

MOLDOVA

**Interim Poverty Reduction Strategy Paper**

Prepared by the Moldovan authorities

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## I. INTRODUCTION

1. Following the regional financial crisis in 1998, Moldova has made significant progress towards achieving and retaining macroeconomic and financial stabilization. It has, furthermore, implemented many structural and institutional reforms that are indispensable for an efficient functioning of a market economy. The results of these efforts have contributed to the maintenance of macroeconomic and financial stability under difficult external circumstances, have enabled the resumption of economic growth, and have contributed towards the creation of an environment that is conducive to the economy's further growth and development in the medium term.
2. Despite the above-mentioned efforts, and the recent resumption of economic growth, Moldova continues to have one of the lowest levels of income per capita in Europe. The government is well aware of this reality and is of the view that rapid and sustainable growth is the main instrument for reducing the development gap of the country relative to the rest of Europe, improving the standard of living of the population and reducing the poverty of those most in need. To address these aims in a comprehensive fashion a full Poverty Reduction Strategy Paper (PRSP) will be elaborated by spring 2003. This policy is consistent with Moldova's aspirations to become more integrated in Europe. To strengthen the policy's effectiveness the full PRSP will be prepared in close consultation with, and broad participation from the relevant stakeholders in the process. These include representatives of the government, parliament, the local administration, civil society, and the donor community, under the co-ordination of the presidential administration.
3. With the aim of achieving a rapid and sustainable growth path, the government has agreed with the Fund and the Bank staff on a three year macroeconomic framework and a set of policy measures, which are described in the attachments to this document. The government has a three-year Poverty Reduction and Growth Facility (PRGF) arrangement with the Fund and will continue to cooperate with the World Bank in the context of structural adjustment and investment operations.
4. The present document is an update of Moldova's Interim-PRSP approved by the boards of the IMF and the World Bank in December 2000. This document updates and completes the earlier Interim-PRSP in the light of additional information and the latest trends in the economy, expands the set of monitoring indicators and reflects the recent changes in the institutional mechanism for the elaboration of the full PRSP within an updated time frame. It, finally, ensures that Moldova's Interim-PRSP reflects the policy vision of the government appointed after the parliamentary elections of February 2001, as expressed in the government's programme and the recently approved medium-term Social and Economic development strategy for Moldova.

## II. CHARACTERISTICS OF POVERTY IN MOLDOVA

### A. Causes of Poverty, Data Sources and International Comparisons

5. The poverty increase in Moldova over the transition period is the combined result of a number of developments, both external and domestic. These include: (a) the effect of the dissolution of the Soviet Union, the accompanied disruption of trade and payments and, especially, the price shock which accompanied the liberalization of the price of energy, a key (and imported) component of Moldova's domestic costs. A comparative study undertaken by the World Bank suggests that Moldova was the hardest hit country of the Former Soviet Union by the terms-of-trade effect which accompanied the movement of domestic energy prices towards international prices; (b) the conflict with Transnistria in 1992 and a series of natural disasters and their effect on the country's agricultural sector and agro-processing, which account for around half of the country's GDP. These include floods in 1992 and 1994 and the drought and icing disaster in 2000; (c) the continuing regional instability and, especially, the effects of the Russian crisis of 1998. Current GDP per capita decreased from \$527 in 1997 to \$353 in 2000. Evaluated at purchasing power parity GDP per capita dropped from \$2207 to \$2033. The above exogenous factors were exacerbated by intermittent policy reversals in the implementation of the country's structural reform program.

6. Existing studies on poverty in Moldova include an ethnographic survey of poor households conducted in late 1996, the World Bank's Poverty Assessment, Moldova's Household Budget Surveys that are compiled on a quarterly basis from the second quarter of 1997 onwards, and the General Country Evaluation undertaken with support of the United Nations (UN). The evidence generated by these studies suggests that poverty in Moldova is high and mainly due to limited job opportunities and low incomes, especially in rural areas and in the agricultural sector.

7. International comparisons reveal that Moldova ranks low in comparison with other transition economies in terms of commonly used living standard and human development indicators. Per capita GDP in Moldova is lower than the average for Former Soviet Union economies, and significantly lower than the average for Central European and Southern European transition countries. The UNDP's human development index for 1999 (based on 1997 data) ranks Moldova 104 out of the 174 countries ranked. More recent studies by UNDP suggest that there has been a slight improvement in the country's relative position, placing Moldova in 102 position in 2000 and in 98 in 2001, though no significant real improvement in living standards has occurred over the last four years. Moldova's ranking is lower than all the transition countries in Central Europe, South-eastern Europe and all the Former Soviet Union economies, with the exception of Tajikistan and Uzbekistan that follow closely behind. Moldova's economic and social conditions were adversely affected by the regional crisis in 1998. Further shocks, including the icing disaster and the drought experienced in the country in 2000, have had an adverse effect on the country's living standards and poverty, especially in rural areas.

## **B. Characteristics of the Poor in Moldova**

8. The poor in Moldova range from less educated, unskilled workers, or very large single-parent families, to highly educated persons who once enjoyed socially prestigious and well compensated positions as scientists and professionals. Among the poorest groups are the working poor, especially the landless workers in the agricultural sector, families with children, families numbering more than 5 members, families with one or more vulnerable members, elder people and the unemployed, a third of which are in extreme poverty.

9. The growth in unemployment during the transition period is only partially reflected in official statistics, where registered unemployment has remained fairly constant at around 2 percent of the active labour force. However, using the International Labour Organisation's methodology the unemployment rate is estimated at around 9 percent. According to the latest official statistics around 8.5 percent of the active labour force have emigrated. Of these 54 percent are less than 30 years old. Youth unemployment is growing, with the latest official estimate of the youth unemployment rate being close to 16 percent. Official statistics suggest that there is only one vacancy for every 17 people who are unemployed.

10. One fifth of the poor are children. Moldova's transition period was also characterised by increasing food insecurity and children malnutrition, both of which are key dimensions of poverty. According to UNICEF and Ministry of Health studies, 28 percent of children and 20 percent of women are suffering of anaemia. Out of children under 10 years, 10 percent are underdeveloped, mostly because of chronic malnutrition.

## **C. Poverty and Inequality Dynamics**

11. The existing studies indicate that a significant, and growing, share of Moldova's population is poor. According to the Poverty Evaluation Report by the World Bank, about 37 percent of Moldovans were below an absolute poverty line of MDL 82.1 (\$17.6) per person per month in 1997. The results of the 2000 household budget survey indicate that the disposable income of close to 88 percent of households was less than the subsistence minimum of MDL 413.1 per person per month. The share of the population with an income less than half of the subsistence minimum (lei 207) is about 53.4 percent. Work undertaken for the formulation of the government's National Poverty Reduction Strategy suggests that one of every four inhabitants of the Republic of Moldova can be considered "relatively" poor. Using a poverty line equivalent to 50 percent of average consumption about 22,8 percent of the population was "relatively poor" in 2000, down from around 25.5 percent over the period 1997-99.

12. The increase in poverty has been associated with an increase in inequality. According to international standards, Moldova has become a country with high income inequality, with most of the increase in inequality having occurred at the initial and middle part of the country's transition. The Gini coefficient for income inequality increased from a value of 0.24 for 1987-88 to 0.344 in 1992 and 0.36 in 1993. During the 1997-99 period, the Gini coefficient

was at a standstill at 0.44 level, and preliminary estimates suggest that it dropped slightly to 0.42 in 2000. The richest 20 percent of the population earns close to half of the total income, 11 times more than the poorest 20 percent.

#### **D. Urban and Rural Poverty**

13. The inequality in income distribution as expressed by the Gini coefficient does not capture the high differentiation of cash incomes in urban areas, which contrasts with the effect of relatively less differentiated income distribution in rural areas. A deeper analysis of recent trends shows that the society's differentiation in extremely poor and extremely rich in urban areas is continuing at a much higher pace than in rural areas. The analysis of the household budget survey's data indicates that in the year 2000 the extreme poverty in urban areas is more severe. While the share of people in extreme poverty in urban areas is only marginally higher than those in rural areas, accounting for 3.4 percent versus 3.2 percent respectively, the inequality among those classified as poor people in urban areas is much higher. The latest statistics estimate the unemployment rate in urban areas according to the International Labour Organisation's methodology at 15.7 percent versus 3.4 percent in rural areas, where subsistence agriculture does provide some employment opportunities and food.

14. However, it is clear that poverty in Moldova is prevalent in the countryside. The poorest quintile in Moldova is composed by 35.8 percent of urban population and 64.2 percent of rural population. Revenues in rural areas are mostly in-kind (71.5 percent of the total disposable income), with cash accounting for only 28.5 percent. The cash share in total income for the poorest quintile in rural areas amounts to approximately 26 percent. Rural poverty is closely correlated with the drop in agricultural activity over the transition. The agricultural sector has been severely hit by the onset of transition by a combination of an adverse terms-of-trade effect between the prices of the inputs to production and the prices of agricultural output, the loss of competitiveness of Moldovan agricultural markets in its traditional markets, and the little restructuring in the sector over the transition.

15. Subsistence agriculture is the most important revenue source for rural poor population. The weight of income from agricultural activities in the structure of incomes of the rural population amounts to 76.8 percent. At the same time the weight of this incomes in the structure of incomes of the poor population from the rural area amounts to 78 percent. Despite their capacity to produce some of their own food—which has kept many rural poor out of extreme poverty—conditions in rural areas remain difficult. Many rural households survive on subsistence farming. For the rural population, the weight of food consumption is close to 72 percent in the total consumption expenditures, while the weight of other kinds of expenditures is very modest: ranging from 7.7 percent for house keeping to 0.13 percent for education. For poor people the situation is worse with food consumption accounting for 85.3 percent of total consumption expenditures. The very high weight of food consumption in the structure of the rural population's expenditures is indicative of the extent of rural poverty in the Republic of Moldova.

16. Agricultural households interested in farming lack the means to expand into more profitable farm activities. Cash-poor, with fewer opportunities to obtain credit, these households are unable to branch into more profitable crops because they cannot afford equipment, fertilizers, pesticides, seeds or irrigation. Although the country has made good progress in farm restructuring and land privatisation, the reforms were delayed until the collective farms had largely collapsed along with the processing/marketing system that supported the agricultural sector. A promising development has been the land consolidation that is underway following the privatisation of land and the creation of voluntary cooperative associations.

### **E. Further Work**

17. The full PRSP is envisaged as a comprehensive and participatory program aiming at ensuring the economy's and society's sustainable growth and development in the medium term and explicitly tackling the issue of poverty in the country. The very brief discussion of the characteristics of poverty in Moldova is indicative of the complexity of poverty as a social and economic phenomenon. The current document provides an outline of poverty alleviation policies in a number of key areas, which are outlined in the remaining part of this document. However, the relevance and impact of the envisaged interventions presuppose a detailed understanding of the characteristics and dynamics of poverty in the country. With this aim a sustained effort has and will continue to be made to update the available poverty database. A collaborative program supported by the UNDP was signed in August 2000 aiming at developing further the informational instruments and policymaking in the social sector and improving the institutional structure for assessing and monitoring the poverty alleviation impact of policies. Work is currently underway in order to identify knowledge gaps, and specify the analytical work necessary for the preparation of the full PRSP.

### **III. THREE PILLARS OF A POVERTY REDUCTION STRATEGY**

18. The government's poverty reduction strategy will be founded on three pillars: (i) sustainable and inclusive economic growth that will provide the population with productive employment; (ii) human development policies emphasizing increased access to basic services (especially primary medical services and primary education); and (iii) social protection policies targeting those most in need.

19. The government's poverty reduction strategy will focus on a fair distribution of the benefits of growth for the entire population and will take into account the existing social capital at the community level. The PRSP approach provides Moldova with the opportunity to clearly address poverty reduction as an explicit policy goal and formulate the strategy in a participatory fashion thereby increasing ownership.

### **A. Sustainable and Inclusive Economic Growth**

20. The government will maintain a stable macroeconomic environment tailored to the country's financing constraints and conducive to the economy's growth and development in the medium term. The program aims at consolidating the recently achieved stabilization and growth and providing the conditions for the economy's sustained growth and development in the medium term. It will also continue to diversify the economy's structure, from an agriculture economy to a service economy, including the development of information and communication services. The government has elaborated a macroeconomic framework for the next three years. The program projects that Moldova's economy will expand at a growth rate of 6 percent a year over the medium term. Its main elements appear in Appendix I of this document.

21. The promotion of sustainable growth and inclusive development is the overarching priority in the government's development and poverty reduction strategy. And sustainable growth in the medium term is likely to stem from the development of private sector activities in areas where the country has a comparative advantage. These areas are likely to include the agro-industrial sector, the small and medium enterprise sector and the service sector, i.e., areas that either reflect the country's endowments or were underdeveloped under the command economy. A detailed study will be conducted to identify the sources of economic growth in Moldova.

22. The government is of the view that sustainable and rapid economic growth will be achieved through a model of development based on private sector growth and the development of export industries in areas where Moldova has a comparative advantage. The development of the private sector is essential for the creation of a market economy and for reaping the benefits associated with a well functioning market system. The government plans to develop an export led-growth strategy with an aim to diversify export products based on its comparative advantage and gain access to non-traditional export markets. In this respect the implementation of the international standards is an important issue and the implementation of ISO 9000 and Codex Alimentarius standards is on government's agenda.

23. The government remains committed to further progress in its structural reform program that will promote the creation of a stable and predictable framework to facilitate private sector activities, attract foreign direct investment, as well as increase domestic investment to support its led growth strategy. Toward this end, the government intends to adopt structural measures including financial sector reform to increase access to cheaper credits necessary for the development of private enterprises, privatisation of key strategic industries, enterprise restructuring, improved business environment, deregulation of the private sector, rationalization of licensing and registration, improved corporate governance, and improved institutional and legislative environment conducive to foreign and domestic investment.



### **Privatisation and enterprise restructuring**

24. With regard to the government's privatisation program, emphasis will be placed on finalizing the open and transparent privatisation of the energy sector (three electricity distribution companies were already sold to a strategic investor and further work is underway to privatise the remaining two distribution companies and the three power generating companies), the telecommunication sector (with the privatisation of "Moldtelecom", where a contract with financial advisor for its privatisation has been already signed), and the wine and tobacco sectors. The land privatisation program has been completed. And in all recent privatisations land was also privatised along with an enterprise's assets.

25. With regard to enterprise restructuring, the bankruptcy and liquidation of enterprises with significant debts will continue throughout the period. The recent law on insolvency passed by the parliament provides the legislative base for restructuring and liquidation of insolvent enterprises in Moldova. The legislative framework for efficient corporate governance will be improved further. The government will identify specific measures in this area with donor assistance.

26. Finally, a sustained effort is and will continuously be made to create a better investment climate by eliminating barriers to entry for new enterprises. This includes the recent law on licensing which significantly simplified entry procedures (through the simplification of licensing activities from 150 to 55 and registration requirements) and the improvements in the legal framework required for the further growth and development of private sector activities in Moldova. Also, the government will undertake sustained effort to develop the infrastructure and the general environment in which an enterprise operates. In particular, no electricity, gas or water disconnection of debt-free enterprises will occur.

### **Rural development**

27. As noted already, poverty in Moldova is especially prevalent in rural areas. In parallel to the above measures, the government will give high priority to agricultural and rural development to address the existing constraints in the development of the rural areas and generate employment and income on a sustainable basis. The government will develop and adopt a comprehensive agricultural and rural development strategy. The strategy will finalise the reform of the agrarian sector, stimulate the voluntary association and co-operation among farmers, facilitate the development of the land market, and the restructuring of the agro-processing industry.

28. The overall objective of the rural development strategy is the increase in rural incomes and living standards by promoting rural entrepreneurship, agricultural production, economic diversification, and trade in rural areas. Branches of the agro-processing complex that are expected to develop include wine production, tobacco growing and tobacco processing and cigarettes production, vegetables and fruits production and canning industry, sugar beet production and sugar production.

### **Public sector reform strategy**

29. Poverty reduction through sustainable and inclusive growth requires not only a dynamic private sector but also an efficient public sector that can operate in a transparent and accountable fashion and is accessible to the entire population. The government intends to build market-oriented and service/client oriented, merit-based, de-politicised and corruption-resistant public sector, which meets EU "best practice" standards; is affordable and fiscally sustainable; and ensures cost-effective delivery of priority public goods and services and interacts with and supports the development of the private sector.

30. Additionally, the approval of the Public Sector Reform Strategy will be reconsidered and the establishment of a Steering Committee and sectoral working groups to implement policy measures in four areas. These are: i.) public administration reform ii.) management of public expenditure, iii.) interaction between private bodies and public sector, and iv.) social sector reform and poverty alleviation.

### **Anti-corruption strategy**

31. Related to Public Administration Reform are the recent Presidential initiatives to improve governance in Moldova and fight against corruption. These include the commitment to pursue the restructuring of the state institutions, the elimination of duplication of functions among government agencies through mergers, and the formulation of an anti-corruption strategy. Fighting corruption and improving transparency and accountability are among the priorities in all areas of public administration. The transparency of income, property and expenditure of senior officials are important elements of the anti-corruption campaign. As a first step in this efforts the government drafted and the parliament approved the Law on financial disclosure of public officials.

## **B. Human Development**

32. The government is of the view that economic growth that does not translate into improvements in the standard of living for everyone is socially, economically and environmentally unsustainable. The promotion of sustainable human development in the Republic of Moldova would mean strengthening social cohesion through an identification of the sources and consequences of social exclusion and the elaboration of necessary policies to address these in order to meet the basic needs of the most vulnerable layers of the population.

33. The government will promote human development through the design and implementation of comprehensive and integrated strategies based on the assessment of the extent to which existing expenditures benefit the poor, aiming at sustainable improvements in health and education. The strong correlation between poverty and related human development indices provide firm support for the poverty alleviation impact of human development programs; improvements in health and education have a direct effect on poverty reduction. They, furthermore, entail significant positive externalities for the improvement in

the economy's supply side and the promotion of sustainable and inclusive economic growth within a socially cohesive society. Moldova has few natural resources and its human capital could become the main source of economic growth.

## **Health**

34. Over the transition period the health sector has deteriorated significantly with a steep decline in health expenditures (which accounted for only 3 percent of GDP in 2000 down from 6 percent in 1997).

35. The government's health care strategy aims at:

- Maintaining the level of health expenditures in real terms at least at the level of the 2000 budget;
- Instituting poverty reduction interventions, such as emphasizing primary health care and disease prevention;
- Improving the allocation of resources to make it more equitable and efficient, including the restructuring of the provider network;
- Developing health services autonomy, especially for hospitals;
- Training general practitioners and health managers; and
- Introducing the mandatory health insurance.

36. In the short run the health reform aims at:

- Guaranteeing transparent access to a minimum package of health services which are affordable to the state and for which the state's commitments are fully funded;
- Modernizing emergency services and primary health care;
- Targeting and prioritising investment in health sector;
- Strengthening the health sector's institutional capacity while reducing excess capacity; and
- Developing the legal and financial base required for the mandatory health insurance.

## **Education**

37. Mirroring developments in health, education over the transition period has deteriorated significantly with a steep decline in enrolment rates, chronic absenteeism among poor children, and, and reduction in education expenditures (which accounted for around 4.5 percent of GDP in 2000 down from 10 percent in 1997). Given the importance of education in providing its recipients with the means for a sustained reduction in poverty and the positive externalities of human capital development for the country, the government remains committed to a sustained effort to improve the country's educational sector.

38. In particular the government's education policy aims to improve the efficiency of the educational system while maintaining fiscal sustainability. The new social and economic realities have necessitated the reform of the education system in Moldova, so as to assure that the knowledge and skills transmitted by the education system properly respond to the newly created conditions. In this context, an Education Sector Strategy, is underway and the government's reform efforts, in this context will include the following components:

- Arrest the decline in basic education attendance and promote access to, and retention in, basic and secondary education for poor students;
- Improvements in the governance and accountability of the education system, including the transfer of management responsibilities of education institutions to the local entities;
- Review curriculum standards and address issues related to the quality and remuneration of teaching staff for the entire education system and improve the evaluation and certification procedures in this sector;
- Review the structure of the secondary and professional education system. Elaborate a Program, which will assure that the system correspond to the current demands in the labour market and identify measures for improving the quality of secondary schooling;
- Increase the role of private educational establishments;
- Develop analytic data bases including: an education management information system that includes a school mapping data base, financing data, and human resources data; a study of informal payments by families at all levels of education; and a study of alternative ways to save energy in schools; and
- Establish a participatory education system through the creation of the social partnership mechanisms: involving the family, the school and the local community.

### **C. Social Protection**

39. The government recognizes that the reform of the country's social protection system is necessary in order to provide fiscally sustainable and well-targeted assistance to those in need. In the past Moldova's social protection system relied on pensions supplemented by poorly targeted and, to a large extent, under-financed benefits and privileges. Work undertaken by the government in the process of formulating its national program for poverty alleviation suggests that over one-third of Moldova's population enjoyed privileges which were both poorly targeted and expensive, accounting for around 8 percent of Moldova's GDP in 1998.

#### **Targeted assistance**

40. Recent developments in social protection in Moldova have included the rationalization of energy, communal services and, partially, transport subsidies by eliminating the old system and approving a fully funded and targeted compensation scheme based on category targeting which is paid in cash and directly to recipients. The Law on the special social protection of certain categories of population, that eliminated non-targeted energy subsidies, communal services and limited energy privileges to eleven categories representing the most vulnerable segments of society, is likely to have a beneficial effect on government finances and improve significantly the efficiency and targeting of the government's social assistance program.

41. This law replaces the previous 100 normative acts stipulating the provision of different kinds of compensations to more than 1.2 million beneficiaries. The envisaged compensations were inefficient and overly costly, amounting to around MDL 600 million which were poorly targeted. As envisaged in the budget 2001 close to MDL 204 million were provided as targeted compensations to over 260 thousand beneficiaries. Work is underway to clarify further the recipient categories and ensure the efficient disbursement of the targeted amounts.

42. Designing a social assistance system that is transparent, fully funded, fiscally sustainable, well targeted and according to real possibilities of the country will be the focus of the next phase of the social protection policy development. Under the constraint of lacking a reliable income certification process, future social assistance system would need to rely on a combination of targeting mechanisms and will consist of a mixture of programs at national levels and local levels.

#### **Pension reform**

43. With regard to the reform of the pension system the government remains committed to strengthening the linkage between contributions and benefits, eliminating privileged pensions and tightening eligibility criteria, making the system more transparent. Recently, the parliament adopted the law on pension recalculations, which provides a considerable increase (around 36 percent) in pensions starting with December 1<sup>st</sup> 2001. Additionally, the government will take steps for defining an indexation rule for the adjustment of pensions

within the social insurance budget constraints. It is further envisaged that an individual pension record for everybody will be established along with a clearly specified benefit formula correlating the compulsory social insurance contribution with the pension size.

### **Unemployment and labour market policies**

44. As a second element of the social protection program, work on improving the functioning of labour markets and the protection of those in poverty while unemployed, together with improved access to job search and job creation services will be undertaken. Finally it is envisaged that locally administered programs will be an important element in the social assistance system. Nevertheless, a thorough analysis of the available options and monitoring mechanisms is necessary in order to ensure that the programs would be sustainable and can assist the poor in an efficient and equitable manner.

45. The employment policy and labor market development is an important area of the government's poverty alleviation program. In this context the government undertook a series of concrete policy measures, including the implementation of the Law on establishing and revising the minimum wage, amounting lei 100, submission to the parliament of the law on salary (new draft), drafting the Law on the system of establishing basis salaries in budgetary sector for public servants. Nevertheless, the transition to the market economy envisages the formulation of a new concept of employment that would correspond to the new economic conditions. In this context, to facilitate the development of a flexible labor market which would lead to a more efficient use of the labor force, the government's strategy will include: (a) a comprehensive analysis of the labor market developments and the impact of structural reforms on the employment, job creation and wage adjustment; (b) the identification and removal of the legal constraints on the functioning of a flexible labor market; (c) the evaluation of the efficiency of the existing labor market programs such as job searching and retraining and work out a new design.

### **Child poverty alleviation**

46. The government will place particular emphasis on alleviating child poverty. The available studies suggest that households with children are the most vulnerable group in Moldova. The government's national poverty reduction program aims at addressing the issue of child poverty through focused and well-targeted interventions within the limits imposed by the country's financial situation. These include interventions aiming at ensuring adequate levels of food security and childcare, and the social protection of orphans and disabled children.

47. Analysing options to rationalize existing child benefits, providing further assistance at local government level and developing community based child protection measures, would be the first steps in this direction. Options of direct in-kind assistance to children of school age could be considered as a measure to supplement cash transfers while at the same time encouraging school attendance. The government is currently working with development

partners (UNICEF, European Trust, and SIDA) to pilot de-institutionalization programs. The World Bank has also been supporting this effort through the Social Investment Fund project.

#### IV. INSTITUTIONAL MECHANISMS FOR THE PRSP

##### A. Institutional Arrangements

48. The development of Moldova's poverty reduction strategy will be overseen through the mechanism approved by the PRSP **Coordination Council**. The Coordination Council was created through President Decree nr. 732 and operates under the auspices of the Presidential Administration and chaired by the President of Moldova. The Coordination Council elaborates the general concept of the PRSP, which includes the establishment of the mechanism and common action plan for the participation in PRS process, as well as coordinates the activities of the public and local administrations bodies in the process of formulating, implementing and monitoring the poverty reduction strategy. Within the framework of the Coordination Council a **Secretary's office** will operate in order to coordinate the process between all the relevant stakeholders. The Secretary's office includes representatives from the presidential administration, parliament and government. A **Committee for negotiations with donors and investors** headed by the Prime Minister has been created in order to attract the external resources required for the elaboration and implementation of projects within the frame of PRSP. In addition to the Prime Minister, the Committee will include the Vice-Prime Minister and Minister of Economy, the Ministry of Finance, the Governor of the National Bank of Moldova and the Secretary of the Coordination Council.

49. A Council of Experts and a Technical Committee, reporting to the Coordination Council headed by the President will operate towards the production of the full PRSP. The **Council of Experts** is made up by academic, private sector and local public administration representatives, as well as donors, NGO's and independent experts. It will facilitate the involvement of the civil society in the PRS process; will create sectoral groups of experts for each direction of the PRSP, thus ensuring the participation of experts in the process of elaboration and evaluation of the PRSP. In addition the Council of experts will synthesize the final PRSP. The **Technical Committee** technically coordinates the process, controls and makes the analysis of the project's execution and generalizes the information regarding new projects. The Technical Committee is headed by the Vice Minister of Economy, comprising other line vice ministers. Under the Technical Committee, **Sectoral Working Groups** will be created and will include senior specialists from ministries and departments and will be responsible for the elaboration of preliminary sectoral blocks for the PRSP. In the sectors in which the government policies and programs can have a significant impact on poverty reduction, **Sectoral Groups of Experts** will be responsible for the analysis of the situation in the sector, project expertise as well as for the elaboration of preliminary sectoral blocks for the PRSP. The Sectoral Working Groups and the Sectoral Groups of Experts will monitor the fulfilment of the current projects and elaborate new ones in the relevant sectors. Besides this a

**Group for poverty diagnosis and monitoring** comprising experts from the Department of Statistics and Ministry of Economy, which already are working in this field will elaborate a generalized poverty “map”. Finally a **media-group**, which will provide support for the information dissemination regarding the PRSP, will be created.

## **B. Measures to Strengthen Public Expenditure Management**

50. The efficient implementation of the government's poverty reduction strategy requires that weaknesses in the planning and management of public expenditure are addressed. Under the government's public sector reform program, the government aims to build a robust, sustainable and effective public sector resource management system which provides for high levels of fiscal control (hard budget constraints at all levels of government); strategic prioritisation (allocative efficiency in budget formulation and expenditure review and prioritisation at all levels of government); and technical efficiency in budget execution (at all levels of government). Specific measures are already being developed and implemented to: (i) introduce a strategic approach to the prioritisation of public expenditure under which expenditure decisions are explicitly linked to government policies; (ii) adopt a three year time horizon for the programming of public expenditure, thus placing the design of expenditure policy in a medium-term framework; (iii) refocus of budget management towards placing emphasis on the realization of outputs and outcomes rather than the utilization of inputs and perceived needs. Furthermore, the government plans to introduce the programme budgeting concept. In addition measures have and will continue to be taken throughout the period in order to improve the monitoring of public expenditures and ensure that resources reach the intended beneficiaries.

51. The government recognizes that effective implementation of the expenditure policy will require significant increases in capacity at the centre of government; in the Ministry of Finance; and in line Ministries. These capacity-building measures will be addressed under the government's Public Sector Reform Program, to be supported by World Bank's Public Sector Reform Credits. With the assistance of Moldova's development partners the government has begun to address these requirements through the introduction of a medium-term expenditure framework (MTEF) and other initiatives to strengthen budget implementation procedures. The MTEF process will ensure that sector policies and public expenditures have a clear poverty reduction focus and are designed taking into consideration the country's available financial resources. In parallel further technical improvements are also envisaged in the efficiency of the medium-term revenue side projection.

52. The government will continue its efforts aimed at improving budget implementation. Past work undertaken with the support of international organizations included a revision of the budget classification system to strengthen the targeting and monitoring of public expenditure, through the central treasury system, and implementing the law on local public finance. Further work will be undertaken aiming at improving Treasury operations to ensure the more timely release and predictability of funds and better timely reporting of expenditure



and increasing responsibility and accountability of local governments for service delivery that could be more effectively carried out by the local governments, complying with minimum standards of public financial management to ensure that public resources are being used to achieve the government's poverty reduction goals, and promoting broad participation of the public by publishing information on the MTEF, the budget and accounts.

53. To successfully implement the law on Local Public Finance, the government is well aware of the need to strengthen the capacity of local governments over the medium and long-term. Currently, the government is working with development partners to improve and streamline the budget execution at the local government levels. Plans are being developed to build the capacity of local governments and to streamline the system of inter-government fiscal relations including a thorough reviewing of the existing legislation on the budget system, local public finance; adjusting the assignment of expenditures; carefully levelling the transfers to the local budgets depending on the level of economic and social development; and finalizing the regulation of transfer of property rights to sub-national governments.

54. The preparation of the PRSP will be closely linked with the MTEF process in ensuring consistency between the government's poverty reduction strategy, its expenditure plans and the country's available financial resources.

#### **V. PARTICIPATORY PROCESS AND TIMETABLE FOR THE PRSP**

55. The full PRSP will be elaborated in a participatory manner under the auspices of the Presidency. With assistance from Moldova's international partners local and regional meetings will be conducted to facilitate information exchange among government and local administration officials, civil society, and donors about the new initiative and, in particular, the participatory aspect of the PRSP exercise.

56. The Council of experts will be responsible for the coordination of the participatory process. Thus, the organizations or the independent experts important in areas relevant to the PRSP process will be identified with clear and transparent selection criteria for the participation in the consultation process, aiming to ensure broad representation of domestic and international stakeholders in the PRSP exercise. The rights and obligations of expert community will be specified in a Memorandum signed between all its representatives.

57. The background information for the PRSP process will be widely disseminated to relevant stakeholders and the public through a sustained public awareness exercise and the posting of relevant information in the PRSP web site. The web site will contain a PRSP progress archive, as well as allow the discussion of issues relevant to this process. Institutional mechanisms for the consultations with stakeholders will include interviews, focus groups, workshops, and conferences. The participatory process for the PRSP will culminate in an information workshop at the national level on poverty evaluation results and in order to validate and finalize the full PRSP by the end of March 2003. The participatory approach for the formulation, implementation and monitoring of the PRSP is outlined in Appendix III.

## VI. MONITORING INDICATORS

58. A number of measures have and will continue to be undertaken in order to improve and/or establish appropriate mechanisms for the regular and timely collection, analysis and publication of the database required for the monitoring of social indicators relevant to the PRSP process.

59. In addition to improving the database, the government will, with the support of Moldova's development partners, undertake a sustained effort throughout the period to improve the analytical and research capability necessary in order to understand the nature and causes of poverty in the country. This will improve both the design as well as the monitoring of the impact of its policy interventions. The results of all information gathering activities and the relevant analytical work will be widely publicized, and we remain committed to consult with relevant stakeholders on these results through appropriate channels, including interviews, workshops and conferences.

60. At present, the progress of the poverty reduction strategy will be monitored on the basis of a set of indicators consisting of (i) male and female life expectancy, (ii) death rate and natural increase in population, (iii) infant mortality rate, (iv) maternal mortality rate, (v) under-five mortality rate, (vi) immunization rates, (vii) basic education enrolment rate, and (viii) secondary education enrolment rate. A list of the relevant indicators for Moldova appears in Appendix II. In addition, the results of the 2000 Household Budget Survey and other related work, most notably the program supported by the UNDP aiming at developing further the informational instruments and policymaking in the social sector and improving the institutional structure for assessing and monitoring the poverty alleviation impact of policies, will be used to assess progress.

## **Three-year Macroeconomic Framework**

### **I. INTRODUCTION**

1. Rapid and sustainable economic growth is the main instrument for improving the standard of living of the Moldovan population and reducing the poverty of those most in need. The government's macroeconomic policies aim at consolidating the recent positive output developments achieved under difficult external circumstances and providing the preconditions for the economy's sustained growth and development in the medium term.

### **II. RECENT DEVELOPMENTS**

2. The development of output indicators has been very favorable. Over the year 2001 Moldova's real GDP registered a growth of 6.1 percent, reflecting an increase in industrial output (14.2 percent), in agriculture (4 percent) and in service sector.

3. At the same time inflation has decelerated further, with the rate of growth of the consumer price index over the year 6.3 percent (December 2001 to December 2000) in comparison with 18.4 percent over the 2000.

4. Fiscal policy has remained tight. In the absence of the foreseen external financing the retention of a tight fiscal stance has necessitated a reduction in government expenditures. Netting out operations were further reduced in line with the government's programme of fiscal reform.

5. Credit conditions were gradually eased in line with the favorable, output, inflation and exchange rate developments, as well as the international drop in interest rates. The monetisation of the economy continued, reflecting increases in money demand as well as purchases of foreign currency by the National Bank of Moldova which brought gross international reserves at the end of September at the level of \$221 million. The exchange rate has remained stable.

6. Finally, growth was also registered in Moldova's external trade. In particular custom's statistics suggest that over the 2001, a 17.6 percent growth was registered in total trade. The rate of growth of exports, at 21 percent, was higher than the rate of growth of imports, at 15.5 percent. In accordance with Moldova's export led growth and development strategy, the remaining trade restrictions on the export side were recently removed.

### **III. FUTURE POLICIES**

7. Turning into the future policies and projections the program envisages that Moldova's economy will expand by about 6 percent per year over the medium term.

8. The government's fiscal policies will remain tight throughout the period, with the budget deficit on a commitment basis accounting for around 1–2 percent of GDP throughout the programmed period. Netting out operations are envisaged to be totally phased out.

Further improvements in revenue collection are foreseen through improvements in the efficiency of the tax administration. A sustained effort will be made throughout the period to further consolidate non-priority government expenditures, while improving the efficiency and targeting of the expenditure program in line with the government's fiscal reform and poverty alleviation program.

9. Monetary policy will remain tight. Reserve money is programmed to increase at slightly over the rate of growth of prices, allowing for a slight increase in money demand over the period. The government's prudent monetary and fiscal stance will allow the continuation of the increase in credit to the economy's private sector. The exchange rate will continue to reflect market conditions, with intervention in the foreign exchange market limited to smoothing-out short run fluctuations. Gross international reserves are programmed to increase throughout the period reaching the equivalent of over 3 months coverage of imports by the end of the current year.

10. The Government is of the view that the maintenance of Moldova's open and liberal trade regime is essential for encouraging investment and facilitating the country's export-led growth and poverty reduction strategy. The Government will refrain from increasing import tariffs and intensifying trade restrictions. The current account deficit will remain modest, averaging around 5 percent of Moldova's GDP throughout the programmed period, and following a downward trend reflecting efficiency gains in energy consumption and robust export growth. The deficit will be financed in part through foreign direct investment inflows tied to privatization and other investment projects.

11. Moldova's debt service obligations represent a significant burden on current operations and severely limit the resources available for the Government's targeted poverty alleviation programme. The government is well aware of the need to reduce the stock of debt and the debt-service burden, especially over the short to medium term. The Government intends to earmark a part of privatization receipts for debt servicing or use them to retire debt. Efforts have and will continue to be made to initiate and/or complete rescheduling discussions with creditors.

12. Underpinning the above macroeconomic policy, the Government is of the view that structural reforms are necessary in order to ensure the economy's growth and development in the medium term. It, therefore, remains committed to further progress in its structural reform program, which will be fully reflected in the full PRSP and related sectoral reform strategies.

### Monitoring indicators

	1993	1994	1995	1996	1997	1998	1999	2000	2001
General economic development indicators									
GDP per Capita (US\$)	348.1	323.3	400.5	470.5	527.9	464.9	321.4	354.0	406.7
Average monthly salary (US\$)		26.6	31.8	40.7	47.6	46.5	28.8	32.7	40.3
Annual GDP growth rate (percent)	-1.2	-30.9	-1.4	-5.9	1.6	-6.5	-3.4	2.1	6.1
Agricultural growth rate (percent)		-25.0	1.9	-11.9	11.4	-11.6	-8.4	-3.3	4.0
Industrial growth rate (percent)		-27.8	-3.9	-6.5	0	-15	-11.6	7.7	14.2
Rate of inflation, end of year (percent)	1702	104.6	23.8	15.1	11.1	18.2	43.7	18.5	6.3
Current account deficit (percent of GDP)		-7.9	-6.6	-11.3	-14.2	-19.7	-4.4	-9.8	
Gross reserves (months of import coverage)		2.9	3.1	3.0	3.1	1.4	2.9	2.7	2.8
Debt/GDP ratio (percent)	20.4	43.6	46.4	48.7	55.6	64.5	91.2	89.8	
<b>Social indicators</b>									
Average pension (lei)		55.2	64.3	78.7	82.8	83.9	82.8	85.1	135.8
Number of registered unemployed (thous)	14.1	20.5	24.5	23.4	28	32	34.9	28.9	27.6
<b>Health and fertility indicators</b>									
Male life expectancy at birth (years)	63.9	62.3	61.8	62.9	62.9	64	63.7	63.9	
Female life expectancy at birth (years)	70.9	69.8	69.7	70.4	70.3	71.4	71	71.2	
Crude death rate (per 1000)	10.7	11.8	12.2	11.5	11.8	10.9	11.3	11.3	11.0
Natural increase (per 1000)	4.5	2.5	0.8	0.5	0.7	0.4	-0.7	-1.1	-1.0

	1993	1994	1995	1996	1997	1998	1999	2000	2001
Fertility rate (births per woman)	2.1	1.95	1.76	1.6	1.66	1.49	1.37	1.29	
Infant mortality rate (per 1000 births)	21.5	22.6	21.2	20.2	19.8	17.5	18.2	18.3	16.3
Maternal mortality rate (per 100,000 births)	51.8	25.8	40.8	40.2	48.3	36.3	28.6	27.1	
Under-five mortality rate	27.6	28.8	27.4	26.2	25.9	22.9	23.9	23.3	
Immunization rate— diphtheria, pertussis, tetanus (percent of children under 2)	85.2	92	97	97.7	98	97.4	97.4	96.0	
Immunization rate—polio (percent of children under 2)	91.8	94	97	98.6	98.4	97.6	98.2	97.2	
Immunization rate—measles (percent of children under 2)	92	95	98	98.4	98.9	99.2	98.8	98.6	
Physicians (number per 10,000 population)	37.9	38	37.1	37.5	37.4	37.6	33.7	35.6	35.3
Nurses (number per 10,000 population)	107.2	104	99	95.1	93	89.5	79.1	80.5	76.0
Number of beds (per 10000 population)		122.3	122.3	121.4	116.4	112.4	82.0	76.0	69.0
Health expenditures as share in GDP (percent)		6.22	5.79	6.68	6.02	4.31	2.91	2.95	2.85
<b>Education indicators</b>									
Basic education enrolment rate (percent)	93.7	92.3	93.1	92.7	92.5	92.7	95.4	96.6	96.5
General secondary education enrolment rate (percent)	24.8	25.3	25.6	27.3	29.3	31.7	28.8	30.5	33.6
Higher secondary and professional education enrolment rate (percent)	48.5	47.7	44.6	45.4	46.2	48.3	39.7	41.1	44.4
Pupil-teacher ratio in basic education	12.5	18.1	18.7	19.2	19.2	19.3	20.9	20.8	19.9
Education expenditures as share in GDP (percent)		8.75	8.89	10.25	9.97	7.02	4.67	4.50	4.86
<b>Poverty indicators</b>									
Gini coefficient	0.36	0.379	0.39		0.44	0.44	0.44	0.42	0.43

	1993	1994	1995	1996	1997	1998	1999	2000	2001
Human development index	0.718	0.709	0.689	0.696	0.699	0.702	0.698	0.700	
Head Count Ratio of Poverty (percent)					25.33	25.70	25.49	22.83	
Poverty Gap (percent)					8.22	8.06	7.41	6.13	
Severity of poverty (percent)					3.96	3.67	3.17	2.5	

#### EXPLANATORY NOTE ON CALCULATION OF POVERTY INDICATORS

13. The recent analysis of the poverty evolution in the Republic of Moldova was based on the absolute poverty line. The equivalent of 30 per cent of the existence minimum was used in the Republic of Moldova as an unofficial poverty line since 1997. This level was used for a number of research projects as well as in the elaboration of the National Poverty Alleviation Program (approved by the Government decision of July 14, 2000).

14. In the table above, the equivalent of 50 per cent of average consumption expenditures was used as the **poverty line** for the identification of poverty and the analysis of its profile. This amounted to lei 89.87 lei in 1997, lei 83.52 in 1998, lei 92.61 in 1999, and lei 125.34 in 2000. These indicators were calculated in the basis of the Household Budget Survey compiled quarterly from the second quarter of 1997 onwards.

15. The **equivalence scales** used for calculating the relative poverty line follow the “old” OECD equivalence scale by assigning the value of 1.0 to the head of the household, the value 0.7 to an adult in the household, and the value 0.5 to children in the household.

16. The **Poverty Gap** indicator was calculated according the calculation method of Foster, James., J. Greer, E. Thorbecke.

The Plan for Developing Poverty Reduction Strategy Paper (PRSP) April 2002–March 2003

Nr.	Objective	IV. ACTIONS AND ACTIVITIES	Participants	Deadline
1.	Identify the mechanism for managing the process of PRSP development	(i) Setting up the Council of Experts under Coordinating Council responsible for coordinating participatory process (ii) Setting up sector groups of experts (iii) Organizing the Forum of experts community and signing the Memorandum between the participants thereof (iv) Disseminating information among participants and facilitating the efficient exchange of opinions and comments	Coordinating Council, Secretariat Council of Experts Council of Experts Mass-media Group	June 2002 June 2002 July 2002 July 2002
2.	Providing informational basis for targeted poverty reduction and monitoring this process, as well as developing sector strategies	(i) Developing the plan for information gathering necessary for poverty assessment and monitoring and for the development of sector strategies (ii) Updating poverty characterizing indexes, developing the “picture” of poverty in the Republic of Moldova (iii) Assessing the current analytical researches and identifying additionally required researches for poverty assessment, including in the area of social protection, human development, healthcare, education, agriculture, labor market, etc. (iv) Improving the household budget survey (as well as other components of poverty monitoring as necessary) as an instrument of poverty assessment and monitoring in consultations with the related ministries. (v) Assessing the impact of the national policies on the level of poverty, estimating the efficiency of using public funds allocated for poverty reduction	Sector groups within the Technical Committee, including the Poverty Assessment and Monitoring Group Poverty Assessment and Monitoring Group Sector groups within the Technical Committee, including the Poverty Assessment and Monitoring Group Poverty Assessment and Monitoring Group (Department of Statistics) Sector groups within the Technical Committee, Poverty Assessment and Monitoring Group	May 2002 June 2002 May 2002 May 2002 June 2002 November 2002 June 2002



	(vi) Completing the social assistance beneficiary database	Ministry of Labour and Social Protection	2002-2005
	(vii) Organizing a seminar on nation-wide dissemination of information about the results of poverty assessment	Mass-media Group	June 2002
3.	Developing the medium-term expenditure framework in line with the drafted sector strategies	<b>(i) Approval of the updated I-PRSP</b>	<b>APRIL 2002</b>
		(ii) Publicizing the updated I-PRSP	June 2002
		(iii) Developing the medium term expenditure framework for 2004 – 2006	March 2003
		<b>(iv) Developing PRSP preliminary sector strategies</b>	July 2002
		(v) Holding negotiations with donors on financing priority projects	SEPTEMBER 2002
4.	Finalizing PRSP	<b>(i) Discussing sector strategies in the context of participatory process framework</b>	<b>August-September 2002</b>
		(ii) Assessing, analysing and synthesizing sector strategies, information obtained during consultations with the participants to PRSP development, submitting the aforementioned information to the Coordinating Committee	November 2002
		<b>(iii) Finalizing and approval of PRSP</b>	<b>March 2003</b>