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Republic of Moldova: 2003 Article IV Consultation—Staff Report; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2003 Article IV consultation with the Republic of Moldova, the following documents have been released and are included in this package:

- the staff report for the Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **November 11, 2003,** with the officials of the Republic of Moldova on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on January 7, 2004.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its January 26, 2004 discussion** of the staff report that concluded the Article IV consultation.

The document(s) listed below have been or will be separately released.

Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF MOLDOVA

Staff Report for the 2003 Article IV Consultation

Prepared by the Staff Representatives for the 2003 Consultation
with the Republic of Moldova

Approved by Carlo Cottarelli and Martin Fetherston

January 7, 2004

The 2003 Article IV consultation discussions were held in Chisinau during October 29–November 11, 2003. Participating staff included Mr. Owen (head), Messrs. Mikkelsen and Lundback (all EUR), Ms. Delechat (PDR), Mr. Kinoshita (FAD), Ms. Maechler (MFD), and Mr. Bouton (World Bank). Mr. Ruggiero, the IMF's Resident Representative, assisted the mission. The team met with Prime Minister Tarlev, National Bank of Moldova (NBM) Governor Talmaci, Minister of Economy Lupu, Finance Minister Grecianîi, and other senior government officials. The team also met with representatives of parliament, business, civil society, and the diplomatic community.

In concluding the 2002 Article IV consultation on June 18, 2002, Executive Directors stressed the vital importance of promoting structural reforms more vigorously to achieve sustainable growth. They expressed concern about Moldova's limited trade diversification and external debt burden. Directors supported the NBM's prudent monetary policy.They also urged the authorities to keep fiscal policy tight and undertake the reforms needed to put the public finances on a sustainable path.

A three-year program under the PRGF facility was approved in December 2000. The arrangement expired at end-2003, leaving ¾ of the available funds undisbursed. Moldova accepted the obligations of Article VIII, Sections 2, 3, and 4, of the Fund's Articles of Agreement in June 1995. Its exchange system remains free of restrictions on payments and transfers for current international transactions (Appendix I). Legislation for anti-money-laundering and combating the financing of terrorism seems to cover all relevant areas, according to the authorities' response to the AML/CFT questionnaire. However, the authorities could benefit from Fund technical assistance to improve implementation.

The authorities report core data to the Fund on a timely basis. Although data quality generally has improved, there are still some shortcomings, especially on price and national accounts statistics (Appendix II). The authorities would welcome the support of a resident advisor in these areas. They also expressed a strong interest in an FSAP and in completing the fiscal module of a ROSC in early 2004.

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EXECUTIVE SUMMARY

The sustainability of recent strong growth performance is at risk. This mainly reflects a poor investment climate and the slow pace of structural reforms. Growth prospects are also hampered by continuing external debt service difficulties.

Short-term economic financial indicators have been favorable, but inflation has picked up. Real GDP growth was 6.2 percent in the first three quarters of 2003. Consumer price inflation increased to 17 percent in the 12 months to October. The external current account deficit is widening, but large unrecorded inflows of workers' remittances have allowed the central bank to maintain international reserves virtually unchanged.

Largely unsterilized purchases of foreign exchange fueled rapid money and credit growth in 2002–03. Monetary policy was tightened in 2003 by increasing reserve requirements and raising REPO interest rates, but these moves had limited effect on inflation and credit growth. Later in the year, the central bank moderated its foreign exchange purchases.

Fiscal policy remained reasonably tight in 2003, but external arrears started to accumulate. During the first three quarters, the general government posted a cash surplus of ½ percent of annual GDP, reflecting robust collection of VAT and import duties, and accumulation of arrears. With little new external financing, the external debt service remains a fiscal challenge. The authorities suspended debt service payments to Gazprom already at end-2001 and to bilateral creditors in August 2003. Requests for bilateral reschedulings have met with limited success so far.

Progress in structural reforms remains slow. There has been no significant improvement in the business climate, with corruption remaining widespread. Government interference in the private sector continues to cast doubt over Moldova's commitment to market-oriented reforms. There has also been little progress in completing the privatization program.

Policy adjustments are needed to sustain economic growth and mitigate short-term risks. Tighter fiscal and monetary policies are needed to curb inflationary pressures and resume external debt service. At the same time, the authorities should accelerate structural reforms that could be supported by IFIs and bilateral donors. The authorities did not see a need for further fiscal adjustment, and signaled their intention to continue suspending payments on external debt, while seeking individual reschedulings.

Looking forward, the authorities agreed to focus on developing their own economic strategy in the context of the Economic Growth and Poverty Reduction Strategy Paper (EGPRSP) process. This strategy should identify measures to achieve sustained growth and poverty reduction. After completing the EGPRSP in early 2004, the authorities intend to seek international financial support, including from the Fund. Before discussions of a new Fund-supported program could begin, evidence of a change in economic policy would be needed. This would require a clear demonstration of the government's commitment to maintain financial stability, improve the business climate, and reduce corruption.

I. Background

1. **The May 2003 local government elections confirmed the lead of the Communist Party of Moldova (CPM).** The CPM secured 45 percent of the votes, somewhat below the 50 percent obtained in the 2001 parliamentary elections. Following the local elections, a territorial reorganization was implemented, reversing a 1999 reform aimed at streamlining regional governments; the ten regional districts were replaced with smaller units (rayons) harking back to the pre-independence local government arrangements. The parliamentary elections scheduled for early 2005 will shape policy decisions in the coming months.

2. **Both Fund and Bank-supported structural programs are off-track.** While implementation of macroeconomic targets under the PRGF-supported program was broadly satisfactory, weak implementation (and some reversals) of structural reforms prevented the completion of the second PRGF review. For the same reasons, the World Bank's SAC-III expired at end-September 2003, leaving about 2/3 of the credit undisbursed (Appendix III).[1] The slow pace of structural reforms continues to hamper the investment climate and growth prospects. The latter are also constrained by continuing external debt service difficulties and slow progress in settling the conflict with the breakaway region of Transnistria.

3. **Short-term economic and financial indicators have been favorable, but inflation has picked up (Table 1).** Real GDP growth was 7 percent in 2002 and 6.2 percent in the first three quarters of 2003, driven by strong consumer spending, which in turn was underpinned by a marked increase in real wages and workers' remittances (Figure 1 and Box 1).[2] Private sector investment recovered in 2003 but, at 14 percent of GDP, remained too low to support strong medium-term growth. Consumer price inflation declined to 4½ percent at end-2002, but started to pick up in early 2003, on the heels of higher food prices. Fueled by rapid money growth, inflation reached 17 percent in the 12 months to November. While higher real GDP growth generally mirrors strong performance by Moldova's neighbors, the sharp pick-up in inflation was observed only in Moldova and, to a lesser extent, Ukraine (Figure 2).

4. **The external current account deficit is widening (Table 2).** This deterioration reflects strong import growth in 2003, only partly offset by higher exports and (recorded) inflows of workers' remittances.[3] While foreign direct investment has dropped sharply, net foreign exchange inflows have been strong, suggesting large unrecorded inflows, including of workers' remittances. The NBM has intervened to avoid an appreciation of the leu; as a result, toward the end of 2003 the MDL/$ exchange rate was roughly at the same level of

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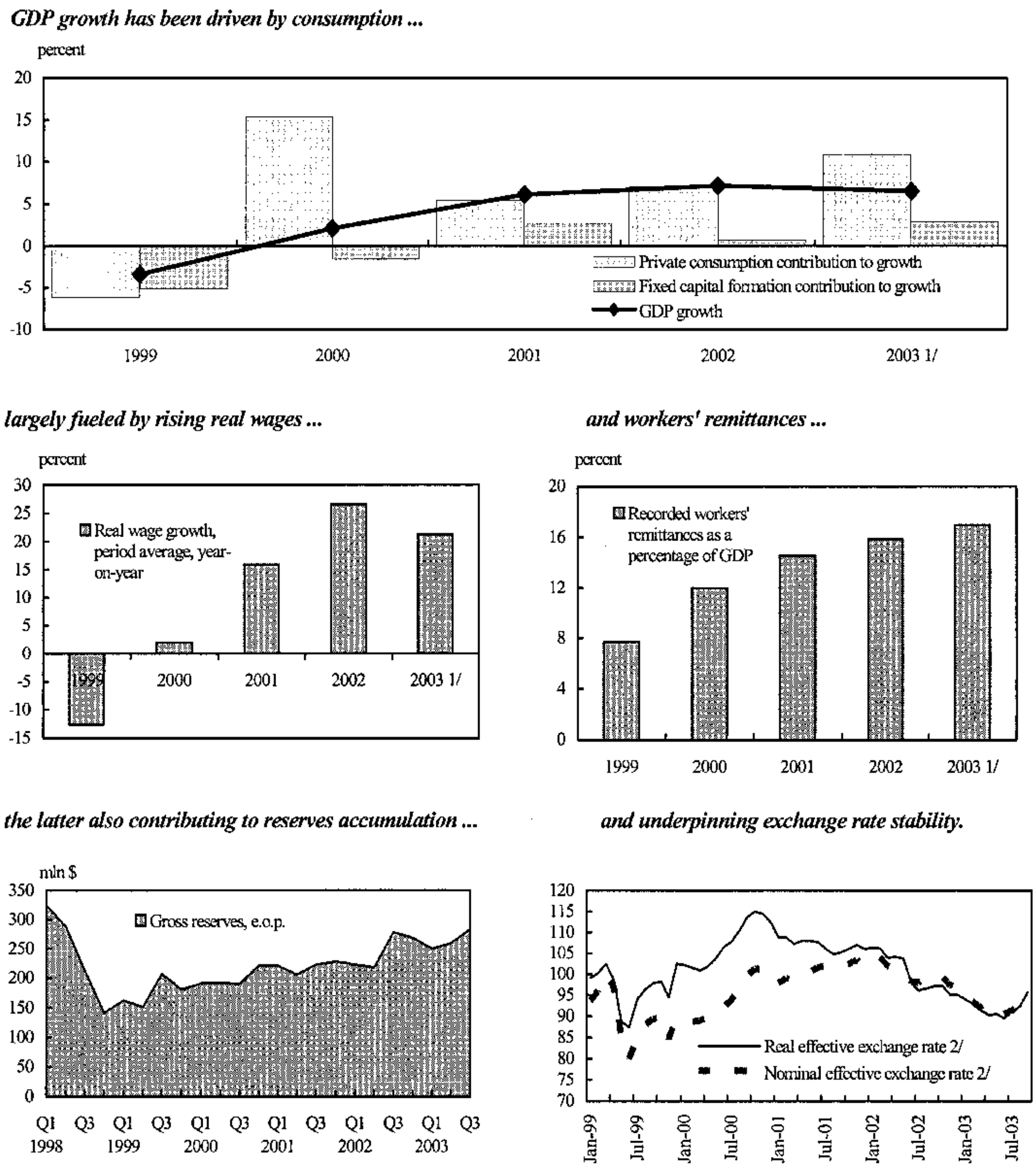
[1] EBRD relations are described in Appendix IV.

[2] Following a sharp decline after the 1998 crisis, real wages recovered in 2001 (16 percent) and 2002 (26½ percent), and continued to gain strength in 2003.

[3] The measured current account deficit tends to be overstated, since unrecorded remittances are reflected in the capital account or in errors and omissions.

Figure 1. Moldova: Driving Forces Behind Real GDP Growth



Source: Moldovan authorities and Fund staff estimates.

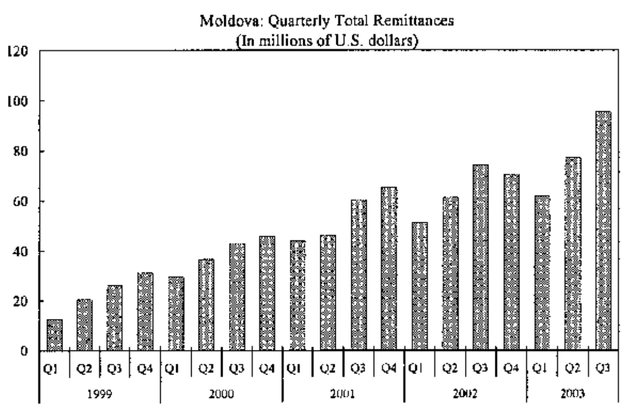
1/ 2003 data are for Q1 - Q3.
2/ Index 2002=100.

Box 1. Moldova: Workers' Remittances

Workers' remittances have become the single largest source of foreign exchange inflows after exports. *Recorded* remittances amounted to $268 million (16 percent of GDP) at end-2002 (almost half of total exports and twice the amount of official transfers) and are projected to reach at least $320 million by end-2003 (17 percent of GDP). They are recorded in the balance of payments as income (compensation of employees), given the lack of information on duration of stay abroad. These amounts substantially underestimate the actual flows, as remittances in cash, kind, or by check through regular mail, are not reported. According to international and local estimates (see table below), as of mid-2002 up to 600'000 Moldovans were living abroad, compared to a population of 3.6 million (4.4 million including Transnistria). Under the conservative assumption that each of them sends on average $1,000 home each year, remittances could be as high as $600 million (31 percent of projected GDP) in 2003.

The economic impact of remittances has been mixed. They have contributed to growth mainly through their effect on consumption, with little impact on investment (except in housing) so far. By fueling domestic consumption and credit growth, these inflows are partly responsible for the recent pick-up in inflation. They have also created "Dutch disease"-type pressure for a nominal appreciation. Remittances generate moral hazard, reducing incentives for reform and political change.

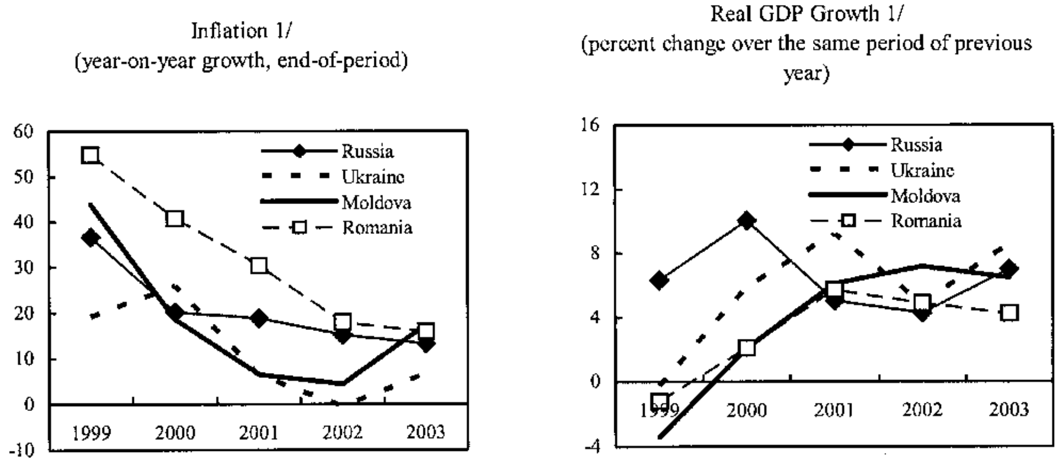
Are these large inflows sustainable, and if so could remittances play a role in Moldova's future development? Remittances have been more stable than other short-term capital inflows and are expected to continue to grow in the coming years, while emigration remains important. However, their growth rates should taper off progressively as migrants become settled in host countries. Since individual transfers are small and come from several countries, a negative shock such as a recession or a tightening of immigration policy in destination countries is not expected to lead to a sudden drop in these transfers. With appropriate policies in place to improve the investment climate, these resources could play an important catalytic role in private sector development. Remittances could also represent a powerful instrument for poverty reduction and community development, especially in rural areas, if they could be pooled into micro-credit schemes or rural investment funds.



Host Country	Estimated Number of Moldovan Nationals
Russian Federation	240,000–270,000
Italy	150,000
Portugal	80,000
Greece	30,000
Czech Republic	40,000
Turkey	20,000–50,000
Spain, France, Israel	20,000

Source: Moldovan authorities and Migration Department.

Figure 2. Moldova: Inflation and Real GDP Growth, 1999-2003

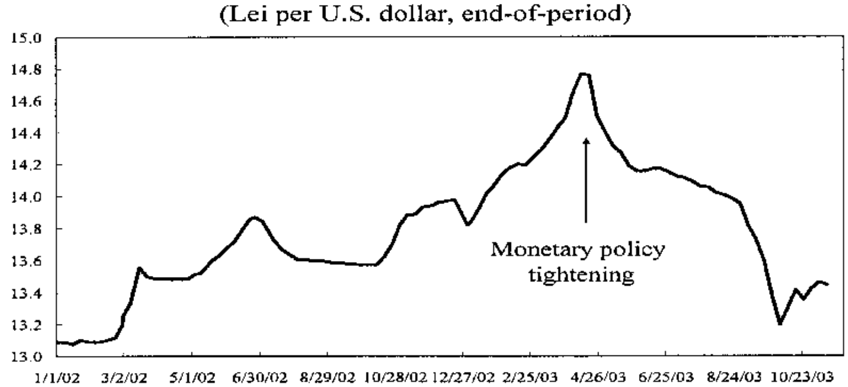


Source: IMF
1/ 2003 data are for end-October.

Source: IMF
1/ 2003 data are for first half.

early 2002 (Figure 3). The real effective exchange rate appreciated by about 0.7 percent over the first three quarters of 2003. The foreign exchange purchases allowed the NBM to keep international reserves at about two months of imports through October.

Figure 3. Moldova: Exchange Rate, Jan. 2002-Nov. 2003
(Lei per U.S. dollar, end-of-period)



Source: National Bank of Moldova.

5. **Largely unsterilized foreign exchange purchases fueled rapid money and credit growth in 2002–03 (Table 3).** The NBM tightened monetary policy in mid-2003 using its direct instruments, including higher reserve requirements, but made only limited use of indirect instruments. The gradual increase in the REPO rate (by a total of 3½ percentage points between March and end-October) had little liquidity impact. Starting from September 2003, the NBM moderated its foreign exchange purchases and the leu appreciated somewhat.

6. **Fiscal policy has remained reasonably tight, but external arrears started to accumulate (Tables 4a and 4b).** The general government posted a cash deficit of 1.8 percent of GDP in 2002, while net arrears of 0.9 percent of GDP were cleared. During the first three quarters of 2003, a cash surplus of 0.5 percent of GDP was recorded, reflecting robust collection of VAT and import duties, and lower-than-anticipated interest expenditures, owing to accumulation of external arrears (net arrears increased by 0.6 percent of GDP). The strengthening in tax collection reflects high consumption and imports growth, and some improvements in tax and customs administration. External financing has remained scarce, while several unfunded spending initiatives (including the territorial reorganization and recent pension/wage/veteran benefits increases) threaten medium-term fiscal sustainability.

7. **External debt service continues to be a key fiscal challenge.** Scheduled debt service on public and publicly-guaranteed debt represents about 45 percent of projected central government revenues in 2003. Moldova suspended debt service payments to Gazprom at end-2001 and to bilateral creditors in August 2003, while continuing to pay multilaterals and Eurobond holders. The authorities' requests for individual reschedulings have met with limited success so far.[4] New external arrears during the first three quarters of 2003 amounted to $25.6 million (1.3 percent of GDP), of which $17.3 million are due to Gazprom and $5.6 million to Russia.

8. **Progress on structural reforms remains slow.** The business climate remains poor and corruption widespread, while the share of private sector in GDP is only 50 percent (2003 EBRD Transition Report). Government interference in private sector activity—including formal and informal restrictions on exports of scrap metal and some agricultural goods (sunflower seeds, wheat, and soy)—continues to cast doubt over Moldova's commitment to market-oriented policies. The renationalization of Air Moldova in mid-2002 (without compensation to investors), the recent attempts to renationalize the electricity distribution networks, and the cancellation of several privatization contracts concluded before 2001, all have dented investors' confidence in the government's privatization program. While the privatization of some wineries has moved forward, Moldtelecom could not be privatized owing to lack of interest from qualified investors.

9. **The authorities intend to finalize their EGPRSP by February 2004.** Following recommendations of IMF/World Bank staff, the original March 2003 deadline was extended to allow for improvements in the quality of the sector strategies and broader public participation.

II. Policy Discussions

10. **The suspension of most international financial support and some external debt payments provided a difficult background to the discussions.** Discussions centered on:

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[4] While Turkey, Romania, and small commercial creditors have been somewhat responsive, Paris Club creditors have made clear that they would consider a rescheduling only within the context of a Fund-supported program.

(i) a review of economic and policy developments during the past decade (in line with the new procedures for Countries with Longer-Term Engagement, an "Ex-Post Assessment of Performance Under Fund Arrangements" (EPA) is presented in Appendix V); (ii) the policies needed to facilitate a rapid resumption of international financial support and restoration of a sustainable external debt position; and (iii) medium-term challenges and prospects.

A. Moldova's Transition: Taking Stock

11. **After a promising start in the early 1990's, Moldova's reform process stalled.** While macroeconomic policies have been broadly in line with Fund-supported programs since the 1998 crisis, structural reforms progressed only slowly, reflecting the lack of broad-based consensus for reform. The sharp deterioration in living standards during the past decade led to massive emigration and growing skepticism toward market reforms. At the same time, rising workers' remittances have contributed to keeping the currency stable, fostering short-term growth, and easing pressure for reforms. Commitment to market-oriented policies has weakened of late, as demonstrated by the recent tendency to reverse some structural reforms implemented in the late 1990's (EPA, paragraphs 19–21).

12. **The EPA identified some weaknesses in staff assessments and lessons learned during the past decade.** High tolerance for policy slippages during the initial stages of transition, excessive structural conditionality under extended arrangements, underestimation of the importance of informal norms and practices, and overestimation of Moldova's capacity to repay external debts, all contributed to complicate program implementation. Among the lessons learned is the **need for stronger ownership by the authorities**. The Fund's policy advice was most effective regarding monetary policy, since the NBM generally showed both strong ownership and good implementation capacity. Fiscal policy performance under successive Fund programs was typically hostage of political pressure, and was tightened only under the discipline of financing constraints. In hindsight, ownership might have been strengthened through better sequencing of reforms (with earlier focus on energy sector, safety nets, and civil service), more emphasis on private sector development (compared to focus on privatization), tighter limits on non-concessional borrowing, and better coordination among IFIs and other development partners (EPA, paragraphs 25 and 26). The authorities recognized that a key problem with Fund-supported programs had been poor implementation, stemming from weak ownership.

13. **The main challenge ahead is to achieve sustainable growth and reduce poverty.**[5] This will require consistent implementation of stabilization policies and elimination of current obstacles to growth. Key elements in the structural reform agenda include: visible improvements in the business environment (particularly in reducing corruption); elimination of state intervention in economic activity; strong commitment to private ownership and property rights; and maintenance of a liberal trade regime (EPA, paragraphs 27–28).

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[5] The poverty rate has remained high (48 percent in 2002), notwithstanding the recent economic recovery (EPA, paragraph 2).

14. **The authorities emphasized the positive results achieved so far.** They did not share the staff's view that excessive government intervention and the poor business environment would compromise their growth and poverty reduction goals. Rather, they highlighted the pick-up in economic activity, and the fact that some reforms had been successfully implemented, including privatization of the banking system, trade liberalization, implementation of a treasury system, and a strengthening of budgetary management and tax administration. Staff acknowledged that past reforms and the post-1998 adjustment policies had paved the way for steady growth, but noted that the economic recovery had been driven mainly by an acceleration in workers' remittances and the strong performance of Moldova's neighbors.

15. **Going forward, the authorities agreed to focus on developing their own economic strategy in the context of the EGPRSP.** In discussing prospects for renewed Fund support, staff noted that, while longer-term engagement was expected in a transition country, clear evidence of a change in economic policy direction would be needed before discussions on a new program could begin. This would require not only adequate progress in developing a coherent and well-defined economic strategy, but also a clear demonstration of the government's stated commitment to maintain financial stability and improve the business environment.[6] The authorities indicated their intention to move forward quickly with the EGPRSP. While the current draft still suffers from lack of policy prioritization and specification, unclear links between poverty analysis and identified policies, and a bias toward excessive monitoring indicators, it is a useful tool to initiate broad participation. Following staff's recommendation to strengthen the participatory process, several public debates were scheduled for December 2003.

B. Macroeconomic Outlook for 2003–04

16. **Tighter monetary and fiscal policies are needed to curb inflationary pressures and generate resources for external debt service.** While it may be possible to muddle through in the coming months, a prolonged period of inflation and default would dent confidence and aggravate downside risks.

17. **Higher growth and inflation are now expected for 2003, boosted by strong consumer demand.** Real GDP growth was revised up to 6 percent, while annual inflation could reach 18 percent. The external current account deficit is expected to widen to 8 percent of GDP. With investment slightly lower in terms of GDP relative to 2002, national saving is expected to fall by about 2 percentage points, to 8½ percent of GDP.

18. **With unchanged policies, a large external financing gap would emerge in 2004.** Real GDP growth is projected to moderate to 5 percent in 2004, as the post-98 rebound tapers off and the contribution of workers' remittances declines. Following adverse weather

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[6] As noted in the EPA (paragraph 23), the EBRD ranked Moldova below the 2002 CIS average regarding the quality of the business environment (it was above the CIS average in 1999).

conditions in late 2002/early 2003, a modest recovery of agricultural production is expected to contribute to growth and to bring food prices down to normal levels. Under these circumstances, an inflation target of 8 percent would be feasible for 2004. The authorities agreed with the inflation target, but felt that growth could be higher than projected by the staff. Reflecting slower expected domestic demand growth, the external current account deficit is projected to narrow to about 7 percent of GDP. With reserves held at end-2003 levels, an external financing gap of 6.9 percent of GDP would emerge, assuming payments of all scheduled debt service and clearance of outstanding arrears. Excluding clearance of arrears, the comparable "flow" financing gap would amount to 4.3 percent of GDP.

Fiscal policies

19. **Staff urged the authorities to tighten fiscal policies and resume external debt payments during the remainder of 2003.** Despite a shortfall of foreign grants of about 1½ percent of GDP, the general government is projected to post a cash surplus of ½ percent of GDP in 2003. With external amortization payments of 1½ percent of GDP and limited domestic financing possibilities, resuming current payments to all creditors in 2003 would require drastic expenditure cuts. As a second-best solution, staff advised the authorities to consider using part of an NBM credit already included in the 2003 budget; this would still leave end-2003 foreign exchange reserves at about 1.8 months of imports. The government was unwilling both to use the NBM credit and to cut expenditures. Under these circumstances, further accumulation of external arrears seems inevitable.

20. **The fiscal stance in 2004 is set to loosen.** The 2004 general government budget envisages a cash deficit of ¾ percent of GDP, implying a fiscal loosening of more than 1 percent of GDP (Text Table 1). In addition, the budget does not provide for all scheduled debt service and makes overoptimistic assumptions about grants and privatization receipts. Staff projects revenue to decline by one percentage point, to 29.4 percent of GDP, owing to new tax measures (including several tax cuts), and a slowdown in revenues from trade taxes, consistent with lower expected import growth.[7] As an offsetting measure, VAT exemptions on machinery (0.3 percent of GDP) will be eliminated. Staff noted that this measure should be supported by improved administration of VAT refunds, to avoid an excessive burden on enterprises. On the expenditure side, higher outlays to cover the full-year effect of a 15 percent hike in public sector salaries in 2003 and of scheduled interest

Text Table 1. General Government Accounts, 2002-04
(In percent of GDP)

	2002	2003	2004	
			Government	Staff 1/
		Proj.	budget	proj.
Overall balance (cash)	-1.8	0.4	-0.7	1.2
Excluding external interest payments	-0.3	1.7	0.5	2.5

Sources: Moldovan authorities and Fund staff estimates.

1/ Includes fiscal measures of 1.9 percent of GDP.

[7] The 2004 budget includes cuts in the corporate income tax rate (from 22 to 20 percent) and in the highest personal income tax rate (from 25 to 22 percent).

payments are partly compensated by lower capital and education spending.[8] Total expenditures (excluding foreign-financed project spending) are budgeted at the same level of 2003 (29 percent of GDP).

21. **The 2004 budget will entail further accumulation of arrears.** A fiscal financing gap of 4½ percent of GDP could emerge if Moldova stays current on external debt and repays all external arrears. Excluding arrears payments, the "flow" gap is projected at nearly 2 percent of GDP. Staff strongly urged the authorities to adopt additional fiscal measures to at least close the "flow" gap in 2004. This would provide a positive signal to creditors, which could facilitate a resumption of external financial support, and would help stem inflationary pressures. Possible gap-filling measures included postponing planned tax cuts, eliminating a larger number of VAT exemptions, and cutting expenditure, mainly on purchases of goods and services. The authorities were not prepared to consider policy scenarios involving fiscal adjustment. They signaled their intention to continue to seek individual reschedulings and, failing that, to close the "flow" gap by suspending some external debt service payments.[9] Staff pointed out that this strategy was risky, as it might result in a severe drying up of foreign finance.

Monetary and exchange rate policies

22. **Staff urged the NBM to tighten monetary policy to curb inflationary pressures.** Continued price increases affecting a broad selection of goods and services suggest that monetary policy has been too accommodating. The mission welcomed the monetary tightening implemented earlier in 2003, but noted that it had been insufficient to offset the impact of the strong inflow of worker's remittances. The NBM argued that, in practice, monetary policy had to balance multiple objectives, including lowering inflation, accumulating reserves, preserving external competitiveness, and keeping interest rates low to limit the cost of government borrowing. The NBM agreed with the staff, however, that more focus should be placed on the inflation objective in the future.

23. **The mission proposed a monetary program consistent with a significant drop in inflation in 2004.** Broad money growth would be limited to 23 percent (compared to about 30 percent in 2003) and credit growth would be just below 30 percent (40 percent expansion in 2003). A fiscal tightening of about 2 percentage points of GDP relative to the 2004 budget would reduce the external "flow gap" to 2.3 percent of GDP. Additional fiscal measures or external financing of that magnitude would be required to maintain gross reserves at the end-2003 level (about $260 million).

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[8] Budget sensitivity to domestic interest rates is limited by the relatively low stock of T-bills held outside the NBM.

[9] The draft budget proposed eliminating VAT exemptions equivalent to 0.8 percent of GDP, but parliament rejected this proposal on the President's recommendation.

24. **Staff generally supported the managed float exchange rate regime, but noted that a nominal appreciation might be warranted if remittances continued to grow fast and inflationary pressures did not abate.** The NBM reiterated its concern about competitiveness. Staff stressed that monetary policy could only influence the real exchange rate in the short-term and that, ultimately, competitiveness should be improved by implementing appropriate structural policies. Furthermore, dollar wages in Moldova were still low compared to the main CIS trading partners (EPA, paragraph 13) and the real effective exchange rate had appreciated only slightly compared to 2002. All considered, the level of the real exchange rate seemed appropriate.

25. **The mission assessed banking sector vulnerabilities, ahead of the FSAP planned for early 2004 (Box 2).** Banks' credit risk management appears to be satisfactory, reflecting recent strengthening of NBM supervision and progress in risk management techniques. Although the share of non-performing loans has fallen steadily, the mission stressed the importance of carefully monitoring the recent rapid credit growth (Table 5). The NBM agreed that there was no need for further liberalizing foreign currency credits. Staff welcomed the NBM's recent initiative to examine the nature of banks' open foreign exchange positions, including their use of off- balance sheet operations to limit exposures. Staff also encouraged the NBM to consider maintaining reserve requirements on foreign exchange deposits in foreign exchange.

Box 2. Moldova: Banking Sector Vulnerabilities

Moldova's banking sector has some vulnerabilities, with potential implications for overall financial stability:

Fast credit growth. Annual credit growth reached 48 percent by end-September 2003, raising concerns about the quality of banks' credit portfolios. Overall, credit risk seems to be under control, thanks to a strengthening of NBM's supervision and what appears to be progress in banks' risk management techniques, both leading to a declining share of non-performing loans. Non-performing loans, however, can lag behind lending growth, so continued close monitoring of credit risk is warranted.

Interest rates unresponsive to current macroeconomic conditions. Despite significant liquidity shortages, higher inflation, and sharp credit growth, nominal interest rates have remained sticky. Ultimately, this may build up financial system imbalances, suggesting that the authorities should review the transmission mechanism of monetary conditions through interest rates.

Rising currency substitution. About 53 percent of total deposits and over 40 percent of total credit were denominated in foreign currency at end-September 2003. It is essential that the NBM strengthens further its ability to monitor developments in the maturity and currency composition of banks' balance sheets, including the way in which banks use off-balance sheet operations to hedge their exposures.

Rising foreign currency credit. Presently, banks are allowed to extend foreign exchange credit to (unhedged) importers, while (naturally hedged) exporters can only borrow in local currency. This regime represents a vulnerability to the banking system. In this context, the NBM should continue to monitor and manage the risks associated with greater exposure to foreign exchange movements, an area where the NBM recognizes the need for further strengthening. This will require: (i) banks to have adequate information systems and appropriate risk management techniques; (ii) the NBM to be able to supervise market risk and country risk; and (iii) foreign exchange risk to be priced adequately.

Reserve requirements in domestic currency. All deposits, regardless of their currency denomination, are subject to a reserve requirement to be held in domestic currency. The current macroeconomic context suggests that required reserves for foreign currency deposits could be held in foreign currency. In particular, the level of currency substitution is much higher than a few years ago, introducing new risks, including the risk of liquidity crises following sharp and unexpected exchange rate swings.

C. Medium-Term Outlook and Policies

26. **Without policy adjustments, medium-term growth is expected to be anemic.** While the authorities argued that current policies were appropriate to sustain the economic recovery, staff noted that the government's increasingly interventionist behavior, slow progress in market-oriented reforms, and widespread corruption in the public sector, cast doubts about medium-term prospects. Given the authorities' reluctance in making policy adjustments in the near future, staff developed a medium-term macroeconomic framework on the basis of unchanged policies and no new external financing from IFIs. In this baseline scenario, real GDP growth would decline to 3 percent per year from 2006.[10] With investment remaining close to 16 percent of GDP and foreign saving roughly unchanged, national saving would remain at around 8 percent of GDP (Table 6).

27. **In the absence of new financing, the external outlook is grim.** Large external financing gaps, ranging between $150 and $300 million annually, are likely to emerge throughout 2012 (Tables 7 and 8). In particular, the debt sustainability analysis points to a serious liquidity problem in the next few years, unless new financing comes forward (Appendix VI). Without renewed IFIs involvement, it would be difficult to finance these gaps and remain current on debt service obligations, suggesting a high probability of default. If the financing gaps could be covered by new borrowing, the public external debt stock would settle at around 50 percent of GDP in the medium-term, indicating relatively low solvency risks. Stress tests show that Moldova remains most vulnerable to export and current account shocks. Moreover, public debt dynamics could be even more fragile than indicated should domestic borrowing be greater than assumed (Appendix VI, Table 4).

28. **The medium-term scenario is subject to a number of risks and vulnerabilities.** As illustrated by the 1998 crisis, Moldova is highly dependent on good performance of its main trading partners, notably Russia and Ukraine. Although trade patterns have started to change, the share of exports to CIS countries remains high. Moreover, Moldova's main exports are agricultural products, which are subject to price and weather-related shocks. Staff encouraged the authorities to address existing vulnerabilities through further efforts to diversify the export base, enhance productivity, and foster a liberal trade environment.

29. **Moldova would need to pursue growth-oriented policies steadfastly to alleviate poverty.** While medium-term prospects under unchanged policies are unfavorable, a swift change in policy stance could improve the outlook relatively quickly, since Moldova's financing needs are modest compared to other countries, and it has already established some

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[10] Massive emigration is likely to result in falling or stagnant labour force in the medium-term. Therefore, Moldova's long-term growth could be 1–2 percent lower per year compared to countries with more normal employment growth.

important building blocks for sustained growth (paragraph 14 and EPA paragraph 19). Nevertheless, achieving the Millennium Development Goals will be difficult.[11]

30. **Structural reforms need to be accelerated to complete the transition process.** Efforts are needed to revamp privatization and complete reforms in the energy sector, civil service, and the financial sector, while maintaining a liberal trade regime:

- The **privatization** process needs to be finalized, particularly in the wine, tobacco, and energy sectors. Moreover, the state continues to have minority share holdings in many companies that were part of the 1998 privatization program. The government seems reluctant to privatize the larger wineries, the two remaining electricity distribution companies, and the railways, while being open about privatizing power generation.

- Restructuring the **energy sector** is urgent in view of the significant accumulation of external arrears. Although some progress has been made, further reforms are needed to address the deterioration of electricity transmission equipment, strengthen the sector's institutions and investment environment, and reduce technical and commercial losses. The World Bank's recently-approved Energy II Project will support the government's efforts in this area.

- There is a need to continue **public administration** reform to raise public sector efficiency and reduce corruption. Although improvements have been made in the tax administration area, there is scope for further advancements, for example in VAT refunds administration. In the customs area, following their decision to abolish pre-shipment inspections, the authorities are considering alternative measures to enhance transparency and collection efficiency.

- Continued attention and resources need to be devoted to developing and monitoring indicators on **financial soundness and vulnerability**. The authorities agreed with the need to strengthen bank supervision, with a particular focus on the risks related to rising currency substitution. The introduction of a well-functioning and sound deposit insurance scheme would further buttress confidence in the banking system.

- While Moldova's **trade policy regime** is fairly liberal (Appendix VII), protectionist pressures have been rising. The authorities are considering raising some tariff lines to 35 percent, while reducing tariffs on imported inputs to zero, all leading to higher effective protection. While these measures would not be inconsistent with WTO commitments, staff cautioned the authorities against increasing protection of special interests and non-competitive industries, stressing the benefits of a stable, transparent, and reasonably uniform tariff regime. Staff renewed its objection to formal and

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[11] According to recent World Bank estimates, Moldova is unlikely to achieve the poverty, child mortality, and HIV/AIDS/TB goals.

informal restrictions on exports, and the authorities indicated their intention to remove them.

III. Staff Appraisal

31. Moldova's macroeconomic developments since the last Article IV consultation discussions are reasonably favorable, as reflected by robust GDP growth, a relatively stable exchange rate, and (until recently) moderate inflation. To a large extent, these positive achievements reflect the accumulated impact of market reforms carried out since the early 1990s, as well as relatively stable macroeconomic conditions. Workers' remittances have also played a major role in jumpstarting the recovery. Looking beyond the short-term, however, prospects are less promising, as the fundamentals for sustained economic growth still need to be established. In particular, the economy is becoming increasingly remittances-driven, while foreign investment continues to lag, reflecting the perception of a difficult business environment.

32. The lack of broad-based consensus for reform has weakened ownership, stifling the implementation of structural policies. Economic liberalization continues to be resisted and interventionist measures advocated as the first line of defense against corruption and weak governance. In contrast to this approach, Moldova's growth prospects rest on the government's ability to provide an enabling environment for private business and to reduce administrative intervention in the economy.

33. There are increasing signs of overheating, with domestic demand, imports, and inflation all rising sharply. By failing to respond to these signs, there is a risk of eroding domestic confidence and undermining prospects for renewed external financing. A prompt change in gear is recommended, including sufficient monetary and fiscal adjustment to curb inflation and allow a resumption of external debt payments. The authorities should adopt revenue and expenditure measures to close at least the emerging "flow" fiscal gap in 2004, while accelerating the implementation of a structural reform program that could provide the basis for international financial support.

34. Fiscal policy has been reasonably prudent, and tax collection has strengthened markedly. Nevertheless, a number of recent tax cut and spending initiatives could threaten fiscal sustainability, suggesting that fiscal policy remains exceedingly captive to political objectives. Moreover, the likelihood of policy slippages remains high, especially in light of the 2005 parliamentary elections. Recent improvements in tax collection are encouraging; the authorities should further develop efficient and fair tax and customs administrations, including effective methods for VAT refunds, to make such improvements sustainable. It is also important to strengthen the budget planning process by adopting realistic financing assumptions and resisting pressure for unfunded spending.

35. The recent surge in inflation is worrisome, suggesting that the NBM should tighten its stance as necessary to keep inflation low. The accommodating monetary policy that accompanied the economic recovery was appropriate, in light of the remonetization process

taking place in the region, but the uptick in inflation calls for tighter policies. The NBM should be commended for the recent improvements in banking supervision and the resulting strengthening in the banking sector, as demonstrated by the financial soundness indicators. Given the potential vulnerabilities, the NBM should remain vigilant and continue to develop and monitor macroprudential indicators to be able to adequately assess the banking sector's exposure to shocks.

36. The managed float regime has provided an appropriate basis for the NBM's external policies. Looking ahead, if faced with strong foreign exchange inflows, the NBM should be prepared to let the exchange rate appreciate to stem inflationary pressures. At the same time, given the high vulnerability of the economy and the delicate external debt situation, the NBM should continue to seek to accumulate international reserves on a precautionary basis, as long as this policy does not jeopardize the inflation objective.

37. Although there are signs of increasing trade diversification, Moldova's export base remains narrow and the country is still highly dependent on the economic performance of a few trading partners. External competitiveness could be enhanced by eliminating structural bottlenecks, while maintaining a liberal exchange and trade regime.

38. Moldova's large external debt service is a burden on the public finances and a hindrance to growth. The liquidity problem is particularly severe in the next few years, when the bulk of Moldova's relative short-term and non-concessional external debt falls due. Any solution to the debt problem will require additional net foreign exchange inflows, which are unlikely to materialize unless market-oriented reforms are implemented. In the absence of additional foreign financing, further fiscal tightening and some form of debt restructuring would be necessary to achieve external and fiscal sustainability. A short-term strategy based on continued arrears accumulation and on unrealistic expectations about prospects for rescheduling is not conducive to an early or sustainable resolution of the debt problem, while remaining current on external debt obligations would help restore creditors' goodwill and foster renewed financial support.

39. While generally adequate for surveillance purposes, Moldova's official statistics have serious deficiencies, particularly in the area of national accounts. The staff supports the authorities' request for further technical assistance to upgrade their statistical database.

40. Medium-term prospects are clouded by uncertainty. Moldova's narrow export base, together with its excessive dependence on Russian markets and workers' remittances, aggravates the economy's vulnerability. Even if the fiscal stance is not relaxed and the overall macroeconomic situation deteriorates only marginally, substantial external financing will be required to pay scheduled external obligations while maintaining NBM reserves at reasonable levels. Without a credible improvement in the government's willingness to implement market-oriented reforms, it is hard to envisage how this external financing could be generated. By contrast, with a committed effort and immediate implementation of policies that could be supported by the IFIs, the medium-term outlook could improve significantly.

41. At the end of the day, only the steadfast implementation of structural reforms will allow Moldova to grow out of its external debt and poverty problems. In particular, growth is unlikely to continue at the current pace without major improvements in the business environment and in governance. Going forward, clear evidence of a change in the direction of economic policy would be needed before discussions on a new Fund-supported program could begin. The authorities' intention to use the EGPRSP as a vehicle to develop its medium-term economic strategy is welcome.

42. Staff recommends that the next Article IV consultation be held within the regular 12-month cycle.

Table 1. Moldova: Selected Indicators, 2000-2004 1/

	2000	2001	2002	2003			2004
				H1 2/	Jan.-Sep. 2/	Year Proj.	Proj. 6/
I. Real sector indicators	(Percent change; unless otherwise indicated)						
Gross domestic product							
Real growth rate	2.1	6.1	7.2	6.5	6.2	6.0	5.0
Nominal GDP (MDL million)	16,020	19,052	22,040	...	...	26,720	31,817
Nominal GDP (S million)	1,289	1,480	1,624	...	...	1,909	2,268
CPI Inflation (average)	31.3	9.8	5.3	7.4	10.0	11.9	11.5
CPI Inflation (end of period, y-o-y)	18.5	6.4	4.4	11.0	16.2	18.0	8.0 5/
Average monthly wage (MDL)	408	519	692	820	859	...	...
Average monthly wage ($)	33	40	51	57	61	...	...
Saving-Investment balance (percent of GDP)							
Foreign saving	9.0	4.9	6.1	...	...	8.1	7.1
National saving	6.5	11.9	10.5	...	...	8.3	8.6
Private	4.9	9.8	8.7	...	...	6.0	7.8
Public	1.5	2.1	1.8	...	...	2.3	0.9
Gross investment	15.4	16.7	16.6	...	...	16.4	15.7
Private	12.5	14.4	13.9	...	...	14.3	14.1
Public	2.9	2.4	2.7	...	...	2.1	1.6
II. Fiscal indicators (general government)	(In percent of GDP)						
Primary balance (cash)	3.2	4.1	0.4	0.9	2.2	2.9	2.0
Overall balance (cash)	-3.1	-0.1	-1.8	-0.2	0.5	0.4	-0.7
Change in arrears	-1.7	0.2	-0.9	0.3	0.6	0.2	0.0
Overall balance (commitments)	-1.4	-0.3	-0.9	-0.5	-0.1	0.2	-0.7
III. Financial indicators	(Percent change; unless otherwise indicated)						
Broad money (M3)	40.1	36.4	36.0	40.8	33.8	30.4	22.6
Velocity (GDP/end-period M3; ratio)	4.6	4.0	3.4	3.2	3.0	3.1	3.0
Reserve money	29.8	27.9	31.1	30.3	23.4	17.0	16.3
Credit to the economy	40.1	35.4	34.3	43.8	48.5	39.8	27.4
IV. External sector indicators							
Current account balance ($ million)	-79	-72	-99	-68	...	-154	-160
Current account balance (percent of GDP)	-6.2	-4.9	-6.1	-3.5	...	-8.1	-7.1
Gross official reserves ($ million)	223	229	269	260	284	259	259
Gross official reserves (months of imports)	2.4	2.1	2.1	...	...	1.8	1.7
Exchange rate (MDL/$) period average	12.4	12.9	13.6	14.3	14.2	...	...
Exchange rate (MDL/$) end of period	12.4	13.1	13.8	14.1	13.3	...	...
External debt/GDP (percent) 3/	81.6	67.3	64.8	...	...	52.5	43.6
Debt service/exports of goods and services (percent)	16.4	16.8	14.1	...	...	13.9	12.8
Debt service/central govt. revenues (percent) 3/ 4/	88.7	44.7	58.1	...	...	44.7	36.1

Sources: Moldovan authorities and IMF staff estimates.

1/ Data exclude Transnistria.
2/ End-period CPI inflation, broad money, and reserve money are growth rates over the last 12 months.
3/ Public and publicly-guaranteed debt.
4/ Central government revenue, excluding grants.
5/ The inflation figure for end-2004 is a target recommended by the mission.
6/ Projection implies a fiscal "flow" financing gap of 1.9 percent of GDP. This gap could be closed by a combination of fiscal measures and additional financing.

Table 2. Moldova: Balance of Payments, 2001-04
(In millions of U.S. dollars; unless otherwise indicated)

	2001	2002	2003					2004
	Year	Year	Q1	Q2	Q3	Q4	Year	Year
	Act.	Act.	Prel.	Prel.	Proj.	Proj.	Proj.	Proj.
Current account	-72.4	-99.1	-7.9	-59.7	-46.3	-40.3	-154.1	-160.2
Trade Balance	-313.0	-378.3	-75.5	-151.6	-155.7	-139.0	-521.8	-594.6
Exports	567.2	659.8	174.0	175.9	193.3	214.0	757.2	825.4
Imports	-880.3	-1,038.1	-249.5	-327.5	-349.0	-353.0	-1279.0	-1420.0
Of which: Energy	-201.0	-194.2	-56.8	-47.2	-54.0	-78.0	-236.0	-259.6
Services (net)	-39.5	-34.8	-7.0	-3.9	-6.0	-10.0	-26.9	-30.3
Income (net)	119.6	159.1	38.6	56.6	74.4	66.7	236.4	302.7
Compensation of employees (net)	186.0	239.2	54.5	77.9	93.0	95.0	320.4	360.0
Income on direct and portfolio investment	-25.2	-38.9	-4.9	-14.7	-8.9	-8.9	-37.4	-13.6
Income on other investment (interests)	-41.2	-41.2	-11.1	-6.5	-9.6	-19.4	-46.6	-43.7
Current transfers (net)	160.6	154.9	36.0	39.1	41.0	42.0	158.1	162.0
Capital and financial account	54.8	31.7	-28.8	20.6	65.9	19.5	77.2	84.1
Capital transfers (net)	-20.7	-15.3	-3.6	-3.6	-3.6	-3.6	-14.4	0.0
Direct investment	147.1	116.7	12.8	8.3	11.8	15.0	47.8	76.0
Portfolio investment (net)	-25.3	-61.5	-4.5	-5.5	-4.5	-5.5	-20.0	-20.0
Eurobond 1/	-25.3	-43.7	0.0	-1.0	0.0	-1.0	-2.0	-2.0
Gazprom	0.0	-18.0	-4.5	-4.5	-4.5	-4.5	-18.0	-18.0
Loans (net)	25.7	50.8	-3.8	-2.1	-6.3	-30.9	-43.1	-39.0
Medium- and long-term loans (net)	17.7	50.8	-3.8	-2.1	-6.3	-30.9	-43.1	-39.0
Disbursements	88.2	136.2	10.3	19.0	12.0	23.4	64.6	97.1
World Bank	18.3	26.4	2.7	6.8	4.3	9.1	22.9	25.0
Of which: SAC III		10.0	0.0	0.0	0.0	0.0	0.0	0.0
EBRD	11.0	6.9	0.0	0.0	0.4	0.4	0.8	0.0
IFAD	0.8	1.8	0.7	0.3	0.8	0.7	2.4	3.0
Private debt	58.1	100.5	6.9	11.5	6.2	12.5	37.1	66.3
Amortization due	-70.5	-85.4	-14.1	-21.1	-18.2	-54.2	-107.7	-136.0
Short-term loans (net)	8.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other capital flows (net)	-72.0	-59.0	-29.6	23.5	68.5	44.5	106.9	67.0
Errors and omissions	13.1	16.3	4.1	44.9	0.0	0.0	49.0	0.0
Overall balance	-4.4	-51.1	-32.5	5.8	19.6	-20.8	-27.9	-76.1
Financing	4.4	51.1	32.5	-5.8	-19.7	20.8	27.8	-80.9
Net official reserves (-, increase)	-12.9	-46.1	12.8	-13.6	-32.6	20.8	-12.6	-20.2
Use of Fund credit	-2.5	-5.8	-5.6	-3.9	-8.6	-3.9	-22.0	-20.2
Change of gross official reserves	-10.4	-40.3	18.4	-9.7	-24.0	24.7	9.4	0.0
Exceptional financing	17.3	97.1	19.7	7.9	12.9	0.0	40.4	0.0
Arrears external debt 2/	32.6	2.6	1.7	2.1	7.2	-2.5	8.5	-11.7
Arrears on energy and other suppliers	-30.9	35.2	18.0	5.7	5.7	0.0	29.4	-48.3
Rescheduling 1/	15.6	59.4	0.0	0.0	0.0	2.5	2.5	-0.3
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	157.0
Of which: excluding arrears clearance								96.7
Memorandum items:								
Gross official reserves	228.5	268.8	250.4	260.1	284.1	259.4	259.4	259.4
In months of imports of goods and services	2.1	2.1	...	...	...	...	1.8	1.7
Current account (in percent of GDP)	-4.9	-6.1	...	...	...	...	-8.1	-7.1
Trade balance (in percent of GDP)	-21.1	-23.3	...	...	...	...	-27.3	-26.2

Sources: National Bank of Moldova and Fund staff estimates.

1/ In 2002 includes the Eurobond rescheduling.
2/ External arrears are assumed to be cleared in 2004.

Table 3. Moldova: Accounts of the National Bank of Moldova and Monetary Survey, 2001-04
(MDL millions; unless otherwise indicated)

	2001	2002	2003				2004
			Q1	Q2	Q3	Q4	
	Actual	Actual	Actual	Actual	Actual	Proj	Proj
National Bank of Moldova							
Net foreign assets	1,074	1,616	1,495	1,591	1,918	1,720	2,153
NFA (convertible)	1,074	1,616	1,496	1,593	1,919	1,722	2,154
Gross reserves	2,992	3,716	3,632	3,679	3,783	3,554	3,788
Reserve liabilities	-1,918	-2,100	-2,136	-2,086	-1,864	-1,832	-1,633
Net domestic assets	1,415	1,647	1,642	1,688	1,787	2,097	2,288
Net claims on general government	1,788	2,037	2,053	2,096	2,059	2,336	2,376
Credit to banks	76	58	51	54	49	83	233
Other items (net)	-448	-448	-462	-462	-321	-321	-321
Reserve money	2,489	3,263	3,137	3,279	3,705	3,817	4,441
Currency in circulation	1,834	2,289	2,193	2,364	2,908	2,849	3,283
Banks' reserves	655	974	944	915	797	969	1,157
Required reserves	333	512	576	706	774	828	903
Excess reserves	322	462	368	209	24	141	255
Monetary Survey							
Net foreign assets	1,342	1,943	2,227	2,376	2,881	2,683	2,671
NFA (convertible)	1,346	1,900	2,185	2,309	2,783	2,586	2,573
Net domestic assets	3,445	4,568	4,659	4,925	5,318	5,829	7,764
Net claims on general government	2,011	2,094	1,890	1,988	1,768	2,081	2,421
Credit to economy	3,101	4,166	4,675	4,879	5,615	5,814	7,409
Other items (net)	-1,667	-1,691	-1,907	-1,942	-2,066	-2,066	-2,066
Broad Money (M3)	4,787	6,512	6,886	7,301	8,199	8,513	10,435
Broad Money (M2: excluding FCD)	3,465	4,518	4,460	4,752	5,386	5,501	6,632
Currency in circulation	1,834	2,289	2,193	2,364	2,908	2,849	3,283
Total deposits	2,953	4,223	4,688	4,935	5,291	5,664	7,152
Domestic currency deposits	1,630	2,229	2,262	2,386	2,477	2,652	3,349
Foreign currency deposits	1,323	1,994	2,426	2,550	2,814	3,012	3,803
Memorandum items:							
Reserve money growth (percentage change; quarterly)	12	...	-4	5	13	3	...
Reserve money growth (percentage change; annual)	28	31	27	30	23	17	16
Broad money growth (percentage change; quarterly)		...	6	6	12	4	...
Broad money growth (percentage change; annual)	36	36	42	41	34	31	23
Credit to the Economy, (percentage change, annual)	35	34	46	44	48	40	27
Gross international reserves (in millions of U.S. dollars)	229	269	250	260	284	259	259
Net international reserves (in millions of U.S. dollars)	82	117	103	113	144	121	141
Velocity (M3; end of period)	4.0	3.4	3.3	3.2	3.0	3.1	3.0

Sources: National Bank of Moldova and Fund staff estimates.

Table 4a. Moldova: General Government Budget, 2001-04 1/

(MDL millions; unless otherwise indicated)

	2001	2002	2003					2004	
	Year	Year	Q1	Q2	Q3	Q4	Year	Year	
	Actual	Actual	Actual	Actual	Actual	Proj.	Proj.	Budget 5/	Proj. 6/
Revenues and grants	5,540	6,611	1,702	2,004	2,201	2,207	8,114	9,479	9,339
Revenues	5,394	6,537	1,702	2,004	2,201	2,207	8,113	9,190	9,339
Tax revenues	4,644	5,827	1,444	1,793	1,963	2,060	7,259	8,411	8,474
Profit tax	350	428	180	119	109	100	508	485	530
Personal income tax	348	468	104	170	158	116	548	574	602
VAT	1,498	2,034	480	664	773	858	2,774	3,214	3,253
Excises	681	658	127	203	247	211	788	873	872
Foreign trade taxes	234	333	82	106	135	146	470	490	512
Other taxes 2/	231	263	34	60	68	105	267	338	267
Social Fund contributions	1,304	1,644	437	471	472	521	1,901	2,024	2,024
Health Fund contributions	...	...	...	...	1	3	3	413	413
Non-tax revenues	749	710	258	211	238	148	854	779	865
Grants	147	73	1	0	0	0	1	289	0
Expenditures and net lending (cash)	5,589	7,056	1,665	2,165	2,000	2,240	8,070	9,717	9,577
(excl. project loan spending)	5,399	6,722	1,615	2,048	1,913	2,174	7,750	9,225	9,227
National Economy	298	417	100	160	113	108	481	661	661
Social sphere	1,795	2,489	624	750	623	839	2,836	2,247	2,247
Education	924	1,240	327	377	281	406	1,391	1,474	1,474
Health care 3/	542	792	195	222	205	321	942	153	153
Other	329	456	102	151	137	113	503	620	620
Interest payments	797	486	146	151	151	223	671	883	885
Domestic	345	141	51	75	103	105	334	511	459 7/
Foreign	453	345	96	76	47	118	337	372	426
Capital expenditures	206	258	38	59	102	46	244	172	172
Other expenditures	946	1,251	283	354	340	366	1,342	1,796	1,796
Social Fund expenditures	1,373	1,900	439	584	593	586	2,202	2,467	2,467
Health Fund expenditures	...	...	...	...	4	10	15	1,026	1,026
Net lending	-17	-78	-15	-9	-12	-5	-41	-27	-27
Project loan spending	190	334	50	117	87	67	321	492	351
Balance of extra-budgetary funds	23	44	49	9	5	0	63	0	0
Overall surplus(+)/deficit(-) (cash)	-25	-402	87	-153	206	-33	107	-238	-238
(excl. project loan spending)	165	-68	137	-35	292	34	427	254	112
Primary balance (cash)	772	85	233	-2	356	190	778	645	647
Change in arrears (+, increase)	29	-202	71	9	75	-90	65	...	...
Domestic expenditure	-15	-294	38	-3	-25	-90	-80	...	...
External interest	44	92	33	12	100	0	145	...	...
Overall surplus(+)/deficit(-) (commitments)	-54	-200	15	-161	130	57	41	...	...
Financing	67	322	-28	153	-262	33	-104	238	238
Budget financing	-123	-12	-77	36	-349	-34	-424	-254	-112
Central government	-123	246	-37	-50	-184	-84	-355	-281	-139
Net domestic	413	417	25	37	-56	270	276	189	228
Net foreign	-621	-315	-66	-96	-148	-403	-713	-799	-1,895
Privatization	85	144	4	10	20	48	82	329	89
Financing gap	0	0	0	0	0	0	0	0	1,439
Local governments	...	-75	-18	47	-150	112	-9	27	27
Social fund	...	-184	-22	39	-13	-62	-58	0	0
Health fund		...	...	...	-2	0	-2	0	0
Project loans	190	334	50	117	87	67	321	492	351
Statistical discrepancy	42	-80	59	1	-57	0	3	0	0
Stock of general government debt	13,678	15,167	...	...	...	...	15,165	...	...
Domestic debt	2,400	2,821	...	...	...	...	3,173	...	...
Domestic expenditure arrears	669	375	413	410	385	295	295	...	...
External debt 4/	10,609	11,971	...	...	...	...	11,697	...	...
Memorandum items:									
GDP (in millions of lei)	19,052	22,040	...	...	...	...	26,720	27,700	31,817
Financing gap	...	...	...	...	...	0	0	...	1,439
Of which: excluding external arrears clearance	...	...	...	...	...	0	0	...	596

Sources: Data provided by the authorities; and Fund staff estimates and projections.

1/ Includes the republican government, local governments, Social Fund, Health Fund, and other extra-budgetary funds.
2/ Includes land tax, real estate tax, natural resources tax, and State tax.
3/ After 2003, excludes expenditure of the Health Fund, which is shown as a separate item.
4/ Excluding IMF loans and publicly-guaranteed debt that is serviced by borrowers.
5/ Government estimates as of end-October.
6/ Incorporates parliamentary decisions after submission of the draft budget.
7/ Staff projection excludes budgeted interest payments on an NBM loan that was not disbursed in 2003. For the remaining domestic debt, the budgeted 14 percent T-bill interest rate is used.

Table 4b. Moldova: General Government Budget, 2001-04 1/

(as a percent of GDP; unless otherwise indicated)

	2001 Year Actual	2002 Year Actual	2003 Q1 Actual	2003 Q2 Actual	2003 Q3 Actual	2003 Q4 Proj.	2003 Year Proj.	2004 Year Budget 5/	2004 Year Proj. 6/
Revenues and grants	29.1	30.0	6.4	7.5	8.2	8.3	30.4	29.8	29.4
Revenues	28.3	29.7	6.4	7.5	8.2	8.3	30.4	28.9	29.4
Tax revenues	24.4	26.4	5.4	6.7	7.3	7.7	27.2	26.4	26.6
Profit tax	1.8	1.9	0.7	0.4	0.4	0.4	1.9	1.5	1.7
Personal income tax	1.8	2.1	0.4	0.6	0.6	0.4	2.0	1.8	1.9
VAT	7.9	9.2	1.8	2.5	2.9	3.2	10.4	10.1	10.2
Excises	3.6	3.0	0.5	0.8	0.9	0.8	2.9	2.7	2.7
Foreign trade taxes	1.2	1.5	0.3	0.4	0.5	0.5	1.8	1.5	1.6
Other taxes 2/	1.2	1.2	0.1	0.2	0.3	0.4	1.0	1.1	0.8
Social Fund contributions	6.8	7.5	1.6	1.8	1.8	1.9	7.1	6.4	6.4
Health Fund contributions	...	...	...	...	0.0	0.0	0.0	1.3	1.3
Non-tax revenues	3.9	3.2	1.0	0.8	0.9	0.6	3.2	2.4	2.7
Grants	0.8	0.3	0.0	0.0	0.0	0.0	0.0	0.9	0.0
Expenditures and net lending (cash)	29.3	32.0	6.2	8.1	7.5	8.4	30.2	30.5	30.1
(excl. project loan spending)	28.3	30.5	6.0	7.7	7.2	8.1	29.0	29.0	29.0
National Economy	1.6	1.9	0.4	0.6	0.4	0.4	1.8	2.1	2.1
Social sphere	9.4	11.3	2.3	2.8	2.3	3.1	10.6	7.1	7.1
Education	4.8	5.6	1.2	1.4	1.1	1.5	5.2	4.6	4.6
Health care 3/	2.8	3.6	0.7	0.8	0.8	1.2	3.5	0.5	0.5
Other	1.7	2.1	0.4	0.6	0.5	0.4	1.9	1.9	1.9
Interest payments	4.2	2.2	0.5	0.6	0.6	0.8	2.5	2.8	2.8
Domestic	1.8	0.6	0.2	0.3	0.4	0.4	1.3	1.6	1.4 7/
Foreign	2.4	1.6	0.4	0.3	0.2	0.4	1.3	1.2	1.3
Capital expenditures	1.1	1.2	0.1	0.2	0.4	0.2	0.9	0.5	0.5
Other expenditures	5.0	5.7	1.1	1.3	1.3	1.4	5.0	5.6	5.6
Social Fund expenditures	7.2	8.6	1.6	2.2	2.2	2.2	8.2	7.8	7.8
Health Fund expenditures	...	...	...	...	0.0	0.0	0.1	3.2	3.2
Net lending	-0.1	-0.4	-0.1	0.0	0.0	0.0	-0.2	-0.1	-0.1
Project loan spending	1.0	1.5	0.2	0.4	0.3	0.3	1.2	1.5	1.1
Balance of extra-budgetary funds	0.1	0.2	0.2	0.0	0.0	0.0	0.2	0.0	0.0
Overall surplus(+)/deficit(-) (cash)	-0.1	-1.8	0.3	-0.6	0.8	-0.1	0.4	-0.7	-0.7
(excl. project loan spending)	0.9	-0.3	0.5	-0.1	1.1	0.1	1.6	0.8	0.4
Primary balance (cash)	4.1	0.4	0.9	0.0	1.3	0.7	2.9	2.0	2.0
Change in arrears (+, increase)	0.2	-0.9	0.3	0.0	0.3	-0.3	0.2	...	...
Domestic expenditure	-0.1	-1.3	0.1	0.0	-0.1	-0.3	-0.3	...	...
External interest	0.2	0.4	0.1	0.0	0.4	0.0	0.5	...	...
Overall surplus(+)/deficit(-) (commitments)	-0.3	-0.9	0.1	-0.6	0.5	0.2	0.2	...	...
Financing	0.4	1.5	-0.1	0.6	-1.0	0.1	-0.4	0.7	0.7
Budget financing	-0.6	-0.1	-0.3	0.1	-1.3	-0.1	-1.6	-0.8	-0.4
Central government	-0.6	1.1	-0.1	-0.2	-0.7	-0.3	-1.3	-0.9	-0.4
Net domestic	2.2	1.9	0.1	0.1	-0.2	1.0	1.0	0.6	0.7
Net foreign	-3.3	-1.4	-0.2	-0.4	-0.6	-1.5	-2.7	-2.5	-6.0
Privatization	0.4	0.7	0.0	0.0	0.1	0.2	0.3	1.0	0.3
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	4.5
Local governments	...	-0.3	-0.1	0.2	-0.6	0.4	0.0	0.1	0.1
Social fund	...	-0.8	-0.1	0.1	0.0	-0.2	-0.2	0.0	0.0
Health fund		...	...	...	0.0	0.0	0.0	0.0	0.0
Project loans	1.0	1.5	0.2	0.4	0.3	0.3	1.2	1.5	1.1
Statistical discrepancy	0.2	-0.4	0.2	0.0	-0.2	0.0	0.0	0.0	0.0
Stock of general government debt	71.8	68.8	...	...	...	...	56.8	...	...
Domestic debt	12.6	12.8	...	...	...	...	11.9	...	...
Domestic expenditure arrears	3.5	1.7	1.5	1.5	1.4	1.1	1.1	...	...
External debt 4/	55.7	54.3	...	...	...	...	43.8	...	...
Memorandum item:									
Financing gap	...	...	...	...	...	0.0	0.0	...	4.5
Of which: excluding external arrears clearance	...	...	...	...	...	0.0	0.0	...	1.9

Sources: Data provided by the authorities; and Fund staff estimates and projections.

1/ Includes the republican government, local governments, Social Fund, Health Fund, and other extra-budgetary funds.
2/ Includes land tax, real estate tax, natural resources tax, and State tax.
3/ After 2003, excludes expenditure of the Health Fund, which is shown as a separate item.
4/ Excluding IMF loans and publicly-guaranteed debt that is serviced by borrowers.
5/ In percent of GDP as projected by staff.
6/ Incorporates parliamentary decisions after submission of the draft budget.
7/ Staff projection excludes budgeted interest payments on an NBM loan that was not disbursed in 2003. For the remaining domestic debt, the budgeted 14 percent T-bill interest rate is used.

Table 5. Moldova: Financial Sector Indicators, 1998-03
(End-of-period and in percent; unless otherwise indicated)

	1998	1999	2000	2001	2002	Sept. 2003
Size						
Number of banks	23	20	20	19	16	16
Total assets of the banking system (in percent of GDP)	29	26	29	31	36	36
Credit to nongovernment sector (percent of GDP)	19	13	14	16	19	23
Ownership 1/						
Share of total assets of banks with foreign ownership exceeding 50 percent	22	34	40	35	37	38
Share in total assets of banks with state ownership exceeding 50 percent	-	8	9	10	13	14
Capital adequacy						
Capital adequacy ratio 2/	40	46	49	43	36	32
Liquidity						
Liquidity ratio 3/	67	79	67	60	56	49
Asset quality						
Nonperforming loans as a share of total loans	32	29	21	10	8	6
(Loan loss provision - non-performing loans)/tier one capital	-31	-20	-15	-5	-3	-2
Loans under supervision as a share of total loans	38	32	30	31	35	34
Non-performing and loans under supervision as a share of total loans	70	61	51	41	43	40
Profitability						
Return on equity	15	18	25	14	17	23
Return on assets	4	4	7	4	4	5
Non-interest income / Total income	25	39	39	35	40	38
Interest rates 4/						
Domestic currency average lending rate	34	35	32	26	19	19
Domestic currency average deposit rate	30	28	24	18	13	13
Interest rate spread, domestic currency	4	8	9	8	7	6
Foreign currency average lending rate	20	19	15	12	12	11
Foreign currency average deposit rate	6	5	5	3	3	3
Interest rate spread, foreign currency	14	14	10	9	9	7
91 day T-bill (effective nominal yield)	48	38	25	8	11	20
Foreign currency deposits						
Share of foreign currency deposits in broad money	23	28	28	28	31	34
Share of foreign currency deposits in all deposits	44	50	49	45	47	53

Source: National Bank of Moldova

1/ Latest obsevations are from June 2003.

2/ Total regulatory capital over total risk weighted assets.

3/ Liquid assets over total deposits.

4/ Latest observations are from October 2003.

Table 6. Moldova: Macroeconomic Framework, 2002-2007

	2002	2003 Proj.	2004 Proj.	2005 Proj.	2006 Proj.	2007 Proj.
Growth and inflation			(Percent change)			
Real GDP growth	7.2	6.0	5.0	4.0	3.0	3.0
CPI Inflation (end of period, y-o-y)	4.4	18.0	8.0	6.0	5.0	5.0
Saving-Investment balance			(In percent of GDP; unless otherwise indicated)			
Foreign saving	6.1	8.1	7.1	7.5	7.5	7.4
National saving	10.5	8.3	8.6	8.1	8.1	8.2
Private	8.7	6.0	7.8	7.6	7.7	7.8
Public	1.8	2.3	0.9	0.5	0.4	0.3
Gross investment	16.6	16.4	15.7	15.6	15.6	15.6
Private	13.9	14.3	14.1	14.0	14.0	14.0
Public	2.7	2.1	1.6	1.6	1.6	1.6
General Government						
Revenue and grants	30.0	30.4	29.4	29.4	29.4	29.4
Expenditure 1/	32.0	30.2	30.1	30.4	30.5	30.7
Of which: capital expenditure	2.7	2.1	1.6	1.6	1.6	1.6
Balance of extra-budgetary funds	0.2	0.2	0.0	0.0	0.0	0.0
Change in arrears	-0.9	0.2	...	...	...	...
Primary balance (commitments)	1.3	2.7	2.0	2.3	2.3	2.4
Overall balance (commitments)	-0.9	0.2	-0.7	-1.1	-1.2	-1.3
Memorandum items:						
GDP per capita (in millions of dollars)	447	525	624	662	695	731
GNDI per capita (in millions of dollars)	533	634	752	795	837	877

Sources: Moldovan authorities and IMF staff estimates.

1/ Including project loan spending.

Table 7. Moldova: Balance of Payments, 2001-12
(In millions of U.S. dollars; unless otherwise indicated)

	2001 Act.	2002 Act.	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
			Projections									
Current account	-72.4	-99.1	-154.1	-160.2	-180.6	-188.5	-197.8	-181.4	-176.1	-158.9	-141.3	-139.2
Merchandise trade balance	-313.0	-378.3	-521.8	-594.6	-633.8	-672.3	-701.6	-714.6	-732.3	-744.8	-754.2	-769.5
Exports of goods	567.2	659.8	757.2	825.4	891.4	958.3	1,025.4	1,097.1	1,168.4	1,239.7	1,307.9	1,373.3
Imports of goods	-880.3	-1,038.1	-1,279.0	-1,420.0	-1,525.2	-1,630.6	-1,727.0	-1,811.7	-1,900.7	-1,984.5	-2,062.1	-2,142.8
Of which: energy	-201.0	-194.2	-236.0	-259.6	-277.7	-295.8	-312.1	-326.1	-340.8	-354.4	-366.8	-379.7
Balance of services	-39.5	-34.8	-26.9	-30.3	-30.2	-29.9	-27.7	-22.6	-17.6	-11.5	-5.1	-0.2
Exports of services	168.2	210.5	238.1	260.5	281.4	302.5	323.6	345.3	367.7	390.2	411.6	432.2
Imports of services	-207.7	-245.2	-265.0	-290.8	-311.6	-332.4	-351.3	-367.9	-385.3	-401.6	-416.7	-432.4
Income (net)	119.6	159.1	236.4	302.7	316.5	341.9	354.5	375.2	389.6	409.5	426.4	435.0
Compensation of employees	186.0	239.2	320.4	360.0	388.8	419.9	449.3	476.3	500.1	525.1	546.1	557.0
Income on direct and portfolio investment	-25.2	-38.9	-37.4	-13.6	-12.3	-12.5	-12.3	-11.1	-12.1	-12.1	-12.1	-12.1
Income on other investment	-41.2	-41.2	-46.6	-43.7	-60.0	-65.6	-82.5	-89.9	-98.4	-103.5	-107.5	-109.9
Current transfers (net)	160.6	154.9	158.1	162.0	166.9	171.9	177.0	180.6	184.2	187.9	191.6	195.4
Capital and financial account	54.8	31.7	77.2	84.1	65.2	40.2	59.0	-7.3	-55.1	-90.1	-121.4	-153.2
Capital transfers (net)	-20.7	-15.3	-14.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	75.5	47.0	91.7	84.1	65.2	40.2	59.0	-7.3	-55.1	-90.1	-121.4	-153.2
Direct investment	147.1	116.7	47.8	76.0	90.0	92.7	95.5	97.4	99.3	101.3	103.4	105.4
Portfolio investment (net)	-25.3	-61.5	-20.0	-20.0	-24.3	-24.3	-6.3	-6.3	-6.3	0.0	0.0	0.0
Of which: Eurobond 1/	-25.3	-43.7	-2.0	-2.0	-6.3	-6.3	-6.3	-6.3	-6.3	0.0	0.0	0.0
Of which: Gazprom	0.0	-18.0	-18.0	-18.0	-18.0	-18.0	0.0	0.0	0.0	0.0	0.0	0.0
Medium- and long-term loans	17.7	50.8	-43.1	-39.0	-0.4	-28.1	-30.1	-98.4	-148.0	-191.5	-224.8	-258.6
Disbursements	88.2	136.2	64.6	97.1	104.7	105.9	107.9	107.6	107.3	107.0	106.7	106.4
World Bank	18.3	26.4	22.9	25.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0
EBRD	11.0	6.9	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IFAD	0.8	1.8	2.4	3.0	3.0	3.0	0.0	0.0	0.0	0.0	0.0	0.0
Other official creditors	0.0	0.6	1.4	2.8	3.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private creditors	58.1	100.5	37.1	66.3	77.9	82.9	87.9	87.6	87.3	87.0	86.7	86.4
Amortization	-70.5	-85.4	-107.7	-136.0	-105.1	-134.0	-138.0	-206.0	-255.3	-298.4	-331.5	-365.0
Other capital flows	-64.0	-59.0	106.9	67.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	13.1	16.3	49	0	0	0	0	0	0	0	0	0
Overall balance	-4.4	-51.1	-27.9	-76.1	-115.4	-148.3	-138.8	-188.8	-231.1	-249.1	-262.7	-292.4
Financing	4.4	51.1	27.8	-80.9	-29.5	-41.9	-37.5	-33.9	-31.7	-22.2	-58.6	-18.2
Use of Fund credit	-2.5	-5.8	-22.0	-20.2	-20.2	-22.7	-20.0	-19.1	-16.2	-7.6	-3.8	-2.5
Change of gross official reserves (increase -)	-10.4	-40.3	9.4	0.0	-8.5	-18.4	-16.8	-14.8	-15.5	-14.6	-54.8	-15.7
Exceptional financing	17.3	97.1	40.4	-60.7	-0.8	-0.8	-0.7	0.0	0.0	0.0	0.0	0.0
Change in debt and energy arrears 2/ 3/	1.7	37.8	37.9	-60.3	0.0	0.0	-150.7	0.0	0.0	0.0	0.0	0.0
Rescheduling 1/ 2/	15.6	59.4	2.5	-0.3	-0.8	-0.8	150.0	0.0	0.0	0.0	0.0	0.0
Debt forgiveness 3/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	157.0	144.9	190.2	176.3	222.6	262.9	271.3	321.3	310.6
Of which: excluding arrears clearance				96.7								
Memorandum items:												
Gross official reserves	228.5	268.8	259.4	259.4	267.9	286.3	303.1	317.9	333.4	348.0	402.8	418.5
In months of imports of goods and services	2.1	2.1	1.8	1.7	1.8	1.8	1.8	1.8	1.8	1.8	2.0	2.0
Central government revenue 4/	213.2	237.4	310.1	386.2	409.6	430.4	452.1	475.0	499.1	524.3	550.8	578.7
Nominal GDP	1,480	1,624	1,909	2,268	2,406	2,527	2,655	2,790	2,931	3,079	3,235	3,399
Real GDP growth rate (in percent)		7.2	6.0	5.0	4.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Current account balance (in percent of GDP)	-4.9	-6.1	-8.1	-7.1	-7.5	-7.5	-7.4	-6.5	-6.0	-5.2	-4.4	-4.1
Trade balance (in percent of GDP)	-21.1	-23.3	-27.3	-26.2	-26.3	-26.6	-26.4	-25.6	-25.0	-24.2	-23.3	-22.6
Exports (in percent of GDP)	38.3	40.6	39.7	36.4	37.1	37.9	38.6	39.3	39.9	40.3	40.4	40.4
Imports (in percent of GDP)	59.5	63.9	67.0	62.6	63.4	64.5	65.0	64.9	64.9	64.5	63.7	63.0
Debt service (in percent of exports of goods and services) 5/	16.8	14.1	13.9	12.8	12.6	13.2	12.3	13.9	15.1	15.6	17.0	18.5
Debt stock (in percent of GDP) 5/	67.3	64.8	52.5	43.6	43.9	45.6	46.6	48.0	49.8	51.1	52.7	52.1

Sources: National Bank of Moldova and Fund staff estimates.

1/ In 2002 it includes the Eurobond rescheduling.
2/ 2007 projections assume a partial rescheduling of energy arrears.
3/ External arrears are assumed to be cleared in 2004.
4/ Excluding grants and privatization revenue.
5/ Public and publicly-guaranteed debt.

Table 8. Moldova: Debt Service by Creditors, 2001–12 1/

(In millions of U.S. dollars; unless otherwise indicated)

	2001 Act.	2002 Act.	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
			Projections									
Debt service	123.9	122.6	138.7	139.3	147.4	167.0	166.5	200.5	231.6	254.4	292.2	334.2
New borrowing 2/	0.0	0.0	0.2	9.2	17.5	50.2	79.1	115.5	150.9	191.9	239.6	285.2
Existing borrowing	123.9	122.6	138.5	130.1	129.8	116.8	87.5	85.0	80.7	62.5	52.6	49.0
Multilateral	62.4	67.6	79.7	74.7	57.9	55.0	49.1	48.5	46.1	36.0	27.3	24.9
Of which: World Bank	17.9	17.5	25.2	22.7	22.2	21.8	21.9	22.5	23.2	22.4	20.9	20.7
IMF	20.5	21.0	24.5	20.0	20.0	22.3	19.8	18.9	16.1	7.6	3.8	2.5
EU	10.3	13.4	14.0	13.5	7.6	3.3	0.0	0.0	0.0	0.0	0.0	0.0
EBRD	13.7	15.8	16.0	18.5	8.0	7.7	7.4	7.0	6.7	6.0	2.6	1.6
IFAD	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Bilateral	19.5	21.9	24.9	24.5	38.7	31.4	30.2	29.0	27.7	26.5	25.3	24.1
Of which: Paris Club members	16.9	18.5	21.8	21.5	35.3	31.4	30.2	29.0	27.7	26.5	25.3	24.1
Russia 3/	6.5	6.5	8.9	8.7	20.7	19.8	18.9	18.1	17.2	16.3	15.5	14.6
US	3.3	3.9	4.1	4.1	4.1	4.0	4.0	3.9	3.8	3.7	3.6	3.6
Japan	3.3	3.1	3.3	3.1	3.0	2.9	2.8	2.7	2.6	2.5	2.4	2.3
Germany 4/	0.9	1.1	1.7	1.8	3.9	4.7	4.5	4.3	4.1	3.9	3.8	3.6
Turkey	2.8	3.9	3.8	3.8	3.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Of which: Non Paris Club members	2.6	3.4	3.0	3.0	3.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Romania	2.6	3.4	3.0	3.0	3.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial	42.0	33.0	33.9	30.8	33.3	30.4	8.1	7.5	6.8	0.0	0.0	0.0
Eurobond	30.3	7.4	4.2	4.9	9.4	8.8	8.1	7.5	6.8	0.0	0.0	0.0
Gazprom	6.8	24.2	22.9	21.5	20.2	18.8	0.0	0.0	0.0	0.0	0.0	0.0
Others	5.0	1.4	6.8	4.4	3.7	2.8	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:												
Debt service as a share of total debt (in percent)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Multilateral	50.4	55.2	57.6	60.2	51.2	63.0	77.0	81.8	85.1	89.6	91.3	92.8
Bilateral	15.7	17.9	17.9	17.6	26.2	18.8	18.1	14.5	12.0	10.4	8.7	7.2
Commercial	33.9	26.9	24.5	22.1	22.6	18.2	4.9	3.7	3.0	0.0	0.0	0.0
Debt service/EXGS (in percent)	16.8	14.1	13.9	12.8	12.6	13.2	12.3	13.9	15.1	15.6	17.0	18.5
Debt service/central government revenues (in percent) 5/	58.1	51.6	44.7	36.1	36.0	38.8	36.8	42.2	46.4	48.5	53.0	57.7
Arrears to Gazprom (flows)	3.4	24.2	17.3	...	...	...	...	...	...	...	...	...

Sources: Moldovan authorities Fund staff estimates.

1/ Contractual public and publicly-guaranteed debt service only, assuming no debt relief.
2/ From 2004, includes new borrowing to fill part of the financing gaps.
3/ Includes contractual debt service on behalf of Transnistria from 2003. Accumulated arrears on behalf of Transnistria are assumed to be cleared in 2004.
4/ It includes AKA and KFW loans.
5/ Excluding grants and privatization revenue.

MOLDOVA—FUND RELATIONS

(As of September 30, 2003)

I. **Membership Status**: Joined August 12, 1992; Article VIII

II. **General Resources Account**:	**SDR million**	**Percent of Quota**
Quota	123.20	100.00
Fund holdings of currency	194.24	157.66
Reserve tranche position	0.01	0.00

III. **SDR Department**:	**SDR million**	**Percent of Allocation**
Holdings	0.13	N/A

IV. **Outstanding Purchases and Loans**:	**SDR million**	**Percent of Quota**
Extended arrangements	69.17	56.14
Systemic Transformation	1.88	1.52
PRGF arrangements	27.72	22.50

V. **Latest Financial Arrangements**:

Type	**Approval date**	**Expiration date**	**Amount approved (SDR million)**	**Amount drawn (SDR million)**
PRGF	12/21/2000	12/20/2003	110.88	27.72
EFF	05/20/1996	05/19/2000	135.00	87.50
Stand-by	03/22/1995	03/21/1996	58.50	32.40

VI. **Projected Obligations to Fund[1]**: (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2003	2004	2005	2006	2007
Principal	2.81	14.58	14.58	16.42	14.53
Charges/Int	0.45	1.45	1.13	0.82	0.53
Total	3.26	16.03	15.71	17.24	15.06

[1] Disbursements made after November 28, 2000—with the exception of disbursements of emergency assistance and loans from the Poverty Reduction and Growth Facility—are expected to be repaid on the expectations schedule. Countries may request the IMF Executive Board to make repayments according to the obligations schedule if their external payments position is not strong enough to meet the repayment expectations without undue hardship or risk. Please note: Repayments under the Supplemental Reserve Facility are scheduled to be repaid on the expectations schedule.

VII. **Safeguards Assessments**:

Under the Fund's safeguards assessment policy, the National Bank of Moldova (NBM) is subject to a full safeguards assessment with respect to the PRGF Arrangement that was approved on December 15, 2000, and expired on December 20, 2003. The safeguards assessment was completed on June 12, 2002, and determined that the NBM's procedures and controls to manage resources, including IMF disbursements, were not adequate in all areas of the IMF's safeguards framework. Therefore, specific remedial actions to address identified vulnerabilities were recommended to the authorities and all priority measures identified have been implemented.

VIII. **Exchange Arrangement**:

Moldova's exchange rate regime was reclassified to *managed floating with no pre-announced path for the exchange rate* on June 30, 2002; previously it was classified as independently floating.

Prior to the introduction of the Moldovan leu on November 29, 1993, the Russian ruble (supplemented by NBM-issued ruble denominated coupons) was the legal tender in Moldova. The government introduced the leu at a conversion rate of one leu equal to 1,000 Moldovan rubles and an exchange rate of one dollar equal to lei 3.85. The leu remained broadly stable around MDL 4.75/$ until mid-October 1998. It has since depreciated against the dollar and traded at MDL 13.3133=$1 on September 30, 2003.

Foreign exchange was traded on the Chişinău Interbank Foreign Currency Exchange (CIFCE). Operations of the CIFCE started at the beginning of 1993, and daily auctions commenced in early February 1995. An active foreign exchange cash market exists within authorized banks and foreign exchange bureaus. From November 16, 1993 through end-October 1998, the U.S. dollar exchange rate established in the CIFCE was the official exchange rate quoted by the NBM. Since November 2, 1998, the official rate as announced by the NBM is determined as the weighted average of all daily market transactions. The NBM quotes exchange rates of the leu for other currencies on the basis of the leu-U.S. dollar rate and the cross-rate relationships between the U.S. dollar and the currencies concerned in the international market.

IX. **Article IV Consultation**:

Moldova is on a 12-month consultation cycle. The last Article IV consultation was concluded on July 10, 2002 (EBS/02/116; 6/26/02).

X. **FSAP Participation**:

Moldova has not received an FSAP mission but may participate in such an assessment in the financial year FY2005. Its participation is subject to the up-coming prioritization round with EUR.

XI. **Use of Fund Resources**:

On February 4, 1993, Moldova purchased Fund resources totaling SDR 13.5 million, equivalent to 15 percent of quota under the Compensatory and Contingency Financing Facilities (CCFF) (EBS/93/8, 1/15/93). This was followed by a first drawing under the Systemic Transformation Facility (STF) of SDR 22.5 million, equivalent to 25 percent of quota, which was approved by the Board on September 16, 1993 (EBS/93/149, 9/8/93). On December 17, 1993 (EBS/93/177, 11/16/93), the Board approved a purchase of Fund resources under a stand-by arrangement (SBA) in the amount of SDR 51.75 million and the drawing of the second tranche of the STF totaling SDR 22.5 million. On December 19, 1994, Moldova made a second purchase under the CCFF totaling SDR 12.2 million, equivalent to 13.5 percent of quota, in conjunction with the second review of the SBA that expired at end-March 1995. The Board approved a successor SBA for Moldova in an amount totaling SDR 58.05 million (equivalent to 65 percent of quota) on March 22, 1995 (EBS/95/26, 3/2/95). Three purchases, totaling SDR 32.4 million (equivalent to 36 percent of quota), were made under the arrangement. An Extended Arrangement in an amount totaling SDR 135 million (equivalent to 150 percent of old quota) was approved by the Executive Board on May 20, 1996 (EBS/96/68, 5/6/96). At the time of the third review, the program was extended by one year to May 19, 2000. While the fourth review was completed (EBS/99/142; 7/29/99), the program expired on May 19, 2000 without the completion of the scheduled last review because parliament rejected twice an important program condition. Five purchases totaling SDR 87.5 million (equivalent to 97 percent of old quota) were made under the EFF arrangement. The PRGF arrangement, approved on December 15, 2001 (EBS/00/249), is in the amount of SDR 110.88 million (equivalent to 90 percent of quota). SDR 9.24 million was disbursed on December 29, 2000, followed by SDR 9.24 million on February 23, 2001, and SDR 9.24 million on July 26, 2002.

XII. **Resident Representative**:

Mr. Ruggiero is the Resident Representative as of July 2002.

XIII. **Resident Advisors**:

An FAD resident advisor, Mr. Agarwal, completed a second six-month posting to support the development of the treasury in June 1998. Peripatetic return visits were conducted through 1999. During 1998, Mr. and Mrs. Faulk were assigned as resident advisors on banking supervision at the NBM. During 1999, they paid various follow- up visits as external experts. In July 1999, an FAD resident tax administration advisor, Mr. Vandenberghe, was extended for a third six month period to support the development of a large taxpayer unit. His contract ended in mid-2000.

XIV. **Short-Term Assistance**:

Mr. Antao conducted regular visits to assist the ministry of finance on macroeconomic analysis since mid-1997. From April 1996 to July 1998, Mr. Richards paid regular visits as a regional balance of payments statistics advisor to Moldova, Armenia, and Georgia. Mr. Van Sluys and Dr. Peeraer visited Chişinău on several occasions in 1998/99 to assist in the area of supervision of commercial bank's foreign exchange activities. Mr. Thompson has been advising the NBM on accounting issues since 1999 and visited Moldova regularly during the past three and a half years, including for preparation of the NBM international audits.

XV. **Technical Assistance**:

The following table summarizes the technical assistance missions provided by the Fund to Moldova since January 1998.[2]

Moldova: Technical Assistance Provided by the Fund, 1998–2003

Department	Subject/Identified Need	Timing	Counterpart
MAE	Modernization of central bank operations: monetary operations, accounting and auditing, and banking supervision	March/April 1998	NBM
FAD	Public expenditure policy; expenditure priorities.	July 1998	MoF
MAE	Monetary and foreign exchange operations; and banking, accounting, and auditing issues.	April/May 1999	NBM
STA	Government financial statistics	August 1999	MoF
FAD	Tax administration	May 2000	MoF
FAD	Customs administration	June 2000	MoF
MAE	Monetary policy management; payment system; foreign exchange operations; and banking supervision.	September 2000	NBM
LEG	Banking legislation	October 2000	NBM
LEG	Free economic zone legislation	Jan./Feb. 2001	MoE
FAD	Expenditure policy	May 2001	MoF
LEG	Bankruptcy law	June 2001	MoE
LEG	Banking legislation	June 2001	NBM
MAE	TA assessment/evaluation	October 2001	NBM
MAE	Payments system; liquidity projection and monetary policy framework; central bank accounting and internal audit; and bank supervision.	May 2002	NBM
MFD	Payments system	Aug. 2003	NBM
STA	National accounts	Nov./Dec. 2002, Oct. 2003	MoF
STA	Price statistics	Nov. 2003	MoF

Note: MoF: Ministry of Finance; NBM: National Bank of Moldova; MoE: Ministry of Economy.

[2] For technical assistance before 1998, see previous reports.

Moldova—Statistical Issues

1. **Although generally adequate** for surveillance and program monitoring, Moldova's official statistics still have shortcomings, especially regarding the national accounts. The lack of an updated census also hampers statistical analysis in several areas. Data for monitoring macroeconomic developments are provided by the Moldovan authorities in a timely manner (see attached matrix). Moldova is a participant in the GDDS.

2. **National accounts statistics** are prepared following the *1993 SNA* methodology. Estimates do not include the Transnistria region for which data have not been collected since 1991. GDP is estimated from the production and the expenditure sides, on both an annual and quarterly basis. The data are prepared in current and constant (previous-year) prices, and annual data are revised—in two stages—as updated information becomes available. However, the quarterly data remain unadjusted, thus limiting their consistency with the revised annual data. In all, the national accounts statistics need improvement in the following areas: (i) compiling annual and quarterly GDP in constant prices; (ii) coordinating annual and quarterly data; and (iii) estimating the consumption of fixed capital in line with international standards.

3. **Price statistics** still have various shortcomings. Price collection for the CPI and PPI is limited geographically and missing data are not imputed following a standard procedure. The weights of the CPI basket, which currently is derived primarily from the Household Budget Survey, need to be improved to represent all segments of the population.

4. **Labor market statistics** remain inadequate for analyzing macroeconomic developments: (i) unemployment data following ILO methodology are not available; and (ii) wage data do not include fringe benefits, which form an important part of workers' compensation.

5. **Fiscal statistics.** A 1999 GFS statistical mission assisted the authorities in resolving data issues and provided technical assistance in the classification of accounts. Mission recommendations that still need to be implemented are: (i) improving the consolidation of general government data; (ii) reclassifying the financing data by type of debt holder and by type of debt instrument; and (iii) reporting to STA for inclusion in *International Financial Statistics* of discrete monthly fiscal data, based on correspondent accounts at the NBM, by the MoF. In addition, World Bank technical assistance was provided to improve the budgetary reports of local authorities as well as the Social Fund. The authorities reported data in the GFSM 2001 format for publication in the *2003 GFS Yearbook*. However, unless several issues with these data are resolved, they cannot be published.

6. **Balance of payments.** The compilation methodology follows the fifth edition of the *Balance of Payments Manual*. Problems remain related to: (i) under-reporting of imports and exports; (ii) collection of data on services; (iii) measurement of private capital inflows, including direct investment data; and (iv) treatment of transactions with Transnistria. Moldova disseminates quarterly international investment position statistics.

7. **Money and banking statistics** have improved, following a series of technical assistance missions from the Fund. A new chart of accounts for the NBM was introduced in 1996 and commercial banks adopted a new chart of accounts and moved to IAS with effect from January l, 1998. Following completion of the first IAS-based external audit in the early months of 1999, the NBM's accounts were moved to a full accruals basis as at end-December 1998, and regular accruals were commenced since then. This process was assisted by MAE technical assistance in accounting. Subsequent IAS-based external audits were carried out for end 1999, 2000, and 2001, respectively. Apart from a technical qualification in 1999 regarding omission of a cash flow statement, the NBM accounts have been unqualified. The NBM is currently in the process of further refining its chart of accounts and implementing new accounting software consistent with best international practice. The accounting function has also recently been restructured to better suit the needs of a modern central bank.

MOLDOVA—SURVEY OF REPORTING OF MAIN STATISTICAL INDICATORS
(As of November 30, 2003)

	Exchange Rates	Inter-National Reserves	Reserve Money	Central Bank Balance Sheet	Broad money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt
Date of latest observation	11/30/03	10/31/03	10/31/03	10/31/03	10/31/03	10/03	10/03	Q3/03	Q3/03	10/03	Q2/03	9/30/03
Date received	11/30/03	11/10/03	11/10/03	11/10/03	11/15/03	11/20/03	11/10/03	11/03	11/03	11/15/03	9/15/03	10/15/03
Frequency of data	D, M	W	W	W	W	M	M	M	Q	Q	Q	Q
Frequency of reporting	M	M	M	M	M	M	M	M	Q	Q, V	Q	Q
Frequency of publication	D; M	M	M	M	M	M	M	M	Q	O	Q	Q
Source of update	A, N	A	A	A	A	N, A	N, A	A, C	A, C	A	A	A
Mode of reporting	E	E	E	E	E	E	E, M	E[1]	E, C[1]	E, V	C, V	E
Confidentiality	C	C	C	C	C	C	C	C	C	C	C	C

[1]Received through the resident representative office.

Explanation of abbreviations:

Frequency of data:	D=daily, W=weekly, M=monthly, Q=quarterly, A=annual, or O=other;
Frequency of reporting:	D=daily, W=weekly, M=monthly, Q=quarterly, A=annual, V=irregularly in conjunction with staff visits, or O=other;
Source of data:	A=direct reporting by central bank, ministry of finance, or other official agency, N=official publication or press release, P=commercial publication, C=commercial electronic data provider, E=EIS, O=other;
Mode of reporting:	E=electronic data transfer, C=cable or facsimile, T=telephone, M=mail, V=staff visits, or O=other;
Confidentiality:	A=for use by the staff only, B=for use by staff and the Executive Board, C=for unrestricted use, D=embargoed for a specified period and thereafter for unrestricted use, or E-Subject to other use restrictions

Moldova—IMF-World Bank Relations
(As of November 30, 2003)

Country Director: Mr. Luca Barbone Telephone: +380 44 490 06671

A. Partnership in Moldova's Development Strategy

1. The government and other major stakeholders consider poverty reduction to be the major development challenge facing Moldova. The government has welcomed the PRSP process as the primary mechanism for orienting and coordinating government and development partner activities. An Interim Poverty Reduction Strategy Paper (I-PRSP) was presented to the Boards of the IMF and IDA in December 2000. The change in government in March 2001, however, delayed progress towards the full PRSP. The new government submitted an updated I-PRSP and PRSP Preparation Status Report to the Boards of the IMF and IDA in April 2002. The Joint Staff Assessment at that time noted that the delay was understandable and concluded that progress on the development of the full PRSP was satisfactory and provided a sound basis for continued access to concessional assistance.

2. Since then, the government has taken a number of steps toward completing the full PRSP. The document was renamed Economic Growth and Poverty Reduction Strategy Paper (EGPRSP) to emphasize the centrality of growth to poverty reduction. A first draft was circulated to civil society and the donor community in early 2003 for informal comments. Recognizing that the quality of the EGPRSP needed to be further improved, both in content and participatory process, the government decided to extend the timetable for completion beyond its original deadline of November 2003. The EGPRSP has been supported by a Poverty Reduction Strategy Trust Fund from the World Bank.

3. The IMF has taken the lead in assisting Moldova in promoting and maintaining macroeconomic stability through prudent monetary and financial policies. In this regard the Fund has encouraged the Moldovan authorities to implement a policy reform agenda that would attract the needed level of concessional foreign financing from bilateral and multilateral creditors and encourage the international community to reschedule Moldova's external debt to enhance debt sustainability. The Fund has supported Moldova's economic reform program since 1993. A three-year program under the PRGF facility was approved in December 2000. The first PRGF review was not completed until Mid-2002 as a result of disruptions stemming from a change in government in early 2001. Several attempts to complete the second review have failed owing to the incomplete implementation of agreed actions. The program will expire at the end of 2003, leaving ¾ of the available funds undisbursed. Moldova is a prolonged user of Fund resources and is likely to request a new arrangement after the current PRGF-supported program expires.

4. The World Bank has taken the lead in the policy dialogue on a number of structural issues relevant to economic growth and poverty reduction, including private sector development, infrastructure, social protection, and agricultural sector reforms. A range of

instruments is used to conduct this dialogue. Since 1994, three structural adjustment operations have been carried out, which aimed at supporting structural reforms in the areas of financial discipline, cash privatization, de-monopolization and privatization of the energy sector and telecom, and urban and rural land markets. The First Structural Adjustment Loan ($60 million) was approved in December 1994. The Second Structural Adjustment Loan and Credit ($100 million, of which IDA credit of $45 million) was approved in 1997. The third tranche was cancelled and replaced with a $40 million Structural Adjustment Credit (approved on June 24, 1999). The second tranche of the SAC was accompanied by a $10 million budget support grant from the Dutch Government. A supplement of $5 million was disbursed in December 2001 to help the government fill a financial gap created by ice storm damages of November 2000. A Third Structural Adjustment Credit ($30 million) was approved in June 2002. Lack of progress in structural reforms resulted in the credit expiring in September 2003 with 2/3 of the credit undisbursed. Adjustment operations have been combined with sector projects in rural finance, energy, agriculture, environment, health, education, social protection and private sector development. A *Public Expenditure Management Review* was completed in 2003 as were an *Investment Climate Assessment*, *Country Procurement Assessment Review* and *Country Financial Accountability Assessment*. A *Trade Diagnostic Study* and second *Poverty Assessment* are currently nearing completion.

5. The next section describes the Bank program and the division of responsibility between the two institutions. In a number of areas—social sectors, environment, infrastructure—the Bank takes the lead in the dialogue and there was no cross conditionality in the IMF-supported program. The Bank also is leading the dialogue on private sector development and agricultural sector reform and Bank analysis serves as input into the Fund program. In other areas—trade and customs reform, financial sector policies, public sector management—both institutions work together and share cross conditionality. Finally, in areas like fiscal, monetary, and exchange rate policies, and tax administration, the IMF takes the lead with little Bank involvement.

B. IMF-World Bank Collaboration in Specific Areas

Areas in which the World Bank leads

6. Areas in which the Bank leads the policy dialogue are social sectors, infrastructure, and environment. In the **social sphere**, the Bank has carried out *Poverty Assessments* to monitor and evaluate progress in alleviating poverty. A second poverty assessment is currently under way. A *Social Protection Management Project* supports the implementation of comprehensive reform of the public pension system and the introduction of a regulatory framework for private pension funds. The project also supports the implementation of the new organizational structure for social insurance. The Bank has also supported a *Social Investment Fund* to assist in the building of local community and municipal capacity and skills through the rehabilitation of social infrastructure. The fund also focuses on improving the delivery of social services, creating short-term employment and opportunities in rural areas by financing small-scale public works and supporting micro-business development.

7. In **health**, the Bank is focusing on improving the allocation of resources to ensure a more equitable and efficient orientation of healthcare resources to enable the government achieve a better utilization of finances and to appropriately meet the health needs of the population. The ongoing *Health Investment Fund Project* is focused on improving the health status of the Moldovan population and increasing the quality and efficiency of public health services by improving access to essential services by the poor. The *Moldova TB/AIDs* project aims at improving Moldova's health status and assists in achieving the health-related Millennium Development Goals by reducing mortality, morbidity, and transmission of HIV/AIDs.

8. In **Education,** the *General Education Project* supports the introduction of new general education standards. It develops, tests and implements: a new curricula; teaching materials; textbooks; teaching methodology; and teacher training. The technical activity, *Reconciliation Through General Education in the Transnistria Region*, addresses the issue of access to mother tongue education through the rehabilitation of school infrastructure in schools affected by military conflict and promotes reconciliation and integration of communities separated by civil strife. A *Youth Inclusion Learning and Innovation Credit* contributes to a more effective, participatory and transparent collaboration between youth relevant stakeholders.

9. With regards to **Infrastructure** development, the Bank is concentrating on upgrading basic utility services impacting the population at large and the poor in particular. The *Energy II* project has two main components: (i) power system infrastructure—investments to upgrade and rehabilitate metering, dispatch and communications, selected priority rehabilitation of the electricity of the electricity transmission network, and institutional development and regulation of the electricity market; and (ii) heating supply and consumption—investments in improving heating supply and energy efficiency in selected public buildings. A *Pilot Water Supply and Sanitation Project* is aimed at enhancing the welfare of the population living in some of the poorest rural areas and medium-sized towns and cities by improving the quality, efficiency, and sustainability of water supply and sanitation services by rehabilitating and improving operations of selected water and sewage systems to increase service quality and efficiency, improving the financial viability and commercial practices of the participating utilities, and involving the private sector in the sector.

10. The Bank has supported a number of projects aimed at the **Environment**. The *Agriculture Pollution Control Project* focuses on significantly increasing the use of environmentally friendly agricultural practices by farmers and agro-industry thereby reducing nutrient discharge from agricultural sources into the Danube River and Black Sea. A number of technical assistance activities are also under implementation. A *Biodiversity Strategy Development* is assisting the government in implementing Articles 6 and 8 of the Convention on Biological Diversity. The project also supports the formulation and adoption of strategies and actions for the protection and sustainable use of bio-diversity, through a participatory process involving the public and private sectors and local NGOs. Similarly, the *Preparation of a Wetlands and Biodiversity Conservation Project* addresses existing national

environmental priorities of improved water quality and habitat management on the Nistru River.

11. In the area of **Rural and Agricultural Development**, the Bank's *First Cadastre Project* has initiated the first cadastre, implemented a rural land registration system, and helped develop the institutional framework to complete and manage the legal cadastre in urban areas. The project helped establish a system of clear and enforceable ownership rights so as to promote the privatization of land the development of real markets in Moldova. The *Rural Investment and Services Project* increases rural incomes and living standards by promoting rural entrepreneurship, agricultural production, economic diversification, and trade in the rural areas. The project provides public investment support to alleviate key institutional constraints in farmer's group formation, supporting development of marketing institutions and infrastructure for improved access to input and output markets, and developing a rural advisory service. The project also provides investment and working capital at commercial terms to support a broad range of agribusiness.

12. While the Bank has taken the lead in the areas described above, the IMF has a strong interest in these areas since many of these reforms are critical to achieving macroeconomic stabilization and enhancing growth prospects. Accordingly, there is a high degree of consultation and coordination between the two institutions on these matters.

Areas of shared responsibility

13. The Bank and Fund are working jointly in a number of areas (supported by the Bank's adjustment operations, several investment and technical assistance projects and the Fund's PRGF):

14. **Private Sector Development.** While substantial progress in improving Moldova's business environment has been made, a challenging reform agenda remains. Both the Bank and the Fund have focused on this agenda in their assistance programs, including SAC III and PRGF. The Bank has undertaken a number of studies, including the *Investment Climate Assessment*, the *Business Environment and Enterprise Performance Survey* (together with EBRD), a *Diagnostic Review of the Environment For Foreign Investment*, and a number of *Costs of Doing Business Surveys*, to gauge ongoing developments in this area and determine the most important impediments to private sector development. The Bank's *Private Sector Development II* project strengthens the competitiveness of private and public enterprises in Moldova through the hands-on training of local managers abroad (human capital investment) and creation of a Competitiveness Center (market information and benchmarking). The IFC has promoted financial sector development by extending credit lines to a number of private banks for on-lending to private sector. The Fund has focused on policies needed to maintain a stable macroeconomic environment and remove obstacles to growth, thus encouraging private sector activities. The PRGF program included a number of structural benchmarks that focused on promoting a liberal trade regime and eliminating excessive state intervention in the economy. A number of technical assistance missions have been undertaken to improve banking legislation and banking supervision.

15. In the area of **Public Sector Management**, the Bank's *Public Economic Management Review, Country Procurement Assessment Review* and *Country Financial Accountability Assessment* examine fiscal adjustment and reform efforts in the social sectors and suggest policy measures to strengthen public expenditure management and actions needed to build capacity for increased government effectiveness. The Bank's project, *Trade and Transportation Facilitation in Southeast Europe* (part of the Stability Pact initiative), aims to strengthen and modernize the Customs Administration and other border control agencies with the objective reducing non-tariff costs to trade and transport and preventing smuggling and corruption at border crossings. The Fund has also provided technical assistance to improve custom and administration, government financial statistics, and public expenditure policies.

Areas in which the IMF leads

16. The Fund takes the lead in the formulation and execution of fiscal and monetary policies, external policies, and issues involving economic and financial statistics. In budgetary area, the Fund leads the dialogue on fiscal matters, setting the overall envelope for public expenditures, and taking the lead on tax policy and reforms. In addition to the achievement of overall fiscal targets, the Fund has taken the lead on setting monetary and exchange rate policy objectives and strategies to manage the public external debt burden.

17. In these areas the Bank takes into account the policy recommendations of the IMF and ensures that its own policy advice is consistent.

C. The World Bank Group Strategy

18. The Bank's last full Country Assistance Strategy (CAS) for the period 1999 to 2001 was discussed by the Bank's Board in May 1999. The Bank had initially planned to prepare a full CAS for Board discussion in FY02 but decided to wait until Moldova's full PRSP is ready to ensure that the two documents were fully consistent. In the interim, the Bank presented a CAS progress report for the period 2002–2003 to its Board June 2002. The Bank has started developing a full CAS for the period 2004 to 2006. The main objective of the new CAS is to support the implementation of the government's EGPRSP and capitalize on the gains of previous assistance programs.

MOLDOVA—RELATIONS WITH THE EBRD
(As of October 1, 2003)

The EBRD's strategy in Moldova is aimed primarily at supporting private sector development in the country, and increased policy dialogue with the authorities. The EBRD is providing support to (i) the financial sector through credit lines, the participation in the equity of local banks, expansion of its trade facilitation program, and the provision of new financial products, such as leasing and mortgage financing; (ii) private enterprises through credit lines and co-financing with local banks, offering privatization and post-privatization support, and the expansion of programs that provide advisory services; and (iii) public utilities with a special focus on improvement of the regulatory and operational environment. In the context of finalizing and implementing Moldova's Poverty Reduction Strategy, the Bank is working with other institutions in increasing its policy dialogue with the authorities on improving the business climate in the country.

To date the total value of projects supported in Moldova, in whole or in part, amounted to around ∈298 million.

Twenty seven projects have been signed totaling ∈171.6 million of EBRD resources. Of this amount, ∈147.3 million has been disbursed, including to: (i) a wine export promotion project, which is targeting the main Moldovan wineries and glass producer, through restructuring of the sector (∈25.9 million) and equity investment into a glass producer (∈6.8 million); (ii) an energy efficiency project for upgrading the heating distribution networks in Chisinau (∈8.1 million); (iii) several credit lines and equity investment for Moldova-Agroindbank for on-lending to small and medium enterprises (∈31.3 million in total); (iv) several credit lines and equity investment for Victoria Bank (∈7.8 million in total); (v) a project for linking Moldovan satellite earth stations to the Eurovision Network (∈0.9 million); (vi) a road rehabilitation loan (∈10.5 million); (vii) partial financing for construction of a new oil terminal at Giurgulesti (∈10.3 million); (viii) credit facilities for micro enterprises through four local banks (∈2.9 million); (ix) rehabilitating Chisinau's water services (∈18.8 million); (x) Chisinau Airport Modernization (∈8.1 million); (xi) trade facilitation program for Victoriabank, Moldova-Agroindbank, Moldindconbank, and Mobiasbanca (regional TFP); (xii) equity participation in and a loan to the micro-lending company (∈1.0 million); and (xiii) equity participation and loan financing for three privatized power distribution companies (∈28.7 million).

Several projects totaling around ∈33 million are currently being prepared and reviewed, including a number of ∈2-7 million transaction with private companies and banks. In addition, some 65 Technical Cooperation projects have been completed or approved (totaling ∈9.6 million).

Moldova—Ex-Post Assessment of Performance Under Fund Arrangements[1]

I. Introduction

1. Moldova's reform process has clearly stalled. During the early years of transition, Moldova made significant headway in price liberalization and stabilization, while structural reforms accelerated following the 1998 Russian crisis. However, the recent tendency to reverse some of the structural reforms implemented in the late 1990s casts serious doubts about the authorities' commitment to market reform. This note reviews economic and policy developments during the last decade. The focus is on progress made under Fund-supported programs, the lessons learned, and the challenges ahead.

2. Moldova remains one of the poorest countries in the region. With the population estimated at 3.6 million, per capita GDP amounted to about $450 in 2002.[2] Several years of economic decline led to a severe deterioration in social protection systems and to rising poverty. The government intends to address these issues in the context of its Economic Growth and Poverty Reduction strategy (EGPRSP), scheduled to be finalized in early 2004.

3. The sharp deterioration in living standards has encouraged a process of massive emigration. According to some estimates, the number of emigrants is as high as one third of the pre-independence labor force, comprising mostly younger workers, who, at home, would be likely to support reforms. At the same time, their rising remittances have contributed to keeping the currency stable, fostering short-term growth, and, arguably, easing pressure for reforms. The long-term impact of remittances on economic development is less certain, since the moral hazard problems they create for individual recipients (lower work effort) and governments (incentive to postpone adjustment) could discourage economic activity.[3]

4. Political economy factors stifled the implementation of structural reforms. The past decade witnessed chronic political instability (nine governments in ten years), ethnic fragmentation, high tolerance for corruption, and a deep-seated lack of trust within the Moldovan society, making it difficult to build consensus for reforms. The Communist Party's

[1] Prepared by a team of EUR, PDR, and FAD staff. The team benefited from valuable insights from several World Bank and Fund colleagues, as well as Moldovan economists, (former and current) policy makers, and political scientists.

[2] Per capita gross national disposable income was much higher in 2002 (around $530), reflecting the importance of workers' remittances. In the absence of an updated census, per capita figures are uncertain, as outward migration is likely to have reduced population size.

[3] For a recent analysis of the role of remittances on development, see IMF Working Paper WP/03/189, by Chami, Fullenkamp, and Jahjah.

decisive victory in the 2001 parliamentary elections resulted in strong parliamentary support for the executive. However, the relative political stability under the current government has not translated into an acceleration of structural reforms. Indeed, some market reforms have been reversed on account of election promises. Political economy considerations will continue to play a major role in Moldova's prospects, especially in view of upcoming parliamentary elections in early 2005.

5. Prospects for closer integration with the European Union are dim. Difficult relations with Romania (the natural conduit for the EU) and the unresolved conflict with the breakaway region of Transnistria contribute to Moldova's relative isolation. Moreover, the Moldovan society seems to be split regarding the most appropriate geo-political orientation for the country—toward the EU or toward the CIS.

II. Performance under Fund-Supported Programs

6. Moldova has been continuously engaged in Fund programs since 1993, with a mixed record on economic policy performance. While monetary policy was generally adequate during the past decade, fiscal policy was loose until the 1998 crisis, and tightened significantly thereafter. Structural reform implementation was weak throughout the period, except for an intense reform effort between mid-1998 and 2000. Weak program performance was reflected in an increasing amount of undisbursed funds (Table 1).

7. The initial arrangements focused on macroeconomic stabilization and on jumpstarting the transformation to a market-based economy. The stabilization objective was by and large achieved. A new currency (the leu) was introduced in November 1993, and a gradual remonetization process took place under the cautious stewardship of the National Bank of Moldova (NBM). However, even at that early stage, structural reform implementation was partial and uneven, undermined by vested interests.

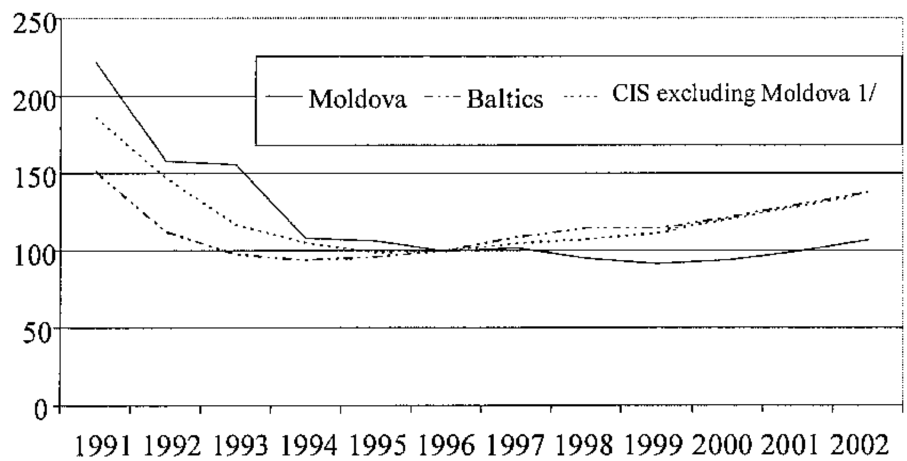
8. The following two medium-term arrangements aimed at consolidating the structural transformation initiated under previous programs. The emphasis was on growth-oriented policies that would help reduce poverty and—during the PRGF period—ease the external debt burden. To achieve these objectives, the programs included a comprehensive structural reform agenda. Performance under the EFF was disappointing. Slow progress in structural reforms and an increasingly loose fiscal policy delayed the completion of program reviews and increased Moldova's vulnerability to external shocks. The program went off track in late 1997, but was revived in early 1999, when a new cabinet took office. Their ambitious reform program merited renewed financial support from the Fund, and a new three-year program under the PRGF facility was approved in December 2000. Recognizing the economy's dependency on imported energy and its undiversified export base, the PRGF-supported program included strong structural conditionality. With the economy hit hard by the August 1998 crisis, the government had little choice but to adopt painful adjustment policies, including an impressive fiscal adjustment and a sizeable depreciation of the exchange rate.

9. A change in government in early 2001 disrupted the structural reform agenda and lending from IFIs. The first PRGF review was not completed until mid-2002. Since then, several attempts to complete the second review have failed, owing to incomplete implementation of agreed structural measures and the government's tendency to move away from market-oriented policies. While stabilization efforts have been reasonably successful and growth has resumed, these achievements are unlikely to be sustained, since structural reforms have continued to lag (or are being reversed), government intervention has intensified, and the business climate has not improved. Not surprisingly, foreign investment inflows have dwindled. Lack of progress in structural reform, in turn, led the World Bank to discontinue budgetary support to the government: the SAC-III expired at end-September 2003, with about 2/3 of the credit undisbursed.

A. Macroeconomic Performance

10. Growth performance during the 1990s was disappointing. GDP growth was consistently below program targets (Table 2), with Moldova lagging significantly behind other CIS countries already before the 1998 crisis (Figure 1). Slow or negative growth reflected not only transition-related factors, but also continuous political instability and poor governance, exacerbated by a high degree of vulnerability to external shocks. The Transnistria conflict also adversely affected growth prospects, since it deprived Moldova of a large part of its industrial base.

Figure 1. Real GDP
(Index 1996=100)

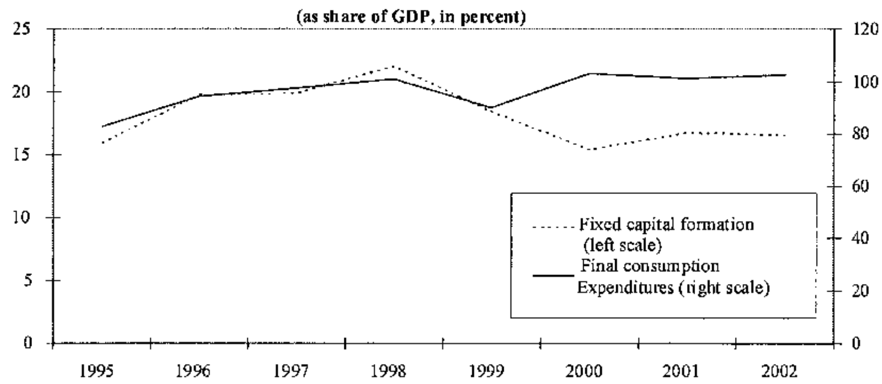


1/ Turkmenistan is not included owing to lack of data.

Sources: FSU database; staff estimates.

11. After several years of economic slump, activity rebounded in 2000 and since then real GDP growth has been in line with program expectations. The recovery was driven by privateconsumption (Figure 2), fueled by workers' remittances and a marked increase in real wages.[4] Remittances have played a crucial role in the fragile recovery process: officially-recorded remittances reached almost 20 percent of GDP in September 2003.

Figure 2. Moldova: Consumption and Fixed Capital Formation



Source: Moldovan authorities.

12. Inflation performance has been mostly satisfactory. The gradual disinflation achieved throughout the 1990s came to a halt in 1998, when inflation shot up dramatically in the wake of the Russian crisis. With the subsequent tightening of fiscal policy, inflation was brought down to single digits again in 2001–02, a better performance than envisaged under the PRGF-supported program. However, consumer prices started to pick up in early 2003, reaching 17 percent (y-o-y) as of end-October, driven by rapid money growth as well as higher food and administrative prices.

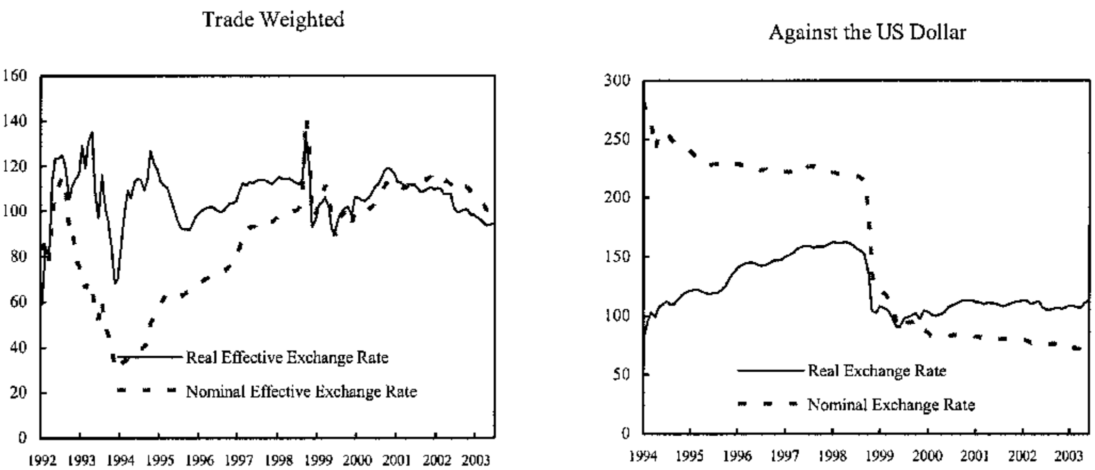
13. Current account deficits have remained high throughout the decade. In recent years, the rising inflow of workers' remittances has partly offset massive trade deficits. While there are no obvious signs that competitiveness has been a major problem, exports have yet to reach pre-1998 crisis levels, suggesting that export performance could improve. Between late 2000 and the third quarter of 2003, the leu depreciated by 18 percent in real terms vis-à-vis Moldova's main trading partners and is now close to its 1999 level (Figure 3). Monthly dollar

[4] After a sharp decline following the 1998 crisis, real wages recovered markedly in 2001 (16 percent) and 2002 (26½ percent), and continued to edge up in 2003.

wages ($57 in the first half of 2003) are low compared with those in the main CIS trade partners, but the continued rapid rise in nominal wages could erode this margin.[5]

14. Little export diversification has been achieved, notwithstanding reasonably successful trade liberalization. Moldova still relies significantly on trade with CIS countries (about 55 percent of exports), although trade with EU countries has been steadily expanding. Exports are dominated by food, beverages (notably wine), and other agriculture-based products, with light-manufactured products such as textiles gaining some ground. Export growth has recently been hampered by restrictions imposed by trade partners (Romania, Ukraine, and Russia). However, according to a draft World Bank study, domestic constraints (e.g., informal restrictions on exports, problems with VAT refunds, excessive tax inspections, frequent changes in legislation, cumbersome registration and customs procedures) represent a far more important obstacle to faster export growth.

Figure 3. Moldova: Nominal and Real Exchange Rates 1/
(1999=100)



Source: IMF, and Fund staff estimates
1/ An increase means an appreciation.

B. Macroeconomic Policies

15. For the past twelve years under the same governor, the NBM has implemented sensible monetary and financial policies. Apart from the Russian crisis spike, inflation was on a downward trend until end-2002, despite rapid credit and money growth. Current international transactions remained free of restrictions, even during the 1998 crisis.

[5] For the same period, monthly wages were much higher in Ukraine ($80), Belarus ($116), and Russia ($161), although wages in these countries are also growing fast.

Moreover, an orderly bank restructuring process and the steady enforcement of prudential regulations have created a reasonably healthy banking sector.

16. Although formally based on a flexible exchange rate regime, the NBM's monetary policy until the 1998 crisis aimed at exchange rate stability. The de facto peg against the dollar was abandoned in late 1998, and was followed by a dramatic nominal depreciation of the leu (78 percent between August and December). Post-1998 NBM intervention has been one-sided (only purchases), with the twin objectives of preventing a real appreciation of the currency and of accumulating reserves. Given Moldova's high external debt service, reserve accumulation is viewed as a precautionary measure against the uncertain external financing situation. This policy has led to reserve money growth well above PRGF targets.

17. Fiscal policy turned rather loose in the mid-1990s, but was tightened considerably after the 1998 crisis. Fiscal laxity was driven by political pressure (including the 1996 presidential elections) and excessively optimistic growth expectations, and was accommodated by soft external borrowing constraints. Moreover, significant energy-related quasi-fiscal deficits and expenditure arrears piled up.[6] The drying-up of external finance following the August 1998 crisis added urgency to the fiscal reforms launched in the spring of 1999. The subsequent fiscal tightening was instrumental for the post-crisis stabilization efforts (the commitments deficit, excluding project lending, was slashed by about 6 percentage points between 1998 and 1999). At the same time, the fiscal reforms implemented during the late 1990s—together with tight monetary policies and exchange rate flexibility—paved the way for the resumption of growth in the early 2000s. Fiscal policy remained tight during 2000–02, largely under the discipline of external financial constraints. However, external arrears started to accumulate. Looking ahead, the adoption of various unfunded spending initiatives (including the recent territorial reorganization and pension/wage increases) threatens medium-term fiscal sustainability and continued economic growth. The rekindling of inflation has already demonstrated the limitations of monetary policy to contain inflationary pressures under these circumstances.

18. During the period 1993–97, total external debt grew from virtually zero to about 70 percent of GDP. Increasingly loose fiscal policy, artificially low energy tariffs, and (unfunded) widespread energy privileges, were accommodated by high levels of non-concessional lending. The external debt burden was considerably aggravated by the sharp depreciation of the leu in 1998. While a series of (mostly non-concessional) bilateral reschedulings contributed to a marked reduction in debt indicators during the PRGF arrangement period, external debt service remains a key fiscal challenge. Scheduled public debt service for 2003 (excluding any clearance of arrears) takes up about 45 percent of central government revenues, and significant debt service obligations are due in the next few years. The high level of arrears to Gazprom is a particular source of concern.

[6] Moldova is dependent on imported gas (notably from Russia's Gazprom), electricity (from Romania and Ukraine), and oil (mostly from Romania).

C. Structural Reforms

19. The slow pace of structural reforms has been the main obstacle to sustainable growth. Except for an intense reform effort in the late 1990s, the track record on structural reforms has been generally disappointing, marred by excessive administrative intervention, corruption, and weak governance. Still, progress was made in several areas:

- Land reform was undertaken early in the transition process and was hailed as a model for other FSU countries. Nearly all of the agricultural land formerly owned by the state is now in private hands.

- In the late 1990s, the government rationalized public expenditure (especially in health and education); initiated pension reforms; introduced a treasury system; adopted a territorial reform streamlining regional governments and reducing public employment; removed some tax exemptions; and created a large taxpayer unit.

- The NBM introduced modern monetary management and bank supervision.

- Moldova adopted a liberal exchange and trade regime and joined the WTO in 2001.

- Reform in the energy sector was initiated in 1998, including the dismantling of the power sector monopoly and the creation of an independent energy regulatory agency. Three out of five power-distribution companies have been privatized, leading to significant improvement in collection rates. In 2000, a targeted system of nominal compensations replaced the existing unfunded and widespread energy privileges.

- Notable progress was achieved in adopting a market-oriented legal framework, including a civil code, bankruptcy law, financial disclosure law, and law on pledges.

20. Nevertheless, the transition to a market economy is far from complete. Progress in setting up a market-oriented institutional framework was not followed by consistent implementation, often reflecting strong resistance from vested interests. For example, the privatization of key economic sectors, such as agro-processing (in particular wineries and tobacco), energy companies, and telecommunications, still remains to be completed, while land privatization failed to raise efficiency in the agricultural sector. Incomplete reforms in the energy sector, in turn, have led to the accumulation of large external arrears, aggravating the external debt problem. Despite commendable efforts to eliminate privileges, social assistance programs are not well-targeted, with 50 percent of benefits going to the non-poor. There has been no serious attempt to boost the country's low administrative capacity and strengthen governance, nor to encourage private sector development. Government interference in the economy has been rising, while widespread corruption continues to increase the cost of doing business. Implementation of the legal framework adopted during the past few years has been weak, with the judiciary widely perceived as corrupt and dominated by the executive. Not surprisingly, the overall investment climate is among the most unfriendly in transition economies.

21. More disturbingly, some of the reforms implemented in the 1990s have been or are under threat of being reversed:

- In agriculture, re-collectivization efforts are reportedly under way, supposedly in order to address agricultural inefficiencies related to the small size of plots and lack of equipment.

- Air Moldova and several other formerly privatized companies have been re-nationalized. Moreover, there have been serious attempts to overturn other past privatizations, the most notable example being the case of the three electricity distribution networks owned by the Spanish investor Union Fenosa.

- Formal and informal restrictions have been imposed on exports of some agricultural goods (notably sunflower seeds, wheat, and soy) and scrap metal, and protectionist pressures have been rising.

- The May 2003 territorial-administrative reorganization reversed the 1999 local administration reform, replacing the prevailing 10 districts with smaller Soviet-style units (rayons). The reorganization reduced local autonomy and hindered the provision of services by local governments.

- The Law on Veterans (spring of 2003) reintroduced a number of privileges and subsidies that were removed during the 1998 reforms. It also granted special telecommunications privileges for veterans without approval of the telecom regulator.

- The tariff rebalancing plan implemented as part of SAC-III conditionality (and WTO commitments to liberalize the telecommunications market by 2004) was reversed in mid-2003. Tariff adjustments for energy and water have lagged and cost-recovery has deteriorated.

D. Implementation of Fund Programs

22. After a promising start in the early1990s, implementation of Fund programs has been disappointing in many areas (Tables 2 and 3). The frequent delays in completing program reviews reveal a lack of political consensus on liberalization policies and weak ownership of Fund programs. Program implementation deteriorated as Fund conditionality became increasingly stricter and more focused on (harder to implement) structural reforms, following an initial phase in the transition process where slippages were often tolerated, with the authorities given the "benefit of the doubt." The last two program reviews under the EFF were not completed, while only the first out of six PRGF reviews was completed. Inconsistent implementation of structural policies, together with the legacies of the Transnistria conflict, prevented a rapid turnaround of economic activity, resulting in deteriorating living standards and nostalgia for the Soviet times. Vested interests and corruption added to the population's skepticism toward market principles. The growing anti-reform sentiment, in turn, weakened the governments' resolve to press for change, especially

in light of the unexpectedly high social cost of reforms. The exodus of young Moldovans, by reducing the size of the potentially pro-reform electorate, aggravated the vicious circle of slow reforms, disappointing economic performance, weakening of ownership, and further slowing of reforms. Although weak implementation capacity may have contributed to poor performance, it would not have hindered progress had ownership been stronger. For example, the NBM, with its positive attitude toward reform, has been quite successful in absorbing external technical assistance and strengthening monetary and financial management.

23. Although program ownership has always been weak at the highest political levels, there is compelling evidence that the commitment to market-based policies has declined markedly under the current government. While macroeconomic policies have been broadly in line with Fund programs since the 1998 crisis, slow progress in structural reforms has continued to undermine program implementation. The EBRD Transition Report placed Moldova below the 2002 CIS average regarding the quality of the business environment (it was above the CIS average in 1999), while the 2003 Report shows a *decline* in Moldova's transition indicators. Various enterprise surveys indicate a marked increase in state regulation and control, despite some improvement in aspects of the business environment related to licensing and registration. Corruption also deteriorated between 1999 and 2002, when Moldova moved to the 93rd position in the Transparency International Corruption Perception Index (only nine countries ranked worse).[7] Finally, the EGPRSP process continues to suffer from limited efforts to encourage society-wide participation and to prioritize policy measures.

24. Program monitoring is difficult when ownership is weak. First, implementation of reform measures has to be reviewed very closely. Second, new policy initiatives tend to run counter to the spirit of the reform program, even if they don't breach the letter of agreements. Third, some of the key obstacles to growth (such as unfriendly business environment, government intervention and harassment) are not easily monitored, although they may be crucial in explaining poor performance. The focus on some "representative" measures of the general problem (e.g., pre-shipment inspection, sunflower seeds) has led to criticism about the specificity of Fund conditionality.

25. Throughout the decade, some weaknesses in staff assessments contributed to complicate program implementation:

- *Too much "benefit of the doubt".* The initial success in economic stabilization led Fund staff to overestimate the authorities' commitment to reform. In the absence of a long track record—independence took place only in 1991—and in light of the formidable transformation task ahead, all too often governments were given the

[7] The index reflects perceptions during the previous year. The 2003 index shows a small improvement, with Moldova ranked 100th out of 133 countries.

"benefit of the doubt," even when there were serious questions about genuine commitment.

- *Excessive structural conditionality.* As the focus of Fund programs moved toward structural reform, the number of conditions increased dramatically (e.g., 71 structural benchmarks under the EFF). The establishment of long lists of measures tended to discourage the authorities to take responsibility for economic programs.

- *Underestimation of the importance of informal norms and practices.* Although much effort was devoted to build a market-oriented legal framework to lower the cost of doing business, entrenched informal (and nontransparent) norms have tended to prevail over formal rules of the game, raising transactions costs.

- *Overestimation of Moldova's capacity to repay external debts.* Excessively optimistic growth projections in the mid-1990s led staff to overestimate Moldova's capacity to repay, especially considering the non-concessional terms of external debt.

Lessons from the last decade

26. In hindsight, it seems clear that successful implementation of structural reforms depends crucially upon the local ownership of reforms. Given the strong financial interests underlying the resistance to reform (typically dressed up as a defense of the public interest), it would have been difficult to prescribe specific measures to strengthen program ownership. However, a few lessons can be drawn from past experience, in particular regarding:

- *Appropriate sequencing and speed of reforms.* Although there was broad consensus among IFIs about the need for certain policy measures, there was much less agreement (or understanding) about the right timing, as well as the required speed and sequencing for their implementation. Notably, structural reforms took longer to implement that initially envisaged. In addition, some reforms should have come earlier in the transition process:

  > *Energy sector reform.* Earlier efforts in this area could have prevented the accumulation of large quasi-fiscal deficits and the related external debt build-up.

  > *Safety nets.* Effective social safety nets could have attenuated the population's perception that their poverty was associated with economic liberalization, and thus helped obtain support for market reforms.

  > *Civil service reform.* The low administrative capacity in the civil service and the lack of continuity of government officials contributed to hinder implementation of programs, suggesting that civil service reform should have been tackled early on.

- *More emphasis on private sector development.* Private sector development and enterprise restructuring should have received at least as much attention as quick privatization.

- *Tighter limits on non-concessional borrowing.* The relatively short-term maturities and high interest rate structure of existing debt clearly are not suitable for a poor country, suggesting that grants and long-term concessional loans would have been a more appropriate financing strategy.

- *Better coordination among IFIs and donors.* Arguably, better coordination and alignment of priorities could have helped reduce excessive debt build-up (by limiting budgetary financing to essential projects), and avoid conflicting advice provided by different sources of technical asssistance.

III. CHALLENGES AHEAD

27. The main challenge for Moldova is to get out of its vicious circle and move on to a sustainable growth path with reduced poverty. Concretely, this would involve implementing steadfastly the policies needed to maintain a stable macroeconomic environment and to eliminate current obstacles to growth, thus encouraging private activity. These policies should also help reverse the current emigration flow and encourage Moldovans living abroad to convert their compensatory transfers into productive investments in Moldova.

28. A consistent action plan to move onto a virtuous circle with higher growth and lower poverty would involve the following elements:

Macroeconomic policies

- Increased efforts to extinguish the current inflationary spike and avoid the build-up of inflationary expectations, with a view to maintaining a low-inflation environment.

- Tight fiscal policies to support price stability and to ensure medium-term fiscal sustainability. This would involve: (i) adopting realistic budget financing assumptions; (ii) resisting pressures for unfunded spending; and (iii) strengthening revenue by broadening the tax base and rationalizing expenditure.

- External debt restructuring, including a long-term solution to the accumulated arrears to Gazprom.

Measures to remove obstacles to growth

- A concerted effort to reduce corruption in the public sector through deregulation, de-monopolization, removal of red tape, and simplification of registration and licensing requirements; civil service reform; a clearly defined strategy to increase efficiency and to eliminate corruption in the customs and tax administrations; and a strengthening of the independence of the judiciary.

- Elimination of arbitrary and non-transparent government interventions in the economy, including interference with pricing decisions, export restrictions, and tax breaks directed at individual enterprises.

- A strong commitment to private ownership and property rights, reinforced by actions to complete the privatization of the energy and agro-processing sectors.

- Maintenance of a liberal trade regime, in line with commitments under the WTO.

29. The low level of expertise in the civil service and weak institutions will continue to require ***technical assistance*** to strengthen economic policy design and implementation. Further assistance from the Fund and other partners would be needed to improve governance; public administration; external debt management; tax and customs administration; and financial intermediation. To ensure an effective delivery of technical assistance: (i) donors should coordinate better to avoid overburdening the authorities with either excessive or inconsistent advice; (ii) more focus should be placed on institution-building, relative to human capital development, to ensure positive long-term effects (there are many examples of staff leaving the public administration shortly after receiving training); and (iii) the most effective (and preferred by the authorities) form of delivery is through resident advisors, who can provide hands-on assistance on TA implementation.

30. The nature and extent of the ***World Bank's involvement*** in Moldova will depend on the government's ability to establish a credible track record of reform. Short of that, the Bank is unlikely to provide budgetary support, and will instead focus on low-scale project lending. The development of a credible and coherent EGPRSP could serve as a basis for increasing future Bank support.

31. In light of the weak track record of the past decade, ***future Fund involvement*** should be contingent on the development of sufficient program ownership. The experience to date has clearly shown that, without local support for reforms, programs quickly go off track, resulting in further erosion of support for reforms. While it is difficult to set objective criteria to measure ownership, staff assessments would depend not only on adequate implementation of an agreed set of measures, but also on the government's ability to refrain from adopting policies that undermine the effectiveness of the program.

32. The Fund is likely to be involved in program-intensive work with Moldova for some time. The main rationale for Fund involvement to date, despite often unsatisfactory performance, has been the country's poverty level, high external debt, and weak policy-making capacity. Since these problems are likely to persist in the near term, it will be crucial that future Fund-supported programs ensure that adequate measures are taken to resolve these issues. Without a change in the current policy and political environment, it will be difficult to find common ground as a basis for Fund lending. On the other hand, a credible change of direction in economic policy could unlock much-needed external financing.

33. Over the medium term, Fund-supported programs could help Moldova achieve sustainable growth and reduced poverty, and thus move toward the MDGs. A number of years may be needed before Moldova achieves macro stability; more resilience to external shocks; fiscal and debt sustainability; and an adequate institutional capacity to formulate and implement macroeconomic policies. A closer engagement with the EU (with a view to future membership) could serve both as a catalyst for reforms and as an exit strategy from Fund programs. Before the Fund disengages, however, Moldova's transformation into a market economy would have to be more advanced, as evidenced, for example, by higher levels of foreign investment and a reversal of emigration flows.

34. Against this background, the best way forward is for the authorities to formulate their own medium-term economic strategy, consistent with EGPRSP objectives. Consequently, efforts to improve poverty analysis, strengthen participation, and prioritize policy objectives within the EGPRSP process should be given high priority. Such strategy should be adopted publicly by the government as its framework for economic policy, and should specify clearly defined and monitorable measures to achieve the stated economic goals. This set of measures could then become the basis for establishing a track record of policy implementation, which would be required for future Fund support.

Table 1. Moldova: History of Lending Arrangements

(In millions of SDRs; unless otherwise indicated)

Facility	Date of Arrangement	Date of Expiration or Cancellation	Amount Agreed	Amount Drawn	Percent Drawn
PRGF	Dec-00	Dec-03	111	28	25
EFF	May-96	May-00	135	88	65
SBA	Mar-95	Mar-96	59	32	55
CCFF	Dec-94	...	12	12	100
SBA	Dec-93	Mar-95	52	52	100
STF	Sep-93	...	45	45	100
CCFF	Feb-93	...	14	14	100
Total			427	270	63

Source: IMF, FIN Department

Table 2. Moldova: Program Targets and Outcomes 1994-2003 1/

	1994		1995		1996		1997		1998		1999		2000		2001		2002		2003	
	SBA	Actual	SBA	Actual	EFF	Actual	EFF	Actual	EFF	Actual	EFF	Actual	EFF	Actual	PRGF	Actual	PRGF	Actual	PRGF	Proj.
Real sector																				
Real GDP growth (in percent)	-3	-31	2	-1	4	-6	5	2	5	-7	1	-3	3	2	5	6	6	7	7	6
Inflation (eop, in percent)	37	105	9	24	15	15	10	11	6	18	15	44	4	18	10	6	10	4	10	18
Nominal GDP (MDL million)	6,645	4,737	8,655	6,480	10,340	7,798	12,183	8,917	13,789	9,122	13,301	12,322	14,540	16,020	20,572	19,052	23,987	22,040	28,233	26,720
General government																				
Fiscal balance (in percent of GDP) 2/	-3	-13	-4	-8	-3	-12	-3	-7	-3	-10	-2	-4	-2	0	-2	1	-2	1	-1	1
Total revenue (in percent of GDP)	15	39	19	39	23	36	24	38	24	38	28	30	...	31	26	29	26	30	26	30
Expenditure (in percent of GDP)	18	52	23	47	26	48	27	46	27	47	30	34	...	31	28	28	27	29	27	29
Monetary sector																				
Broad money growth (in percent)	40	116	11	65	37	15	30	34	24	-8	35	42	18	40	20	36	23	36	25	31
Money multiplier	1.6	1.4	1.4	1.6	1.7	1.7	1.8	1.7	2.0	1.7	2.0	1.7	2.0	1.8	1.9	1.9	2.0	2.0	2.1	2.2
Monetization (broad money/GDP, in percent)	7	16	7	19	16	18	18	22	20	19	19	20	20	22	21	25	22	30	23	32
External sector																				
Current account balance (in percent of GDP)	-12	-7	-9	-6	-7	-11	-3	-14	-2	-20	-13	-6	-12	-9	-7	-5	-6	-6	-6	-8
Gross international reserves																				
in millions of dollars	70	180	170	257	292	314	293	366	278	140	254	181	303	223	257	229	286	269	369	259
in months of imports 3/	3.1	2.9	2.5	3.1	3.4	3.0	3.3	3.1	3.0	1.4	2.6	2.7	3.0	2.7	3.1	2.5	3.1	2.5	3.5	2.0
Public external debt (in percent of GDP) 4/	...	44	...	46	...	47	...	52	...	59	...	80	...	82	74	67	67	65	61	53

Source: Various staff reports, Moldovan authorities and Staff estimates.

1/ Program projections are taken from the following reports: 1994: EBS/93/177; 1995: EBS/95/26; 1996-1998: EBS/96/68; 1999-2000: EBS/98/226; 2001-2003: EBS/00/249.

2/ Commitments basis excluding project loans.

3/ Same year's imports.

4/ Includes IMF.

Table 3. Moldova: Performance under Fund-Supported Programs

Arrangement	Number of Performance Criteria		
	Met	Not Met	Total
SBA (Dec-93 to Mar-95)	32	10	42
SBA (Mar-95 to Mar-96)	29	5	34
EFF (May-96 to May-00)	72	47	119
PRGF (Dec-00 to Dec-03	47	9	56

Arrangement	Number of Prior Actions and Structural Benchmarks			
	Met on time or with some delay	Met with considerable delay	Not Met	Total
SBA (Dec-93 to Mar-95)	11	...	3	14
SBA (Mar-95 to Mar-96)	9	...	4	13
EFF (May-96 to May-00)	51	3	17	71
PRGF (Dec-00 to Dec-03	14	4	2	20

Sources: MONA, Moldova Country Strategy Paper (2000), Staff Reports.

Moldova—Debt Sustainability Analysis

The analysis points to a serious liquidity problem in the next few years. In the absence of renewed IFIs' involvement, the substantial financing gaps will be extremely difficult for the authorities to finance while remaining current on their debt service obligations, indicating a high probability of default.[1] Debt service indicators would remain at high levels in the coming years and decline only very slowly thereafter.

A. Background

1. Despite a significant reduction in the total debt stock between 1999 and 2002 following a series of bilateral reschedulings, the current level of indebtedness will continue to represent an important obstacle to growth and poverty reduction in Moldova.[2] As of end-2002, total external debt amounted to $1.7 billion or 107 percent of GDP, compared to $1.5 billion as of end-1999 (124 percent of GDP)[3]. Public and publicly-guaranteed (PPG) debt was about $1 billion or 65 percent of GDP (compared to 80 percent of GDP in 1999). Private debt and external payment arrears on imported energy supplies constitute the remainder of the stock.The NPV of debt-to-export ratio (three-year average) was 213 percent, and the debt service to exports ratio was 27 percent. The NPV of PPG debt to revenue ratio was 387 percent at end-2002, and the PPG debt service to revenue ratio was 51.6 percent. Domestic public debt (all short-term) represented about 15 percent of GDP.

2. Moldova's external debt problems can be traced back to: (i) a sharp depreciation of the leu following the August 1998 crisis, which led to a rapid deterioration in all external debt indicators as the domestic currency cost of the dollar-denominated debt increased dramatically; (ii) negative GDP growth rates until 1999, which, combined with loose fiscal policies, aggravated the external debt problem considerably; (iii) a large accumulation of energy arrears (starting in the mid-1990s), especially to Gazprom;[4] and (iv) the contracting of some obligations on nonconcessional terms.

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[1] Moldova already suspended payments to bilateral and commercial creditors (with the exception of Eurobond holders) as of August 1, 2003.

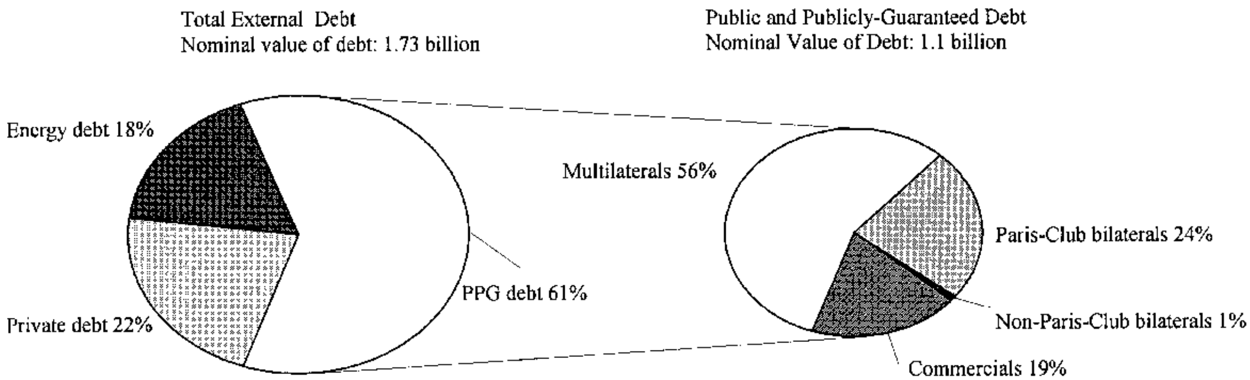
[2] A total of $360 million of debt was rescheduled, mostly on non-concessional terms.

[3] These figures include arrears. The numbers presented in this note do not strictly compare with the information presented in EBS/02/116 since the authorities have been updating macroeconomic data for 1999–2001, including GDP, debt, the balance of payments, and the fiscal accounts.

[4] During the Soviet period Moldova enjoyed artificially low prices for imported energy and highly subsidized prices for its agricultural exports. These favorable terms of trade reversed during the 1990s. Due to the high dependence on energy imports, especially from Russia, and to the failure to impose a hard budget constraint on consumers, Moldova accumulated considerable external payment arrears on imported energy supplies.

3. PPG debt represented about 61 percent of external debt at end-2002 (Figure 1). In turn, PPG debt is composed mostly of claims by multilateral institutions (56 percent), including the IMF (13 percent), the World Bank (32 percent) and the EBRD (7 percent); Paris Club creditors (24 percent), other official bilateral creditors (1 percent); and commercial creditors (19 percent).

Figure 1. Moldova: Total External Debt Stock (end-2002)



Source: Moldovan authorities and Fund staff estimates

4. The end-2002 stock of PPG debt includes arrears to multilateral creditors (EBRD, $5 million), bilaterals (Russia, $5.6 million) and Germany ($0.7 million), and to commercial creditors (Gazprom, $31 million). Moldova has also accumulated large external arrears on imported energy supplies during 1994-1999. The end-2002 stock amounted to $302 million, of which $182.4 million could be considered government contingent liabilities, and $119.6 were private sector liabilities. The main creditors are Russia (gas imports), Ukraine, and Romania (electricity and oil imports).[5]

[5] A full audit of Moldova's external energy arrears has still not been completed. Therefore, the extent of potential government contingent liabilities on energy imports is unclear. In particular, there is no official record of the payments already made through various intermediaries in the form of barter or trilateral clearing operations. In addition, creditors have sometimes passed their claims on to other (domestic) suppliers, some of which have ceased to exist. Accordingly, the reported amount of energy arrears and the potential government liability should be considered an upper limit.

B. Outlook for 2003–2012

5. The approach used for assessing Moldova's debt sustainability follows the draft PDR templates for assessing debt sustainability in low-income countries. Given Moldova's poor performance under the PRGF-supported program, the baseline scenario assumes unchanged policies relative to 2003, implying no strong adjustment effort and no new structural adjustment credits by the IFIs during the projection period (Table 1).

- Real GDP growth is expected to decelerate from an expected 6 percent in 2003 to 5 percent in 2004 and to remain at 3 percent between 2005 and 2012. End-period inflation, which is projected at 18 percent in 2003, should decline to 8 percent in 2004 and remain at 5 percent between 2006 and 2012.

- The overall budget deficit is projected at 0.7 percent of GDP in 2004. The primary surplus would be about 2 percent of GDP, and would remain roughly constant throughout the projection period.

- The growth rates of exports and imports of goods and services are expected to decelerate in the medium-term, dropping from about 9 and 11 percent respectively in 2004, to 5 and 4 percent in 2012. Worker remittances would remain important and their share in GDP would be maintained throughout the period.[6] The current account deficit would improve progressively from about 7 percent of GDP in 2004 to about 4 percent of GDP in 2012.

- International reserves are expected to slowly increase throughout the period, from about 1.7 months of imports in 2004 to 2 months in 2012. Notwithstanding this modest accumulation, the financing gaps until 2012 would remain substantial. It is assumed that these gaps would be filled with new external borrowing on commercial terms.[7] The baseline scenario assumes no debt relief on PPG nor private debt in the future (all arrears are assumed to be cleared in 2004), but assumes a partial rescheduling of the energy arrears in 2007-2008.[8]

6. Under this scenario, the total nominal external debt to GDP ratio would fall steadily from 107 percent of GDP in 2002 to 71 percent in 2012 (Table 1). Similarly, the NPV of total

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[6] Emigration is assumed to continue, and as a result the inflow of remittances would remain important, though they would be expected to gradually taper off toward the end of the period. The growth of remittances is projected to fall from about 12 percent in 2004 to 2 percent in 2012.

[7] Even though Moldova is a poor country, given the lack of structural adjustment programs with the IFIs, it is assumed that it will not be able to fill the financing gaps with concessional borrowing. This is a conservative assumption: if a larger degree of concessionality of new borrowing is projected, the path of the debt indicators becomes more favorable.

[8] As mentioned earlier it was not be possible to reconcile the total of existing energy claims. Therefore, as a preliminary working hypothesis, the DSA assumes that only part (half) of the outstanding total will be rescheduled in 2007–2008 on non-concessional terms (zero grant element).

external debt to exports ratio would decline from 213 percent to 132 percent (and the NPV of PPG debt to exports ratio from 123 percent to 94 percent). The debt service to export ratio and the debt to revenue ratios would follow more u-shaped paths as the debt dynamics become dominated by the new borrowing (Tables 2 and 3). For example, the NPV of PPG debt to revenue ratio would decrease from 388 percent in 2002 to 227 in 2004, mainly on account of strong revenue growth, and would increase again over the period to 278 percent in 2012. Assuming a relatively constant rate of domestic borrowing (between 7 and 8 percent of GDP), the share of public domestic debt in GDP is expected to slowly decline to about 11 percent in 2012 (Table 4).

7. The stress tests on the debt/exports ratios show that Moldova is most vulnerable to export and current account shocks (Table 2). A shock on export growth alone in 2004–005 would cause the NPV of debt/exports ratio to remain at about 400 percent from 2007 onwards, while the debt service ratio would increase from 23 percent in 2003 to 44 percent at the end of the period. Under a combined export and current account shock (where imports are allowed to adjust to the fall in exports), the NPV of debt/exports ratio remains above 200 percent throughout the whole period, and the debt service to exports ratio increases from 23 percent in 2003 to 47 percent in 2012. The NPV of external PPG debt/revenue ratio would be most vulnerable to a large (30 percent) real depreciation, and in this case the ratio would increase from 277 percent in 2003 to 414 percent in 2012, and the PPG debt to revenue ratio would increase from 45 percent in 2003 to 78 percent in 2012 (Table 3).

8. A temporary shock to workers' remittances (for example due to a tightening of immigration policy in the EU, or a recession in destination countries) would lead to a larger current account deficit, and have only a transitory impact on debt indicators as indicated above. A permanent shock would have more sizeable effects (Table 2, stress test nr.1). If GDP growth were to remain at 2 percent from 2004 onwards, the NPV of debt to revenue would increase to 312 percent by the end of the period compared to 278 percent under the baseline, and the debt service to revenue ratio would increase to 65 percent compared to 58 percent under the baseline. The public debt to GDP ratio would be most sensitive to a permanently lower GDP growth and a one-time large real depreciation (Table 6).

9. The above analysis indicates that under the baseline scenario short-term liquidity risks are serious, as the large financing gaps raise serious doubts about the ability of the authorities to remain current on their debt service obligations. In the medium-term, the debt dynamics are fragile, and become unstable under various (mostly external) shocks. The projections are also sensitive to the terms of new borrowing (both external and domestic). External debt dynamics dominate the evolution of total public debt. In the current situation, a combination of strong policy adjustment, the renewal of IFIs structural and balance of payments financing, as well as debt relief would be necessary to improve the situation.[9]

[9] A non-concessional flow rescheduling would only push the problem a couple of years into the future, as it would provide only temporary cash flow relief. It would even make the situation more difficult on a cash basis as debt service would suddenly jump back to high levels at the end of the consolidation period. Moldova would likely need both concessional flow and stock relief in order to achieve sustainability.

Under a more optimistic scenario envisaging resumption of Fund involvement in the second half of 2004, accompanied by some Paris Club debt relief, the authorities would be better able to manage the high debt service obligations in the coming years. The larger amounts of concessional financing and grants would imply much smaller financing gaps so that debt sustainability indicators would keep declining, and return to sustainable levels.

Table 1. Moldova: External Debt Sustainability Framework 1/
(In percent of GDP, unless otherwise indicated)

		Actual								Projections									
		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
	I. Baseline Medium-Term Projections																		
2	**External debt (nominal)**	**57.3**	**66.9**	**69.1**	**86.1**	**124.1**	**124.2**	**106.8**	**106.5**	**89.7**	**78.0**	**77.2**	**77.9**	**78.5**	**73.7**	**74.0**	**73.5**	**73.5**	**71.4**
3	Change in external debt	36.0	9.6	2.2	17.0	38.0	0.1	-17.3	-0.3	-16.8	-11.7	-0.8	0.7	0.6	-4.9	0.4	-0.5	0.0	-2.0
4	Identified net debt-creating flows (5+10+11)	3.4	1.5	2.3	25.7	32.9	-7.7	-18.8	-6.9	-7.1	-7.8	1.8	2.5	2.4	1.4	1.2	0.3	-0.5	-0.7
5	Current account deficit, excluding interest payments	6.0	9.4	12.6	12.9	-1.1	1.0	-1.3	2.5	5.2	4.2	4.5	4.4	3.8	2.8	2.2	1.3	0.5	0.3
6	Deficit in balance of goods and services	-130.3	-129.3	-129.2	-119.0	-119.4	-125.2	-123.2	-132.6	-133.0	-123.3	-125.1	-127.6	-129.1	-129.8	-130.4	-130.4	-129.8	-128.9
	Exports	59.9	55.3	54.8	46.7	52.0	49.8	49.7	53.6	52.2	47.9	48.8	49.9	50.8	51.7	52.4	52.9	53.2	53.1
	Imports	-70.4	-74.0	-74.3	-72.3	-67.4	-75.4	-73.5	-79.0	-80.9	-75.4	-76.4	-77.7	-78.3	-78.1	-78.0	-77.5	-76.6	-75.8
7	Net current transfers (negative = inflow)	-3.9	-4.3	-2.8	-3.9	-7.4	-12.9	-10.8	-9.5	-8.3	-7.1	-6.9	-6.8	-6.7	-6.5	-6.3	-6.1	-5.9	-5.8
8	o/w official	-1.8	-2.0	-2.1	-2.6	-4.6	-5.9	-5.0	-4.0	-3.1	-2.7	-2.6	-2.6	-2.5	-2.4	-2.4	-2.3	-2.2	-2.2
9	Other noninterest current account flows (negative = net inflow	140.1	142.9	144.6	135.8	125.7	139.1	132.7	144.7	146.6	134.7	136.6	138.7	139.6	139.1	138.8	137.8	136.2	135.0
10	Net FDI (negative = inflow)	-4.9	-1.1	-3.9	-3.3	-11.8	-6.3	-7.6	-3.5	0.7	-0.7	-1.2	-1.2	-1.3	-1.3	-1.3	-1.3	-1.3	-1.3
11	Endogenous debt dynamics 2/	2.3	-6.8	-6.5	16.1	45.8	-2.4	-9.9	-5.8	-13.1	-11.4	-1.5	-0.6	-0.1	-0.1	0.3	0.3	0.3	0.2
12	Contribution from nominal interest rate	2.0	1.7	1.6	6.8	7.0	8.0	6.2	3.6	2.8	2.8	3.0	3.1	3.6	3.7	3.9	3.9	3.8	3.8
13	Contribution from real GDP growth	0.3	2.9	-1.0	5.1	4.3	-2.4	-6.6	-7.0	-5.5	-3.7	-2.9	-2.2	-2.2	-2.2	-2.1	-2.1	-2.1	-2.1
14	Contribution from price and exchange rate changes	0.0	-11.4	-7.1	4.3	34.5	-8.1	-9.5	-2.4	-10.4	-10.5	-1.5	-1.5	-1.5	-1.5	-1.4	-1.5	-1.4	-1.4
15	Residual (3-4) 3/	32.6	8.1	-0.1	-8.7	5.1	7.8	1.4	6.6	-9.7	-3.9	-2.6	-1.8	-1.8	-6.3	-0.8	-0.8	0.5	-1.3
	NPV of external private debt						0.2	0.3	0.4	0.4	0.5	0.5	0.5	0.5	0.6	0.6	0.6	0.5	0.5
	NPV of external PPG debt-to-exports ratio (in percent) 4/	...	...	...	...	...	...	**146.2**	**122.9**	**98.9**	**88.9**	**86.2**	**87.2**	**87.4**	**88.8**	**91.0**	**92.2**	**94.5**	**93.5**
	Ratio of NPV of private debt to exports	...	...	...	...	...	34.1	45.4	50.1	47.1	48.6	46.1	43.9	43.4	41.7	38.6	35.9	33.4	31.6
	NPV of external PPG debt-to-GDP ratio (in percent)	...	...	...	...	...	..	65.4	56.7	44.9	38.6	38.9	40.5	41.5	43.0	44.8	46.0	47.6	47.3
	Ratio of NPV of external private debt to GDP (percent)	...	...	...	...	...	18.0	20.3	23.1	21.4	21.1	20.8	20.4	20.6	20.2	19.0	17.9	16.8	16.0
	Debt service-to-exports ratio	10.0	6.5	13.4	26.8	54.1	28.7	22.1	26.9	22.5	22.5	22.2	22.8	21.0	23.1	25.4	26.0	26.7	27.5
	Energy arrears/exports ratio	...	30.0	23.4	36.0	50.6	46.4	43.4	40.3	34.8	30.7	27.8	25.7	23.9	11.2	10.4	9.1	7.8	6.7
	II. Key macro and external baseline assumptions																		
	Nominal GDP (billions of US dollars)	1.4	1.7	1.9	1.7	1.2	1.3	1.5	1.6	1.9	2.3	2.4	2.5	2.7	2.8	2.9	3.1	3.2	3.4
	Real GDP growth (in percent)	-1.4	-6	1.7	-6.5	-3.4	2.1	6.1	7.2	6.0	5.0	4.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
	GDP deflator in US dollar terms (change in percent)	-0.1	24.7	11.9	-5.8	-28.6	6.9	8.3	2.3	10.8	13.2	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
	Effective interest rate (percent) 5/	9.2	3.5	2.8	8.6	5.6	7.0	5.7	3.7	3.1	3.7	4.1	4.2	4.9	5.0	5.5	5.5	5.5	5.4
	Growth of exports of G&S (US dollar terms, in percent)	32.8	8.3	12.9	-24.9	-23.2	5.2	14.7	18.3	14.4	9.1	8.0	7.5	7.0	6.9	6.5	6.1	5.5	5.0
	Growth of imports of G&S (US dollar terms, in percent)	35.2	23.4	14.4	-14.3	-35.7	23.2	11.9	18.0	20.3	10.8	7.4	6.9	5.9	4.9	4.9	4.4	3.9	3.9
	Price of main export commodity	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	Nominal exchange rate depreciation (percent)	9.8	2.5	0.4	16.1	95.8	18.2	3.5	5.5	3.1	0.2	4.8	3.4	2.9	2.9	2.9	2.9	2.9	2.9

III. Averages and Standard Deviations 6/	Historical Average	Standard Deviation	Average 2003-12
Current account deficit, excluding interest payments	5.3	5.8	2.7
Export growth (US dollar terms, in percent)	5.5	20.0	6.8
Official grants to GDP ratio	3.5	1.6	2.4
Net non-debt creating capital inflows	5.3	3.3	1.2
Effective interest rate (in percent) 5/	5.8	2.4	4.9
Real GDP growth rate (in percent)	0.0	5.2	3.3
GDP deflator in US dollar terms (change in percent)	2.5	15.5	3.2

Source: Country authorities and staff estimates, projections and simulations.

1/ Includes both public and private sector debt.
2/ Derived as [r - g -ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate;
g = real GDP growth rate, and r = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes change in arrears, exceptional financing, change in gross foreign assets, and valuation adjustments.
4/ Based on three-year backward-looking average of exports of goods and services.
5/ Current-year interest payments devided by previous period debt stock.
6/ Historical averages and standard deviations are for the period of 1995-2002.

Table 2. Moldova: External Debt Indicators 1/
(In percent of exports, unless otherwise indicated)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
	Actual					Projections					
NPV of debt ratio 2/											
Baseline	**213**	**181**	**168**	**160**	**157**	**155**	**142**	**140**	**137**	**136**	**132**
Stress tests 3/											
1. Export growth and non-interest current account (NICA) at historical averages	213	181	172	168	169	172	165	162	157	153	147
2. Export growth at historical average minus one standard deviations in 2004-05	213	181	207	272	349	401	402	405	401	400	394
3. NICA at historical average minus one standard deviations in 2004-045	213	181	185	188	179	170	152	145	139	137	133
4. Export growth and NICA at historical averages minus 1 and 1 std dev in 2004-05, resp.	213	181	183	200	228	245	238	232	224	220	211
5. Net official transfers at historical average minus two standard deviations in 2004-05	213	181	174	165	160	157	143	141	137	136	132
6. 10 percent of GDP increase in other debt-creating flows in 2004	213	181	192	179	171	164	147	142	138	136	132
Debt service ratio 4/											
Baseline	**26.9**	**22.5**	**22.5**	**22.2**	**22.8**	**21.0**	**23.1**	**25.4**	**26.0**	**26.7**	**27.5**
Stress tests 3/											
1. Export growth and non-interest current account (NICA) at historical averages	26.9	22.5	23.2	24.1	25.5	24.3	27.7	31.4	31.6	32.0	32.3
2. Export growth at historical average minus one standard deviations in 2004-05	26.9	22.5	28.7	35.8	36.7	33.9	37.3	40.9	42.0	43.1	44.3
3. NICA at historical average minus one standard deviations in 2004-045	26.9	22.5	22.5	25.7	29.4	27.3	29.0	30.8	29.1	27.5	28.0
4. Export growth and NICA at historical averages minus 1 std dev in 2004-05	26.9	22.5	28.7	36.7	38.1	35.9	40.3	45.6	46.0	46.5	47.0
5. Net official transfers at historical average minus two standard deviations in 2004-05	26.9	22.5	22.5	23.5	23.9	22.1	24.1	26.3	26.2	26.8	27.5
6. 10 percent of GDP increase in other debt-creating flows in 2004	26.9	22.5	22.5	27.4	27.6	25.5	27.3	29.2	26.7	27.2	27.8

Source: Country authorities and staff estimates, projections and simulations.

1/ Includes public and publicly-guaranteed debt, private debt and energy arrears.
2/ Based on three-year backward-looking average of exports of goods and services.
3/ Historical averages are for period 1995-2002.
4/ Based on current-year exports of goods and services.

Table 3. Moldova: Public External Debt Indicators Relative to Revenue 1/
(In percent)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
	Actual	Projections									
NPV of debt to revenue ratio 5/											
Baseline	**388**	**277**	**227**	**228**	**238**	**244**	**253**	**263**	**270**	**279**	**278**
Stress tests											
1. Real GDP growth at 2 percent from 2004	354	277	233	239	252	261	273	287	298	311	312
2. Real GDP growth at historical average in 2004-05	354	277	265	233	226	230	240	246	255	265	272
3. 30 percent real depreciation in 2004	354	277	305	308	321	329	341	366	386	408	414
4. Net official transfers at historical average minus two standard deviations in 2004-05	354	277	241	240	247	250	256	264	271	280	278
5. 10 percent of GDP increase in other debt-creating flows in 2004	354	277	287	278	276	271	269	268	273	281	279
Debt service to revenue ratio 5/											
Baseline	**51.6**	**44.7**	**36.1**	**36.0**	**38.8**	**36.8**	**42.2**	**46.4**	**48.5**	**53.0**	**57.7**
Stress tests											
1. Real GDP growth at 2 percent from 2004	47.2	44.7	37.1	37.7	41.1	39.4	45.6	50.6	53.5	59.0	64.9
2. Real GDP growth at historical average in 2004-05	47.2	44.7	40.1	40.0	43.2	41.0	47.0	51.6	54.0	59.0	64.3
3. 30 percent real depreciation in 2004	47.2	44.7	48.8	48.4	52.3	49.6	56.9	62.5	65.7	71.9	78.2
4. Net official transfers at historical average minus two standard deviations in 2004-05	47.2	44.7	36.1	39.5	42.2	40.1	45.3	49.3	49.1	53.4	58.0
5. 10 percent of GDP increase in other debt-creating flows in 2004	47.2	44.7	36.1	50.6	53.0	50.4	55.0	58.3	50.8	54.6	58.8

Source: Country authorities and staff estimates, projections and simulations.

1/ Includes public and publicly-guaranteed debt only.
2/ Based on three-year backward-looking average of exports of goods and services.
3/ Historical averages are for period 1995-2002.
4/ Based on current-year exports of goods and services.
5/ Central government revenue excluding grants and privatization revenue.

Table 4. Moldova: Public Sector Debt Sustainability Framework, 1996-2012
(In percent of GDP, unless otherwise indicated)

	Actual							Projections									
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
I. Baseline Medium-Term Projections																	
Public sector debt 1/	73.7	73.4	121.4	108.7	98.7	84.4	80.5	64.6	56.9	56.4	57.7	58.7	60.1	61.8	63.0	64.6	63.9
o/w foreign-currency denominated	51.9	54.9	92.1	84.1	81.2	68.3	66.0	51.6	45.2	45.2	46.7	47.8	49.3	51.1	52.4	54.1	53.4
NPV	21.8	18.5	29.3	24.5	17.5	82.7	72.2	57.2	51.7	51.2	52.6	53.5	54.9	56.7	57.8	59.4	59.0
Change in public sector debt	0.4	-0.4	48.0	-12.7	-10.0	-14.2	-3.9	-15.9	-7.7	-0.5	1.4	0.9	1.4	1.7	1.2	1.6	-0.7
Identified debt-creating flows	10.6	12.8	74.0	41.4	1.3	0.6	6.3	-4.8	2.0	5.2	5.7	5.5	1.8	1.7	1.3	1.0	0.6
Primary deficit	4.9	6.9	2.7	-1.2	-3.2	-3.9	-0.2	-2.7	-2.0	-2.3	-2.3	-2.4	-2.4	-2.5	-2.5	-2.5	-2.5
Revenue and grants	36.1	38.6	37.7	31.0	30.8	29.2	30.3	30.5	29.4	29.4	29.4	29.4	29.4	29.4	29.4	29.4	29.4
of which: grants	0.2	0.1	0.1	1.5	0.9	0.9	0.6	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Primary (noninterest) expenditure	40.9	45.5	40.5	29.8	27.6	25.2	30.1	27.9	27.3	27.0	27.0	27.0	26.9	26.9	26.9	26.8	26.8
Automatic debt dynamics	-9.4	-5.8	54.7	16.9	-11.9	-6.7	-5.6	-11.8	-4.6	-0.6	0.3	0.6	0.6	0.7	0.7	0.8	0.7
Contribution from interest rate/growth differential	-11.9	-5.7	3.0	-24.2	-18.1	-11.5	-9.2	-11.6	-7.6	-2.4	-1.0	-0.8	-0.8	-0.8	-0.8	-0.8	-0.9
Of which contribution from real interest rate 2/	-13.9	-3.8	-2.1	-28.5	-15.8	-5.8	-3.6	-7.0	-4.5	-0.2	0.6	0.8	0.9	1.0	1.0	1.0	1.0
Of which contribution from real GDP growth 3/	4.6	-1.3	5.1	4.3	-2.2	-5.7	-5.7	-4.6	-3.1	-2.2	-1.6	-1.7	-1.7	-1.8	-1.8	-1.8	-1.9
Contribution from exchange rate depreciation 4/	2.4	-0.2	51.7	41.1	6.2	4.8	3.7	-0.3	3.0	1.8	1.4	1.4	1.4	1.5	1.5	1.6	1.6
Other identified debt-creating flows	15.2	11.7	16.6	25.7	16.3	11.3	12.1	9.7	8.6	8.1	7.7	7.3	3.6	3.5	3.1	2.7	2.4
Privatization receipts (negative)	0.5	2.7	0.8	1.1	2.9	0.4	0.7	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Recognition of implicit or contingent liabilities	14.7	9.0	15.8	24.5	13.5	10.9	11.4	9.4	8.4	7.8	7.4	7.0	3.3	3.2	2.8	2.4	2.1
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Residual, including asset changes	-10.2	-13.1	-26.0	-54.1	-11.3	-14.9	-10.3	-11.1	-9.7	-5.7	-4.3	-4.6	-0.4	0.0	-0.1	0.6	-1.3
Public sector debt-to-revenue and grants ratio	204.5	190.1	321.9	351	321	290	266	212	194	192	197	200	205	211	215	220	218
Gross financingneed 5/	23.4	34.9	29.1	43.3	25.1	18.7	20.9	17.0	16.0	15.8	16.0	15.5	16.3	16.8	17.1	17.7	18.4
in billions of U.S. dollars	0.4	0.7	0.5	0.5	0.3	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.6	0.6
II. Key macro and external baseline assumptions																	
Real GDP growth (in percent)	-5.9	1.7	-6.5	-3.4	2.1	6.1	7.2	6.0	5.0	4.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Average nominal interest rate on public debt (in percent) 6/	5.1	6.6	6.4	8.2	7.6	5.0	3.0	3.8	5.1	6.5	6.6	6.6	6.7	6.8	6.7	6.8	6.6
Average nominal interest rate on forex debt (in percent) 6/	3.6	3.4	12.1	9.7	11.5	5.7	4.4	3.8	4.1	4.6	4.8	4.8	5.0	5.2	5.2	5.3	5.2
Average nominal interest rate on domestic debt (in percent)	10.3	14.0	-10.5	3.5	-5.8	2.0	-3.0	3.7	9.1	14.0	14.0	14.0	14.0	14.0	14.0	14.0	14.0
Average real interest rate (in percent) 7/	-17.8	-5.2	-2.7	-22.6	-14.9	-6.3	-4.5	-9.2	-7.3	-0.3	1.1	1.5	1.6	1.7	1.6	1.7	1.5
Nominal depreciation of local currency (percentage change in LC per dollar)	3.9	-0.3	78.6	39.3	6.7	5.9	5.5	-0.4	5.9	3.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9
Inflation rate (GDP deflator, in percent)	27.9	12.4	9.4	39.8	26.4	12.1	7.9	14.3	13.5	6.9	5.5	5.0	5.0	5.0	5.0	5.0	5.0
Growth of real primary spending (deflated by GDP deflator, in percent)	-6.3	13.1	-16.8	-28.9	-4.8	-2.9	27.7	-1.8	2.9	3.0	2.8	2.9	2.9	2.9	2.9	2.9	2.9
III. Stress Tests for Public Debt Ratio																	
1. Real GDP growth and primary balance are at historical averages							80.5	64.6	62.8	68.3	75.6	82.9	91.3	100.6	109.8	120.1	127.8
2. Real GDP growth is at historical average in 2004-2005							80.5	64.6	61.4	65.8	69.8	73.4	77.5	81.9	85.8	90.0	91.8
3. Primary balance is at historical average minus two standard deviations in 2004-2005							80.5	64.6	67.7	77.7	78.8	79.6	80.8	82.4	83.5	85.0	84.2
4. Combination of 2 and 3							80.5	64.6	70.6	83.6	85.1	86.1	87.7	89.6	91.0	92.9	92.3
5. Long-run real GDP growth is at 2 percent from 2004							80.5	64.6	59.6	61.5	65.2	68.7	73.1	78.3	83.2	88.9	92.4
6. One time 30 percent real depreciation in 2004 8/							80.5	64.6	96.6	93.3	93.1	92.9	93.4	94.5	95.3	96.7	96.0
7. 10 percent of GDP increase in other debt-creating flows in 2004							80.5	64.6	67.1	65.5	66.0	66.1	66.9	67.9	68.5	69.5	68.2
8. Grants are at historical average minus two standard deviations in 2004-2005							80.5	64.6	57.6	57.5	58.7	59.5	60.8	62.4	63.4	64.9	64.0
IV. Averages and Standard Deviations				Historical Average		Standard Deviation			Average 2003-07		Average 2008-12						
Primary deficit				1.0		3.8			-2.3		-2.5						
Real GDP growth (in percent)				0.0		5.2			4.2		3.0						
Nominal interest rate (in percent) 6/				6.0		1.8			5.7		6.7						
Real interest rate (in percent)				-10.6		7.8			-2.9		1.6						
Inflation rate (GDP deflator, in percent)				18.2		11.7			9.0		5.0						
Revenue and grants to GDP ratio				34.1		4.2			29.6		29.4						
Grants to GDP ratio				0.5		0.5			0.0		0.0						

1/ General government.
2/ Derived as $rd/(1+g)$, where r = average real interest rate, d = previous period debt ratio, and g = real GDP growth rate.
3/ Derived as $gd/(1+g)$, where the variables are defined as in footnote 2.
4/ Derived as $aed(1+r_f)$, where a = the share of debt denominated in foreign currency in the previous period and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar) and other variables are defined as in footnote 2.
5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
6/ Derived as nominal interest expenditure divided by previous period debt stock.
7/ Derived as $r = (i - \pi)/(1+\pi)$, where i = the nominal interest rate and π = the inflation rate
8/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Moldova—Trade Policy

Moldova's trade regime is fairly liberal and compares favorably with other countries in the region. However, the frequent changes in the legal framework (tariff levels, tariff exemptions, temporary safeguards) introduce uncertainty and may artificially distort production and trade patterns. As a small open economy, Moldova would benefit from a low, uniform, and stable tariff regime. On the export side, further diversification of products and markets would be necessary to reduce the economy's vulnerability to external shocks.

A. Import Regime

1. *Import Tariffs.* Moldova's trade regime is fairly liberal, and is rated "one" on the Fund's ten point index of trade restrictiveness (with a lower score indicating a more open trade regime).[1] Moldova joined the WTO in 2001, with a maximum bound tariff of 35 percent (only applied on 5 percent of all tariff lines). Imported goods are subject to customs duties, excises (some products only), VAT (20 percent) and a fee for customs procedures (0.2 percent).

2. The 2003 tariff schedule has 14 tariff rates, ranging from zero to 25 percent, with a simple unweighted average tariff of 5.49 percent and a simple weighted average of 4.12 percent (Text Table 1). Including specific duties, the simple average tariff is 6 percent and the weighted average 4.2 percent. Whereas this structure compares favorably with other countries of the region, it is more complex than the 1999 schedule, which had only 4 tariff rates (0, 5, 10, 15). Under the December 2000, PRGF-supported program, Moldova had committed to keeping the maximum tariff rate at 15 percent, but some tariff lines were raised in the period following the Board's approval of the program. In July 2003, following discussions between the staff and the authorities, the maximum tariff was again brought down to 15 percent, but a new increase is already being envisaged for 2004. Under the new proposal, tariffs on imports of finished textile products, agricultural goods and processed foods would be increased up to 35 percent, while the duty on imported inputs would be reduced to zero, thereby leading to even higher effective protection in these sectors.

3. Given that over 75 percent of Moldova's total trade is covered by free-trade agreements, these frequent changes in the tariff regime are likely to have a relatively small impact on the overall rate of protection, and on government revenue.[2] Nevertheless, they may introduce distortions in trade patterns, and prove disruptive for domestic and foreign businesses. As a small open economy, Moldova should aim at maintaining a liberal, stable and transparent tariff regime.

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[1] Only 27 out of 183 Fund members are rated 1 under the trade restrictiveness index.

[2] While trade taxes (VAT on imports and excises) accounted for a 57 percent of total government revenue in 2002, tariff revenues represented only 5 percent of the total.

Table 1. Moldova: Import Tariff Developments, 1997–2003 1/

	WTO Final Bound Rate	1997	1998	1999	2000	2001	2002	2003 2/
Simple average tariff	6.6	11.6	11.8	8.6	7.0	6.8	5.5	5.4
Weighted average tariff		6.8	4.3	4.8	4.5	3.5	4.2	4.1
Distribution of imports by tariff band:								
0 percent	27	10	31	34	41	47	37	47
5 percent	17	38	29	28	30	29	30	28
6.5 percent	7	0	0	0	1	1	5	1
8 percent	9	0	0	0	0	0.3	2	0.3
10 percent	29	17	9	7	10	8	10	8.3
15 percent	6	2	1	31	16	15	16	15
20 percent	6	29	24	0	0	0.1	0.2	0
above 20 percent	0.3	3	7	0	0	0.2	0.1	0

Sources: Moldovan authorities; and Fund staff estimates.

1/ Based on 4,015 import categories, excluding alcohol, tobacco, and vehicles.
2/ After changes in the tariff law in July and August 2003.

4. *Tariff exemptions and special regimes.* The Law on Customs Tariffs and the Budget Laws provide a list of imported goods that are exempted from customs duties. The list includes charitable donations from organizations and individuals to authorized charity institutions, goods imported under external cooperation contracts, including technical cooperation, imports for re-exports (temporary imports and transit imports), goods imported under the "active processing regime", and imports into free economic zones. Similar to the tax regime, the tariff regime changes frequently, as changes can be introduced in the annual budget laws.

5. *Non-tariff barriers and safeguards.* Most formal non-tariff barriers have been eliminated, although there still exist licensing requirements for health, security, and environmental reasons, as well as for precious metals and fuels. However, following recent large imports of cane sugar at below market prices the government is implementing a 40 percent temporary tariff-quota on sugar as of August 1, 2003, which was duly notified to the WTO.

6. *Customs valuation.* According to its WTO commitments, Moldova is implementing the customs valuation code. The definitions and methodology for establishing the customs value of goods are specified in the Customs Law. Moldova has had difficulties in applying the code since it lacks both a computerized customs information system that could help build and maintain an accurate data base on transaction prices of various goods, and has

implemented only briefly pre-shipment inspection. However, under the Trade and Transportation Facilitation Program, the World Bank will also provide financing for the installation of UNCTAD's ASYCUDA system, which should help improve customs administration, and build a transparent valuation data-base. The project implementation is scheduled to begin in early 2004, and the ASYCUDA installation should take at least 18 months.

B. Export Regime

7. *Export restrictions.* Export licenses are required for the same products as import licenses (see above). Recent export restrictions have been removed by a government decision complying with a prior action for completion of the second PRGF review. However, there still remain problems concerning exports of non-ferrous metal scraps. The current export licensing system de facto allows only one single firm to operate as an exporter, and there seems to be no intention on the part of the authorities to remove this restriction. In addition, there is continuing evidence of informal export restraints, in particular on some agricultural products (sunflower seeds, soy).

8. According to exporter surveys, other obstacles to exports include the repatriation requirement of export proceeds (which sets deadlines for export proceeds repatriation that are judged too short by exporters, and leads to under-valuation of exports), problems with the VAT refund system and excessive tax inspections, frequent changes in legislation, cumbersome registration and customs procedures, lack of adequate certification procedures, complex standards which are not recognized internationally, and high logistics costs.

C. Regional Trade Agreements and Market Access

9. *Regional Trade Agreements.* So far, Moldova has signed 11 bilateral Free-Trade Agreements (FTAs), and signed a regional trade agreement with other CIS countries to establish a free trade area on April 15, 1994, in Moscow. The agreement provides for elimination of tariffs among CIS states (with some exceptions). Moldova is also a member of the Stability Pact for South-Eastern Europe, and is making progress in finalizing FTAs with each participating state.[3] In addition, in 2002 Moldova was granted observer status in the Eurasian Economic Community, signed in 2002, which envisages a customs union between Belarus, Kazakhstan, the Kyrgyz Republic, the Russian Federation, and Tajikistan. A Partnership and Cooperation Agreement with the European Union became effective in 1998. There is a risk that the multiplicity of regional and bilateral trade agreements might lead to a non-transparent and uncertain trade regime, undermining Moldova's commitments under the WTO. A useful first step would be to strengthen existing FTA's conformity with WTO rules.

[3] The FTA with Romania is already in place, agreements with Albania, Bosnia, Croatia and Macedonia are being finalized, and agreements with the other member states (Bulgaria and Serbia) are under negotiation.

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10. *Certificates of Origin.* Widespread fraud in delivering certificates of origin by the Chamber of Commerce is leading to increased protection by trade partners—mainly Ukraine and Romania (e.g., the case of hides and skins and sugar, exported tax-free to Moldova and then re-exported duty-free with a fake certificate of Moldovan origin to a third country).

11. *Market access.* Given the progressive reorientation of exports toward Western Europe, the issue of market access into the EU is becoming more pressing. However, a recent draft study by the World Bank ("Trade Diagnostic Study"), finds that EU trade protection and agricultural subsidies can only explain a small part of the gap between the current share of the EU in Moldova's exports (about 21 percent) and the share that could be expected under normal trade relations (between 40 and 50 percent,) based on economic size and EU proximity. The study also indicates that EU enlargement will pose key competitive challenges for Moldova, as some of the accession countries export similar goods (e.g., Poland). It concludes that effective exploitation of the available opportunities in the EU market requires that a range of domestic constraints on investment, quality upgrading, and exports be addressed, in order to place Moldova on a path toward a free trade agreement with the EU.

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IMF Concludes 2003 Article IV Consultation with the Republic of Moldova

On January 26, 2004, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Moldova.[1]

Background

Real GDP grew by 7 percent in 2002 and 6.2 percent in the first three quarters of 2003, driven by strong consumer spending, which in turn was underpinned by a marked increase in real wages and workers' remittances. Private sector investment seems to have recovered in 2003 but remains too low to support strong medium-term growth. Consumer price inflation declined to 4½ percent at end-2002, but picked-up in 2003, reaching 17 percent in the 12 months to October. The increase in inflation was driven by rapid money growth, as well as higher food and administrative prices.

The external current account deficit was 6 percent of GDP in 2002. The deficit widened in 2003, reflecting strong import growth, only partly offset by higher exports and the recorded inflow of workers' remittances. The trade deficit increased by almost 6 percentage points of annual GDP during the first three quarters of the year, compared to the same period in 2002. While foreign direct investments dropped sharply in the first three quarters, net foreign exchange inflows were

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

strong, suggesting large unrecorded inflows, including workers' remittances. The National Bank of Moldova (NBM) intervened in the foreign exchange market to avoid an appreciation of the leu. Over the last two years, there has been no clear trend change in the nominal exchange rate. The foreign exchange purchases in 2003 allowed the NBM to keep international reserves at about two months of imports through October.

The largely unsterilized purchases of foreign exchange fueled rapid money and credit growth in 2002 and 2003. Broad money and credit to the economy grew by 34 percent and 49 percent, respectively, in the 12 month to September. To stem the inflationary pressure, the NBM tightened monetary policy in 2003 by increasing reserve requirements and its main policy interest rate. Although the REPO rate was gradually raised by a total of 3½ percent, this had little effect on NBM's net credit to banks. In September, the NBM moderated its foreign exchange purchases, leading to appreciation of the leu against the dollar.

Fiscal policy has remained reasonably tight, but external arrears started to accumulate. The general government posted a cash deficit of 1.8 percent of GDP in 2002, while net arrears of 0.9 percent were cleared. During the first three quarters of 2003, a cash surplus of 0.5 percent of GDP was recorded, reflecting robust collection of VAT and import duties, and lower-than-anticipated interest expenditures, owing to accumulation of external arrears.

With limited new external financing, external debt service continues to be a fiscal challenge. Scheduled debt service on public and publicly-guaranteed debt represents about 45 percent of projected central government revenues in 2003. Moldova suspended debt service payments to Gazprom at end-2001 and to some bilateral creditors in August 2003. The authorities' requests for individual reschedulings have met with limited success so far. Accumulated new external arrears during the first three quarters of 2003 amounted to about US$26 million.

Progress in structural reforms remains slow. In particular, there has been no significant improvement in the business climate, while corruption remains widespread. Government interference in the private sector—including formal and informal restrictions on exports of scrap metal and some agriculture goods—casts doubt over the authorities' commitment to market-oriented reforms. While the privatization of some wineries has been completed, a number of large-scale privatizations have been postponed.

Executive Board Assessment

Executive Directors welcomed Moldova's robust economic growth in 2003, but noted that the prospects for sustained economic growth are less positive. They expressed concern about weak ownership and implementation of structural reforms, and about the increasing signs of overheating—reflected in sharply rising domestic demand, imports, and inflation. However, they were encouraged by the authorities' recent decision to develop a medium-term economic strategy focused on tight financial policies, private sector development, public administration reform (including fighting corruption), and rationalization of social policies. Directors urged the authorities to develop a concrete set of measures to achieve these goals.

Directors stressed the need to adhere to prudent macroeconomic policies and to embark on a structural reform program that could provide the basis for renewed international financial support. To improve growth prospects, Directors urged the authorities to reduce administrative intervention in the economy and provide an enabling environment for business. At the same time, tighter monetary and fiscal policies would be needed to curb inflation, improve the debt dynamics, and allow a resumption of external debt service payments.

Directors noted that fiscal policy in the recent past has been prudent and that tax collection had strengthened, and encouraged the authorities to press ahead with fiscal reform. At the same time, Directors regretted the fiscal loosening implied by the 2004 budget and the increasing threats to fiscal sustainability. They urged the authorities to take additional fiscal measures to avoid further accumulation of arrears and to keep the public finances on a sustainable path, including eliminating Value Added Tax exemptions, delaying planned tax cuts, reducing non-essential current spending, and improving budget planning and public expenditure management.

Directors agreed that monetary policy should focus on keeping inflation low. They warned that the recent surge in inflation called for tighter policies. They also expressed concern that the rapid credit growth could lead to a deterioration in the quality of bank's portfolios. Directors commended the NBM for recent improvements in banking supervision and the resulting strengthening in the banking sector. Given the potential vulnerabilities, the NBM should remain vigilant in assessing the banking sector's exposure to shocks. They hoped that the upcoming Financial Sector Assessment Program will help to address remaining banking sector vulnerabilities.

Directors acknowledged that the managed float exchange rate regime has served Moldova well. They observed, however, that a nominal appreciation might be warranted if the inflow of workers' remittances continues to rise rapidly. Ultimately, external competitiveness should be improved by implementing appropriate structural policies, while maintaining a liberal exchange and trade regime. In that context, Directors urged the authorities to resist pressure for protectionist measures.

Directors expressed concern about the fiscal burden of Moldova's external debt service, particularly during the next few years when the bulk of the relatively short-term and non-concessional external debt falls due. Directors remarked that a solution to the debt problem would require a combination of further fiscal tightening, some form of debt restructuring, and additional concessional external financing. They added that additional financing is unlikely to materialize unless market-oriented reforms are implemented. They also cautioned the authorities against continued arrears accumulation, since this strategy is not likely to lead to a sustainable resolution of the debt problem. At the same time, remaining current on external debt obligations would help restore creditors' goodwill and foster renewed financial support to Moldova.

Directors stressed that the slow progress in market-oriented reforms has aggravated Moldova's vulnerability to external shocks and could undermine medium-term economic prospects. Therefore, they urged the authorities to accelerate the implementation of structural reforms in order to improve growth and poverty reduction prospects. Directors supported the authorities' intention to use the Economic Growth and Poverty Reduction Strategy Paper (EGPRSP) as the main vehicle to develop their medium-term economic strategy. They encouraged the authorities to include policies to improve the business environment and governance and to implement these policies as soon as possible. They considered that reforms should be properly timed and sequenced, and that an effective safety net with well-targeted assistance should be established.

Directors welcomed the opportunity to assess Moldova's program engagement with the Fund. They thought the Ex Post Assessment contained a balanced analysis of the country's performance under Fund programs and of the design by the Fund of those programs. They emphasized that clear evidence of a change in the direction of economic policy would be needed to facilitate Moldova's re-engagement with the international community on discussions of new programs.

Republic of Moldova: Selected Economic Indicators

	2001	2002	2003 Proj.	2004 Proj.
	(Percent change; unless otherwise indicated)			
Production and prices				
Nominal GDP (in MDL millions)	19,052	22,040	26,720	31,817
Real GDP growth	6.1	7.2	6.0	5.0
Consumer prices (end of period) [1/]	6.4	4.4	18.0	8.0
	(In percent of GDP)			
Public finance (general government)				
Overall balance (cash)	-0.1	-1.8	0.4	-0.7 [2/]
Overall balance (commitments)	-0.3	-0.9	0.2	...
	(Percent change; unless otherwise indicated)			
Money and credit				
Broad money (M3)	36	36	31	23
Credit to the economy	35	34	40	27
External sector				
Current account balance (in percent of GDP)	-4.9	-6.1	-8.1	-7.1
Public and publicly guaranteed debt (in percent of GDP)	67.3	64.8	52.5	43.6
Debt service (in percent of exports of goods and Non-factor services)	16.8	14.1	13.9	12.8
Gross official reserves (in millions of dollars)	229	269	259	259

Sources: Moldovan authorities; and IMF staff estimates.

1/ The inflation figure for 2004 is a target recommended by IMF staff.
2/ Staff projection of budget without additional measures.