IMPLEMENTATION OF EU-MOLDOVA ASSOCIATION AGREEMENT IN THE CONTEXT OF THE PANDEMIC

Adjusting policies and financial instruments to ensure sustainability of the EU integration path

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Table of Contents

INTRODUCTION **2**

APPLYING THE LENS OF INSTITUTIONS **3**

Figure 1: Framework for analysing institutions *5*

COVID-19 PANDEMIC AND CHANGING CONTEXT **6**

THE HEALTH EFFECTS OF THE PANDEMIC 6
Figure 2: Total confirmed Covid-19 cases *6*
Figure 3: Total confirmed Covid-19 deaths, per million *6*
THE VOLATILE POLITICAL CONTEXT 7
Figure 4: Intention to vote, June 2020 .... *8*
THE ECONOMIC CONSEQUENCES OF THE PANDEMIC 9
Figure 5: Key dimensions of sovereign risk *9*
Figure 6: Monthly evolution of exports *10*
Figure 7: Monthly evolution of imports *10*
Figure 8: Flow of remittances, USD million *11*
Figure 9: Percent of firms adapting to Covid-19, by firm size *12*

RESPONSE TO THE COVID-19 PANDEMIC **12**

GOVERNMENT RESPONSE TO THE CONSEQUENCES OF THE PANDEMIC 12
Figure 10: Government response stringency index *13*
EU RESPONSE TO THE CONSEQUENCES OF THE PANDEMIC 15

POTENTIAL IMPACT OF THE COVID-19 PANDEMIC ON ECONOMIC INSTITUTIONS AND IMPLICATIONS FOR EU ASSISTANCE **16**

THE CASE FOR A MOLDOVA ENTERPRISE AND GROWTH FUND **19**

Box 1. Western NIS Entreprise Fund (WNISEF) *20*
Box 2. Global Innovation Fund *21*

ANNEX 1: COMPARATIVE FISCAL MEASURES IN MOLDOVA AND NEIGHBOURING COUNTRIES **24**

ANNEX 2: LIST OF PEOPLE MET **25**

ANNEX 2: REFERENCE LIST **26**

Introduction

In the last decade, Moldova's policy course has been firmly oriented towards political association and economic integration with the European Union, as set out in the objectives of the Eastern Partnership. In 2014, Moldova signed the Association Agreement (AA) and the Deep and Comprehensive Free Trade Agreement (DCFTA) with the EU. Internal policy reforms have been guided by two National Action Plans for the Implementation of the EU-Moldova Association Agreement (NAPs), the second one expiring at the end 2019.

After 5 years of implementation of the Association Agreement, the political association with the EU remains challenging due to internal political volatility, weak rule of law, and pervasive corruption. Nevertheless, the implementation of the DCFTA and the support provided by the EU, in conjunction with an IMF programme, ensured macroeconomic stability and consistent (albeit relatively low) growth rates, and a closer economic integration with the EU. As of end 2019, around 70% of the Moldovan exports were oriented towards EU countries, and 50% of the imports originated in the EU market.

Since November 2019, the Chicu Government, supported by the pro-Russian President Igor Dodon and the Socialist Party, has pursued a political course that de-prioritised the Europeanisation of Moldova. Although European Integration remained a stated goal in policy documents and on the technical level of government, on the political level the Chicu Government sought closer ties with Russia, Turkey, and the Eurosceptical forces within the EU. Considering the electoral cycle and upcoming Presidential elections at the end of 2020, as well as the dependence of the Government on the centrist Democratic Party for a majority, the Chicu Government has not fully abandoned the European Agenda, but rather adopted a selective approach to implementing reforms and accessing EU's financial assistance. At the same time, the EU continued to pursue its pragmatic conditionality mechanism and 'more-for-more' approach.

The onset of the Covid-19 pandemic catalysed some decisions and processes that demonstrated non-democratic tendencies of the ruling coalition and the Chicu Government, as well as weaknesses in democratic institutions and state capacity. This contributed to the poor management of the health crisis and a weak response to the economic consequences of the lock-down. Despite this, the European Union acted quickly to pivot and increase its financial assistance and provide emergency support for the health sector, Macro-Financial Assistance for budget support, and credit lines for businesses.

Considering the growing consensus regarding the protracted nature of the pandemic and the profound recession that will affect most countries in the EU and the region, it is highly probable that Moldova will undergo an economic downturn capable of wiping out the economic gains achieved in the last 5 years of the implementation of the Association Agreement and the DCFTA. In the short to medium term, the crisis will change profoundly both the role of the state and the structure of the economy, with significant consequences for the Europeanisation of the country. If poorly managed, the crisis will create additional pressures and challenges for building democratic institutions and implementing the structural reforms required to achieve closer political cooperation and economic convergence with the EU. Under these conditions, both the EU conditionality mechanism and its financial support should be further refined to protect the gains achieved under the Association Agreement and DCFTA over the last 5 years, as well as to support reforms for stronger good governance and institutions and ensure the sustainability of the European Integration path of Moldova.

This paper outlines the current and expected consequences of the Covid-19 pandemic on the political and economic institutions in Moldova and presents some considerations for improving policies and financial instruments for the implementation of the Association Agreement. The analysis is particularly focused on the consequences of the economic crisis on small and medium enterprises, and the resulting impact on European integration. It takes an 'institutions' approach to Europeanisation, positing that economic institutions should not be just growth-enhancing, but also contribute to a European-style development, with strong democratic institutions and respect for human rights. The paper argues that a more pronounced focus on supporting business development and growth is required and puts forward a case for the creation of the Moldovan Enterprise and Growth Fund, a locally-anchored hybrid fund that would provide flexible financing and support enterprise growth based on sound corporate governance principles.

Applying the Lens of Institutions

In analysing Moldova's development along the European integration path, this paper takes a 'new institutional economics' approach, which emphasises the role of institutions as key drivers of economic development and considers how changes in institutional settings result in progress or stagnation. Institutions, according to a widely-cited definition put forward by Douglas North (1990:3), '… are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction." He argues that individuals who are free and rational, design institutions consisting of rules, procedures and norms to constraint the behaviour of others and to maximise their own interests of wealth and utility. Institutions can be formal (constitutions, laws, rules) and informal (norms, customs, traditions). They influence micro level individual behaviour by incentivizing a certain course of action, but also shape the structure of entire economies at the macro level, by influencing the way of an economic sector or a policy develop. Changing institutions or weakening them over time could lead to economic prosperity or decline because they determine how effective and efficiently the resources would be used (North, 1990).

Institutions as a necessary pre-condition, or binding constraint, for economic growth and development has been embraced in academia, but also by international organisations, including the European Commission and the International Monetary Fund. In their book '*Why Nations Fail*', Daron Acemoglu and James A. Robinson ascertain that the lack of inclusive political and economic institutions is the main obstacle to achieving growth and prosperity (Acemoglu and Robinson, 2013). A number of historic institutionalists have been concerned with dynamic nature of institutions. For example, Kathleen Thelen posits that institutions are a product of concrete temporal processes, which are determined and sustained by specific characteristics of the political and social context (Thelen, 1999). According to Andre Sorensen, 'once established some institutions tend to become increasingly difficult to change over time, and so small choices early on can have significant long-term impacts' (Sorensen, 2015:7). Consequently, one of the key concepts in historical institutionalism is 'path dependence'

Furthermore, considering institutions are path dependent, it is natural to consider why certain institutions persist over time, what are the 'critical junctures' that determine the formation of new institutions, and what are the determinants of institutional change (Sorensen, 2015). Recent work by historic institutionalists has also studied incremental institutional change, beyond the critical junctures, that are viewed more as rare windows of opportunity (Sorensen, 2015).

Institutions have long been important for the process of European integration, and remains an important issue on the association agenda in Southeastern Europe. It is widely recognised that the prospect of joining the EU created incentives for countries to improve their political and economic institutions, with the EU serving as an 'outside anchor' for the reform process (see, for example, Berglöf and Roland, 1997). Referring to the Danube region specifically, Mirtl (2019) argues that weak institutions left behind by socialist regimes have prevented countries in the region from developing inclusive institutions and closing gaps in terms of economic development. Rather, informal institutions, such as grey economies, low levels of the rule of law, authoritarian tendencies, and behavioural settings that are not conducive to development, account for differences in economic cohesion and degree of Europeanisation (Mirtl, 2019).

The quality and strength of institutions, in particularly related to rule of law and corruption, have also been emphasised as one of the main impediments for economic growth in Moldova and closer cooperation with the European Union. Policy documents of Moldova's external partners increasingly focus on institutions as the priorities for reform going forward. The latest European Parliament assessment on the implementation of the EU-Moldova Association Agreement points out to insufficient progress in reforming political institutions (decisions on elections and electoral system and justice sector reform), as well as economic institutions (corruption, incoherent policies on business and investment environment, as well as sectoral reforms on energy efficiency, connectivity, climate action, etc.). In laying out their vision for the future of Eastern Partnership in an oped at the beginning of 2020, HR/VP Josep Borrell and Commissioner Oliver Varhelyi included two specific objectives that directly relate to quality of institutions:

> *"**Together for accountable institutions, the rule of law and security**: Good governance and democratic institutions, the rule of law, successful anti-corruption policies and security are essential for sustainable development and the consolidation of democracy. They are the backbone of resilient states and societies as well as strong economies.*
>
> ***Together for resilient, fair and inclusive societies**: Free and fair elections together with transparent, citizen-centred and accountable public administrations are essential for democracy. The EU will continue to focus on these key areas, engaging with civil society, which needs to be given sufficient space, and supporting free, plural and independent media and human rights, as well as ensuring mobility and people-to-people contacts, all particularly important also due to growing disinformation against EU values.*

In March 2020, the IMF issued the Staff Report for the Article IV consultation and the last review under the IMF Programme, where it concluded that widespread governance and institutional vulnerabilities are severe and macro-critical, and prevent faster income convergence (IMF 2020b). In this context, the IMF indicated that future collaboration should centre on improving economic institutions. Mr. Mitsuhiro Furusawa, Deputy Managing Director and Acting Chair of the Executive Board stated that:

> "Looking ahead, addressing widespread governance and institutional vulnerabilities in Moldova will help boost the economy's growth potential, and support an acceleration

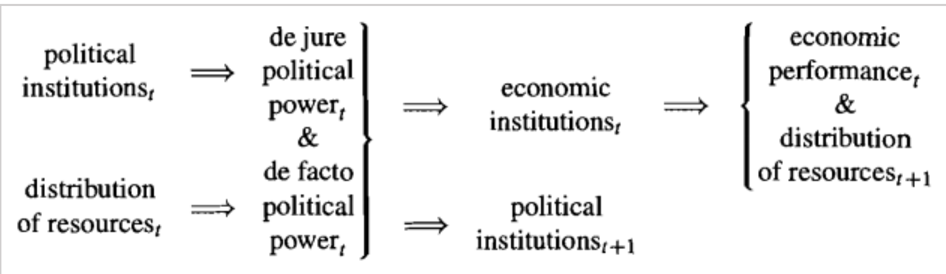
of its income convergence with the rest of Europe. Enforcing the rule of law and strengthening the supervisory and regulatory frameworks—particularly those governing the non-bank financial sector, SOEs, and AML/CFT—are expected to contribute significantly to growth dividends, helping to unlock Moldova's untapped economic potential."

There are, however, a number of very difficult practical challenges when it comes to building quality political and economic institutions. If institutions are path dependent, as described above, what are the drivers that can ensure positive change? Acemoglu, Johnson, and Robinson (2005) developed a framework for analysing institutions that allows to look deeper into the reasons for path dependence and critical junctures (Figure 1). They consider three institutional characteristics: (1) economic institutions; (2) political power; and (3) political institutions. They point out that it is economic institutions, which shape the incentives of key economic actors in society, such as security of property rights, entry barriers, the set of contracts available to businessmen, that matter for economic growth. Economic institutions determine the aggregate economic growth potential of the economy, but also the distribution of resources in the society.

Economic institutions, in turn, are collective choices of the society determined by political power. Political power can be exercised de jure, through the political institutions of the society, or de facto, depending on the distribution of the resources within the society and the ability of groups to overcome collective action challenges. The framework indicates that political institutions and the distribution of economic resources in society are two *state* variables, affecting how political power will be distributed and how economic institutions will be chosen.

When talking about political power, Acemoglu, Johnson, and Robinson introduce the notion of 'persistence', to reflect the inherent slow-changing nature of distribution of resources and political institutions. By the same token, the framework shows the potential for change, through 'shocks' to the balance of de facto political power, including changes in technologies and the international environment, have the potential to generate major changes in political institutions, and consequently in economic institutions and economic growth (Acemoglu and Robinson, 2008).

Figure 1: Framework for analysing institutions



Source: Acemoglu, Johnson, and Robinson (2005).

This paper is not intended to go into a profound analysis of institutions in Moldova and their potential for change – this requires a comprehensive political economy analysis, with many moving variables. Rather, in assessing the consequences of the Covid-19 pandemic on economic and political institutions in Moldova, it will employ the Acemoglu, Johnson, and Robinson framework to look deeper into the real drivers of change and their dynamic effect, not just their state of equilibrium. As such, this paper will employ concepts and refer to the institutional characteristics laid out in the framework above.

Covid-19 Pandemic and Changing Context

The health effects of the pandemic

As of mid-July 2020, Moldova registered a total of 20,040 confirmed cases of Covid-19, one of the highest rate of infection in the region, particularly taking into consideration Moldova's population (Figure 1). Moldova also has one of the highest death rate per million people from a sample of comparable countries in the region and in Western Balkans, outpaced only by North Macedonia (Figure 2).

Figure 2: Total confirmed Covid-19 cases

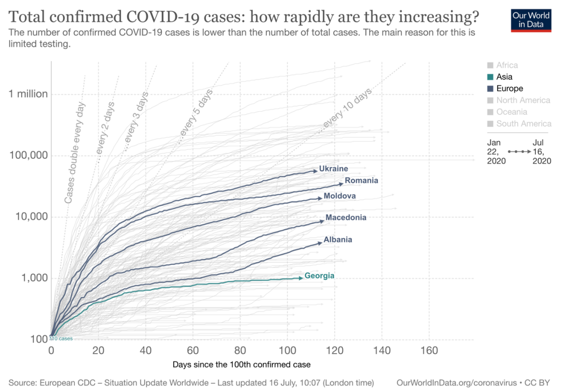
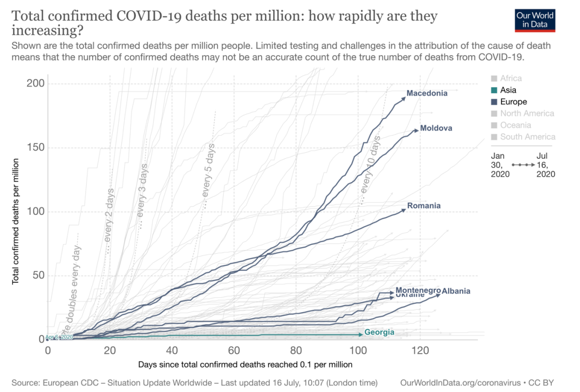


Figure 3: Total confirmed Covid-19 deaths, per million



It is notable that the Moldovan Government introduced a state of emergency just 10 days after the first Covid-19 case was confirmed on 7 March, and instituted workplace and school closures and strict restrictions on travel and public events and gatherings. Despite this, it did not use effectively the 60-day state of emergency to equip and train doctors, institute a system of contact tracing, and develop a strategy for gradual lifting of the restrictions (IPRE, 2020). Larger amounts of personal protective equipment for doctors were secured only some 5 weeks after the onset of the state of emergency, amids calls of civil society organisations to equip, test, and support medical staff[1]. As a result, Moldova had a high infection rate among medical workers – as of 15 July, there were 2,654 cases of infection and 27 deaths among medical personnel. In fact, medical facilities have become important sources of infection for the general population.

So far, Moldova seems to have avoided critical pressure on the health system. A new Covid-19 triage centre has been opened to identify confirmed cases and refer patients to specialised hospitals. Although at the beginning of June Prime Minister Chicu stated that there were enough hospital beds only for 5 days[2], there have not been subsequent reports of shortages and the number of patients requiring intensive care seems to be below the critical threshold of

[1] https://promolex.md/17292-apel-public-cu-privire-la-necesitatea-sporirii-nivelului-de-protectie-a-lucratorilor-medicali-in-contextul-starii-de-urgenta-si-a-pandemiei-cu-covid-19-in-republica-moldova/?lang=ro

[2] https://agora.md/stiri/72187/ion-chicu-indeamna-oamenii-sa-evite-cimitirele-in-acest-weekend-locuri-in-spitale-mai-avem-pe-cinci-zile

hospitals' available capacity. The planned medical interventions for other illnesses have been resumed on 16 May, but anecdotal evidence indicates that people with chronic diseases and ailments are reluctant to access health services, due to risk of infection.

The volatile political context

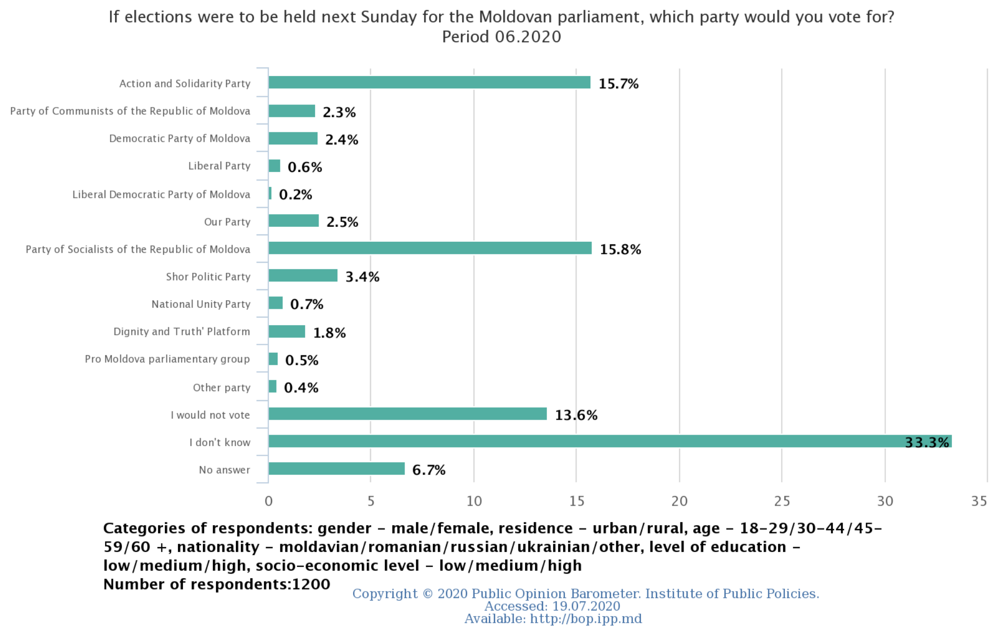
The political situation in Moldova has been chronically complex and volatile, but the pandemic catalysed some political processes and crystallised tendencies of key stakeholders. Politically, 2020 was always bound to be influenced by the expiration of President Dodon's mandate and presidential elections due to be held on 1 November 2020. After the dismissal of the pro-European Sandu Government in November 2019, President Dodon has gradually strengthened his grip on power. Although publicly, President Dodon claimed the Chicu Government was technocratic, with the onset of the emergency situation and simplified decision-making, the huge influence of President Dodon over the executive became even more apparent (Cenusa, 2020).

The Chicu Government is supported by a coalition between Socialist Party and Democratic Party, formalised in early March just at the outset of the pandemic. The Democratic Party, weakened after the flight of its former leader and oligarch Vladimir Plahotniuc, has split and faced continuous defection of its members, amidst allegations of corruption. By late-June, the coalition numbered just 51 Members of Parliament (out of 101), the minimum number required for a majority. The extraordinary volatility of the situation was highlighted when in early July one member of the Socialist Party first left Socialist Party, leaving the Parliament without a functioning majority, and then returned several days later. Despite allegations of undue pressure, there has been little action from the Prosecutor's Office and little communication of the MP himself with the press. What is certain is that the political support for the Chicu Government is very weak, and an attempt to oust the Government is expected in mid-July.

The defection of MPs and the resulting lay-out of the Parliament, which makes the creation of a functioning coalition extremely difficult, has weakened significantly the legitimacy of the Parliament and led to calls for early parliamentary elections. However, the Constitution provides that the Parliament cannot be dismissed in the last six months of the Presidential mandate and the Constitutional Court confirmed this in a ruling, which stipulates in effect that parliamentary elections can be held in spring 2021 at the earliest. However, the latest Barometer of Public Opinion from June 2020 demonstrated a high degree of voter polarisation, with two parties – Action and Solidarity Party and Socialist Party – accumulating some 16% of voter intent, and all other parties situated at 3% or less. Most importantly, approximately 33% of voters do not know who they would vote for, and 14% of voters do not intend to vote at all (Figure 4). This shows profound disillusion with the political class and indicates a high probability for continued political volatility.

In this environment, President Dodon and the Chicu Government stepped up pressure on independent and regulatory institutions. The Constitutional Court, following a complete reset of its entire composition in 2019 and a change of the Court's President in early 2020, started issuing decisions that indicated its independence from political parties, or at the very least an equilibrium of representation that lead to balanced decisions. In particular, the Court blocked a revision to the 2020 budget on account of undue process, and then declared unconstitutional both the financing agreement for a EUR 200 million Russian loan, establishing both procedural and substantial violations. Constitutional Court Judges were subject to pressure not only through political declarations of President Dodon and Prime Minister Chicu, who claimed that the Government may not be able to pay salaries in case of a negative decision[3], but also through alleged surveillance of judges by state institutions, including the General Prosecutor's Office. A number of civil society organisations issued a public statement calling for politicians to halt intimidation of judges[4].

Figure 4: Intention to vote, June 2020



Following a number of politically-charged declarations regarding the National Bank of Moldova (NBM), the government initiated a legal amendment to deny NBM employees coverage of legal representation costs. The IMF expressed concern this would undermine the independence of the NBM in a letter to the Speaker, the Prime-Minister, and the President, which was leaked to the press[5]. The nature of the legal amendments was revised to deny NBM employees coverage of legal representation costs only if wrongdoing on their part is proved in court. Nevertheless, with the expected appointment of three new Deputy Governors, the pressure on the NBM will probably increase.

After the 2019 Parliamentary elections and the investiture of the pro-European Sandu government in June 2019, the Parliament adopted several important laws that reversed the undue influence and capture of political institutions by political forces. Most importantly, the Parliament adopted legislative changes to the electoral system cancelling the mixed electoral system that was introduced in 2017 in spite of negative international expertise and EU concerns. In early July 2020, the Socialist Party proposed new amendments to the Electoral Code, which caused an outcry of civil society due to provisions that were considered to weaken democratic standards, in particular on exclusion of electoral candidates from the race,

[3] http://tvrmoldova.md/economic/rectificarea-bugetului-de-stat-pentru-anul-2020-a-fost-publicata-in-monitorul-oficial/

[4] https://crjm.org/en/declaratie-politicienii-trebuie-sa-inceteze-intimidarea-judecatorilor-2/

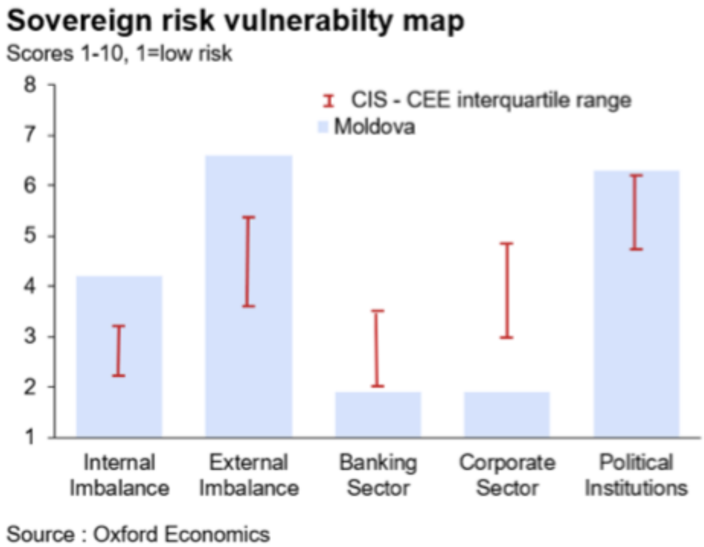
[5] https://www.moldova.org/en/the-imf-official-letter-the-hard-won-strengthening-of-the-nbm-independence-is-at-risk-of-being-reversed/

sanctioning actions of the mass-media, limiting the rights of observers. The amendments also did not provide solutions for preventing vote buying and organised transportation of voters. The second reading of the Electoral Code amendments was postponed following pressure from civil society and international partners.

The economic consequences of the pandemic

In the period since the implementation of the Association Agreement and the DCFTA, Moldova improved its macroeconomic situation, with consistent growth rates around 4% in the period between 2016-2019. Moldova implemented a number of structural reforms in the banking sector and improved business regulations, with support from the EU and an IMF programme. By end-2019, Moldova's NBM reserves constituted around USD 3 billion[6], liquidity in the banking sector was high at 50% of assets[7], and public debt was relatively low at 30% of GDP. As a result, Moldova entered 'coronacrisis' with stronger fiscal, financial, and external buffers to fight with the negative impact of COVID-19 on the economy in 2020 (Betiliy, 2020). Nevertheless, Moldova remains one of the riskiest countries in the CEE-CIS region, with the quality of institutions and high internal and external imbalances considered the major weak spots (Figure 5) (UN/ Oxford Economics, 2020).

Figure 5: Key dimensions of sovereign risk



The Covid-19 pandemic caused a significant economic downturn around the world, with IMF projecting a decline of global output by 4.9%, the biggest global recession since the Great Depression. There has been unprecedented decline in economic activity in many countries simultaneously, affecting consumption and trade, mobility, and labour markets. The adverse impact on low-income households is particularly acute, imperilling the significant progress made in reducing extreme poverty in the world since the 1990s. Deep recessions are expected

[6] https://www.bnm.md/ro/content/informatie-privind-evolutia-activelor-oficiale-de-rezerva-luna-decembrie-2019

[7] https://www.bnm.md/ro/content/situatia-financiara-sectorului-bancar-pentru-anul-2019

in all of Moldova's main trading partners and migration destinations – Romania (-6%), Italy (-12,8%), Germany (-7,8), and Russia (-6,6%) (IMF 2020a).

Considering both the effect of the internal lockdown, and Moldova's external imbalances, Moldova is expected to face a deep recession as well. At the end of April 2019, Oxford Economics modelled the economic impact of the pandemic under several scenarios and estimated that the recession in Moldova would be between 1.4% and 6%. They highlighted several important sources of risk:

- Although Moldova registered similar reduction in workplace mobility as other countries, around 40%, the cost of such reduction is likely to be higher due to the important role of SMEs in the economy. SMEs in Moldova provide 70.6 % of employment and 70.7% of value added, higher than the EU averages (66.5 % and 56.3% respectively). They are also concentrated in the wholesale and retail sectors where the containment measures have hit hard (they account for 24% of total employment).
- The high level of informality in Moldova generate a strong likelihood that informal workers are pushed into poverty as a result of the pandemic.
- Moldova is likely to face greater challenges to obtain fresh resources for financing imbalances, as export revenue and remittances experience a sharp drop.

Available macroeconomic data provided by the National Bureau of Statistics for the first quarter of 2020 already indicate a slowdown in economic activity, with real GDP growth at 0.9%. More recent data on main economic indicators show a growing decline in economic activity in the second quarter. In April 2020, industrial production fell by 25% compared to the same month of last year, with the biggest declines in production of textiles and clothes, machines and electric equipment, and furniture.

Data on external trade indicates that exports of goods declined by 26% in May 2020 compared to the same month of last year, and this followed a decline in previous months (Figure 5). Cumulative data for January-May 2020 shows a decrease in exports of goods of 15.4% compared to the same period of 2019, with exports to the EU countries declining by 14.2%, and exports to CIS countries declining by 5.1%. Country data indicates a fall of more than 25% in the export of goods to Moldova's two main trading partners in the EU – Romania (-25.1%) and Italy (-27.3%). The fall of exports was for the same categories of goods, the production of which declined - textiles and clothes, machines and electric equipment, and furniture.

Figure 6: Monthly evolution of exports

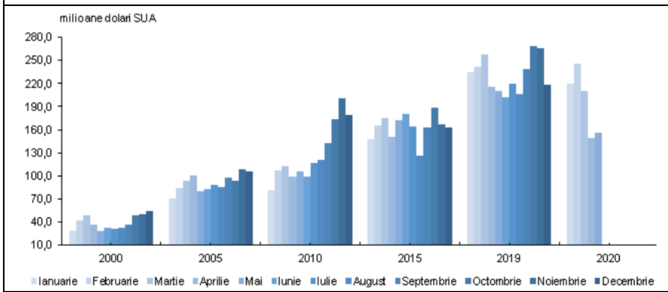
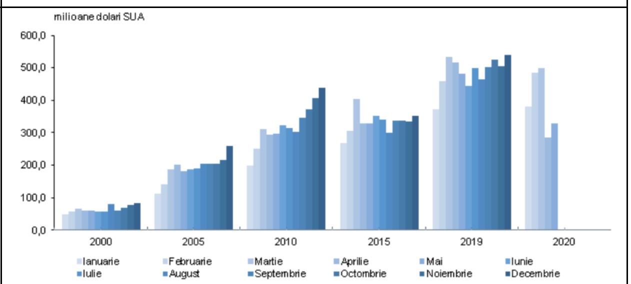


Figure 7: Monthly evolution of imports

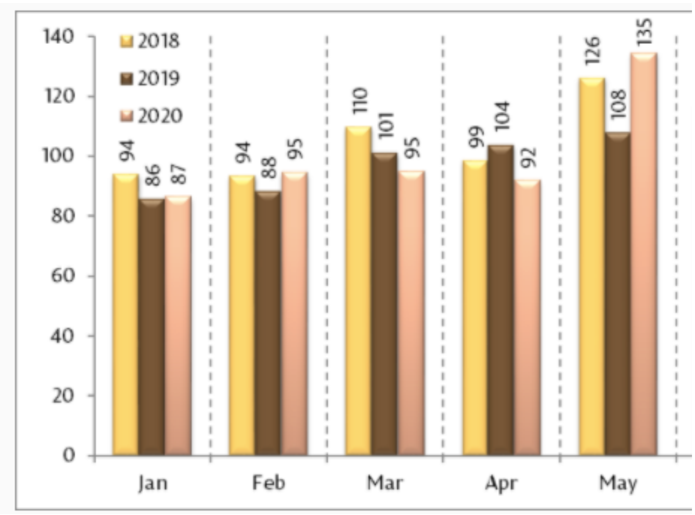


Source: National Bureau of Statistics, www.statistica.md

Imports of goods declined even more than exports, with a fall of 31.6% in May, and 16.2% in the period January-May compared to the periods of last year. Imports from EU countries declined by 18.8% in the first 5 months of the year, while imports from CIS countries – by 18.4%. Imports fell for petrol, gas, machines and equipment, textile and clothes, cars, fertilisers, and other categories of goods. The fall in exports and imports determined a reduction of the balance of trade deficit.

The flow of remittances, on the other hand, has increased, amounting to USD 135 million in May 2020, after a slight negative trend (year-on-year) in March and April (Figure 8). In the first 5 months cumulatively, the flow of remittances was 3.1% higher than last year. The largest share of remittances in May 2020 originated in Israel (19.7% of total), followed by Italy (16.8%) and Russia (12.7%). The increase in the flow of remittances may seem counterintuitive, particularly considering that a rapid diaspora survey conducted by IOM in April 2020 showed that up to 20% of Moldovan labour migrants already indicate their intention to return to Moldova and 17% stopped remitting in the current climate, figures that likely to increase as the COVID-19 imposes a further negative impact on the job markets of the destination countries of Moldovan migrants (UN/ Oxford Economics, 2020). However, this is in line with academic literature that demonstrates the countercyclical nature of remittances, which tend to increase when income in home countries fall (see for example Frankel, 2011). In addition, travel restrictions may have determined higher electronic transfers of money, thus leading to a better recording of remittance flows in official data.

Figure 8: Flow of remittances, USD million



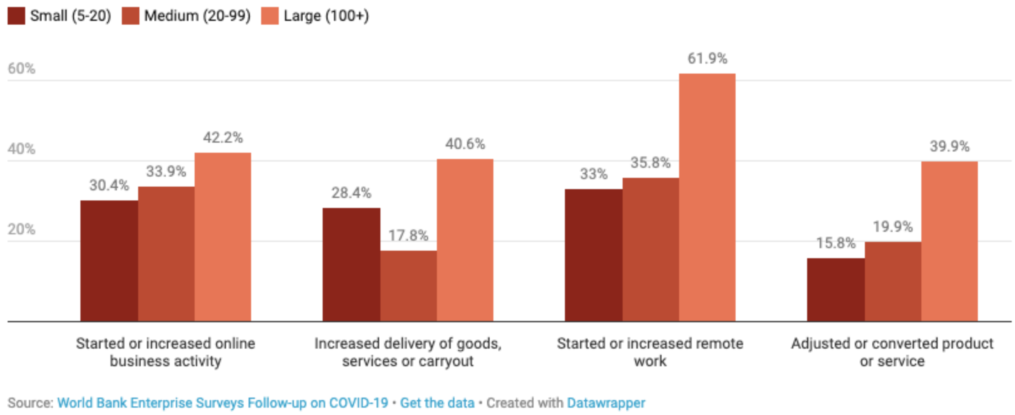
Source: National Bank of Moldova, https://www.bnm.md/ro/node/60781

Firm-level data indicates the severe impact of the pandemic on the private sector. The results of the 2020 round of the World Bank Enterprise Survey indicate that almost one-fifth of businesses may have succumbed to the economic shock caused by the required shutdown. Compared to the same period in the previous year, annual sales declined by 57 percent on average, with small businesses faring the worst. The change in sales has disproportionately affected small businesses that employ between 5 and 19 workers and businesses engaged in manufacturing. Employment has dropped at a lower rate, with roughly 13 percent of companies reporting a cut in their workforce, though 20 percent of the overall workforce in the sample have been affected by the crisis in some way. The negative impact is likely to continue in the coming weeks, as 55.8% of the firms in Moldova anticipate falling into arrears on outstanding liabilities in the coming weeks[8].

[8] https://blogs.worldbank.org/europeandcentralasia/growing-impact-covid-19-moldovas-private-sector

It is important to note that businesses appear to be adapting to the changing circumstances caused by the outbreak of COVID-19. One-third of businesses have started or increased their online business activity, and a quarter have started or seen a rise in the delivery of goods or services (Figure 9).

Figure 9: Percent of firms adapting to Covid-19, by firm size



Response to the Covid-19 Pandemic

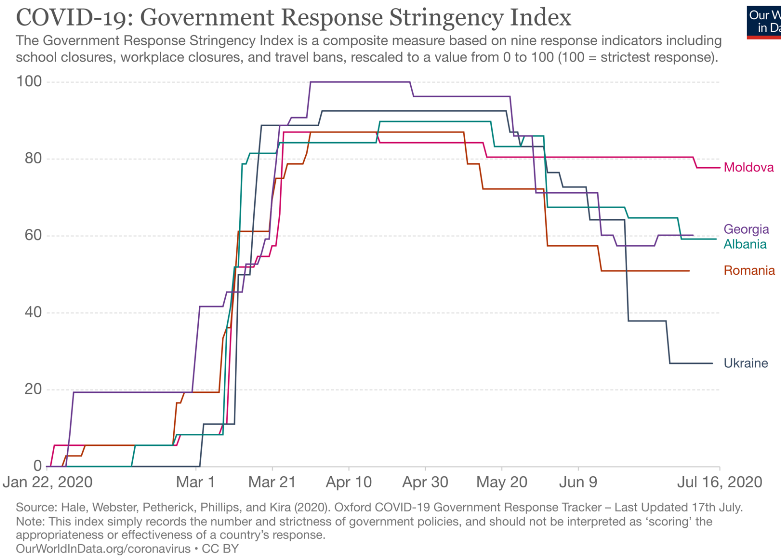
Government response to the consequences of the pandemic

At the outset of the pandemic, the majority of countries opted for strict lockdowns to prevent the exponential spread of the virus and avoid overwhelming the health systems. However, this led to an unprecedented shock to the economy and a steep decline in economic activity. Consequently, most countries adopted rapid and decisive monetary and fiscal policies to mitigate the economic impact of the lockdowns and prevent distress to firms and loss of jobs.

As mentioned above, the Moldovan Government moved quickly to introduce a state of emergency just 10 days after the first Covid-19 case was confirmed on 7 March, and opted for quite a strict lockdown, in line with most of the countries in the region (Figure 10). The government was slow to move on training and equipping doctors, expanding testing capacity, and preparing health infrastructure (IPRE, 2020). Consequently, the number of infections continued to grow and the Moldovan Government, following a 60-days state of emergency, instituted a public health emergency instead, and maintained school closures, travel limitations, and restrictions on public events and gatherings. Some of the restrictions could be politically motivated, to prevent calls for protests. Despite this, some groups, such as representatives of the restaurant and events industries, communities of parents, and veterans, have organised relatively small protests to show their discontent with government policies.

Several special commissions have been instituted after the onset of the pandemic, with a confusing management structure and overlapping competencies. The main bodies responsible for crisis management are the Exceptional Situations Commission and the Extraordinary National Commission on Public Health were led by the Prime-Minister. In early March, the Supreme Security Council led by the President also got involved in decision-making relating to the pandemic and mandated the creation of a Single Command Centre under the President, which exceeded both the President and the SSC's competencies (IPRE, 2020).

Figure 10: Government response stringency index



Public communication on the pandemic has been unstructured and confusing, with contradictory messages being sent by the President on one hand, and the Prime Minister, Minister of Health, Labour, and Social Protection, and the Head of the Public Heath Agency on the other hand. The President made statements about the flu-like nature of the virus, gave wrong information on restrictions, contradicting Government regulations, and assured priests that they will not be sanctioned for disobeying restrictions on religious services. Fake news on the nature of Covid-19 have not been effectively tackled, with the Security and Information Service using its prerogative to clamp down on fake news only twice throughout the duration of the state of emergency. Moreover, disinformation, anti-EU rhetoric and attacks on judges, independent media and the civil society, have been orchestrated by the Socialists Party and the office of the President, with the aim of undermining the legitimacy of European integration, and influencing forthcoming elections, such as for the presidency later in 2020 (Cenusa, 2020).

On the economic side, the National Bank moved swiftly on the monetary policy response and implemented one of the most aggressive rate cuts among emerging markets, cutting the policy rate by 2.25% in March, to 3.25%. Accounting for inflation, this means a real rate that is negative, at -2.75% (UN/ Oxford Economics, 2020). The fiscal policy response, in contrast, has been slow and ineffective.

Even before the onset of the pandemic, the Government promoted a 2020 budget with a sizeable deficit of 3.9% of GDP and significant implementation and financing risks. In particular, funding previously envisaged under the EU's Macro-Financial Assistance (MFA) and the World Bank's new development policy operation (DPO) was uncertain due to concerns over wavering reform momentum and fiscal costs of the several costly and poorly targeted social initiatives (IMF, 2020b). After the onset of the pandemic, the Government approved two additional budgets – one in April, and another one in July, which increased the deficit first to 7.5% of GDP, and then to 8.1% of GDP.

Despite this large fiscal expansion, the mix of policies promoted by Government proved ineffective in supporting jobs and providing an injection of liquidity into companies in distress. The fiscal measures focused especially on tax measures – tax deferrals or fiscal relief, and subsidized interest rates on loans to enterprises, which benefited companies that continued their activities and received revenues. The fiscal package did not include two key policies implemented in most European countries and all countries in the region: 1) a furlough scheme, where the government subsidises a certain minimum of a monthly wage to workers in affected industries who have become temporarily unemployed, and 2) expanded loan guarantees to induce banks to lend. A comparison of fiscal measures implemented in Moldova, Romania, Ukraine, and Russia, as of end-April 2020, is included in Annex 1.

As a result, only 3 percent of the firms interviewed in the 2020 round of the World Bank Enterprise Survey indicated that they already received or expected to receive government assistance. Twenty-seven percent of firms thought they do not qualify for assistance, while 23 percent were not even aware of the available business support programs. The survey also showed that large firms were disproportionately benefiting from government support[9].

Despite calls from most of the opposition parties and business associations, the Government did not introduce a furlough scheme even in the July round of budgetary amendments, and provided a very small increase of EUR 2.5 million for an existing SME guarantee fund. Instead, the government expanded previously-approved policies, despite the fact that only 7% of the funds budgeted for salary tax relief and 10% of the funds budgeted for subsidised interest rates on loans seem to have been accessed by companies[10]. The Government also made a 10% increase in the existing agricultural support fund of around EUR 50 million (0.5% of GDP) to support farmers in dealing with the consequences of drought and other natural calamities. However, agricultural subsidies are also largely ineffective in supporting those most in need - only 30 percent of subsidies are allocated towards the smallest entities, and the smallest farms receive only 44 percent of the average subsidy per request (Chistruga, 2019).

Support to households, in the form of increased allocations for unemployment and targeted assistance programmes were initially very small, at only 0.15% of GDP. In the second round of amendments, support to households was increased, through increases in salaries to doctors, and social assistance payments that were not as effectively targeted, such as a one-time support to the retired with pensions under a certain threshold.

The financing strategy of the Government remains uncertain and risks crowding-out significant resources from the private sector. Since the onset of the crisis, the Government received USD 235 million in emergency assistance from the IMF, and the EUR 30 million second tranche of the EU MFA offered in 2017. Initially, the 2020 budget included the disbursement of the third and final instalment of the programme in the amount of EUR 40 million. However, the first additional budget replaced that with the delayed second tranche. The third instalment was cancelled, as the availability period of the programme ended in July 2020 and the Government did not follow through with the fulfilment of specific policy conditions, particularly relating to energy sector reforms, and reform of the judiciary.

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[9] https://blogs.worldbank.org/europeandcentralasia/growing-impact-covid-19-moldovas-private-sector

[10] https://cutt.ly/vaJ9Doi

Despite large financing needs, the Government proceeded reluctantly with the implementation of institutional reforms to access the second tranche, such as the adoption of legislation on non-governmental organisations and anti-money laundering, and an independent audit of the Court of Accounts and Audio-visual Council. Progress on this was made only after the ruling of the Constitutional Court, which found provisions of the financing agreement with the Russian Federation for a EUR 200 million-loan anti-constitutional, and significant pressure from the opposition.

The budget currently includes several uncertain sources of financing. The Russian loan is still included as a financing source, although it is not sure whether a new agreement can be negotiated without certain provisions on conversion and participation of Russian companies that were stricken out by the Court. The budget also includes the full amount of EUR 100 million under the new MFA programme with the EU. The financing agreement has not been signed as of mid-July, and the ability of the Chicu Government to implement both political and technical conditionalities in the context of looming presidential elections is highly uncertain.

Another important source of financing included in the budget are government bonds issues on the local market. With the two additional budgets, the planned value of issued bonds increased to a whooping EUR 300 million. The capacity of the government to sell such a large amount of bonds on the internal market is highly uncertain, considering that issues in previous years were under EUR 50 million. Moreover, even though there is significant liquidity in the banking sector, the issuance of such a large amount of bonds will certainly crowd out investment to firms in the private sector at the time when they need it most.

EU response to the consequences of the pandemic

EU assistance to Moldova is provided under the European Neighbourhood Instrument, in the form of the Country Action Programme, as well as Macro-Financial Assistance, regional and thematic programmes. The stated aim of EU assistance is to ‘improve the quality of life of ordinary Moldovans in a tangible and visible manner’ and is based on strict conditionality, linked to the satisfactory progress in reforms and the respect of the rule of law, effective democratic mechanisms and human rights. The funding for the period 2017-2020 has been programmed under the Single Support Framework. In 2018, in light of deterioration in democratic standards, including the non-transparent invalidation of Chisinau elections, and lack of progress on combatting corruption and money laundering, and judicial reform, the EU decided to substantially recalibrate its financial assistance and redirect support to projects that have a direct, positive impact on Moldovan citizens. In effect, the EU support was scaled back and redirected from the central government towards civil society organisations, media, reform-minded local authorities, and SMEs. In 2019, the funding envelope constituted EUR 42.4 million[11].

At the end of March 2020, the EU announced that it will support its Eastern partners by reallocating EUR 140 million for the most immediate needs in the supply of medical devices and personal equipment, such as ventilators, laboratory kits, masks, goggles, gowns, and safety suits, as well as by redirecting the use of existing instruments worth up to EUR 700

[11] https://ec.europa.eu/neighbourhood-enlargement/neighbourhood/countries/moldova_en

million to help mitigate the socio-economic impact of the coronavirus crisis[12]. For Moldova, this will translate into grants in the amount of EUR 87 million, using a mix of existing and new funds to support the health sector, civil society and vulnerable groups, and SMEs. In mid-July, a first shipment of medical respirators and masks, goggles and gowns to help enable health-care workers was delivered to Moldova. In addition, Moldovan SMEs will have access to credit lines and loans through the EU4Business initiative, a new support programme to help SMEs, and de-risking instruments to access liquidity under the European Fund for Sustainable Development[13].

In addition, on 22 April 2020, the Commission adopted a proposal for a EUR 3 billion MFA package to ten enlargement and neighbourhood partners to help them limit the economic fallout of the coronavirus pandemic. As part of this package, the EU agreed on a MFA programme of EUR 100 million to Moldova[14]. The financing agreement is expected to be signed in mid-July, with half of the amount disbursed immediately, and another half after the implementation of a set of conditionalities.

Potential Impact of the Covid-19 Pandemic on Economic Institutions and Implications for EU Assistance

The Covid-19 pandemic is still in its early stages – the number of infections globally continue to rise, and there is significant uncertainty about its evolution in the medium term. Although progress has been made on developing vaccines, approval is not expected until 12 to 18 months from now[15], and more time will be necessary for mass production, distribution, and vaccination. The economic and social effects, as well as the speed of recovery, are also difficult to estimate.

Considering global trends and the analysis above, one can expect the following trends to dominate medium-term developments in Moldova:

- Prolonged political volatility
- Increasing role of the state, government policy and public investments
- Increasing financing needs and corresponding leverage of international funders and partners
- Widespread disinformation, fake news, anti-globalist sentiment, and Euroscepticism
- Growing degree of digitalisation both in the public and private sectors
- Firm restructurings and bankruptcies, and changing economic relations on the domestic and international market
- Rising unemployment, poverty, and vulnerability
- Significant changes in travel and migration trends

[12] https://ec.europa.eu/commission/presscorner/detail/en/IP_20_562

[13] https://ec.europa.eu/neighbourhood-enlargement/sites/near/files/coronavirus_support_eap.pdf

[14] https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/international-economic-relations/enlargement-and-neighbouring-countries/neighbouring-countries-eu/neighbourhood-countries/moldova_en

[15] https://www.theguardian.com/world/ng-interactive/2020/jul/22/coronavirus-vaccine-tracker-how-close-are-we-to-a-vaccine

- Deficit of medical professionals and focus on state capacity in health management

The worsening of the economic situation, coupled with political volatility and weak institutions, may also spur separatism and generate conflict, particularly in the Transnistrian region. This, however, is a geopolitical risk with significant implications that is beyond the purview of this paper.

These trends will have a complex and profound impact on institutions, both immediately and in the medium and long term. First, political volatility will imply weak *de jure* political power, with continued pressure on the ruling coalitions and sitting governments. The role and influence of the Constitutional Court and independent institutions is likely to increase. The Presidential elections are of a nature to change the balance of power, and will be hotly contested, so doubts regarding the legitimacy of the electoral process may spark discontent and civil unrest. That, coupled with the weak legitimacy of the current Parliament, will generate further political volatility. Under these circumstances, the strict conditionality approach to EU assistance should continue, and political conditionalities should focus on actions that enhance the legitimacy of political institutions and processes, such as elections, independence of the media and free speech, appointments to key regulatory bodies and the judiciary, high-profile corruption cases, etc.

Political volatility will also signify weak state capacity to prioritise and implement reforms under the EU-Moldova Association Agreement. On one hand, it will be important to ensure that the Europeanisation agenda continues to drive technical work, which could be achieved by developing and adopting a new National Action Plan for the implementation of the EU-Moldova Association Agreement and continuous technical assistance at the level of ministries to support progress. On the other hand, any agreed implementation plans should not be overly ambitious, as evidence indicates that attempts to do too much, too soon, with too little - through adopting formal laws and policies that require sophisticated and robust capabilities for implementation – actually increase the gap between formal laws, regulations, policies and actual implementation on the ground, making it more difficult to build capability (Andrews, Pritchett and Woolcock, 2017).

Changes in economic institutions will accelerate and will be characterised both by shifting economic realities and a fight over future distribution of resources. In terms of economic realities, one can expect genuine challenges around issues, such as health and safety at work; digital trading, electronic payments, and telework; contract execution and regulation of bankruptcies; and risk regulation and management in the financial sector, to rise to the top of the political agenda. As evidenced above, the tendency of the current government is to support large companies, which have better lobbying capacity and exert more political power. The achievement of optimal societal outcomes, under these conditions, will depend on improving collective action abilities of smaller and less influential groups, through small business associations, platforms for consultations and sharing of expertise, mass-media coverage, and civil society engagement.

One of the major impediments for ensuring broad participation of various groups in the decision-making process is the tendency of the political leadership, but also of the non-transparent bureaucracy to pass legislation and regulations quickly, without providing time for opinions to be voiced and discussed in the public sphere. One of the most notable recent examples is Parliament adopting in first reading a draft new Customs Code just a week after it was adopted by Government and submitted to Parliament. The hundreds-page document, which is extremely important for the future of economic institutions, was provided to MPs just one day before considerations in Parliamentary committees and subsequent vote in the plenary session. The EU and other international partners could play an important in ensuring the transparency of the decision-making process, at the very least in regards to legislation and regulations that are the object of the Association Agreement and agreed conditionalities.

With the fiscal expansion of the state, rules around public procurement and public investment will have a higher impact on distribution of resources and therefore on economic institutions in the medium and long term. As indicated above, the real effect of government support to the economy and firms that need it the most depends not only on the size of the programs but also on good governance and state capability. Multiple assessments by local and international organisations have shown that the public investment management process in Moldova is politically influenced, economically ineffective, and marred by violations and allegations of misappropriations (see, for example, Expert-Grup, 2019 and Morcotilo, 2018).

When a government spends more, but procurements are carried out in an unfair or corrupt manner, then resources end up flowing in a concentrated manner towards a number of firms and interests close to the centres of power and connected interest groups. In the times of economic crisis, when liquidity is scarce and asset prices fall, it is precisely those interest groups that will benefit from a disproportionate distribution of resources. This will in turn prevent the establishment of growth-enhancing institutions in the medium term. The EU and other partners that have been working with the government on improved procurement systems and practices could focus conditionality and technical assistance to target improved transparency and governance of public procurement.

Importantly, in this period of economic downturn, the ability of SMEs to access liquidity for working capital, distress and bridge funding, restructuring advise and support, will have an important influence on competitiveness of Moldova firms, distribution of resources and development of European-style economic institutions in the medium term. SMEs and entrepreneurship are the backbone of the EU economy and considered key to ensuring economic growth, innovation, job creation, and social integration in the EU. In the past five years, they have created around 85% of new jobs and provided two-thirds of the total private sector employment in the EU[16]. In Moldova, some 60% of employees work for SMEs and they create some 70% of the value add in the economy.

The EU has recognised the importance of SMEs for the economic development of the region and established in 2009 EU4Business, an umbrella initiative aiming at improving the regulatory environment, access to finance, and knowledge base of SMEs. As of 2019, the EU4Business Initiative had 16 ongoing and 7 closed projects, mostly in the area of access to finance (EU4Business, 2019). This support is implemented through banks, and a survey of beneficiaries in 2018 indicated that banks were entry points for all entrants into the programme and most of them had been in operation for 10 years or longer. Interestingly, because the SMEs entered the programme through banks, 80% of them were not aware of the fact that the funding originates in the EU. Advising services are provided by a number of organisations, in particular EBRD and the Organisation for Developing SMEs under the Ministry of Economy. Nevertheless, these programmes provide a limited number of financial instruments (mostly loans), reach mostly bankable firms and those firms that are experienced

[16] https://ec.europa.eu/growth/smes_en

in navigating the complex institutional framework of advisory projects. Additional instruments for supporting SMEs' access to finance are needed, and the next section puts forward the case for a Moldova Growth and Enterprise Fund.

Ability of groups to overcome collective action challenges and exert de facto political power will also change as a result of the crisis. Collective action abilities in Moldova are relatively weak, due to low levels of trust, the multi-ethnic composition of the population and regional heterogeneity, and a weak culture of civic participation and mobilisation. Although the EU and other international partners have supported NGOs, the stronger organisation are expertise-based and disconnected from various constituencies. Support at the local level, by funding community-anchored organisations, or providing direct support to local public authorities, thought proposed projects, such as 'the European Village[17]' could help build trust and improve collective action at local level. Collective action may improve significantly with the return of migrants, particularly from EU countries. The ability of Moldovan migrants to overcome collective action challenges has increased in the last several years, as proven by active diaspora groups, Hometown associations supporting villages of origin, and charity projects implemented by diaspora communities.

Combatting disinformation and fake news, which erode trust and promote Euroscepticism, will be even more of a challenge during the crisis, particularly considering upcoming elections. This will require rapid reaction to curb particularly damaging narratives. In addition, the EU and other international partners should put more effort in communicating about the assistance provided to Moldovan citizens and ways in which Europeanisation improves their everyday life.

The Case for a Moldova Enterprise and Growth Fund

As mentioned in the section above, the ability of SMEs to access finance will have an important impact on distribution of resources and development of European-style economic institutions in the medium term. A broader formalized financial system, which is capable of taking care of entrepreneurs, in particular young firms at the community level, at different stages of the lifecycle of small firms, is imperative to provide business growth and foster innovation (Wellalage and Hernandez, 2019). Access to finance remains a critical issue for SMEs in Moldova (EU4Business, 2019). Banks represent the primary source of financing for local SMEs. However, numerous problems for accessing bank loans have been cited by entrepreneurs, including inability to access unsecured loans, overvalued collateral, lack of instruments for new entrants, and high transaction costs. The banking sector has undergone significant restructuring and reform during the last couple of years, under an IMF programme, and has adopted Basel III requirements, with some exceptions for SME lending. Although the range of financing instruments for SMEs has grown, including guarantee schemes, most SME support programmes tend to be both donor-funded and targeting a very specific segment or use (OSCE 2020).

There are a limited number of organisations that provide equity funding. The most notable example is the Western NIS Enterprise Fund/Horizon Capital fund established in 1994 by USAID to invest in Ukraine, Moldova, and Belarus (Box 1). EBRD also makes equity investments, including with funding from the EU. However, these organisations, working

[17] https://www.moldpres.md/en/news/2019/09/16/19007282?src=ilaw

regionally, end up concentrating more on the larger and potentially more profitable Ukraine market and on the largest and most profitable enterprises.

Box 1. Western NIS Entreprise Fund (WNISEF)

Western NIS Entreprise Fund (WNISEF) is a $150 million regional fund founded in 1994 by the U.S. Agency for International Development (USAID), with the mission to develop small and medium-sized businesses, support solid corporate governance and transparency, and attract additional capital to Ukraine, Moldova, and Belarus. WNISEF has provided loans, equity, grants, technical and other assistance to companies operating in a variety of sectors, including financial institutions, agriculture, manufacturing, and services. Since its inception, WNISEF has invested $168 million in 118 companies, employing over 25,000 people in Ukraine and Moldova. In Moldova, WNISEF invested in some of the largest companies, such as Glass Container Company, Vitanta, and Agroindbank.

In 2005, WNISEF created Horizon Capital, a private equity fund manager and launched a private successor fund, Emerging Europe Growth Fund (EEGF). Horizon Capital currently manages four funds with assets under management of over $850 million, including EEGF III.

In March 2015, USAID approved the launch of a $30 million Legacy Program funded by a portion of the profits earned from investment activities. The program focuses on export promotion, local economic development, impact investing and economic leadership. In April 2016, USAID approved i) expanding the Legacy Program to $35 million; ii) $5 million earmarked for direct investments in SMEs, primarily start-ups; and iii) a $30 million commitment to Emerging Europe Growth Fund III, L.P. (EEGF III), a fund launched by Horizon Capital and focused on providing financing to SMEs in Ukraine and Moldova. In June 2017, the Fund committed $30 million to EEGF III.

In November 2017, WNISEF launched U.Ventures, a new $5 million fund for early stage technology startups offering co-financing and scaling assistance for Seed to Series A startups with Ukrainian or Moldovan co-founders.

WNISEF is governed by an independent Board of Directors comprised of leading representatives of the U.S. business community. Following the initial closing of the EEGF, in early 2006, all employees became employees of Horizon Capital and private sector investment are managed through the fund manager. In 2015, WNISEF has hired certain employees for Legacy Programs realization. In 2002, the Board of Directors established the Long-Term Equity Incentive Plan for certain employees, which awards an interest in the net realized gain upon sale of the equity interest in a portfolio company.

A study of the economic impact of WNISEF's investments carried out in 2003 concluded that for every dollar invested into Ukrainian and Moldovan companies, an estimated additional $8.02 effect was created for local economies.

Sources: https://wnisef.org/, https://horizoncapital.com.ua/, and WNISEF (2017).

The EU is planning to allocate up to EUR 966 million for the short and medium term to support the social and economic recovery of the region. Rather than complement existing programmes and credit lines, the EU could allocate a small part of this funding, for example EUR 30-50 million, which would constitute less than 5% of the funding envelope, to a country-specific, contextually-relevant hybrid fund for SMEs – Moldova Enterprise and Growth Fund. A EU-financed, locally-anchored hybrid fund – which can provide cheap and flexible funding, through a range of financing instruments to support competitiveness and growth of SMEs – could reach more effectively local SMEs, in particular micro SMEs, and achieve the aim of improving their access to finance and support the economic development of the country. A range of different hybrid and development-oriented funds exist; one example is the Global Innovation Fund based in London which supports the scaling of evidence-based innovations for the world's poor (Box 2).

The Moldova Enterprise and Growth Fund, if properly set-up and structured, would have the potential to generate a number of positive outcomes:

- Provide increased opportunities for SMEs to access the right type of finance, particularly start-ups and companies with riskier profiles that cannot access banking loans
- Serve as a single entry-point and a platform for accessing technical assistance, coaching support, and get matched to advisory services
- Contribute to integration of the informal sector into the formal sector, which is proven to provide opportunities for expanding innovation (Wellalage and Hernandez, 2019)
- Contribute to the development of the regulatory framework for corporate governance and venture capital in Moldova. Although a draft law taking into account existing EU regulations on venture capital exists since 2015, it has essentially been dormant (OECD, 2020).

Box 2. Global Innovation Fund

The Global Innovation Fund (GIF) is a non-profit innovation fund that invests in the development, rigorous testing, and scaling of innovations targeted at improving the lives of the world's poorest people. GIF is a hybrid investment fund, which provides grants, loans (including convertible debt) and equity investments ranging from $50,000 to $15 million at all stages of an innovation's life cycle, from start-up and pilot-testing through to larger scale implementation. GIF backs innovations with the potential for social impact at a large scale, whether they are new technologies, business models, policy practices, technologies or behavioural insights. They can scale up commercially, through the public/philanthropic sector, or through a combination of both in order to achieve widespread adoption.

GIF is backed by a number of bilateral funders, in particular USAID, UKAID, SIDA, and DFAT, as well as private foundations such as Omidyar Network and Unilever. GIF is governed by a Board of Directors, which comprises both representatives of the funders and independent Directors, and includes world-leading academics, impact investors, thought leaders, and development experts from across the public and private sectors. The GIF Board is responsible for oversight of the organisation's strategy and performance, and holds it accountable for its work. The GIF team across London and Washington D.C. is comprised of investors, economists, and development experts, who identify and due diligence investments, but also provide portfolio/venture support to innovators throughout the duration of the investments. This includes membership on boards, support to improve policies and manage Environmental, Social, and Governance (ESG) risks, support to measure performance and social impact, dissemination of learnings, and other areas of support.

GIF's goal is to scale innovations backed by rigorous evidence, and every investment is designed to support innovations on their path to scale. GIF takes a venture capital approach, using a tiered financing model, and offering graduated funding. The goal of the staged funding approach is to support organisations to scale up to reach millions of people. This staged funding approach allows sensible management of risk, with smaller bets on riskier, unproven innovations at the pilot stage, and investment of larger amounts in innovations that have demonstrated strong evidence of success, through rigorous impact evaluations where possible.

As of end-2019, GIF invested $73.5 million to support 35 innovations. GIF boasts 13 follow-on investments raised by for-profit portfolio companies and 240% revenue growth across the for-profit portfolio since initial investment.

Source: https://www.globalinnovation.fund/

The set-up and governance structure of the Moldova Enterprise and Growth Fund is of utmost importance – ultimately, the incentives that are built into the operations of such a fund will make the difference between its success and failure. The Fund should be a credible financing vehicle for EU support and investment, but also for other credible public and private investors. First and most importantly, this Fund should have a strong Board and CEO, with positions filled by high-level, independent, and qualified investment professionals that can exert de facto political power and be able to resist capture by local and international interest groups. The Board should include representative of major funders, as well as prominent local investment and business professionals.

The Fund should also have competent and motivated investment professionals, who would not only be capable of doing due diligence and structuring deals, but also be able to work with entrepreneurs as a team, and be reasonably invested in their success. This would require thinking about a performance management system and an incentive scheme that would foster such behaviours. The Fund should also have a technical assistance arm and be able to serve as a knowledge platform that is capable of matching entrepreneurs and other appropriate funders, programmes, and organisations.

Although the mission of the fund – to provide cheap and flexible funding, through a range of financing instruments to support competitiveness and growth of SMEs – seems relatively straight forward, the exact risk profile, financing instruments and ranges, criteria for investment, have to be carefully worked out. This should take into account Moldova's early experience and the due diligence carried out by large investors and other potential funders who considered entry into market, as well as consider global trends and medium-term projections for local business conditions. Profit maximization should not be its primary objective, and its risk profile should not be similar to a bank, as then it will risk crowding out banks and have the tendency to concentrate on mature entrepreneurs and larger companies. Rather, it should be able to forego part of the return or have a longer time horizon for expected profit, if the growth of the company will have externalities in terms of improving competitiveness and growth.

This fund should invest in improving the business skills and the financial literacy of entrepreneurs, as well as their resilience to various form of rent-seeking. The fund could tackle this through structural mechanisms designed to guarantee the success of the investees, but unlikely to cause political issues. The accomplishment of these elements could be integrated into the Fund's due diligence and contracting process as prequalification for accessing the funds, but implemented by specialised partners. In particular, the Fund could require:

- **Financial/investment literacy programme**, focused on the basic elements of running a business. The goal is to improve the entrepreneur's understanding and planning of the business, as well as to take informed decisions about the consequences of the investment.
- **Mandatory compliance training,** focused on key risk areas, mitigation strategies, experience from entrepreneurs in the field and a "know your rights" component. The goal is to protect people from government corruption by promoting compliance.
- **Defence guarantee for clients**, focused on a concrete set of actions and steps to be taken by the client, resulting from the compliance training. The Fund itself should have a legal defence mechanism prepared to step in and defend their investments (in court or via consulting and advice) in the event of corrupt actions threatening their company. Formed as an "advocate" for the fund's investments and backed up by the trainings mentioned above this could create significant deterrence in the marketplace of corruption.

Finally, the Moldova Enterprise and Grow Fund would be a pioneer of venture and equity type investment on the Moldovan market and should have built-in capabilities to identify policy constraints and support the government to improve the regulatory framework for risk capital funding in Moldova. The fund could contribute with evidence and practical experience to the approximation of the European venture capital framework. More broadly, the Fund could tackle the regulatory environment for structure and investment mechanisms for SMEs. Since no fund has been working with equity investments in SMEs in Moldova, there has not been an institutional player that could address the inadequacy of the LLC structure in Moldova for taking on investors. It is nearly impossible to manage shareholders in Moldova in a dynamic way (for example, taking on a new investor). As such, equity investment is extremely complicated, especially for entities that are not physically present in Moldova. This not only limits investment, but also leads to the creation of overseas entities and the offshoring of profits.

By being a locally-anchored equity investor, the Fund would have a stake in their member successes, but be limited to operations in Moldova. As such, the Fud would not institutionally be able to recommend a local entrepreneur open their IT company in other jurisdictions in order to be able to simply operate in the modern high-tech marketplace. This would make this fund critically financially interested in understanding the country's regulatory issues for SMEs and growth companies in a way that no other player is incentivized to.

If well conceptualised and organised, the Moldova Enterprise and Growth Fund could have a significant positive effect on economic institutions in Moldova, both by providing SMEs with access to finance at a particularly important time, and by directly influencing the regulatory environment for investment in SMEs.

Annex 1: Comparative fiscal measures in Moldova and neighbouring countries

Fiscal measures				
Fiscal measures	**Moldova**	**Ukraine**	**Russia**	**Romania**
Healthcare support				
Equipment and PPE for hospitals	X	X	X	X
Increased compensation for healthcare workers		X	X	
Elimination of import duties on medical supplies		X	X	
Support to households				
Increase in the unemployment benefits *	X	X	X	
Active labour market policies	X			
Increased threshold for social assistance (Ajutor Social)	X			
Furlough scheme - government guarantee of a certain minimum of a mothly wage for workers in affected industries*		X	X	X
One-off increase in pensions		X		
Moratorium on penalties and disconnection for non-payment for utilities	X	X		
Increased household utilities subsidies		X		
Covid-positive and quarantined people to receive sick leave equivalent to a minimum wage until end-2020			X	
Additional childcare support		X	X	
Partial coverage of salaries for workers affected by school closures			X	X
Support to the economy				
Tax measures				
Tax and social insurance subsidies***	X	X	X	X
VAT reimbursement scheme	X			
Reduction of VAT for HORECA sector	X			
Increased thresholds for simplified taxation	X	X		
Tax deferrals	X		X	
Temporary cancellation or deferral of real estate tax on non-residential properties		X		X
Land rental payments eliminated or deferred		X		
Credit measures				
Loan guarantees to SMEs in affected industries		X	X	X
Interest rate subsidies on loans	X	X	X	
Preferential loans to SMEs and micro enterprises (subsidised interest rates)	X			
Other support measures				
Increase in government emergency Fund	X	X		
Compensation of budget revenue shortfall	X	X	X	X

Source: IMF Covid-19 Policy tracker, Moldovan Government, Oxford Economics

* Moldova - during state of emergency, until 15 May. Ukraine - from March to 31 May. Russia - at least for 3 months.

** Ukraine: min. 2/3 of basic wage, but not higher than min. wage. Unemployment benefit to equal at least min. wage for 3 month
Romania: partial coverage of wages for at least one month

*** Moldova: Social Insurance subsidies.Ukraine: Social Insurance Contributions (SIC) cancelled in March. No penalties for late payment or filing of SIC payments. Russia: SIC permanently reduced from 30% to 15% for SMEs

Source: UN/ Oxford Economics (2020)

Annex 2: List of people met

1. Ana Groza, Executive Director, Foreign Investors Association in the Republic of Moldova
2. David Smith, President, Alliance of Small Business of Moldova
3. Dorin Recean, CEO Performa
4. Dumitru Budianschi, Programme Director, Public Sector, Expert-Grup Independent Think-Tank
5. Dumitru Udrea, former Secretary of State at Ministry of Finance
6. Marco Gemmer, Head of Operations EU Delegation to Moldova
7. Mariana Rufa, Executive Director, European Business Association
8. Nicu Popescu, Director of the Wider Europe Programme, European Council on Foreign Relations
9. Sergiu Gaibu, Programme Director, Financial and Banking Sector, Expert-Grup Independent Think-Tank
10. Tatiana Laryushin, Senior Economist, IDIS-Viitorul
11. Vasile Tofan, Partner, Horizon Capital

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