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Republic of Moldova: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

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The following item is a Letter of Intent of the government of Republic of Moldova, which describes the policies that Republic of Moldova intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Republic of Moldova, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

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June 25, 2007

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
700 19th Street NW
Washington, DC 20431 USA

Dear Mr. de Rato:

The attached Memorandum is an update to the previous version of the Memorandum of Economic and Financial Policies (MEFP) for 2007. It describes policies and measures we intend to implement this year and for which we request the support of the International Monetary Fund under the three-year Poverty Reduction and Growth Facility (PRGF). These policies are consistent with our Economic Growth and Poverty Reduction Strategy (EGPRSP) as well as with the action plan agreed between the European Union and the Republic of Moldova.

Now that the external shocks have receded, the government and the National Bank believe that all efforts should focus on the core goals of the program, which are to promote sustainable growth and reduce poverty. To this end, the policies set forth in the attached memorandum aim at ensuring macroeconomic stability and financial sector development, and improving the business environment, including through reduction of the footprint of the state in the economy. In addition, in consultation with the Fund, we will take additional measures that may become appropriate for reaching these objectives.

We hereby request completion of the second review under the PRGF arrangement, and we also request a waiver for nonobservance of the performance criterion on raising heating tariffs in Chişinău to 55 percent of cost-recovery at end-December 2006. This non-observance was technical as tariffs were increased on January 25 with the retroactive effect to January 1. Tariffs for water were raised as of February 1, though the financial impact of this delay was small. We also regret that an indicative ceiling on non-accumulation of domestic arrears was breached at end-March 2007 as the Chişinău city council delayed payment of the subsidy to compensate households for the increased heating costs. This non-payment was also technical in nature as the decision to subsidize households came in when the municipal budget had already been long approved and thus did not contain the necessary allocation. The problem will be corrected at the first opportunity when the municipal budget is revised during the summer.

We will communicate to the IMF the information needed to monitor progress in implementing the program, and will conduct discussions with the Fund for the third review under the PRGF arrangement before end-December 2007.

We are committed to transparency, and thus we authorize the IMF to disseminate the MEFP and the associated Technical Memorandum of Understanding, as well as staff report that will be examined by the IMF Executive Board.

Sincerely yours

_____/s/
Vasile Tarlev
Prime Minister
Government of the Republic of Moldova

_____/s/
Mihail Pop
Minister
Ministry of Finance

_____/s/
Leonid Talmaci
Governor
National Bank of Moldova

Updated Memorandum of Economic and Financial Policies for 2007

25 June 2007

A. Introduction

1. The present Memorandum is an updated version of the Memorandum of Economic and Financial Policies for 2007, and it summarizes our current view on the strategic objectives and priorities of the Republic of Moldova for the current year. Now that we have passed through the most difficult period of adjusting to the external shocks—including with the help of the international community, which supported our reform efforts at a Consultative Group meeting in Brussels in December—our central objective for 2007 is to ensure that the key goals and priorities of the three-year PRGF-supported program are achieved.
2. Economic performance in 2006 was influenced by a number of external factors, in particular the disruption of exports to the Russian Federation and a doubling in the price of energy imports. At 4 percent, real economic growth was weaker than in recent years. The trade deficit rose by 36.7 percent as import growth was strong and exports fell because of the Russian ban on imports of Moldovan wine, as well as difficulties in penetrating new export markets. Similarly, the 14.1 percent inflation outcome for 2006, significantly higher than in 2005, largely stemmed from accommodating higher prices of imported energy resources.
3. The economic outlook has improved recently, as some progress has been achieved in restoring economic relations with the Russian Federation. In particular, we have secured a medium-term agreement for the supply of natural gas, and settled on a framework to facilitate the resumption of wine exports. Although exports to the Russian Federation decreased by 47.6 percent in 2006, some progress was registered in diversifying exports, with sales to Central and Eastern Europe rising by 43.1 percent and by 13.6 percent to the countries of the European Union as well as to some countries of the CIS. As a result of the efforts of the National Bank of Moldova (NBM) in sterilizing excessive liquidity in the market, supported by limiting the fiscal deficit to lei 126.1 million (0.3 percent of GDP) in 2006, inflation fell to 11.2 percent by March 2007, and cumulative inflation during the first quarter of 2007 was 2.1 percent compared with 4.8 percent during the same period of the previous year.

B. Program Performance

4. With a few exceptions, the government and the NBM have implemented the actions included in the November 29, 2006, Memorandum on Economic and Financial Policies (MEFP). In particular, by March 31, 2007:
 - a. The parliament of the Republic of Moldova approved a law according to which local public authorities, including the Municipal Council of the City of Chisinau, are obliged to set tariffs for communal services on supply of heat and drinking water in

line with the methodology approved by the National Energy Regulatory Agency (ANRE).

- b. In line with the new law, the Municipal Council of the City of Chisinau approved new tariffs for communal services on the supply of heating equal to 100 percent of the cost recovery. Given that the development of a targeted social assistance system has been delayed, the municipal budget is temporarily covering the cost of the increase for households; tariffs for enterprises and budget sector institutions are not compensated. Thus, the weighted average tariff at the end of 2006 was 59.5 percent, exceeding the 55 percent threshold identified in the program. The tariffs for supply of drinking water remain differentiated for households and enterprises, with the weighted average tariff constituting almost 70 percent of cost recovery. The municipality will compensate the increase of tariff for the supply of drinking water only to some vulnerable categories of population (such as pensioners).
- c. The ministry of finance is actively seeking the assistance of the International Finance Corporation in preparing Banca de Economii (BEM) for privatization, the timetable for which shall be determined upon completion of the evaluation to be conducted in 2007. Moreover, a winner of the tender to conduct this evaluation was announced on 29 December 2006.
- d. The ministry of social protection, family, and children and the National Social Insurance House—in coordination with the ministry of finance, ministry of economy and trade and Main State Tax Inspectorate—have approved an action plan meant to ensure medium-term financial stability of the state social insurance budget.
- e. Pursuant to the law No. 223-XVI dated July 14, 2006 amending the law of insolvency, the Council of Creditors ceased its activity on September 30, 2006 and was subsequently dissolved on December 31, 2006. Thereafter, the responsibility for monitoring tax and non-tax liabilities was entrusted to the State Tax Inspectorate as well as to the courts.
- f. By the end of 2006, the second—“vertical”—stage of the functional analysis of subordinated institutions and some deconcentrated services was conducted under the central public administration reform. This analysis covered the lower level units of central agencies that had been analyzed during the first stage of the reform, as well as some that had not been covered by that analysis.
- g. Financial relations between the National Bank of Moldova and the ministry of finance were upgraded by the signing on December 12, 2006 of an agreement on payment for rendering services to the ministry of finance by the National Bank of Moldova, and on the payment of market-related interest rates on government deposits held in the Treasury account in the NBM.
- h. On December 7, 2006, the parliament of the Republic of Moldova approved the law No. 382-XVI amending the law of the National Bank of Moldova to stipulate that the

capital of the NBM will grow dynamically with the size of the bank's balance sheet, either through the retention of profit or through contributions made by the government of the Republic of Moldova. In particular, the capital of the NBM should equal 10 percent of the monetary liabilities of the NBM (except for the liabilities to the government of the Republic of Moldova and to the International Monetary Fund), while up to 50 percent of the NBM's net profit can be retained by the NBM. To ensure that the target level of capital was reached at end-2006, the government injected lei 250 million to the charter capital of the National Bank of Moldova, directly from the state budget.

- i. A supervisory board was established on April 2, 2007 to oversee our tax administration reform strategy. The board comprises representatives of the Main State Tax Inspectorate, ministry of finance, ministry of economy and trade, ministry of informational development, government office and representatives of professional and public associations. At the same time, the State Tax Inspectorate has set up a working group to manage the reform and coordinate activities with foreign donors.
- j. In December 2006, the parliament approved the new law on public debt, state guarantees and state on-lending.

Implementation of three program measures was delayed, relative to the program timetable. These measures have now been or will shortly be completed.

- On May 4, 2007, the parliament of the Republic of Moldova adopted a law on denationalization and management of public property. This law is intended to reinvigorate the privatization process and improve management of public property. In particular, the new law includes a negative list of assets, which for now are not subject to privatization; all other state assets can be sold. In addition, on the basis of this law the government has produced a list of regulatory acts to be drafted and implemented in the field of managing state assets.
- The draft law on public functions and the statute of civil servants will shortly be submitted to parliament by June 11. Submission of the draft law was delayed to permit incorporation of the recommendations of experts from OECD-SIGMA. It envisages (i) establishing a central administrative body responsible for managing personnel recruited for civil service; (ii) recruiting and promoting in civil service on the basis of merit; and (iii) separating political from administrative functions.
- On June 7, 2007, the parliament of the Republic of Moldova adopted a set of legislative acts creating the National Commission for the Financial Markets (NCFM), which will combine functions currently exercised by the authorities supervising the securities market, insurance market and nongovernmental pension funds, savings and loan associations, credit history bureaus, and mortgage companies. The competencies of the newly created supervisory authority for the nonbank financial sector will not include the banking system, which will continue to be supervised by the National Bank of Moldova. Initially, the law gives the NCFM the right to suspend licenses

held by non-bank financial institutions and stipulates that the validity of licenses cannot be restored without the consent of the NCFM. By the end of September 2008, the NCFM shall become the sole authority vested with the right to issue and revoke licenses for enterprises rendering financial non-banking services.

C. Program Objectives

5. Despite the persistent effects of the external shocks encountered last year, the key objectives pursued by the government for 2007 remained unchanged. Our goal is to reduce poverty by ensuring macroeconomic stability and sustainable economic growth, and we hope to achieve this by limiting government involvement in the economy, developing the financial sector, creating a favorable investment environment, stimulating the development of small and medium-sized business, rehabilitating infrastructure, promoting exports, creating new jobs in the country and granting social protection to vulnerable categories of population. These objectives, which include achieving the Millennium Development Goals, are clearly stated in the Economic Growth and Poverty Reduction Strategy Paper (EGPRSP), implementation of which shall continue through 2007, and in the EU-Republic of Moldova Action Plan.

6. While the EGPRSP will extend through 2007, beyond that the objectives of the government will be outlined in the National Development Plan for 2008–11 (NDP), which is now in preparation. The government's intention is to focus on the short list of strategic priorities, both economic and political. In the draft NDP that will be discussed within the participatory process, the five fundamental priorities are as follows:

- Consolidating a modern democratic state based on the principle of the rule of law;
- Settling the Transnistrian conflict and promoting reintegration of the country;
- Enhancing the competitiveness of the national economy;
- Developing human resources, promoting employment and facilitating social inclusion; and
- Promoting regional development.

One of the objectives of the NDP is the integration of key external commitments of the Republic of Moldova into one basic strategy (without replacing agreed bilateral policy documents) and establishing a single system of monitoring implementation of these commitments.

D. Fiscal Policy

7. Fiscal policy for 2007 shall remain tight, given continued high inflation and the need to ensure macroeconomic stability and to foster confidence of the population in the program more broadly. In this context, the government will maintain the budget deficit at 0.5 percent of GDP.

8. For many years, budget sector wages have been insufficient to attract and retain qualified employees, many of whom have opted instead to work abroad. Thus, wages in the budget sector are to be increased, on average, by 12 percent in 2007 and by 23 percent in 2008, following a significant (45 percent) increase in 2006. To finance the increase, we will set the size of the general government wage bill at about 10 percent of GDP. Further, the government intends to begin a medium-term program of public employment rationalization. By end-September 2007, we will prepare a multi-year concept paper, the goal of which is to attract and retain the best performing and most promising staff. The concept paper will include plans for a census of budget sector workers, an inventory of their wage and nonwage remuneration, and an assessment of sectoral needs for highly qualified staff. Although we will carry it out on our own if necessary, we hope to secure the support of international development partners in this work, both on an analytical level and—if possible—in terms of financial support to facilitate the reform.

9. To promote investment, both foreign and domestic, we have announced a major reform of corporate income taxation, as well as a wide-ranging amnesty of tax arrears and a liberalization of the rules governing legalization of capital. Corporate income tax rates will be set to zero, except when dividends are paid and non-business expenses are incurred, and all pre-2007 tax arrears (and associated fines and penalties not paid at the time the law goes into effect) will be cancelled. We understand that these reforms entail some risks, particularly to budget revenue, so we are prepared if necessary to take compensating measures to ensure that the fiscal and macroeconomic targets in the program will be achieved. With the aim of ensuring that the tax amnesty occurs only once, we intend to accelerate implementation of our strategy to strengthen tax administration. Thus, by end-September 2007, we will adopt an action plan to improve the system of tax arrears management, which would involve enhancing the tax arrears accounting system to permit distinction of arrears on the basis of vintage, introducing prompt and unconditional measures to ensure forced collection of arrears, passing legislation for shortening and streamlining the procedure for writing off uncollectible tax arrears, and consolidating all domestic tax assessing and collecting activities in one agency. We expect this plan to be implemented by March 31, 2008. Finally, we recognize that the capital legalization could pose some risk for our anti-money laundering (AML) regime, so we intend to accelerate the adoption of amendments to the AML law (prepared with assistance from the IMF and other partners), and will discuss the implications of the capital legalization with MONEYVAL and key bilateral partners.

10. The government continues to view reducing Moldova's vulnerability to international energy price changes as a key priority. Therefore, the authorities will continue to ensure that tariffs for natural gas and electricity remain at full cost recovery for all categories of consumer. Further, we will gradually move to increase tariffs for heat and water to full cost recovery, while also improving the targeting of social assistance to ensure that poor households do not suffer unduly in the adjustment process. Specifically, we will adopt the methodology for our targeted social assistance system by September 30, 2007, and introduce it throughout Moldova by September 30, 2008. Insofar as enterprises and public sector institutions currently pay a full cost-recovery tariff, the tariff paid by households will be increased sufficiently to reach a weighted average tariff paid by all categories of consumer of heat in Chişinău equal to 70 percent of cost recovery by September 30, 2007. In accordance

with the decision of the municipal council Nr.64/2 from January 25, 2007, the difference between the amount paid by households and the cost recovery tariff will be covered from the municipal budget. Finally, we will amend the law to ensure that the regulatory authority (ANRE) establishes tariffs for heat and water directly, rather than indirectly through the municipality as at present.

E. Monetary and Financial Policies

11. During the balance of 2007, the National Bank of Moldova will continue to maintain a tight and prudent monetary policy with the aim of achieving a single-digit level of inflation. The program envisages that the monetary base will increase by 14.3 percent over the year to end-December, while interest rates will remain positive in real terms. This objective will be achieved by applying indirect instruments of monetary policy, and will be facilitated by the strengthened capital position of the NBM, as well as by the transfer of remaining deposits of the health and social funds to the single treasury account in the NBM.

12. The priority objective of our monetary policy is to ensure price stability. Thus, the National Bank of Moldova will continue to maintain a floating exchange rate and will intervene on the foreign exchange market mainly to smooth out volatility in the exchange rate, which we expect will permit an increase in international reserves to a level equivalent to almost three months of prospective imports.

13. We are considering the possibility of moving to an inflation targeting (IT) framework at an appropriate point in the future. Although we realize that Moldova is not yet prepared to move to inflation targeting, we are taking a number of intermediate steps to improve the monetary policy framework, and thus to lay the groundwork for IT in the future. In this context, when carrying out sterilization of excessive liquidity, the NBM will announce either a maximum interest rate, or the volume of intended sales. Further, beginning with the 2008 budget, the law on the budget will not oblige the NBM to roll over treasury bills; instead, coordination of monetary and fiscal policy will be handled by the joint NBM-Ministry of Finance liquidity managing committee. Further, in order to ensure that the NBM will have the tools to conduct monetary policy, by September 30, 2007, the ministry of finance and the NBM will adopt a plan for securitizing the stock of government debt owed to the NBM, with the securitization to take place in the first quarter of 2008.

14. After the legislation to establish the National Commission for the Financial Markets (NCFM) is passed, the expectation is that it will begin operations by August 31, 2007, including having the right to suspend the licenses of nonbank institutions in violation of prudential norms (and this suspension may not be revoked without the NCFM's approval). The legislation specifies that the NCFM will be financially and operationally independent, and that, once it reaches its full operational capacity—but not later than September 30, 2008—it will fully acquire the right to issue and revoke licenses for all types of supervised non-banking financial activity.

15. We are committed to privatize BEM to a strategic banking investor following completion of the market valuation to be completed by year-end, and possibly by September

30, 2007. Further, we have solicited the assistance of the International Financial Corporation in preparing to bring BEM to market shortly after completion of evaluation. In the meantime, the government and the NBM will continue to abstain from granting preferential treatment to the bank, including as regards taxation, prudential regulation or access to resources.

16. We have solicited an update under the Financial Sector Assessment Program (FSAP) in order to assess our progress in improving prudential regulation, transparency in ownership of the banking sector, and supervision of the nonbank financial sector. It is hoped the FSAP update will take place in the second half of 2007.

F. Structural Reforms

17. The external shocks faced by Moldova in 2006 highlighted the need to accelerate structural reforms to facilitate resumption of rapid economic growth. As a consequence, during the balance of 2007 and over the medium term, we intend to take significant measures to make the public sector more efficient and to improve the business environment. We will pay special attention to measures aimed at promoting exports and diversifying export markets.

Trade policy and promotion of investments

18. The government is implementing its strategy for attracting investment and promoting exports during 2006–15. During 2007, the key priorities include (i) obtaining autonomous trade preferences from the EU; (ii) conducting a detailed study of the economic implications for Moldova stemming from Romania's accession to the EU; (iii) creating in 2008 accredited laboratories for testing and ensuring quality of a number of Moldovan products (starting with wine and expanding it onto other farm products) in compliance with the European standards; (iv) implementing reform on granting entrepreneurial permits; and (v) establishing simplified methods of accounting for small and medium-sized enterprises.

19. The government has also prepared a concept paper on public-private partnerships (PPP), which will offer a wide spectrum of instruments and mechanisms for cooperation and interaction between the public and private sectors to increase infrastructure investment. The concept paper envisages that contingent liabilities that could appear in this process will be transparently reported to the financial market as well as to the parliament. In this connection, once the law is passed, we intend to consult with the staff of the IMF before concluding any significant PPP agreements. In this context, we will also consult with the staff of the IMF prior to entering into the second phases of the EBRD loan agreement and the EIB loan agreement for the road rehabilitation project (in the amount of €17.5 million each) to ensure that grant financing is obtained sufficient to ensure that the level of concessionality on these phases reaches the target of at least 35 percent.

20. Development of small and medium-sized business is one of the key elements that will contribute to economic growth and poverty reduction in Moldova. Thus, during 2007 we will implement our Strategy for developing small and medium-sized business, as well as the law of granting support to small and medium-sized enterprises.

Public administration reform

21. We have completed a functional analysis of all levels of central public administration, and based on these results and recommendations, during 2007–08 we plan to i) approve the finalized mandate of these institutions, and ii) amend their regulations with the aim of reassigning their tasks and responsibilities. A policy analysis and coordination unit will be set up to coordinate policies within the government office and, based on an evaluation of experience gained by the pilot units created in seven ministries, policy analysis, monitoring and evaluation units might be set up in the remaining ministries. Finally, the government intends to create a unit at the central level authorized to improve human resource management policies and procedures in the civil service.

Regulatory reform

22. The second stage of the regulatory reform will continue in 2007, including revising the legislative framework in compliance with the law on basic principles and mechanisms of regulating entrepreneurial activity. The government will implement the National Strategy of Regulatory Reform, including by regularizing the system of granting entrepreneurial permits. Similarly, elements of the “one-stop shop” approach will be introduced into the activity of public authorities, including through the electronic exchange of data. The regulatory impact assessment (RIA) methodology will be introduced as well to limit excessive state intervention in the economy.

23. The government will continue efforts to improve and facilitate insolvency and bankruptcy procedures. In this context, we intend to adopt measures to simplify and reduce the time necessary to liquidate a business, including once again the “one-stop shop” principle.

Public finance management

24. The government will further improve public finance management by reforming budgetary institutions and aligning the legislative framework with EU requirements and standards. During 2007, the ministry of finance jointly with the National Social Insurance House and the National Health Insurance Company will develop (and by June 30, 2008 implement) a system to manage the state social insurance budget (BASS) as well as that of the mandatory health insurance fund through the State Treasury, which shall ensure zero balance on the accounts of the commercial banks at the close of every business day. While working out the state budget for 2008 the government intends to continue eliminating special funds.

25. Simultaneously with preparing the 2008 draft budget law the government, as part of budgetary documentation, will submit information on the financial performances for 2006 of state-owned enterprises and joint stock companies in which the state is holding a majority stake.

Table 1. Prior Actions, Performance Criteria and Benchmarks¹

Prior Actions

Parliamentary passage of law on NCFM establishing that, until the NCFM is fully operational, the NCFM has the right to suspend licenses of nonbank financial institutions it supervises on grounds of violation of prudential norms, and that the suspension of these licenses cannot be revoked unless NCFM agrees that prudential regulations are being met. The law will also specify that the NCFM will become fully operational no later than September 30, 2008, by which time it will fully acquire the right to issue and revoke licenses. (¶ 14)

Parliamentary passage of the law on divestiture and management of state assets. (¶ 4)

Structural Performance Criteria*Continuous*

Neither the government nor the NBM will provide preferential treatment to Banca de Economii (including tax treatment, prudential regulation and access to resources). (¶ 15)

August 31, 2007

As a follow-up to the measures taken under the prior action, implementation of all actions necessary to establish the NCFM, including the appointment of a chairman, and to grant the NCFM the operational ability to suspend licenses of nonbank financial institutions in violation of prudential norms. (¶ 14)

September 30, 2007

Government adoption of a medium-term concept paper on rationalization of public employment consistent with the aim of limiting the general government wage bill to no more than 10 percent of GDP. (¶ 8)

Adoption of an action plan to improve tax arrears management which we expect to implement by March 31, 2008, and which would involve enhancing a tax arrears accounting system to permit distinction of arrears on the basis of vintage, introducing prompt and unconditional measures to ensure forced collection of arrears, passing legislation for

¹ All conditions agreed in the MEFPs of April 14 and November 29, 2006, retain force, except as modified here.

shortening and streamlining the procedure for writing off uncollectible tax arrears, and consolidating all domestic tax assessing and collecting activities in one agency. (¶ 9)

Structural Benchmarks

Continuous

Tariffs for consumption of natural gas and electricity to remain at cost-recovery levels. (¶ 10)

September 30, 2007

Draft 2008 budgetary documentation to include information on the financial performances for 2006 of state-owned enterprises and joint stock companies in which the state is holding a majority stake. (¶ 25)

The ministry of finance and the NBM to adopt a plan to securitize the remaining outstanding stock of NBM claims on government. (¶ 13)

Government will adopt the methodology for a targeted social assistance system. (¶ 10)

Parliamentary passage of legislation ensuring that ANRE establishes tariffs for heat and water directly, rather than indirectly through the municipality as at present. (¶ 10)

Increase household tariffs for heat and water sufficiently to reach a weighted average tariff paid by all categories of consumer of heat in Chişinău equal to 70 percent of cost recovery. (¶ 10)

In accordance with the decision of the municipal council Nr.64/2 from January 25, 2007, the difference between the amount paid by households and the cost recovery tariff to be covered from the municipal budget. (¶ 10)

December 31, 2007

Transfer of balances on accounts of Social Fund and Health Fund to Single Treasury Account in NBM. (¶ 11)

March 31, 2008

Outstanding stock of NBM claims on government fully securitized. (¶ 13)

Implementation of the system to modernize tax arrears management, including an enhanced tax arrears accounting system to permit distinction of arrears on the basis of vintage, introducing prompt and unconditional measures to ensure forced collection of arrears, passing legislation for shortening and streamlining the procedure for writing off uncollectible tax arrears, and consolidation of all tax assessing and collecting activities in one agency. (¶ 9)

June 30, 2008

Introduction of a system whereby the State Treasury ensures that the balances in commercial banks of the social insurance budget (BASS) and the mandatory health insurance fund are zero-ed out on a daily basis. (¶ 24)

September 30, 2008

Introduce the targeted social assistance system throughout Moldova. (¶ 10)

TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This Technical Memorandum of understanding (TMU) defines the variables subject to quantitative targets (performance criteria and indicative benchmarks as shown in Table 1), established in the Memorandum of Economic and Financial Policies (MEFP) and describes the methods to be used in assessing the program performance with respect to these targets.

I. PROGRAM ASSUMPTIONS

2007

2. Loan disbursements of \$59.1 million.
3. Receipts to the general government budget of privatization proceeds in the amount of MDL 235 million in 2007.
4. For program monitoring purposes, U.S. dollar denominated components of the NBM balance sheet will be valued at the program exchange rate. The program exchange rate of the Moldovan leu (MDL) to the U.S. dollar has been set at MDL 13.2911/\$. Amounts denominated in other currencies will be converted for program purposes into U.S. dollar amounts using the cross rates USD/€ = 1.2660, USD/£ = 1.8702, SDR/USD = 0.6773.
5. To calculate the adjustments for disbursements from external sources exceeding the programmed amounts, the actual exchange rate at the time of the disbursement will be used. To calculate the adjustments for shortfalls of disbursement, the assumed exchange rate in the program for that disbursement will be used.

II. REPORTING REQUIREMENTS

6. Macroeconomic data necessary to assess performance criteria and indicative benchmarks to measure performance will be provided to Fund staff with including, but not limited to data as specified in Table 2. The authorities will transmit promptly to Fund staff any data revisions.

III. PROGRAM TARGETS AND DEFINITIONS

Floor on the Stock of Net International Reserves (NIR)

(In millions of lei)

Position on	Minimum Levels Net international reserves
March 31, 2007	8,500 (actual)
June 30, 2007	9,483 (indicative target)
September 30, 2007	9,830 (performance criterion)
December 31, 2007	10,705 (indicative target)

7. **Net international reserves of the NBM** in convertible currencies are defined as gross reserves minus reserve liabilities in convertible currencies. For program monitoring purposes, gross reserves of the NBM are defined as monetary gold, holdings of SDRs, reserve position in the Fund, and holdings of foreign exchange in convertible currencies that are readily available and controlled by the NBM, including holdings of securities denominated in convertible currencies that are freely usable for settlement of international transactions, calculated using program assumptions on bilateral exchange rates. Excluded from reserve assets are capital subscriptions to foreign financial institutions, long-term non-financial assets, funds disbursed by the World Bank or other international institutions assigned for on-lending and project implementation, assets in nonconvertible currencies, and foreign assets pledged as collateral or otherwise encumbered, including claims in foreign exchange arising from transactions in derivative assets (futures, forwards, swaps, and options). Reserve liabilities in convertible currencies are defined as use of Fund credit, and convertible currency liabilities of the NBM to nonresidents with an original maturity of up to and including one year. Excluded from reserve liabilities are liabilities with original maturities longer than one year.

Ceilings on Reserve Money and the Net Domestic Assets (NDA) of the NBM (In millions of lei)

Position on	Maximum level NDA	Maximum level Reserve Money (Indicative target)
March 31, 2007	-2,003 (actual)	6,497 (actual)
June 30, 2007	-2,468 (indicative target)	7,014
September 30, 2007	-2,606 (performance criterion)	7,223
December 31, 2007	-3,261 (indicative target)	7,443

8. **Reserve money** is defined as currency in circulation (outside banks), vault cash of banks, total required reserves, and balances on correspondent accounts of banks in the NBM in lei.

9. **Net domestic assets of the NBM** are defined as the difference between reserve money (defined in paragraph 8) and net foreign assets of the NBM.

10. **Net foreign assets of the NBM** are defined as gross reserves in convertible currencies (defined in paragraph 7) plus foreign assets in nonconvertible currencies, funds disbursed by the World Bank or other international institutions assigned for on-lending and project implementation, and foreign assets pledged as collateral or otherwise encumbered, including claims in foreign exchange arising from transactions in derivative assets, and net other foreign assets, minus foreign exchange liabilities of the NBM to nonresidents.

Floor on the Overall Cash Balance of the General Government
(In millions of lei)

	Cash balance
Cumulative change from December 31, 2006	
March 31, 2007 (performance criterion)	386 (actual)
June 30, 2007 (indicative target)	-248
September 30, 2007 (performance criterion)	-238
December 31, 2007 (indicative target)	-233

11. The **general government** is defined as comprising the central and local government budgets. The central government includes also the Social Insurance Fund, the Health Insurance Fund, special and extrabudgetary funds, and foreign-financed investment projects. The local government includes also special and extrabudgetary funds. The authorities will inform the Fund staff of any new special or extrabudgetary funds that may be created during the program period to carry out operations of a fiscal nature and will ensure that these will be included in the general government. Excluded are any government-owned entities with a separate legal status. Net credit of the banking system to general government is defined as outstanding claims of the banking system on the general government (exclusive of the claims associated with accrued interest, tax and social contribution payments by commercial banks, and foreign financed on-lending by banks), including overdrafts, direct credit and holdings of government securities, less deposits of the general government (excluding accrued interest on government deposits, and including the accounts for foreign-financed investment

projects).¹ The Ministry of Finance will provide data on the holdings of government securities and foreign-financed investment projects.

12. The **quarterly limits on the overall cash deficit of the general government** are cumulative and will be monitored **from the financing side** as the sum of net credit of the banking system to the general government (excluding the change in the stock of government securities issued to recapitalize the central bank), the general government's net placement of securities outside the domestic banking system, other net credit from the domestic non-banking sector to the general government, the general government's receipt of disbursements from external debt² for direct budgetary support and for specific projects minus amortization paid, and privatization proceeds stemming from the sale of the general government's assets, after deduction of the costs directly associated with the sale of these assets.

13. The **quarterly limits on the general government wage bill** are cumulative and measured as the sum of total salaries, bonus payments and other types of remuneration, social security contributions to the National Social Insurance House, and contributions to the National Health Insurance Company paid to all employees in the general government sector as defined in paragraph 11, excluding wages paid to employees of the National Social Insurance House and the National Health Insurance Company. For 2006, the general government wage bill based on such a definition amounted to 4,183 million lei.³

Ceiling on the General Government Wage Bill
(In millions of lei)

	Indicative Target
<hr/>	
Cumulative change from December 31, 2006	
March 31, 2007 (actual)	1,093
June 30, 2007	2,430
September 30, 2007	3,635
December 31, 2007	4,966

¹ For the calculation of the net credit of the banking system to general government the following accounts will be excluded: 1731, 1732, 1733, 1735, 1761, 1762, 1763, 1801, 1802, 1805, 1807, 2711, 2717, 2721, 2727, 2732, 2733, 2796, 2801 and 2802.

² Debt is defined as in footnote 3 in the section on limits on external debt.

³ For the calculation of the total general government wage bill the following accounts for central government, local government, and special funds from the Treasury system in the Ministry of Finance will be used: 111, 112, 1161.

14. **Government securities** in the form of zero-coupon obligations sold at a discount to face value will be treated as financing items in the fiscal accounts, in the amount actually received from buyers. At the time of redemption, the sales value will be recorded as amortization, and the difference between amortization so defined and the face value will be recorded as domestic interest payments.

15. **External-debt limits** apply to the contracting or guaranteeing of (i) short-term non-concessional external debt (with an original maturity of up to and including one year) and (ii) non-concessional medium- and long-term debt with original maturities of more than one year. The limit is zero with the exception of the road project to be partly financed by €30 million from the European Investment Bank (EIB) and by €30 million from the European Bank for Reconstruction and Development (EBRD), as well as for the health project financed by €9 million from the Council of Europe Development Bank (CEB). The first phases of the EBRD and EIB road project (in the amount of €12.5 million each) will not have grant co-financing, but the second phases (in the amount of €17.5 million each) are expected to include grant co-financing sufficient to bring the overall level of concessionality on the second phases of the project to at least the target level of 35 percent. Short-term debt includes all short term obligations, excluding import trade credits. Short-term debt denominated in currencies other than the U.S. dollar shall be valued in U.S. dollars at the exchange rate prevailing at the time of disbursement. Medium- and long-term debt denominated in currencies other than the U.S. dollar shall be valued in U.S. dollars at actual cross-exchange rates.

Ceilings on Contracting or Guaranteeing of Non-concessional External Debt of the General
Government
(In millions of Euro)

	EBRD/EIB Road Rehabilitation	CEB Health	Other
Cumulative change from December 31, 2006			
March 31, 2007 (performance criterion)	0	0	0
June 30, 2007 (indicative target)	60	9	0
September 30, 2007 (performance criterion)	60	9	0
December 31, 2007 (indicative target)	60	9	0

16. The term debt has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), adopted August 24, 2000).⁴ This performance criterion applies not only to debt as defined above, but also to commitments contracted or guaranteed for which value has not been received.

⁴ Debt is defined as a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Arrears,

(continued)

17. For purpose of the program, the **guarantee** of a debt arises from any explicit legal obligation of the government or the NBM or any other agency acting on behalf of the government to service such a debt in the event of nonpayment by the recipient.

18. **Concessional**ity will be calculated using currency-specific discount rates based on the OECD commercial interest reference rates (CIRRs). The ten-year average of CIRRs will be used as the discount rate to assess the concessionality of loans of an original maturity of at least 15 years, and a six-month average of CIRRs will be used to assess the concessionality of loans with original maturities of less than 15 years. To both the ten-year and six-month averages, the following margins will be added: 0.75 percent for repayment periods of less than 15 years; 1 percent for 15–19 years; 1.15 percent for 20–30 years; and 1.25 percent for over 30 years. Under this definition, only loans with a grant element equivalent to 35 percent or more will be excluded from the borrowing limits. The debt limits will not apply to loans classified as international reserve liabilities of the NBM.

19. For the purposes of the program, external payments arrears will consist of all overdue debt-service obligations (i.e. payments of principal or interest) arising in respect of any debt contracted or guaranteed or assumed by the government of the Republic of Moldova, or the NBM, or any agency acting on behalf of the government of the Republic of Moldova. The ceiling on new external payments arrears shall apply on a continuous basis throughout the period of the arrangement. It shall not apply to external payments arrears arising from external debt being renegotiated with external creditors, including Paris Club creditors; and more specifically, to external payments arrears in respect of which a creditor has agreed that no payment needs to be made pending negotiations.

20. Expenditure arrears are defined as the difference between payment obligations due, and actual payments made. They can arise on any expenditure item, including transfers, debt service, wages, pensions, energy payments and goods and services. Expenditure arrears for goods and services to suppliers are defined as obligations to suppliers, which are due but not paid for more than 30 days and are non-disputed. Arrears between the state budget, local government, social and health funds, and all extrabudgetary funds are not counted towards the expenditure arrears' ceiling on the general government.

penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

IV. ADJUSTERS

21. In the event that privatization receipts exceed the program assumptions, the limits on the overall cash deficit of the general government will be increased by the corresponding magnitude up to a cumulative cap of lei 125 million.

22. In case disbursements of external loans exceed the program assumptions, the limits on the overall cash deficit of the general government will be increased by the corresponding magnitude up to a cumulative cap of lei 188 million. In case of shortfalls, the limits will be decreased by the full amount.

23. The limits on the overall cash deficit of the general government will be increased by the amount of paid in cash for recapitalization of the NBM or by the face value of government securities issued for the same purpose.

Table 1. Moldova: Quantitative Performance Criteria and Indicative Targets, December 31, 2006–December 31, 2007 1/ 2/

	31-Dec-06		31-Mar-07		30-Jun-07		30-Sep-07		31-Dec-07	
	Indicative				Indicative		Indicative		Indicative	
	EBS/06/154	Actual	EBS/06/154	Prel.	EBS/06/154	Revised	EBS/06/154	Revised	EBS/06/154	Revised
1. Quantitative performance criteria										
	(In millions of lei unless noted otherwise)									
Floor for general government fiscal balance	-210	...	-144	...	-248	-248	-238	-238	-233	-233
<i>Adjusted floor for general government fiscal balance 3/ 4/</i>	-488	-133	-45	386	...	...	...	...	...	...
Ceiling on net domestic assets of the NBM (level)	-768	-1,728	-997	-2,003	-1,081	-2,468	-1,174	-2,606	-1,535	-3,261
Floor on net international reserves of the NBM (level)	7,380	8,260	7,737	8,500	7,967	9,483	8,207	9,830	8,789	10,705
Ceiling on contracting or guaranteeing of non-concessional external debt of the general government (Euro million) 5/	0	0	0	0	0	69	0	69	0	69
EBRD/EIB road project	...	...	...	...	...	60	...	60	...	60
CEB health loan	...	...	...	...	...	9	...	9	...	9
Other	...	...	...	...	...	0	...	0	...	0
2. Continuous performance criteria										
Ceiling on accumulation of external payment arrears	0	0	0	0	0	0	0	0	0	0
	(In millions of lei)									
3. Indicative targets										
Ceiling on reserve money (level)	6,612	6,512	6,740	6,497	6,886	7,014	7,033	7,223	7,255	7,443
Ceiling on change in domestic expenditure arrears of the general government	0	0	0	161	0	0	0	0	0	0
Ceiling on the general government wage bill	...	4,183	...	1,093	...	2,430	...	3,635	...	4,966
	(In millions of lei, unless noted otherwise)									
4. Baseline assumptions										
Concessional external debt financing	387	410	184	78	319	370	472	491	703	705
in millions of dollars	29	31	13	6	22	30	32	40	46	57
Privatization receipts	28	168	0	67	40	107	80	162	155	235

Sources: Moldovan authorities; and Fund staff estimates.

1/ Numbers for 2007 refer to cumulative flows from end-2006, unless noted otherwise. Quantitative targets are based on the accounting exchange rate of MDL 13.2911/US\$.

2/ All variables are stocks, except general government fiscal balance and concessional external debt borrowing, which are flows.

3/ In case disbursements of external debt exceed the program assumptions, the limits on the overall cash deficit of the general government will be increased by the corresponding amount up to a cumulative cap of MDL 188 million. In the case of shortfalls, the limits will be decreased by the full amount.

4/ In accordance with the TMU, the 2006 deficit limit was increased by MDL 250 mln - by the amount of paid in cash for recapitalization of the NBM.

5/ See MEFP ¶19 and TMU ¶15.

Table 2. Moldova: Data to be Reported to the IMF

Item	Periodicity
Fiscal data (to be provided by the MoF)	
General budget operations for revenues, expenditure and financing (functional and economic).	Monthly, within three weeks of the end of each month
General government wage bill	Monthly, within three weeks of the end of each month
Domestic debt	Monthly, within two weeks of the end of each month
Domestic arrears	Monthly, within three weeks of the end of each month
Privatization receipts received by the budget (in lei and foreign exchange, net of divestiture transactions costs).	Monthly within three weeks of the end of each month
Monetary data (to be provided by the NBM)	
Monetary survey of the NBM	Weekly within one week of the end of each week
Monetary survey for the whole banking system	Weekly within two weeks of the end of each week
Net claims on general government (NBM and commercial banks)	Weekly within two weeks of the end of each week
Financial indicators of commercial banks (from NBM's Banking Supervision)	Monthly within four weeks of the end of each month
Foreign exchange cash flows	Monthly, within two weeks of the end of each month
Foreign exchange operations (NBM data)	Monthly, within two weeks of the end of each month
Foreign exchange market data (volume of trades, interventions, exchange rates)	Daily within 12 hours of the end of each day
NBM's sterilization operations	Weekly within one week of the end of each week
Interbank transactions (volumes, average rates)	Weekly within one week of the end of each week
Balance of Payments (to be provided by the NBM)	
Current and capital account data.	Quarterly within six weeks of the end of each quarter
Transfers/remittances through the banking system	Monthly within six weeks of the end of each month
External debt data (to be provided by MoF)	
Information on all new external loans contracted by the government or government guarantee.	Monthly within three weeks of the end of each month

Item	Periodicity
Total debt service due by creditor, and debt service paid.	Monthly within three weeks of the end of each month
Disbursements of grants and loans by creditor	Monthly, within three weeks of the end of each month
Other data (to be provided by NBS)	
Overall consumer price index.	Monthly within two weeks of the end of each month.
National accounts by sector of production, in nominal and real terms.	Quarterly within three months of the end of each quarter.
Export and import data on value, volume, and unit values, by major categories and countries.	Monthly within two months of the end of each month.