

ADJUSTMENT OF ECONOMIC POLICIES IN THE REPUBLIC OF MOLDOVA TO THOSE IMPLEMENTED IN NEIGHBORING EUROPEAN STATES

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ABSTRACT

The main purpose of this paper is to assess the economic vulnerabilities of the Republic of Moldova (RM) at the macro level, as well as to formulate policy proposals for sustainable economic development. The paper focuses on the analysis of time series data between the previous global crisis (2009) and that caused by the COVID-19 pandemic (2020). The paper identifies the following economic vulnerabilities of the RM, which formed during the years of independence: pro-cyclical fiscal policy, reduced public revenues, consumption-based economic model, low investment in the economy, declining labor force, exchange rate instability in crisis situations. The paper also highlights the differences between the policies of the RM compared to neighboring European countries, especially in terms of indicators of their economic stability in crisis situations. The paper identifies the following policy areas for sustainable economic development: modernizing the structure of the economy, countercyclical fiscal policy, increasing public revenues, streamlining public services, increasing public investment, developing of private pension funds, implementing public policy in the field of financial education, accelerating growth and investment in the future. In this context, the question is "what should national policies contain?" in order to ensure a sustainable development of national economy. The experience of the new EU Member States was taken into account in formulating policy proposals. If all these economic policies will be implemented in the first decade after the COVID-19 pandemic, the RM can move from a consumer-based economic model financed by loans to an investment-based and sustainable economic development one.

KEYWORDS: *economic crises, economic vulnerabilities, European Union, Republic of Moldova, sustainable development.*

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1. INTRODUCTION

The global crisis caused by COVID-19 has affected all countries of the world and has had negative effects in most economic sectors. At the moment, it is not known how long it will take for them to overcome the consequences. The global economic downturn has reached 3.3% in 2020. Another consequence of this crisis is the decline in world trade in goods and services, which according to the World Trade Organization (WTO, 2021), accounted for 9.6% in 2020. Moreover, the COVID-19 pandemic has had an uneven impact on countries and economic sectors. Starting in 2021, the global economy is showing signs of recovery. However, the pace of economic recovery in developed countries is much higher than in developing countries due to the massive fiscal and financial support programs from the state, as well as the high share of the vaccinated population. In contrast

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to these countries, in most developing countries macroeconomic support is very limited, and the vaccination process has been much slower, which contributes to their slower recovery rates.

We can point out a considerable number of analyzes that elucidate that the COVID-19 pandemic, unlike previous financial crises, was noted by the fact that it generated two shocks at the same time, on the supply side and on the demand side (e.g. McKibbin & Fernando, 2020; Badri & Villafuerte, 2020; ITC, 2020). Measures to slow the spread of the virus require the partial or total closure of economic activities. Simultaneously, these measures contradict the development of economic activities that involve the movement of factors of production and labor, as well as the disruption of global value chains. The "shutdown" effect not only stopped the supply, but also caused a sudden cessation of demand. Stopping economic activity by initially affecting developed countries and gradually affecting developing countries as well as countries with economies in transition through external channels (stopping or decreasing import demand in developed countries, reducing remittances from migrants working abroad, to their homeland, etc.) had the effect of a chain reaction. In this context, the role of international trade in building and sustaining economic resilience is discussed in the specialized literature (WTO, 2021). This economic crisis also indicates that contemporary interdependent and globalized society is extremely fragile.

All the previous financial crises were caused by the accumulation of imbalances in a certain sector, which had negative consequences for other sectors of the economy, such as, for example, the previous financial crisis of 2008-2009, called the subprime mortgage crisis.

Unlike previous financial crises, the COVID-19 crisis affected most economic sectors, especially those sectors whose beneficiaries consume the product sitting side by side, such as HoReCa, air and road transport, tourism, culture, etc.

The analysis of the scientific literature highlights the work of Scott Galloway, who recently demonstrated the impact of the pandemic as a factor in accelerating economic trends: "consumer and market behavior is now at 2030 on the trend line - positive or negative" (Galloway, 2021, p.13). Therefore, "companies considered innovative receive an evaluation that reflects estimates of cash flow over 10 years from now and its updates at incredibly low rates" (Galloway, 2021, p.23). Moreover, he points out that many of the trends that the pandemic has accelerated are negative, which weakens the ability of the economy to recover in the post-pandemic period.

A comparative assessment of how six countries have survived crises in the past, as well as a pragmatic analysis of why some nations have succeeded in building a prosperous society while others have failed, is made in Jared Diamond's fundamental work. Analyzing the twelve factors related to the effects of national crises, he emphasizes the crucial role of national political and economic institutions by accepting national responsibility for resolving the crisis situation, making selective changes in their institutions and policies; using other nations as role models for building institutions and problem-solving policies, as well as obtaining material and financial help from other nations (Diamond, 2020, p.55). The COVID-19 crisis has highlighted the key role of the state in protecting the population, jobs and companies.

Unlike previous analyzes on the crisis, this paper will review the experience of implementing the necessary measures in some EU countries and highlight those elements of national policy that make the Moldovan economy more resilient to crises, i.e. have the systemic ability to prevent, prepare for shocks, as well as handle them and recover from them.

In addition to the introductory part, the paper has five sections, including a brief overview of policies and measures to stabilize economies during the COVID-19 crisis, and then expose to the analysis both the elements of economic vulnerability and the factors that negatively influence the development, after that, some policy proposals for sustainable economic development are being formulated for the Republic of Moldova. In this context, the policies and strategies used by some EU countries to increase the resilience of national economic structures and through the implementation of which national policies in the Republic of Moldova can act in favor of economic

stability, both during and after the crisis, will be examined. Finally, we explained the results obtained and drew conclusions.

2. METHODOLOGY AND DATA SOURCES

This paper is a comparative study of macroeconomic policies in the Republic of Moldova and neighboring European countries, implemented in these countries, especially in crisis situations. The method of comparative analysis was selected because it has the advantage of providing perspective and detection of problems that could not arise by studying a single case. In the context of the application for EU membership, submitted by the Republic of Moldova, the successful experience of neighboring European states is of particular interest. Also, this paper is a concise study, aiming to compare the important economic issues of the Republic of Moldova with those of neighboring European states, without being overwhelmed by some details and exceptions. It is based on the analysis of indicators of their economic stability in crisis situations.

For application of this method paper identifies following sources of data, extracted from two databases, i.e. the International Monetary Fund (IMF) World Economic Outlook database, but also the Eurostat database.

Regarding the Republic of Moldova, data sources used for this paper are the data of the National Bureau of Statistics of the Republic of Moldova (NBSRM), the Ministry of Finance of the RM (MFRM), the National Bank of Moldova (NBM).

3. POLICIES AND MEASURES TO STABILIZE THE ECONOMY DURING THE COVID-19 CRISIS

The transformation of the global health crisis into a financial one has led governments to take specific measures to support the current crisis. Therefore, the effect of total or partial shutdown cannot be counteracted by standard fiscal measures, which can be adopted by governments to stimulate production, such as lowering credit, reducing taxes, accelerating depreciation and tax relief for new investments. In this context, the protection of human capital by assisting those who have lost their jobs or are technically unemployed, as well as companies at risk of insolvency, have become the main targets of fiscal and budgetary programs in countries everywhere.

To this scope, the EU has temporarily suspended the application of the fiscal rules set out in the Stability and Growth Pact by removing fiscal deficit ceilings (EC, 2020). In addition, the Council of Europe allocates 1% of EU GDP to combat the effects of COVID-19. The United States also considered the budget deficit irrelevant during the crisis. The amounts allocated by governments through a package to increase state spending, as a stimulus to the economy, amount to hundreds of trillions of euros and dollars US (In comparison with hundreds of billions of aid in the previous financial crisis of 2008-2009 (author's remarks), including the German government has allocated half a trillion euros, the government the French government has launched a 345 billion EUR program and the British government a 400 billion USD program (Guda, 2020, p.28). The US government has poured 2.2 trillion dollars into the economy, much of which has entered the capital markets (Guda, 2020, p.24).

IMF has made 1 trillion USD available to countries in need to maintain the stability of global finances. The Republic of Moldova also received financial support of about 235 million USD for the urgent balance of payments needs arising from the COVID-19 pandemic (IMF, 2020).

In the Republic of Moldova, as well as in countries everywhere, temporary restrictions on economic activity have been introduced to stop the spread of coronavirus, and expenditures for urgent health care and social protection needs have been intensified, as well as some modest support measures were introduced for economic operators. In addition, the NBM relaxed the liquidity conditions and ensured the orderly adjustment of the exchange rate, and allowed the rescheduling of loans at risk of

non-repayment of installments. All of these were the first support measures offered to the population and economic operators less than 100 days after the first cases of COVID-19 were reported.

In August 2021, the Republic of Moldova received essential and unconditional support from the IMF in the amount of 236 million USD. By *Law 138 (2021)*, the Parliament adopted the allocation of this money for the direct financing of the needs of the state budget.

The measures taken have led to a restoration of domestic demand and an increase in domestic consumption. However, the economic recovery in 2021 was accompanied by an acceleration of inflation, which far exceeded the range of variation of the inflation target set by the NBM (5% +/- 1.5%), amounting to 18.5 percent in February 2022, which corresponds to the highest level recorded in Europe in that period. Starting with July 2021, the NBM has undergone a cycle of tightening monetary policy and a gradual increase in the base rate for the main monetary policy operations, which is currently aimed at reducing the demand for consumer credit.

Moreover, in the case of the Republic of Moldova, the financial resources needed to mitigate the effects of the crisis far exceed the capacity of the national budget. According to the *State budget law for 2022*, the significant budget deficit is set at over 15 billion lei and which will be mainly covered by external sources.

An important role, in support of macroeconomic stabilization and increasing the credibility of external creditors, was played by the signing in December 2021 of the new *Memorandum on Economic and Financial Policies with the IMF*, which called for certain reforms during the years 2022-2025, which were to contribute to the consolidation of the stability of the economy of the Republic of Moldova, including in case of future crises. The memorandum provides for the support of 558.3 million USD for the reform of budgetary and fiscal policies in support of the economic recovery, the emphasis on development and the strengthening of governance; pursuing monetary policies in strengthening the inflation targeting framework; increase resilience and strengthen governance in the financial sector; reforming the state-owned enterprise and the energy sector; strengthening the rule of law and fighting corruption.

According to the mentioned memorandum, for the year 2022, the deficit of the national public budget at the level of 6% of GDP was approved by activating the derogation clause from the *Law on public finances and the budgetary-fiscal responsibility* established in par. (3) lit. a) in art.15 of the general budgetary-fiscal rule, which limits the budget deficit to 2.5% of GDP. The provisions of the article in question shall apply in exceptional circumstances which endanger national security.

Memorandum with the IMF preceded the provision of assistance from other creditors, such as the European Commission's decision to provide EUR 150 million in macro-financial assistance to the Republic of Moldova, which is strictly conditional on good progress in implementing the IMF program. EU macro-financial assistance would support Moldova's economic stabilization and structural reform agenda, supplementing the resources made available under the IMF's financial arrangement (EC, 2021).

There are currently a number of risks that could have a significant impact on the achievement of the IMF macroeconomic forecast scenario, including the continued acceleration of inflation as a result of rising global energy and food prices. In addition, rising food prices globally and especially regionally and nationally are being affected by the war in Ukraine, as Russia and Ukraine are major food producers. The economic impact of the war will be reflected in the reduction of global economic growth, as well as the restoration of global and regional value chains started in 2021, which will also affect the Republic of Moldova and slow down the implementation of structural reforms.

Moreover, the data analysis shows the excessive dependence of the Republic of Moldova on external assistance and loans, which is characteristic for being in a vulnerable stage of development.

4. ECONOMIC VULNERABILITIES OF THE REPUBLIC OF MOLDOVA

Vulnerability, from an economic point of view, is perceived as an explosive situation in the economy, which appears as a result of shocks, coming from outside it and generated by the opening of the economy. When this disruption of the economy, whether temporary or permanent, is significant, these deviations make the economy vulnerable to such events. On the other hand, sustainable economic development is defined as a policy aimed at annihilating or mitigating the consequences of the crisis, as well as reducing the possibility of similar crises in the future. In many cases, this vulnerability is obvious and can be easily detected. For example, small, low-yielding (or underdeveloped) economies are described as vulnerable (Guillaumont, 2009).

In addition, in the scientific literature, a distinction is made between the structural vulnerabilities resulting from factors other than the current political will of the country and the vulnerabilities caused by policies resulting from the recent elections. As long as the vulnerability is not the result of current or recent policies and is based on persistent factors and characteristics, it is considered "structural" (Guillaumont, 2011).

The economy of the Republic of Moldova faces number structural vulnerabilities, the most significant of which will be examined below.

4.1 Procyclical fiscal policy

The business cycle theory, also known as the economic cycle, explains how short-term fluctuations move around the long-term growth trend. The upward trend is determined by factors which are not sensitive to economic fluctuations and which cannot be changed by the use of stabilization policy measures. According to Kondratiev (1989), major economic cycles have a 40-60 year cyclical pattern influenced by innovation and technology and have periods of growth, stagnation and recession within a cycle.

The world economy is currently not in the process of exiting the normal recession cycle, which is why the governments of several countries are not limited to taking measures to self-adjust the market economy through cyclical crises. In the modern world, the influence of the state on the economy is able to change the dynamics of economic fluctuations, the duration of periods of the economic cycle, especially the depth of crises. In times of crisis, state regulatory measures are aimed at mitigating all the negative components of the crisis, which is why they are countercyclical. So, the modern self-regulation mechanism of the market economy, through the economic cycle, is modified by the measures taken by the state.

From a macroeconomic point of view, one of the most effective methods of protection against any crisis is the pre-crisis fiscal surplus. Surplus funds can be used during the crisis to stabilize demand in the economy by increasing public spending and raising wages, avoiding the need to increase taxes to increase budget revenues. As basic instruments, during the economic recession, in order to stabilize, the state can use the monetary and fiscal levers, as well as the redistribution of income in favor of people with lower incomes. If these means are prepared in advance, the need to save, in times of crisis and beyond, will diminish. All these measures are in line with the state's countercyclical fiscal policy and contribute to reducing the amplitude of economic fluctuations, generating a relatively steady economic growth of GDP, and creating a more predictable and stable business environment in the face of economic crises. On the contrary, pro-cyclical fiscal policy intensifies economic fluctuations, and the business environment and the population go from a positive extreme (very strong consolidation during a period of growth) to a negative one (sudden contraction during a recession).

The differences between the two fiscal policies, as well as the different effects they have on the economy, are discussed below.

The analysis of real GDP fluctuations indicates that the Republic of Moldova had a much higher range of economic fluctuations than Poland and the EU in general, as well as severe contractions during the recession, especially in the first years of independence (Figure 1).

The economic growth of the Republic of Moldova has been interrupted eight times in the last 30 years, followed by periods in which the economy regains its pace of growth.

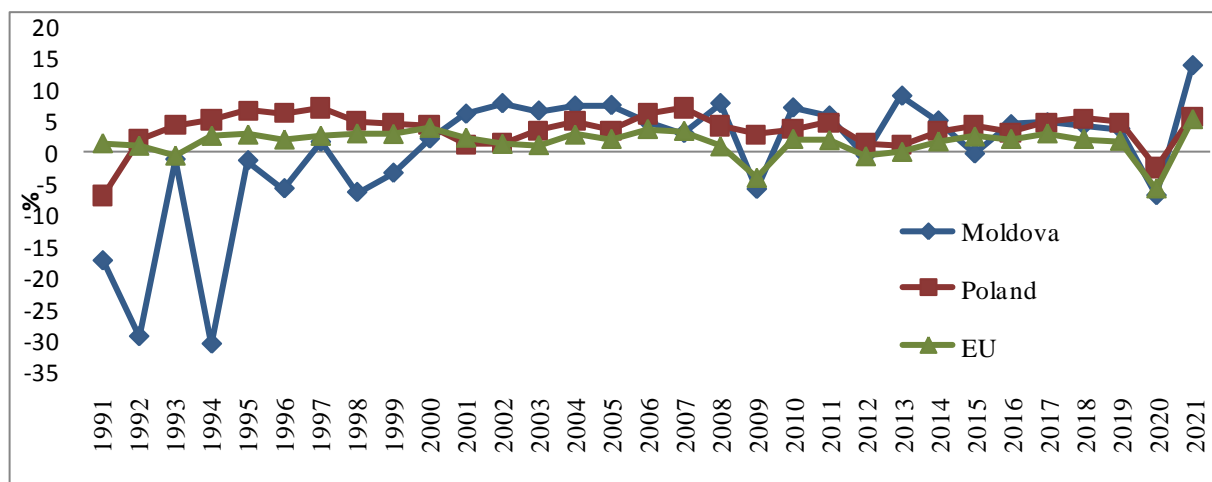


Figure 1. Real GDP (annual percentage changes)

Source: elaborated by the author using data from the IMF and the NBSRM

In comparison, Poland's economic growth has stopped only twice (in 1992 and 2020). Poland's GDP grew by 2.8% in the year of the previous global crisis - 2009. It is also noted that in most years the amplitude of fluctuations in Poland's economic growth is between 1 and 4% per year, in the period 2008-2021. The analysis of the data also shows a close correlation between the economic growth of Poland and the EU, which is also evident in the pre-EU accession period (before 2004) and especially after the accession to the EU, as well as to the Schengen area in 2007.

The data analysis indicates that the Republic of Moldova has seen a significantly higher increase in real GDP than Poland in the 12 years of the last 30 years, especially in the years following the severe recession. However, Poland has achieved a cumulative increase in real GDP of 112.8% since 1991, while the Republic of Moldova has seen a cumulative increase in GDP of only 1.2% since independence, in particular due to recessions in the early years of independence. Also, in the period between the last crises of 2009-2020, the Polish economy grew faster in real terms, reaching a cumulative growth of 36.8% (annual growth rate of 3.1%) than that of Moldova of 30.1% (annual growth rate of 2.5%).

The correlation between the stages of the economic cycle and fiscal policy in some EU countries and the Republic of Moldova is highlighted in Figure 2.

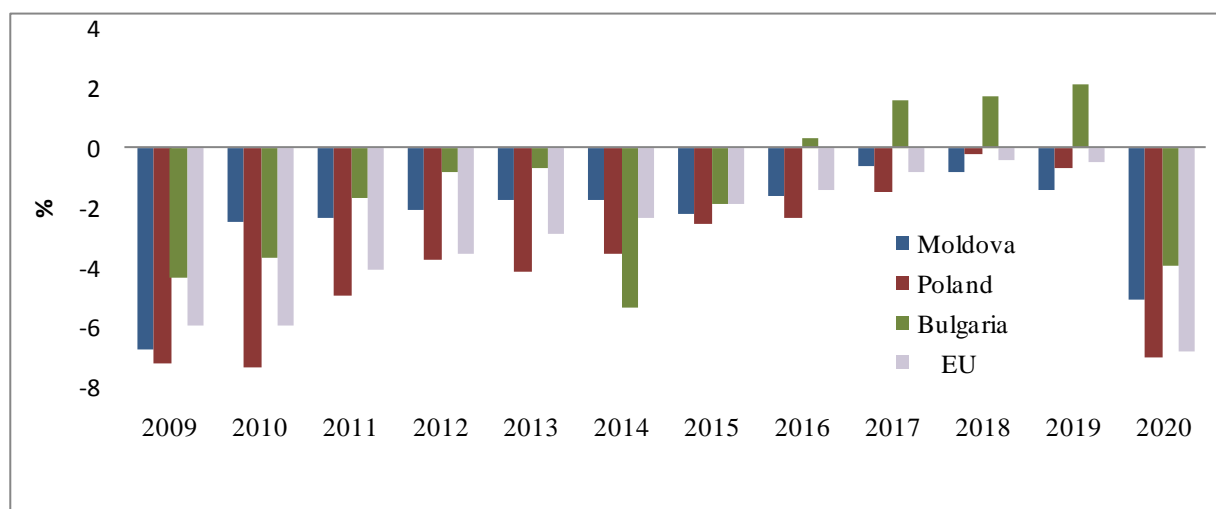


Figure 2. Fiscal deficit / surplus (as % from GDP)

Source: elaborated by the author using data from Eurostat and the MFRM

The analysis of the data shows that Poland has a policy of fiscal consolidation during the period of economic growth. Even in the year of the global crisis 2009, the increase in the fiscal deficit to 7.3% of GDP was accompanied by economic growth in Poland. There is a tendency for the fiscal deficit to gradually decrease in the four years preceding the 2020 crisis, which in the year before the crisis (2019) reached 0.7% of GDP.

The data analysis also indicates the accumulation of fiscal surpluses during the years 2016-2019 in Bulgaria, while real GDP growth ranged from 3 to 4%. During this period, similar GDP growth rates were reached in the Republic of Moldova. But if in the Republic of Moldova the economic growth of the last years was accompanied by the increase of the fiscal deficit, the opposite tendency is attested in the case of Bulgaria. Thus, in the case of the Republic of Moldova, in the year before the crisis of 2019, the maximum fiscal deficit in the last three years was reached, and in the case of Bulgaria, the maximum fiscal surplus.

The policies of fiscal consolidation in Poland, as well as the recording of fiscal surpluses, namely revenues in excess of public spending in Bulgaria, during the period of economic expansion, allow the accumulation of a fiscal space to intervene to stimulate the economy during the recession. In turn, in the Republic of Moldova, fiscal deficits accompany the stages of economic growth, which significantly reduces the state's ability to stimulate the recovery of the real sector of the economy during the recession. In this case, the economy can only be revived by consumption fueled by short-term social incentives, including public sector wage increases, pension increases, which is evidenced in the case of the Republic of Moldova. In 2020, the fiscal deficit in the Republic of Moldova exploded, reaching a maximum of the last ten years, of 5.1% of GDP. The analysis of measures to stabilize the economy during the crisis in the previous chapter indicates that the fiscal deficit will remain high for the next period, requiring its financing on the basis of assistance from the IMF and other external partners.

4.2 Reduced public revenues

Although the last four years before the economic crisis (2016-2019) reached a cumulative economic growth of over 17%, the annual revenues of the public budget remained almost at the same low level, slightly exceeding 30% of GDP in 2019 and 2020 (Figure 3).

The analysis of public revenues accumulated in recent years also shows very large differences between the Republic of Moldova and EU countries, placing the Republic of Moldova 16 percentage points below the EU average (46.3%) in 2020.

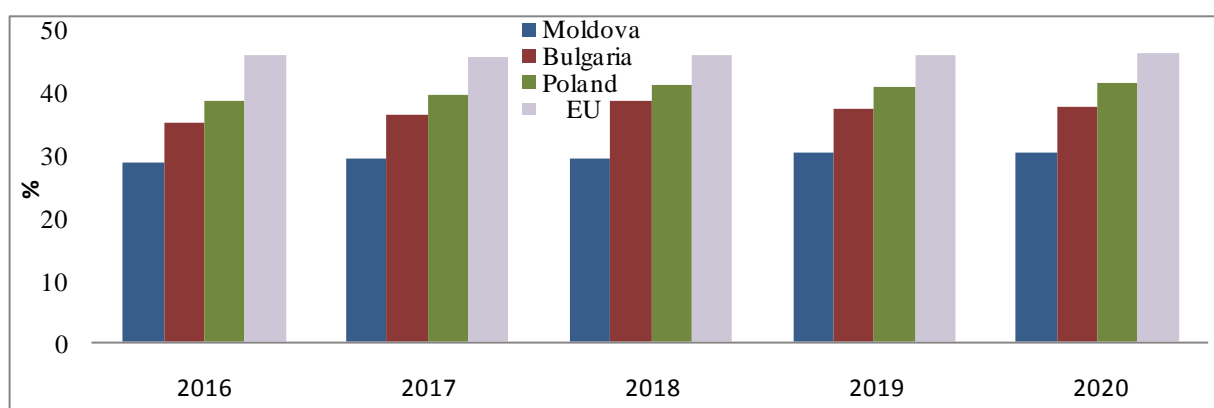


Figure 3. Public revenues (as % from GDP)

Source: elaborated by the author using data from the following sources: Eurostat, the MFRM and the NBSRM

The differences are evidenced even by comparison of the Republic of Moldova with some EU countries selected for analysis. Thus, with regard to public revenues expressed as a percentage of GDP, the Republic of Moldova was more than 7 percentage points lower than Bulgaria and more than 11 percentage points lower than Poland respectively in 2020. Unlike the Republic of Moldova, there is also a strengthening of public revenues in the last two years in Bulgaria and Poland compared to 2016-2017.

Taxes and fees accounted for 63.6% of all public revenues in 2020 in the Republic of Moldova. The data analysis demonstrates the inefficiency of the tax administration in using the potential for growth that can be explained by the high level of tax evasion and the underground economy.

4.3 The economic model based on consumption

In the Republic of Moldova in recent years, economic growth has been stimulated by increased consumption by increasing wages, especially in the budget sector, pensions and money, coming from abroad. During the years 2018-2020, the gross transfers of funds from abroad made in favor of individuals, expressed as a share in GDP (Current prices, expressed in lei), amounted to a considerable figure - about 11%.

This model of economic development is quite fragile, not only from the point of view that in the 2 months of "shutdown", in March and April of 2020, remittances decreased by 10% and 12.5% (The calculations are made by the author based on the estimations of increasing the salaries of employees in the budget sector, provided in the state budget law for 2022.) respectively compared to this period of last year. In 2021, the growth rate of remittances was restored to 8%, which is in line with the level of the year (2018) before the crisis.

We can determine the following unfavorable implications of this model that will increase the vulnerability of the economy to fluctuations in the business cycle. Economic theory states that medium-term investments must generate productivity growth in the first stage, followed by wages and consumption. This conclusion is consistent with the fundamental economic laws that talk about triggering the inflationary spiral, which consists in fueling inflation due to rising wages over the dynamics of productivity (Agenor & Hoffmaister, 1997). In the Republic of Moldova, public sector staff costs, as a share of public revenues, are 25% and 26% (The calculations include 22 EU countries with available data, which are part of the Organization for Economic Co-operation and Development.) in 2021 and 2022, respectively, which is high compared to the EU average of 20.5% (2020)(OECD, 2021). The analysis shows the reduced capacity of public revenues, which are growing much slower than wages and pensions, to support these expenditures.

Moreover, this model has been fueled by the growing demand for consumer credit recently. In addition, the increase in salaries in the public sector in the Republic of Moldova, although ensured by some structural reforms in recent years, their implementation has not resulted in increased efficiency of public services. The continuation of this practice in the coming years will deepen the fiscal deficit.

4.4 Low investments in the national economy

The implementation of the consumption-based economic model has shifted investments in the national economy to the secondary level. The Republic of Moldova allocates the least little resources for public investment relative to GDP (1% in 2020) compared to EU countries (3.29%) (Figure 4).

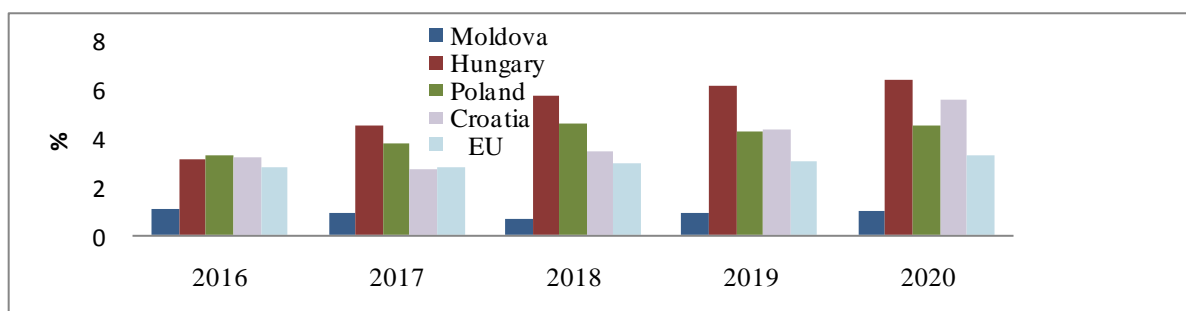


Figure 4. Public capital investments (as % of GDP)

Source: elaborated by the author using data from Eurostat and the MFRM

The analysis of the data also shows a gradual increase in public investment in recent years in EU countries, especially in Croatia (5.63% in 2020) and Hungary (6.42%) compared to 2016-2017, which demonstrates their anticyclical character. Unlike EU countries, in the Republic of Moldova, public investment, expressed as a share of GDP, remained virtual at the same low level in the period 2019-2020. Although, according to the *State budget law for 2022*, this indicator is expected to increase slightly to 1.2% in the coming years, the gap with neighboring European countries will continue to be maintained.

The evaluation of the execution of the *Medium Term Budget Framework* (MTBF) for the analyzed years demonstrates the planning of public investments at a higher level than their execution. Pro-cyclical elements in the national economy, such as fluctuations in economic growth associated with financial constraints, as well as the following weaknesses in public investment management: lack of clearly defined public investment priorities, poor project evaluation and approval procedures, an unsatisfactory portfolio of ongoing projects, are the main reasons for the failure of public investment at the planned level. In recent years, they have been identified and approved by Decisions of the Governments and Specialized committees almost annually (MTBF, 2014; MTBF, 2017; MTBF, 2018; MTBF, 2020).

Taking into attention that the largest share of investments is covered by externally funded projects, the Republic of Moldova loses every year huge opportunities for investment in infrastructure and other important economic areas that have moved to other countries.

4.5 Decrease in the workforce

In 2021 the economically active population (employed population plus the unemployed) in the Republic of Moldova decreased almost 2 times compared to 1995, from 1696 thousand people to 871.6 thousand in 2021, according to the NBS. Simultaneously, the decline in the workforce is accompanied by an active aging of the population: the number of people aged 60 and over per 100 inhabitants has increased from 17.5 in 2014 to 22.5 in 2021. Also, in recent years, the ratio of the

number of people of non-working age (children and pensioners) to 100 people of working age has been increasing from 60.63 (2014) to 68.42 (2021). Due to population emigration, the lack of skilled labor and adapted to the requirements of the labor market has become one of the most pressing issues limiting the potential for economic growth in the Republic of Moldova. Labor market constraints fuel pressures on the pension system, which can only function effectively when the economically active population (payers of social security contributions) far exceeds those receiving pensions.

4.6 Exchange rate instability in crisis situations

Weak monitoring and governance of the banking sector generated crisis and panic in the foreign exchange market in the Republic of Moldova in early 2015. In just one week (February 13-20, 2015) foreign exchange reserves, used by the NBM for foreign exchange interventions decreased by more than 51 million USD. Moreover, the sudden depreciation of the leu against the main currencies was accompanied by the establishment of a speculative exchange rate, when the difference between the purchase and sale rates of the US dollar and the euro was 3 lei. In addition, a week later, the reverse process of consolidating the leu was again accompanied by the establishment of the nominal speculative exchange rate (Dumitrascu, 2015).

The war in Ukraine, which began on February 24 this year, had a similar impact on the foreign exchange market of the Republic of Moldova. For more than 3 weeks, there has been a panic in the foreign exchange market fueled by the depreciation of the leu against the euro and the US dollar and has been accompanied by the establishment of a speculative exchange rate between the purchase and sale rates, this time around 1 leu, especially at exchange offices.

According to the governor of the National Bank: "between February 24 and March 18, the foreign exchange deficit increased 6.5 times compared to the deficit recorded for 23 days before Russia's invasion of Ukraine" (Armasu, 2022). During that period, the foreign exchange reserves used by the NBM for foreign exchange interventions decreased by 346 million USD. There was also a withdrawal of lei deposits to individuals and the transfer of funds in foreign currency.

Moreover, exchange rate instability has had an additional effect on rising inflation in the Republic of Moldova.

Therefore, we find the same mistakes from one crisis to another, repeated from one generation to another.

5. POLICIES FOR SUSTAINABLE ECONOMIC DEVELOPMENT

The analysis of the data in the previous chapter shows not only the major discrepancies in relation to the neighboring European states, but also the negative economic effects accumulated in the last three decades. In order to accelerate the country's development, sustainable medium- and long-term policies are needed, the positive effects of which go beyond the electoral cycle and the current generation. The policy areas, which create long-term economic growth, would be part of the European strategy for the development of the economy at the service of the people (Ursula von der Leyen, 2019), both by virtue of the European choice of the country and by the fact that the single model European social market economy, is a basis for sustainable economic development.

Next, we will elucidate the basic policies for the Republic of Moldova, the implementation of which would contribute to a sustainable economic development of the country.

5.1 Modernization of the sectoral structure of the economy

In a market economy, there are both pro-cyclical and non-cyclical sectors. In this context, there are some sectors of the economy that are less affected by economic cycles, even during times of crisis.

In the event of a recession, first of all, industries that absorb a large amount of capital, producing long-lasting consumer goods (especially construction), are affected. Thus, an analysis of

overcoming past economic crises shows that the demand for labor in the construction sector is 70% more sensitive to recessions-growth of business activity, and that of long-term goods - by 40%, compared with the average for all sectors (Brian & Patrick, 2010, pp.53-54). Short-term consumer goods industries react more gently in case of decline. This is explained by the low elasticity of demand for these products. In this sense, expanding the category of short-term consumer goods will lead to a reduction in cyclical fluctuations. Simultaneously, the demand for food and clothing is growing more slowly than for other products. Because of this, the development of the nominated sectors correlates little with economic growth. The same analysis of overcoming crises in the past confirms that the expansion of service delivery sectors, such as the information technology and communications sector, makes the economy more resilient to crises. This sector is less affected by the economic crisis, as well as by the COVID-19 crisis, allowing remote work, than other sectors of the economy of the Republic of Moldova. This, in turn, contributes to easing pro-cyclicality in the national economy.

5.2 Countercyclical fiscal policy

The Republic of Moldova is facing the problem of limited public funds due to the accumulated pro-cyclical fiscal deficits. The experience of EU member states in recent enlargements indicates the advantages of countercyclical budgetary policies, namely the accumulation of surpluses (revenues in excess of public spending) in the period of economic growth and deficits in the period of recession, compared to pro-cyclical or neutral ones. It is to be accompanied by a counter-cyclical wage policy by limiting their growth during booms and increasing wages and other public spending in times of economic recession.

Countercyclical policies ensure the stability of economic development by avoiding very large economic fluctuations of the transition from an extremely positive (very strong consolidation during a period of growth) to a negative one (sudden contraction during a recession). In this context, the implementation of the countercyclical fiscal policy contributes to the development of the business environment, as well as stimulates long-term investment projects.

5.3 Increasing public revenues

The lack of funds necessary for the initiation of the economic development policies of the Republic of Moldova is announced every year in the exercise of updating the *Sectoral Spending Strategies for the Medium Term Period*.

A study by Blyth (2013) traces the origins of austerity around the world to the beginning of the 2010s, and comes as arguments that it never worked and continues to block economies that could grow in other conditions.

As mentioned above, Moldova's problem is the inefficiency of the tax administration and the high level of tax evasion and the underground economy. In addition, limited budgetary resources are spent on fueling the consumption-based economic model, namely increasing budget wages and pensions, etc. In this context, the promotion of policies to combat the underground economy may attract additional revenue to the national public budget. In this regard, we can mention Bulgaria's experience of digitalisation of tax reform, which allowed the verification of invoices along the entire internal value chain in the internal market, from the initial supplier to the final consumer, as well as the identification of dubious transactions using formation and liquidation of companies, including fictitious companies.

The result of this reform was an increase in the share of public revenues, expressed as a percentage of GDP, to 38% by 2020 (compared to 30% in the case of the Republic of Moldova).

A positive example is the reform of the Polish tax administration in 2015. It was based on the introduction of innovative analysis tools, based on information technology, digitalisation of reports, which made it possible to identify fictitious transactions and tax fraud. Moreover, criminal law has been amended to "drastically increase the penalties for issuing and using false invoices (sentences

of between 5 years and a maximum of 25 years in prison for VAT fraud exceeding 10 million zlotys)" (Guda, 2020, p. 309-310).

The Republic of Moldova in the coming years should aim to increase the share of public revenues as a percentage of GDP by at least 5 percentage points based on the launch of similar reforms.

5.4 Efficiency of public services

Although in the Republic of Moldova the volume of personnel expenditures in the budget sector, as a share in public revenues, is at a high level compared to the EU average, the size of salaries has been one of the most pressing issues in recent years. The analysis shows the need to streamline public services, as well as the closer correlation of salaries of employees in the public sector with performance.

First, the gradual digitalisation of public services will reduce the size of public administration. A similar reform has been successfully implemented in Estonia, which has significantly reduced the physical presence of citizens in public administration bodies, as the state offers most online services, including paying taxes, setting up new businesses in less than an hour, receipt of digital prescriptions by patients, etc., because those data collected about citizens are exchanged between authorities (Guda, 2020, p. 312).

Secondly, it is necessary to introduce the public service remuneration system in accordance with the performance criteria. Although public sector employees are subject to periodic evaluations, their performance has been weakly correlated in recent years with public sector employee salaries, influencing the volume of awards granted quarterly and annually. At the very least, the protective nature of existing legislation on the dismissal of employees in the budget sector that does not meet the set objectives and does not demonstrate performance should be reduced.

Decisions on increasing budget allocations to some ministries for salary increases should also take into account the increase in performance and annual results obtained by these ministries.

5.5 Increasing public investment

Moldova will not catch up with neighboring European countries if public investment remains at 1% of GDP. At least part of the public revenues, which can be obtained as a result of the implementation of the reforms discussed above, can be directed to public investments: modernization and refurbishment of transport infrastructure, health system, educational institutions of all levels, etc.

5.6 Develop and ensure the functionality of private pension funds

In recent decades, most developed countries, including the EU, have been facing the acute problem of an aging population. As mentioned above, the Republic of Moldova is no exception to this trend. As a result of the aging of the population nationally and globally, many states have reformed their pension schemes by gradually raising the retirement age, reducing benefits for some categories of retirees, and introducing private and public pensions schemes simultaneously. If the first of these measures are being implemented in the Republic of Moldova, the development of private pension funds is a challenge. Despite the government's awareness of the need to create non-state pension funds from the first years of independence, the adoption of the law in 1999 and its eight amendments did not lead to the establishment of functional private pension funds in the Republic of Moldova. The National Financial Market Commission (NFMC) authorized the creation of three private pension funds, but they failed to persuade the population or the workforce to invest in these funds to start functioning.

On June 18, 2021, the new Law no. 198 *on voluntary pension funds* came into force. The newly created mechanism contains some attractive provisions, including that the income of voluntary pension funds is not subject to taxation, but any payments made from this fund are included in the gross income of the beneficiary; the specific norms for the protection of the participants and

beneficiaries of the pension funds, the establishment of the Contribution Guarantee Fund in the voluntary pension system regulated and managed by NFMC, etc. However, given the very low level of financial education in the Republic of Moldova, it is difficult to ensure the development of private pension funds at a sufficient pace. In this context, a campaign is needed to inform the population and the workforce about the need to create private pension funds, including the pressure on the public pension system by reducing the number of taxpayers and increasing the number of pensioners (beneficiaries) in the coming years. Moreover, the alternative of not creating private pension funds involves: a new increase in the retirement age (which is now attested), a slow increase in the size of the pension, the need to increase social contributions for the active population, etc.

In addition, the advantages of the voluntary pension system include: ensuring a decent level of pensions in the future by directing contributions to private pension funds, based on continuous investment and accumulation of these contributions; directing long-term investments to the economy, developing the capital market. A similar reform was initiated in 2007 in Romania, which had the following positive results: "private pension funds have become the largest institutional investor, concentrating 20% of Romania's government securities and ensuring almost 20% of the liquidity of the local market of capital" (Guda, 2020, p. 349).

5.7 Development and implementation of public policy in the field of financial education

The global financial crisis of the first decade of the 21st century has given impetus to the general recognition of the need to disseminate knowledge in the financial field among society. Financial education is recognized worldwide as a key skill and an important element of economic and financial stability and development.

With the development of modern society, the importance of the level of financial education of the population increases, which is to actively participate in the process of distributing financial flows on the increasingly complex market. Under these conditions, everyday life is inconceivable without financial skills, namely without a sufficient level of education in the financial field.

Currently, some financial education measures are implemented by central public authorities and non-governmental organizations within their competences, including the MFRM, responsible for the financial education of the population on the budgetary-fiscal dimension, by preparing budgets for citizens and placing them on the institution's website, NBM by raising public awareness of the concepts of planning, saving, etc., but also promoting responsible financial behavior, in an agreement with the MFRM (2022); "OK" Foundation for Financial Education by developing the financial culture at the company level within the special programs; Expert-Grup in partnership with the NBM by carrying out, for three years, the financial education project "Learn! It makes sense for money", etc.

Simultaneously, as demonstrated and mentioned above, the level of financial education of the population of the Republic of Moldova remains very low. Within the economic model based on consumption, developed in the Republic of Moldova, the money of the population is used for current consumption purposes and is not invested in the economy, which has negative effects on the economic system.

In order to reduce the fragmentary and sporadic nature of the measures taken, as well as to increase the level of financial education, it is necessary to develop and approve a Strategy for Financial Education of the population of the Republic of Moldova. The purpose of promoting financial education will be to teach citizens how to properly manage their income and expenses, because knowing all the possibilities on the financial market offers citizens the opportunity to choose the most efficient ways of lending, investing, etc. In this context, the following objectives are proposed as general ones of the Strategy: equal access of all citizens of the Republic of Moldova to secure, clear, relevant and timely financial educational resources; financial skills developed according to the age and stages of life of citizens; up-to-date knowledge available on financial education.

5.8 Accelerate the economic growth and investments in the future

The experience of adopting the mechanisms of economic regulation shows us that an economic growth can be managed by a certain direction of the fiscal revenues. In this context, investment in education, research and innovation has a positive effect on long-term economic growth, which is why these costs are to be supported in the economic policy adopted by the government. The benefits of innovation are worth more than any cost, because "any innovation eventually becomes a public good, which everyone enjoys at a modest or even free cost" (Butler-Bowdon, 2021, p.43). The experience of developing the innovation activity shows that innovation firms, which have a highly qualified workforce, are in a better position to produce specialized goods and find solutions for customers to order and, as a rule, are less exposed to risk during the crisis. Competitiveness, based on improving quality instead of lowering prices, raises resistance to the crisis and allows it to occupy higher positions in important niche markets, usually by applying new technologies. In this sense, economists Brynjolfsson and McAfee, who specialize in business issues, studying the correlation between the stock of knowledge and the ability to generate wealth, came to the conclusion that "in the 21st century, the most valuable resource is not capital, but well-educated and skilled people who can best exploit technology" (Butler-Bowdon, 2021, p.68).

In times of crisis, private companies usually reduce investment in long-term projects, which involve R&D spending. Under these conditions, the state's efforts against the cyclical nature of research and development expenditures are necessary. This means that state funding for research is set to increase in times of crisis.

6. DISCUSSION AND CONCLUSIONS

Our empirical study contributes to the research of the vulnerabilities of small countries with economies in transition. For the Republic of Moldova there are following explications for the records obtained by the Republic of Moldova.

In the last three decades, most government plans and reforms in the Republic of Moldova have focused on the term of the political mandate. Most political parties and governing coalitions, after coming to power, managed for their electorate, not for the general good of all citizens. On June 8, 2019, the Parliament of the Republic of Moldova approved the declaration on the recognition of the captive character of the state of the Republic of Moldova. During the period of independence, there were 21 governing teams in the Republic of Moldova, of which 9 in the last 10 years. Political instability and frequent change of governments have not provided the necessary conditions for the continuation of reforms for the general good of all citizens, allowing them to focus on solving current or pressing problems facing society, but not on the country's medium- and long-term development policies as well as implementing populist measures with unfavorable effects on long-term. Practically every government, especially in the last decade, has justified its own failure to achieve its goals by the short period of government and the heavy legacy left by the previous government.

It is noteworthy that most of economic problems that have been known since the first years of independence have not been resolved over the past three decades. The crisis caused by COVID-19 only exacerbated all these problems in the weak and vulnerable economy of the Republic of Moldova. The following economic vulnerabilities are identified in the paper: pro-cyclical fiscal policy, reduced public revenues, consumption-based economic model, low investment in the economy, declining labor force, exchange rate instability in crisis situations, pro-cyclical research and development expenditures, inefficiency of the tax administration, decreased efficiency of public services etc.

This finding is in line with the argument, that during the independence period, the economic transformations of the Republic of Moldova took place under the influence and insistence of

international organizations, without a strong strategic vision of reforming the country's economy and state institutions from national governments. Moreover, the governments' concern about getting loans first, rather than producing reforms, has enabled a consumer-based economic model financed by loans in the Republic of Moldova. Results of research show that in spite of significant sums of privilege credits and loans with an interest rate below market value and for very long periods of time received, there is no significant economic development of country after three decades of independence. These results are consistent with that of Moyo (2009), who argue that large flows of aid money reduce the stimulus to the economy by distorting local markets and affecting businesses, increase inflation and corruption, create a culture of dependency on them and through these impede the construction of institutes and industries.

The research also highlights the differences between the policies of the Republic of Moldova compared to neighboring European countries, especially Poland and Bulgaria, in terms of indicators of their economic stability in crisis situations. The research has shown a close correlation between Poland's and the EU's economic growth, which is also evident in the pre-EU accession period. In this context, the experience of the new EU Member States was taken into account in formulating policy proposals, including the implementation of modern IT systems and the digitalisation of the tax administration (Poland, Bulgaria), the digitalisation of public services (Estonia), accelerating the development of private pension funds (Romania) etc.

The present research is limited by the analysis of economic vulnerability at the macro level. But it should be supplemented with a similar one at the micro level in the framework of future research.

The best way for the development of the Republic of Moldova is the transformation of state institutions into accountable to their people and responsible for themselves. Deep-assessment of every government institution is out of scope of this study. However, it points to the necessity of further research which findings will complement one-size-fits all policies that do not work well in all institutional set-ups and which are not be fully implemented. Further assessment of government institutions would enable in-depth analyses of the problem and probably yield more targeted results.

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