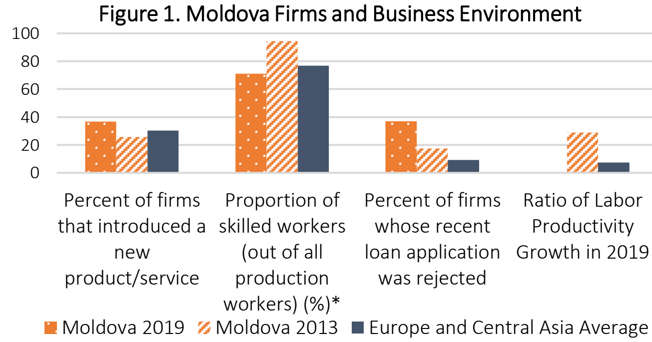
Moldova Special Focus Note: Are Moldovan Firms Ready for Fast Recovery?

THE WORLD BANK
IBRD • IDA

The unprecedented COVID-19 shock hit Moldovan firms through several channels and necessitated immediate liquidity support to protect them from massive closures. Going forward, once markets open, addressing the barriers to faster recovery and resilience will be paramount. Moldovan companies became more productive and innovative before the COVID-19 shock. However, the 2019 Enterprise Survey also shows that they struggle with a lack of qualified workforce and access to finance.

Performance of Moldovan Firms Before the COVID-19 Shock Improved

Figure 1. Moldova Firms and Business Environment



Performance of Moldovan companies has improved since 2013, with annual labor productivity growing faster than the average for Europe and Central Asia (ECA) before the crisis.[1] The 2019 Enterprise Survey shows that labor productivity growth recovered from the negative values in the aftermath of the European Financial Crisis. Labor productivity growth in Moldova in 2019 was 0.5 percent, higher than the average in ECA (Figure 1). While labor productivity growth in Moldova is due to a reduction in unproductive labor[2], it shows the ability of businesses to adapt to market conditions. Innovation has increased: almost 40 percent of companies have introduced a new product/service in the last 3 years (Figure 1). This is higher than in the last round of the Enterprise Survey and is higher than in ECA. Yet, firms still faced two big constraints to growth: skilled labor force and access to finance. Almost one third identified lack of an adequately skilled labor force as a major constraint, and the proportion of skilled workers among production workers has decreased by 25 percent since 2013. Further, rejections of loans applications doubled since 2013, with nearly 40 percent of companies experiencing loan rejections, four times higher than in ECA, suggesting that the country has not fully recovered from the 2014 bank fraud. Finally, 27 percent of firms still believe corruption is an obstacle to productivity growth.

COVID-19 Shock Required Immediate Support to Moldovan Firms

Figure 2. Survival Time of Manufacturing Firms in Moldova

The unprecedented COVID-19 shock necessitated immediate liquidity support to protect firms from massive closures and layoffs. The program included payroll taxation and interest rate subsidies, tax liabilities deferral, a reduction of the VAT in select sectors or the accelerated reimbursement of the input VAT paid. Without any sales or government intervention, and assuming that businesses are retaining last year's profits and can only access financing for working capital (supplier credit or financing from banks), half of the Moldovan firms in the manufacturing sector would face liquidity problems and closures in less than 20 weeks (Figure 2).[3]

---

[1] In 2019, after 5 years from the last round, a representative sample of 360 Moldovan firms were surveyed as part of the Enterprise Survey (ES) project. The survey does not cover Transnistria. For info about the Enterprise Survey, visit the website www.enterprisesurvey.org. A follow-up to the 2019 survey is also underway to assess the impact of COVID-19 on firms and employment.

[2] The increase in labor productivity growth may be due to the observed greater reduction in the growth of labor than the reduction in the growth of sales.

[3] http://www.lse.ac.uk/fmg/assets/documents/papers/discussion-papers/DP797.pdf

The COVID-19 shock has triggered a twin demand-supply shock and has affected Moldovan companies through several channels. What started as a health crisis has caused a socio-economic crisis, not only due to the loss of human lives, but also due to the consequences of containment measures. The containment measures, including social distancing and stay-at-home orders, have forced some businesses to stop or restrict operations. Travel and transport bans, by generating supply-chain disruptions, have limited input availability, worsening the negative supply shock. The effect on labor markets has caused a decline in households' income and consumption, hence triggering a negative demand shock in parallel.

Trade Channel. A drop in foreign demand and a growth slowdown in key trading partners—EU and Russia—will particularly hit exporting companies. According to the 2019 Enterprise Survey, about one out of five Moldovan businesses make some of their sales abroad, with 15 percent of all businesses making more than 10 percent of their sales from exports. Exporters are not the only ones affected. About 3 out of 4 Moldovan businesses use material inputs or supplies from abroad, thus affecting firms focusing on domestic markets (Figure 3).

Labor Channel. Reduced economic activity will limit firms' ability to pay and retain their workforce which will force them to either downscale labor or incur further losses. Although a vast majority of workers, 97 percent, in the private sector are under a permanent contract, at par with ECA, workers in some sectors are more vulnerable. For example, 20 percent of the workers in the construction sector, which accounted for almost 10 percent of GDP in 2019, are temporary workers. Measures are needed to protect this vulnerable group of workers that may not enjoy the protections that permanent workers do. In addition, the percentage of companies identifying labor regulation as the main constraint has doubled since 2013. Labor regulation rigidity may limit companies' ability to reallocate staff to organize work more flexibly at the time of containment measures, or simply for faster restructuring (Figure 4).

Figure 3. Trade Exposure of Moldovan Firms

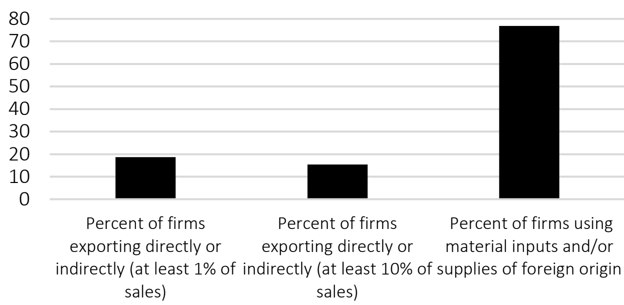
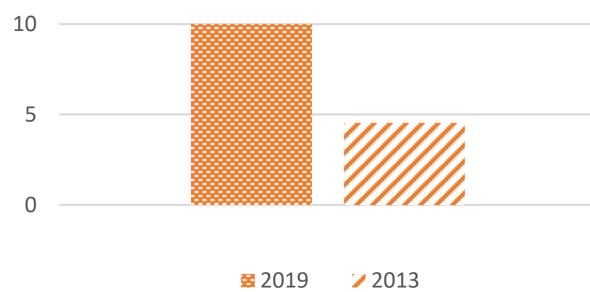


Figure 4. Percent of firms identifying labor regulations as a major constraint



Source: World Bank Enterprise Survey 2013 and 2019.

Productivity and Investment Channel. As firms and workers need to adapt to a new modality of work, productivity may be negatively affected. Although an increasing number of companies has introduced a new product or service in the last 3 years (Figure 1), thus showing ability to adapt to market conditions, technological integration is still lacking. Only about one half of businesses have a website or social media presence. As e-commerce and digital transactions gain prevalence in today's exchanges, firms need to speed up their online transition. In addition, the Moldovan business sector has a large state presence, with an average proportion of government/state ownership in a firm more than 3 times larger than in ECA. Given their lower and declining productivity[4], but larger access to state aid, state-owned enterprises may dampen competition and bring down overall productivity.

Finance Channel. The COVID-19 outbreak and the efforts to contain it may cause difficulties for businesses to continue servicing debts, financing operational expenses, and meeting tax obligations. According to the 2019 Enterprise Survey, less than 1 in 4 Moldovan businesses have a line of credit or a loan. These businesses may require interest payment suspension or debt rollover assistance. More than 1 in 4 firms rely on supplier/customer credit to finance working capital, despite extensive bank and non-bank financial sectors. During the COVID-19 crisis, however, as many companies along the value chain are liquidity constrained, this may trigger a domino effect along the payment chain.

[4] World Bank. 2019. Moldova Country Economic Memorandum. Rekindling Economic Dynamism. World Bank: Washington DC.

Policies to Support Moldovan Firms' Resilience

The government has already adopted a package of emergency measures to shield businesses from immediate bankruptcies as a consequence of demand shock as well as disrupted supply chains and a lockdown. The three-pillar strategy currently used during the first phase of the COVID-19 crisis by many countries in the world and to a certain extent followed by Moldova focuses on:

- Providing liquidity to avoid closures and layoffs through extending working capital credit and liquidity; reducing bankruptcies through debt restructuring, forbearance, payment deferral, a quicker VAT and income tax refunds and carry-back of company losses, accelerated depreciation; as well as preserving the network of economic linkages/supporting `recovery through ensuring supply chain liquidity, supporting transitions to digital platforms, access to investment capital.
- Supporting worker retention through employment subsidies, expanded use of leave with flexible sick leave, use of advance vacation; shortened working hours where government subsidy covers the wage gap.
- Reducing bureaucracy and improving service provision through regulatory and e-governance reforms.

After the initial liquidity support to firms, the focus should turn to policies supporting a swift and equitable recovery. As lockdown ends, and markets open up, firms need support to swiftly restore supply chains, and strengthen competitiveness. The pandemic has brought nearshoring and the need to shorten supply chains. This is also an opportunity for Moldovan firms already integrated into the European supply chains. The reform areas that should be in focus are the same ones that have been constraining growth potential even before the crisis:

- Reforming policies that constrain competition. These policies include, among others, entry or conduct barriers to market entry (in particular through extensive price controls, and barriers in the food and network sectors)[5]; a cumbersome insolvency law; extensive state ownership (also in wine production, pharmaceuticals, basic metals, etc.); legal barriers to foreign direct investment (an example is that cabotage is not allowed for foreign firms); tariff barriers (still higher compared to EU or OECD countries); controls/inspections (despite progress, 46 percent of companies believe laws are applied selectively)[6]; or barriers to fair justice, and access to land.
- Reducing the space for discretionary policy implementation and ensuring open and transparent policy making. An even-handed enforcement of laws demands that public officials have incentives to exercise discretion fairly and transparently. Such incentives are more likely when laws are clear; entry and promotions into the administration are based on merit instead of connections; and when merit is judged by contributions to legitimate public policy goals.
- Creating institutions that safeguard competition. Such institutions include, but are not limited to, an independent and well-functioning competition authority, appropriate and effectively enforced procurement laws, an independent judiciary, an accountable and professional public administration.
- Reducing the state footprint in the business sector. The state-owned enterprises (SOEs), 211 of them, account for about a third of GDP and employ up to 24 percent of the labor force. They are active in at least 19 sectors where private participation is economically viable, compared to the OECD average of 14. The SOE sector is characterized by severe inefficiency, considerable losses, rising long-term debt, poor service delivery, low productivity, and inadequate governance. Rationalization of SOEs with a commensurate opening of the sectors to competition would ensure a level-playing field and provide a boost to growth.

Contact: Filip Jolevski (fjolevski@worldbank.org), Natasha Rovo (nrovo@worldbank.org), Sanja Madzarevic Sujster (smadzarevic@worldbank.org) www.worldbank.org/en/country/moldova

[5] World Bank (2019), Moldova: Product Market Regulation
[6] World Bank (2020), Moldova: Cost of Doing Business Survey