INDICATORS

	Moldova	CIS†	ECA Region
MACROECONOMIC			
GDP growth (annual %)	6.1	8.0	5.2
GDP per capita, PPP (current international $)	2,351	4,194	6,938
Foreign direct investment, net inflows (% of GDP)	9.9	3.4	4.1
Government expenditure, total (% of GDP)	26.9	20.7	37.0
Trade (% of GDP)	124.9	84.7	92.2
Inflation, GDP deflator (annual %)	11.9	19.3	16.9
FINANCING			
Domestic credit provided by banking sector (% of GDP)	27.5	16.6	32.6
Deposit interest rate (%)	20.9	15.2	12.9
Lending interest rate (%)	28.7	31.0	19.5
Real Interest Rate (%)	15.0	13.9	15.7
STOCK MARKETS			
Stocks traded, total value (% of GDP)	1.9	2.3	5.6
Stocks traded, turnover ratio (%)	97.9	22.0	4.0
Market capitalization of listed companies (% of GDP)	23.7	14.4	12.7
TAXES			
Highest marginal tax rate, corporate rate (%)	25	29.6	27.4
Highest marginal tax rate, individual rate (%)	25	30.8	34.5
Export duties (% of exports)	0.0	0.9	0.3
Import duties (% of imports)	1.4	2.2	3.0
BUSINESS REGULATIONS			
Number of procedures to start business*	11.0	12.1	11.6
Number of days to start business*	41.0	57.3	63.7
Cost to start business (in US$)*	123.2	316.4	560.3
Number of procedures to enforce contracts*	36	23.5	22.0
Number of days to enforce contracts*	210	171.0	337.9
INFRASTRUCTURE			
Electricity production (kwh) per capita	893	4,299	3,732
Internet hosts (per 10,000 people)	4.0	3.9	34.2
Internet users (as % of total population)	1.23	1.42	3.14
Mobile phones (per 1,000 people)	31.7	15.7	124.8
Roads, paved (% of total roads)	87.0	88.8	79.6
Telephone mainlines (per 1,000 people)	133.2	130.6	218.2
GOVERNANCE AND OVERALL REGULATORY QUALITY			
Index of economic freedom**	3.2	3.62	3.29
Government effectiveness***	–1.10	–0.55	–0.40

(Table continued on next page)

INVESTMENT CLIMATE AT-A-GLANCE INDICATORS—continued

Regulatory quality***	–1.11	–1.06	–0.38
Rule of law***	–0.42	–0.72	–0.23
Corruption***	–0.83	–0.82	–0.36
POPULATION, HEALTH, AND LABOR			
Population, total	4,272,519	281,551,144	476,557,605
Illiteracy rate, adult total (% of people ages 15 and above)	1.0	0.8	2.3
Life expectancy at birth, total (years)	67.8	68.8	70.8
Mortality rate, infant (per 1,000 live births)	18.4	18.1	14.8
Health, education, housing, social security and welfare (% of total expenditure and net lending)	47.4	42.1	62.6
Unemployment, total (% of total labor force)	11.1	8.9	2.9

SOURCE: All data are for 2000–01 and are drawn from the World Development Indicators Database, 2002, World Bank, unless otherwise noted.

NOTES:
**Data are from Doing Business Database, Private Sector Advisory Service, World Bank, 2002, http://rru.worldbank.org/DoingBusiness/default.aspx.*
***Data are from O'Driscoll, Gerald and Edwin J. Feulner, Mary Anastasia O'Grady, "2003 Index of Economic Freedom," Heritage Foundation, 2002, http://www.heritage.org/research/features/index/. Measures of economic freedom (or the absence of government coercion or constraint on the production, distribution, or consumption of goods and services beyond the extent necessary for citizens to protect and maintain liberty itself) based on the unweighted average of 10 categories (that are aggregates of 50 economic variables). Each factor is scored according to a grading scale that is unique for that factor. The scales run from 1 to 5 with a score of 1 signifying an institutional or consistent set of policies that are most conducive to economic freedom.*
****Data are from Kraay, Aart, Daniel Kaufmann, and Pablo Zoido-Lobatón, "Governance Matters II: Updated Indicators for 2000/01," World Bank, Policy Research Working Paper 2772, February 2002, http://www.worldbank.org/wbi/governance/govdata2001.htm. The governance indicators are measured in units ranging from about –2.5 to 2.5, with higher values corresponding to better governance outcomes.*
† The 12 countries of the Commonwealth of Independent States (CIS) are: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan.

This chapter describes the collapse of the Moldovan economy following its independence in 1991 and the subsequent recovery growth since 2000. It points to advances the government has made both through macroeconomic policy and structural reforms, as well as indicators that the reform agenda—particularly on the investment climate[1]—is far from finished. With the clear link between economic performance and poverty alleviation made by looking at trends in Moldova over the last ten years, a main challenge for Moldova to achieve further poverty reduction will be to realize significant improvement in its investment climate.

An Economy in Transition: The Collapse and Recovery of Moldova's Economy

The Republic of Moldova is a small landlocked country with a population of 4.3 million in the southeastern part of Europe. After gaining independence in 1991, it experienced a sharp economic decline. Real GDP fell continually between 1991 and 1999 (except in one year) (figure 1.1). The cumulative decline of the economy between 1990 and 2000 exceeded 60 percent, second only to Tajikistan among transition economies.

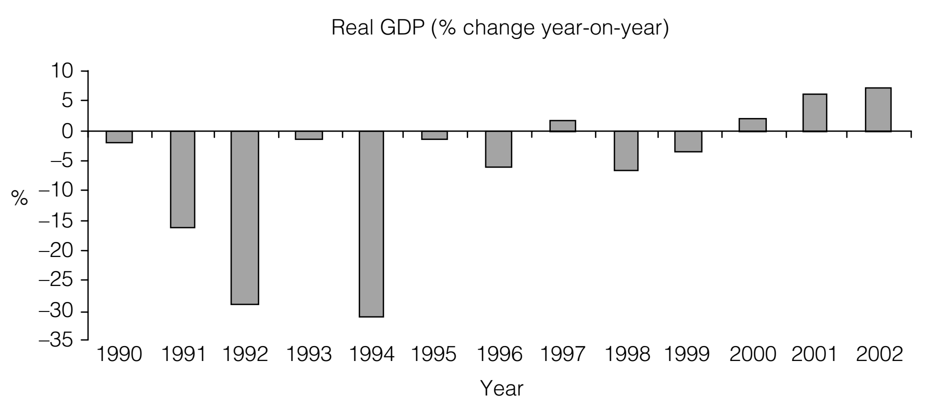
Terms of Trade Shock and Other Determinants of Initial Output Decline

An extremely high degree of external resource dependence, the disintegration of the country's trade, payment, and central planning system contributed to one of the largest contractions suffered by economies in transition.[2] A study by Tarr (1993) estimates a terms of trade shock of –16.1 percent of GDP, the worst among transition economies.[3] This effect was exacerbated by the secession of the Transnistrian region in 1991, following armed struggle.[4, 5] As the eastern bank of the Dniester River accounted for approximately 70 percent of industrial output in the pre-independence Moldavian S.S.R., the Moldovan economy emerged from the post-conflict era with a large agro-business sector. Agriculture now contributes about 20 percent of GDP and employs roughly half the population (table 1.1).

Some Progress on Macroeconomic Policy and Structural Reforms

Despite these adverse conditions, Moldova's success in achieving stable prices and embarking on structural reforms relatively early on in the transition is impressive. Inflation, approaching 2000 percent in 1992, was brought down to less than 30 percent by the be-

Figure 1.1 Real GDP (% change year-on-year)



Source: WDI, MET.

Table 1.1 Composition of GDP by Output (1995–2002), %

	GDP	Agriculture	Manufacturing industry	Services	Trade
1995	100	29	25	34	8
1996	100	27	23	37	8
1997	100	26	20	40	8
1998	100	26	17	42	10
1999	100	25	17	47	15
2000	100	25	16	46	13
2001	100	22	19	47	12
2002	100	21	19	47	12

Source: Moldovan Economic Trends 2002

ginning of 1995 and to 11 percent by 1997, when the economy grew for the first time since independence. During 1993–94 the Government of Moldova also initiated and deepened structural reforms including the development of a modern commercial banking system, the abolition of directed credit programs, and the preliminary elaboration of a regulatory and supervisory regime overseen by the autonomous National Bank of Moldova (NBM). The NBM was particularly important in establishing a stable national currency and tackling high inflation. In addition, the privatization of state enterprises—delayed by the Transnistrian conflict—moved ahead in 1994.

But significant internal political divisions within successive governments delayed the implementation of structural reforms conducive to improving the business climate and attracting investment to the economy. This lack of progress in structural reforms was accentuated in the aftermath of the Russian financial crisis. The devaluation of the ruble in 1998 presaged a major contraction in Moldovan exports to the Russian Federation—Moldova's major trading partner. GDP fell by 6.5 percent in 1998 and 3.4 percent in 1999, while the external debt to GDP ratio jumped to more than 100 percent.

Economic Recovery Since 2000

After this nine-year plunge, the Moldovan economy began to recover in 2000. Cumulative growth of more than 20 percent has been recorded since 2000. Economic recovery since 2000 can be attributed to higher import demand from Russia and workers' remittances as well as from the gradual improvement of the current account resulting from the depreciation of the Moldovan leu, progress on some needed structural reforms, and fiscal adjustments.

Improved macroeconomic conditions helped turn the economy around. The lack of foreign financing following the ruble crisis in the 1990s forced the Government to maintain a prudent fiscal stance and cut expenditures (the general government balance improved from –14.1 percent of GDP in 1997 to –0.5 percent in 2001). Both monetary and fiscal policies remained tight throughout 2000–02. Inflation was brought down to single digits, and the central government fiscal deficit was reduced to a sustainable level. Meanwhile, average lending rates fell from 35.5 percent in 1998 to 23.1 percent in 2002.

The legal and regulatory framework for encouraging private investment has also improved. The Law on Insolvency, Title 5 of the Fiscal Code (Tax Administration), the Law on Licensing, the Law on Financial Institutions, a new Civil Code, and other laws have passed over the past two years. But, as detailed in the chapters below, significant weaknesses in the investment climate remain.

Evidence of An Unfinished Agenda

Limited Export Diversification Points to Weak Competitiveness

During the 1990s the structure of the Moldovan economy underwent change similar to that in other CIS countries. The shares of agriculture and industry contracted, and services and the financial sectors expanded. Even so, agriculture and agro-processing continue to account for around 55 percent of export revenue.

Trade has diversified after the collapse of the Soviet Union, especially imports, but the CIS market continues to be an important destination for Moldovan exports (table 1.2). Why the lack of progress in export diversification? Historical patterns in Moldovan trade play a part. Also important are the slow progress in structural reforms and the lack of investment to acquire new technologies that would make Moldovan products competitive on European and other markets. The state still accounts for about 40 percent of economic output and retains control of key sectors, including telecommunications and energy. The lack of progress on the privatization of state assets has discouraged foreign investors and limited FDI inflows.

FDI Inflows Not Robust

Slow progress on structural reforms also explains why FDI has not advanced the economic recovery. The cumulative net FDI in Moldova stood at only $714 million at the end of 2002. About that time, there were 2,670 enterprises with foreign capital in Moldova, mainly wholesale and retail trade, processing industry, real estate, communications, and transportation. The main home countries of foreign investors have been Russia, the Netherlands, Germany, France, the United States, and Spain.

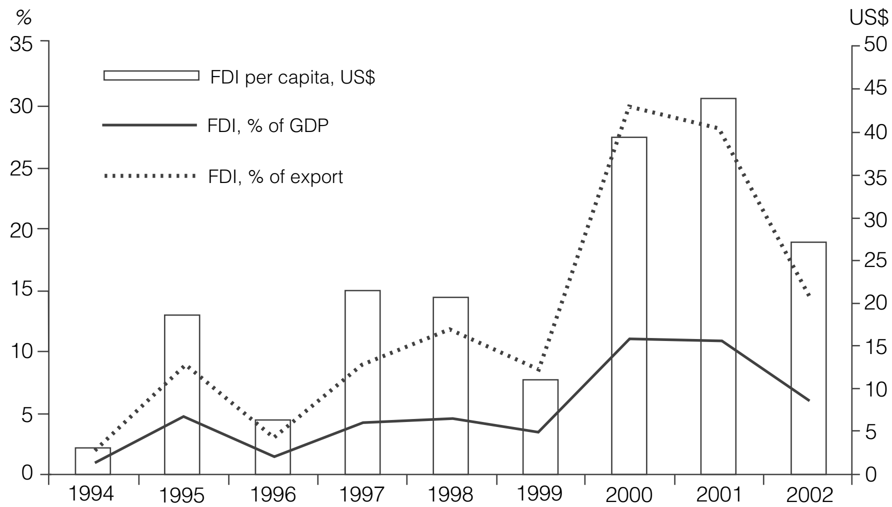
Moldova ranks higher than some of its neighbors in attracting new FDI in 2001 as a percentage of GDP. However, with the inflow of FDI increased significantly in 2000 with large-scale privatizations (figure 1.2), sustainability of these flows are questionable, and have indeed fallen in 2002, as privatization activity fell off.

Table 1.2 Exports and Imports (US$ millions)

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Export	**745.5**	**795.0**	**874.1**	**631.8**	**464.2**	**471.4**	**568.1**	**643.9**	**790.3**
To CIS countries, % of total	62.6	68.3	69.6	67.9	54.7	58.5	60.9	54.4	53.6
To rest of the world % of total	37.4	31.7	30.4	32.1	45.4	41.5	39.1	45.6	46.4
Import	**840.7**	**1072.3**	**1171.2**	**1023.6**	**586.7**	**776.6**	**892.7**	**1038.5**	**1402.7**
From CIS countries % of total	67.7	60.9	51.6	43.0	41.3	33.5	38.1	39.4	42.3
From rest of the world % of total	32.3	39.1	48.4	57.0	58.7	66.5	61.9	60.6	57.7
Balance	**–95.2**	**–277.3**	**–297.1**	**–391.8**	**–122.5**	**–305.2**	**–324.6**	**–394.6**	**–612.4**

Source: Departamentul Statistica si Sociologie a Republicii Moldova.

Figure 1.2 Foreign Direct Investments in Moldova



Source: Moldovan Economic Trends 2002.

Low Firm Productivity

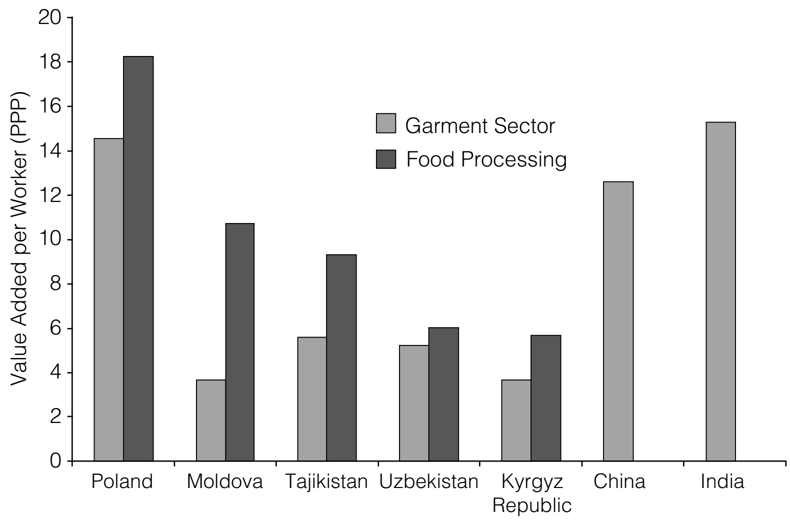
The recent economic growth in Moldova is still a recovery growth. Will it become sustainable?

The key to economic growth and poverty alleviation is productivity growth. Like all countries in the former Soviet Union (FSU), by the 1980s Moldova had exhausted its potential to improve economic efficiency. During the early years of transition for Moldova and FSU countries, market distortions, incomplete reforms and deteriorating capital stocks continued to drive productivity down. By the end of the 1990s productivity growth began to recover in most transition countries. According to the IMF estimates, total factor productivity (TFP) growth in the CIS-7 countries averaged 4 percent between 1998 and 2002, except for Moldova, where TFP growth was negative.[6]

Much of the GDP growth in the other CIS-7 countries was driven by increase in investments in export-oriented sectors, particularly FDI, which contributed directly to productivity improvements. In addition, there were gains from the re-deployment of resources to more productive uses. However, in Moldova growth continued to be consumption driven, capital formation stagnated and investment as a percentage of GDP fell from 19.4 percent of GDP in the 1994–1998 period to 16.8 percent in the 1999–2002. The slow pace of privatization and the fact that the government still retains control of vast swathes of the economy[7] have discouraged investors and reduced the competitive pressures that drive firms to innovate. Moldova's poor investment climate, has constrained the growth of productivity, sales and employment.[8]

To gain a better understanding of the link between the investment climate and firm productivity the Investment Climate Assessment (ICA) analyzed the results of a small survey of garments and food processing firms in Moldova and 6 other transition and developing countries. These two sectors were selected, because they represent important and growing sectors in the Moldovan economy and also allow international comparison.[9] The results show that Moldovan industry has not yet attained the productivity found in more advanced transition countries or in some of its main international competitors, which began reforms many years ago. But its productivity is above that in Central Asian countries and other transition countries that have been slower to reform and improve the investment climate (figure 1.3).

Figure 1.3 Median Value Added per Worker (US$ thousands) in the Garment and Food Sectors



Labor productivity in Moldovan garments and food processing falls between the high levels found in Poland, China, and India and the low levels in some Central Asian countries. Moldova has lower wages than Poland and other European countries, but they are not low enough to offset the low labor productivity. In value added over total labor costs, Moldova still lags behind China and India, but lower wages allow Moldovan labor to compare more favorably with Poland (table 1.3).

The analysis of total factor productivity (TFP), which investigates the contribution to output of capital, labor, and material inputs, accounting for differences in labor quality and adjusting for capacity use, reveals the pattern similar to what the partial factor productivity measures identify. Moldova falls midway between Poland, India, and China, which have higher efficiency, and the Central Asian countries, which have lower average TFP.

The assessment makes it clear that the poor investment climate is a major reason for Moldova's low productivity and lack of international competitiveness. A multivariate regression analysis of TFP for the five transition countries identified some key investment climate indicators in such areas as infrastructure, finance, and regulation, and demonstrates the investment climate importance in determining productivity.

- *Training and worker skills*. The regression analysis shows that firms which engage in worker training have higher productivity levels than those that do not. Moldovan firms fall in the middle. A higher proportion of Moldovan firms conduct formal training than Uzbek or Tajik firms, but a much lower one than Polish enterprises.

Table 1.3 Comparative Productivity Measures in Food and Garments

	Median Value Added over Labor Costs (thousands US$)	
	Garments	**Food**
India	3.43	NA
China	2.85	NA
Uzbekistan	2.72	2.96
Tajikistan	2.00	2.41
Moldova	1.91	2.40
Poland	1.83	2.39
Kyrgyz Republic	1.51	1.54

- *Exports*. Exporting is a key learning mechanism that enables enterprises to improve productivity. Enterprises must continually improve productivity to remain competitive on the world market. In the ICA sample, the regression results show that the percentage of a company's total sales that are exported is highly significant in explaining productivity. Even though the Moldovan sample had a high proportion of exporters, because the sectors chosen for productivity analysis are important export sectors, productivity still lags behind Poland's, again spotlighting the poor investment climate.
- *Foreign ownership*. Foreign investors bring new technologies and links to foreign markets, enabling enterprises to improve their productivity. The analysis here confirms that foreign ownership is a significant factor increasing productivity in the sample. The lack of FDI in Moldova is reflected in the low levels of productivity and points to the need to continue to improve the investment climate to attract more FDI.
- *Access to bank credit*. Higher productivity is significantly associated with the use of bank credit. Around 58 percent of the sample in Moldova had some form of bank credit, the same as in China but higher than in the Central Asian countries. Similarly, Moldova ranked in the middle, below Poland and above the Central Asian countries in the difficulty of obtaining bank loans.
- *Inspections*. Bureaucratic burden, red tape, and administrative barriers increase the cost of doing business and lower productivity. Inspections are one measure of bureaucratic burden and the analysis here shows that high levels of inspections are a significant factor reducing productivity. Inspections appear to be a large problem in Moldova, and the average days spent in government inspections is higher than in any other country except the Kyrgyz Republic.
- *Power*. Power outages are a proxy for all infrastructure needs and are highly significant in explaining productivity levels. The average number of hours without power in the last year was more than twice the figure in Poland but well below the figures reported in the Central Asian countries.

A simple heuristic exercise shows the power of the investment climate. How would productivity change if all the countries in the five-country sample had the same investment climate indicators as the best country, Poland? Each country is assumed to retain its own levels of foreign ownership, percentage of exports, and age distribution. But all countries are given the average levels of the investment climate indicators—including inspections, access to credit, and power outages—found in Poland. Under these assumptions, if Moldova had the same investment climate as Poland, its productivity would be 9 percent higher in food processing and garments. A significant one time increase given that these two sectors are already among the most productive in Moldova, suggesting that the productivity gains would be even greater in other spheres of economic activity.

Economic Growth and Poverty Alleviation Go Hand-in-Hand

Along with the economic collapse in the 1990s, the Moldovan people experienced a significant deterioration of living standards. The 1999 UNDP Human Development Index ranked Moldova 104th of 174 countries, the lowest position among CIS countries except Tajikistan. With the economic growth in recent years, the share of population below the absolute poverty line fell from 73.3 percent in 2000 to 48.3 percent in 2002.[10] But notably, the Gini coefficient deteriorated from 0.24 in 1987–1990 to 0.42 in 2000–2002.

The Government recognizes these important links between economic growth and poverty alleviation. The poverty reduction strategy of the Government emphasizes its commitment to poverty amelioration based on three pillars:

- Sustainable and inclusive economic growth that will provide the population with productive employment.
- Human development policies emphasizing greater access to basic services (especially primary medical services and primary education).
- Social protection policies targeting those most in need.

With a vibrant private sector the main source of productive and high-paying jobs, a healthy investment climate that encourages new firms to enter markets and existing businesses to invest productively and expand is thus central to the Government's poverty reduction strategy.

The firm level analysis above clearly demonstrates the importance of the investment climate in constraining Moldova's productivity and consequently limiting growth and advances on poverty alleviation. The next chapters spell out in detail the areas of the investment climate deserving special attention. Tanzi and Zee (2000) note that the best strategy for sustained productive investment has three parts. First is providing stable and transparent legal and regulatory frameworks. Second is having adequate supporting institutions and facilities. And third is putting in place a tax system in line with international norms. Against these three criteria, Moldova fares poorly.

Notes

1. Defined as: The policy, institutional, and behavioral environment, both present and expected, that influences how entrepreneurs perceive returns and risks associated with investment.
2. The price of energy increased 40-fold in 1992.
3. Tarr (1993).
4. The predominantly ethnic Russian and Ukrainian Transnistrian region broke away from Moldova in late 1991, fearing the possibility of Moldova's reunification with Romania.
5. The status of Transnistria remains uncertain. The "federalization" of Moldova has been proceeding slowly. Relations between Chisinau and Tiraspol deteriorated in 2001 when Moldova, after joining the World Trade Organization (WTO), changed its customs procedures to increase the security of transborder trade—prompting the Transnistrian authorities to institute a 20 percent excise tax on all goods entering the region from Moldova (the tax was recently raised to 100 percent). Meanwhile Transnistrian authorities responded to new requirements that Transnistrian businesses register with Moldovan authorities by introducing a 10 percent transport fee on goods delivered by vehicles not registered in Transnistria, thus complicating the transit of goods to Ukraine and Russia.
6. Unpublished IMF estimates from "Growth in the CIS-7: Recent Developments and Prospects" October 2003 an unpublished working paper by Elena Loukoianova.
7. Evidence from various firm-level surveys shows that the state is still present in all stages of enterprise activity. As a result, many businesses operate in the gray economy. Djankov and others (2002c) estimate that the informal sector accounts for 44 percent of GDP in Moldova (and 35 percent of employment), significantly more than in the advanced reformers of Central and Eastern Europe.
8. M. Hallward-Driemeier and others (2003).
9. The sample consisted of 100 privately owned firms in each country, split equally between sectors.
10. Draft Economic Growth and Poverty Reduction Strategy Paper, Government of Moldova, 2004.

Given Moldova's investment dynamics in the past decade and the results of Chapter 1's productivity analysis, a more comprehensive description of the investment climate and how it is perceived by the private sector is presented here. This analysis builds on the results of two recent business surveys: the second Business Environment and Enterprise Performance Survey[1] and the Cost of Doing Business surveys.[2]

Policy Uncertainty and Overburdening Regulations Among Top Concerns of Business

A map of the relative importance of 18 business constraints across eight types of Moldovan firms from BEEPs survey data indicates that macroeconomic policy instability, legal and regulatory burdens, corruption, and crime generally pose more serious constraints to business than do access to finance, labor costs, and infrastructure (annex 10). Policy uncertainty clearly leads the concerns of Moldovan enterprise managers (table 2.1). More than 80% of them are concerned with macroeconomic and microeconomic (regulatory) policy uncertainty. Tax rates, tax administration, and the cost of financing ranked next. Nearly 60 percent of firms identified corruption as a major or moderate constraint and, perhaps related to this, 58 percent identified business licensing and operating permits as constraining. Rounding out the top constraints are access to finance (collateral) and customs and trade regulation, each identified by roughly half the sample as moderate or major constraints.

Not surprisingly, there are differences by firm size. Both surveys reveal that in many important areas (taxes, tax administration, licensing and permits, regulatory policy uncertainty) the business perception of the regulatory burden and its dynamic among small enterprises is consistently above the Moldovan average. Small firms (with fewer than 100 employees) also report being somewhat more constrained than large firms the cost of and the access to financing.

Other noteworthy differences by firm-type are revealed in the BEEPs survey findings:

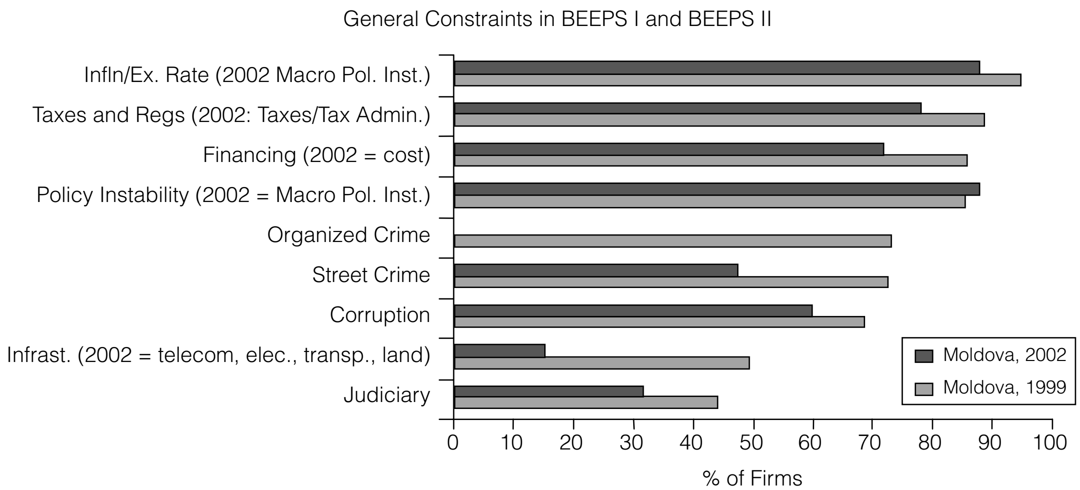
- Large firms find customs and trade regulations and worker skills substantially more constraining than do small ones.
- Foreign-invested firms find tax rates and tax administration especially daunting, identify customs and trade regulations as substantially more constraining than do domestically owned firms, and are disproportionately likely to identify corruption as a constraint.
- Domestically owned firms are more constrained by financing cost and access.
- Exporters are distinguished by their identification of customs and trade regulations as a constraint. They are almost twice as likely to identify it as a "major" or "moderate" constraint as are nonexporters. They also find taxes and tax administration more daunting and are more troubled by corruption.
- Nonexporters are far more constrained by access to financing. Firms operating below 75 percent capacity feel more constrained on a number of fronts than those operating at higher capacity, including macroeconomic instability, tax rates and administration, and customs and trade regulations.

There are also a few noteworthy trends. From the 2000–2001 BEEPS surveys, most notable is the dramatic decline in organized crime, and in infrastructure as a moderate or major constraint (figure 2.1).

The Cost of Doing Business—Highest Compliance Costs in the Region and Corruption a Problem

The excessive regulatory framework is incurring significant costs in doing business in Moldova.

Figure 2.1 Evolution of Constraints in Moldova, 1999–2002



Source: BEEPS I and II.

Table 2.1. Evaluation of General Constraints to Operation and Growth—Moldova and Comparators, 2002

(% of firms evaluating constraint as "moderate" or "major"—as opposed to "minor" or "no obstacle"

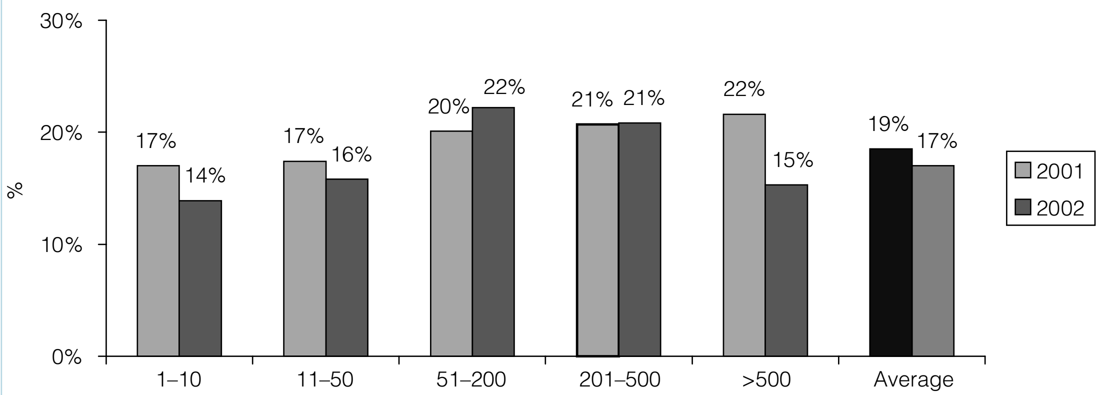
	Czech Republic	**Hungary**	**Moldova**	**Romania**	**Ukraine**	**Russia**
Macroeconomic instability (inflation, exchange rate)	52.96	43.55	**87.21**	83.00	68.87	57.49
Regulatory policy uncertainty	53.61	45.12	**84.88**	72.65	76.11	62.83
Tax rates	61.45	63.71	**81.61**	77.60	65.33	56.00
Tax administration	54.86	37.75	**73.99**	56.02	59.91	61.57
Cost of financing (interest rates)	53.28	45.16	**71.35**	65.20	53.99	43.39
Corruption	28.23	23.53	**59.26**	56.02	53.94	29.12
Business licensing and operating permits	34.12	19.92	**57.89**	43.90	39.86	31.85
Access to financing (collateral)	49.00	41.63	50.88	**55.02**	49.20	44.83
Customs and trade regulations	28.29	24.38	**50.00**	30.86	41.75	27.74
Crime, theft, and disorder	30.68	15.16	**46.95**	34.16	39.41	25.88
Anticompetitive or informal practices	50.99	42.34	41.82	**54.84**	39.09	36.83
Legal system and conflict resolution	27.16	13.22	31.55	**49.80**	34.55	26.62
Skills and education of available workers	35.36	**37.50**	23.53	31.20	31.45	32.24
Access to land	24.90	6.47	21.82	21.20	24.06	**25.00**
Transportation	14.72	10.84	17.92	**18.73**	9.47	12.00
Labor regulations	26.07	23.48	13.02	25.20	22.05	9.92
Electricity	11.32	6.40	11.49	**19.37**	14.19	10.22
Telecommunications	10.19	7.26	8.05	**15.02**	10.71	12.45

Source: BEEPS II Survey.

The two Cost of Doing Business surveys indicate that managers spent an average of 17 percent of their time in 2002 meeting regulatory requirements, down slightly from 19 percent in 2001 (figure 2.2). The report concludes that Moldova has the highest regulatory compliance costs in the region.

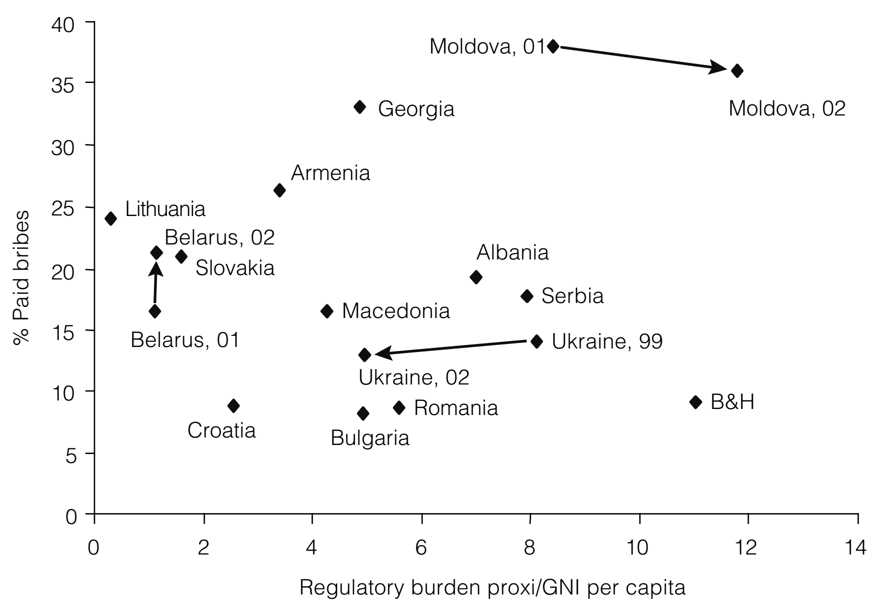
The results of the Early Warning System[3] off-shoot from the Cost of Doing Business complement this finding, show a noticeable deterioration of the business environment for small firms in Moldova over the last three years (figure 2.3). The main cause of this trend is the increased burden of inspections and overall regulatory compliance.

Figure 2.2 Share of Time Devoted to Meeting Regulatory Requirements by Firm Size, 2001 & 2002



Source: Doing Business II Survey.

Figure 2.3 Changes in Regulatory Burdens and Bribe Taking



Source: EWS Moldova Report 2002.

Policy Uncertainty: Selective Use of Regulations for Political and Economic Purposes

An investment climate entails not only policy and institutional dimensions, but also behavioral environment, both present and expected, formal and informal. From the investor's perspective, all aspects count. In Moldova regulations are increasingly being used for political and economic purposes (box 1), which in part may account for the dominant perception of the 80% of firms surveyed by BEEPs that identified policy uncertainty as a main or major constraint.

Information from the focus groups of the Doing Business Survey sheds light on the problem of arbitrary use of regulatory power and complements survey results.[4] The selective enforcement of the law for political purposes ranks high in Moldova. Clearly, the regulatory power of the state is being used today to meet political ends. Additionally, the power of the state is perceived as being used as a means of unfair competition. This is consistent with the broad per-

Box 1: Arbitrary Use of Regulatory Power Breeds Uncertainty

There are numerous recent examples of government interference into private business activities, violating contractual obligations and other agreements, selective application of regulations against international companies. They include cases of harassment of private companies and re-nationalization of others (Farmaco, Air Moldova, Hotel Dacia, Ciment, Foxtel, Megadat). In all cases there was reference made to a law or regulation allowing repossession of enterprises by the state or justifying breach of contract. None of the investors was compensated for the losses, even when required by the court.

The case of Union Fenosa, whose investment in Moldova was supported by the IFC, EBRD and guaranteed by the MIGA, has received most prominence. However, the lawsuit regarding the validity of the privatization deal has involved courts of all levels and has taken years to get resolved, which created lots of uncertainty, not only to Union Fenosa but to other existing and potential foreign and local investors. Despite substantial improvements in the quality of services by the Union Fenosa–owned distribution companies, including higher reliability of electricity supply (power cuts reduced from 4,710 hours per year prior to privatization to the most recent figure of 51 hours), the Department of Standards and Metrology of Moldova imposed a fine of $45.7 million, in a stronghand legal manner (suing the company the next day after imposition of the main fine on the grounds of nonpayment), claiming violations by Union Fenosa of the law on standards and the law on consumer protection. Subsequently, this decision was repelled by ANRE. There are many other smaller and less high profile companies that are receiving similar treatment to that of Union Fenosa.

Examples of discretionary use of licensing in telecommunications, air transportation and services and export of scrap metal are well-known. In the telecommunications sector, government has given license to a second cellular operator without a tender, has violated agreed upon periods of exclusivity, and has created situations of unfair advantage and competition by giving the fixed line state operator a cellular license at the fraction of cost that other operators had to pay. The government effectively bypasses the so-called independent regulators (ANRE and ANTRI) and imposes its decisions.

In other cases, vested interests are hindering competition in agriculture and scrap metals industry. All kinds of non-tariff barriers were created to prevent the export of sunflower seed and protect monopolistic interests of the processing enterprise (mandating various types of inspections, certificates, demanding multitude of documents, preventing access to railroad transportation, etc.). Such practices inflict heavy losses on farmers and discourage them from production and trade. In general such policies of the government destroy the investment climate for foreign and domestic investors.

ception, that those in control of the government use their power as an instrument to protect their interests and fight off competition. This may mean, for instance, fighting off or capturing emerging competing concerns. Arbitrary use of regulatory power is illustrated by the examples in the box below. Faced with these encroachments of rights and the selective implementation of the law, focus group participants felt unprotected by the courts, as courts can potentially also be used to pursue political or economic objectives.

In Chapter 2 this report analyzed enterprise perceptions regarding investment climate as a whole and its various determinants. The following chapters will review in detail administrative and legal constraints for business development, factor markets, and infrastructure services.

Notes

1. The Business Environment and Enterprise Performance Survey (BEEPS), developed jointly by the World Bank and the European Bank for Reconstruction and Development (EBRD), covered 4,000 firms across all sectors in 22 transition countries in late 1998 and early 1999. It examined a wide range of interactions between firms and the state. A second survey was completed in 2002.
2. A "Cost of Doing Business" survey was conducted in January 2003 on behalf of the World Bank to measure administrative and regulatory compliance costs in Moldova in 2002. This is the second such survey, the first having been conducted in January 2002. Similar studies were carried out in other countries of the region. The sample comprised 630 businesses in the City of Chisinau, nine districts of Moldova and Gagauz-Yeri. The survey focused on the following areas: registration, regulations on the use of premises, licensing, import-export procedures, certification and standardization, tax administration, inspections, pricing controls, labor regulations, contract execution, and the legal system. Agricultural enterprises and monopolists fell outside the survey's purview.
3. The Early Warning System study surveys 150 primarily small businesses and focuses mainly on three areas: licensing, inspections, and construction permits. The aim is to provide a more accurate picture of market entry and quality of business environment.
4. World Bank. 2003. The Quality of the Business Environment: Early Warning System—Europe and Central Asia. Private and Financial Sector Development Department of the Europe and Central Asia Region. Washington, D.C. Draft.

Looking at more quantitative indicators, and benchmarking them to neighboring countries and competitors, it becomes clear that administrative barriers are major constraints in the investment climate. Despite certain improvements, registering a new business is still cumbersome, and licensing remains one of the most restrictive among transition economies. Certifying compliance with standards is getting more time-consuming and costly, not less. The frequency of inspections increased, while duration and cost of inspections have come down, they still remain greater than in most neighboring countries. Smaller businesses may be finding things more complex, keeping them in the informal sector.

Another major constraint: customs and trade regulations. Two-thirds of Moldovan entrepreneurs believe the conditions for import transactions are getting worse, mainly because of the many documents required. Seen as particularly pernicious are preshipment inspections and customs clearances.

Paying bribes to get things done is pervasive, even more so for smaller firms. Moldovan businesses spend on average more than 2 percent of their revenues on side payments. Contract enforcement, worse than the average for transition countries, is another big problem. Of Moldovan businesses in commercial disputes, more than 80 percent used the courts—but a similar proportion saw unofficial dispute resolution as more efficient. The situation leaves them wary of dealings with firms they do not know well.

In broader terms, the business environment in Moldova continues to be restrictive, and a high degree of state interference in economic activity persists. The network of government bodies with control functions is complex, and their responsibilities are vaguely defined and oftentimes overlapping. Supervisory agencies retain the right to confiscate property, freeze bank accounts, and suspend business activities without administrative review. Indeed, the whole system of controlling bodies and their activities requires a comprehensive review and radical reform.

Given the constraints to business development that might emerge from an improper regulatory environment, this chapter focuses on the different aspects of the regulatory framework in Moldova.

Administrative Barriers—The Number One Problem

In competitive markets with no constraints to entry and exit, one would expect more efficient firms that produce at lower costs and exhibit higher productivity levels to either force less efficient firms to increase their competitiveness or drive them out of the market, raising aggregate productivity. But entry and exit constraints, such as cumbersome registration procedures, frequent inspections, and excessive licensing regulations, increase the operational costs of firms and prevent new firms from entering the market, thus limiting competition and removing the incentive of inefficient firms to become more productive.

Registering a New Business

In the past several years the Moldovan Government has made a significant effort to simplify business registration procedures. More important, the provisions of the new law on "State Registration of Enterprises and Organizations," passed in March 2001, brought about several favorable innovations to the registration process. First, according to the new law, the registration procedure is centralized in the State Chamber for Registration, part of the Department of Informational Technologies. Second, the new law clarifies the set of documents needed to register a business, reducing the number from between 7 and 13 to 5. Third, the business address of a business entity, according to the new law, is the one indicated in founding documents.

Starting in November 2002 new enterprises undergoing registration at the State Chamber for Registration receive a National Identification Number of a Legal Entity, which automatically becomes their fiscal code and is stored in the electronic Registry of Legal Entities. The information in the registry is then used by the fiscal and statistical bodies to issue fiscal and statistical codes, thus simplifying the registration procedure by requiring only a single submission of necessary documents by the entrepreneur at the State Chamber for Registration. Transition to the new system is envisaged to be gradual—enterprises registered before November 2002 are not required to reregister in accord with the new regulations. Instead they will receive a National Identification Number when they address the State Chamber for Registration to reregister or make changes to registration documents.

The impact has been mixed. While it took less time to renew registration for a business in 2002 than it did in 2001, both initial registration and subsequent changes to registration documents became more time-consuming. One explanation could be that the Cost of Doing Business survey uses three-year averages—1999–2001 and 2000–03—and may not reflect recent policy changes. Eighteen percent of respondents indicated that registration procedures became less complex, equal to the share of those who perceive registration to have become more constraining, showing that the policy for registration is evolving in the right direction.

Centralizing the registration activity at the State Chamber for Registration reduced “unofficial payments” from $119 in 2001 to $84 in 2002. A breakdown by size of firm, however, suggests that improvements in registration procedures are reported mostly by medium-size and large enterprises. Small businesses, especially individual enterprises, suggest an increase in registration complexity. This is alarming because individual and small enterprises probably present the best litmus test for the state of business environment. The centralization of the registration activities was accompanied by the elimination of intermediaries that provide services pertaining to the preparation of registration documents—a change likely to harm small enterprises that lack the in-house expertise in these matters.

Licensing

Over the years licensing in Moldova became a rather profitable activity for the state. At one point the number of licensed activities exceeded 300, while the list of licensed activities was subject to frequent change. But licensing activity changed significantly with the adoption of the Law No. 451-XV on “Licensing of Certain Types of Activities” in July 2001 and of the Ordinance No. 38-g on “Adoption of licensing conditions for certain types of activities” in September 2002. According to the new regulations the authority to grant licenses was transferred from the branch ministries to the newly founded Chamber of Licensing, and the number of activities requiring a license was reduced from 106 to 57.

These changes were good for businesses (table 3.1). In 2002 businesses required an average of 2.2 licenses, down from 3 in 2001. Obtaining one license required on average 22.4 days and $456 (28.6 days and $522 in 2001). And the validity of a license was extended from an average of 2.6 years in 2001 to 3.2 years in 2002.

Several caveats are in order, however. First, even with the recent changes in the licensing regulations, Moldovan businesses perceive to have the most restrictive licensing environment among transition economies. According to the BEEPS II survey, 57 percent of polled business owners identified “business licensing and operating permits” as a “major or moderate” constraint to business activity, making Moldova the only country where the figure exceeds 50 percent. Second, the lower average number of licenses per business in Moldova, in comparison with neighboring countries, is compensated by a much higher cost of licenses and

Table 3.1 Licensing Regimes in Moldova and Its Neighbors

	Georgia 2001	Ukraine 1999	Belarus 2001	Bulgaria 2002	Moldova 2001	Moldova 2002
Number of licenses per average business	0.9	1.6	5.5	5.5	3.0	2.2
Time to get one license, days	12	21.4	30	21.7	28.6	22.4
Average costs, US$	167	162	120	262.7	522	456
% paid unofficially	19	19	18.9	9.7	37.6	28.1
Amount paid unofficially, US$	157	140	66.7	189.2	62.4	154.1

Source: Cost of Doing Business II Survey.

higher incidence of unofficial payments. (With the new legislation in 2001–02, the cost of a license was doubled from MLD 900 to MLD 1,800). Third, despite the reduction in the number and cost of licenses, the broad proliferation of authorizations issued by line ministries imposes tremendous compliance burden.

Certification and Standardization: Costs on Business Rising and Implementation of Reform Sluggish

The Law on Standardization, the Law on Certification, and the Law on Technical Barriers to Trade regulate the standardization and certification activity. Certification and standardization functions are exercised by the Department of Standards and Metrology of Moldova (Moldova-Standard), responsible for the national policy and its enforcement. About 340 groups of goods and 38 types of processes and services are currently subject to certification. There are 2,630 active standards, including 203 developed in Moldova, 790 adaptations of EU and international standards, and such other interstate standards as the Euro-Asian Standardization Council (EASC)-GOST and Russia GOST-R standards.[1] According to the Cost of Doing Business II survey, about half the economic entities had to certify their goods and services, with larger entities subject to more certification. Import transactions were hit particularly hard. Of the respondents in the Cost of Doing Business II survey that were involved in import transactions during 2000–02, 66 percent of them had to obtain certificates confirming compliance of imports with Moldovan standards.

The costs of compliance to these regulations are high and increasing. Obtaining the certificates required 18.3 days, a four-day increase from 1999–2001. While official certification costs declined from $127 to $97, unofficial payments increased from $117 to $142. Equipment certification is another important area. More than 60 percent of surveyed businesses purchased equipment during 2000–02, 71 percent of which had to obtain a certificate confirming the equipment's compliance with Moldovan standards. Obtaining such a certificate required 21 days and $195 (an increase of 7 days and $60 from the survey in 2001). A breakdown of payments by type illustrates the point (table 3.2).

Table 3.2 Certification Costs

	Average payments for those who paid, US$	
	2001	2002
Official payments	75	94.5
Expert assessment fees	39.8	140.8
Notaries' fees	1.0	26.1
Lawyers' and intermediaries' fees	—	226
"Voluntary donations"	6.0	61.7
Unofficial payments	32.6	48.1
Total (excluding Lawyers' and intermediaries' fees)	154.4	371.2

Source: Cost of Doing Business II survey.

Some progress, albeit slow, has been made on the legal and regulatory framework, but reform is sluggish and incomplete. Several important amendments to the Law on Standardization in 2000 considerably advance Moldovan legislation in this area toward European standards. The new law provides for the transition of standardization process in Moldova from mandatory standards to voluntary standards and mandatory technical regulations by 2005 (the date was set initially for 2002, but postponed until 2005) and ensures supremacy of application of international and regional standards. This is important given Moldova's joining the WTO in 2001, which requires compliance with WTO regulations.

But there still seems to be a basic lack of understanding of the role of standards and technical regulations in a market economy.[2] The transition from mandatory standardization to voluntary standardization is proceeding at a slow pace, and the current share of mandatory standards is about 85 percent. There can be several reasons, beyond a lack of understanding, for this. The delineation of functions and responsibilities among the state bodies involved in this process is vague and overlapping. In particular, the fact that Moldova-Standard is responsible for both policy development and enforcement creates a conflict of interest, opening the way to corruption. Thus constant delays in the transition of the standardization system toward one based on voluntary standards may indicate that mandatory standard continues to be a prodigious source of rents for the state. There is evidence to support this view—according to the Cost of Business II survey, about 28 percent of those subject to mandatory certification made unofficial payments, more than in neighboring countries. Another reason for this slow transition is the lack of funding for upgrading laboratories and training staff, for translating international standards, and for establishing new structures. The 127 underwriting laboratories and 56 laboratories currently accredited in Moldova are under-funded and lack appropriate expertise and equipment.

Even more important is the fact that converting mandatory standards to voluntary ones will not have the desired results if the affected products remain on the official "List of Goods Subject to Compulsory Certification." This is just one example of the convoluted framework of the present regulatory system. With respect to this list, there are at least 17 statutory instruments, with 7 new ones in various stages of development, define standards and conformity assessment functions and relationships. This patchwork of laws, decrees, and orders has numerous conflicting practices and procedures, resulting in overlapping activities and duplication of testing. A pragmatic solution could be to waive requirements for compulsory certification on all exported products, leaving it to buyers and sellers to satisfy any conformity requirements in the importing country.[3] And the possibility of adopting directly other countries' technical regulations and standards should be explored more rigorously.

The beneficiaries of standardization should be mainly consumers and producers, but the system is set up for the benefit of government. The most recent example is the $45.5 million lawsuit filed by the Department of Metrology and Standardization against the Spanish company "Union Fenosa." While the reason behind the lawsuit is the reparation of damages to consumers, the amount would have been transferred to the budget, while Moldovan legislation provides only for direct compensation to consumers. The charges were eventually dropped, but the incident does not create a favorable image for attracting foreign investment to Moldova.

Inspections

The supervision and inspection of Moldovan commercial entities are complex, with more than 60 state bodies and their commercial outfits having the right to exercise control over the activity of economic entities. Throughout the 1990s the Government expanded its oversight of businesses by increasing the number of inspections and fines. Today, Moldova continues to compare unfavorably with neighboring countries (Table 3.3).

There are indications that the duration and cost of inspections have fallen in 2002, but the frequency of visits is increasing. According to the Cost of Doing Business survey the average total duration of inspections was halved in 2002 and stood at 48 days, while average costs also decreased. In 2002 Moldovan businesses were subject, on average, to 19.5 inspections a year (16.6 in 2001), with this increasing trend experienced by enterprises of all sizes. This trend was confirmed by the BEEPs survey in which over half the polled entrepreneurs, regardless of size, noted that the number of inspections to have increased in 2002, while fewer than 10 percent indicate that the number decreased.

On the policy reform front, the Government adopted the "Decree on coordination of supervisory and control activity," in February 2003, designating the Ministry of Economy as the general coordinator of the supervisory and control activity. Moreover, the Government requested that the Ministries of Economy and Finance develop the optimized structure and principle attributes of supervisory and control bodies. Later, following a round with Moldovan businessmen, the President stated that he would take small and medium-size business "under his protection" and demanded a unified system and schedule of controls of enterprises.

It is unclear whether this change of heart will lead to significant progress. One common view is that when additional revenue in the budget is needed, supervisory activity is relied on as a source of funds.

Corruption—Not Much Change

The Corruption Perception Index published by Transparency International in 2000 placed Moldova 75th (with a score of 2.6) in a group of 90 countries.[4] Since then, Moldova's score deteriorated to 2.4, making it 102nd of 133 countries (CPI 2003). The distorting impact of corruption on Moldovan economy is quite significant. In 2001 the shadow economy was estimated at 39 percent of GDP according to IMF figures, although others suggest that it could be as much as 65 percent. Tax evasion increased sevenfold and reached 30 percent of the consolidated budget. And 89 percent of the entrepreneurs in a Transparency International survey in Moldova indicated that they prefer paying bribes to evade taxation.[5]

Businesses in Moldova spend 2.1 percent of their revenues to "get things done," a figure similar to those for other CIS countries but higher than for Eastern Europe and the Baltics (in the Czech Republic managers pay 0.9 percent of revenues to "get things done," in Estonia 0.3 percent). The BEEPS II survey confirms these results: 59 percent of respondents consider corruption to be a "moderate or major" constraint to business activity (only Georgia has a higher figure, 66 percent). This perception is generally independent of the size or origin of firm or the direction of business activity. Moldova's strategy for socio-

Table 3.3 Inspections in Different Countries

	Moldova 2002	**Moldova 2001**	**Bulgaria**	**Ukraine**
Average number of inspections per business	19.5	16.6	14.2	15.7
Duration of inspections, days per year	48	93	12	24
Fines paid annually, US$	1,280	1,418	892	1,214

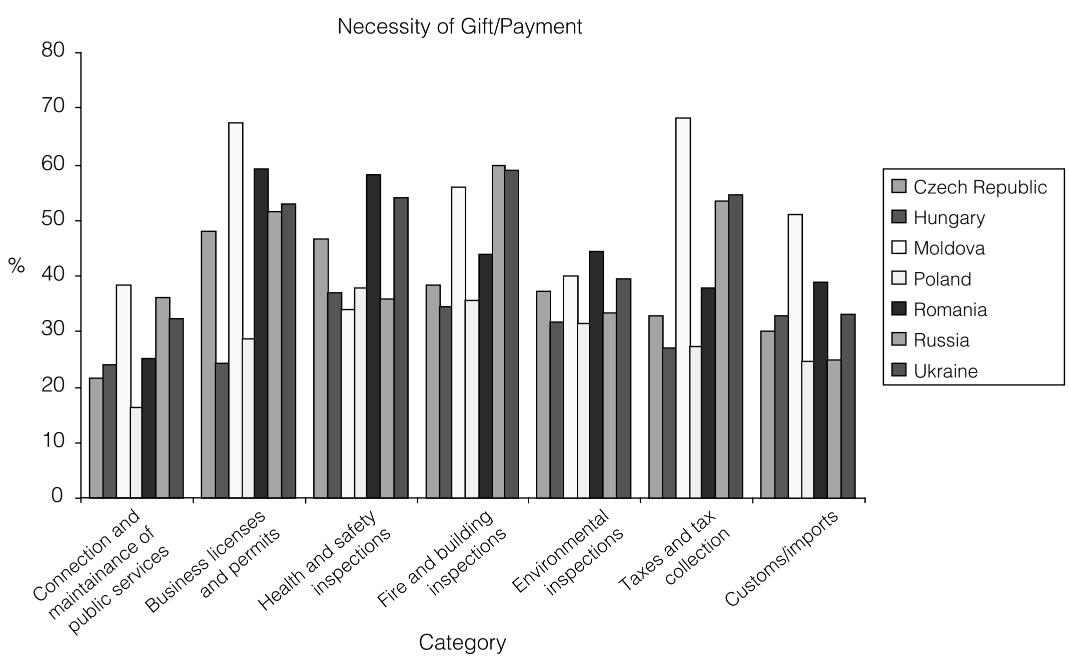
Source: Cost of Doing Business II survey.

economic development recognizes that corruption and criminality have reached alarming proportions. Recently the Government founded the Center for Combating Economic Crimes and Corruption, to unify three control bodies: the Financial Guard, the Department of Revision and Control, and the Economic Police. At the end of 2002 the Government adopted the "National Program for Combating Criminality and Corruption" for 2003–2005.

The Center can be viewed as a positive development in the sense that it will unite previously separate control bodies and give a clearer structure to the control activity in the country. But the Government continues to regard tighter control as the main tool of tax collection and tax policing. Under conditions of widespread corruption and low pay of government employees, tighter control has prompted significant flight from the formal economy. Ratings by enterprises place Moldova among the most governance-constrained countries in the region. Moldova ranks third worst, after Romania and Ukraine, for the expense of bribes. Petty corruption appears to be more common in Moldova than in many other countries in the region. Moldovan firms report the highest incidence of informal payments among the comparator countries for many interactions with government (figure 3.1 and annex 11). Bribery associated with government contracts and legislation, however, is not reported to be especially high.

Small firms pay a higher proportion of annual revenues in bribes than medium-size and large firms, which exerts a negative effect on growth in this sector and in the economy (annex 12). Domestic firms estimate the cost of illicit payments to be far higher than do foreign-invested ones, and are substantially more likely to have paid "under the table" for some services, such as a telephone connection, obtaining permits, or dealing with health, safety, or environmental inspections. Foreign-invested firms are far more likely to report payments associated with obtaining government contracts (as are exporters). There is also a significant discrepancy between the constraining effect of ad-

Figure 3.1 Taking Bribes in Seven Countries



Source: BEEPS II. Survey.

ministrative corruption on private and state-owned enterprises, with private entrepreneurs having to pay a higher percentage of their revenues in bribes, undermining their competitiveness.[6]

Taxation—Reasonable Income Rates, High VAT and Unreasonable Administration

Since tax rates and the fiscal regulatory environment figure greatly into investment decisions by businesses, designing an appropriate strategy in this area has clear benefits for both the state and the private sector. For the public sector, the trend is not promising. Total fiscal revenues of the general government from taxation fell from 30 percent of GDP in 1997 to about 23 percent in 2003.[7] While still better than the average rate of 17–18 percent of GDP in developing countries during 1985–1997—it is half the share of tax revenues in the OECD countries.[8] Some progress has been made on reforming the tax structure. In 1998 a new Fiscal Code changed Moldova's taxation system by reducing budget dependence on indirect taxes and expanding the tax base. However, to reverse this trend of declining tax revenue as a share of GDP, fiscal policy reform would need to be more comprehensive, examining tax rates and structure, tax administration capacity, and incentives (both fiscal and regulatory) for firms to operate in the informal economy.

Tax Rates

Almost 90 percent of the surveyed businesses considered the level of taxation as a major or moderate constraint, the highest percentage in the group, with foreign-invested businesses having a particularly negative attitude toward taxation levels. While income and corporate taxation levels in Moldova are moderate, comparable to those in other emerging markets, only two of some 30 developing countries have a higher VAT than Moldova.[9]

The high VAT is contributing to Moldova having the highest rates of unreported sales in the CIS and Central and Eastern Europe alongside Georgia, Kyrgyz Republic, and Tajikistan, according to BEEPS II findings. More important, Moldova is falling behind compared to its neighbors. Unreported sales remained unchanged at about 20 percent of total sales since 1999, while the situation improved considerably in many other countries in the region.

Tax Administration and Policy Uncertainty—Where the Problems Reside

From the firm perspective, the leading concern of Moldovan firms regarding taxes is tax policy uncertainty (table 2.1) The Cost of Doing Business survey indicates the concern regarding tax policy uncertainty, with respondents citing highly unstable legislation and the practice of reviewing certain taxes annually, on the occasion of state budget discussions. At times tax regulations are applied retroactively. In addition, the Moldovan approach to tax violations is highly "predatory," excessively penalizing minor violations, regardless of their nature

Administration of tax policy is another, related issue, with almost 40 percent of the businesses surveyed in BEEPS II—more than in most other peer countries—considering tax administration in Moldova a major constraint to their activities. In terms of number of taxes firms are obliged to pay the Cost of Doing Business survey reports that in 2002, all types of businesses paid on average 9 different taxes in 2002 and registered limited liability firms paid on average 6 different taxes.

Price Controls and Competition Policy—Prices Not a Major Problem, But Export Restrictions Hurt

Moldovan competition policy derives from the Law "On Protection of Consumers" (No. 1453-XII from

25/05/1993), the Law "On Restriction of Monopolistic Activity and Development of Competition" (No. 906-XII from 29/01/1992), and the Government Decree "On Measures of State Coordination and Regulation of Prices (Tariffs)" (No. 547 from 04/08/1995). The pricing regime has been liberalized, but several goods and services remain subject to price controls, including electricity, heating, telecommunications services, land, transportation, and medical services. A number of "socially important" goods are sold with a maximum commercial markup of 20 percent, including canned food for children, sunflower oil, dairy products, butter, flower, bread, drugs, and others.

State interference, though limited, does exist. Recent examples include interference in the grain market in 2001 through provision restrictions on bakeries, and the initiative of regulating pricing on the basis of a law in 2001, when the Parliament was considering a draft of the "Law on Prices," which elicited significant reservations from the World Bank and the IMF.[10] A recent initiative to restrict exports of sunflower seeds was aimed at protecting the interests of local sunflower processing companies

Even with these constraints, price controls are not perceived by businesses as considerably constraining their operations. According to the Cost of Doing Business survey, about 70 percent of respondents do not perceive the state to be influencing prices. Those who do report state interference in price-setting, emphasize such mechanisms as ceilings on retail prices, restrictions on profitability, and minimum retail prices.

The business environment does appear to be competitive. According to the BEEPS II survey 84 percent of firms report at least four competitors, and 76 percent have four or more suppliers. Sixteen percent of respondents see anticompetitive and informal practices as a "major" constraint on business activity, similar to other CEE and CIS countries.

The Legal Environment

Contract Enforcement and the Workings of the Commercial Court System

Efficiency of the courts is what matters most in ensuring that business contracts are properly structured, that firms are not hesitant to deal with new clients for a fear of being cheated (knowing that in a case of client nonperformance courts will efficiently resolve the dispute), and that trade flourishes in the formal sector not the gray market. With an inefficient court system firms many of the advantages of a competitive market environment are lost.

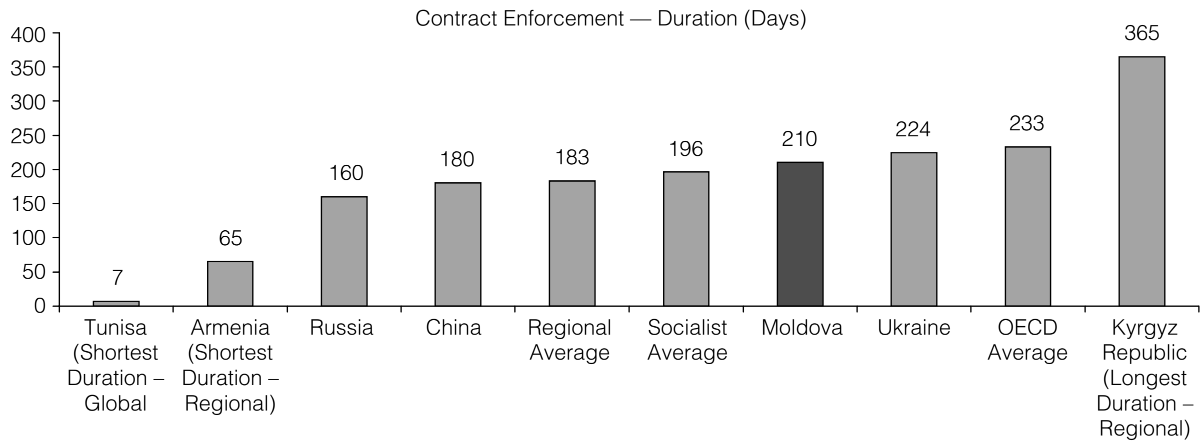
Commercial disputes and contract enforcement are handled by the economic courts for Chisinau District and the Moldova Republic. The Cost of Doing Business survey found that, during 2001–02, 86 percent of the Moldovan businesses involved in commercial disputes used courts. Of these, the majority (60 percent) considered the courts to be efficient conflict resolution venues. The procedural complexity of contract enforcement not out of line by the region's standards. According to the Doing Business survey, Moldova—with a score of 53 out of 100 (100 is the most complex)—is just below the regional and socialist averages, but lower than the scores for Czech Republic, Croatia, Austria, France, and Germany.

In most cases, the courts may issue adjudications within 6–8 months of the start of the procedure—about a month longer than the region's average (figure 3.2).

Other important issues related to formal contract enforcement and performance of the economic courts are judges being overburdened with cases and lacking the competency to resolve market-based commercial transaction disputes.

Compared to commercial courts, unofficial dispute resolutions, which are mostly used in the sectors of the economy where the legal culture is still relatively

Figure 3.2 Duration of Contract Enforcement



Source: Doing Business Database, World Bank.

weak, such as in farming and small enterprise, are cheaper and are viewed as more efficient by firms surveyed. Eighty-two percent of BEEPs surveyed firms view unofficial dispute resolution methods as more efficient. Another incentive is cost. According to the Doing Business Survey, the cost of dispute resolution is considerably lower in Moldova compared to both the regional average and the average in countries with a socialist legal system.

Other sources corroborate these findings. According to the BEEPs survey, corruption—mainly, the perceived need for side-payments to judges for a favorable judgment—and long delays were the two top reasons for avoiding courts in the resolution of disputes. The problem of corruption as key reason for the low credibility of judicial institutions and the legal profession was also a key finding of the World Bank initial review undertaken in preparation for a full-fledged Judicial Sector Assessment. The review found the manipulation of the courts to be fairly prevalent, as personal relationships with state and political officials can be decisive for a dispute's outcome. Systemic flaws that create incentives and opportunities for corruption include inadequate compensation for judicial staff, the absence of accountability mechanisms, political influence over the judiciary, and low legal awareness by the public. There is a lack of transparency in the process of selection, dismissal, and discipline of judges, causing a public perception that the selection and appointment of judges are political rather than meritorious. The political autonomy of the judiciary is compromised by existing rules and regulations.[11] The lack of formal procedural regulations at all levels of the justice system leads to highly uneven enforcement of laws and standards. Public bailiffs services receive little new investment and are poorly functioning—and the bailiffs themselves have little accountability and supervision. A formal system of private bailiffs could be a solution. In summary, the legal system requires significant improvements, such as paying higher salaries to judges and eliminating political interference, before it can be the basis for the rule of law in Moldova.

Commercial Law—Good on Paper But Weak Implementation

Over the last few years Moldova managed to put in place a comprehensive legislative base, for the transition to a market economy. The EBRD legal transition indicator for Moldova in 2002 for both commercial and financial legislation "extensiveness" was "4-," the highest score for the CIS countries and on par with the Eastern European states and the Baltics. But the implementation of legislation has generally been lagging behind.

The main pillar of this legislative framework is the Constitution, adopted in 1994. It states that Moldova is a market economy in which the state ensures the inviolability of investments by physical and juridical entities, including those from abroad.[12] Then in June 2002, after several years of preparation and public discussions, the Moldovan Parliament adopted a new Civil Code replacing a 40-year-old Soviet Civil Code. The new code, effective in July 2003, is broadly in line with commercial statutes in market economies, especially in property rights, contracts, and secured transactions. The implementation rules and procedures, particularly those for commercial transactions, have yet to be issued.

The pledge registry in Moldova is based in the Ministry of Justice. Its performance has improved since the central register was transformed in 2000 from a manual entry system operated by notaries to computerized registration in the ministry. The performance appears to be satisfactory as the system allows fairly quick and affordable registration of pledges. Around 13,000 pledges were registered from May 2002 to May 2003. Even with these developments, access to the pledge database should be improved by upgrading the technical parameters of the central register to support faster access by more users. Only about a third of notaries and a third of banks now have direct access to the register. Lack of funding is the main bottleneck.

The main piece of legislation regulating investment activity in Moldova is the Law on Foreign Investments, adopted in 1992. Though detailed and comprehensive, the law contains deficiencies and ambiguities on the repatriation of investment proceeds, the protection from changes in legislation that adversely affect foreign investors, and the suspension of activity of enterprises with foreign investments. So the Ministry of Economy drafted a new law on "Investment and Entrepreneurial Activity," which is pending examination by the Parliament. Comments by the OECD and IFC indicate that the draft law hasn't addressed the deficiencies and has to be amended to achieve its objectives.

Company Insolvency—Average, But Could Be Better

The *Doing Business* study suggests that Moldova's insolvency system is not significantly different from the systems in the peer group countries (regional and socialist) as regards to duration and cost of bankruptcy. It takes 2.8 years and 8 percent of a bankrupt estate to resolve a typical bankruptcy case (annex 13). Secured creditors, as in most peer group countries, get paid after the court and administrator fees are deducted but before all other creditors, including workers and tax authorities. However, Moldova trails behind most peer countries and regional and socialist averages in the Goals-of-Insolvency Index, mostly on account of the failure to achieve efficient outcomes through the insolvency process (annex 14).[13]

Moldova's Parliament approved a new Insolvency Law in November 2001, consistent with the World Bank and IMF's technical assistance recommendations. The EBRD Legal Indicator Survey[14] lauded the new law as a marked improvement over the previous insolvency regime (Moldova scored only 44 points on a 100-point scale in the EBRD survey of lawyers on the effectiveness of local bankruptcy laws in 2000, prior to adopting the new law). The new legislation combines reorganization as well as bankruptcy and liquidation procedures into one law and establishes uniform bankruptcy and reorganization procedures for commercial enterprises. Focusing on the role of the administrator during the bankruptcy proceedings, it establishes how the relevant creditor groups are organized and how they operate. The law also transferred responsibility for appointing bank liquidators and monitoring progress of the liquidation process to the courts.

Practitioners say that the law is not perfect because it combines provisions from foreign insolvency laws that are not always consistent. Even so, the number of insolvency cases brought to the courts increased visibly with the new law. As of May 2003, the number of outstanding cases was around 150, almost all of them liquidations (mostly initiated by the tax inspectorate).

The law is also seen to contain a conflict between its liquidation and reorganization provisions, which come from different time periods and are not fully compatible. This makes the law difficult to implement, for bankruptcy trustees in particular. Various interpretations of the provisions by the economic court judges are common. To reduce the inconsistencies, the Ministry of Finance proposed changes to the law, under initial preparation in May 2003.

Customs and Trade Regulation—Another Constraint

Given the small domestic market, and thus the importance of exports and imports for the Moldovan economy, the regulatory framework for customs and trade affects many economic entities. The surveys of Moldovan entrepreneurs reveal that compliance with customs and trade regulations, despite recent improvements, remains cumbersome and costly, imposing a significant constraint on business activity (table 3.4).

The Moldovan current account was liberalized in the early years of transition, and quotas and other export restrictions were eliminated as early as 1994. Moldova signed a trade and cooperation agreement with the European Union and received MFN status from the United States in 1992. MFN treaties were also signed with other 13 countries. Moldova was one of the first CIS states to join the WTO in 2001. Moldova's maximum tariff rate is 15 percent,[15] while the trade-weighted average is just above 4 percent. The IMF's trade restrictiveness index for Moldova is 1, indicating a highly liberal trade regime (the average for early transition economies and the Baltics is 1.9 and –4.2 for the former Soviet Union).

Both foreign and domestic businesses voice concerns about trade regulations. Moldova is one of three countries (with Albania and Belarus), where more than 25 percent of managers polled by the BEEPS II survey indicate that "customs and trade regulations" constitute a "major" constraint to operation. Border procedures and streamlined processing are being addressed by the Trade and Transport Facilitation in Southeast Europe (TTFSE) project supported by the World Bank and the U.S. Government.

A new Customs Code was passed in 2000, but legislation is subject to frequent changes, creating uncertainty. Another troubling trend is the increasing fiscal role of the customs service. The State Budget expects to receive 51 percent of government revenue from customs activity.[16]

Entrepreneurs' perceptions of import regulations remain negative, with 68 percent of respondents indicating that conditions related to import transactions became worse in 2002. This discontent is mainly attributed to the many documents required for customs clearance, complex certification procedures, and frequent changes in regulations. Preshipment inspec-

Table 3.4 Average Costs and Time Spent (per Transaction) on Compliance with Customs Procedures (US$)

	2001	**2002**
Days	4.1	1.7
Official payments (except for customs duties)	72	102
Penalties (including confiscations)	94	47
Other payments (unofficial)	63	35
Idle time losses	123	67

Source: Cost of Doing Business survey.

tions were at the core of the negative perception of the import regime in 2002.

Preshipment Inspections

Preshipment inspections of certain imported products were introduced in the fall of 2000 to protect the local consumer and increase tax revenues from foreign trade. This measure came about because of the large discrepancies in the export statistics of Moldova's trading partners and Moldovan import data—and the large quantity of low quality products on the internal market. But following severe opposition from business,[17] the Government's ordinance for preshipment inspections was abrogated by Parliament in December of the same year. At the insistence of the IMF, they were reinstated in 2001. After a short period in 2002, they were declared unconstitutional by the Constitutional Court of Moldova.

Exports and VAT Rebates

The time required to obtain export permits increased by 40 percent in 2002, delaying and complicating export transactions, although the cost of these procedures declined. More than half the survey respondents saw a deterioration in procedures and conditions related to export transactions in 2002, and 64 percent suggest that the situation is worse than three years ago. Among the main reasons: problems with VAT rebates and administrative interference in export operations.

Exporters are eligible for refunds on the VAT tax paid on exported products, and the refund procedure should not exceed 45 days. In reality the procedure is extremely cumbersome and lengthy, and only a few taxpayers can receive the VAT refund without documents establishing compliance with the Fiscal Code. For the rest of the exporters the VAT refund procedure entails a compulsory control and can last far more than the 45 days. The average period from request to receipt is 112 days.

A few issues require the authorities' attention:

- If an exporter does not make payment to a supplier during the reporting period (say, if the exporter has a term credit), the VAT from the transaction cannot be included in the reimbursement calculations for that period. But when the actual payment takes place, tax inspection treats it as belonging to a previous reporting period and does not accept it for reimbursement. Effectively, exporters forfeit VAT reimbursement in transactions extending over two or more reporting periods.
- Cash payments to suppliers, fairly common in the farming sector, are not eligible for VAT reimbursement.
- The state treasury, due to the lack of liquid funds, encourages offsetting transactions, either between itself and the exporters, or with the involvement of a third party that owes taxes to the treasury. An exporter uses its reimbursable VAT credit to cover outstanding taxes of the third party in return for a payment, frequently discounted, by the third party.

Nontariff Restrictions

As a WTO member, Moldova is committed to a free trade regime and cannot apply nontariff trade restrictions. But recent restrictions on exports of sunflower seeds indicate otherwise. As of March 2003 exports of sunflower seeds were allowed only on registration of the contract on the Commodity Exchange.

As of December of 2002, moreover, exporters were required to submit copies of the documents submitted to customs certified by a notary. Even though the decision was annulled in April 2003 by the Ordinance on "Elimination of Barriers to Export of Goods", exporters were still required to submit notarized copies in addition to the original documents until the new Ordinance was officially published.

At least on paper the Government understands that cumbersome customs procedures are a significant constraint on business operations. The recent Government Ordinance 478 regarding "The Elimination of Barriers to Export of Goods" states that "Ministries and Departments are forbidden to apply any restrictions through departmental normative acts, requests of documents in addition to those listed in normative acts regulating foreign trade, as well as setting indicative export prices or other measures that would complicate export transactions of domestic economic entities."

Prompt execution of the ordinance is necessary and long overdue. Most important, the process of customs clearance should be significantly simplified—mainly by reducing the number of examined documents and not having the same document examined twice or more times by different institutions. Problems with VAT rebates, as outlined above, should be resolved to make the VAT restitution procedure more efficient.

Real Estate and Construction

Two important additions to the existing legal framework were Chapter VI on "Real Estate" in the Fiscal Code, approved in 2000, and the "Law on Valuation of Real Estate," passed in 2002. These provide for the unification of taxes on land and real estate into a single tax based on the market value of real estate, not the previously used (and oftentimes significantly lower) normative value. The Civil Code and a range of other legal acts regulate the use of premises. According to current legislation, premises for businesses activity can be secured through lease, acquisition, or construction.

Obtaining construction permits is expensive and time-consuming—on average it took 171 days and $1,082 in 2002 (141 days and $764 in 2001), (table 3.5). Obtaining permits continues to be a complex undertaking, requiring a long list of various authoriza-

Table 3.5 Average Costs and Duration of Procedures for the Use of Premises

	Duration in days		Cost in US$	
	2001	2002	2001	2002
Construction	141	171	764	1082
Renovation and reconstruction	32	53	313	876
Change of use	47	70.7	557	927
Premises remained unchanged	13	16	72	206

Source: Cost of Doing Business survey.

tions by at least 15 state bodies, making it especially susceptible to corruption. This is confirmed by the fact that 43 percent of businesses surveyed in 2002 reported unofficial payments averaging $370 ($178 in 2001). According to the Cost of Doing Business survey only 13 percent of respondents have built their own business premises, but all of them had to obtain permits for the use of premises, even when premises remained unchanged.

These procedures registered substantial increases in official and unofficial payments for obtaining permits. Particularly alarming is the share of businesses paying bribes—at least 40 percent and in some cases more than 50 percent. Significant benefits can thus be secured by simplifying the procedures for the use of premises and by making them more transparent.

Notes

1. Standards and Conformity Assessment, World Bank.
2. IMF Article IV Consultation and Trade Diagnostic Study, 2003.
3. ibid.
4. The Corruption Perception Index is measured on a 1–10 scale: higher scores indicate less corruption.
5. "Борьба с коррупцией как национальная идея" *Logos Press,* No. 9 (409), March 16, 2001.

6. Frankauser and others (2003).
7. IMF data
8. See Tanzi and Zee, "Tax Policy for Emerging Markets—Developing Countries" (2000).
9. ibid.
10. The Government of Moldova tried to revive the discussion of the draft "Law on Prices" several times, most recently in February 2004, asking the Bank and IMF to comment on it. Reservations of the Bank and IMF regarding the antimarket nature of this law remained unchanged.
11. The Minister of Justice and the Prosecutor General are able to appoint and dismiss judges, with considerable discretion. Moreover, these same officials can initiate and enforce disciplinary actions against judges.
12. Constitution of RM, Art. 126.
13. The index calculates efficiency of the insolvency system in reaching goals of insolvency, and is constructed based on the duration and cost of bankruptcy, priority of claims for secured creditors, and the efficient outcome achieved by bankruptcy process (either foreclosure or liquidation with sale of a going concern, or successful rehabilitation which brings new management).
14. The survey was a part of the European Restructuring and Insolvency Guide 2002–03.
15. Exceptions include tariffs of 20 percent on fresh and refrigerated tomatoes (from May 1st to October 31st), 25 percent on certain wines, and 20 percent on rice and corn flour. In an agreement with the IMF the Government pledged to eliminate these deviations by July 2003.
16. Moldova Trade Diagnostic Study Concept Paper, World Bank, 2003.
17. Entrepreneurs polled in the Cost of Doing Business II survey viewed preshipment inspections, together with customs clearance problems, as the most serious difficulties in import transactions.

The workforce is well educated and wages are low, two pluses for investment. Yet the labor market is depressed. The workweek is short, at about 28 hours. And with the entry barriers for small businesses, Moldovan workers either stay in the informal sector or seek work abroad. About 300,000 Moldovans, a quarter of the labor force, are working or seeking work outside the country.

For finance, delays in the development of the technical infrastructure for payments, banking sector inefficiencies and excessive regulations are reflected in high interest margins and intermediation costs. Lack of financial products and services diversification, banking skills and adequate lending policies prevent banks from servicing private sector needs efficiently. As a result, businesses are reluctant to borrow, and they rely predominantly on their own funds. There are few other options available due to underdevelopment of alternative forms of financing. Access to finance has not improved since 1998, negatively affecting productivity of enterprises.

For land, Moldova has a sound cadastre and registration system, and the real estate market is getting stronger. But cadastre mapping needs to be upgraded in most areas, and the legal environment needs to be strengthened, especially for the licensing of notaries, valuers, surveyors, and realtors.

Labor

With the transition reforms correcting the distortions in the economy's structure, the liberalization process should reallocate labor resources from import-competing industries to the export sector, resulting in export growth and overall economic growth. But labor market rigidities raise obstacles to their reallocation and are often cited as one of the reasons behind unfavorable investment conditions and poor economic performance. These rigidities are important for Moldova, since the comparatively low wages combined with a well educated labor force create favorable conditions for investment.

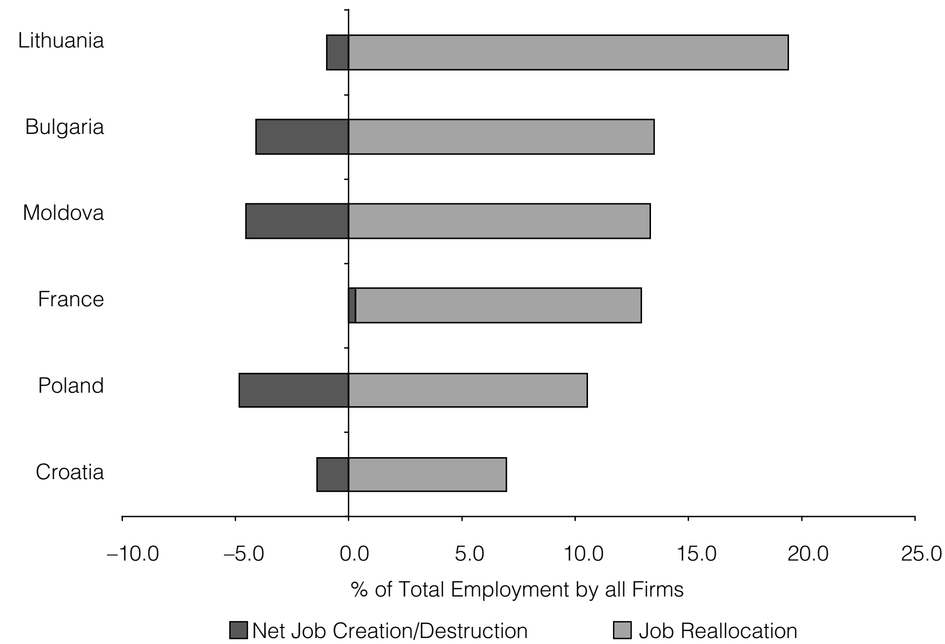
Employment

The official rate of unemployment, now about 2 percent, was low throughout the 1990s, despite significant changes to the structure of the economy. The International Labour Organization estimate of about 7 percent (end of 2002) is more accurate but probably still below the true rate. The employment rate of 41.4 percent in 2002, from the Department of Statistics, reinforces the findings of a poverty assessment of the Moldovan job market: Low unemployment masks a depressed labor market, in which underemployment and nonregular employment persist. Moldova's workweek is approximately 28 hours (compared with 42 hours in Poland), and 9 percent of workers have been forced to take unpaid leave.[1] This also explains the fact the labor market in Moldova clears quickly: Firms report that it takes one to two weeks to fill any type of position.

The Cost of Doing Business survey reports that 80 percent of respondents state that they have optimal staffing levels (60 percent in 2001). The largest percentage of enterprises claiming staff overhangs is among joint stock companies (20.5 percent in 2002 and 54 percent in 2001). Joint stock companies also represent the majority of the surveyed companies to hold social assets.

Large firms were more likely to have too many workers and are primarily associated with the job destruction process, while major new jobs contributors are micro and small enterprises. One of the reasons is that it is more difficult for larger firms to avoid compliance with labor regulations. Job reallocation in Moldova is comparable to its neighbors, but job destruction proceeds faster than job creation (figure 4.1).[2] Weak job creation[3] indicates that there are entry barriers for small businesses. The slow process of

Figure 4.1 Jobs Are Being Destroyed in Moldova



Source: Rutkowski, "Job and Firm Dynamics in Moldova" (2003)

creating new jobs in the economy also helps explain the fact that about 300,000 Moldovan citizens (a quarter of the labor force) are currently outside Moldova, either employed or seeking employment. That is the official figure; the true figure could be almost twice that.

Labor Regulations

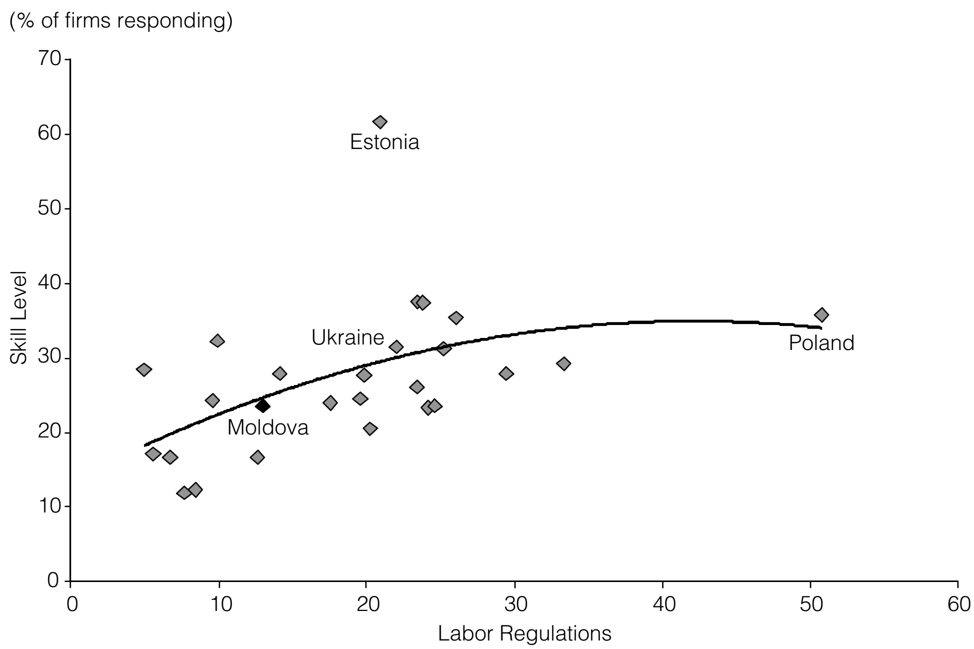
The current regulations on labor issues reflect the norms of Moldova's neighbors and some legal concepts of the Western European Labor Codes. More than 60 laws and government decrees influence labor regulations in Moldova.[4] Foreign investors in Moldova face a complex system of laws and decrees that control every aspect of labor relations, including employee rights, work hours and remuneration, training, pension benefits, management, dispute resolution, and collective and individual collective agreements.

Dismissing employees appears to be particularly difficult. Excessive rules on compensation make the right to lay off a person rather expensive. To avoid issues of hiring and firing, foreign investors often hire contractual employees. In addition, many firms operate in a gray area without paying social contributions for their employees and neglecting labor safety standards. This makes it very difficult for a firm that produces according to all standards to offer products at competitive prices.

In March 2003 the Parliament approved a new Labor Code, effective in October 2003. The new code should help streamline and clarify a variety of aspects of labor relations. The draft code envisions a simplified mechanism of labor litigation and the introduction of an individual written contract as the basis for employment.

Despite the restrictive and complex character of current labor regulations, only 13 percent of respondents in the BEEPS II survey regard them to be a major or moderate obstacle to operation, suggesting poor enforcement. Indeed, businesses in Moldova

Figure 4.2 Firms in Moldova Worry Less about Labor Regulations than Do Those in Neighboring Countries.



Source: Doing Business Indicators database, WB.

are much less concerned about labor regulations than those in most other transition economies (figure 4.2)

Workforce Education

The workforce in Moldova appears to be generally well educated, as it is elsewhere in Eastern Europe. The share of the workforce with more than 12 years of education is lower than in Ukraine and Russia but higher than in several other countries (table 4.1).

A medium-size firm reports that almost 57 percent of its workers have at least some secondary education. More than 34 percent had some higher education, and 10 percent are university graduates. In addition, larger firms employ a greater share of university graduates. Few workers have only primary schooling, a substantially higher level than in many less developed countries. However, according to the national statistics the level of education has deteriorated significantly in the last decade.

Table 4.1 An Educated Workforce

	Moldova	**Ukraine**	**Hungary**	**Czech Republic**	**Romania**	**Russia**
Share of workforce, < 6 years schooling	9.5	25.6	3.0	9.5	4.3	19.0
Share of workforce, > 12 years schooling	43.3	56.7	37.0	29.3	30.9	44.1
Share of firms offering formal training	42.5	51.1	52.0	67.1	43.3	54.6
Share of skilled workers receiving training	32.9	41.4	58.4	73.6	36.2	41.0

Source: BEEPS II Survey.

With an educated workforce, demand for training, particularly for workers in low skilled positions, is limited. Only about 9 percent of firms reported the lack of skilled workers as a major constraint, and 43 percent of firms report doing any kind of training. Professionals have the highest rate of training with 33 percent of the sample providing some training to professionals. Fewer than 2 percent of the firms train unskilled workers, and only about 4 percent train support workers.

Finance

Despite decisive improvements in financial intermediation in the years following the crisis of 1998, access to finance in Moldova is constrained by weaknesses in the technical, legal, and regulatory infrastructure supporting intermediation. The main factors affecting access to finance:

- High intermediation costs and interest margins.
- Lack of long-term bank financing.
- Legal and regulatory restrictions on transactions and lending denominated in foreign currencies.
- Deficiencies in the framework for bankruptcy, property, and creditor rights, increasing transaction costs.

Other important factors affecting access to finance are the underdevelopment or lack of alternative forms of financing other than bank lending, the incapacity of banks to effectively and efficiently serve the needs of the private sector, and delays in the development of the technical infrastructure for payments. Bank lending in Moldova is still largely based on collateral rather than the cash generation capacity of businesses. The banking sector is concentrated, and most banks lack basic banking skills and a developed product base. The nonbank, capital market, and insurance sectors are embryonic.

Access to Financing

When asked how easy it would be to obtain a short-term working capital loan at commercial rates, 27 percent of the respondents said “very easy” or “fairly easy.” For long-term loans the story was different: 73 percent of the sample said it would be “fairly difficult,” “very difficult,” or “impossible,” and 14 percent said it would be impossible to get a long-term loan at a commercial rate.

Moldovan firms do perceive themselves to be credit constrained, but their difficulty in accessing credit is similar to other transition economies. Long-term bank lending remains limited, with few companies being able to obtain loans with terms longer than 12 months. Nominal and real interest rates and collateral requirements are also high.

Moldova performs above average in the use of international accounting standards - almost 82 percent of the sampled firms use them, and some 46 percent of the respondents had external auditors. This should allow banks and other potential lenders to more easily assess credit worthiness.

The median debt to asset ratio of the full sample is a mere 9 percent, lower than any other country in the BEEPS II sample. It has shown little change since 1998, suggesting that firms are not becoming more leveraged and that access to affordable finance has not improved (fewer than half the firms provided information on the debt to asset ratio).

Roughly 15 percent of the firms reported any borrowing denominated in foreign currency, bringing the average level of foreign denominated liabilities down to 8.4 percent. But for these firms the mean amount of total borrowing denominated in a foreign currency is 56 percent. For the six firms that report 100 percent of their borrowing to be in foreign-denominated currency, the median interest rate is 18.5 percent, the collateral ratio is 122 percent, and the median term is 18 months. It appears that borrowing in a foreign currency is only slightly cheaper but on longer terms.

Trade credit, a major source of external credit in many countries, does not seem well developed. Moldovan firms in the survey reported that on average 3–5 percent of their working capital needs were provided by trade credit. Almost half the firms do not extend credit, and most demand prepayment for at least some of their sales.

The Banking Sector

The financial system is largely dominated by the banking sector, which represents almost 36 percent of GDP in terms of total assets, and by two nonbank financial institutions providing small lending and banking services in the rural areas. The two-tier system, created in 1993, comprises the National Bank of Moldova (NBM) and 16 commercial banks. The commercial banks have a small network of 33 branches in the capital city and 120 throughout the country. The banks have 125 representative offices and 438 agencies. The banking sector is mostly privately owned, with only one state-owned bank.[5] There are few banks with foreign participation, most of which are from neighboring countries. International financial institutions are also present in the capital of five of the operating banks in the country.

The financial condition of the banking sector is improving after the shake-up of the Russian crisis. As of end-2002, the sector looks sound and liquid, with liquid assets of 28 percent of total banking sector assets. During these last three years, the banking sector has also been experiencing a surprising boom in intermediation. From end-2000 to end-2002, for example, the credit portfolio of banks increased by 94.5 percent and the deposit base by 105 percent. Savings mobilization in Moldova has also been increasing sharply, with bank deposits increasing from 16 percent of GDP to 23 percent between 2000 and 2002.

The banking sector, however, remains concentrated, underdeveloped, and less than efficient. Five large banks account for 71 percent of total banking sector assets and 74 percent of total banking sector deposits. Banks are also characterized by a low degree of sophistication, particularly the smaller banks. Lack of product diversification, poor banking skills, and inadequate lending and crediting policies are de facto limiting the efficient development of new banking services. The costs of these inefficiencies are eventually transferred to the private sector as high interest margins and transaction costs.[6]

There are distortions in the structure and functioning of the Moldovan banking and financial sector that may contribute to these shortcomings, in particular:

- Operating costs are high owing to restrictive monetary policies with reserve requirements excessively high and only Lei denominated, and weaknesses in the payment system as banks must hold large liquid resources due to netting and clearing on a gross basis and at the end of each business day.
- Difficulties in expanding customer and product base are exacerbated by a number of factors. Banks are not allowed to pay wages and salary or lend to exporters in foreign currency. Banks are not active in providing letters of credit because Moldova's trading partners do not trust domestic guarantees and require advance cash payments.[7] And banks face difficulties in developing leasing, since leasing is subject to full up-front VAT.
- Crediting is still based on the value of the collateral and not on the cashflow-generating capacity of borrowers.[8]
- Delays in the full implementation of the Law on Pledges (2001) and in the development of the Special Information System for collateral registration affect bank lending and increase transaction costs.
- Court procedures are lengthy and enforcement of decisions inefficient, making the recovery of collateral and the enforcement of property and creditor rights difficult.

As a result of all this, businesses are reluctant to borrow from banks. The BEEPS II survey showed that 69 percent of the interviewed enterprises use their own funds to finance their investment and working capital needs, affecting the productivity of enterprises, especially smaller ones, which need more accessible financing to upgrade equipment and finance the production cycle.

Nonbank Financial Markets

Nonbank financial markets are still too small to contribute significantly to private sector development. Nonbank credit is available through Micro Enterprise Credit (MEC) and the Savings and Credit Associations (SCAs). MEC was established in 1999 with the support of the Western NIS Enterprise Fund, the DOEN Foundation, the EBRD, and the IFC. MEC makes available loans from $100 to $50,000 in lei, indexed to the dollar and euro. MEC has so far disbursed more than $4.2 million, with 55 percent going to microentrepreneurs. Most of these loans were for trading activities, services, and small home improvements. MEC is expanding fast, with one office in Chisinau and seven regional offices. The portfolio was expected to grow to $6.3 million by the end of 2003.

SCAs were established before the breakup of the Soviet system and reorganized under the Rural Finance Corporation, created in 1997. The network of SCAs channels donor funding through a network of 483 units. SCAs can extend loans up to $250,000 for maturities that range from one month to 15 years. The SCAs system requires collateral of 130 percent for all maturities and amounts, and sometimes minimum contribution by the borrowers. The SCA system has performed relatively well throughout these years. By 2002 the SCAs had extended loans to almost 52,000 clients totaling about $8 million, with 96 percent of the loans having terms less than 12 months. They still depend on donor and government funding, with savings limited to $600,000.

The Stock Exchange of Moldova (SEM), a self-regulating authority, organizes the primary market for securities and stock trading in the country. It opened in 1995 and is now an active member of the European-Asian Stock Exchange Federation. The SEM organizes the trading floor, which is fully automated, and the National Securities Depository. As of the end of 2002, 1,452 companies were listed with a total capitalization of $440 million.

There are 50 insurance companies operating in Moldova, of which only one has foreign participation. At end-2000, the sector's revenues were $16 million. Insurance companies in Moldova provide services in the life, liability, and health segments. There are no insurance companies providing coverage for agriculture crops and natural disasters. The sector is supervised by the State Inspection for Insurance and Non-State Pension Funds under the Ministry of Finance. Licensing, though, is granted by the Ministry of Justice.

The leasing industry is not yet developed. There are 22 small leasing companies in the country, most of them engaged in leasing motor vehicles for households. Weaknesses in the legal framework and tax regime are the main constraints to leasing in Moldova.

Land

The Land Code states that private and state ownership of land are allowed in Moldova and that equal protection is provided to both by the state. Most of the relevant land legislation is in place or pending.

Land Privatization

Land privatization started slowly in the early years of transition but accelerated significantly after 1997, within the framework of the "Pamant" (land) program. The land reform envisaged a transfer of 1.5 million hectares of agricultural land to about 1.2 million people based on equal shares. On completion of the "Pamant" program 701,000 hectares of land were distributed to more than 500,000 people. Another 741,000 hectares were transferred (mostly leased out) by their title holders.

The land reform achieved its objectives, but it also led to excessive parceling, with small, often disparate plots. That led in turn to recent efforts by the Government to consolidate parcels viewed by some as attempts of recollectivization. The draft of the new Land Code that the Government was working on in 2001 was written in the spirit of land consolidation. But the donor community did not accept the draft, due to disagreements over land expropriation and minimum lease periods. The alternative Law on Amendments to the Land Code,[9] adopted in 2002, is supposed to stimulate consolidation, which can be undertaken only at the initiative of land owners.

The privatization of industrial land has moved at a much slower pace. The Government Decision No. 562 on "Regulation on Sale and Purchase of Land Associated with Privatized Objects and Objects Subject to Privatization," adopted in 1996, established a fairly straightforward procedure of industrial land privatization. But the process has been progressing slowly because the normative price of land, calculated for land sales, was extremely high.

Real Estate Market

Moldova has a sound modern cadastre and land registration system, supported by local databases and information systems, developed in 39 cadastral offices that register titles and provide legal security to owners and relevant public information about real estate. Fixed and common boundaries are provided by law and work well. An indemnity fund provides compensation to owners who may have suffered damages from loss of documents or clerical errors by the land registry authorities. Both cadastral mapping and land registration are administered by a single authority, the State Agency of Land Relations and Cadastre.

The number of registered real estate transactions almost doubled between 2000 and 2001, increased by about 18 percent in 2002, and began to level off in 2003. Another positive development is the increase in the number of mortgages. Registered mortgages almost doubled between 2000 and 2001, and increased by about 30 percent in 2002, reaching a cumulative number of 25,600 transactions as of March 2003.

Even though the progress in the land market development in recent years has been significant, much remains to be done at this point. Cadastre mapping needs to be upgraded in most areas. And the legal framework needs to be properly completed. The real estate professionals, notaries, valuers, surveyors, and realtors are operating well but in an unstable legal environment especially for licensing. Also the 39 cadastre offices, including the Chisinau Territorial Cadastre Office and its three branches, are facing serious challenges to their financial sustainability.

Notes

1. Jan Rutkowski, "Firm and Job Dynamics in Moldova: Findings of the Poverty Assessment Study," World Bank, June 2003.
2. Jan Rutkowski, "Firms, Jobs, and Employment in Moldova," 2003 (Draft).
3. Sum of employment gains in expanding firms less the sum of employment losses in contracting firms as a percent of total employment of all firms in the economy.
4. FIAS: "Moldova—A Diagnostic Review of the Environment for Foreign Investment in Moldova," 1999.
5. Banca de Economii is the only state-owned bank in the country. Its assets represent about 7 percent of total banking sector assets.
6. At end-2002, interest margins of banks fell slightly to 6.7 percent in lei and 8.6 percent in foreign cur-

rency, despite the improved macroeconomic and monetary conditions.

7. The EBRD, for example, has two LC guarantee lines with local commercial banks for about US$ 4 million only and not fully disbursed.
8. Banks in Moldova require collaterals for up to 140 percent of loan (BEEPS II and other sources).
9. Law Nr. 1006-XV from 25/04/2002 (Monitorul Oficial N 71-73 from 06/06/2002)

Moldovan firms—no matter which way they are categorized—generally do not see infrastructure as a major constraint, and indeed the proportion of firms seeing it as a minor (or no) constraint was 85 percent in 2002. In each type of infrastructure, there is room to improve services:

- *Telecommunications services* have been expanding and improving. Though fixed lines can be unreliable, most companies surveyed said they had no days without telephone service. There is ample room to improve Internet services, as penetration is fairly low and its is not being used much as a business tool. Only 38 percent of companies in the sample reported using e-mail regularly, and less than 30 percent regularly used the Internet to deal with customers and suppliers. This is the lowest of any of the comparator countries. The low use reflects an underdeveloped telecommunications system and suggests that firms in Moldova face higher transaction costs in finding suppliers, customers, and expert advice. Small firms are much less likely to use Internet services than large firms.
- *Transportation services* are fairly well developed, but the road and rail infrastructure has been poorly maintained, with few additions to accommodate changing patterns of commerce and trade.
- *Electricity services* have also improved in recent years, with the privatized distribution companies cutting power outages from nearly 5,000 hours a year to 50. The BEEPS survey reveals that firms perceive these benefits, with only 11 percent of the surveyed enterprises described the sector as a moderate or major constraint to their activities, compared to 50% of firms surveyed in 1999. This latest survey result is about the same as the Czech Republic, Ukraine, and Russia, with small and non-exporting companies in Moldova having a somewhat more negative view than large and exporting ones. But, as in telecom, there is room to improve. The electricity sector's infrastructure is deteriorating, and as a result power outages are more frequent in Moldova than in its comparators. Reforms have to be pushed through to get the sector on a sound footing.
- *Water services* seems to be a bigger problem. The average number of days without water is reported at 30, though the median was only 1.5 days.

Telecommunications

Moldova's telecommunications network consists of MoldTelecom, a state-owned fixed-line monopoly, two mobile phone companies,[1] and around 40 Internet service providers. Internet telephony is also provided to some extent (though there are some uncertainties over the legality of the service). Telecommunications services overall have been improving and expanding, but there is still lack of full reliability in the fixed-line service.

The BEEPS survey shows that businesses do not consider telecommunications to be a major barrier to their activities—fewer than 5 percent of respondents ranked it as a "major" problem. According to the survey, it takes about eight days to obtain a fixed-line telephone connection,[2] faster than in Russia, Ukraine, but slower than in Romania and most other CEE economies. Mobile telephony still has room to develop among business users—77 percent of the surveyed companies in Moldova use mobile phones, compared with 96–97 percent in Hungary and the Czech Republic. Moldovan businesses also lag considerably behind the comparators (Russia, Ukraine, Romania, and other CEE countries) in e-mail and Internet use at work.

Fixed-line telecommunications infrastructure is being upgraded, but its penetration is still low. In 2002, there were about 20 fixed lines per 100 inhabitants, up from about 13 in 2000 and 15 in 2001. Three-quarters of the users are in urban areas, while many rural areas have no fixed-line access. Recently, MoldTelecom has invested in the modernization of the telecommunication network, by wiring the whole country with a fiber optic network that connects the major urban centers and provides uplinks to Romania and Ukraine. The Government has attempted twice to privatize MoldTelecom unsuccessfully. In 1997 a bid by OTE, a Greek operator, fell through. In 2002, a bid from MGTS, a Moscow-based operator was initially accepted but later rejected due to low levels of the offered price and future investments. No new date has been set for another privatization attempt.

Moldova's telecommunication services face developmental issues that will need to be addressed to make the services a helpful tool for business. Two issues that stand out are the fitness and independence of the national telecommunications regulator, NARTI, and related issues of intrasector competitiveness, and the readiness for e-commerce. On the first issue, the authorities have to ensure that the NARTI can take independent and unbiased decisions to promote sector development. On e-commerce, there is no explicit legal recognition of digital signatures or electronic contracts in Moldova. To be legally recognized, a contract must be in printed form, with manual signatures, and approved by a notary. Nor is there protection of private digital data. Addressing these and related issues would surely contribute to the growth of commerce and would bring onshore many functions currently performed and paid for offshore, such as digital certification, financial and credit functions, and Web hosting.

Transportation

Transportation services in Moldova are fairly well developed. But the road and rail infrastructure in Moldova has been poorly maintained, and reform of the transport management and financing has been slow. The poor quality of transport infrastructure impedes the mobility of goods and people—and the expansion of trade.

Although Moldova had 87 percent of its roads paved in 1999, higher than ECA country average of 74 percent, only 30 percent of the network was in good or fair condition, with 70 percent poor or extremely poor. Automobile, bus, and truck transport carries most local cargo and 85 percent of all passengers. Road freight is characterized by an oversupply of service providers and increasing competition. The quality of road freight needs to improve by renewing the fleets and implementing modern principles and technologies for logistics management. Railways, though less important in domestic haulage, carry 95 percent of transborder shipments.

There are three local airlines in Moldova—two private and one state-owned. Russian, Romanian, Turkish, and Austrian airlines fly to Moldova. Chisinau has connections with some 30 foreign cities, while the airlines have code-sharing agreements with 25 foreign airlines. Passenger-handling capacity of the Chisinau airport will be tripled by 2010, to about 600,000 passengers. But there is a lack of daily connections to major European airports. Recent developments in the Moldovan air transport industry have reduced competition and increased the role of the state (see box 5.1)

Energy

Moldova, poorly endowed with energy resources, imports almost all of its primary energy (around 98 percent). Gas, imported from Russia, is the main fuel for local electricity generation and district heating. Power plants on the right bank of the Nistru river include only three combined heat-and-power plants, covering about 20 percent of electricity consumption of that part of the country. The rest of the electricity is imported from Ukraine and Transnistria, and to less ex-

Box 5.1

Government actions are reducing competition in air transport. Unistar-Ventures GmbH, the foreign partner of Air Moldova, the 51 percent state-owned company, withdrew its participation after the state infringed the company's by-laws.[3] Furthermore, a private Moldovan airline that operated the route to Frankfurt was denied a renewal of its license, and the license was passed with no competitive bidding to the state-owned company. Cirrus Airlines, a German company affiliated with Lufthansa, introduced its own Frankfurt–Chisinau route, yet was refused landing rights on one of its introductory charter flights on this route and was forced to land in Romania. As a result, there is no direct connection between Moldova and Germany. These developments appear detrimental to the investment climate for air transport and for the entire private sector.

tent from Romania. Electricity tariffs are among the highest in the former Soviet Union. There is potential for hydropower in Moldova, but that will require substantial rehabilitation of 17 small hydropower stations.

In 1997, Moldova established an independent energy regulatory agency and in the late 1990s adopted new gas and electricity laws, creating a modern, market-oriented legal and regulatory framework for the energy sector. Under this new framework, the energy sector is undergoing privatization and structural reforms:

Gas: The majority of shares in the industry has been sold to Gazprom of Russia (a equity-for-debt arrears deal to cancel large debts of the Moldovan gas utility to Gazprom). The Government intends to sell the remaining 35 percent of shares to a strategic investor. Electricity: The power sector, previously a vertically integrated electricity monopoly, is now organized into five distribution and three generation companies, as well as a dispatch and transmission company. Electricity distribution and generation companies have been offered for sale, and a wholesale competitive electricity market is being established. Three of the distribution companies[4] in Chisinau and the central and southern regions of Moldova, covering about 70 percent of the market, were bought in 2000 by Union Fenosa Internacional of Spain (UFISA). The company is a subsidiary of Union Electrica Fenosa S.A., a major private Spanish utility with electricity distribution experience in emerging markets.

District Heating: The district heating sector, now organized into two state-owned companies, is being reorganized into smaller, municipally-based companies.

Electricity: Restructuring has led to some tangible improvement in services, particularly in the electricity distribution. The distribution companies owned by Union Fenosa alone were able to cut power outages from 4,710 hours per year before privatization to around 51 hours more recently. However, the energy sector remains plagued by obsolete and physically deteriorated equipment, high commercial losses in electricity distribution, mostly a result of theft, and defunct or bankrupt municipal district heating companies with inefficient and expensive systems. The sector will remain burdened by legacy debts. And vested interests are fiercely resisting the reform agenda, with particular pressure on Union Fenosa.

Water

Since independence in 1991, water systems have deteriorated and are difficult to operate. Service standards have dropped significantly, and service is often intermittent. The water quality in small cities and rural areas is very poor. The water and wastewater network is in dismal condition, and 50–80 percent of the pipes need replacement.

Water and sewerage services are provided through Apa Canals in small and medium-size cities. The majority of Apa Canals are generally in a perpetual financial crisis as a result of low collections, low tariffs, and high water losses. The largest defaulters in monetary terms are public institutions and enterprises, in particular district heating companies that are the main suppliers of heat and hot water and among the largest consumers of water. Because many customers are in arrears on their bills, it is impossible for the Apa Canals to pay their own bills. As a result, many Apa Canals are in arrears to suppliers, contractors, government agencies (including VAT payments), and electricity suppliers.

The large cross-subsidies from industries to domestic consumers are gradually being phased out, but since tariffs for public institutional and commercial enterprises are up to 10 times the average tariff for domestic consumers, this can only be done gradually. The Apa Canals are moving closer to end the cross-subsidy between industry and domestic customers. With gradually increased hours of service per day and with extended and more precise metering, individual Apa Canals will also gain more reliable consumption and billing data which will make it possible to analyze who is subsidizing and who is receiving subsidies. Such data will be valuable in restricting subsidies to the general population and gradually targeting them at a smaller number of better identified poor consumers.

Notes

1. The third license was issued to MoldTelecom in February 2003. It was issued in a manner that doesn't qualify as transparent and competitive, and apparently was issued only to increase the investment attractiveness of MoldTelecom. The fee for the new licence was set at $1 million, to be paid in eight years, whereas the other operators paid $8 million. As of the date of this report, MoldTelecom had not yet established a separate legal entity to become the third mobile phone service operator, as required in the license.
2. This indicator is significantly different from that reported by the national regulator—the National Agency for Regulation in Telecommunications and Informatics (NARTI). NARTI reports that during 2002, the average waiting time for a fixed phone line was 21 months, calculated by dividing the average waiting list for the year by the actual number of connections. This calculation doesn't take into account the hidden demand, that is, the potential applicants who never apply due to the long waiting period. No information is available on the waiting time by various customer categories. The huge difference in the figures reported by the surveyed businesses and the NARTI suggests that it may be general population which is subjected to the very long waiting period, while businesses don't experience delays.
3. Unistar-Ventures GmbH, backed by Dresdner Bank and the EBRD, with 49% stake in Air Moldova
4. S.A. Retele Electrice Municipiu Chisinau, S.A. Retele Electrice de Distributie Centru, and S.A. Retele Electrice de Distributie Sud.

6. Policy Recommendations 54

Regulatory burdens remain at the core of investment climate weaknesses in the Moldovan economy. Moldovan firms continue to perceive aspects of business licensing, registration, inspection, certification, and standardization as major costs of doing business. Overall the regulatory burdens tend to be greater in Moldova than in other CIS countries of similar income levels. And excessive government interference affects large and small firms, domestic and foreign companies, and exporters as well as firms oriented toward domestic production. This makes the deregulation agenda a top priority for Moldovan policymakers.

This agenda is large. To progress with setting priorities, sequencing reforms and implementing them, the Government should develop a strategy and institutional framework for deregulation. Effective improvement of the investment climate is not a series of ad hoc regulatory actions, but a continuous process articulated and implemented as an interplay between the government, business, NGOs, and the civil society at large. To bring central direction and leadership to improvement and maintenance of business environment, and to ensure a sustainable progress of the reforms, the business environment concern should be institutionalized. A potential deregulation "champion" would be a focal point for working-out regulations and policies regarding business activities, and intermediation between the business regulators and business community. It would bring together representatives from public and private sector and equip them with expertise and resources necessary for continuous improvement of the investment climate.

This institution will have to deal with three major challenges:

- Reviewing and revising the large body of existing laws, rules, and formalities that have built up over years. This body of rules is often inefficient, outdated, and inconsistent with market principles and the role of the state in a market economy.
- "Filtering" efficiently the large flow of new draft laws and regulations by assessing their impact on business development. This can be done through introduction of regulatory impact analysis (RIA) of regulations affecting the investment climate.
- Building on effective public-private consultation process to address issues of business concern and protecting business rights whenever they are seriously violated.

There are different options for setting up an institutional framework for deregulation (See Box 6.1). Moldova needs to consider existing experience and make a choice of its approach to creating an independent body that can lead deregulatory efforts.

The investment climate reform agenda is extensive. It is recommended that in the short- and medium-term the reform efforts should be focused on a range of priority areas outlined below.

Easing the Burden of Regulations

Deregulation Framework Establishment

- Develop a strategy and institutional framework for deregulation, including *inter alia* consideration of the option of establishment of Business Support Agency (BSA).
- Develop an Action Plan covering priority simplification measures, and put into place a process for its periodical review and update.
- Implement a program of introduction of Regulatory Impact Analysis (RIA) of government regulations affecting the investment climate with a goal to analyze the impact of new regulations on the economy by providing framework for cost-benefit analysis of new legislation at its development stage before enactment.
- Build local capacity to conduct the RIA. Donor assistance could be requested for creating an as-

Box 6.1 Examples from Ukraine and Serbia of Institutional Frameworks for Deregulation

Ukraine has followed policies of creating a "lobby" within the government—the Committee for Regulatory Policy and Entrepreneurship. The Committee *inter alia* was empowered to veto regulatory initiatives with potential negative impact on business development. It also reviews existing legislation that causes business concerns, monitors and benchmarks progress in improvement of business environment, and protects business rights. These policies seem to have yielded positive results—visible reduction of regulatory burden, including inspections frequency and licensing incidence.

In Serbia, the Government created the high-level Council for Regulatory Reform of the Economic System as a permanent subcommittee, chaired by the Ministry for Economy and Privatization. This inter-ministerial Council was created so that the Government could plan, implement, and monitor a multi-year, government-wide program of reform of domestic legislative and regulatory processes aimed at establishing an environment supportive of private enterprises and economic growth. The Council has a dedicated expert Secretariat. The Council works with the Government by (i) reviewing drafts of laws and other major regulations relevant to the business environment, and making its recommendations to the Government; (ii) initiating legal and procedural reforms relevant to its goals, such as regulatory impact analysis and "silence is consent"; (iii) consulting with stakeholders; and (iv) making periodic reports to the Government with respect to actions needed and progress made.

sessment unit within the Government, developing methods, training regulators, and providing other technical support.
- Establish procedures for government-wide consultation with affected groups on new draft laws and other major regulations.

Business Registration

The system of business registration continues to be complex and time-consuming, particularly for small businesses. The following measures are intended to further streamline registration procedures:

- The costs of companies' registration for the entrepreneurs should be further reduced through the elimination of paid information services.
- All post-registration procedures, such as fiscal authorities and the National House of Social Security, should be centralized at the State Chamber of Registration to provide a one-stop shop.
- Currently, a company cannot have more than five types of business activities in the charter for its first registration. Such restrictions should be eliminated, to move to the practice common in more developed countries.

Licensing

Even though the range of licensed activities was significantly reduced, their definition was expanded, such that in some cases a separate license is needed for a sub-category of licensed activity. Obtaining a license still requires a large number of various documents and authorizations provided by various ministries, making the process time-consuming and prone to corruption. To improve the licensing environment, for small businesses in particular, the following measures are recommended:

- The number of licenses should be further reduced through their aggregation, and their validity periods extended.
- The licensing costs should be reduced at least by 20 percent in the short-term to bring Moldova to the current average sub-regional level.

- Since the size of unofficial payments has increased, easy access to information on all aspects of licensing should be provided to improve transparency and limit opportunities for bribes.
- Further deregulation measures should include reducing the number of documents and authorizations necessary to obtain a license—and limiting the involvement of branch ministries in the licensing process.
- Deregulation efforts should be extended to incorporate the activities of local authorities in the areas related to issuing licenses and permits.

Certification and Standardization

Further actions need to be taken to transform mandatory standards into regulations and concurrently move toward a system of voluntary certification. This process should be accompanied by improving the access of entrepreneurs to certification-related services and information—and by delineating the functions of different certification bodies to eliminate overlap. Five things are needed here:

- A clear strategy and time-bound action plan for transferring to the two-tier system of voluntary standards and mandatory technical regulations compatible with the WTO requirements.
- A clear definition of the functions of Moldova Standard to eliminate the conflicts of interest arising from the double function of policy formulation and enforcement.
- Measures to strengthen the infrastructure for testing and certification (such as establishing several centers of excellence in key sectors).
- Acknowledgement of other countries' (EU) certificates of compliance with standards (for example, for imported equipment), thus eliminating the necessity for businesses to obtain the equivalent certificates in Moldova.
- Agreements with other countries on the use of their laboratories and certification centers.

Inspection Regimes

The inspection regime continues to be extremely complex and involves too many government bodies. Comparative analysis shows that the frequency on inspections in Moldova is higher than in the neighboring countries. Several recommendations for improving the situation in this area are advanced with the aim of making inspection regimes more rule-based and less discretionary:

- Law should limit both the number and duration of inspections. It is important that limiting the planned inspections should not be offset by a concurrent increase in extraordinary ones. The progress of the reform should be measured by monitoring the number of inspections per enterprise per year.
- Inspections by different controlling bodies should be combined, at least in their timing. This should increase the coordination between controllers and the time entrepreneurs devote to business activity.
- Direct link between financing of controlling bodies and the revenues they generate by imposing fines and charging fees for services should be eliminated. The list of services provided for fees should be reviewed and restricted. Inspection costs should be monitored on an annual basis and decreased at least by 30 percent in the short-term.

Customs Regulations

The excessive amount of authorizations and other documents, which often need to be presented to different regulatory bodies, make the process time-consuming. The recent efforts toward simplification of customs regulations should be continued, in particular:

- The measures outlined in the Government Ordinance Number 478 on "Elimination of Barriers to Export of Goods" should be implemented.

- Customs clearance should be significantly simplified by reducing the number of documents examined and avoiding examination of the same document two or more times by different institutions. The average clearance time should be reduced from current 500 minutes to 60 minutes in the short-term.

Lightening Other Constraints

Law and the Enforcement of Contracts

Improvements in contract enforcement are warranted, given the preference for informal resolution and the long times that courts take to resolve commercial disputes.

- Conflict mediation outside the courts could accommodate the business community's fondness for informal resolution methods and current distrust of judges. Informal mediation by trained mediators is complementary to the courts—it can relieve the courts of a heavy caseload allowing them to focus on more serious cases that fail mediation.
- Formal resolution procedures could also be implemented, introducing more oral procedures, limiting the duration of appeals, making them more costly to the defendant, and reducing the duration of pre-trial procedures and admissions of lawsuits.
- The performance of bailiffs should be strengthened, the option of introduction of private bailiffs should be considered.
- Procedures for the resolution of small claims should be simplified.

Taxation

The reforms in this area should focus on improvements of tax administration that remains at the top list of constraints for enterprise activities:

- Problems with VAT rebates should be resolved with the aim of making the VAT restitution procedure more efficient.
- The simplified taxation of sole proprietors based on patent system should be preserved at its initial scope, options for simplification of small business taxation should be considered.
- Tax administration practices affecting private sector development should be analyzed and measures for tax administration improvement should be developed.

Financial Sector

Despite the impressive growth of the banking sector in the last two years, there seem to be serious impediments for businesses to access financial and credit resources, mainly due to excessive operating costs of banks reflected in high interest margins, and lack of development of other elements of the financial sector, such as leasing, insurance, and capital markets. The Government and the NBM should:

- Eliminate restriction on lending, transferring, and holding foreign currencies, including the foreign currency surrender regime and the limitations to interbank transactions in foreign currencies.
- Further consolidate the banking sector by increasing the minimum capital requirements and eliminating the three-type banking license system. Also recommended is introducing minimum capital requirements according to Basle Tier I capital requirements.
- Postpone the introduction of a deposit insurance scheme until the banking sector is further consolidated and more efficient.
- Enhance the payments system infrastructure, to reduce transaction costs and further de-monetize the financial system.
- Facilitate the establishment of an efficient, and possibly privately owned, credit information bureau system to support the development of cash-flow-based credit policies and retail banking (this could be facilitated by the further development of a card-based payments system).

- Review the tax framework to remove impediments for leasing
- Improve the access of concerned parties to the pledge database by upgrading the technical parameters of the central register so that it can support faster access by more users (notaries and banks).
- Enhance the supervision functions of the SSB and address the Savings and Credit Associations dependence on donor funding and overall sustainability.

Land and Real Estate

Even with significant progress in the establishment of a stable land registration and cadastre system, further actions are needed to improve services and increase their legal security:

- Restructure the 12 separate state cadastre enterprises into one structure, to optimize management, certification, and training.
- Link the 39 local databases in a network.
- Provide online access to the database for real estate professionals (notaries, valuers, realtors).
- Improve the feedback from the notaries to the cadastre and land register on transactions completed but not yet registered.
- Upgrade cadastre mappings in many areas.

Telecommunications

- The authorities need to ensure the independence of NARTI, the national telecommunications regulator, to secure a level playing field for fixed and mobile phone service operators.
- To promote e-commerce, digital signature and other regulations applicable to electronic transactions (online privacy protection) need to be developed.
- MoldTelecom needs to boost its capital and advance its investments—which may not happen without its privatization. Allowing access to the fixed lines to competing fixed service providers could be an option for the authorities to consider in further attempts to privatize MoldTelecom.

Development Action Plan

Area	Recommended Action	Responsibility	Priority	Timing: Short-term (less than 1 yr)	Timing: Medium-term (1 to 3 yrs)	Timing: Long-term (over 3 yrs)
Strategy and framework for deregulation	• Develop a strategy and institutional framework for deregulation, including *inter alia* consideration of the option of establishment of Business Support Agency (BSA)	Inter-Ministerial Commission for Regulatory Reform, MOE	High	X		
	• Develop an Action Plan covering priority simplification measures, and put into place a process for its periodical review and update		High	X		
	• Implement a program of introduction of Regulatory Impact Analysis (RIA) of government regulations affecting the investment climate		High		X	
	• Build local capacity to conduct RIA		High		X	
	• Establish procedures for government-wide consultation with major affected groups on new draft laws and other major regulations.		High	X		
Business registration	• The costs of companies' registration for the entrepreneurs should be further reduced through the elimination of paid information services.	State Chamber of Registration	Medium	X		
	• All post-registration procedures, such as fiscal authorities and the National House of Social Security (NHSS), should be centralized at the State Chamber of Registration to provide a one-stop shop.	State Chamber of Registration, fiscal authorities, NHSS	High		X	
	• The restriction on the number of types of business activities that a company can include in the charter for its first registration (currently 5) should be eliminated.	State Chamber of Registration	Low		X	
Licensing	• The number of licenses should be further reduced through their aggregation, and their validity periods extended.	State Licensing Chamber, MOF, Government	Medium		X	
	• The licensing costs should be reduced at least by 20 percent in the short-term to bring Moldova to the current average sub-regional level.	State Licensing Chamber, MOF	High	X		
	• Easy access to information on all aspects of licensing should be provided to improve transparency and limit opportunities for bribes.	State Licensing Chamber	Medium	X		
	• Further deregulation measures should include reducing the number of documents and authorizations necessary to obtain a license—and limiting the involvement of branch ministries in the licensing process.	State Licensing Chamber, MOF	High	X		
	• Deregulation efforts should be extended to incorporate the activities of local authorities in the areas related to issuing licenses and permits.	Inter-Ministerial Commission for Regulatory Reform, MOE, State Licensing Chamber	High		X	

(Table continued on next page)

Development Action Plan (continued)

Area	Recommended Action	Responsibility	Priority	Timing: Short-term (less than 1 yr)	Timing: Medium-term (1 to 3 yrs)	Timing: Long-term (over 3 yrs)
Certification and Standardization	• A clear strategy and time-bound action plan for transferring to the two-tier system of voluntary standards and mandatory technical regulations compatible with the WTO requirements.	Government, MOE	High	X		
	• A clear definition of the functions of Moldova Standard to eliminate the conflicts of interest arising from the double function of policy formulation and enforcement.	Government, MOE	High	X		
	• Measures to strengthen the infrastructure for testing and certification (such as establishing several centers of excellence in key sectors).	MOE, Moldova Standard	High		X	
	• Acknowledgement of other countries' (EU) certificates of compliance with standards, thus eliminating the necessity for businesses to obtain the equivalent certificates in Moldova.	Government, MOE, Moldova Standard	High	X		
	• Agreements with other countries on the use of their laboratories and certification centers.	Government, MOE, Moldova Standard	Medium			X
Inspection Regimes	• Law should limit both the number and duration of inspections, ensuring that limiting the planned inspections is not offset by a concurrent increase in extraordinary ones. The progress of the reform should be measured by monitoring the number of inspections per enterprise per year.	Inter-Ministerial Commission for Regulatory Reform, MOE, line ministries	High	X		
	• Inspections by different controlling bodies should be combined, at least in their timing.	MOE, line ministries	High	X		
	• Direct link between financing of controlling bodies and the revenues they generate by imposing fines and charging fees for services should be eliminated. The list of services provided for fees should be reviewed and restricted.	MOF, MOE	High		X	
	• Inspection costs should be monitored on an annual basis and decreased at least by 30 percent in the short-term.	MOE	High	X		
Customs Regulations	• The measures outlined in the Government Ordinance Number 478 on "Elimination of Barriers to Export of Goods" should be implemented.	Government, MOE, Customs …	High	X		
	• Customs clearance should be significantly simplified by reducing the number of documents examined and duplication of functions of different institutions. The average clearance time should be reduced from current 500 minutes to 30 minutes in the short-term.	MOE, Customs …	High		X	
Taxation	• Problems with VAT rebates should be resolved with the aim of making the VAT restitution procedure more efficient.		Medium	X		

(Table continued on next page)

Development Action Plan (continued)

Area	Recommended Action	Responsibility	Priority	Timing: Short-term (less than 1 yr)	Timing: Medium-term (1 to 3 yrs)	Timing: Long-term (over 3 yrs)
	• The simplified taxation of sole proprietors based on patent system should be preserved at its initial scope, options for simplification of small business taxation should be considered.	MOF, State Tax Inspection	High		X	
	• Tax administration practices affecting private sector development should be analyzed, measures for tax administration improvement should be developed.		High	X		
Law and the Enforcement of Contracts	• Conflict mediation outside the courts should be introduced. Informal mediation by trained mediators is complementary to the courts—it can allow the courts to focus on more serious cases that fail mediation.	MOJ	Medium		X	
	• Formal resolution procedures should be improved, introducing more oral procedures, limiting the duration of appeals, making them more costly to the defendant, and reducing the duration of pre-trial procedures and admissions of lawsuits.	MOJ	High	X		
	• The performance of bailiffs should be strengthened, the option of introduction of private bailiffs should be considered.	MOJ	Medium	X		
	• Simplified procedures for the resolution of small claims should be introduced.	MOJ, MOE	High		X	
Financial Sector	• Eliminate restriction on lending, transferring, and holding foreign currencies, including the limitations to interbank transactions in foreign currencies.	NB, MOF	High	X		
	• Further consolidate the banking sector by increasing the minimum capital requirements and eliminating the three-type banking license system. Introducing minimum capital requirements according to Basle Tier I capital requirements.	NB, MOF	High		X	
	• Postpone the introduction of a deposit insurance scheme until the banking sector is further consolidated and more efficient.	NB, MOF	Medium	X		
	• Enhance the payments system infrastructure to reduce transaction costs and further de-monetize the financial system.	NB, MOF	High		X	
	• The tax framework should be reviewed to remove impediments for leasing.	MOF, State Tax Inspection	Medium		X	
	• Facilitate the establishment of an efficient, and possibly privately owned, credit information bureau system to support the development of cash-flow-based credit policies and retail banking.	MOF, MOE	High		X	
	• Improve the access of concerned parties (notaries and banks) to the pledge database by upgrading the technical parameters of the central register.	MOJ	Medium	X		

(Table continued on next page)

Development Action Plan (continued)						
				Timing		
Area	Recommended Action	Responsibility	Priority	Short-term (less than 1 yr)	Medium-term (1 to 3 yrs)	Long-term (over 3 yrs)
	• Enhance the supervision functions of the SSB and address the Savings and Credit Associations overall sustainability.	MOF	Low			X
Land and Real Estate	• Restructure the 12 separate state cadastre enterprises into one structure, to optimize management, certification, and training.	State Agency of Land Relations and Cadastre (SALRC)	Medium		X	
	• Link the 39 local databases in a network.	SALRC	High		X	
	• Provide online access to the database for real estate professionals (notaries, valuers, realtors).	SALRC	Medium		X	
	• Improve the feedback from the notaries to the cadastre and land register on transactions completed but not yet registered.	SALRC	Medium	X		
	• Upgrade cadastre mappings in many areas.	SALRC	Low			X
Telecommunications	• The authorities need to ensure the independence of NARTI, the national telecommunications regulator, to secure a level playing field for fixed and mobile phone service operators.	MOE, Ministry of Transportation/ Communications (MOTC)	High	X		
	• To promote e-commerce, digital signature and other regulations applicable to electronic transactions need to be developed.	MOE, Department for Information technology, NARTI	High		X	
	• MoldTelecom needs to boost its capital and advance its investments—which may not happen without its privatization. Allowing access to the fixed lines to competing fixed service providers could be an option to consider.	MOTC, NARTI	Medium			X

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Annex 1. Macroeconomic and Trade Policies

Macroeconomic and Trade Policy Indicators	**Moldova**	**Moldova 1995**	**ECA Region**	**CIS**	**EU Accession**	**Data Source**
GDP growth (annual %), 2001	6.07	–1.4	5.24	7.95	3.79	WDI
GDP per capita, PPP (current international $), 2001	2,351	2,413	6,938	4,194	11,627	WDI
GNI Per Capita (US$), 2001	400	820	2,294	829	4,719	WDI
Government Expenditure, total (% of GDP), 2000	29.58	. .	30.55	20.71	36.28	WDI
Inflation, GDP deflator (annual %), 2001	11.93	38.74	16.93	19.30	5.02	WDI
Trade (% of GDP), 2000	126.54	130.34	101.85	99.38	122.25	WDI
External debt (% of GNI), 2000	90.57	22.69	58.80	60.51	51.74	WDI
Total debt service (% of exports of goods and services), 2000	16.71	7.87	15.93	14.27	16.76	WDI
Monetary policy*	4.0	5.0	3.29	3.83	2.25	Heritage
Trade policy index**	2.0	5.0	3.32	3.50	2.63	Heritage
Trade and foreign exchange system index***	4.30	. .	3.64	3.08	4.30	EBRD
Political Risk Rating****	5.22	. .	9.07	5.49	16.66	Euromoney

Notes: Year of statistics: 2002 unless noted otherwise.
**: Weighted Average annual rate of inflation from 1992–2001. Score 1–5, with lower value indicating lower inflation rate.*
***: An index of weighted average tariff rate, non tariff barriers, and corruption in the customs service. Score 1–5, with lower value indicating lower trade barriers.*
****: Score 1–4, the higher the better.*
*****: Score 1–25, with higher value corresponding to lower level of political risk.*

Annex 2. The Private Sector

Private Sector Indicators	**Moldova**	**Moldova 1995**	**ECA Region**	**CIS**	**EU Accession**	**Data Source**
Gross Domestic Capital Formation (% of GDP), 2001	4.24	. .	9.30	13.87	9.64	WDI
Government Intervention in the Economy*	3.0	3.0	2.66	2.79	2.00	Heritage
Governance and enterprise restructuring index**	2.00	. .	2.22	1.81	3.04	EBRD
Large-scale privatization index**	3.00	. .	2.88	2.55	3.58	EBRD
Small-scale privatization index**	3.30	. .	3.71	3.36	4.30	EBRD
Private sector share of GDP***	50.00	. .	59.81	51.25	73.75	EBRD

Notes: Year of statistics: 2002 unless noted otherwise.
**: Score 1–5, with lower value representing lower level of government intervention.*
***: Score 1–4, the higher the better.*
****: Represents rough EBRD estimates based on available statistics from both official and unofficial sources. The underlying concept of private sector value added includes income generated by the activity of private registered companies as well as the private entities engaged in informal activity in those cases where reliable information on informal activity is available.*

Annex 3. Investment and Access to Finance

Investment and Access To Finance Indicators	**Moldova**	**Moldova 1995**	**ECA Region**	**CIS**	**EU Accession**	**Data Source**
Foreign direct investment, net inflows (% of GDP), 2000	9.93	0.83	4.08	3.43	5.90	WDI
Private capital flows, total (% of GDP), 2000	17.87	2.13	4.63	3.74	5.86	WDI
Domestic credit provided to Private sector (% of GDP), 2001	14.78	6.72	19.47	10.56	29.02	WDI
Stocks traded, total value (% of GDP), 2001	14.20	0.12 (1996)	5.64	4.72	4.57	WDI
Stocks traded, turnover ratio (%), 2001	. .	97.9 (1999)	3.98	2.32	4.21	WDI
Market capitalization of listed companies (% of GDP), 2001	23.67	2.77 (1996)	12.65	14.41	14.42	WDI
Deposit interest rate (%), 2001	20.93	25.42 (1996)	12.86	15.16	6.57	WDI
Lending interest rate (%), 2001	28.69	36.67 (1996)	19.52	31.02	11.75	WDI
Interest Rate Spread (Lending—Deposit Rates), 2001	7.76	11.24 (1996)	9.91	15.86	5.18	WDI
Real Interest Rate (%), 2001	14.98	6.87 (1996)	10.06	13.90	6.53	WDI
Banking and Finance Index*	3.0	5.0	3.00	3.75	1.88	Heritage
Capital flow and foreign investment index*	3.0	4.0	2.93	3.42	2.00	Heritage
Securities markets and non-bank financial institutions index**	2.00	. .	2.10	1.78	2.96	EBRD
Banking Reform & Interest Rate Liberalization**	2.00	. .	2.63	2.00	3.50	EBRD
Financial regulation extensiveness index**	4.00	. .	3.01	2.73	3.54	EBRD
Financial regulation effectiveness index**	3.00	. .	2.58	2.26	3.30	EBRD
Investment Profile, 2001***	7.50	5.0 (1998)	8.86	7.29	10.50	ICRG/PRS
Access to bank finance****	3.30	. .	1.78	0.72	3.75	Euromoney
Access to short-term finance****	1.79	. .	2.07	1.60	2.93	Euromoney
Access to capital markets****	1.00	. .	1.79	0.77	3.60	Euromoney
Creditworthiness rating****	0.00	. .	2.21	0.73	5.55	Euromoney

Notes: Year of statistics: 2002 unless noted otherwise.
**: Score 1–5, with lower value indicating lower level of government involvement/influence in financial sector or better investment climate.*
***: Score 1–4, the higher the better.*
****: Score 1–12, the higher the better.*
*****: Score 1–5, the higher the better.*

Annex 4. Tax Policy

Tax Policy Indicators	**Moldova**	**Moldova 1995**	**ECA Region**	**CIS**	**EU Accession**	**Data Source**
Highest marginal tax rate, corporate rate (%)	25.00 (1999)	. .	27.38	29.60	26.88	WDI
Highest marginal tax rate, individual rate (%)	25.00 (1999)	. .	34.53	30.80	35.00	WDI
Export duties (% of exports)	0.00	0.00 (1996)	0.33	0.93	0.00	WDI
Import duties (% of imports)	1.42	0.67 (1996)	1.96	2.24	1.34	WDI
Fiscal Burden of the Government Index, 2002*	3.5	3.0	3.57	3.08	4.06	Heritage

Notes: Year of statistics: 2000 unless noted otherwise.
**: Score 1–5, with lower value corresponding to lower fiscal burden of the government—lower tax rates and lower government expenditure as % of GDP.*

Annex 5. Administrative and Regulatory Costs of Business

Administrative and Regulatory Cost Indicators	**Moldova**	**Moldova 1995**	**ECA Region**	**CIS**	**EU Accession**	**Data Source**
Number of Procedures to Start Business	11.00	. .	11.63	13.10	9.14	RRU/WB
Number of Days to Start Business	41.00	. .	63.67	66.60	67.57	RRU/WB
Cost to Start Business (in US$)	123.15	. .	560.28	183.44	1,054.13	RRU/WB
Cost to Start Business (as % of GNP per capita)	30.79	. .	25.34	21.18	22.96	RRU/WB
Number of Procedures to Enforce Contracts	36	. .	22.00	23.50	20.33	RRU/WB
Number of Days to Enforce Contracts	210	. .	337.93	171.00	496.17	RRU/WB
Property Rights Index*	3.0	3.0	3.46	3.83	2.50	Heritage
Commercial law extensiveness index**	3.30	. .	3.20	2.94	3.56	EBRD
Commercial law effectiveness index**	3.70	. .	3.22	2.95	3.64	EBRD

Notes: Year of statistics: 2002.
**: Score 1–5, with lower value indicating higher level of private property rights protection.*
***: Score 1–4, the higher the better.*

Annex 6. Infrastructure

Infrastructure Indicators	**Moldova**	**Moldova 1995**	**ECA Region**	**CIS**	**EU Accession**
Electricity production (kwh) Per Capita, 1999	893	1,420	3,107	2,509	4,617
Personal computers (per 1,000 people)	14.50	2.13	75.15	20.53	130.88
Internet hosts (per 10,000 people)	4.00	0.01	34.15	3.93	107.97
Internet users (as % of Total Population)	1.23	0.0035	4.82	0.84	12.55
Mobile phones (per 1,000 people)	31.74	0.00	124.81	15.66	301.46
Roads, paved (% of total roads), 1999	87.00	87.30	74.26	88.82	68.36
Telephone mainlines (per 1,000 people)	133.20	130.20	217.85	132.25	340.04

Notes: Data source: All from WDI.
Year of statistics: 2000 unless noted otherwise.

Annex 7. Quality of Governance

Governance and Regulation Indicators	Moldova	Moldova 1995	ECA Region	CIS	EU Accession	Data Source
Government Effectiveness, 2001*	–1.10	–0.46 (1998)	–0.40	–0.89	0.47	WBI
Regulatory Quality, 2001*	–1.11	–0.28 (1998)	–0.38	–1.06	0.54	WBI
Rule of Law, 2001*	–0.42	–0.02 (1998)	–0.23	–0.72	0.58	WBI
Control of Corruption, 2001*	–0.83	–0.39 (1998)	–0.36	–0.82	0.45	WBI
Black market index**	3.5	5.0	3.96	4.33	3.06	Heritage
Regulation Index**	4.0	3.0	3.79	4.17	2.75	Heritage
Competition policy index***	2.00	. .	2.17	1.94	2.84	EBRD

Notes: Year of statistics: 2002 unless noted otherwise.
**: Score between –2.5 and 2.5, with higher values corresponding to better governance outcomes.*
***: Score 1–5, with lower value corresponding to lower level of black market activity or higher level of easiness to open and operate a business.*
****: Score 1–4, the higher the better.*

Annex 8. Labor Conditions

Labor Condition Indicators	Moldova	Moldova 1995	ECA Region	CIS	EU Accession	Data Source
Unemployment, total (% of total labor force), 1999/2000	11.10	1.00	11.10	7.52	11.59	WDI
Wage and Price Index*	3.0	3.0	2.86	3.42	2.25	Heritage
Employment Laws Index**	2.12	. .	1.83	2.02	1.78	RRU/WB
Industrial Relations Laws Index**	0.93	. .	1.44	1.46	1.44	RRU/WB
Index of Labor Regulations***	3.05	. .	3.27	3.48	3.22	RRU/WB
Informal Economy (as % of GNI)	45.10	. .	37.68	48.28	26.86	RRU/WB

Notes: Year of statistics: 2002 unless noted otherwise.
**: Score 1–5, with lower value corresponding to higher degree to which a government allows the market to set wages and prices.*
***: Score 0–3, with higher value representing higher level of regulation.*
****: Sum of the Employment Laws Index and the Industrial Relations Index. Score 0–6, with higher value representing higher level of regulation.*

Annex 9. Population and Health

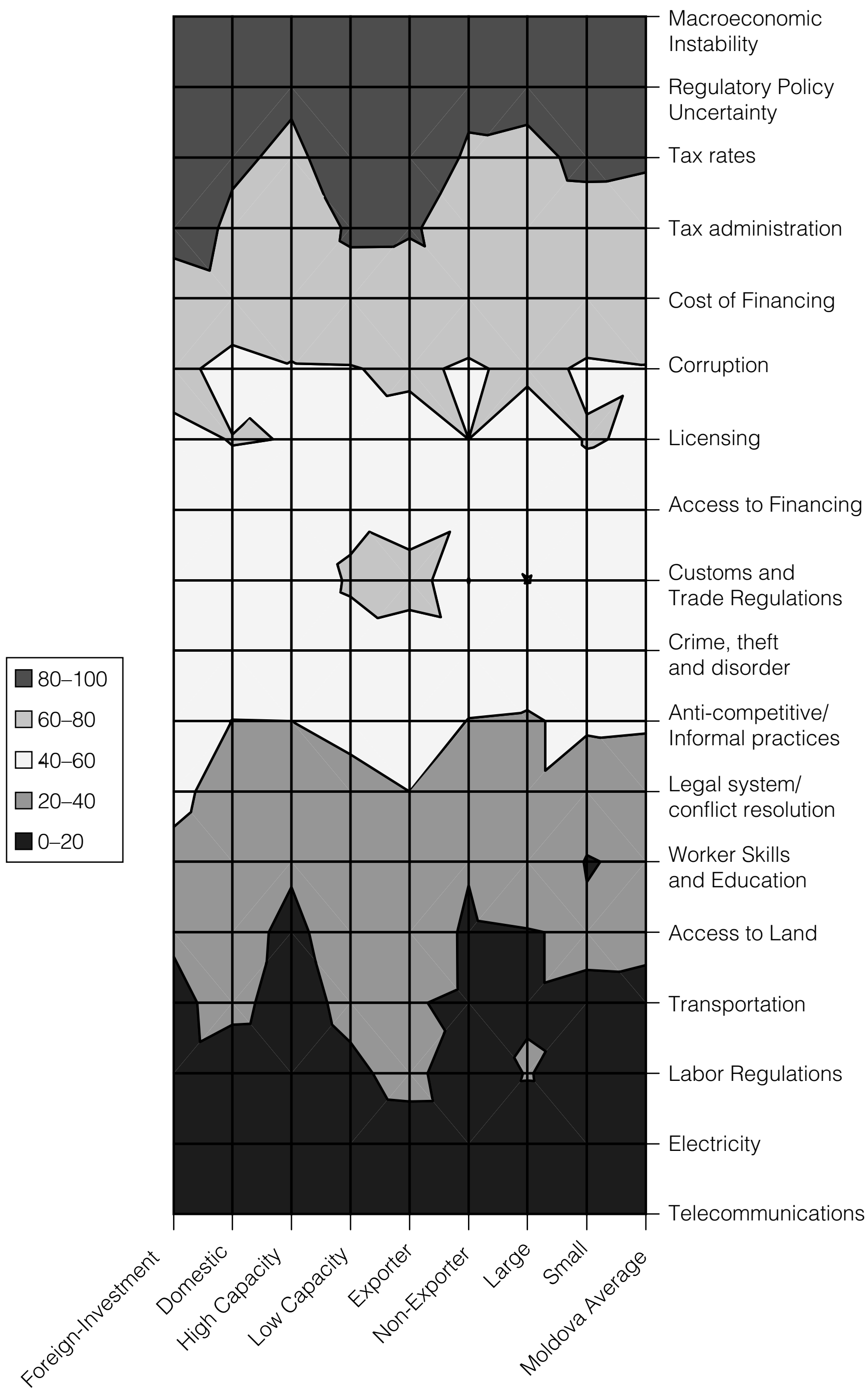
Population and Health Indicators	Moldova	Moldova 1995	ECA Region	CIS	EU Accession	Data Source
Population, total, 2001	4,272,519	4,339,000	17,019,914	23,462,595	9,210,695	WDI
Life expectancy at birth, total (years)	67.76	65.65	70.85	68.79	72.66	WDI
Infant Mortality rate (per 1,000 live births)	18.40	21.20	14.75	18.09	7.71	WDI
Illiteracy rate, adult total (% of people ages 15 and above), 2001	1.04	1.72	2.30	0.75	0.35	WDI
Health, education, housing, social security and welfare (% of total expenditure and net lending)	47.96	50.1 (1996)	50.15	42.13	59.69	WDI
Population Below the National Income Poverty Line (%), 1987–2000	23.30	. .	29.62	36.58	13.77	UNDP
Human Development Index Value*	0.70	0.70	0.77	0.74	0.83	UNDP

Notes: Year of statistics: 2000 unless noted otherwise.

**: Score 0–1, with higher value corresponding to higher level of human development.*

Annex 10. Moldova Firms' Evaluation of Business Constraints

(% of firms evaluating constraints as "moderate" or "major")



Annex 11. Corruption by Country

	Czech	Hungary	Moldova	Poland	Romania	Russia	Ukraine
Percent of revenues that are needed for informal payments?	0.92	0.97	2.07	1.22	2.57	1.43	2.19
% Saying Gift/Payment Required for:							
To get connected to and maintain public services (electricity and telephone)	21.60	24.05	38.37	16.15	25.21	36.23	32.27
To obtain business licenses and permits	47.97	24.26	67.44	28.75	59.26	51.72	53.09
To obtain government contracts	43.98	45.18	22.70	32.96	36.16	30.17	38.24
To deal with occupational health and safety Inspections	46.53	37.02	33.92	37.84	58.33	35.86	54.00
To deal with fire and building inspections	38.37	34.47	55.88	35.47	43.93	59.80	59.04
To deal with environmental inspections	37.30	31.60	40.12	31.48	44.30	33.47	39.53
To deal with taxes and tax collection	32.93	27.04	68.02	27.41	37.71	53.54	54.59
To deal with customs/imports	30.20	32.90	50.92	24.54	38.86	24.79	33.00
To deal with courts	21.14	24.68	17.22	19.28	37.28	19.18	30.05
To influence the content of new legislation rules decrees etc.	15.90	23.81	13.89	19.96	21.59	16.92	15.27
Confidence in the judiciary (% who disagree)	47.06	40.33	70.18	41.95	45.82	65.30	49.00
Percent of payment disputes resolved in the courts	15.39	24.33	25.68	28.00	18.32	11.92	37.67

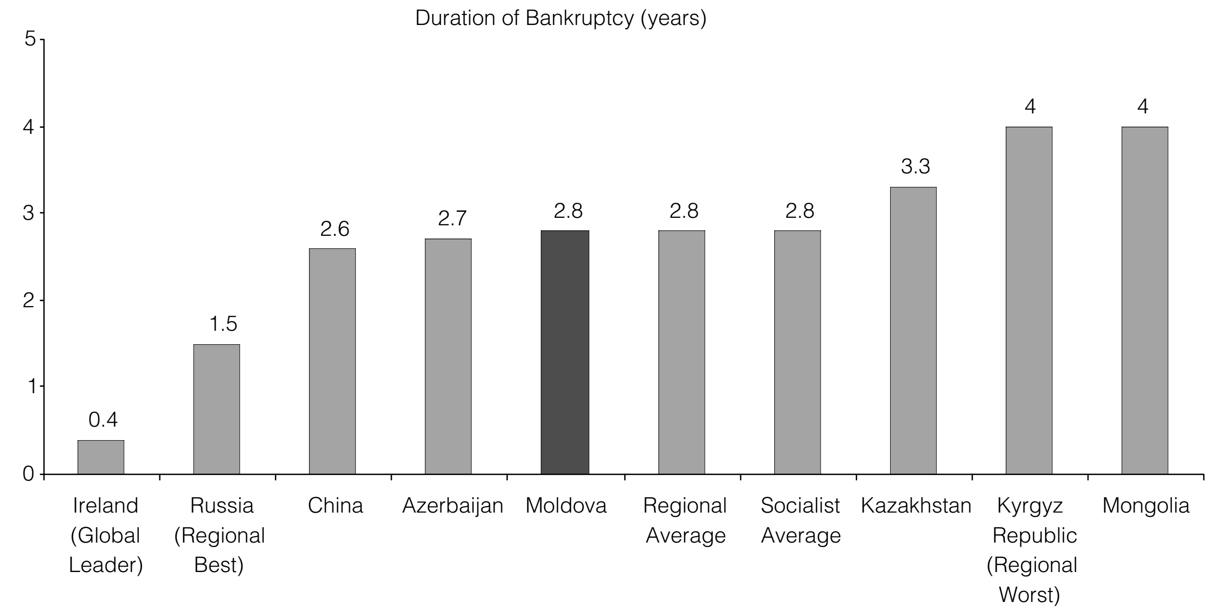
Source: BEEPS II Survey

Annex 12. Corruption by Firm Characteristics

	Moldova	Small	Large	Foreign-Invested	Domestic	Exporter	Non-Exporter	Low Capacity	High Capacity
Corruption									
Percent of revenues that are needed for informal payments?	2.07	2.20	1.62	0.50	2.45	1.88	2.15	2.39	1.82
% Saying Gift/Payment Required for:									
To get connected to and maintain public services (electricity and telephone)	38.37	41.79	26.32	20.69	47.67	32.00	40.98	39.19	37.11
To obtain business licenses and permits	67.44	69.40	60.53	60.71	71.26	66.00	68.03	71.23	64.29
To obtain government contracts	22.70	21.43	27.03	41.38	24.05	31.25	19.13	28.99	18.28
To deal with occupational health and safety Inspections	33.92	30.60	45.95	27.59	44.19	34.69	33.61	35.62	31.96
To deal with fire and building inspections	55.88	55.97	55.56	48.28	63.22	65.31	52.07	60.56	52.04
To deal with environmental inspections	40.12	37.04	51.35	44.83	41.38	52.00	35.25	41.10	38.78
To deal with taxes and tax collection	68.02	69.40	63.16	55.17	78.16	72.55	66.12	73.97	63.27
To deal with customs/imports	50.92	46.83	64.86	53.57	56.79	76.47	39.29	60.29	44.68
To deal with courts	17.22	12.71	33.33	16.00	18.92	30.23	12.04	17.19	17.44
To influence the content of new legislation	13.89	8.85	32.26	26.92	7.35	30.00	7.69	13.79	14.12
Judiciary									
Confidence in the judiciary. (% disagree)	70.18	71.43	65.79	68.97	77.65	70.59	70.00	75.34	65.98
Percent of payment disputes resolved in the courts	25.68	19.33	31.63	33.67	8.00	31.89	17.08	16.15	32.56

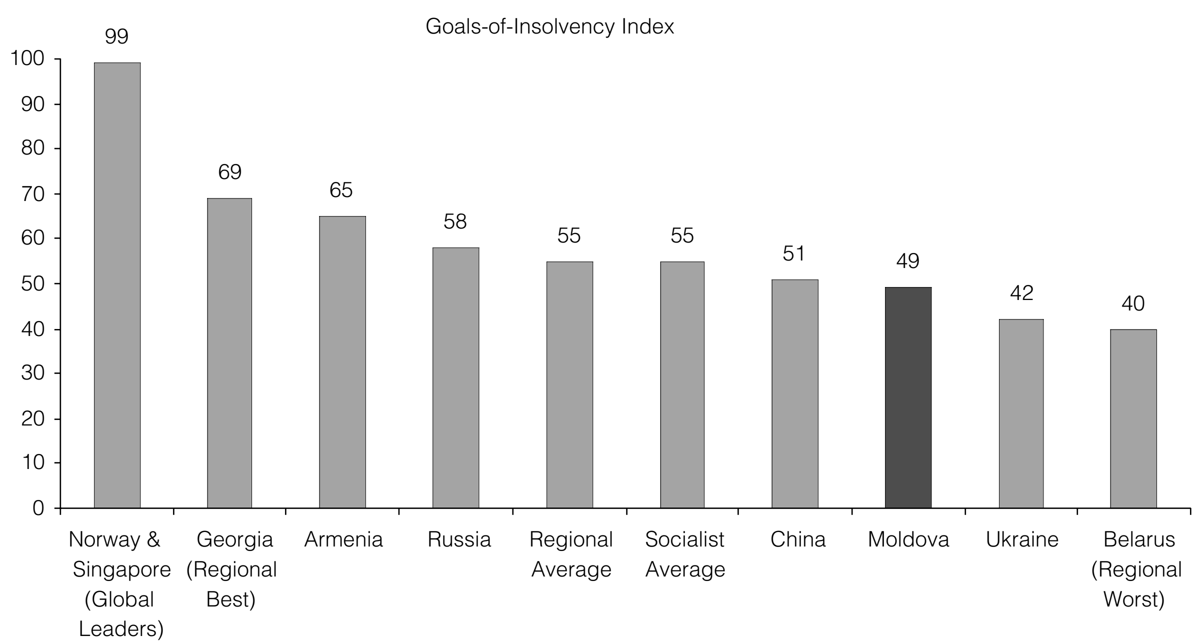
Source: BEEPS II Survey

Annex 13. Duration of Bankruptcy across Countries



Source: Doing Business Database, WB

Annex 14. Goals-of-Insolvency Index across Countries



Source: Doing Business Database, WB

Annex 15: Technical appendix

Estimating Sectoral Productivity Gaps Across Countries

The calculation of sectoral productivity gaps was based on the estimation of country-pooled production functions, where ordinary least squares combined with White correction for heteroskedascity was used to fit an augmented Cobb-Douglas technology for garment and food processing separately. The specification used for both sectors was:

$$\ln(Output_i) = cons + \beta_m \ln(Material_i) + \beta_l \ln(Labor_i) + \beta_c \ln(Capital_i) + \sum_{n=1}^{J-1} \beta_n D_n + \varepsilon_i \qquad (1)$$

Where *i* indexes the firm, *n* the country where the firm is located, and *J* denotes the number of countries used for each sector studied (as described in the chapter). *Output* denotes gross output produced, *Material* is raw materials used in production, *Labor* is total number of workers including both permanent and temporary employees, and *Capital* denotes the total replacement value of machinery, equipment, land, and buildings. Moldova was chosen as the base country, and sector-specific productivity gaps expressed in relative percentage terms were retrieved from the estimated coefficients on the country dummies as follows:

Productivity Gap for country n = [exp (β_n) – 1] * 100, for any country n other than Moldova (2)

The tables below report estimation results for equation (1) and country productivity gaps as calculated in expression (2) for each sector.

Linking Total Factor Productivity and Investment Climate Indicators

Empirical evidence supporting the connection between TFP and the Investment Climate is obtained by regressing productivity estimates against firm-specific characteristics and a set of variables assumed to be representative of the business environment. Due to harmonization issues concerning IC variables across surveys, only the five countries targeted for the BEEPS II extension were used. The methodology used is explained below.

Table I — Garment

	Nominal Exchange Rate			PPP		
ln (Output)	**Coeff**	**Std. Error**	**Productivity Gap (%)**	**Coeff**	**Std. Error**	**Productivity Gap (%)**
Ln (Material)	.67[1]	.0210	NA	.67[1]	.0210	NA
ln (Labor)	.27[1]	.0226	NA	.26[1]	.0228	NA
ln (Capital)	.05[1]	.0158	NA	.05[1]	.0158	NA
Poland	.39[1]	.0646	48	.06[N]	.0527	6
Tajikistan	–.25[1]	.0645	–22	–.20[1]	.0644	–18
Uzbekistán	–.26[1]	.0820	–23	–.15[10]	.0818	–13
Kyrgyzstan	–.33[1]	.0761	–28	–.25[1]	.0753	–22
China	.34[1]	.0805	40	.25[1]	.0766	29
India	.23[1]	.0595	26	.19[1]	.0587	21

[1]Significant at 1 percent; [10] Significant at 10 percent; [N] Not significant

Table II — Food Processing						
	Nominal Exchange Rate			**PPP**		
ln (Output)	**Coeff**	**Std. Error**	**Productivity Gap (%)**	**Coeff**	**Std. Error**	**Productivity Gap (%)**
Ln (Material)	$.72^{1}$	.0277	NA	$.72^{1}$	.0277	NA
ln (Labor)	$.26^{1}$	.0323	NA	$.26^{1}$	.0323	NA
ln (Capital)	$.03^{10}$	.0141	NA	$.03^{10}$	.0141	NA
Poland	$.31^{1}$	.0586	NA	$.02^{N}$	.0409	2
Tajikistan	$-.04^{N}$	.0665	–4	$.06^{N}$	.0636	0.6
Uzbekistan	$-.27^{1}$	.0588	–23	$-.17^{1}$	.0547	–15
Kyrgyzstan	$-.29^{1}$	.0619	–25	$-.22^{1}$	.0566	–20

[1]Significant at 1 percent; [10] Significant at 10 percent; [N] Not significant

First Stage

Productivity estimates are generated by fitting a production function after pooling sectors and countries. Thus, the relationship between TFP and IC indicators is investigated at a higher level of aggregation when compared to the productivity gap calculations. The estimated production function includes measures of labor quality (schooling) and capacity utilization since homogenous regressors are available across the 5 surveys used. We use nominal exchange rate to convert local currency units to US dollars and the following specification is adopted:

$$\begin{aligned} \ln(Output_i) = {} & cons + \beta_m \ln(Material_i) + \beta_l \ln(Labor_i) \\ & + \beta_c \ln(Capital_i) + \beta_u \ln(CapUtil_i) \\ & + \beta_s \ln(Schooling_i) + \beta_t SectorDummy \\ & + \sum_{n=1}^{4} \beta_n D_n + \varepsilon_i \end{aligned} \tag{3}$$

Where *CapUtil* denotes capacity utilization, *Schooling* is a weighted average of education years of the workforce, and the remaining variables are the same as in (1). The table below summarizes the results:

Table III — Regression Results		
ln (Output)	**Coefficient**	**Std. Error**
Ln (Material)	$.70^{1}$	.0213
Ln (Labor)	$.27^{1}$	.0208
Ln (Capital)	$.05^{1}$	.0151
Ln Ln (CapUtil)	$.08^{5}$	.0386
Ln Ln (Schooling)	$.42^{1}$	.1260
Dummy Food	$.01^{N}$	.0307
Poland	$.34^{1}$	.0469
Tajikistan	$-.19^{1}$	.0518
Uzbekistan	$-.29^{1}$	.0531
Kyrgyzstan	$-.31^{1}$	.0573

[1]Significant at 1 percent; [5] Significant at 5 percent; [N] Not significant

The coefficients above are then used to back out TFP measures as follows:

$$\hat{TFP}_i = \exp\begin{pmatrix} \ln(Output_i) - \hat{\beta}_m \ln(Material_i) - \\ \hat{\beta}_l \ln(Labor_i) - \hat{\beta}_c \ln(Capital_i) - \\ \hat{\beta}_u \ln(CapUtil_i) - \hat{\beta}_s \ln(Schooling_i) \end{pmatrix} \tag{4}$$

The formula above implies that country dummies are relevant to TFP calculation only to the extent that they allow for a cleaner estimation of input elasticities and coefficients on capital utilization and schooling. In fact, the dummies are not explicitly subtracted in (4). Although it is true that linking TFP figures net of country-specific effects to IC indicators would be a more powerful test, it is also reasonable to claim that the concept of investment climate contains a strong country-specific component and, as a result, dummies may wash away much more than what they are supposed to. Indeed, this seems to be the case in the present analysis.

Second Stage

TFP estimates obtained as in (4) are regressed against firm characteristics and variables assumed to capture the business environment surrounding the firm. High performing firms are likely to be able to reduce the investment climate problems they face. The process of choosing such variables is non-trivial and it reflects a tension between the breadth of the IC concept and necessary compromises associated with a quantitative approach. From a pragmatic perspective, multicollinearity among IC indicators force the election of a subset of variables. In this study, those variables were chosen on the basis of which institutional constraints were identified as the most relevant ones by regional teams, and on the basis of data quality.

Another complication associated with the second stage regression is the potential endogeneity of IC indicators when taken at the firm-level. Averaging IC indicators within sample cuts is one way to lessen this problem, since the firm is less likely to affect the average than its individual observation. The question then is what cut to pick. Because country-level averaging would not fully exploit the richness of the firm-level dataset, there is a case for implementing compounding cuts which exploits breakdowns inside the country and produces a greater variability in the regressors. However, in doing so, the researcher must remember that the thinner the cut, the closer he gets to the endogeneity issue already mentioned.

Having these points in mind, this study generates IC indicators by averaging firm's responses belonging to the same country, region, sector, and size class (small, medium, and large). In order to mitigate endogeneity problems, we drop firms for which the IC average is formed by less than 4 individual observations. Using TFP estimates from the first stage, the following specification is adopted:

$$\begin{aligned} TFP_i = {} & cons + \beta_1 \ln(Age_i) + \beta_2 Exports_i \\ & + \beta_3 ForeignOwnership_i + \beta_4 DummyGarment \\ & + \beta_5 IC\_BankCredit_b + \beta_6 IC\_Inspection_b \\ & + \beta_7 IC\_TimeTax_b + \beta_8 IC\_Power_b + \varepsilon_i \end{aligned}$$

Where *b* indexes the breakdown at which IC averages are calculated, *IC_BankCredit* denotes the proportion of firms with bank loans or line of credit, *IC_Inspection* captures the number of days spent in required meetings with officials in the previous year, *IC_TimeTax* captures the per cent of senior management's time spent on interpreting laws and regulations in the previous year, and *IC_Power* measures the total number of hours (during the year) that the establishment experienced interruption in the power service. These four IC indicators cover areas of finance, regulatory burden, and infra-structure. The table below report the results.

Table IV — Regression Results

TFP	**Coefficient**	**Std. Error**
Ln (Age)	.03[5]	.0151
Export	.0008[10]	.0004
Foreign Ownership	.08[10]	.0431
Ln Dummy Garment	.026[N]	.0204
IC_BankCredit	.20[1]	.0457
IC_Inspection	–.003[1]	.0009
IC_TimeTax	.001[N]	.0027
IC_Power	–.0001[5]	.00006

[1]Significant at 1 percent; [5] Significant at 5 percent; [N] Not significant

Counter-Factual

The counter-factual is a useful exercise for gauging the quantitative implications in terms of productivity boost stemming from an one-shot improvement in the investment climate. However, because of the many assumptions involved, the figures obtained must be interpreted with caution and seen as illustrative only. In particular, the exercise does not take into consideration the costs associated with changing the business environment.

The counter-factual exercise was designed to answer the following question: By how much would the TFP figures for Moldova, Tajikistan, Uzbekistan, and Kyrgyzstan change if the investment climates of these countries were to be replaced by the one of Poland? This question is answered by means of comparing two different TFP figures for each country. The first figure is a "true" value and it is calculated through actual country data, while the second TFP figure is a "fictitious" number which is calculated using Poland data. The exercise makes use of coefficients estimated in (5) to quantify the sensibility of productivity with respect to the various control variables included.

Since the question is being posed in terms of the whole country and, as explained before, the IC indicators contain further breakdowns, country-wide IC averages (weighted by the number of firms in each breakdown) are used to generate "true" (or base) TFP value for each country as follows:

$$\begin{aligned} \hat{TFP}_i^{BASE} = {} & \hat{cons} + \hat{\beta}_1 \ln(Age_i) + \hat{\beta}_2 Exports_i \\ & + \hat{\beta}_3 ForeignOwnership_i + \hat{\beta}_5 IC\_ \\ & BankCredit_n + \hat{\beta}_6 IC\_Inspection_n \\ & + \hat{\beta}_8 IC\_Power_n \end{aligned} \tag{6}$$

Where $IC\_Indicator_n = \sum_b \alpha_b IC\_Indicator_b$ for each breakdown b in a country n, and α_b denotes the share of firms belonging to breakdown b within country n. Also note that only the statistically significant coefficients displayed in table IV were used to form the base TFP in (6).

Next, the "fictitious" TFP figure is formed by assigning to all firms the IC indicators of Poland (calculated as explained above). The estimated coefficients and firm-specific characteristics (age, export, and foreign ownership) are retained. Equation (7) shows the exact step:

$$\begin{aligned} \hat{TFP}_i^{FICTITIOUS} = {} & \hat{cons} + \hat{\beta}_1 \ln(Age_i) + \hat{\beta}_2 Exports_i \\ & + \hat{\beta}_3 ForeignOwnership_i + \hat{\beta}_5 IC\_ \\ & BankCredit_{Poland} + \hat{\beta}_6 IC\_ \\ & Inspection_{Poland} + \hat{\beta}_8 IC\_Power_{Poland} \end{aligned} \tag{7}$$

After calculations (6) and (7) are performed, pairs of "base" and "fictitious" TFP's are available for each firm in the entire sample. The counter-factual numbers reported along the chapter are the associated percentage changes of country average TFP's. The table below reports these averages and the percentage changes.

Likelihood of Investing

Research has shown that investment behavior (specially at the firm-level) is a lumpy process, where positive investment are followed by non-negligible periods of inaction (zero investment). As a result, one would like to exploit as much temporal variation as possible when examining factors that lead firms to invest. Unfortunately, the survey at hand can not deliver such information.

Table V — Counter-factual

	TFP		Percentage
Country	**Base**	**Fictitious**	**Change**
Kyrgyzstan	.42	.59	40
Moldova	.55	.60	9
Poland	.60	.60	0
Tajikistan	.42	.57	.35
Uzbekistán	.52	.59	.13

Nevertheless, its cross-sectional richness make it worthy to carry out the investigation from other perspective. Next, a probit model with White Correction for heteroskedascity is estimated to assess the probability of observing positive investment at the firm level during the year 2002. Countries and sectors are polled, and the list of regressors includes firm-specific characteristics, a sectoral dummy, a measure of bank access at the firm-level, country dummies (*CD*), and the levels of capital and labor inputs.

$$\Pr(I) + \Phi(Age, ForeignOwnership, Exports, FoodDummy, Bankcredit, CD, Capital, Labor) \qquad (8)$$

Where *I* can be either 1 denoting positive investment or 0 denoting inaction. The table below reports the results:

Table VI — Regression Results

Positive Investment	**Coefficient**	**Std. Errors**
Age	–.00034[N]	.0082
Foreign Ownership	.5484[10]	.3331
Exports	.3652[10]	.2110
Food Dummy	.2645[10]	.1457
Ln Bank Credit	.3998[5]	.1601
Poland	–.0471[N]	.2351
Tajikistan	–.1607[N]	.2442
Uzbekistan	–.5613[5]	.2286
Kyrgyzstan	.1748[N]	.2306
Labor	–.0007[N]	.0006
Capital	.0004[10]	.0002

[1]Significant at 1 percent; [5] Significant at 5 percent; [N] Not significant

Annex 16: Sources of Data

BEEPS (Business Environment and Enterprise Performance Survey)

BEEPs, which was developed jointly by the World Bank and the European Bank for Reconstruction and Development, was originally carried out in late 1998 and early 1999 as a survey of over 4000 firms in 22 transition countries. The survey examined a wide range of interactions between firms and the state. The BEEPS began as the Transition Europe/Central Asia version of the World Business Environment Survey (WBES)—a World Bank Group initiative. EBRD substantially enhanced coverage of governance and industrial structure issues. Based on face-to-face interviews with firm managers and owners, BEEPS was designed to generate comparative measurements in such areas as corruption, state capture, lobbying, and the quality of the business environment, which could then be related to specific firm characteristics and firm performance. BEEPS provided the empirical basis for the 1999 Transition Report. This instrument can be downloaded at the following site:
http://www.worldbank.org/wbi/governance/pdf/beeps_questions.pdf

In 2002, EBRD and the World Bank launched a second round of BEEPS, largely to track how conditions had changed over time. BEEPS II was implemented in more countries (27) and interviewed some 6,000 firms. Under an MOU with the World Bank, it uses a substantial amount of the World Bank's new core investment climate survey (PICS). However, it does not include questions on firm-level financial performance ("productivity data") included in the PICS core. BEEPS II omits certain core WBG investment climate survey questions and does not include questions on firm-level finances (costs, assets, liabilities, employment) that would allow calculation of productivity; a supplemental approach was developed for ICA countries to be used in the first year after the introduction of BEEPS. The questionnaire and an interactive webtool for organizing and reporting the survey results are available at:
http://info.worldbank.org/governance/beeps2002/

ICA Survey Sample Structure

Firm Size (%)		**Firm Activity (%)**	
	Sample		**Sample**
Small (<100 emps)	78.16	Mining and quarrying	0
Large (100+ emps)	21.84	Construction	2.87
Firm Ownership (%)		Manufacturing	28.74
	Sample	Transport storage and communication	6.32
Single proprietorship	27.01	Wholesale and retail trade; repair of	42.53
Partnership	5.17	Real estate, renting and business service	1.72
Cooperative	0.57	Hotels and restaurants	5.17
Corporation, privately held	35.63	Other services***	12.64
Corporation listed on a stock exchange	0.00	***Market Orientation (%)***	
Other private sector	16.09		**Sample**
State/municipal/district-owned enterprise	8.05	Exporter (>= 5% sales)	29.31
Corporatized state-owned enterprise	0.57	Non-Exporter	70.69
Other state owned	6.90		

The sample. Moldovan sample of the BEEPS II survey comprised 174 business units. Over two thirds of the sample have fewer than 50 employees, and over three quarters have fewer than 100 employees. Sectorally, the sample was constructed to roughly reflect the relative contributions of manufacturing firms versus commercial and service firms. However, while food processing firms were included in manufacturing, agriculture (i.e. farming) was not included as a sector in the sample. The great majority of firms reporting their corporate form were either privately-held corporations or single proprietorships. Only 4% of firms had foreign ownership, while a further 48% were purely private. A number of firms with private corporate forms had a degree of state ownership, while only 8% had majority state ownership. Almost three in ten firms in the sample export.

Productivity and Investment Climate Survey

In order to achieve better comparability with the growing set of surveys conducted under the World Bank's global investment climate assessment (ICA) initiative, a small supplement to BEEPS was carried out for 100 manufacturing firms (generally in two sectors, garments and food processing) in 5 ECA countries (Poland, Moldova, Kyrgyz Republic, Tajikistan and Uzbekistan). This small-scale supplement to BEEPS II provides both the basis to compare firm performances in two sectors (garment and food processing) to that in other ECA countries and India, and China, and the ability to relate performance to the costs and constraints imposed by a particular country's investment climate conditions. The core PICS instrument may be downloaded from the following site:
http://www.worldbank.org/privatesector/ic/ic_ica_tools.htm

Cost of Doing Business Survey (CODB)

The CODB survey was carried out in January 2003 on behalf of the World Bank, with the aim of assessing the business climate in Moldova in 2002 and monitoring its changes over the last 3 years (2000–2002). This is the second CODB survey, the first one was conducted in January 2002. Similar studies were carried out in other countries of the region, namely Ukraine (in 1997; 1998; 1999), Bulgaria, Georgia, Armenia and Belarus (in 2001).

The general objective of the CODB surveys is to assess the impact of state policies, requirements, and institutional arrangements on business entities operating in Moldova. In doing so, the survey focused on the following areas:

- Registration procedures
- Regulations on the use of premises
- Licensing
- Import-export activities
- Equipment
- Tax administration
- Inspections
- Pricing controls
- Labor regulations
- Contract execution
- Social liabilities of companies
- Legal system

Sample details

There are about 115 thousand enterprises in Moldova registered by the State Chamber of Registration as of September 1, 2002. However, only 24 thousand enterprises have presented the financial statements to the statistical and fiscal authorities. The sample comprised enterprises that submitted financial statements and the individual enterprises. To preserve the comparability of CODB II with CODB I, the surveyed enterprises were predominantly selected from the first survey's list. The second survey includes 21% of new companies, which were not interviewed within the first survey, due to their refuse.

The CODB sample comprised 630 businesses in the City of Chisinau, nine districts of Moldova and Gagauz-Yeri. Agricultural enterprises and monopolists

Table i. Regional Distribution of Surveyed Enterprises

	Number of Surveyed enterprises	Share, in percentage points
Chisinau	329	52%
Balti District	49	8%
Chisinau District	39	6%
Cahul District	33	5%
Edinet District	41	7%
Lapusna District	29	5%
Orhei District	28	4%
Soroca District	24	4%
Tighina District	14	2%
Ungheni District	17	3%
Gagauz-Yeri	27	4%
Total	630	100%

fell outside the purview of the survey. The survey sample is representative nationally of the Moldovan businesses, their net sales, legal forms and geographic distribution as it is based on the statistical information furnished by the Department of Statistics and Sociology.

The survey included a limited sub-sample of 61 individual enterprises (10%). The size of this sub-sample was not intended to be representative due to the disproportionately large number of this category of economic entities and their small share in net sales, and certain differences in their regulatory environment. By legal form, limited liability companies (53%)

Table ii. Distribution of Enterprises by Legal Form

Organizational form	No. of enterprises	% of enterprises
Limited liability companies	337	53%
Joint stock companies	206	33%
Individual enterprises	61	10%
State or municipal enterprises	13	2%
Others	13	2%
Total	630	100

Table iii. Distribution of Enterprises by Number of Employees

Number of employees	No. of enterprises	% of enterprises
1 – 10	198	31%
11 – 50	228	36%
51 – 200	155	25%
201 – 500	28	4%
> 500	21	3%

and opened joint-stock companies (33%) account for the majority of businesses surveyed (see Table ii).

Small businesses that employ up to 50 employees account for 68% of the respondents and thus make up the majority of polled enterprises, whereas enterprises with over 50 employees constitute 32% of the sample (see Table iii).

The majority of surveyed enterprises are engaged in trade (30.3), services (27.9%) and manufacturing (39.6%), while only 2.2% are knowledge-based companies, law firms, consultancy companies and notaries.

Doing Business

This Bank project embodies a methodology that does not rely on enterprise surveys but covers some of the same ground on regulatory and administrative transaction costs. The Doing Business database provides indicators of the cost of doing business by identifying specific regulations that enhance or constrain busi-

Table iv. Sector Distribution of Enterprises

Major lines of business	No. of enterprises	% of enterprises
Manufacturing – food processing	110	17.5%
Manufacturing – other	139	22.1%
Wholesale and retail trade	191	30.3%
Services	176	27.9%
Research and development, Science	9	1.4%
Law firms, notaries, consultancy	5	0.8%

ness investment, productivity, and growth. The principal data collection methods for the indicators are the study of the existing laws and regulations in each economy, targeted interviews with regulators or private sector professionals in each topic, and cooperative arrangements with other departments of the World Bank, other donor agencies, private consulting firms, business and law associations. In each area, the project establishes a network of informants who can identify the procedures and costs encountered by a firm or transaction of specific characteristics in the leading city. The project team prepares a set of templates or questionnaires that can be used by staff of the World Bank Group, or other agencies, in their work on business environment issues. The topics covered to date are: credit markets, bankruptcy, business licensing, contract enforcement, entry regulations and labor regulations. More topics will be added over the next two years. Once published, each topic will be updated annually. The database covers 24 countries in Transition Europe and Central Asia. Complete descriptions of the indicators and methodology, as well as the database itself, can be found at:
http://rru/DoingBusiness/default.aspx