International Monetary Fund

Republic of Moldova and the IMF

Press Release: IMF Executive Board Completes Third Reviews Under the Extended Credit Facility and the Extended Fund Facility Arrangements with Moldova, Approves US$79 Million Disbursement
July 13, 2011

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

June 27, 2011

MOLDOVA: LETTER OF INTENT

Chişinău, June 27, 2011

Mr. John Lipsky
Acting Managing Director
International Monetary Fund
700 19th Street NW
Washington, DC 20431 USA

Dear Mr. Lipsky:

The economic recovery continues to gain strength, bolstered by our IMF-supported stabilization and reform program. Having recovered to its pre-crisis level, real GDP is expected to continue expanding at a healthy rate. Exports are rising much faster than expected, the fiscal adjustment set in the adopted 2011 budget remains on track, and inflation has declined to mid-single digits. Confidence in the financial sector continues to grow, reflected in narrowing interest spreads and acceleration of credit growth. However, unemployment has yet to decline.

The program is on track. All end-March quantitative performance criteria and applicable structural benchmarks were met. Two end-March indicative targets—the ceilings on accumulation of domestic expenditure arrears and on reserve money—were missed, largely due to delayed payment of heating bills by the Chisinau municipality and stronger than expected money demand associated with buoyant economic activity. We will put in place corrective measures to rectify the slippages, and will continue to decisively implement other reforms set forth in our IMF-supported program.

In consideration of our strong record of program implementation, we request the completion of the third reviews of the program supported by the Extended Credit Facility and the Extended Fund Facility arrangements and the associated disbursement of SDR 50 million. The fourth program review, assessing performance based on end-September 2011 performance criteria and relevant structural benchmarks, is envisaged for December 2011.

Going forward, our reforms will continue to focus on improving the well-being of the population and reducing poverty by maintaining macroeconomic stability and re-orienting Moldova's economy toward sustainable export-led growth. In this context, key challenges include the need to move ahead with difficult structural reforms notwithstanding political uncertainties; to reduce the still excessive structural fiscal deficit; to contain the emerging inflation pressures stemming from rising international energy prices and strengthening domestic demand; and to resist the widening of the external imbalances fueled by strong foreign exchange inflows.

We believe that the policies set forth in the attached Supplementary Memorandum of Economic and Financial Policies (SMEFP) are adequate to achieve these objectives but will take any additional measures that may become appropriate for this purpose. We will consult with the IMF on the adoption of such additional measures in advance of revisions to the policies contained in the SMEFP, in accordance with the Fund's policies on such consultation. We will provide the Fund with the information it requests for monitoring progress during program implementation. We will also consult the Fund on our economic policies after the expiration of the arrangement, in line with Fund policies on such consultations, while we have outstanding purchases in the upper credit tranches.

Sincerely yours,

/s/
Vladimir Filat
Prime Minister
Government of the Republic of Moldova

/s/
Valeriu Lazăr
Deputy Prime Minister
Minister of Economy

/s/
Veaceslav Negruţa
Minister of Finance

/s/
Dorin Drăguţanu
Governor
National Bank of Moldova

Attachments: Supplementary Memorandum of Economic and Financial Policies (SMEFP)
Technical Memorandum of Understanding (TMU)

MOLDOVA: SUPPLEMENTARY MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

June 27, 2011

1. The present document supplements and updates the Memoranda of Economic and Financial Policies (MEFPs) signed by the authorities of the Republic of Moldova on January 14, 2010, June 30, 2010, and March 24, 2011. It accounts for recent macroeconomic developments and introduces policy adjustments, as well as additional policies necessary to achieve the objectives of the program. We remain determined to meeting our commitments made previously under the program.

I. MACROECONOMIC DEVELOPMENTS AND OUTLOOK

2. **The economy continues its vigorous recovery.** After reaching 6.9 percent last year, real GDP growth rose further to 8.4 percent in Q1 of 2011. The expansion appears broad-based with key indicators—exports, bank credit, and industrial production—posting strong gains. Improved external environment and brisk expansion of domestic demand, as well as the early fruits of our reform efforts—macroeconomic stability, economic liberalization, and gradual opening of the EU markets—have been driving these positive developments. We expect the economic growth to settle at 5 percent in 2011-12 as the expansion matures.

3. **After some decline, inflation may face pressures from the recent spikes in international energy prices and accelerating domestic demand.** Inflation declined to 5¾ percent in March as wage growth remained moderate and increased remittances and other foreign inflows led to some appreciation of the leu against the U.S. dollar. However, the recent surge in international energy prices, combined with strengthening credit growth, may temporarily push inflation up in the remainder of the year. Barring further shocks, we expect inflation to reach 8 percent by end-2011 before declining to 5¾ percent in 2012.

4. **Continuing expenditure restraint allowed us to meet the first quarter fiscal deficit target comfortably.** Our reform efforts and delays in externally-financed investment projects contained expenditure growth to 3 percent relative to a year ago. Revenue increased by over 9½ percent relative to last year—a pace still somewhat slower than projected nominal GDP growth—mainly owing to underperformance in VAT collection.

5. **At the same time, the current account deficit is widening owing to a combination of external shocks and expanding domestic demand.** Rising international energy prices, combined with brisk growth of demand for consumer and investment goods—in turn fueled by higher remittances, bank credit, and other foreign inflows—are expected to widen the current account deficit from 10¼ percent of GDP in 2010 to 11¼ percent of GDP in 2011. The substantial export growth so far in 2011—over 60 percent relative to last year—has been insufficient to offset the effect of the less buoyant import growth from a larger base. The elevated deficit in 2011 will be largely financed by official assistance, private capital flows, and FDI. We expect that our sustained reform and export

promotion efforts, as well as tailwinds from economic recovery in trading partners and increased access to EU markets, will help narrow the current account deficit to 8 percent of GDP in the medium term.

6. **Having successfully pulled through the difficult times, the financial sector is steadily expanding.** Banks continued to mend their balance sheets by writing off bad loans, thereby reducing the non-performing loans (NPL) ratio from 13.3 percent at end-2010 to 10.6 percent in April 2011. Despite the recent monetary policy tightening, domestic bank credit has been growing quickly, with the fastest expansion observed in the industrial and trade sectors. Meanwhile, loan-deposit interest rate spreads have narrowed, and banks' liquidity and capital buffers remain well above the statutory requirements.

II. MID-TERM REVIEW OF THE PROGRAM

7. **Mid-way through our IMF-supported program, we have overcome the economic crisis and laid the groundwork for robust growth and macroeconomic stability.** Helped by the credible stabilization program, significant liberalization efforts, and improved external environment, output quickly rebounded and reached its pre-crisis level already in 2010. Inflation declined to mid-single digits, the National Bank of Moldova (NBM) rebuilt its international reserves, and a strong fiscal consolidation effort reduced the budget deficit by over 3¾ percent of GDP last year; nevertheless, funds for social assistance increased considerably. In the energy sector, the autonomous regulatory agency (ANRE) brought heating tariffs broadly in line with costs. In the financial sector, new bank resolution and contingency planning frameworks have made the country more resilient to financial sector risks. Alongside, recent regulatory changes aimed at liberalization of trade, simplification of business regulations, and export promotion have been helping the business environment and supporting growth.

8. **Nevertheless, our reform agenda remains unfinished and will require sustained efforts in the period ahead.** As a matter of first priority, we will focus on maintaining macroeconomic stability and continuing on the path of fiscal adjustment. Alongside, we will reform tax policy and tax administration to make them more business-friendly; revamp the debt restructuring framework in the financial sector; implement the critical and long-overdue education and civil service reforms; put an end to current arrears in the energy sector and commence its long-term restructuring; and begin a gradual phasing out of the category-based social assistance scheme in favor of the means-tested one (*Sistemul de ajutor social*) that targets the most vulnerable. To promote investment and exports, we will put a greater emphasis on the scale and quality of public investment, continue to simplify regulations and reduce "red tape", and persist in gaining greater access to the EU and other markets for our exporters.

III. Revised Policy Framework for 2011-12

A. Fiscal Policy

9. **In 2011, we will adhere to the adopted budget and move expeditiously to eliminate domestic expenditure arrears.** Specifically, we remain committed to the budget deficit target of 1.9 percent of GDP and implementation of other policies included in the 2011 budget law (¶¶8-9 of the SMEFP dated March 24, 2011). The recent accumulation of domestic expenditure arrears (MDL 79 million) was primarily caused by under-payment of heating bills by the Chisinau municipality. The municipality has committed to a schedule of payments to eliminate both these and older heating-related arrears by October 1, and will seek to find a durable solution to the problem of current payments in the heating sector in cooperation with other partners (¶¶21-22). The central government will work with the Chisinau municipality to ensure implementation of the agreed schedule, and will reduce its own arrears as needed to meet the program targets for arrear clearance.

10. **The medium-term budget framework (MTBF) will reflect our commitment to stay on the course of fiscal adjustment.** By end-June 2011 we will adopt an MTBF consistent with the goal of reducing the fiscal deficit to ¾ percent of GDP in 2012-14. The wage bill and spending on goods and services will be capped at 9½ and 8¾ percent of GDP respectively, while capital expenditure will keep rising in line with strengthened implementation capacity and targeted social assistance will expand to protect the most vulnerable. This adjustment strategy will reduce our dependency on exceptional foreign aid, make public finances more sustainable, and promote our broader development goals.

11. **A new fiscal responsibility framework and improved mechanism for allocating capital expenditure will support the MTBF.** A new draft law on public finance and accountability, to be submitted to Parliament by end-September 2011, will introduce a rule-based fiscal framework, enhance fiscal discipline, and improve transparency. Meanwhile, to address the long-standing concern over ineffective allocation of capital expenditure, we will review the list of existing and envisaged capital projects, with a view to prioritize execution on the basis of their viability, economic growth potential, past execution rates, and capacity for implementation. And by end-December 2011, the Ministry of Finance together with line ministries will develop proposals to reform the mechanism for allocating capital expenditure.

12. **A comprehensive tax policy reform—a major part of the MTBF—will promote investment and reduce economic distortions while securing adequate resources in support of our fiscal strategy.** The reform will initiate a break from a system riddled with incentives and exemptions toward a tax regime that is competitive, simple, transparent, and equitable. Drawing on the work of the recent IMF technical assistance mission, together with the 2012 budget we will adopt a package of the following tax policy reforms:

- To encourage increased investment, from January 1, 2012, we will extend the option to receive **value-added tax** (VAT) cash refunds for new purchases of investment goods (excluding buildings and cars) to the entire country (**structural benchmark**). This would lead to an estimated annual revenue loss of 0.9 percent of GDP, which will be partially offset by making sugar subject to the standard VAT rate of 20 percent.[1]

- **Corporate income tax** (CIT) will be re-introduced with a single rate of 12 percent (**structural benchmark**)—below regional averages—which will raise revenue by 1.1 percent of GDP. In 2012, advance payment of the CIT will be based solely on expected profit. At the same time, incentives to increase investment will be augmented by raising the amortization rate of group 3 assets (machines and equipment) from 10 to 12½ percent, and doubling to MDL 6,000 the threshold for assets eligible for immediate write-off. We will also revise the revenue sharing mechanism between the central and local authorities to ensure that a sufficient share of revenue remains with the central government to offset the loss from the VAT reform. Furthermore, we will level the playing field in the economy by removing all tax facilities except those explicitly grandfathered in the law—including in the existing free economic zones (FEZ) and ports—and refraining from creating new FEZs and other tax expenditure facilities.

- We will seek a gradual alignment of **excise** rates with EU requirements so as to reduce risks of circumvention and increase revenue by about 0.3 percent of GDP in 2012 and similar amounts in the following years. We will continue discussions with the European Commission on the long-term schedule for the harmonization of excises.

- As regards the **personal income tax** (PIT), we plan to index the personal exemption to inflation while maintaining the existing tax rates. Meanwhile, various PIT exemptions will be discontinued and patent holders (lawyers, notaries, mediators, and bailiffs), which are treated as different organizational units, will be required to file taxes as individuals subject to PIT. Going forward, we will consider a PIT reform with a view to increase the personal exemption and the tax rates so as to maintain PIT revenue as a share of GDP at no less than 2¼ percent while reducing the tax burden on low-income taxpayers.

- A simple single-rate **presumptive tax** will replace the cumbersome small business taxation system. The rate will be set at 4 percent on turnover—determined either directly or indirectly—for businesses above the cutoff level for micro-enterprises and below the mandatory VAT registration threshold.

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[1] All estimates of the effects of tax policy changes are relative to a scenario with unchanged policies.

- The reform will seek to streamline and improve collection of **real estate, road, and local taxes**. Specifically, we will seek to better align property valuations with actual transaction prices, and improve recording of real estate transactions in the cadastre. Road taxes will be differentiated by vehicle size to better reflect the anticipated road damage. And local taxes will be simplified and consolidated to reduce the number of nuisance taxes and improve administration.

- Alongside, to improve fairness of the social security system, **contributions** by patent holders, citizens living abroad, and taxpayers paying the presumptive tax will be gradually brought in line with the benefits they are entitled to under the law.

- We will also review our system of **penalties** for tax violations, with a view to make the penalty size reflect, among other factors, the cost to the budget created by the violation and to provide incentives for taxpayers to find and correct mistakes themselves. Moreover, we will introduce administratively binding **advance rulings** by the tax administration at the request of taxpayers.

13. **Speedy rollout of the tax administration reform will be critical to meet the objectives of MTBF and ensure a business-friendly tax climate.** We will intensify our outreach to mobilize external partners' support for the IT reform—a crucial component of the tax administration strategy in the medium term. Meanwhile, the State Tax Service (STS) will begin to implement operational plans in various reform areas, including audit, collection of arrears, and taxpayer service activities. As already planned (¶11 of the SMEFP dated March 24, 2011), we will submit to Parliament legislation to allow indirect assessment of individuals' income as specified in the compliance strategy by September 30, 2011, and prepare operational plans to strengthen their tax compliance by December 31, 2011.

14. **Other structural reforms agreed under the program will continue to support our fiscal strategy while improving the quality of public services.** Key measures in the pipeline include phasing in the procurement reform, as well as measures to rationalize the use of health care (¶11 of the SMEFP dated March 24, 2011).

B. Monetary and Exchange Rate Policies

15. **The recent spike in international energy prices and strengthening domestic demand, driven in part by bank credit, call for a monetary policy response.** Despite appreciation of the leu and the currently tame core inflation, the recent revision of electricity tariffs and the expected hike in other energy prices later in the year threaten to pass through to core inflation and unhinge inflation expectations. Moreover, remaining high excess liquidity despite the tightening in early 2011 is feeding already robust credit growth, putting further pressure on core inflation. Taken together, these developments could put the NBM's end-2012 inflation objective at risk in the absence of policy action. In response, the NBM will raise the required reserve ratio by three percentage points to

14 percent before September and, if necessary, continue its gradual monetary tightening going forward, to limit scope for marked acceleration of domestic credit and anchor expectations.

16. **Facing abundant foreign exchange inflows, the NBM will continue its gradual accumulation of foreign exchange reserves.** Preliminary indicators point to stronger than expected remittances and capital inflows since end-2010, evident in the ample supply on the foreign exchange market, strengthening of the leu, and accumulation of excess liquidity in the banking system. Thus, some sterilized intervention appears appropriate to ensure adequate buffers against the still high external vulnerabilities.

C. Financial Sector Policy

17. **We are finalizing the mechanism to resolve the difficulties in Banca de Economii (BEM) stemming from crisis management measures in 2009.** The NBM's loan to BEM that facilitated paying out all individual depositors of the failed Investprivatbank (IPB) has been extended till end-2015 to mitigate the BEM's liquidity situation. To strengthen BEM's balance sheet, by end-September 2011 the Government will replace the advance to IPB (currently a BEM asset) with a government bond whose amortization schedule will match BEM's loan repayment to NBM. Going forward, we expect that the impact on public finances will be broadly offset by proceeds from the sale of IPB assets and a burden-sharing arrangement with banks. We will make every effort to ensure that this burden-sharing arrangement is based on an equitable loss-sharing formula, bearing in mind the benefits the banks derived from the authorities' chosen mode of IPB resolution back in 2009, which guaranteed financial stability amid an economic and political crisis.

18. **The working group chaired by the Ministry of Economy will intensify implementation of the delayed measures to strengthen the debt restructuring framework.** By end-June 2011, we will submit for government approval draft legal amendments described in the SMEFP dated June 30, 2010 (¶15) and the SMEFP dated March 24, 2011 (¶18) to enhance the speed and predictability of collateral execution by banks and to strengthen incentives for banks to restructure nonperforming loans. By end-September 2011, we will ensure parliamentary passage of these legal amendments **(structural benchmark)**. Furthermore, with technical assistance from the World Bank and in consultation with the IMF staff, we will seek to strengthen and simplify other aspects of the insolvency framework. Specific draft legal amendments in this area will be adopted by the Government by March 2012. We will move ahead with other plans to strengthen the financial sector (¶¶16-18 of the SMEFP dated March 24, 2011).

D. Structural Reforms

19. **Having mapped out the contours of the education reform, we are working to ensure its successful and timely implementation** (SMEFP dated March 24, 2011, ¶19). An action plan to implement the reform has been developed and will be approved by the Government by end-

June 2011. As agreed with WB staff, the plan will detail numeric targets for class and school optimization with their estimated budget impact.

- We have already imposed a freeze on hiring non-teaching personnel and established a wage bill ceiling that ensures an average of 5 percent reduction in the education sector's employment. Moreover, as previously agreed, by end-June we will issue a government decision to cut funding for over 8,000 positions, including 2,400 vacancies.

- Legal amendments to eliminate the existing class size norms and improve flexibility of labor relations in the sector are being finalized and will be adopted by Parliament by end-July. Furthermore, we are finalizing a new Education Code, which will fully reflect the spirit and goals of the reform. As per our agreement with WB and IMF staff, the Code will refrain from making explicit budget commitments, leaving this task to the MTBF and other budget-related acts.

- As regards school network optimization, we have identified 142 hub schools which will absorb students from 248 redundant schools. To ensure continued access to education, these measures will be facilitated by our plan to purchase 77 and rent 62 school buses before September 2011.

- The Ministry of Education, with assistance from the World Bank, is on track to finalize per student financing formulae for 9 additional rayons, as well as Chişinău and Bălți, and to introduce them starting January 1, 2012.

20. **The civil service reform will enter a new phase in October 2011.** Key components of the reform include new job functions and responsibilities for staff in public administration along with a merit- and performance-based wage system for civil servants. We will make certain that the reform does not affect the cap on public sector wage bill's ratio to GDP set in the MTBF.

21. **We are on track to put in place a durable framework for payment of current bills and draw up a broader restructuring strategy in the energy sector by end-September 2011.** To this end, the Ministry of Economy, the Chişinău municipality, and the key participants in the energy sector have agreed on a schedule of payments to eliminate all post-2008 arrears before the next heating season. Starting October 2011, a new Memorandum of Understanding (MoU) will install a similar framework on a permanent basis. The framework will include: (i) a monthly schedule of payments to energy suppliers that is consistent with typical collection lags during cold months and full repayment before the following heating season; (ii) a credible commitment by Termocom to adhere to the agreed payment schedule; and (iii) creditors' commitment to abstain from blocking bank accounts as long as the MoU is observed. Alongside, we will continue to work with the World Bank to finalize a comprehensive energy sector restructuring strategy, also involving options to resolve historic debt.

22. **To support sustainability of these reforms, we will further enhance the heating sector's ability to maintain cost recovery.** As a **structural benchmark**, by end-September 2011, the Government will adopt regulations which would:

- Raise the heating fee for apartments disconnected from central heating from 5 percent to 20 percent of the average building heating bill. This increase is in line with regional practices and would mostly affect consumers with relatively high incomes.

- Introduce a minimum payment of 40 percent of the monthly heating bill and set August 1 as a legal deadline for settling all heating bills for the past heating season**.**

By end-August 2011, the Ministry of Regional Development and Construction, the Chişinău municipality, Termocom, and the water distributor Apă Canal will develop a framework to reconcile common and individual water meters in Chişinău. This would help to end persistent losses caused by under-billing for hot and cold water delivery. Similar solutions will be implemented in other affected municipalities.

23. **Initiatives to resume privatization of public companies are underway.** Until end-June, we expect to finalize our agreement with the IFC to put in place an advisor to review options for private sector participation in Moldtelecom. At the same time, the government has expanded the list of state assets subject to privatization to include other large public companies, which we will put up for sale through tenders. The government is in discussions with international financial institutions to explore options to divest Air Moldova as soon as possible. Also, the Ministry of Economy has initiated contacts with international partners so as to develop by end-September 2011 a roadmap for the privatization of Banca de Economii.

24. **Going forward, we will persevere with our trade liberalization efforts.** The wheat export ban has been abolished and we do not plan to introduce any new tariff or non-tariff barriers to exports. Furthermore, drawing on the Ministry of Economy's assessment of existing tariff and non-tariff barriers, by end-September 2011 we will formulate a roadmap and specific proposals for further trade liberalization measures.

25. **We will also continue reforms to cut red tape, safeguard competitiveness, and stimulate exports.** The work on a detailed strategy to assist local producers striving to comply with the EU veterinary and food safety standards has begun, and the Government will adopt it by end-September 2011. Legal amendments to relax the requirement for repatriation of export proceeds by extending the repatriation period and reducing penalties for noncompliance have also been developed, and will be submitted to Parliament before end-June. The draft legislation to delink the wages in economy from the minimum guaranteed wage will be adopted by end-July 2011. In parallel, we will continue to review and streamline business regulations and permit requirements, and to work on reducing the number of inspections and audits so as to reduce the burden on business. To this end, we will adopt a law on state inspection of entrepreneurial activities by the end of 2011.

26. **Improving targeting of social assistance will remain a high priority.** Improved capacity of social services and continuous awareness campaigns will allow us to meet the target of expanding enrollment in the means-tested social assistance scheme (*Sistemul de ajutor social*) to 50 percent in 2011 and 65 percent in 2012. Alongside, in collaboration with the World Bank, we have developed the first draft of a plan to phase out by end-2012 the entire nominative compensation system, except the assistance currently provided to Chernobyl victims and war veterans. After finalizing the plan, we will draft the necessary legislative amendments and submit them to Parliament by end-September 2011. Also by end-September 2011, we will conduct a comprehensive review of all other non-means tested social payments and develop reform proposals with a view to start implementation in 2012.

E. Program Monitoring

27. **The program will be monitored through semi-annual reviews, prior actions, quantitative performance criteria and indicative targets, and structural benchmarks.** The phasing of purchases under the arrangement and the review schedule are set out in Table 1 of this memorandum. The list of the quantitative performance criteria and indicative targets remains as set in ¶27 of the MEFP of January 14, 2010, except that the target on reserve money has been discontinued after March 31, 2011. We are requesting modifications of the performance criteria and indicative targets for the NBM's NIR and NDA for September 30, 2011, December 31, 2011, and March 31, 2012. Moreover, we are proposing new indicative targets for June 30, 2012 (Table 2). The existing and proposed structural benchmarks are outlined in Table 3. The understandings regarding the quantitative performance criteria described in this memorandum are specified in the attached TMU. An additional adjuster on the ceiling on the overall cash deficit of the general government is proposed to include budget support grants other than EC's macro-financial assistance, up to an additional MDL 250 million per year (TMU ¶24).

28. **To guide the long-term development of Moldova, we have begun work on elaborating a new national development strategy.** The new strategy will outline the national economic and social priorities based on the Millennium Development Goals. Parliamentary adoption of the new strategy is envisaged by November 2011, following consultations with civil society and our external partners.

Table 1. Moldova: Disbursements, Purchases, and Timing of Reviews Under the ECF/EFF Arrangements 1/

Date 2/	Conditions	Amount (millions of SDR)			Percent of quota		
			of which			of which	
		Total	ECF	EFF	Total	ECF	EFF
January 29, 2010	Board approval of the Arrangement	60.00	40.00	20.00	48.70%	32.5%	16.2%
July 16, 2010	Observance of end-March 2010 performance criteria and completion of first review	60.00	40.00	20.00	48.70%	32.5%	16.2%
April 6, 2011	Observance of end-September 2010 performance criteria and completion of second review	50.00	40.00	10.00	40.58%	32.5%	8.1%
June 30, 2011	Observance of end-March 2011 performance criteria and completion of third review	50.00	20.00	30.00	40.58%	16.2%	24.4%
December 31, 2011	Observance of end-September 2011 performance criteria and completion of fourth review	50.00	16.96	33.04	40.58%	13.8%	26.8%
June 30, 2012	Observance of end-March 2012 performance criteria and completion of fifth review	50.00	13.92	36.08	40.58%	11.3%	29.3%
December 31, 2012	Observance of end-September 2012 performance criteria and completion of sixth review	49.60	13.92	35.68	40.26%	11.3%	29.0%
	Total	369.60	184.80	184.80	300.0%	150.0%	150.0%

Source: IMF staff estimates and projections.

Note: A total of SDR 95 million of access under the ECF has been disbursed to the account of the Ministry of Finance at the National bank of Moldova for budget support. This amount was spread over the first three purchases as follows: (i) SDR 40 million from the first purchase; (ii) SDR 40 million from the second purchase, and (iii) SDR 15 million from the third purchase.

1/ Moldova's quota is SDR 123.2 million

2/ For past purchases, actual dates are shown. For potential future purchases, the earliest possible dates are shown.

Table 2. Moldova: Quantitative Performance Criteria and Indicative Targets, December 2010–June 2012 1/

(Cumulative from the beginning of calendar year; millions of Moldovan lei unless otherwise indicated)

	2010		2011							2012		
	Dec. 31		March 31		June 30	Sept. 30		Dec. 31		March 31		June 30
	Indicative targets		Performance criteria		Indicative targets	Performance criteria		Indicative targets		Performance criteria		Indicative targets
	Program	Adjusted program	Program	Adjusted program	Program	Program	Revised	Program	Revised	Program	Revised	Program
1. Quantitative performance criteria												
Ceiling on the overall cash deficit of the general government 2/	3,596	3,491	685	610	994	1,119		1,596		218		470
Actual		1,786		519								
Ceiling on net domestic assets of the NBM (stock) 2/ 3/	-6,224	-5,609	-5,594	-5,052	-7,003	-6,996	-6,509	-6,894	-6,500	-6,831	-6,190	-5,754
Actual		-7,049		-7,090								
Floor on net international reserves of the NBM (stock, millions of U.S. dollars) 2/ 3/	1,464	1,414	1,430	1,423	1,603	1,650	1,707	1,711	1,730	1,678	1,706	1,682
Actual		1,594		1,614								
Ceiling on contracting or guaranteeing of non-concessional external debt of the general government (millions of U.S. dollars) 3/	125		50		80	80		80		80		80
Actual	15											
2. Continuous performance criteria												
Ceiling on accumulation of external payment arrears (millions of U.S. dollars) 2/	0		0		0	0		0		0		0
Actual	0		0									
3. Indicative targets												
Ceiling on reserve money (stock) 3/	11,780		11,990	12,448	…	…		…		…		…
Actual	12,551			12,727								
Ceiling on change in domestic expenditure arrears of the general government	-107		0		-25	-50		-50		0		-24
Actual	-187		79									
Ceiling on the general government wage bill	7,550		1,830		4,064	5,807		7,844		2,028		4,538
Actual	7,317		1,767									
Floor on priority social spending of the general government 4/	9,634		2,369		4,933	7,391		10,457		2,590		5,179
Actual	9,717		2,403									
Memorandum items:												
EC Macro Financial Assistance budgetary grants (millions of euros)	50		0		20	20		50		0		0
Actual	40											
Budget support grants	…		…		…	851	797	1,573	1,488	228	236	236
Actual												
Official external budget support and project grants and loans from the European Commission and the World Bank (millions of U.S. dollars)	232		20		88	149	126	221	201	29	30	40
Actual	180		13									
Foreign-financed project loans	1,070		299		834	1,243	1,117	1,408	1,331	311	165	350
Actual	619		132									
Reserve requirement ratio	8		8		11	11	14	11	14	11	14	14
Actual	8		11		11							

Sources: Moldovan authorities; and IMF staff estimates and projections.

1/ 'Program' columns up to March 2011 refer to targets in effect during the second review of the program; 'Adjusted program' columns refer to program targets incorporating adjusters as defined in the TMU; 'Revised' columns refer to targets, if any, that were revised during the third review.

2/ Adjusters apply to the ceiling on the overall cash deficit of the general government, ceiling on net domestic assets, floor on net international reserves and ceiling on reserve money. The indicative target on reserve money was discontinued after March 2011.

3/ Program target based on the program exchange rates.

4/ The priority social spending of the general government is the sum of essential recurrent expenditures directed to social protection.

Table 3. Moldova: Structural Benchmarks

Measure	Due	Status	Objective
Fiscal consolidation and governance			
Parliamentary passage of legislation to phase out early retirement privileges of civil servants, judges, and prosecutors (¶11). 1/	30-Apr-11	Done	Improve financial sustainability of the social insurance system and allow higher pension replacement rates over time (delayed benchmark for end-2010).
Parliamentary passage of legislation to redistribute the burden of sick-leave benefits between employees, employers, and the Social Fund (¶11). 1/	30-Apr-11	Done	Eliminate abuse of the system and improve employers' incentives to monitor absenteeism (delayed benchmark for end-2010).
The State Tax Service will develop operational plans for the implementation of the tax compliance strategy in 2011 (¶11). 1/	30-Apr-11	Done	Raise tax collection, reduce the administrative burden on compliant taxpayers, and improve taxpayer services.
Re-introduce corporate income tax (CIT) with a single rate of 12 percent (¶12). 2/	31-Dec-11	Proposed benchmark	Increase tax revenue.
Financial stability			
Parliamentary passage of legal amendments to facilitate debt restructuring and speed up execution of collateral on bank loans (¶18). 1/	30-Sep-11		Clean bank balance sheets and reduce structural impediments to bank lending.
Supporting growth and mitigating fiscal risks			
Adoption of legal and regulatory amendments to introduce a minimum payment of 40 percent of the monthly heating bill and set August 1 as a legal deadline for settling all heating bills for the past heating season, as well as raise the heating fee for apartments disconnected from central heating from 5 percent to 20 percent of the average building heating bill (¶22). 2/	30-Sep-11	Proposed benchmark	Ensure financial soundness of the heating companies and current payments for imported natural gas.
Extend the option to receive value-added tax (VAT) cash refunds for new purchases of investment goods (excluding buildings and cars) to the entire country (¶12). 2/	31-Dec-11	Proposed benchmark	Promote new investment and establish equitable taxation regime for all companies.

1/ Paragraph numbers refer to the corresponding paragraphs of the SMEFP dated March 24, 2011.

2/ Paragraph numbers refer to the corresponding paragraphs of the SMEFP dated June 27, 2011.

MOLDOVA: TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This Technical Memorandum of Understanding (TMU) defines the variables subject to quantitative targets (prior actions, performance criteria and indicative benchmarks) 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.

A. Quantitative Program Targets

2. The program will be assessed through performance criteria and indicative targets. Performance criteria are set with respect to:

- the ceiling on the overall cash deficit of the general government;
- the ceiling on the net domestic assets (NDA) of the National Bank of Moldova (NBM);
- the floor on the net international reserves (NIR) of NBM;
- the ceiling on contracting or guaranteeing of nonconcessional external debt of the general government;
- the ceiling on accumulation of external payment arrears of the central government (continuous).

Indicative targets are set on:

- the ceiling on reserve money (applicable up to the test date of March 31, 2011 and discontinued thereafter);
- the ceiling on change in domestic expenditure arrears of the general government;
- the ceiling on the general government wage bill;
- the floor on priority social spending of the general government.

B. Program Assumptions

3. For program monitoring purposes, U.S. dollar denominated components of the NBM balance sheet will be valued at program exchange rates. The program exchange rate of the Moldovan leu (MDL) to the U.S. dollar has been set at 12.3000 MDL/US$. Amounts denominated in other currencies will be converted for program purposes into U.S. dollar amounts using the cross rates as of end-September 2009 published on the IMF web site

http://www.imf.org, including US$/EUR = 1.4643, JPY/US$ = 89.7700, CHF/US$ = 1.0290, US$/GBP = 1.6113, CNY/US$ = 6.8290, SDR/US$ = 0.631164.

C. Institutional Definitions

4. The **general government** is defined as comprising the central government and local governments. The **central government** includes the state budget (including special funds and special means, as well as foreign-financed projects), state social insurance budget, and health insurance budget. The **local governments** include special funds and special means, as well as foreign-financed projects. No new special or extrabudgetary funds will be created during the program period. Excluded from this definition are any government-owned entities with a separate legal status.

D. Program Definitions

5. **Net international reserves (NIR) 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 by the NBM, and convertible currency liabilities of the NBM to nonresidents with an original maturity of up to and including one year. Liabilities arising from use of Fund credit by the NBM do not include liabilities arising from the use of SDR allocation and use of Fund credit by the general government. Excluded from reserve liabilities are liabilities with original maturities longer than one year.

6. **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. For the purpose of assessing compliance with the program targets, the value of reserve money will be calculated as arithmetic average of its values for the last 5 working days before and including the program test date.

7. **Net foreign assets (NFA) of the NBM** are defined as gross reserves in convertible currencies (defined in paragraph 5) 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.

8. **Net domestic assets (NDA) of the NBM** is defined as the difference between reserve money (defined in paragraph 6) and net foreign assets (NFA) of the NBM. For the purpose of assessing compliance with the program targets, the value of NDA will be calculated as arithmetic average of its values for the last 5 working days before and including the program test date.

1. For the purposes of calculating overall cash deficit of the general government, **net credit of the banking system** to the 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 projects).[1] The Ministry of Finance will provide data on the holdings of government securities and foreign-financed projects.

9. The **ceilings on the overall cash deficit of the general government** are cumulative from the beginning of calendar year and will be monitored **from the financing side** as the sum of net credit of the banking system to the general government, 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 debt[2] 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.

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[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.

10. **Government securities** in the form of coupon-bearing instruments sold at face value will be treated as financing items in the fiscal accounts, in the amount actually received from buyers. On redemption date, the sales value (face value) will be recorded as amortization, and the coupon payments will be recorded as domestic interest payments.

11. **External debt ceilings** apply to the contracting or guaranteeing by the general government or any other agency acting on behalf of the general government of (i) short-term 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. Debt denominated in currencies other than the U.S. dollar shall be converted to the U.S. dollars using program assumptions on bilateral exchange rates. The debt ceilings will not apply (i) to loans classified as international reserve liabilities of the NBM, (ii) to changes in indebtedness resulting from refinancing credits and rescheduling operations of existing debt, (iii) to credits from international financial institutions (IFIs), including credits extended by the Fund.

12. For program purposes, the definition of **debt** is set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274, adopted on August 24, 2000 and revised on August 31, 2009).[3] This definition applies also to commitments contracted or guaranteed for which value has not been received, and to private debt for which official guarantees have been extended and which, therefore, constitute a contingent liability of the public sector. Excluded from this definition are normal import-related credits, defined as liabilities that arise from the direct extension, during the normal course of trading, of credit from a supplier to a purchaser—that is, when payment of goods and services is made at a time that differs from the time when ownership of the underlying goods or services changes. Normal import credit arrangements covered by this exclusion are self-liquidating; they contain pre-specified limits on the amounts involved and the times at which payments must be made; they do not involve the issuance of securities.

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

[3] 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, 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.

(involving payments in cash or in kind), or from any implicit legal or contractual obligation to finance partially or in full any shortfall incurred by the debtor.

14. **Concessionality** will be calculated using currency-specific discount rates based on the OECD commercial interest reference rates (CIRRs) and taking into account all details of the loan agreement, inlcuding maturity, grace period, payment schedule, upfront commision, and management fees. 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. Grant element of the loan can be calculated using the concessionality calculator available at the IMF web site http://www.imf.org .[4] For program purposes, a debt is **concessional** if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt. The discount rates used for this purpose are the CIRRs published by the OECD.

15. 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 central government, or the NBM, or any agency acting on behalf of the central government. 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.

16. For the purposes of the program, general government **expenditure arrears** are defined as non-disputed (in or out of court) payment obligations that are due but not paid for more than 30 days. They can arise on any expenditure item, including transfers, debt service, wages, pensions, energy payments and goods and services. Arrears between the state, local government, and social and health insurance budgets, are not counted towards the expenditure arrears' ceiling on the general government.

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[4] Currently available at http://www.imf.org/external/np/pdr/conc/calculator/default.aspx.

17. The **general government wage bill** will be defined as sum of budget spending on wages and salaries of public sector employees. This will include current spending reported in line "Wages" of the general government budget according to the program classification of the annual budget except for salaries of the social and health funds' employees.[5]

18. The priority **social spending of the general government** is defined as the sum of essential recurrent expenditures for social assistance, unemployment insurance, and pension payments by the Social Insurance Fund as well as 95 percent of health expenditures.

E. Adjusters

19. The adjusters set in this TMU apply for assessing compliance with the program's quantitative targets starting from end-March 2010.

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

21. The **ceiling on the overall cash deficit** of the general government will be adjusted upward—that is, the deficit target will be increased—by the net value of government securities that are recorded as budget expenditure in the context of resolving the failed Investprivatbank.

22. The **ceiling on the overall cash deficit** of the general government will be adjusted upward (downward)—that is, the deficit target will be increased (reduced)—by the full amount of any shortfall (excess) between actually disbursed and programmed Macro Financial Assistance budgetary grants from the European Commission (EC), valued at the exchange rates at the program test dates.

23. From end-September 2011, the **ceiling on the overall cash deficit** of the general government will be adjusted upward (downward)—that is, the deficit target will be increased (reduced)—by the amount of any shortfall (excess) between the total amount of actually disbursed and programmed budget support grants excluding Macro Financial Assistance budgetary grants from the European Commission (EC). The upward adjustment

[5] 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, and 116.

is capped at the equivalent of MDL 250 million, valued at the exchange rates at the time of disbursement.

24. The **ceiling on the overall cash deficit** will be adjusted downward (upward)—that is, the deficit target will be reduced (increased)—for any lower (higher) than programmed disbursement of foreign-financed project loans as specified in Table 2 of the MEFP. Owing to monitoring lags, the downward adjustment is capped at a quarter of the programmed amount of foreign-financed project loans. The upward adjustment is capped at the equivalent of US$25 million, valued at program exchange rates.

25. The ceiling on **reserve money** will be adjusted downward (upward) and the ceiling on **NDA of NBM** will be adjusted downward (upward) symmetrically for any reduction (increase) in the required reserve ratio on the deposits of commercial banks denominated in lei. The adjustment amount will be calculated by multiplying the change in the required reserve ratio by the amount of commercial banks' deposits and liabilities in lei subject to reserve requirements.

26. The floor on **NIR of the NBM** will be lowered and the ceiling on **NDA of NBM** will be raised symmetrically by any shortfall in the official external grants and loans from the EC and World Bank capped up to an equivalent of US$50 million. For the purpose of this definition, the program exchange rates will apply for calculating the amounts of the grants and loans.

F. Reporting Requirements

27. Macroeconomic data necessary for assessing compliance with performance criteria and indicative targets and benchmarks will be provided to Fund staff including, but not limited to data as specified in Table 1. The authorities will transmit promptly to Fund staff any data revisions.

Table 1. 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
Number of budgetary sector positions by ministry	Monthly, within three weeks of the end of each month
Number of employees in the budgetary sector by ministry, and their respective wage bill	Monthly, within three weeks of the end of each month
Expenditure on social assistance as stipulated under activity 457 of social payments paid from the social fund budget	Monthly, within three weeks of the end of each month
Expenditure on pensions and unemployment benefits, and health expenditures as reported by NSIH and NHIC respectively	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)	Weekly within one week of the end of each week
Monetary survey of the NBM	
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

Table 1. Moldova: Data to be Reported to the IMF (continued)

Item	Periodicity
Balance of Payments (to be provided by the NBM)	
Current and capital account data.	One quarter after the end of the previous quarter
Transfers of individuals from abroad through the banking system	Monthly within six weeks of the end of each month
External debt data (to be provided by MoF and NBM)	
Information on all new external loans contracted by the government or government guarantee.	Monthly within three weeks of the end of each month
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.