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Research Article

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State Capture in Remission? Reflections on the Moldovan Business Environment

Kerry Longhurst*

Abstract: State capture is a feature of several post-Soviet states where it undermines socio-economic resilience, weakens state institutions and diminishes the rule of law. Devised by the World Bank and European Bank for Reconstruction and Development (EBRD) in the 1990's, state capture remains a compelling concept to understand problems associated with democratisation and shifts to the market economy in the region. Moldova became a captured state with a transition distinguished by endemic corruption and frequent backsliding. This article explores the emergence of state capture in Moldova and prospects for its demise. The possibility of Moldova becoming a member of the European Union (EU) has raised the prospect of a remission of state capture. However, evidence gathered from research on Moldova's business environment suggests that state capture remains potent and continues to have palpably deleterious effects on the country's socio-economic situation and prospects for the future.

Keywords: Moldova, state capture, SMEs, FDI, European Union, business environment

Introduction¹

State capture is a phenomenon connected to the uneven economic and political development that continues to characterise many post-Soviet and Southeastern European transition countries. State capture involves key functions of the state, namely the judiciary, executive and legislative falling under the control of private business entities and individuals who subvert the rule of law and determine policy outcomes aligned to their own business and political interests. State capture is about the intentional distortion of a state's entire institutional arrangements with the goal of shaping the 'rules of the game', and typically with impunity for the captors.²

The notion of state capture was elaborated in the late 1990s by World Bank and European Bank of Reconstruction and Development (EBRD) research studies on

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¹ This article is based on findings from a National Science Centre of Poland (NCN) grant 'Domestic Barriers to the Pro-European Transformation of Moldova' No. 2016/23/B/1155/03635.

² Lapalombara, Joseph. 2021. Structural and Institutional Aspects of Corruption. *Social Research* 61(2): 325-50; Pradhan. Sanjay, Anderson. James, Hellman. Joel, Jones. Geraint, Moore. Bill, Muller. Helga, Ryterman. Randi and Sutch. Helen, 2000. Anticorruption in transition: A contribution to the policy debate. *World Bank Report.* Washington, D.C.: The World Bank.

the business environments of post-Soviet and Central European states.³ The main impulse was the search for a nuanced explanation for problems associated with post-communist economic transitions and why some countries managed to develop rule-based business environments whereas others did not. Integral to this was the search for a better understanding of oligarchy, which manifested in several post-Soviet states during the shift from command to market economies and de-concentration of political power. As an arrangement where power becomes concentrated in the hands of the very few, a new variant of oligarchy emerged in the 1990s in the form of the rise of post-Soviet industrial and financial magnates who gained sufficient resources through both legitimate and illicit moves during the disorder of the late 1980s and 1990s to cast a strong influence on the politics and economics of newly independent states.

Instead of focusing on the 'top-down' effects of state-level reforms on new business environments and the subsequent behaviour of new business elites, as most analysis tended to do, the World Bank and EBRD sought to explore the reverse dynamic. In this context, the notion of state capture was conceived as a measure of how far firms and private individuals in post-communist states had gained agency and therefore capacity to shape and affect the formation of laws, policies, and decrees in accordance with their own private business interests. The World Bank / EBRD defined indicators of state capture to ascertain how businesses in post-Soviet and post-socialist countries were able to capture the state, for example, by buying or influencing presidential decrees and parliamentary votes, the 'sale' of court decisions on criminal and commercial cases in order to affect judicial decisions and illicit financial contributions to political parties and election bodies.

When published in 2000, the findings revealed several points. First, they confirmed that those post-communist states that had achieved market-related reforms and moderate to good progress in establishing state accountability, rule of law and good governance, as well as political pluralism, tended to be more resilient against state capture. This group included Poland, Hungary, the Czech Republic, Lithuania, Estonia, and Slovenia, all of which had thriving private entrepreneurship and growth of small and medium enterprises (SMEs), relatively small informal economies, were attractive to Western FDI, and were also in the midst of deepening their relations with the EU. The findings also ascertained a second group of low state capture countries, including Uzbekistan, Belarus and Kazakhstan. However, rather than reflecting successful reforms and signalling political pluralism, their low capture status resulted from autocratic one-party rule, which exerted a grip over nascent private businesses and kept key industries under state control, with little space for new oligarchs to emerge. Meanwhile, highly captured states tended to be those where market liberalisation and privatisation had occurred after 1991 but were not accompanied by parallel reforms to create stable and accountable state institutions, the rule of law and regulatory frameworks for business environments. States found to be highly captured included Russia, Ukraine,

³ Hellman, Joel S. / Geraint Jones and Daniel Kaufmann. 2000. Seize the state, seize the day: State capture, corruption, and influence in transition. *World Bank Policy Research Working Paper No. 2444*. Washington, D.C.: The World Bank Group.

Bulgaria and Romania, but also Latvia and the Slovak Republic. Moldova sat firmly within this group, and of the twenty-two states analysed, the World Bank / EBRD study found Moldova to be a highly captured state, and second only to Azerbaijan. The research also concluded that Moldova was marked by a relatively small number of oligarchs and ‘captor’ firms who were successfully influencing the structures of the business environment and national socio-economic policies in line with their interests.

Though these findings are over 20 years old, it is posited here that the World Bank / EBRD studies remain relevant to explaining and understanding socio-economic problems associated with many transition countries, especially those in the post-Soviet area. Consequently, this article holds that the notion of state capture developed by the World Bank and EBRD is a robust framework with which to examine the phenomenon in Moldova in a contemporary setting.

Analysing the parameters of Moldova’s state capture

This article looks at state capture and its effects in Moldova with reference to aspects of its contemporary business environment. As noted earlier, it is inspired by the World Bank’s definition of state capture as ‘the exercise of power by private actors - through control over resources, threat of violence, or other forms of influence - to shape policies or implementation in service of their narrow interest’.⁴ In addition, it considers Elizabeth David-Barrett’s research on three systematic effects of state capture: first in control over the *formation* of law and policy to ‘shape the rules of the game’; second, in control over the administrative means and procedures through which policies are *implemented* and third, in control of the *accountability ecosystem*, meaning the checks and balances and scrutinising powers of national audit offices, parliaments, civil society and the media.⁵ The article is also informed by a ‘structuration’ approach, which emphasises the interplay between agent and structure to help understand the dynamics that gave rise to and sustained state capture in Moldova.⁶ Simply put, a structuration approach sees that powerful new business elites (oligarchs) gained sufficient ‘agency’ via informal and formal power grabs during the period of post-communist disarray and early attempts at state building in the early 1990s, that they created new social structures according to their interests and subsequently moulded national legal, political, and economic ecosystems.

Moldova is a pertinent country to reflect on state capture from a contemporary vantage point. Since 1991, the country’s political and economic fate lurched between false starts, incomplete reforms, and backsliding, with problems exacerbated by frequent instances of corruption, misuse of public funds and brain-drain, which saw the working age population shrink. Coupled with this, Moldova remained largely agrarian and dependent on energy imports from

⁴ Fiebelkorn, Andreas. 2019. State capture analysis: How to quantitatively analyze the regulatory abuse by business-state relationships. Discussion Paper Governance Global Practice No.2. Washington, D.C.: World Bank Group.

⁵ David-Barrett, Elizabeth. 2021. *State Capture and Inequality*. Pathfinders for Peaceful, Just and David-Barrett, Elizabeth. State capture and inequality (accessed: 2 November 2023); Barrington, Robert / Elizabeth David-Barrett / Sam Power and Dan Hough. 2022. *Understanding corruption: How corruption works in practice*. Newcastle Upon Tyne: Agenda Publishing.

⁶ Giddens, Anthony. 1984. *The constitution of society*. Cambridge: Polity.

Russia, thus the economy was vulnerable to environmental and geopolitical shocks. The country's capacity to attract foreign investment was marred not only by corruption, but also by the persistence of the frozen conflict between Moldova and the break-away region of Transnistria, which became a *de-facto* state under the political and economic tutelage of Moscow.

This article aims to analyse state capture in Moldova and to draw attention to the possibility of change. It posits that recent domestic developments in Moldova, and the prospect of political stability and reform, as well as changes associated with the country's relationship with the EU, might diminish the conditions that enable state capture. Two interrelated factors stand out. First, after the presidential elections of 2020 and the parliamentary elections of 2021, new leaders came to power with mandates to improve the rule of law and state accountability. Second, in June 2022, Moldova, along with Ukraine, was awarded EU candidate status, which means that once accession starts, possibly in 2024, the EU will impose stronger conditions on Moldova to deliver verifiable reforms in line with EU norms. Amongst other issues, the Commission's opinion on Moldova, emphasised that it should "implement the commitment to de-oligarchisation by eliminating the excessive influence of vested interests in economic, political and public life,"⁷ in other words, to bring down state capture.

With these points in mind, this article's foremost question is whether Moldova's state capture is 'in remission', implying the disappearance of its signs and symptoms. This is addressed by looking at the characteristics of state capture in Moldova since 1991. To diagnose if remission is apparent, a case study on the contemporary Moldovan business environment focused on (a) the informal economy, (b) the Small and Medium Enterprise Sector (SME) and (c) foreign direct investment (FDI) is developed. Analysis is based on official documentation and data from Moldovan and international sources and key-informant interviews.

A business environment is the sum of internal and external factors that shape commercial activities, including political, legal, economic, technical, financial, and social matters. Business environment conditions are important for transition states like Moldova, as they determine levels of entrepreneurship, a country's attractiveness to investors, the ease with which a new company can be set up, scope for SMEs to develop, and the extent to which opportunities for firms to gain access to international trade exist. As outlined in the original World Bank / EBRD studies, a business environment characterised by an 'uneven playing field' is one of the prime symptoms of state capture.

A level playing field implies that business entities, whether big or small, new or old, domestic or foreign, play by the same rules and that such rules are acknowledged amongst all stakeholders, are universally applied, and mediated by the rule of law. In the absence of a level playing field, as is the case in a captured state, a business environment tends to be characterised by distortions to commercial operations caused by political interference, weak institutions and

⁷ European Commission. *Communication from the Commission to the European Parliament, the European Council, and the Council. Commission opinion on the Republic of Moldova's application for membership of the European Union* (accessed: 2 November 2023).

patchy implementation of the rule of law. The consequences of this tend to be untransparent and uneven regulatory frameworks that favour certain actors above others, endemic corruption, trade policies and industry standards inconsistent with international business norms and practices, a large informal economy, an inefficient SME sector, and relatively low levels of FDI.

Retrospect: shaping the rules of the game by and for the very few

Moldova experienced a transition trajectory analogous to other Soviet successor states. Economic liberalisation and privatisation of the means of production, natural resources and the dismantling of public owned industries took place opaquely for the most part. Those who benefitted from the rapid selling-off of state economic concerns, namely the new oligarchs, subsequently obstructed further reforms in governance and the rule of law, which led to a weak state and distorted local business environment. The consequences were acute for Moldova, since compared with other neighbouring countries, there were fewer oligarchs, which amplified the effects of state capture.⁸

Moldova sank into protracted crises in the 1990s, which saw poverty and social stratification emerge, as the economy shrank to around 20% of its late-Soviet size. The dramatic loss of markets for Moldovan agricultural products, reduction of energy subsidies and other forms of support previously afforded to Moldova as a Soviet state, spelt socio-economic devastation which the newly independent state's bureaucracy was ill-equipped to deal with. Profound economic backsliding meant that standards of living also dropped to a quarter of 1989 levels for much of the population. Employment opportunities also went into freefall, prompting the mass migration of the working age population, which was exacerbated by a nosedive in welfare spending and hyperinflation, which peaked at 1600% in 1993, according to the World Bank.⁹

Successive governments tried to create opportunities for citizens to acquire stakes in former state-owned industries to spread the benefits of privatisation, raise revenue and kick-start a new business environment. Ownership, however, tended to fall into the hands of a small number of individuals close to or from within the government, who profited from favourable rates. According to Negura, privatisations benefitted the few and were accompanied by tax arrangements that facilitated evasion, to the detriment of public finances and citizens. This collusion between state officials and business "damaged the business environment and investment climate of the young emerging economy, maintaining the citizens' distrust of the emerging state structures,"¹⁰ in other words, it reinforced nascent state capture.

Though the subsequent decade saw an alleviation of extreme poverty, a tempering of inflation and some evidence of stable economic growth, the structural foundations of Moldova's reform remained fragile, meaning that

⁸ Bagashka, Tanya. 2014. Unpacking corruption: The effect of veto players on state capture and bureaucratic corruption. *Political Research Quarterly* 67(1), 165-180.

⁹ World Bank. *Inflation, consumer prices (annual %) – Moldova* (accessed: 4 September 2023).

¹⁰ Negura, Petru. 2016. The Republic of Moldova's transition between a failed communism and an un-commenced capitalism?. *Studia Politica: Romanian Political Science Review* 16(4), 541-68.

powerful oligarchs were able to carve up the country's assets and control core state functions. Meanwhile, the informal economy remained significant and a source of employment for much of the labour force. Commerce routinely took place either completely or partly in the grey zone, and many households became dependent on remittances from family members working overseas, which also deprived the state of tax revenues. According to the World Bank, in 2006, incoming remittances represented 34% of Moldova's national GDP.¹¹

By 2009 the number of oligarchs in Moldova had reduced, but rather than signifying a weakening of oligarchy those left in the game managed to accumulate a bigger share of power, thereby cementing state capture.¹² In 2015, a deeper concentration of oligarchic power came about when former Prime Minister Vlad Filat, who was also an oligarch, was imprisoned on corruption charges by the Anti-Corruption Centre and the General Prosecutor, both of which were controlled by another oligarch, billionaire business magnate Vladimir Plahotniuc.¹³ This was a critical juncture in the capturing of Moldova, since it meant that Plahotniuc became the only serious veto player, which enabled his grouping to gain control of the remaining parts of the state.

Over the subsequent four years Moldova became synonymous with the deterioration of democracy and rule of law, and consequently slipped from being the EU's star pupil in the region, to a worrisome backslider.

The capturing of parliament was facilitated by Plahotniuc's role as vice-chair of the nominally pro-European Democratic Party (*Partidul Democrat din Moldova*, PDM), via which he steered the legislative agenda and sapped political pluralism. During some of Moldova's most erratic years, the PDM contributed to undermining democracy by helping to engineer electoral reforms. Moldova's electoral reforms of 2017 were criticised by the Venice Commission, on account that they could be "unduly influenced by businesspeople or other actors who follow their own separate interests".¹⁴

Plahotniuc's grabbing of legislative and executive power came in January 2016 when the PDM's Deputy Chairman Pavel Filip became prime minister. After his arrival, 'defections' by members of parliament from the Communist and Liberal Democrat parties to the PDM took place. With no evidence to the contrary, observers considered that Plahotniuc had coerced and 'incentivised' MPs to cross the parliamentary floor. As a result, the PDM went from 19 parliamentary seats in 2014 to 42 within the 101-seat parliament in January 2019.¹⁵ Consequently,

¹¹ World Bank. *Personal remittances received (% of GDP) – Moldova* (accessed: 1 September 2023).

¹² Morar, Stefan and Magdalena Dembinska. 2021. Between the West and Russia: Moldova's international brokers in a two-level game. *Eurasian Geography and Economics* 62(3), 1-28.

¹³ Plahotniuc was regarded as Moldova's wealthiest man. He amassed wealth and political power and was dubbed the puppet master. In 2009 the PDM won thirteen parliamentary seats and became part of the Alliance for European Integration coalition government, which had European integration and democratisation as objectives. He has been associated with fraud, corruption, money laundering and trafficking. He now reportedly lives as a fugitive in Turkey.

¹⁴ Venice Commission / ODIHR. *Republic of Moldova joint opinion on the legal framework of the Republic of Moldova governing the funding of political parties and electoral campaigns, Opinion no. 901/2017* (accessed: 2 November 2023).

¹⁵ European Parliament. *Report of the European Parliament delegation for the observation of the parliamentary elections in the Republic of Moldova 2019* (accessed: 2 November 2023).

the composition of the legislature no longer reflected the electoral choice of voters, thus parliament had been effectively captured and in plain sight.

The acquisition of control over the justice system was, according to Armand Gosu, decisive to the capturing of the Moldovan state, since it enabled Plahotniuc to reduce the significance of other pillars of power, incarcerate his opponents, impede anti-corruption reforms, at the same time as increasing his wealth by hijacking the businesses environment and legalising his actions.¹⁶ A telling example was the Chisinau mayoral election of June 2018, which was won by an anti-corruption candidate, but subsequently invalidated by the Supreme Court. This development was widely regarded as the government exerting its influence over the judiciary to secure a result in line with Plahotniuc's interests in warding off new anti-corruption measures. These developments, twinned with the government's inability or lack of will to pursue the prosecution of individuals known to be responsible for financial crimes in the country, prompted the EU to suspend the disbursement of macro-financial assistance to Moldova.

Identifying state capture's effects

As reported by the Eastern Partnership (EaP) Index 2020-21, Moldova was behind Armenia, Ukraine, and Georgia on indicators to do with democratic rights, elections, political pluralism, state accountability and independent media.¹⁷ Meanwhile, the World Bank's Worldwide Governance Indicators (WGI), found instances of weak progress across state capture-related indicators. On government effectiveness, Moldova displayed miniscule progress; moving from the 36th percentile in 2009 to the 37th in 2019, whilst on the rule of law, it remained stationary around the 41st percentile.¹⁸ Low public trust in state institutions and elites also festered. Moldovan public opinion polls from 2018 and 2019 found that only 25% of respondents had positive views of political parties (71% unfavourably), 26% looked favourably upon parliament (70% unfavourably), and 26% saw the public prosecutor's office in favourable terms (64% unfavourably). The survey also found that between 2004 and 2018 Moldovans strongly believed that the country was going in the wrong direction. This view peaked at 84% in mid-2016. The opinion that the country was going in the right direction was at its highest at 42% in May 2010. During the period 2015-2019 no more than 10% of respondents were ever satisfied that change was happening at the right pace. On the responsiveness of parliament to citizens' needs, between September 2016 and December 2018 only between 1%-3% of respondents thought that it was very responsive, with between 44% and 70% of the view that it was not at all responsive.¹⁹

Similarly, Transparency International's Corruption Perception Index (CPI) reported the intermittent effects of anti-corruption measures. In 2013 Moldova

¹⁶ Gosu, Armand. 2016. Republic of Moldova the year 2015 in politics. *Romanian Political Science Review* (16)1, 21-51.

¹⁷ Eastern Partnership Civil Society Forum. *Eastern partnership index 2020-21: Charting performance in the Eastern partnership: Democracy and good governance, policy convergence and sustainable development* (accessed: 2 November 2023).

¹⁸ World Bank. *Worldwide governance indicators* (accessed: 4 October 2022).

¹⁹ Center for Insights in Survey Research. *Public opinion survey: Residents of Moldova: December 5, 2018 - January 16, 2019* (accessed: 2 November 2023).

ranked at 102, and in 2016 fell to 123, returning to 115 in 2020.²⁰ Furthermore, Transparency International’s 2017 study found that in the judicial sector, “the selective approach regarding appointments and promotions suggests that the Superior Council of Magistracy and the Parliament promotes loyalty over merit”.²¹ Symptoms of state capture were also apparent in successive Moldovan governments slowness to implement anti-corruption strategies. In the 2020 Council of Europe’s Group of States against Corruption (GRECO) compliance report of its fourth evaluation (focused on corruption amongst MPs, judges, and prosecutors), a “globally unsatisfactory” result was documented.²²

The table below uses Elizabeth David-Barrett’s framework on state capture to highlight some instances of state capture in Moldova. Though further examples could be added, emphasis here is given to examples with systemic effects.

Table 1. Summary of State Capture: Objectives, mechanisms, and effects²³

Area of capture and objective	Examples of mechanisms	Instances, actions and examples suggesting ‘systemic’ consequences
Formation of constitution, laws, and policies: to shape the rules of the game in national and sub-national politics and economics	Effecting electoral changes	Annulment of Chisinau Mayor elections in 2018. MPs ‘crossing the floor’ after 2016 to the PDM. Gerrymandered electoral districts in 2019
	Controlling the judiciary	Nomination of politically affiliated candidates as heads of the Supreme Court of Magistracy and Supreme Court of Justice 2016 – 2021, appointment of judges with weak credentials. Attempt of the parliamentary majority to dismiss constitutional judges in 2021
	Business environment shaping	Law requiring retailers to reserve 50% share of shelves for Moldovan products: disadvantageous for small businesses
Implementation of policy by government bodies / civil service to influence administrative procedures: to benefit captor networks and disadvantage other actors	Control of ministries/state institutions and functions	2015: PDM and partners moved the National Anti-corruption Centre (NAC) back under the control of parliament and established political control over the Service of Information and Security
	Influencing privatisation and public procurement	2018: privatisation of Air Moldova with irregularities, devaluation of its price and selling the company to an entity registered only 12 days before auction
	Influencing regulations on FDI	2018: ‘citizenship law’ for international private investors to get citizenship in return for investing in Moldova (posing money laundering risks)
Accountability eco-system: to	Anti-corruption bodies and	Delaying implementation of ‘integrity package’ and selective application of anti-corruption and

²⁰ Transparency International. *Corruption perceptions index 2020* (accessed: 22 October 2023).

²¹ Transparency International. *State capture: The case of Moldova* (accessed: 2 November 2023).

²² Council of Europe: Group of States against Corruption (GRECO). *Corruption prevention in respect of members of parliament, judges and prosecutors: Fourth evaluation round, second compliance report Republic of Moldova* (accessed: 2 November 2023).

²³ Table adapted from: David-Barrett, *State capture*.

undermine bodies revealing	judiciary politicised	enrichment procedures for officials, use of closed courts for hearings against opponents
corruption and holding power to account	Interference in civil liberties and freedom of speech	2016-19: interception of journalists and civil society activists' communications by Ministry of Interior
	Controlling access to broadcasting	Political control over national Audio-visual Council, Selective use of fines for TV channels affiliated to oligarchs

Source: Based on author's own research

2019-2021 - Turbulence, vested interests, and prospects for change

2019 was an eventful year in Moldovan politics. Two political forces with polar-different visions - the pro-Russia Party of Socialists of the Republic of Moldova (*Partidul Socialiștilor din Republica Moldova*, PSRM) and the pro-European electoral bloc 'ACUM' made up of the Party of Action and Solidarity (*Partidul Acțiune și Solidaritate*, PAS) and the Dignity and Truth Platform Party (*Partidul Politic Platforma Demnitate și Adevăr*, PPDA) created a compromise coalition in June to remove the oligarchic regime created by Plahotniuc. The impact of the compromise coalition ended up being short-lived and yielded little in the way of tackling systemic corruption, improving accountability measures, and strengthening the rule of law. The alliance collapsed and a government averse to the kind of change needed to uproot state capture returned to power.

2020 proved to be a sturdier year for reforms after Maia Sandu became President. Sandu's mandate entailed a programme for de-oligarchisation, anti-corruption, transforming the justice system and improving state accountability and social justice. Linked to her domestic agenda was the objective to advance Moldova's relations with the EU. Prospects for sustainable reforms in these areas were boosted by Plahotniuc's flight from Moldova in 2019 and the results of the 2021 parliamentary elections, which returned a legislature led by the liberal Party of Action and Solidarity (PAS), with Natalia Gavrilita as Prime Minister and a much reduced communist / socialist bloc.²⁴ The results of the presidential and parliamentary elections seemed to reflect a consensus that corruption was the major barrier to the country's development and needed uprooting once and for all, and also that integration with the EU should be a national priority. Sandu's victory was warmly received in the West and was seen as an opportunity for de-oligarchisation.

Case study on the Moldovan business environment

As stated earlier, this article proposes that recent domestic changes in Moldova, coupled with the country's evolving relationship with the EU and acquisition of

²⁴ The Party of Action and Solidarity (PAS) received 52.80% of the vote and won 63 seats, thus obtaining a majority in the 101-seat parliament. The alliance Electoral Bloc of Communists and Socialists (BECS) received 27.17% of the vote and won 32 seats, while the pro-Russian Șor Party (led by businessman and oligarch Ilan Șor (who had been previously incarcerated for his part in money laundering) received 5.74% of the votes and won six seats.

candidate status in June 2022 have raised the prospect for state capture's demise. The following case study has been developed to diagnose the extent to which state capture might be in remission based on three pertinent indicators: the informal economy, the SME sector and FDI.

Moldova's informal economy

According to the International Labor Organisation (ILO), the informal economy refers to economic activities by workers and economic units that are - in law or in practice - not covered or are insufficiently covered by formal arrangements. Amongst other outcomes, informal economic activities imply a marked loss of state revenue, perpetuate weak public institutions and imply precarious conditions for workers. Units operating in the informal economy also have a tendency for low productivity and innovation and are less adept at internationalising their operations and acquiring export markets.

The case of Moldova confirms the link between a country's overall development and the size of its informal economy; a small informal economy normally denotes higher socio-economic development, whilst a relatively large informal economy tends to be pervasive in developing and transition states. A relatively high prevalence of informal economic activity can also be symptomatic of state capture in as far as it reflects a problematic or uneven business environment where entrepreneurs, investors, and firms opt to work wholly or partially in the informal sector due to its perceived benefits. Consequently, contraction of the informal sector, when accompanied by relative growth in the formal economy might be a useful indicator of state capture's remission.

As is the case in other transition states, the size and significance of Moldova's informal economy is determined by how businesses weigh up the costs and benefits of formality versus informality. Evidence from Moldova suggests that access to effective justice, the high cost of credit and borrowing, and limited scope for businesses to modernise, diversify, or adopt new technologies and production methods typically reinforce the strong preponderance towards informality.²⁵

Moldova's informal economy is characterised by the routine use of 'envelope salaries', meaning that only a portion of employees' pay gets declared. The ILO noted that in Moldova in 2010, 57% of salaries were not fully reported.²⁶ Widespread informality in Moldova was also driven by high levels of self-employed 'own account' workers and the persistence of small-scale subsistence agricultural activities, mostly maintained by households to cope with financial uncertainty and as a buffer against the prospect of unemployment.²⁷

According to the IMF, Moldova's informal economy was worth on average 43% of national GDP between 1991-2015, by which point it was the second largest

²⁵ Interview with representative from Moldovan business association. Chisinau, Moldova, September 2020.

²⁶ International Labour Organization. *The informal economy in the Republic of Moldova: A comprehensive review* (accessed: 2 November 2023).

²⁷ Interview with official from Chisinau-based international organisation. Chisinau, Moldova, October 2020.

informal economy in Europe (based on national GDP), after Ukraine.²⁸ A subsequent shrinkage of the informal economy was recorded by Moldova's bureau of statistics, which calculated the volume of the country's 'non-observed' economy in 2020 to be 27% of GDP.²⁹ Whilst this might suggest some improvements in the business environment, the evolving situation remains nuanced and official statistics do not necessarily capture the full picture and characteristics of the informal economy and its evolution, or lack thereof.

To begin, Moldova's labour force participation rate is below those of all post-Soviet and European states and is amongst the five lowest-ranked countries globally. Low labour force participation is a structural feature in Moldova and became progressively worse during the 1990s. According to World Bank estimates, only around 39% of the working age population (working or registered as looking for work, aged 15 years and over) were formally employed in 2021 in Moldova.³⁰ This situation reflects first and foremost a lack of employment opportunities and the hollowing-out effects of the outwards migration of Moldovan workers. However, at the same time, it also suggests the persistence of significant informal economic activities that provide alternative employment arrangements 'under the radar'.

Second, in Moldova the under-declaration of incomes and salaries remains a widespread practice by businesses operating for the most part in the formal sector. The extent of this activity is difficult to ascertain, though it has been suggested that it remains a popular way for formal businesses to cope with and overcome economic difficulties, but at the same time resist going fully informal.³¹ Informality within the formal sector is also attractive since evidence suggests that the productivity of formal firms using some informal methods, such as envelope salaries, are at least as good as comparable firms operating fully in the formal sector.³²

A further indicator of how far activities might be switching from the informal to the formal economy, is the extent to which businesses are using official channels to acquire finance to develop their operations, such as applying for a bank loan. Applying for a bank loan can be a sign that an entrepreneur has gained confidence in the business environment. The past ten years have seen Moldovan authorities, the EU, and international financial organisations enact schemes to make borrowing from a bank more attractive, together with other measures to encourage them to operate fully within the formal economy. This has included improving the terms of loans, especially for SMEs, simplifying loan application procedures, co-financing loan guarantees, creating loan opportunities in local

²⁸ Medina, Leandro and Friedrich Schneider. 2018. *Shadow economies around the world: What did we learn over the last 20 years?*. IMF Working Paper WP/18/17. Washington, D.C.: IMF.

²⁹ National Bureau of Statistics of the Republic of Moldova. *Results of the Sampling Structural Survey of Enterprises, Edition 2022* (accessed: 2 November 2023).

³⁰ World Bank. *Labor force participation rate, total (% of total population ages 15+) (modelled on ILO estimate) – Moldova* (accessed: 5 October 2022).

³¹ Interviews with three experts from an independent Moldovan Think Tank. Chisinau, Moldova. April 2020.

³² UNDP. *The phenomenon of informal economy and employment in the context of Covid-19 pandemic* (accessed: 2 November 2023).

currency, and helping entrepreneurs improve their financial literacy.³³ Despite widespread efforts, evidence suggests that Moldovan businesses are strongly averse to applying for bank credit, which in turn might suggest that confidence in the business environment remains fragile. The World Bank found that in 2019 only 13% of Moldovan firms used banks to finance their investments, which is lower than most other European and post-Soviet states.³⁴ This highlights the reality that businesses tend to rely on their own resources, family or money lenders for investment purposes.³⁵

In sum, when it comes to the informal economy as an indicator of state capture's remission, the picture is mixed and although informal economic activities may have decreased, it remains a significant phenomenon in Moldova, especially in the form of 'partial informality'. The persistence of the informal economy is a response to economic uncertainties, but also a symptom of state capture in as far as it reflects broad dissatisfaction in the business environment, and a lack of trust in public services and financial institutions on the part of businesses, especially SMEs.

Evidence from the small and medium enterprise (SME) sector

SMEs are disproportionately affected by the types of distortions in the business environment that are associated with state capture and as such, developments in the sector provide useful markers regarding its possible remission. Evidence from Moldova tends to confirm that SMEs are unlikely to thrive in environments characterised by an uneven playing field, weak institutions, patchy rule of law and subsequent hinderances to market access, justice, and fair competition.

One of the main assumptions behind the post-communist transitions after 1990/91 was that privately owned SMEs would thrive and become integral parts of a new fabric of liberal market economies and that they would contribute to the dispersal of political power and the shift from state to private ownership, as well as foster democratisation, and political pluralism. This scenario played out across Central Europe, where SMEs proliferated and helped erode state monopolies and in so doing, they became core agents of economic and political change. In contrast to Moldova, where oligarchisation and state capture were taking hold in the early 1990s, reforms in the spheres of governance and rule of law in Central Europe nurtured SME-friendly business environments replete with regulated level playing fields. Furthermore, overtime, SMEs in Central Europe became more efficient, innovative and involved in middle and high-value production, which raised their added-value to the economy. This outcome was arguably buttressed by the EU and its member states' early engagement in the region post-1989 through investments, technical support and eventually the prospect of EU membership. The EU helped states solidify their reforms which rendered their economies and trade policies compatible with the EU and

³³ Interview with government official from SME business advisory body. Chisinau, Moldova. June 2022.

³⁴ World Bank. *Firms using banks to finance investment (% of firms) – Moldova* (accessed: 15 December 2022).

³⁵ Interview with expert of an independent Moldovan research institute in Chisinau. Online. June 2022.

international norms more generally. In so doing, integration with the EU helped stabilise local business environments, strengthen the formal economy, create new trade and employment opportunities, and stimulate FDI into Central Europe, all of which furthered an enabling environment for SMEs. Meanwhile, scant EU attention, and persistence of weak governance and rule of law in Moldova, meant that SMEs had fewer resources and opportunities to prosper, shape their political and economic environments and to internationalise.

As in EU states and OECD economies, SMEs form the backbone of the Moldovan economy and have grown in significance since the collapse of communism to account for around 99% of all enterprises. However, beyond this, the Moldovan SME sector remains in a state of transition.

The value-added of SME activities to the Moldovan economy differs to European standards. In 2017 the value-added of SMEs to Moldova's economy was 70%, rising to 75% in 2021, whilst in the EU value-added hovers around 52-56%. Though the situation in Moldova is impressive, if value-added is considered on a per employee basis, the Moldovan SME sector looks relatively unproductive and signals a lack of modernisation. For example, Moldovan SMEs typically employ an average of 7.8 people, which is double the EU average of 3.9 workers. Crucially, SME productivity in Moldova, measured as value-added per employee, amounts to EUR 7932, which is less than a fifth of the EU SME average of EUR 43,604. Trends suggest that the value-added of SMEs may well grow especially considering that in 2021 around 9% of Moldovan SMEs were engaged in higher value "professional, scientific, and innovative activities" (which is a significantly higher rate than other post-Soviet countries: Armenia 5.3%, Belarus 5.5% and Ukraine 7.9%).³⁶ However, at the same time, it remains the case that much of Moldova's SME sector is characterised by low-value and / or labour-intensive production, and that a structural shift towards higher value outputs and manufacturing remains nascent.³⁷ Moreover, despite the efforts of Moldovan authorities and international partners to support innovation, diversification and foreign trade opportunities, the basic condition of the business environment is still viewed by some SMEs as prone to deterioration and not yet a place to thrive.³⁸

Research tends to suggest that when it comes to the business environment, gaps persist between legislation, policy formation, implementation, compliance, and enforcement in spheres that affect SMEs,³⁹ and that entrepreneurs are aware of these deficiencies. Consequently, there is often a lack of trust in the judicial and accountability ecosystems in Moldova, especially amongst those SMEs that are less established or have no 'political connections'. Weak contract enforcement and property rights, untransparent procedures regarding judicial decisions, uneven competition policy application and unsatisfactory dispute mechanisms

³⁶ National Bureau of Statistics of the Republic of Moldova, *Conturi nationale si regionale 2022* (accessed: 2 November 2023).

³⁷ UNECE, *Small and medium sized enterprises in economies in transition: Challenges, opportunities, and UNECE tools* (accessed: 2 November 2023).

³⁸ Interview with SME association representative. Chisinau, Moldova. June 2020 and July 2022.

³⁹ Eastern Partnership Civil Society Forum, *Eastern partnership index*.

are frequently cited by SMEs as barriers, all of which are arguably factors derivative of the effects of state capture.⁴⁰

As mentioned above, during the 1990s Central European SMEs not only became more numerous and economically significant, but they also internationalised their operations. SME internationalisation occurred, amongst other factors, because of general improvements to local business environments, state support for small businesses and entrepreneurs to foster modernisation and diversification, alongside an opening up of EU markets, all of which engendered stability and new opportunities. As a result, states improved their export complexity and diversity and SMEs gained significant trade profiles and become embedded into European and international supply chains. Whilst SME internationalisation has occurred in Moldova, it has been somewhat limited and export complexity and export diversity remain low.⁴¹

Over the course of the 2000s Moldova redirected its trade away from Russia and the Commonwealth of Independent States (CIS) towards the EU largely in response to Moscow's imposition of restrictions on Moldovan goods, which also encouraged the EU to gradually open its markets and extend concessions. The signing of the EU-Moldova Association Agreement, which included a Deep and Comprehensive Free Trade Agreement (DCFTA) in 2014 paved the way for more expansive trade and cooperation. By 2019, Moldova was ranked 38th in terms of 'trading across borders', according to World Bank Doing Business data, which put it ahead of its regional peers in terms of the costs and time involved in importing and exporting with other countries (Ukraine, Georgia and Armenia were ranked at 74th, 45th and 43rd respectively).⁴²

The DCFTA fostered normative alignment between Moldova's economy and trade laws and policies and those of the EU, it contributed to the modernisation of Moldova's customs and border infrastructure and shepherded in a rise in the volume and value of trade. However, evidence from official reports suggests that of those SMEs that have engaged with the DCFTA thus far most have played 'intermediary' roles and have not been principal traders. This situation can be explained in three main ways. First is the fact that the EU remained protective in some trade spheres and continued to place restrictions on certain food products, thus preventing some Moldovan producers from getting access to EU markets. Second, research notes that Moldovan governmental support for SME internationalisation has not been sufficiently aligned to the evolving DCFTA context, nor fully taken up by businesses. Thus some SMEs have had limited tools and requisite knowledge to help them navigate new opportunities.⁴³ The third explanation sees structural conditions present in the local business environment as hinderances to SMEs' capacities to develop, modernise, innovate

⁴⁰ Interviews with SME owners. Chisinau, Moldova. April 2020.

⁴¹ Harvard University. *The atlas of economic complexity growth lab – Moldova* (accessed: 20 December 2022).

⁴² World Bank. *Doing business* (accessed: 10 September 2023).

⁴³ CEPS / European Commission DG TRADE. *Ex-post evaluation of the implementation of the deep and comprehensive free trade area between the EU and its member states and Moldova: Final report* (accessed: 2 November 2023).

to comply with EU standards and thus access new markets.⁴⁴ In 2020 the OECD reported that at 2.74 Moldova had a lower score than the average for the Eastern Partnership region (2.96) for SME internationalisation thus the situation transpired that whilst Moldova's approximation with the EU's *Aquis* proceeded on some levels and trade increased, SME internationalisation did not happen at a comparable rate.

In sum, evidence indicates that although SMEs play an increasingly significant role in the Moldovan economy, their overall impact in terms of efficiency and value-added, as well as internationalisation remains partial. Crucially, this situation suggests a lack of deep structural change in the Moldovan business environment and the ongoing effects of state capture shaping SME development.

Foreign direct investment (FDI) in Moldova

FDI is a poignant state capture indicator. When foreign businesses and governments deliberate investing or pursuing commercial activities in a third country, the state of the local business environment, conduciveness of political and macroeconomic conditions, as well as the quality of the rule of law are integral to any considerations. All other things being equal, a rise in FDI inflows into transition states such as Moldova is indicative of external confidence in a country's reform efforts. FDI is also an important cog in transition economies, in that it stimulates the local job market, creates new tax revenue, and improves regulatory standards, innovation, as well as internationalisation.

Central Europe in the 1990s demonstrated the positive correlation between a rise in FDI inflows, effective domestic reforms, the emergence of political pluralism, and the path to EU accession, as noted above. Crucially, FDI inflows from the West were attracted to those Central European states with significant markets and nascent business environments that were supported by strong regulatory frameworks. In Moldova, meanwhile, relatively low levels of FDI might be explained, amongst other factors, by the prevalence of state capture and the deleterious effects it had on the business environment and rule of law.

As table two shows, at an aggregate level FDI inflows to Moldova remained low and even experienced a slight decline (measured as a percentage of GDP), despite the country's geographical proximity to Europe and relative familiarity to EU states, as well as its well-educated workforce. Russian investment and economic interests remained significant in Moldova throughout the decades after independence, which contrasted with the virtual depletion of Russian FDI in Georgia and Ukraine over the same period.⁴⁵

⁴⁴ Interviews with two academic researchers from Moldovan universities. Chisinau, Moldova. September 2022.

⁴⁵ OECD, *Foreign direct investment*.

Table 2: Inwards FDI (aggregate net inflows from all sources, % of GDP as unit of measurement)

	1995	1999	2003	2007	2011	2015	2019	2021	2022
Moldova	3.8	3.2	3.7	12.1	4.2	2.9	4.1	1.8	4.1
Georgia	6.9 (1997)	2.9	8.3	18.5	7.7	11.6	7.6	6.8	n/a
Ukraine	0.6	1.6	2.7	6.9	4.3	-0.2	3.8	3.7	0.30
Europe and Central Asia	1.4	5.7	2.9	8.9	4.6	5.5	2	1.5	1.9

Source: World Bank⁴⁶

One of the core goals of the Association Agreement and DCFTA, which Moldova signed with the EU in 2014, was to create attractive and conducive conditions for external investors from EU states. By mimicking the Central European experience, the expectation was that ever-closer association with the EU, meshed with far reaching political and economic agreements and a commitment from the side of Moldovan authorities to fulfil their reform programmes and promote investment would create a permissive environment for FDI inflows, which would help anchor Moldova to the EU's orbit.

FDI inflow rose after 2015 from 346 million USD to a peak of 506.7 million USD in 2019 but then fell to 157.4 million USD in 2020 to then rise back to 391 million USD in 2021 and to 592 million USD in 2022.⁴⁷ In this period Russian FDI in Moldova shrank in value relative to FDI from EU / European states. According to figures from the National Bank of Moldova, between 2015 and 2021, Italy, Romania, the Netherlands, and Germany, remained steady sources of FDI. FDI inflows from Cyprus rose substantially (possibly Russian funds), and considerable increases in inflows came from such states as Austria, Bulgaria, Hungary, Ireland, and the UK. Austrian FDI went from 39 to 188 million USD between 2015 and 2021, and Bulgarian stock rose from 10 to 194 million USD during the same period. At the same time, the value of both French and Spanish FDI in Moldova fell, and in the case of the latter, quite substantially, from 212 to 4 million USD.⁴⁸

Analysis tends to suggest that the DCFTA may have facilitated a rise in FDI inflows from European states. For certain, post-DCFTA implementation saw several states that previously had relatively small investments in Moldova increase their FDI, notably Ireland, Hungary, and the UK. Moldova has attracted greenfield investments, which indicate the potential for long term commitment and investor confidence in the local business environment. Greenfield investments have led to the creation of 11,174 jobs mostly within the manufacturing sector. FDI inflows can also be seen to have had positive effects on trade, since Moldova tends to export to those EU states which have the highest levels of investment in Moldova (also including Turkey). This implies

⁴⁶ World Bank. *Foreign Direct Investment net inflows (% of GDP) – Moldova, Europe and Central Asia, Ukraine, Georgia* (accessed: 5 September 2023).

⁴⁷ World Bank. *Foreign direct investment, net inflows (BoP, current USD) – Moldova* (accessed: 4 September 2023).

⁴⁸ National Bank of Moldova. *Coordinated direct investment survey by country* (accessed: 20 September 2023).

that FDI is playing a role in developing Moldova's export capacities, albeit to a small number of states, thus far.

Without disregarding the outcomes mentioned above, as noted earlier, levels of FDI inflows from EU and other European states remain modest. Furthermore, Moldova has had far fewer greenfield investments than Georgia and Armenia, which could signal that amongst other factors, potential foreign investors do not regard Moldova as competitive nor politically and economically stable.⁴⁹ Furthermore, greenfield investments in Moldova have had limited impacts on domestic production owing to low technological sophistication, limited productivity, and the insufficient embedding of local Moldovan producers within the value chains of FDI firms.⁵⁰

In sum, Moldova's DCFTA has brought only nominal changes with regards to FDI inflows. Significant new trends, above and beyond those that had already started to emerge have yet to transpire. This evolving situation leads to three observations which point to the stubbornness of state capture in Moldova. First, though Moldova's score in some business-related and corruption indexes may have improved over the last few years, especially since Sandu became President, some rule of law and public administration-related structural reforms have yet to bear fruit. In turn, this has meant that the practical and procedural changes needed to render Moldova's business environment a level playing field and thus attractive to FDI, especially greenfield investors, have been limited so far. Second, high levels of emigration and a low active employment rate have so far discouraged foreign investors from investing in projects that build human capital and raise the quality and variety of jobs on offer for Moldovans. Finally, there is a strong perception amongst stakeholders that state capture is so deeply rooted in Moldova that any reform efforts to improve the business environment, judicial accountability and the country's alignment with the EU may well turn out to be short-lived and possibly reversible.

Conclusion: Is state capture in Moldova in remission?

The aim of this article was to advance analysis on state capture in Moldova and to provide an assessment as to whether it is in remission. The article suggested that a combination of domestic changes which saw a reform-minded government with an agenda to install the rule of law and dismantle oligarchy come to power with European-level change which witnessed Moldova switch from EU associate state to EU candidate, could diminish the conditions that gave rise to and sustained state capture. To explore this postulation, a case study on the Moldovan business environment was developed to diagnose the possibility of state capture's remission.

The size of the informal economy has been declining which suggests that entrepreneurs have confidence in the business environment and that perceptions of the costs and benefits of going or staying formal are changing. At the same

⁴⁹ Interview with official from European governmental organisation. Chisinau, Moldova. June 2021 and June 2022.

⁵⁰ Foreign Investors Association. *Foreign direct investments: The impact on the economy of the Republic of Moldova: FIA Report Moldova* (accessed: 2 November 2023).

time, it remains commonplace for businesses to rely on partial informality in a bid to remain competitive and to hedge their bets regarding business uncertainty. This suggests that whilst state capture's effects might be waning, and a more regulated and incentive-based business environment is on the ascent, the conditions that facilitate informality are still evident.

The proliferation of SMEs and their rising significance in the Moldovan economy over the past decade alludes to a local business environment increasingly characterised by a level playing field with fewer distortions and hindrances to competition. Whilst this could be taken as a robust indicator of state capture's remission, Moldovan SMEs are still stymied by barriers associated with the effects of state capture, such as gaining permits, assuring property rights, and accessing finance. As a result, SMEs tend to be relatively unproductive, engaged in lower-value goods and services, and are unlikely to be engaged in international trade. This suggests that SMEs are not yet playing a role in bringing about structural change to the Moldovan economy, as was the case in Central Europe in the 1990s.

When it comes to FDI, as a small state with a limited domestic market and an unresolved protracted conflict which involves Russia, Moldova would always struggle to attract and retain significant investment from European and other Western states. This observation notwithstanding, findings suggest that state capture is also part of the explanation as to why Moldova has experienced consistently low levels of FDI, especially when compared to Georgia which is also a small state with its own frozen conflicts.

Case study evidence presents a mixed picture, with instances of both change and stasis, implying that though certain symptoms of state capture are evaporating or are at least less prominent, many features and symptoms persist. This means that state capture in Moldova is not yet in remission. The article's overall conclusions are twofold. First, state capture remains a useful concept to understand Moldova's protracted transition and analysis that sidesteps state capture as a variable tends to overlook some of the sources and factors that contribute to Moldova's problematic development. Second, whilst the conditions that gave rise to state capture in Moldova are abating because of domestic change in Moldova and the acquisition of EU candidate status, the government's reform agenda is still prone to backsliding, and it is too soon to assess whether the route to Moldova's EU accession will provide strong enough footholds for a full remission of the signs and symptoms of state capture to come about.

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