

**Republic of Moldova: 2002 Article IV Consultation, First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria—Staff Report; Public Information Notice and News Brief on the Executive Board Discussion**

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2002 Article IV consultation with the Republic of Moldova and First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria, the following documents have been released and are included in this package:

- the staff report for the 2002 Article IV consultation and First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria, prepared by a staff team of the IMF, following discussions that ended on **May 22, 2002**, with the officials of the Republic of Moldova on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on June 26, 2002.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a Public Information Notice (PIN) and a News Brief summarizing the **views of the Executive Board as expressed during its July 10, 2002** discussion of the staff report that concluded the Article IV consultation.

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

Joint Staff Assessment of the Poverty Reduction Strategy Paper Preparation Status Report\*  
Letter of Intent\*  
Supplement to the Memorandum of Economic and Financial Policies\*  
Technical Memorandum of Understanding\*

\*May also be included in Staff Report.

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REPUBLIC OF MOLDOVA

**Staff Report for the 2002 Article IV Consultation, First Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria**

Prepared by European II and Policy Development and Review Departments  
(In consultation with other departments)

Approved by Oleh Havrylyshyn and Martin Fetherston

June 26, 2002

Discussions for the 2002 Article IV consultation and first review under the PRGF arrangement were held in Chisinau during February 25–March 7 and May 14–22, 2002, following two rounds of discussions in July and September 2001. Participating staff included R. Haas (head, 2001 and February 2002 missions), M. Castello-Branco (head, May mission), R. van Rooden, M. Luecke, J. ten Berge, N. Sheridan (all EU2), P. Tumbarello (PDR), E. Baldacci and N. Kinoshita (FAD), N. Rendak and M. Luedersen (LEG). H. Al-Atrash, the IMF's Resident Representative, participated in the 2001 missions. M. Davis and L. Bouton (World Bank) attended several meetings.

The staff team met with President Voronin, Prime Minister Tarlev, National Bank of Moldova (NBM) Governor Talmaci, First Deputy Prime Minister and Minister of Economy Odagiu, Deputy Prime Minister and Minister of Agriculture Todoroglo, Finance Minister Grecianii, other senior government officials, members of parliament, business and trade union representatives.

In concluding the 2000 Article IV consultation on December 15, 2000, Executive Directors noted that achieving sustainable growth would require determined policy efforts, including forceful implementation of structural reforms to improve the business climate and stimulate investment. Directors also noted that Moldova's ability to meet its large debt service obligations in the coming years depended on a strong recovery of exports, the successful privatization of key state-owned enterprises, and continuing support from international institutions and other donors. They expressed concern that if actual developments fell short of program projections, the country would face serious difficulties in meeting its debt service obligations. An updated debt sustainability analysis for Moldova is provided in Appendix I. The World Bank Executive Board approved Moldova's request for \$30 million assistance under the third Structural Adjustment Credit (SAC III) on June 20. Moldova's relations with the Fund, the World Bank group and the EBRD are summarized in Appendices II–IV.

Moldova accepted the obligations of Article VIII, Sections 2, 3 and 4, in June 1995, and maintains an exchange system that is free of restrictions on payments and transfers for current international transactions. The authorities report core data to the Fund in a timely manner. Data quality is adequate for surveillance and program monitoring, but some areas—notably the national accounts—continue to suffer from weaknesses (Appendix V).

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## EXECUTIVE SUMMARY

**Spurred by a good harvest and a revival in external demand, economic activity has turned around.** Real GDP grew by 6 percent and inflation dropped to 6½ percent in 2001. At the same time, strong export growth and large inflows of workers' remittances led to a significant improvement in the current account deficit, to 7½ percent of GDP. These positive developments continued in 2002; real GDP growth is expected to reach 5 percent, with inflation kept below 8 percent and a small further improvement in the current account.

**Moldova has followed sound macroeconomic policies and most financial targets under the 2001 program were met.** Fiscal policy has been prudent and a surplus of ½ percent of GDP was achieved in 2001. The 2002 fiscal program has been weaker than envisaged, but the authorities agreed to tighten the fiscal stance and to limit the end-year commitments deficit (excluding project loans) to about 1 percent of GDP. While targeting a primary surplus of about 2 percent of GDP, the program would still have room for additional social expenditures and clearance of arrears in the amount of ½ percent of GDP. The NBM has continued to run a tight monetary policy in support of price and exchange rate stability and money demand has been on the rise.

**Structural reforms slowed in 2001, but gained momentum in 2002.** Implementation of most program benchmarks was delayed because of a change in government, but by mid-2002, all but one of the benchmarks had been met. The focus now is on fiscal reforms and on improvements in the legal framework.

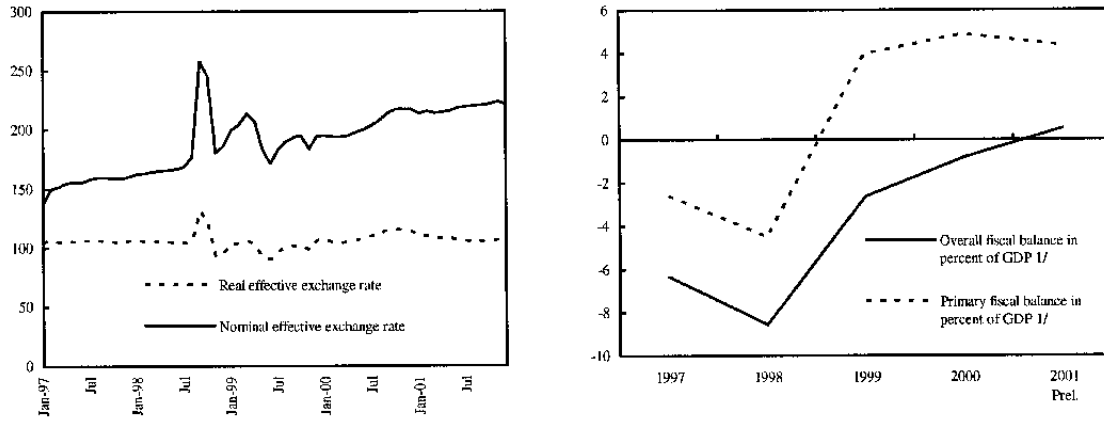
**Reflecting a drop in new disbursements, the external debt burden eased to 58 percent of GDP by end-2001.** Still, Moldova's external debt outlook remains precarious as the country faces large debt service obligations. Continued support from the international community—including from the private sector—is essential for external sustainability and growth.

**Moldova's main policy objectives are to sustain growth, alleviate poverty and reduce the debt burden.** To these ends, the authorities intend to adhere to the growth-oriented structural policies outlined in the December 2000 Memorandum of Economic and Financial Policies (updated in the attached Supplement), while keeping financial policies tight. The government also completed all prior actions required for Board consideration of the first review and reiterated its commitment to finalize a full Poverty Reduction Strategy Paper in early 2003.

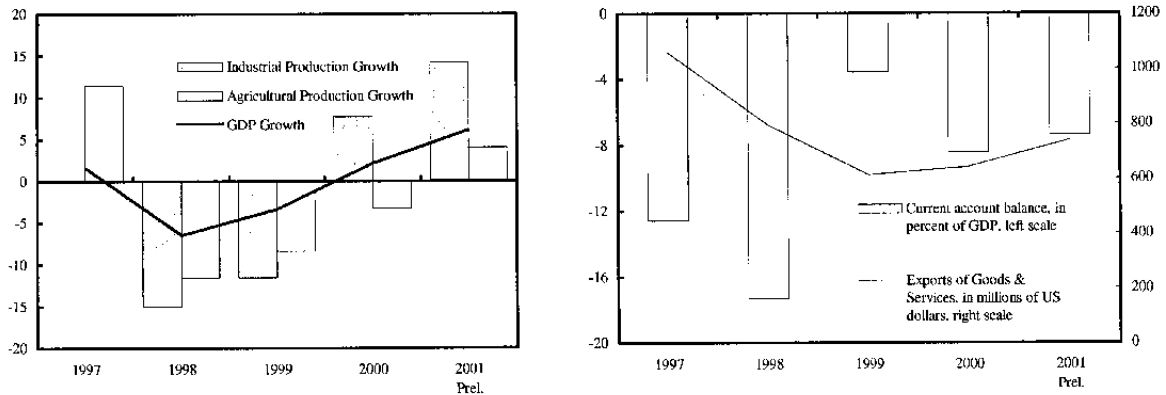
**There are several downside risks to the program.** Ownership remains uncertain, institutional capacity is weak, fiscal slippages could threaten financial stability, and Moldova remains vulnerable to changes in the economic situation of its major trading partners, notably Russia. Nevertheless, the authorities have been following sound financial policies and are committed to bringing the structural program back on track. Therefore, the staff recommends completion of the review.

Figure 1. Moldova: Recent Economic Developments, 1997-2001

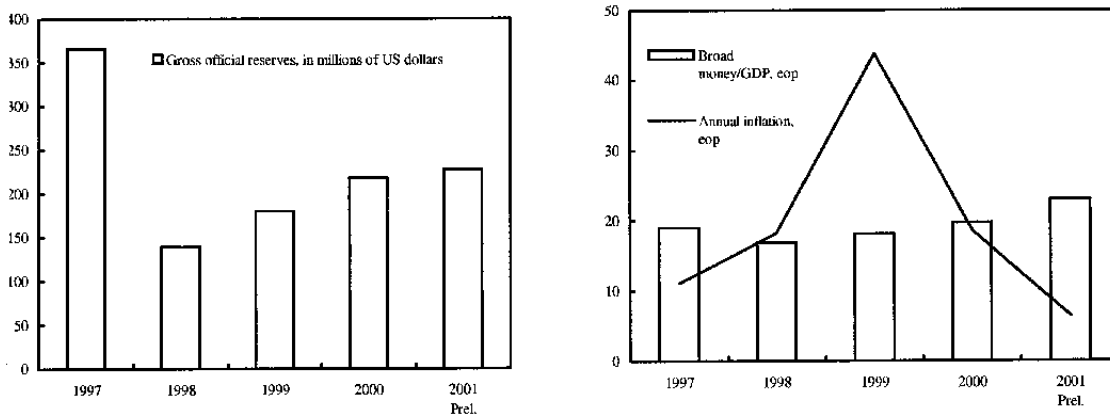
*Significant exchange rate and fiscal adjustment followed the 1998 crisis ...*



*... laying the basis for economic recovery as the external situation improved ...*



*... resulting in lower inflation, higher international reserves, and financial deepening.*



Source: Moldovan authorities and Fund staff estimates.

1/ On commitment basis, excludes project loan spending.

## I. BACKGROUND TO THE DISCUSSIONS

1. Following general elections in February 2001, the Communist Party won control of parliament, the government, and the presidency. The implementation of several structural benchmarks envisaged under the three-year PRGF arrangement approved in December 2000 was delayed considerably owing to the change in government. As a result, completion of the first review was significantly delayed and Fund disbursements have been suspended since February 2001.

2. A Board meeting for the 2001 Article IV consultation and the first PRGF review tentatively scheduled for December 2001 was cancelled because the program went off-track. While macroeconomic policies were on course and the authorities had implemented all prior actions, they signed an agreement on gas deliveries with the Russian Federation including a state guarantee that would have been inconsistent with the PRGF arrangement. In addition, World Bank financing was unexpectedly delayed. These issues continued to preclude completion of the review in the first months of 2002. Subsequently, discussions for financial support under the World Bank SAC III were successfully completed. Finally, the Fund staff reached understandings with the authorities on all outstanding structural issues during the last round of discussions in May.

3. After many years of decline, economic activity has turned around. Boosted by a good harvest and continued industrial growth, real GDP increased by 6 percent in 2001, up from 2 percent in 2000. At the same time, end-of-period inflation was cut to 6½ percent in 2001 from 18½ percent in 2000, partly on account of lower food prices. These developments, which continued through the first quarter of 2002, reflected reasonably sound financial policies and a revival in external demand for exports after the 1998 Russian crisis (Table 1 and Figure 1).

4. Nevertheless, Moldova remains one of the poorest countries in the region. In 2001, per capita GDP was estimated at \$400 and poverty rates at 55–70 percent of the total population. A World Bank study suggests, however, that the recent economic recovery has started to have a positive impact on poverty alleviation (Box 1). Real wages picked up in 2001, rising to \$40 per month from \$33 in 2000. Budget spending on health and education also gained as a percentage of GDP, while targeting improved.

5. Fiscal policy was tightened markedly following the 1998 crisis, but started to slip in late 2001. The general government commitments deficit (excluding project loans) was cut to 2½ percent of GDP in 1999 from 8½ percent in 1998, and narrowed further to less than 1 percent in 2000 (Table 1). A surplus of ½ percent of GDP was achieved in 2001 mainly through a sharp compression of expenditures—about 2¾ of GDP less than the indicative program target (Tables 2 and 3). Total revenue performed well relative to the target because of a sharp increase in Social Fund contributions, reflecting improved compliance, but VAT collection was unsatisfactory. Low foreign financing led to budget sequestration and accumulation of new external arrears during the second half of the year. At the same time,

clearance of domestic arrears (mostly at the local government level) was lower than targeted. The budget continued to record a small surplus in the first quarter of 2002 but the arrears situation showed no sign of improvement. Furthermore, a 20 percent wage increase to social sector employees was granted in May, ahead of another 40 percent hike planned for September.

### **Box 1. Poverty in Moldova<sup>1</sup>**

Different poverty measures suggest that poverty rates in Moldova have increased—particularly after the 1998 crisis—and that poverty incidence has remained high. The 2001 World Bank Dynamic Poverty Study (May 2001, unpublished) showed an increase of poverty incidence from 50 percent in 1997 to almost 70 percent in 1999. However, recent economic growth and improved targeting of poverty reduction measures brought poverty levels down to 65 percent at end-2000.

About 87 percent of the population is estimated to have disposable income below the household monthly “subsistence minimum” (MDL 459, or \$35 in 2001). About half of the population is chronically poor and 20 percent is considered “newly” poor, having fallen into poverty during 1999–2000. Over 70 percent of the poor live in rural areas, and only 8 percent live in large cities.

<sup>1</sup>Based on a note prepared by World Bank staff.

6. With inflation receding, money demand recovered steadily in 2000–01. Broad money (including foreign currency deposits) grew by 40 percent in 2000 and 36 percent in 2001. Deposit growth significantly outpaced that of currency in circulation, resulting in some financial deepening. Broad money growth reflected both a pickup in reserve money and a higher money multiplier, the latter partly related to the reduction in the minimum reserve requirement to 10 percent from 13 percent in mid-2001, on the heels of lower inflation (Table 4).

7. The rapid growth of deposits allowed a sharp expansion in bank credit to the economy. For the first time in several years, credit grew by 18 percent in real terms in 2000, and 27 percent in 2001. Beginning in mid-2001, commercial bank excess reserves at the central bank also expanded significantly. Although the average lending rate stood as high as 25 percent in April 2002, banks apparently had difficulties in finding additional lending opportunities with an acceptable risk-return profile. This enabled the government to issue treasury bills with longer maturities at significantly lower interest rates. The spread between commercial bank lending and deposit rates remained at approximately 10 percentage points, presumably reflecting a combination of high credit risk and limited bank efficiency.

8. The current account has improved considerably. The current account deficit narrowed to 7½ percent of GDP in 2001 (from 8½ percent in 2000) owing to higher-than-expected inflows of workers’ remittances (Table 5). This trend continued into the first quarter of 2002,



with remittances up 20 percent over the year-earlier period. In addition, exports increased by almost 20 percent in dollar terms in 2001, reflecting in part the recovery of agricultural exports.

9. By March 2002, the Moldovan leu had depreciated by 12 percent in real terms since end-2000 and was 5 percent below its pre-Russian crisis level. The recent strong performance of exports suggests that the level of the real exchange rate has been broadly adequate for maintaining competitiveness. At end-March 2002, the NBM's gross international reserves stood at \$223 million (2½ months of imports), broadly unchanged from the end-2000 level, despite dwindling external financing flows, lower-than-expected privatization proceeds, and sizable external debt service payments.<sup>1</sup> An upsurge in earnings of Moldovans working abroad (about \$184 million in 2001) allowed the NBM to purchase large amounts of foreign exchange without putting pressure on the exchange rate.

10. Moldova's public and publicly-guaranteed external debt contracted to \$940 million in 2001. New disbursements—including by IFIs—dropped as the PRGF program went off-track. In terms of GDP, the external debt burden eased to 58 percent, from 69 percent in 2000 (Tables 6–8). The authorities are in the process of negotiating with private creditors for more favorable terms on Moldova's commercial debt—outstanding amounts of the 1997 Eurobond (\$40 million) and Gazprom promissory notes. A framework for a negotiated restructuring of the eurobond has been agreed with private creditors.

11. All performance criteria established under the PRGF arrangement were observed, except for the end-March 2001 performance criterion for net international reserves (NIR). Most indicative targets set through September 2001 were met, and the others were missed by very small margins.<sup>2</sup> However, there were slippages on some of the financial targets agreed with the staff for December 2001, notably regarding the arrears targets (Table 9).

12. The implementation of structural reforms slowed during 2001. Only three out of eight structural benchmarks under the PRGF were met by end-July 2001.<sup>3</sup> Implementation of the other benchmarks was delayed on account of the change in government. Nevertheless, by mid-2002 all benchmarks had been met, except for the adoption of a law on financial disclosure (now envisaged for September 1, 2002).

13. Moldova recently strengthened the legal basis for anti-money-laundering and combating the financing of terrorism (AML/CFT) through the adoption of two laws in late-

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<sup>1</sup> Debt service in 2001 included a partial buy-back of a five-year \$75 million Eurobond, falling due on June 13, 2002.

<sup>2</sup> The international reserves targets were missed because of lower-than-projected cash privatization proceeds.

<sup>3</sup> A tender was launched for the selection of a financial advisor for Moldtelecom privatization; parliament approved the draft chapter of the new Tax Code on tax administration; and import tariff levels were maintained.

2001. The Law on Money Laundering Prevention and Combating, among other things, requires financial institutions to identify and report suspicious transactions, conduct customer due diligence, and establish related internal control mechanisms. The Office of the Prosecutor General is assigned many of the tasks of a financial intelligence unit. The Law on Combating Terrorism defines terrorism and support for terrorism, and determines the responsibilities of various government agencies in this area.

14. A safeguards assessment report prepared recently noted certain vulnerabilities in NBM procedures and controls to manage resources. The report proposed corrective measures, outlined in Box 2.

## **II. REPORT ON THE DISCUSSIONS**

### **A. Overview**

15. Discussions centered on the policies required to achieve sustainable growth, alleviate poverty, and reduce Moldova's high debt burden. The authorities agreed with the staff that the continuation of sound financial policies and acceleration of structural reforms were crucial for reaching these goals. The staff also highlighted the importance of maintaining fiscal discipline to enhance the credibility of the reform program.

16. Discussions reflected the authorities' work on the full Poverty Reduction Strategy Paper (PRSP), whose completion is now envisaged for early 2003.<sup>4</sup> In the meantime, the Interim PRSP has been updated to include an action plan for the participatory process, the implementation of poverty-monitoring indicators, and the integration of the PRSP process with a Medium-Term Expenditure Framework for 2003–05. The latter seeks to bring sectoral policies aimed at poverty reduction in line with the budget planning process, including an efficient and prioritized funding of poverty reduction activities. The authorities have also consulted with international donors to increase support to the PRSP process.

17. The staff reached understanding with the authorities on a supplement to the December 2000 Memorandum of Economic and Financial Policies (MEFP), describing the government's policies for the near future (Attachment I). In the attached Letter of Intent, the authorities request continued Fund support under Moldova's PRGF arrangement. They also request a waiver for the nonobservance of the end-March 2001 NIR performance criterion and the continuous performance criterion on non-accumulation of arrears, as well as a rephrasing of disbursements under the arrangement (Table 10).

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<sup>4</sup> See the accompanying Joint Staff Assessment of the PRSP Preparation Status Report.

## **Box 2. Safeguards Assessment—Summary of Conclusions**

The safeguards assessment of the NBM found certain vulnerabilities and proposed measures as outlined below.

### **Vulnerabilities**

A full safeguards assessment of the National Bank of Moldova (NBM) has been completed. The conclusions indicate that the NBM's procedures and controls to manage resources, including IMF disbursements, may not be adequate in all areas of the safeguards framework. In particular, the assessment noted that improvements could be made in the areas of: (i) internal audit; (ii) controls over accounting data; (iii) board oversight of financial reporting, internal controls and audit functions; and (iv) the treatment and valuation of certain items, including government securities and distributable profit, in the financial statements. Specific remedial actions to address these vulnerabilities have been proposed to the authorities and the NBM has indicated that improvements have been made in some of these areas and are ongoing in others.

### **Recommendations**

To address the identified vulnerabilities, staff proposed the following priority measures:

- The NBM should appoint an independent external party to undertake a review of the adequacy of its internal audit function, and submit to IMF staff the bank's response to the recommendations arising from the external assessment, along with their associated action plan and timetable to implement these recommendations.
- The NBM should provide IMF staff with a reconciliation of the data it submits to the Fund for program monitoring with the bank's accounting records. This should be done for December 31, 2001 and June 30, 2002. In addition, the NBM should commission its external auditor to review the bank's *processes and controls* over the reporting of statistical data to the IMF, including the reconciliation of these data with the bank's audited accounting records for December 31, 2001.
- The authorities should continue to submit to the IMF the NBM's audited annual financial statements and audit management letters, for as long as Fund credit is outstanding.

In addition, staff also proposed the following measures:

- The authorities should include in a future revision of the Law on the National Bank provisions that: (i) explicitly provide for the operational independence of the NBM in carrying out its functions; (ii) require that the NBM's financial statements be subject to an independent external audit; (iii) provide for a non-executive Council to oversee the NBM's institutional governance and audit arrangements; and (iv) would exclude the potential for future distributions of unrealized profit. In terms of the latter, staff also recommended that the NBM report to the IMF the amount of unrealized profit distributed to the government until the Law has been amended.
- The NBM's financial statements should include appropriate disclosures with respect to government assets, including their terms and conditions. Furthermore, NBM management should incorporate a mechanism to appraise the projected financial impact arising from any rescheduling, future or potential, of Government debt on the NBM's capital position.

With respect to the establishment of a non-executive Council, the authorities' response to the safeguards assessment report supported the broad thrust of the recommendations. However, the authorities expressed reservations about the feasibility of implementation given current legal and skills limitations. An independent oversight function is an important aspect of the governance structure of the NBM and, therefore, staff will continue to monitor future developments in this area as the NBM continues to assess its options.

18. The policies outlined in the MEFP Supplement would lay the foundation for achieving the program's medium-term objectives. Real GDP is projected to grow at about 5 percent annually through 2005 and slow to 4 percent thereafter. Economic activity is expected to be led by solid export growth (about 9 percent per year in dollar terms), both to traditional markets and (increasingly) to Western Europe. The current account deficit is projected to narrow slightly further to about 7 percent of GDP in 2002 and to inch up again in 2003, with higher import growth, before gradually declining over the medium term. Official reserves are projected to reach 2.5 months of import coverage in 2002 and increase to 3.3 months by 2004. The projections assume no real appreciation of the leu relative to the U.S. dollar in 2002–03 and a real appreciation of 1–2 percent a year thereafter, to take into account expected productivity gains. Rapid export and GDP growth can be attained only if Moldovan exports remain competitive. Domestically, this requires accelerating structural reforms and enterprise restructuring; externally, access to important non-traditional markets needs to be improved. The medium-term growth outlook would also be negatively affected by external shocks (particularly to export demand), adverse weather conditions affecting agriculture, and insufficient fiscal adjustment that could prevent the government from maintaining and expanding growth-promoting physical and social infrastructure.

#### **B. Fiscal Policy**

19. The authorities explained that the 2002 budget outlook had been adversely affected by unbudgeted wage increases and unsatisfactory VAT collection, leading to lower-than-targeted clearance of arrears. The staff expressed concern over the trends and urged fiscal tightening. The authorities shared these concerns, but argued that wage increases had been granted only to low-paid employees in the social sector, who would still receive only \$27–31 per month after the 40 percent raise; the increases would be partly offset by lower-than-expected interest payments. The authorities also explained that the lower-than-budgeted VAT collection so far this year reflected a surge in export-related refunds. Those resulted from an acceleration of processing claims and were expected to be temporary. Finally, arrears clearance had been slower than targeted because of high external debt payments and lower-than-expected external financing.

20. In the event, the authorities agreed to amend the 2002 budget estimates in line with staff's proposals. The revised budget will be formally approved when parliament reconvenes in the fall, but it will be implemented immediately. It will also reflect the recently agreed social sector wage increase and lower interest rates on government securities. The commitments deficit (excluding project loans) will be limited to about 1 percent of GDP and arrears will be cut by ½ percent of GDP. Revenues are projected to reach 27 percent of GDP, as both tax collection and Social Fund contributions are expected to rise substantially. This target can be realized only if ongoing improvements in tax administration become effective rapidly, including for VAT; expenditure would need to be cut otherwise. Non-interest spending (excluding project loans) is programmed to reach 25½ percent of GDP, or about 3¼ percent of GDP higher than 2001. Correspondingly, the targeted primary surplus (about 2 percent of GDP) is less than the one achieved in 2001 (4 ½ percent of GDP).

21. The authorities highlighted their efforts to maintain a tight fiscal stance while addressing the need to enhance social expenditures, in line with I-PRSP objectives. Expected savings on domestic interest payments will make room for a considerable increase in social spending (including health, education and other categories) in 2002, by 1¾ percentage points of GDP. Most of the additional spending will be absorbed by higher wages for low-paid employees in the health and education sectors.

22. The amended 2002 budget will assume that revenue collection will improve during the rest of this year. VAT collection is expected to pick up, as a result of various policy and administrative measures put in place recently.<sup>5</sup> Furthermore, the government recently reversed an increase in the excise rate on imported cigarettes, which had depressed cigarette imports and the corresponding excise revenues. Personal income tax and profit tax performed relatively well during the first quarter of 2002, despite the cut in the top personal income tax and profit tax rates (from 28 percent to 25 percent) at the beginning of the year.

23. Fiscal deficit targets will continue to be constrained by the limited availability of non-project foreign financing. The revised fiscal program assumes a smaller amount of privatization proceeds during the second half of the year than in the original budget. Overall, a financing gap of 3–4 percent of GDP is projected. The gap is expected to be covered by an extension of maturities for the outstanding commercial debt (see paragraphs 34–35).

24. In preliminary discussions on the 2003 program, the staff emphasized the need to maintain fiscal discipline. This should include continued efforts to rationalize expenditures and to clear arrears. The authorities noted that progress in expenditure rationalization had been made through cuts in allowances and improved targeting of social assistance. Further spending compression was problematic, since the social sector already accounted for more than 50 percent of expenditures. In the event, the authorities agreed to limit the commitments deficit to 0.2 percent of GDP and to reduce arrears by 1 percent of GDP, consistent with a primary budget surplus of 3.2 percent of GDP. The financing side would be boosted by the proceeds from the expected privatization of Moldtelecom.

25. The authorities have begun to address some of the outstanding structural issues that could undermine the budget in 2003 and beyond:

- The proposed indexation scheme to compensate depositors for past inflation will be targeted to the poorest segments of the population and its cost will be spread over a 15-year period (structural benchmark).
- The large taxpayer unit (LTU) will become fully operational by September 2002 (structural benchmark).

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<sup>5</sup> The authorities have introduced a single invoice system and amended the Tax Code to enhance the powers of tax administration. They will eliminate exemptions on imported equipment under the revised 2002 budget.

- In the area of customs administration, preshipment inspection of imports was introduced in late 2001; its effectiveness in addressing such problems as under-valuation and misclassification is being carefully reviewed, and any new exemptions will be strictly limited.

26. Although the authorities were unwilling to renege on their promise to introduce a unified agricultural tax, they agreed to refrain from any changes in the tax system before reaching an understanding with the staff. In their proposal, a higher land tax based on area and quality of land owned would replace the income tax on farmers, VAT on agricultural products, the current agricultural land tax, and social insurance contribution of farmers. The staff stressed that such a tax could have serious implications for the integrity of the VAT and income tax systems and for overall tax revenue.

27. The authorities are also considering further cuts in income tax rates, following other CIS countries. While supportive of efforts to lower the tax burden, the staff advised the authorities to cut tax rates only if they could identify offsetting measures to avoid any short-term adverse impact on the budget.

### **C. Monetary and Financial Sector Policies**

28. The authorities reaffirmed their commitment to run a tight monetary policy in support of price and exchange rate stability. The monetary program is predicated on annual inflation rate of less than 8 percent in 2002–03; to this end, reserve money growth is targeted at about 15 percent in both years, assuming a further strengthening of money demand. To mop up excess bank liquidity, the NBM recently introduced deposit auctions, with interest rates capped just below the prevailing treasury bill rate to ensure that these deposits remain the investment option of last resort for commercial banks.

29. The NBM has made good progress in strengthening the banking sector by raising to international standards the minimum capital requirements for existing and new banks. Non-performing loans declined to 10 percent of banks' total loan portfolios at end-March 2002 from 29 percent at end-1999. The risk-weighted capital adequacy ratio for each of the 19 commercial banks was above 25 percent at end-March 2002, well above the required minimum of 12 percent. The NBM intends to take strong measures against banks that fail to meet prudential regulations, including the withdrawal of their licenses.

### **D. Structural Policies**

30. The authorities recognize that the steady implementation of structural reforms is crucial for generating the supply-side response needed to achieve sustainable economic growth. After some delays following the change in government in early 2001, structural reforms have recently regained momentum, particularly in the context of negotiations on the

SAC III loan. The World Bank is the lead agency for most of the required structural reforms; structural conditionality under the PRGF program is limited to a few areas that are essential for achieving the program's macroeconomic objectives and improving governance (Box 3). The focus now is on fiscal reforms (revenue collection and enforcement capacity; efficiency of expenditure policy, including prioritization of social spending) and on the establishment of a legal framework appropriate for a market economy (Table 1 of the MEFP Supplement for structural benchmarks covering these areas).<sup>6</sup>

31. An adequate legal framework is crucial for developing private economic activity. The experience of other transition economies suggests that newly-established private enterprises are the most important source of economic growth. With technical assistance from the Fund, a number of new economic laws were passed by parliament over the past year, as described in Section VI of the MEFP Supplement. Furthermore, the Civil Code adopted by parliament in April has been revised in light of Fund recommendations, and is now broadly in line with a market-based approach in the areas of properties, contracts, and secured transactions (prior action). A new law requiring senior elected and appointed officials and their relatives to disclose their income and assets will be promulgated by September 1, 2002 (structural benchmark). While the adoption of new laws by parliament is an important first step, lasting improvements in the business environment depend on the consistent implementation of new legislation. The staff emphasized that a strong commitment from the government to promote a market-friendly environment was crucial for the success of the overall economic program.

32. The government agreed that privatizing state-owned enterprises was central to stimulating economic growth. Moldova's privatization strategy—coordinated with the World Bank—included an extensive land reform completed by end-2000, and now focuses on privatizing energy, telecommunication and wine producing enterprises, as well as providing a regulatory framework for their future operation. However, there have been significant delays in implementing the strategy, owing to the change in government and poor market conditions for privatizing telecoms. Measures to advance the privatization of Moldtelecom and the wineries are included in the SAC III.

33. The authorities clarified the status of the gas agreement with Russia. This agreement, signed by the governments of Moldova and Russia in November 2001, provided a state guarantee for Moldovagaz liabilities, a guarantee that would have been inconsistent with the PRGF arrangement. The authorities noted that the gas agreement was currently not effective, since it had not been ratified by parliament. As a prior action for Board consideration of the first review, the authorities have adopted and published a cabinet decision indicating their intention not to enter into agreements leading to an increase in energy-related debt.

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<sup>6</sup> Structural reforms in the fiscal area are discussed in Section II.B.

### Box 3. Streamlining Structural Conditionality

#### Coverage of structural conditionality under the PRGF program

- **Fiscal reform:** revising the tax code to bring it in line with international practices (done); improving customs administration by establishing preshipment inspection for imports (done); reducing the scope of free economic zones (done); extending treasury operations to include local government transactions (done); developing the large taxpayer unit (structural benchmark); amending legislation to improve targeting of the indexation scheme to compensate depositors for past inflation (structural benchmark).
- **Financial sector reform:** amending the law on financial institutions to ensure consistency with the new insolvency law (done).
- **Governance and transparency:** revising the insolvency law to accelerate bankruptcy and reorganization procedures (done); adopting a new civil code in line with IMF recommendations (prior action); adopting a law on financial disclosure for state officials (structural benchmark).
- **Trade liberalization:** eliminating remaining export barriers (done); refraining from raising import tariffs (continuous structural benchmark).
- **External debt:** adopting and publishing a cabinet decision outlining the government's commitment not to enter into international agreements that could lead to an increase in energy-related external debt (prior action).

#### Structural areas covered by World Bank conditionality and lending

Conditionality under the first two structural adjustment operations (SAC I and II) aimed at (i) developing private sector activity, particularly in agriculture and agro processing; and (ii) improving the business environment; (iii) implementing land reform and supporting new private farmers; (iv) advancing the restructuring of public sector enterprises; (v) privatizing the electricity distribution and generation companies and preparing the privatization of the district heating companies; and (vi) creating an appropriate regulatory framework for the energy and telecom sectors, including the establishment of independent regulatory agencies.

The recently approved SAC III focuses on three key areas:

- Improving social service delivery;
- Strengthening social protection and poverty monitoring and evaluation
- Improving the business environment, including through reforms and privatization in the energy, telecom, and winery sectors.

Two structural benchmarks that had been previously included in the PRGF program are now part of the SAC III program: (i) the preparation of necessary documentation (bidding package) for the privatization of Moldtelecom, and (ii) the conclusion of an agreement with a qualified financial advisor for the preparation for sale of key wineries to strategic investors.



### **E. External Sector Policies and Capacity to Repay the Fund**

34. Moldova's external debt outlook remains precarious over the next several years, as the country faces large debt service obligations (Figure 2).<sup>7</sup> In the context of recent negotiations with private creditors, the program assumes that the external financing gap in 2002 (about 3–4 percent of GDP) will be covered by an extension or restructuring of maturities on outstanding commercial debt. The debt sustainability analysis shows that, with continued economic growth, support from the IFIs, and an extension of commercial debt maturities, Moldova's external debt indicators would improve steadily over the medium term to manageable levels (Appendix I). Nevertheless, the immediate period ahead will be difficult. If negotiations with private creditors are not successful, and/or macroeconomic outcomes turn out to be worse than assumed in the program, the debt situation could quickly deteriorate.

35. The authorities have continued to work with creditors to reach a mutually-agreed solution for Moldova's commercial debt. During a bondholder meeting on June 25 in London they reached an agreement for a five-month delay followed by restructuring of the repayment of principal on the outstanding Eurobond (2¼ percent of GDP). In the meantime, they will pay interest on a monthly basis. They are also seeking more favorable terms on Gazprom promissory notes. They also have initiated discussions to clear energy arrears accumulated since mid-2001. The debt strategy also entails:

- Continuing to pursue tight fiscal policies, aimed at maintaining a primary fiscal surplus of 2–3 percent of GDP (excluding foreign-financed projects), with a view to steadily reducing the external debt burden;
- Continuing to earmark privatization proceeds for servicing or retiring external public debt and clearing government wage and pension arrears;
- Refraining from new borrowing on nonconcessional terms;<sup>8</sup>
- Improving debt management.<sup>9</sup>

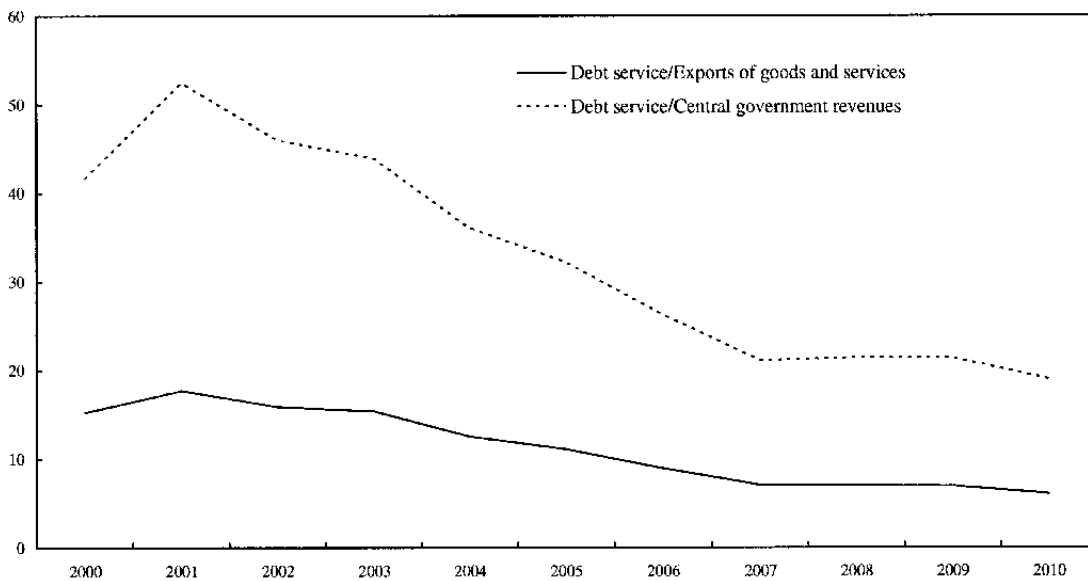
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<sup>7</sup> In 2001 debt service absorbed more than half of central government revenues and about 18 percent of exports of goods and services (Table 7).

<sup>8</sup> Excluding \$18 million for the workout and termination of the Giurgulesti oil terminal project.

<sup>9</sup> As a first step in this direction, the domestic debt and external debt departments at the Ministry of Finance have been merged into one department, now responsible for overall debt management.

Figure 2. Moldova: External Public and Publically Guaranteed Debt Service, 2000-10  
(In percent)



Source: Moldovan authorities and Fund staff estimates.

36. Under current program assumptions, Moldova is not expected to encounter difficulties in servicing its obligations to the Fund. International reserve coverage is projected to remain at reasonable levels and the authorities have a fairly good track record in meeting payments to the Fund. Risks remain, however, and, as noted in paragraph 34, the situation could change quickly if the country were hit by an adverse external shock.

37. The authorities reaffirmed their commitment to a liberal exchange and trade regime (Box 4). They concurred with the staff that a flexible exchange rate policy best served Moldova's interests, given its vulnerability to external shocks. Interventions by the NBM in the foreign exchange market would thus continue to be limited to smoothing short-term exchange rate fluctuations and meeting reserve targets.

38. The authorities acknowledged that much of the projected economic growth would depend on international trade, but underscored the need for improved access to western markets to support their efforts to diversify trade. The staff recognized that the barriers Moldova faced to access European markets—especially in agricultural goods—limits the effectiveness of trade policy. While in principle agreements reached in the context of the WTO would allow Moldova to increase some import tariffs, the authorities undertook to refrain from raising tariffs (relative to the average 1999 level) and from raising the maximum tariff rate of 15 percent (structural benchmark). All export restrictions have been eliminated and the authorities undertook not to introduce any new restrictions. Any new trade measures in response to the recent surge in imports of cane sugar, which threatened the viability of

domestic sugar plants, would be temporary and strictly in accordance with the WTO agreement on safeguards.

#### **Box 4. Current Status of Moldova's Trade Regime**

Moldova is rated 1 on the Fund's 10-point trade restrictiveness index (with a higher score indicating a less open regime). The current maximum import tariff is 15 percent. There are seven tariff bands (0, 5, 6½, 8, 10, 11 and 15 percent) and the simple average tariff is 7 percent. In November 2000, Moldova eliminated restrictions on grain exports introduced earlier during the year in response to a drought.

Moldova has bilateral free trade agreements with all CIS countries (except Tajikistan) and Romania, and signed an agreement on partnership and cooperation with the EU in 1994, which became effective in 1998. In June 2001, Moldova joined the Balkan Stability Pact, signed in 1999 by seven Balkan countries (Albania, Bosnia, Yugoslavia, Macedonia, Bulgaria, Romania, and Croatia). The Pact envisages free trade agreements for goods between these countries; these agreements are expected to be signed by end-2002.

Moldova was accepted as a member of the WTO in May 2001 and the agreement was ratified by parliament in June 2001.

### **III. PROGRAM MONITORING**

39. Program implementation during the period July 2002 to June 2003 will be monitored on the basis of quarterly performance criteria and disbursements, and semiannual reviews. Quantitative performance criteria and indicative targets for end-September and end-December 2002 are specified in Table 2 of the MEFP Supplement and in the attached Technical Memorandum of Understanding. The authorities have implemented some measures prior to Board consideration of the first review under the PRGF to demonstrate their commitment (Table 1 attached to the MEFP Supplement, which also lists the structural benchmarks for September 1, 2002). The second review will be based on end-September 2002 performance, with Board discussion expected to take place in December 2002. In line with the current policy regarding lending into arrears, and while outstanding official arrears to private creditors persist, Fund disbursements in 2002 will be subject, in the context of financing assurances reviews, to satisfactory progress towards agreement in restructuring commercial debt.

### **IV. STAFF APPRAISAL**

40. Moldova has continued to make progress with market-oriented reforms. Structural reforms slowed following a change in government in early 2001, but they regained some momentum in the last few months in the context of SAC III negotiations with the World Bank. Since the PRGF arrangement was approved in December 2000, the authorities have taken a number of measures—albeit with delays—aimed at improving the legal framework,

governance, and the business environment, as envisaged in the MEFP. Importantly, monetary and fiscal policies have remained sound since the 1998 crisis, providing the basis for economic recovery. In the staff's view, it is now crucial to promote structural reforms more consistently and resolutely, while keeping financial policies tight, to maintain the hard-won stabilization gains, regain access to international finance and achieve sustainable growth.

41. The authorities agree with the staff that sustainable growth is imperative for improving living standards and alleviating poverty. They have reaffirmed their intention to adhere to the growth-oriented policies outlined in the MEFP, signed in late 2000 by the previous government and updated in the attached Supplement. The government has also confirmed its commitment to the PRSP process and intends to complete a full PRSP in early 2003. To make that feasible, the authorities will need to improve the process of participation and consultation with civil society, as well as its poverty and social impact analysis and monitoring. They will also need to secure assistance from the international donor community.

42. The authorities have largely followed the staff's advice on fiscal and monetary policies during the past 18 months. Most financial targets under the 2001 program were met or narrowly missed, despite dwindling foreign financing. Furthermore, all prior actions required for Board consideration of the first review have been completed.

43. Fiscal policy has been prudent, but the budgetary position remains vulnerable. The fiscal consolidation achieved since the 1998 crisis is truly impressive: the deficit on a commitments basis was slashed by 6 percentage points of GDP in 1999 and turned into a surplus in 2001. While there are some uncertainties related to external debt service and privatization receipts in 2002, projected improvements in tax collection and lower domestic interest payments should support a higher level of non-interest expenditures than in 2001. Expenditure arrears, however, have again started to edge up since late 2001 and the unbudgeted wage hikes for social workers will need to be accommodated within the programmed spending envelope. With little room for more spending cuts, further improvements in the fiscal position will have to come mostly from the revenue side, especially through better compliance. The authorities are well aware of this and have stepped up their efforts to improve collection. Moreover, their efforts to balance the competing needs of fiscal tightness and increased social expenditure have been met with some measure of success, as reflected in the significant primary surpluses achieved during the last few years (4½ percent of GDP on average during 1999–2001).

44. The NBM has continued to run a tight monetary policy in support of price and exchange rate stability. Money demand has been on the rise, reflecting lower inflation, the resumption of growth and some financial deepening. Interventions in the foreign exchange market have been limited to smoothing out short-term fluctuations or meeting reserve targets. The exchange rate has been stable, moving broadly in line with relative inflation. In the staff's view, a floating exchange rate regime continues to be appropriate for Moldova, particularly given its vulnerability to external shocks; the current level of the exchange rate

seems broadly appropriate for maintaining competitiveness. The NBM has also shown great resolve in enforcing prudential regulations and ensuring a safe and sound banking system.

45. Exports have recovered markedly but have yet to reach the levels achieved before the 1998 crisis. While the current account is improving, trade diversification is limited and access to EU markets is constrained. Another cause for concern is the incipient pressure for protectionist measures, something the government has resisted to date. The staff encourages the authorities to maintain a liberal trade regime and apply contingent protection strictly in line with WTO provisions. To support this, Moldova's trade partners should provide fair access to their markets.

46. Owing to past fiscal laxity and slow structural reform, Moldova has accumulated a very large stock of external debt. To their credit, the authorities so far have been able to service this debt in a timely manner and without recourse to trade, payments, or exchange restrictions. Continued export recovery and successful privatization would help improve their capacity to pay. However, given the country's vulnerability to external shocks, financial support from the international community—including from the private sector—is essential for the success of Moldova's economic program and for the sustainability of its external position. The authorities have entered into good faith negotiations with holders of the Eurobond and Gazprom notes to reach a collaborative agreement on the rescheduling/reprofiling of these instruments. The staff expects the authorities to reach a collaborative agreement with creditors before completion of the second review.

47. Structural reforms remain a challenge. In some areas, such as land reform, considerable headway has been made, but progress has been too slow in other areas, including privatization. This was due partly to delays brought about by the change in government and to the relatively difficult environment foreign investors face in Moldova. However, the authorities have also at times been slow in advancing reforms.

48. The staff commends the authorities for their recent efforts to improve the legal framework and governance. Over the past year, parliament passed several laws providing the underpinnings of a market-based economy. These include a new insolvency law, a pledge and collateral law, and a new civil code. To improve governance, legislation has been introduced limiting rent-seeking opportunities in free economic zones and streamlining licensing.

49. While generally adequate for surveillance and program monitoring purposes, Moldova's official statistics have serious deficiencies, particularly in the area of national accounts. The staff supports the authorities' recent request for further technical assistance to overcome these deficiencies.

50. The recently completed safeguards assessment identified some inadequacies in the NBM's procedures and controls to manage resources. The staff encourages the authorities to build on the significant progress achieved over the past few years by taking further steps to enhance the transparency and accountability of the NBM. The main recommendations of the

safeguards report—including a review of the NBM's internal audit function and of statistical reporting to the Fund—should be implemented within the proposed schedule. Progress with implementation will be assessed during the second review.

51. There are several downside risks to the program: (i) ownership remains uncertain, as evidenced by recent slippages, although lately the authorities have made a strong effort to fulfill their commitments with the IFIs and regain access to international finance; (ii) Moldova's institutional capacity is weak and could delay program implementation, leading to delays in financing from the IFIs; (iii) fiscal slippages could jeopardize the financial program; (iv) given Moldova's vulnerability to external shocks, a deterioration in the prospects of Moldova's major trading partners, notably Russia, could further undermine the program.

52. The Moldovan government is aware of the challenges ahead and is committed to reactivating the PRGF-supported program. In the staff's opinion, Moldova has demonstrated an acceptable track record by meeting most financial targets under the 2001 program, as well as completing all prior actions. Therefore, the staff recommends Executive Board approval of Moldova's request for a waiver of the end-March 2001 performance criterion for NIR and the continuous performance criterion on non-accumulation of new external arrears, and the completion of the first review under the PRGF program.

53. Staff proposes that the next Article IV consultation be held on the standard 12-month cycle.

Table 1. Moldova: Selected Indicators, 1998-2005

	1998	1999	2000	2001	2002		2003	2004	2005
					Q1 Prel.	Year Prog.			
<b>I. Real sector indicators</b>									
(Percent change; unless otherwise indicated)									
1. Gross domestic product 1/									
Real growth rate	-6.5	-3.4	2.1	6.1	4.8	4.8	5.0	5.0	5.0
Nominal GDP									
In MDL (billions)	10.4	13.8	17.8	20.8	n.a.	23.2	26.4	29.6	33.0
In U.S. dollars (billions)	1.9	1.3	1.4	1.6	n.a.	1.7	1.8	2.0	2.2
2. Inflation (CPI) 2/									
Average	7.7	39.3	31.3	9.8	6.1	6.6	8.4	6.9	6.0
End period	18.2	43.8	18.5	6.4	6.0	8.0	8.0	6.0	6.0
3. Average monthly wage									
In MDL	250	305	408	519	n.a.	...	...	...	...
In U.S. dollars	47	29	33	40	n.a.	...	...	...	...
<b>II. Saving and investment balances</b>									
(In percent of GDP)									
1. Government budget balance (commitments basis) 3/ 4/	-10.6	-5.3	-2.0	-0.7	-0.7	-2.3	-1.2	-1.2	-1.2
excluding project loan spending	-8.6	-2.6	-0.8	0.5	0.4	-1.1	-0.2	-0.2	-0.2
Government Saving	-6.6	-1.9	0.1	1.2	0.9	-0.4	0.5	1.2	1.2
Government Investment	4.0	3.4	2.2	2.2	1.6	1.9	1.7	2.4	2.4
2. Current account balance 4/	-17.3	-3.6	-8.4	-7.4	-1.2	-7.2	-7.8	-7.3	-6.6
3. Non-government savings-investment balance	-6.7	1.7	-6.4	-6.7	n.a.	-4.9	-6.6	-6.1	-5.4
Private Saving	15.3	21.4	15.9	12.1	n.a.	15.6	16.9	17.4	19.6
Private Investment	22.0	19.7	22.3	18.8	n.a.	20.5	23.5	23.5	25.0
<b>III. Financial indicators</b>									
(Percent change; unless otherwise indicated)									
1. Broad money (M3)	-8.7	32.9	40.3	36.3	35.8	20.1	20.8	15.3	14.4
2. Velocity (GDP/end-period M3; ratio)	5.5	5.5	5.1	4.3	4.4	4.0	3.8	3.7	3.6
3. Reserve money	-5.6	41.4	29.8	27.9	34.1	14.7	14.7	12.2	13.4
<b>IV. External sector indicators</b>									
1. Current account balance (in millions of US\$)	-334	-47	-121	-119	-5.0	-124	-144	-149	-149
2. Gross official reserves (in millions of US\$)	140	181	218	227	223	251	319	386	415
In months of imports of goods and nonfactor services	1.4	2.8	2.6	2.5	2.2	2.5	2.9	3.3	3.3
3. Exchange rate (MDL/US\$) period average	5.4	10.5	12.4	12.9	13.2	...	...	...	...
end-period	8.3	11.6	12.4	13.1	13.4	...	...	...	...
4. Debt/GDP (percent) 5/	56.2	71.1	69.2	58.3	n.a.	57.0	53.9	51.3	46.9
5. Debt service/exports (GNFS) (percent) 5/	25.1	32.4	15.3	17.7	n.a.	18.4	15.4	12.5	11.1

Sources: Moldovan authorities and IMF staff estimates.

1/ GDP data do not include the Eastern raion. Insufficient coverage of the newly emerging private sector is likely to be reflected in an underestimation of aggregate output growth. GDP real growth is based on same period of the previous year.

2/ For Q1 2002, on a 12-preceding-months annualized basis.

3/ Includes World Bank project loan spending (and financing); all internal and external privatization receipts are recorded as financing items.

4/ For Q1 2002, on an annualized basis.

5/ Total public and publicly guaranteed debt.

Table 2. Moldova: General Government Budget, 2000-03 1/  
(in millions of lei; unless otherwise indicated)

	2000		2001		2002				2003	
	Year	Year		Year		Year		Year		
	Actual	Program	Actual	Q1 Prel.	Q2 Proj.	Q3 Prog.	Q4 Prog.	Budget	Program	Projection
Revenues and grants	4,912	5,367	5,540	1,365	1,556	1,659	1,726	6,302	6,305	7,165
Tax revenues	3,973	4,616	4,644	1,154	1,310	1,454	1,462	5,569	5,380	6,262
<i>Of which: netting operations 2/</i>	130	129	129	0	0	0	0	0	0	0
Profit tax	275	346	350	106	92	101	81	326	379	440
Personal income tax	265	302	348	95	114	115	83	358	405	464
VAT	1,333	1,686	1,498	365	434	502	556	2,010	1,857	2,150
Excises	658	728	681	131	167	224	280	860	803	930
Foreign trade taxes	222	247	234	60	60	79	64	300	263	297
Other taxes 3/	227	258	231	45	55	70	57	273	227	268
Social fund contributions	994	1,050	1,304	352	388	364	341	1,443	1,446	1,713
Non-tax revenues	806	751	749	208	217	205	171	681	801	709
<i>Of which: NBM transfers</i>	387	250	230	77	22	10	11	175	120	140
Grants	132	0	147	2	29	0	94	53	125	194
Expenditures and net lending (cash)	5,381	6,177	5,644	1,387	1,703	1,807	2,055	...	6,952	7,739
(excl. project loan spending)	5,169	5,841	5,399	1,319	1,635	1,742	1,989	6,726	6,685	7,476
Expenditures	5,413	6,201	5,661	1,400	1,705	1,809	2,056	6,740	6,970	7,753
National Economy	331	320	298	69	68	59	58	290	254	290
Social sphere	1,570	1,803	1,795	465	581	651	715	2,253	2,413	2,758
Education	719	928	924	236	319	365	367	1,186	1,288	1,489
Health care	464	543	542	145	165	176	227	656	712	829
Other	387	332	329	85	97	110	121	411	413	440
Interest payments	1,021	1,211	797	140	155	235	225	962	754	912
Domestic	584	612	345	45	80	95	106	436	326	416
Foreign 4/	436	599	453	95	75	140	119	526	429	496
Capital expenditures	175	121	206	26	42	28	78	112	173	180
Other expenditures	776	961	946	243	364	305	359	1,287	1,272	1,240
Social fund expenditures	1,328	1,450	1,373	389	426	466	555	1,835	1,837	2,110
Project loans spending	212	336	245	68	68	65	66	...	267	263
Net lending	-32	-24	-17	-14	-2	-2	-1	-14	-18	-14
Overall surplus(-)/deficit(-) (cash)	-469	-810	-103	-22	-147	-149	-329	...	-647	-574
(excl. project loan spending)	-257	-474	141	46	-79	-84	-263	-424	-380	-311
Primary balance (cash)	552	401	694	118	8	86	-105	...	107	338
(excl. project loan spending)	764	737	939	186	76	151	-39	538	374	601
Change in arrears (+, increase)	-277	-100	33	20	-7	-84	-49	...	-120	-250
Domestic expenditure 5/	-336	-100	-15	-2	-30	-39	-49	...	-120	-250
External interest	59	0	43	22	23	-45	0	...	0	0
Overall surplus(+)/deficit(-) (commitments)	-363	-710	-136	-42	-140	-64	-280	...	-527	-324
(excl. project loan spending)	-151	-374	108	26	-72	1	-214	...	-260	-61
Primary balance (commitments)	658	501	661	98	15	170	-56	...	227	588
(excl. project loan spending)	870	837	906	166	83	235	10	...	494	851
Financing 6/ 7/	469	810	122	-2	147	-600	329	424	-125	574
Net domestic	-149	186	413	-49	11	103	186	163	251	128
Net foreign 7/	160	353	-376	23	107	-744	-10	-564	-624	-410
Privatization proceeds	457	271	85	24	29	43	153	825	249	856
Financing gap	0	0	0	0	0	747	0	0	747	0
Statistical discrepancy	0	0	18	-24	0	0	0	0	-24	0
(as a percentage of GDP)										
Revenues and grants	27.6	26.1	26.7	23.5	26.8	28.6	29.8	27.2	27.2	27.1
Tax revenues	22.3	22.4	22.4	19.9	22.6	25.1	25.2	24.0	23.2	23.7
Nontax revenues	4.5	3.7	3.6	3.6	3.7	3.5	2.9	2.9	3.5	2.7
Expenditures and net lending	30.2	30.0	27.2	23.9	29.4	31.2	35.5	...	30.0	29.3
(excl. project loan spending)	29.0	28.4	26.0	22.8	28.2	30.1	34.3	29.0	28.8	28.3
(excl. project loan spending and interest payments)	23.3	22.5	22.2	20.3	25.5	26.0	30.4	24.9	25.6	24.9
Expenditures	30.4	30.1	27.3	24.2	29.4	31.2	35.5	29.1	30.1	29.4
Education	4.0	4.5	4.4	4.1	5.5	6.3	6.3	5.1	5.6	5.6
Health care	2.6	2.6	2.6	2.5	2.8	3.0	3.9	2.8	3.1	3.1
Overall surplus/deficit (cash)	-2.6	-3.9	-0.5	-0.4	-2.5	-2.6	-5.7	...	-2.8	-2.2
(excl. project loan spending)	-1.4	-2.3	0.7	0.8	-1.4	-1.4	-4.5	-1.8	-1.6	-1.2
Overall surplus/deficit (commitments)	-2.0	-3.5	-0.7	-0.7	-2.4	-1.1	-4.8	...	-2.3	-1.2
(excl. project loan spending)	-0.8	-1.8	0.5	0.4	-1.2	0.0	-3.7	...	-1.1	-0.2
Primary balance (commitments)	3.7	2.4	3.2	1.7	0.3	2.9	-1.0	...	1.0	2.2
(excl. project loan spending)	4.9	4.1	4.4	2.9	1.4	4.1	0.2	...	2.1	3.2
Stock of Dom. Exp. Arrears (in millions of lei)	777	695	762	760	730	691	642	...	642	392
GDP (in millions of lei)	17,815	20,572	20,754						23,185	26,395

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

1/ The accounts comprise the republican government, local governments, and Social Fund net balances.

Privatization receipts accrued to the budget since 1995 have been classified as a financing item and project loan spending has been included among expenditures.

2/ Consolidated budget.

3/ Includes land tax, real estate tax, natural resources tax, and State tax.

4/ Includes clearance of external interest arrears.

5/ Includes write-off of MDL 171 million of arrears to three energy companies that were privatized.

6/ Details are shown in Table 3.

7/ Includes project loans except for 2002 budget.



Table 3. Moldova: Budget financing, excluding project financing, 2000-2003

	2000	2001		2002					2003 Year Projected
		Program	Actual	Q1 Actual	Q2 Projected	Q3 Program	Q4 Program	Year Program	
(in millions of lei, unless otherwise indicated)									
Overall balance (commitment)	-151	-374	108	26	-72	1	-214	-260	-61
Change in arrears (+, increase)	-277	-100	33	20	-7	-84	-49	-120	-250
Domestic expenditure 1/	-336	-100	-10	-2	-30	-39	-49	-120	-250
Foreign interest	59	0	43	22	23	-45	0	0	0
Overall balance (cash)	-257	-474	141	46	-79	-84	-263	-380	-311
Total Financing	257	474	-141	-46	79	84	263	380	311
Statistical Discrepancy	0	0	-18	24	0	0	0	0	0
Domestic financing	-149	186	413	-49	11	103	186	251	128
NBM	-160	50	389	-41	10	52	59	81	-2
Commercial Banks-direct credit	-69	0	-142	0	0	0	0	0	0
Commercial Banks-securities	84	116	166	-6	0	50	126	170	130
Non-bank	-4	20	-1	-3	1	1	1	0	0
Foreign financing	-52	17	-621	-45	39	-809	-76	-891	-673
Borrowing	236	467	65	0	135	0	138	273	144
Amortization due 2/	-369	-450	-676	-104	-158	-642	-214	-1,118	-816
Rescheduling (prin & int)	2292	0	0	0	0	0	0	0	0
Change in principal arrears	-2211	0	-10	59	61	-167	0	-46	0
Privatization proceeds	457	271	85	24	29	42	153	249	856
Domestic	141	120	85	11	29	29	29	98	110
Foreign	317	151	0	13	0	13	124	151	746
In millions of U.S. dollars	26	12	0	1	0	1	9	11	52
Financing gap 3/	0	0	0	0	0	747	0	747	0
(in millions of U.S. dollars, unless otherwise indicated)									
Foreign financing	-4.0	1.2	-48.2	-3.4	2.9	-60.1	-5.5	-66.1	-46.9
Borrowing	19.2	36.3	5.0	0.0	10.0	0.0	10.0	20.0	10.0
World Bank (excluding project lending)	19.2	30.0	5.0	0.0	10.0	0.0	10.0	20.0	10.0
Bilaterals	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Commercial debt	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	0	6.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortization	-29.7	-35.1	-52.5	-7.9	-11.6	-47.7	-15.5	-82.7	-56.9
Rescheduling (principal and interest)	181.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Change in Principal Arrears (and old interest arrears)	-175.1	0.0	-0.8	4.5	4.5	-12.4	0.0	-3.4	0.0
Memorandum items:									
Foreign interests payments due (\$ million)	39.9	46.1	42.2	8.9	7.2	10.4	8.6	35.1	34.6
Project financing (\$ million)	17.0	27.0	19.6	4.9	4.9	4.9	4.9	19.6	20.0

Sources: National authorities and Fund staff estimates.

1/ In 2000 includes write-off of MDL 171 million of arrears to three energy companies that were privatized.

2/ Amortization due in Q3 of 2002 includes the outstanding principal of the Eurobond, following the expiration of the grace period.

3/ The financing gap in Q3 of 2002 includes the outstanding principal of the Eurobond as well as the clearance of principal and interest arrears on the Gazprom promissory notes accumulated from Q3 of 2001 through Q2 of 2002.

It is assumed that the Eurobond and Gazprom promissory notes are restructured in Q3 of 2002; therefore, no financing gap is shown in this table for 2003.

Table 4. Moldova: Accounts of the National Bank of Moldova and Monetary Survey, 2000-2003  
(In millions of lei; unless otherwise indicated)

	2000	2001					2002				2003 Projected
		Q1	Q2	Q3	Q4		Q1 Actual	Q2 Projected	Q3 Program	Q4 Program	
					Program	Actual					
Program exchange rate (MDL/US\$)											
<b>National Bank of Moldova</b>											
Net foreign assets	791	699	597	770	853	933	1071	1096	1057	1149	1704
NFA (convertible)	791	699	597	771	855	933	1071	1097	1057	1149	1704
Gross reserves	2673	2687	2538	2669	3146	2786	2914	2893	2939	3288	4182
Reserve liabilities	-1882	-1988	-1941	-1898	-2291	-1854	-1843	-1797	-1882	-2159	-2478
NFA (non-convertible)	0	0	0	-1	-2	0	0	0	0	0	0
Net domestic assets	1155	1185	1356	1454	1451	1556	1407	1502	1655	1707	1571
Net claims on general government	1398	1376	1558	1681	1589	1788	1747	1758	1810	1869	1867
Credit to banks 1/	62	103	102	97	266	76	39	134	225	248	154
Other items (net)	-305	-293	-303	-324	-404	-307	-380	-390	-400	-410	-450
Reserve money	1946	1884	1953	2223	2304	2489	2477	2599	2692	2856	3275
Currency in circulation	1473	1406	1476	1698	1747	1834	1751	1937	2032	2155	2550
Banks' reserves	472	478	478	525	557	655	726	662	660	700	725
Required reserves	298	322	355	301	354	353	367	355	373	395	484
Required reserves in accounts	254	272	302	245	304	268	296	291	305	323	396
Cash in vaults (counted toward reserve req.)	44	49	53	56	51	65	71	65	68	72	88
Excess reserves	175	156	123	225	203	322	359	307	288	305	242
On correspondent accounts	156	135	92	180	165	254	301	258	237	251	176
Cash in vaults	18	21	31	44	38	68	58	48	51	54	66
<b>Monetary Survey</b>											
Net foreign assets	1062	963	927	1101	949	1147	1200	1228	1188	1280	1835
NFA (convertible)	1061	943	902	1077	955	1151	1220	1228	1188	1280	1835
Gross reserves of commercial banks	824	763	748	732	700	733	653	655	655	655	655
Foreign liabilities of commercial banks	-554	-519	-444	-426	-600	-514	-504	-524	-524	-524	-524
NFA (non-convertible)	2	20	25	24	-6	-4	-20	0	0	0	0
Net domestic assets	2449	2611	2959	3322	3330	3640	3653	3937	4230	4468	5110
Net claims on general government	1635	1731	1877	1985	2011	2050	2094	2014	2117	2302	2429
Credit to economy	2291	2374	2544	2827	2839	3101	3203	3507	3727	3810	4445
Other items (net)	-1476	-1494	-1462	-1488	-1520	-1511	-1554	-1584	-1614	-1644	-1761
Broad Money (M3)	3511	3574	3886	4424	4279	4787	4853	5165	5418	5748	6945
Broad Money (M2: excluding FCD)	2514	2526	2691	3191	3319	3465	3451	3719	3955	4253	5279
Currency in circulation	1469	1406	1476	1698	1747	1834	1751	1937	2032	2155	2550
Total deposits	2042	2167	2410	2726	2532	2953	3101	3228	3386	3592	4396
Domestic currency deposits	1045	1120	1216	1493	1572	1630	1700	1782	1923	2098	2729
Foreign currency deposits	997	1047	1194	1233	960	1323	1401	1446	1463	1494	1667
Money Market Instruments						0	0	0	0	0	0
<b>Memorandum items:</b>											
Program Exchange Rate (MDL/US\$)	12.26	12.26	12.26	12.26	12.26	12.26	13.09	13.09	13.09	13.09	13.09
Reserve money growth (percentage change; quarterly)	10.2	-3.2	3.7	13.8	4.2	11.9	-6.5	4.9	3.6	6.1	14.7
Reserve money growth (percentage change; annual)	29.8	...	...	...	18.4	27.9	...	...	...	14.7	14.7
M3 Broad money growth (percentage change; quarterly)	10.4	1.8	8.7	13.8	4.7	8.2	1.4	6.4	4.9	6.1	20.8
Broad money growth (percentage change; annual)	40.3	...	...	...	21.8	36.3	...	...	...	20.1	20.8
Gross international reserves (in millions of U.S. dollars)	218.1	219.2	207.0	217.7	256.7	227.3	222.6	221.0	224.5	251.2	319.4
Net international reserves (in millions of U.S. dollars)	64.5	57.3	48.8	63.1	69.8	76.4	81.8	83.8	80.8	87.8	130.2
Velocity (M3; end of period)	5.1	...	...	...	4.8	4.3	...	...	...	4.0	3.8
Velocity (M2; end of period)	7.1	...	...	...	6.2	6.0	...	...	...	5.5	5.0

Sources: National Bank of Moldova and Fund staff estimates.

1/ From February 2002 includes interest-bearing deposits of commercial banks that are used by the NBM to absorb excess liquidity in the banking sector. Credit to banks is calculated net of these deposits, which are not part of reserve money.

Table 5. Moldova: Balance of Payments 2000-2003  
(In millions of U.S. dollars; unless otherwise indicated)

	2000		2001				2001		2002				
	Q1	Q2	Q3	Q4	Year Prel.	Prog.	Q1 Est.	Q2 Proj.	Q3	Q4	Year Program		
											Q3	Q4	
Current account	-121.0	-23.0	-22.1	-46.2	-27.4	-118.7	-110.8	-5.0	-33.1	-47.0	-38.6	-123.7	-144.2
Trade Balance	-306.6	-60.0	-60.6	-96.5	-95.8	-312.9	-251.0	-74.0	-80.2	-106.4	-105.0	-365.6	-409.1
Exports	476.6	136.8	142.2	114.3	176.2	569.4	571.0	146.0	149.8	150.0	173.0	618.8	673.0
Imports	-783.2	-196.8	-202.8	-210.8	-272.0	-882.4	-822.0	-220.0	-230.0	-256.4	-278.0	-984.4	-1082.1
Services (net)	-43.1	-9.1	-8.1	-13.2	-18.4	-48.8	-19.8	-7.1	-10.0	-10.7	-12.0	-39.8	-34.8
Exports of services	163.7	40.5	42.1	40.8	46.6	169.9	158.5	42.6	43.0	44.3	47.0	176.9	192.4
Imports of services	-206.8	-49.6	-50.1	-53.9	-65.0	-218.6	-178.3	-49.7	-53.0	-55.0	-59.0	-216.7	-227.2
Income (net)	72.2	16.0	10.9	29.9	33.3	90.2	40.0	27.7	26.9	35.4	38.4	128.4	129.7
Compensation of employees (net)	126.2	38.0	36.3	52.9	56.5	183.7	101.0	45.2	46.0	54.0	56.0	201.2	210.0
Income on direct and portfolio investment	-10.4	-4.00	-9.1	-4.8	-5.9	-23.8	-21.0	-4.4	-5.0	-4.0	-3.0	-16.4	-22.0
Income on other investment (interests)	-43.6	-18.0	-16.3	-18.1	-17.3	-69.7	-40.0	-13.1	-14.1	-14.6	-14.6	-56.4	-58.3
Current transfers (net)	156.6	30.2	35.7	33.5	53.5	152.8	120.0	48.4	30.2	34.6	40.0	153.3	170.0
Capital and financial account	254.3	60.7	25.0	29.9	28.9	144.5	127.2	-0.8	28.8	-1.9	40.8	66.9	171.1
Capital transfers (net)	0.0	0.2	-2.2	0.0	0.0	-2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Direct investment (net) 1/	127.5	79.0	32.4	14.8	23.1	149.3	60.0	15.0	15.4	25.5	39.0	94.9	139.0
Portfolio investment (net)	93.2	-1.7	-9.8	-11.0	-2.8	-25.3	6.0	-4.5	-4.5	-44.2	-4.5	-57.7	-18.0
Equity securities	3.6	0.0	0.0	0.0	0.0	0.0	6.0	0.0	0.0	0.0	0.0	0.0	0.0
Eurobond 2/	0.0	-1.7	-9.8	-11.0	-2.8	-25.3	0.0	0.0	0.0	-39.7	0.0	-39.7	0.0
Gazprom	90.0	0.0	0.0	0.0	0.0	0.0	0.0	-4.5	-4.5	-4.5	-4.5	-18.0	-18.0
Treasury bills	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans (net)	27.2	0.2	18.6	-0.9	8.6	26.5	45.0	9.3	20.0	6.8	16.1	52.1	50.1
Medium- and long-term loans (net)	28.8	-1.8	18.6	-2.9	4.6	18.5	53.0	9.3	20.0	6.8	16.1	52.1	50.1
Disbursements	95.8	26.3	36.2	14.5	31.6	108.6	118.0	31.5	41.5	33.2	42.5	148.8	154.5
World Bank	36.3	3.7	3.2	3.2	8.2	18.3	57.0	4.9	14.9	4.9	14.9	39.6	40.0
EBRD	15.2	2.6	0.8	2.8	4.8	11.0	13.0	4.1	4.1	4.1	4.1	16.5	20.0
EU	0.0	0.0	0.0	0.0	0.0	0.0	7.5	0.0	0.0	0.0	0.0	0.0	0.0
IFAD	0.0	0.0	0.0	0.0	0.4	0.4	0.0	0.0	0.0	1.7	0.0	1.7	0.0
Other official creditors	20.0	0.0	0.0	0.0	0.0	0.0	10.0	0.0	0.0	0.0	0.0	0.0	0.0
Private creditors	24.3	20.1	32.2	8.6	18.1	79.0	30.5	22.5	22.5	22.5	23.5	91.0	94.5
Amortization due	-67.0	-28.2	-17.6	-17.5	-27.0	-90.2	-65.0	-22.2	-21.6	-26.5	-26.4	-96.7	-104.4
Short-term loans (net)	-1.6	2.0	0.0	2.0	4.0	8.0	-8.0	0.0	0.0	0.0	0.0	0.0	0.0
Other capital flows (net)	6.4	-17.0	-14.0	27.0	0.0	-4.0	16.2	-20.6	-2.1	10.1	-9.8	-22.4	0.0
Errors and omissions	-3.3	-15.6	-18.8	23.0	-6.0	-17.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	130.1	22.1	-15.9	6.7	-4.5	8.5	16.4	-5.8	-4.3	-48.9	2.2	-56.8	26.9
Financing	-130.4	-22.0	15.9	-6.7	4.6	-8.3	-16.6	5.8	4.3	-12.8	-7.0	-9.7	-43.6
Net official reserves (-, increase)	-50.3	7.0	8.9	-14.4	-13.1	-11.7	-16.6	-0.4	-1.9	3.0	-7.0	-6.4	-41.6
Use of Fund credit	-12.7	8.1	-3.5	-3.5	-3.5	-2.5	34.1	-5.1	-3.5	6.5	19.7	17.5	26.6
Change of gross official reserves	-37.6	-1.1	12.4	-10.9	-9.6	-9.2	-50.7	4.7	1.6	-3.5	-26.7	-23.9	-68.2
Exceptional financing	-80.1	-29.0	7.0	7.7	17.7	3.4	0.0	6.2	6.2	-15.8	0.0	-3.4	-2.0
Arrears external debt	-107.0	6.0	7.0	6.0	16.0	35.0	0.0	0.0	0.0	0.0	0.0	0.0	-2.0
Arrears on energy and other supplies	-71.0	-47.0	0.0	1.7	1.7	-43.6	0.0	6.2	6.2	-15.8	0.0	-3.4	0.0
Rescheduling	98.0	12.0	0.0	0.0	0.0	12.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap 3/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	61.7	4.8	66.5	16.7
Memorandum items									6.8				
Gross official reserves	218.1	219.2	206.8	217.7	227.3	227.3	256.7	222.6	221.0	224.5	251.2	251.2	319.4
in months of imports of goods and services	2.6	...	...	...	...	...	2.5	...	...	...	...	...	2.5
Current account, in percent of GDP	-8.4	...	...	...	...	...	-7.4	...	...	...	...	...	-7.2
Trade balance, in percent of GDP	-21.4	...	...	...	...	...	-19.4	...	...	...	...	...	-21.3

Sources: National Bank of Moldova and Fund staff estimates.

1/ In 2001, includes the privatization of Moldovagaz (\$47 million).

2/ In 2001, includes partial buy-back of \$35.5 million of the 1997 Eurobond.

3/ The financing gap will be filled through: 1) restructuring of the outstanding Eurobond principal (\$39.7 million) at 8.5 percent interest, 10 year maturity, 18 months grace period; 2) a restructuring in Q3 and Q4 of 2002.

Table 6. Moldova: Balance of Payments, 1997-2010  
(In millions of U.S. dollars; unless otherwise indicated)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
					Prel.					Projections				
Current account	-274.8	-334.2	-47.0	-120.6	-118.7	-123.7	-144.2	-144.8	-144.8	-141.5	-128.2	-119.6	-128.1	-134.7
Merchandise trade balance	-348.0	-387.7	-134.7	-306.6	-312.9	-365.6	-409.1	-434.8	-452.6	-471.2	-484.7	-493.0	-508.2	-522.8
Exports of goods	889.6	644.0	474.8	476.6	569.4	618.8	673.0	736.7	812.1	892.0	978.2	1,069.6	1,162.1	1,262.0
Imports of goods	-1,237.6	-1,031.7	-609.5	-783.2	-882.4	-984.4	-1,082.1	-1,171.5	-1,264.7	-1,363.2	-1,462.9	-1,562.6	-1,670.3	-1,784.8
Of which: energy	-337.3	-244.5	-152.1	-192.1	-201.0	-217.0	-233.3	-250.8	-266.3	-282.6	-299.5	-317.2	-335.9	-355.7
Balance of services	-28.3	-47.1	-32.1	-43.1	-48.8	-39.8	-34.8	-35.8	-35.0	-34.2	-31.7	-27.5	-24.9	-21.7
Exports of services	167.8	149.6	136.8	163.7	169.9	176.9	192.4	210.6	232.1	255.0	279.6	305.7	332.1	360.7
Imports of services	-196.1	-196.8	-168.9	-206.8	-218.6	-216.7	-227.2	-246.4	-267.2	-289.2	-311.3	-333.3	-357.1	-382.4
Income (net)	47.4	35.2	34.0	72.6	90.2	128.4	129.7	138.7	147.8	159.9	174.1	183.5	187.6	192.4
Compensation of employees	93.3	99.7	90.1	126.2	183.7	201.2	210.0	220.0	222.2	228.9	235.7	240.4	240.4	240.4
Income on direct and portfolio investment	-26.5	-36.0	-16.7	-10.0	-23.8	-16.4	-22.0	-13.6	-12.3	-12.5	-10.6	-11.1	-12.1	-12.1
Income on other investment	-19.3	-28.4	-39.4	-43.6	-69.7	-56.4	-58.3	-67.7	-62.1	-56.5	-51.0	-45.8	-40.8	-35.9
Current transfers (net)	54.1	65.4	85.8	156.6	152.8	153.3	170.0	187.0	195.0	204.0	214.2	217.4	217.4	217.4
Capital and financial account	329.1	-8.7	-36.7	254.3	144.5	66.9	171.1	194.1	192.3	199.7	187.1	191.2	195.4	195.9
Capital account	0.0	0.0	0.0	0.0	-2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	329.1	-8.7	-36.7	254.3	146.5	66.9	171.1	194.1	192.3	199.7	187.1	191.2	195.4	195.9
Direct investment 1/	78.1	75.9	154.2	127.5	149.3	94.9	139.0	150.0	161.6	163.0	164.4	166.0	168.0	171.0
Portfolio investment (net)	236.6	-54.8	-140.3	93.2	-25.3	-57.7	-18.0	-18.0	-18.0	-18.0	0.0	0.0	0.0	0.0
Of which: Eurobond 2/	77.6	-30.4	0.0	0.0	-25.3	-39.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Of which: Gazprom & other energy arrears 3/	140.0	0.0	-141.0	90.0	0.0	-18.0	-18.0	-18.0	-18.0	-18.0	0.0	0.0	0.0	0.0
Medium- and long-term loans	9.0	40.3	90.1	28.8	18.4	52.1	50.1	62.1	48.7	54.7	22.7	25.2	27.4	24.9
Disbursements	98.8	83.7	197.1	95.8	108.6	148.8	154.5	174.3	178.5	183.8	186.2	193.2	198.6	203.1
World Bank	38.0	31.6	90.0	36.3	18.3	39.6	40.0	53.9	56.6	60.0	62.4	65.5	68.8	72.2
EBRD	22.8	15.1	22.0	15.2	11.0	16.5	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0
EU	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
IFAD	0.0	0.0	0.0	0.0	0.4	1.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other official creditors	0.0	0.0	18.8	20.0	0.0	0.0	0.0	5.0	6.0	5.0	5.0	5.0	5.0	5.0
Private creditors	38.0	37.0	66.3	24.3	79.0	91.0	94.5	95.4	95.9	98.8	98.8	102.8	104.8	105.9
Amortization	-89.8	-43.4	-107.0	-67.0	-90.2	-96.7	-104.4	-112.3	-129.8	-129.1	-163.5	-168.1	-171.2	-178.2
Other capital flows	5.4	-70.0	-140.7	4.8	4.0	-22.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	11	32	5	-3	-17	0	0	0	0	0	0	0	0	0
Overall balance	66.7	-310.5	-78.6	130.5	8.4	-56.8	26.9	49.2	47.4	58.3	58.9	71.6	67.3	61.2
Financing	-66.7	310.5	78.6	-130.4	-8.3	-9.7	-43.6	-49.9	-47.5	-58.3	-58.9	-71.6	-67.3	-61.2
Use of Fund credit	0.6	-64.4	4.7	-12.7	-2.5	17.5	26.6	16.6	-18.4	-20.8	-18.4	-24.6	-31.3	-25.7
Change of gross official reserves	-52.1	226.6	-41.0	-37.6	-9.2	-23.9	-68.2	-66.4	-29.1	-37.5	-40.5	-47.1	-36.0	-35.5
Exceptional financing	-15.2	148.3	114.9	-80.1	3.4	-3.4	-2.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Change in debt and energy arrears	-15.2	148.3	107.8	-178.0	-8.6	-3.4	-2.0	-298.0	0.0	0.0	0.0	0.0	0.0	0.0
Rescheduling 4/	0.0	0.0	7.1	98.0	12.0	0.0	0.0	298.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap 5/	0.0	0.0	0.0	0.0	0.0	66.5	16.7	0.7	0.1	0.0	0.0	0.0	0.0	0.0
Memorandum items:														
Gross official reserves	366.1	139.5	180.5	218.1	227.3	251.2	319.4	385.8	414.9	452.4	493.0	540.0	576.0	611.5
in months of imports of goods and services	3.1	1.4	2.8	2.6	2.5	2.5	2.9	3.3	3.3	3.3	3.3	3.4	3.4	3.4
Nominal GDP	2,188	1,930	1,313	1,433	1,613	1,718	1,839	1,995	2,179	2,359	2,539	2,719	2,913	3,120
Current account balance (in percent of GDP)	-12.6	-17.3	-3.6	-8.4	-7.4	-7.2	-7.8	-7.3	-6.6	-6.0	-5.0	-4.4	-4.4	-4.3
Debt service/exports of goods and services 6/	13.0	25.1	49.3	15.3	17.7	18.4	15.4	12.5	11.1	8.9	7.0	7.0	6.9	6.0
Debt stock (in percentage of GDP) 6/	49.2	56.2	71.1	69.2	58.3	57.0	53.9	51.3	46.9	43.9	41.5	39.3	36.9	35.0

Sources: National Bank of Moldova and Fund staff estimates.

1/ In 2001, includes the privatization of Moldovagaz (\$47 million).

2/ In 2001, includes partial buy-back of \$35.5 million of the Eurobond.

3/ In 1999, includes the amortization (buy-back) of \$140 million bonds, and in 2000 a new issuance of \$90 million bonds to Gazprom.

4/ 2004 projections assume a rescheduling of private energy arrears.

5/ The financing gap will be filled through: 1) restructuring of the outstanding Eurobond principal (\$39.7 million) at 8.5 percent interest, 10 year maturity, 18 months grace period; 2) a restructuring of Gazprom bonds and interests (\$114 million) at 5 percent interest, 10 year maturity, 18 months grace period. The gap includes debt service accrued to Gazprom in Q3 and Q4 of 2002.

6/ Public and publicly-guaranteed debt.

Table 7. Moldova: Selected External Debt Indicators, 2000-2010

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

	2000	2001 Prel.	2002	2003	2004	2005	2006	2007	2008	2009	2010
			Projections								
Total external debt stock	1,547.0	1,464.0	1,541.8	1,583.3	1,635.1	1,638.5	1,645.7	1,634.2	1,619.1	1,599.5	1,582.9
<i>of which</i> : Public and publicly guaranteed	991.9	940.1	979.9	991.0	1,023.0	1,023.1	1,035.3	1,054.6	1,067.9	1,076.1	1,091.4
Private debt	209.9	225.6	263.7	296.1	315.8	319.2	314.2	313.1	314.2	316.0	313.7
Energy debt	345.2	298.2	298.2	296.2	296.2	296.2	296.2	266.6	237.0	207.4	177.7
Public and publicly guaranteed debt stock	991.9	940.1	979.9	991.0	1,023.0	1,023.1	1,035.3	1,054.6	1,067.9	1,076.1	1,091.4
New borrowing <sup>1/</sup>	0.0	41.3	134.9	241.4	355.4	438.2	519.9	601.5	674.9	740.3	804.2
Existing borrowing	991.9	898.9	845.0	749.5	667.6	584.8	515.3	453.1	393.0	335.9	287.2
Multilateral	569.4	520.4	470.1	413.3	361.3	317.1	278.1	244.8	213.4	183.7	162.4
Bilateral	220.6	211.2	199.4	187.2	174.9	153.4	138.5	123.9	109.5	95.5	81.5
Commercial	201.9	167.3	175.5	149.0	131.4	114.4	98.7	84.4	70.1	56.7	43.3
Debt service on total external debt <sup>2/</sup>	158.0	221.9	248.1	227.3	245.9	260.2	257.6	267.9	275.4	282.1	280.3
<i>of which</i> Public-and publicly-guaranteed debt <sup>3/</sup>	97.8	131.0	166.1	133.2	118.7	115.8	102.3	88.4	95.9	102.8	97.8
Private debt	60.3	90.9	82.0	94.1	109.4	126.6	137.5	133.0	134.8	136.3	141.3
Energy debt	0.0	0.0	0.0	0.0	17.8	17.8	17.8	46.5	44.7	43.0	41.2
Public and publicly guaranteed debt											
NPV	853.6	799.4	793.2	777.6	765.8	733.9	716.7	705.7	690.7	669.6	649.6
NPV/Exports of goods and services	133.3	108.1	99.7	89.9	80.8	70.3	62.5	56.1	50.2	44.8	40.0
NPV/Central government revenues <sup>5/</sup>	364.0	319.9	288.6	256.2	232.6	204.1	184.1	168.4	154.0	139.3	126.2
Debt service/Exports of goods and services	15.3	17.7	18.4	15.4	12.5	11.1	8.9	7.0	7.0	6.9	6.0
Debt service/Central government revenues <sup>4/</sup>	41.7	52.4	53.2	43.9	36.1	32.2	26.3	21.1	21.4	21.4	19.0
<i>Memorandum items:</i>											
Debt service on total external debt/Exports of goods and services	24.7	30.0	31.2	26.3	26.0	24.9	22.5	21.3	20.0	18.9	17.3
Debt service on total debt/Central government revenues <sup>5/</sup>	67.4	88.8	90.3	74.9	74.7	72.3	66.2	63.9	61.4	58.7	54.5
Total external debt stock/ GDP	108.0	90.8	89.8	86.1	82.0	75.2	69.8	64.4	59.6	54.9	50.7
Public and publicly guaranteed debt stock /GDP	69.2	58.3	57.0	53.9	51.3	46.9	43.9	41.5	39.3	36.9	35.0
Private debt stock/GDP	14.6	14.0	15.4	16.1	15.8	14.6	13.3	12.3	11.6	10.8	10.1
Energy debt/GDP	24.1	18.5	17.4	16.1	14.8	13.6	12.6	10.5	8.7	7.1	5.7

Sources: Moldovan authorities and Fund staff estimates.

<sup>1/</sup> PRGF disbursements are included in new borrowing.<sup>2/</sup> Includes public and publicly-guaranteed debt, private debt and energy arrears.<sup>3/</sup> In 2001, includes partial buy-back of \$35.5 million of the Eurobond.<sup>4/</sup> Based on a three-year moving average.<sup>5/</sup> Excluding grants.

Table 8: Indicators of Capacity to Repay the Fund, 2000-2010

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
						Projections					
Outstanding use of Fund credit	118.3	116.3	130.3	151.4	164.5	149.9	133.5	119.0	99.6	74.8	54.5
Obligations to IMF	24.6	16.4	16.9	18.8	17.4	17.1	18.5	16.2	20.7	25.7	21.0
Repurchases	18.6	11.2	13.8	15.8	14.6	14.6	16.4	14.5	19.4	24.7	20.3
Charges	6.0	5.2	3.2	3.0	2.8	2.5	2.1	1.6	1.3	0.9	0.7
Outstanding use of Fund credit	154.1	145.8	163.5	190.4	207.3	189.3	168.8	150.5	125.9	94.6	68.9
Obligations to IMF	32.5	20.8	21.2	23.6	21.9	21.5	23.3	20.4	26.2	32.4	26.5
Repurchases	24.6	14.2	17.2	19.9	18.4	18.4	20.7	18.4	24.5	31.2	25.7
Charges	7.9	6.6	4.0	3.7	3.5	3.2	2.6	2.1	1.6	1.2	0.9
Outstanding use of Fund credit to											
Export GS	24.1	19.7	20.6	22.0	21.9	18.1	14.7	12.0	9.2	6.3	4.2
External debt 1/	15.5	15.5	16.7	19.2	20.3	18.5	16.3	14.3	11.8	8.8	6.3
Gross official reserves	70.7	64.1	65.1	59.6	53.7	45.6	37.3	30.5	23.3	16.4	11.3
Debt service obligations to the IMF to											
Exports GS	5.1	2.8	2.7	2.7	2.3	2.1	2.0	1.6	1.9	2.2	1.6
Total external debt service	20.5	9.4	8.6	10.4	8.9	8.3	9.1	7.6	9.5	11.5	9.5
Gross official reserves	14.9	9.1	8.4	7.4	5.7	5.2	5.2	4.1	4.8	5.6	4.3
Memorandum items:											
External debt to GDP ratio 1/	69.2	58.3	57.0	53.9	51.3	46.9	43.9	41.5	39.3	36.9	35.0
Debt service to GDP ratio	11.0	13.8	14.4	12.4	12.3	11.9	10.9	10.6	10.1	9.7	9.0

Sources: Moldovan authorities and Fund staff estimates and projections.

1/ Public and publicly guaranteed external debt.

Table 9. Moldova: Quantitative Performance Criteria and Indicative targets, December 31, 2000 - December 31, 2001

	December 31, 2000		March 31, 2001			June 30, 2001			September 30, 2001			December 31, 2001	
	Performance criteria	Actual	Performance criteria	Adjusted	Actual	Indicative targets	Adjusted	Actual	Indicative targets	Adjusted	Actual	Projected	Actual
<b>I. Quantitative performance criteria</b>													
(In millions of lei)													
1.1 Ceiling on NBM's net credit to the general government	1,540	1,398	1,419	1,500	1,376	1,560	1,641	1,558	1,328	1,776	1,681	1,859	1,788
1.2 Ceiling on NBM's reserve money	1,969	1,946	2,051	2,051	1,884	2,119	2,119	1,953	2,212	2,212	2,223	2,402	2,489
1.3 Ceiling on the general government's cash deficit cumulative from September 30, 2000	230	47	345	345	95	464	464	82	571	571	-57	...	...
1.4 Ceiling on domestic expenditure arrears of the general government	913	777	888	888	743	863	863	745	838	838	704	695	762
(In millions of U.S. dollars)													
1.5 Floor on net international reserves of the NBM	52.0	65.0	67.0	60.4	57.0	59.0	52.4	49.0	83.0	46.4	63.1	66.0	76.0
1.6 Ceiling on amount of non-concessional external debt contracted or guaranteed by the general government, the NBM, or any other agency acting on behalf of the government, cumulative from September 30, 2000	14.0	0.0	14.0	14.0	0.0	14.0	14.0	0.0	14.0	14.0	0.0	...	...
Sub-ceilings:													
1.6.1 With maturities of less than 1 year	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...	...
1.6.2 With maturities of 1 to 5 years	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...	...
<b>2. Continuous performance criteria</b>													
2.1 Accumulation of external payment arrears since September 30, 2000	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.7	0.0	3.4
<b>3. Indicative targets</b>													
(In millions of lei)													
3.1 Ceiling on net domestic assets of the NBM	1,327	1,155	1,226	1,307	1,185	1,394	1,475	1,359	1,187	1,635	1,454	1,587	1,556
3.2 Ceiling on general government wage and pension arrears	240	184	220	220	140	200	200	170	180	180	163	140	174
(In millions of U.S. dollars)													
3.3 Floor on gross international reserves of the NBM	206.0	218.0	229.0	222.4	219.0	229.0	222.4	207.0	262.0	225.4	217.7	217.0	227.0

Source: Moldovan authorities and Fund staff estimates.

Table 10. Moldova: Program Reviews and Revised Phasing of Disbursements  
Under the PRGF Arrangement

(In millions of SDRs)

Date of Disbursement	Conditions	Amount
On December 29, 2000	Board Approval	9.24
On February 23, 2001	End-December 2000 performance criteria	9.24
On or after July 10, 2002	Completion of the first review	9.24
On or after December 15, 2002	Completion of the second review by the Board; completion of financing assurances review; end-September 2002 performance criteria.	18.48
On or after March 15, 2003	End-December 2002 performance criteria	9.24
On or after June 15, 2003	Completion of the third review by the Board; end- March 2003 performance criteria.	9.24
On or after September 15, 2003	End-June 2003 performance criteria	9.24
On or after December 15, 2003	Completion of the fourth review by the Board; end-September 2003 performance criteria.	9.24
On or after March 15, 2004 1/	End-December 2003 performance criteria.	9.24
On or after June 15, 2004 1/	Completion of the fifth review by the Board; end- March 2004 performance criteria.	9.24
On or after September 15, 2004 1/	Completion of the sixth review by the Board; end- June 2004 performance criteria.	9.24
Total Disbursements		110.88

1/ Moldova's PRGF arrangement currently is set to expire on December 20, 2003. The above disbursement schedule, which takes into account the high debt service payments during 2002, implies a need to extend the arrangement.



## MOLDOVA—DEBT SUSTAINABILITY ANALYSIS

### I. OVERVIEW

1. Moldova's total external debt outlook deteriorated from virtually zero debt at the beginning of the 1990s to a level of almost \$1.5 billion (about 90 percent of GDP) at end-2001. This consisted of \$940 million in public and publicly-guaranteed debt (about 58 percent of GDP), \$298 million in energy payment arrears (approximately 19 percent of GDP), and \$226 million in private debt.

2. Moldova's debt problems can be traced to: (i) the accumulation of large external current account deficits in the second half of the 1990s; (ii) a sharp depreciation of the leu following the Russian crisis in August 1998, raising the domestic currency cost of external debt significantly and leading to a rapid deterioration in all external debt indicators; and (iii) until recently, negative growth, which raised the debt burden considerably.<sup>1</sup> These obligations were contracted only on moderately concessional terms.<sup>2</sup> The rates of return of the projects financed by the loans contracted at non-concessional terms were, at times, insufficient to cover debt service costs (i.e., for some EBRD projects). At end 2001, over half of the country's public and publicly-guaranteed debt (60 percent of the total) was owed to multilateral institutions (Figure 1).

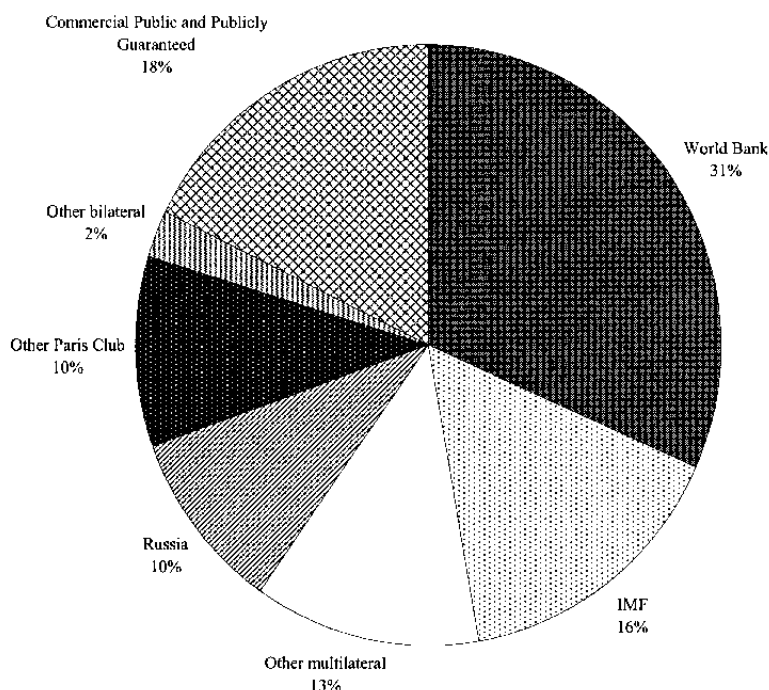
3. The current debt strategy relies on realistic fiscal adjustment, on sound monetary management and on a wide range of structural reforms. It is expected that Moldova will restructure its debt to private creditors (i.e., the outstanding Eurobond and Gazprom bonds) and step up efforts to clear arrears accumulated vis-à-vis Gazprom (about \$16 million). Nevertheless, in the short term problems will be exacerbated if the negotiations with private creditors are not successful, and/or macroeconomic outcomes are worse than assumed in the program. If economic recovery is not sustained because of external shocks, adverse weather conditions, lower than expected private sector contribution, or insufficient fiscal adjustment, the debt situation will become more problematic.

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<sup>1</sup> During the Soviet period Moldova enjoyed artificially low price of energy and highly subsidized export prices. These favorable terms of trade reversed during the 1990s. Due to the high dependence on energy imports, especially from Russia, Moldova accumulated considerable external payment arrears on imported energy supplies.

<sup>2</sup> Moldova was granted IDA eligibility by the World Bank in April 1997 and became ESAF-eligible in March 1999. The country became IDA-only in April 2000.

Figure 1. Moldova: Composition of Public and Publicly Guaranteed Debt, 2001



## II. EXTERNAL DEBT OUTLOOK: RECENT DEVELOPMENTS

4. The NPV of debt-to-export ratio in 2001 and the debt-to-fiscal-revenue ratio (central government) reached 108 percent and 320 percent, respectively. The debt service on public and publicly-guaranteed debt represented about 52½ percent of central government revenues, putting into question Moldova's capacity to meet its current and future external debt service obligations in full, without a restructuring of commercial debt.

5. As to the composition of Moldova's debt at end-2001, more than one half of the outstanding public debt was owed to multilateral institutions, including to the Fund (\$154 million or 16 percent of the total), the World Bank (\$297 million or 31 percent of the total) and the EBRD (\$74 million or 8 percent of the total). Debt owed to bilateral official creditors represented 24 percent of the total, including Russia (\$122 million), the United States (\$59 million), and Japan (\$27 million). Other public sector obligations included the remaining outstanding 1997 Eurobond (\$39.7 million) with bullet repayment due in June 2002, Gazprom promissory notes (\$97 million)<sup>3</sup> and a number of direct and publicly-guaranteed credits from foreign banks.

<sup>3</sup> Including arrears.

6. Moldova also accumulated large external payment arrears on imported energy supplies (gas, electricity, and oil), notably during 1994–2000. By end-2001, the stock of energy arrears was tentatively estimated at \$298 million (18½ percent of GDP), of which up to \$142 million could be considered as public sector obligations and \$156 million were owed by the private sector.<sup>4</sup> The main creditors were Russia (gas imports), Ukraine and Romania (electricity imports), and Romania (oil imports).

7. Steps were taken in 2000 to reduce arrears on debt service obligations and energy payments. In March, \$137 million of arrears due to Gazprom were settled through (i) the issuance of promissory notes, valued at \$90 million, to pay off debts associated with natural gas deliveries of 1996 and 1997 and (ii) an agreement on a debt-equity swap in the gas sector, whereby Gazprom acquired 51 percent of Moldovagaz in return for the clearance of \$47 millions of arrears. The debt-equity swap took place in the first quarter of 2001. In April 2000, a rescheduling agreement with the Russian authorities covering total bilateral debt, including that to Oneximbank, was signed.<sup>5</sup> In September 2000, the Republic of China agreed to convert the outstanding principal and interest (about \$2 million) on a commodity loan contracted in 1992 into a technical assistance grant.

8. In addition, rescheduling discussions on government guarantees were successfully launched with a number of commercial creditors: (i) in March 2000, Dresdner Bank AG agreed to cancel the stand-by guarantee and memorandum of handling assistance issued in 1996 by the Moldovan Ministry of Finance and the National Bank of Moldova, respectively; (ii) in March 2000, the government of Moldova and Hewlett-Packard Europe Finance Ltd. agreed to cancel the original leasing agreement for the purchase of computers and to conclude a financing agreement whereby the Moldovan government would repay the total debt due to HP (\$22.6 million) over the period 2000–06; (iii) in May 2000, the outstanding and overdue debt of the Moldovan company Chirsova, guaranteed by the Moldovan government, to the Italian company TMCI Padovan in the amount of \$1.9 million was restructured with a 9-year amortization schedule; and (iv) in August 2000, the German company AKA agreed to restructure \$4.6 million over 15 years with a 5-year grace period.

9. Rescheduling discussions were successfully launched with Romania and Germany. On July 12, 2001 Moldova and Romania signed a protocol for a rescheduling of \$2 million debt, and in April 2002 a rescheduling agreement was signed with KFW (\$12 million).

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<sup>4</sup> The actual outstanding public obligations or potential government contingent liabilities on energy imports are unclear. There is no official record of the payments already made through various intermediaries in the form of barter or trilateral clearing operations.

<sup>5</sup> According to the agreement, the debt obligations of Moldova to the Russian Federation (including penalties) were set at about \$122 million, including about \$30.5 million owed by the Transnistrian region. The tables do not include Transnistria debt.

### III. EXTERNAL DEBT STRATEGY FOR THE FUTURE

10. In addition to some bilateral rescheduling agreements, Moldova's debt reduction strategy has focused largely on market-based debt reduction schemes (debt buy-backs and a debt-for-equity swap).<sup>6</sup> In 2001, Moldova bought back, in four different operations, \$35.5 million (out of \$75 million) of the Eurobond falling due in June 2002. Bonds with face value of \$35.5 million were purchased for about \$25.3 million, at an average price of 71 cents per U.S. dollar.

11. A medium-term (2002–10) macroeconomic scenario is provided to assess whether Moldova is in a position to serve its external debt obligations in the future (Tables 6, 7, and 8). The projections show a financing gap in 2002–04, to be covered by the restructuring of both the outstanding Eurobond principal (\$39.7 million) due on June 13 and Gazprom bonds and interest payments (\$114 million).<sup>7</sup> The scenario relies on: (i) strong, but realistic, fiscal consolidation; (ii) sound monetary policy; (iii) and the implementation of structural reforms. This scenario assumes that Moldova's external environment will remain favorable, that economic recovery will be led by export growth (with exports reaching their pre-1998 crisis levels in 2006), as well as a gradual diversification of the export base toward non-BRO markets and a sustained recovery of non-energy imports over the medium term. By 2010, exports and imports are projected to reach 40 percent and 57 percent of GDP, respectively. Under this scenario real GDP growth is projected at 4.8 percent in 2002, at 5 percent annually during 2003–05, and would slow to 4 percent thereafter. Exports are projected to increase by about 9 percent on average in dollar terms per year (2002–10). The program assumes no real appreciation of the leu vis-à-vis the U.S. dollar in 2002 and 2003 and a real appreciation of 1–2 percent per year thereafter, reflecting expected gains in productivity. Achieving this rate of economic growth will critically depend on achieving higher domestic private saving and private investment, as the public sector continues to reduce its role in the economy and public savings rise. The program assumes a primary budget surplus (excluding loan project spending) of about 2 percent of GDP in 2002. There appears little scope for additional fiscal adjustment in the short run, given the large cuts already made in recent years. Official reserves are projected to reach the equivalent of 2.5 months of imports of goods and services in 2002 and increase to 3.3 months starting from 2004.

12. Debt indicators are projected to improve steadily to manageable levels over the medium term. The external public and publicly-guaranteed debt, which is estimated at about 58 percent of GDP in 2001, would gradually decline to 35 percent by 2010 (Table 7). The NPV of future debt service obligations would decline from its peak of 50 percent of GDP in

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<sup>6</sup> These operations included a 1999 buy-back of \$140 million bonds to Gazprom, a new issuance of \$90 million bonds to Gazprom for the repayment of energy arrears in 2000, a debt-equity swap in the gas sector, whereby Gazprom acquired 51 percent of Moldovagaz in 2000 and a partial buy back of the Eurobond in 2001.

<sup>7</sup> The terms assumed for the restructuring of the remaining principal of the Eurobond are: 8 percent interest rate, 10 years maturity and 18 month of grace period. About \$13 million is assumed to be retired in 2003, under the assumption of privatization of Moldtelecom. For Gazprom notes the terms assumed are: 5 percent interest, 10 years maturity and 18 months grace period.

2001 to 21 percent of GDP in 2010. The NPV of debt-to-export and debt-to-revenue ratios are also expected to reach satisfactory levels by 2010, at 40 percent and 126 percent respectively. The debt service on public and publicly-guaranteed debt would also decline sharply to less than 10 percent of exports of goods and services by 2006 and about 20 percent of central government revenues by 2010.

13. While—under good policies—debt indicators point in the right direction over the long-term horizon, short-term prospects critically depend on reaching rescheduling agreements with Eurobond holders and Gazprom. If macroeconomic outcomes turn out worse than assumed and/or negotiations with private creditors are not successful, the debt situation could become considerably more problematic.

**MOLDOVA—FUND RELATIONS**  
(As of May 31, 2002)

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

<b>II. General Resources Account:</b>	<b>SDR million</b>	<b>Percent of Quota</b>
Quota	123.20	100.00
Fund holdings of currency	216.01	175.33
Reserve tranche position	0.01	0.00
Holdings exchange rate		

<b>III. SDR Department:</b>	<b>SDR million</b>	<b>Percent of Allocation</b>
Holdings	0.01	N/A

<b>IV. Outstanding Purchases and Loans:</b>	<b>SDR million</b>	<b>Percent of Quota</b>
Extended arrangements	79.69	64.68
Systemic Transformation	13.13	10.65
PRGF arrangements	18.48	15.00

**V. Latest Financial Arrangements:**

Type	Approval date	Expiration date	Amount approved (SDR million)	Amount drawn (SDR million)
PRGF	12/21/2000	12/20/2003	110.88	18.48
EFF	05/20/1996	05/19/2000	135.00	87.50
Stand-by	03/22/1995	03/21/1996	58.50	32.40

**VI. Projected Obligations to Fund<sup>8</sup>:** (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2002	2003	2004	2005	2006
Principal	8.75	15.83	14.58	14.58	16.42
Charges/Int	1.48	2.52	1.99	1.53	1.08
Total	10.23	18.35	16.57	16.11	17.50

<sup>8</sup> Disbursements made after November 28, 2000—with the exception of disbursements of emergency assistance and loans from the Poverty Reduction and Growth Facility—are expected to be repaid on the expectations schedule. Countries may request the IMF Executive Board to make repayments according to the obligations schedule if their external payments position is not strong enough to meet the repayment expectations without undue hardship or risk. Please note: Repayments under the Supplemental Reserve Facility are scheduled to be repaid on the expectations schedule.

**VII. Safeguards Assessments:**

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

**VIII. Exchange Arrangement:**

Prior to the introduction of the Moldovan leu on November 29, 1993, the Russian ruble (supplemented by NBM-issued ruble denominated coupons) was the legal tender in Moldova. The government introduced the leu at a conversion rate of one leu equal to 1,000 Moldovan rubles and an exchange rate of one dollar equal to lei 3.85. The leu remained broadly stable around MDL 4.75/\$ until mid-October 1998. It has since depreciated against the dollar and traded at MDL 13.0909=\$1 on December 31, 2001.

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

**IX. Article IV Consultation:**

Moldova is on a 12-month consultation cycle. The last Article IV consultation was concluded on December 15, 2000 (SM/00/271; 12/01/00).

**X. FSAP Participation:**

Moldova has not received a FSAP mission but may participate in the financial year FY2004.

**XI. Use of Fund Resources:**

On February 4, 1993, Moldova purchased Fund resources totaling SDR 13.5 million, equivalent to 15 percent of quota under the Compensatory and Contingency Financing Facilities (CCFF) (EBS/93/8, 1/15/93). This was followed by a first drawing under the Systemic Transformation Facility (STF) of SDR 22.5 million, equivalent to 25 percent of quota, which was approved by the Board on September 16, 1993 (EBS/93/149, 9/8/93). On December 17, 1993 (EBS/93/177, 11/16/93), the Board approved a purchase of Fund resources under a stand-by arrangement (SBA) in the amount of SDR 51.75 million and the

drawing of the second tranche of the STF totaling SDR 22.5 million. On December 19, 1994, Moldova made a second purchase under the CCFE totaling SDR 12.2 million, equivalent to 13.5 percent of quota, in conjunction with the second review of the SBA that expired at end-March 1995. The Board approved a successor SBA for Moldova in an amount totaling SDR 58.05 million (equivalent to 65 percent of quota) on March 22, 1995 (EBS/95/26, 3/2/95). Three purchases, totaling SDR 32.4 million (equivalent to 36 percent of quota), were made under the arrangement. An Extended Arrangement in an amount totaling SDR 135 million (equivalent to 150 percent of old quota) was approved by the Executive Board on May 20, 1996 (EBS/96/68, 5/6/96). At the time of the third review, the program was extended by one year to May 19, 2000. While the fourth review was completed (EBS/99/142; 7/29/99), the program expired on May 19, 2000 without the completion of the scheduled last review because parliament rejected twice an important program condition. Five purchases totaling SDR 87.5 million (equivalent to 97 percent of old quota) were made under the EFF arrangement. The PRGF arrangement, approved on December 15, 2001 (EBS/00/249), is in the amount of SDR 110.88 million (equivalent to 90 percent of quota). It entails quarterly performance criteria and semi-annual reviews. SDR 9.24 million was disbursed on December 29, 2000, followed by SDR 9.24 million on February 23, 2001.

**XII. Resident Representative:**

Mr. Al-Atrash replaced Mr. Horton as the Fund's Resident Representative in Moldova on September 27, 1999. His assignment ended in February 2002. Mr. Ruggiero has been appointed the new Resident Representative as of July 2002.

**XIII. Resident Advisors:**

An FAD resident advisor, Mr. Agarwal, completed a second six-month posting to support the development of the treasury in June 1998. Peripatetic return visits were conducted through 1999. No further visits are planned. During 1998, Mr. and Mrs. Faulk were assigned as resident advisors on banking supervision at the NBM. During 1999, they paid various follow-up visits as external experts. In July 1999, an FAD resident tax administration advisor, Mr. Vandenberghe, was extended for a third six month period to support the development of a large taxpayer unit. His contract ended in mid-2000.

**XIV. Short-Term Assistance:**

Mr. Antao conducted regular visits to assist the ministry of finance on macroeconomic analysis since mid-1997. From April 1996 to July 1998, Mr. Richards paid regular visits as a regional balance of payments statistics advisor to Moldova, Armenia, and Georgia. Mr. Van Sluys and Dr. Peeraer visited Chişinău on several occasions in 1998/99 to assist in the area of supervision of commercial bank's foreign exchange activities. Mr. Thompson has been advising the NBM on accounting issues since 1999 and visited Moldova regularly during the past three and a half years, including for preparation of the NBM international audits. A follow-up visit is scheduled for early-2003.



### XV. Technical Assistance:

The following table summarizes the technical assistance missions provided by the Fund to Moldova since January 1997.<sup>9</sup>

#### Moldova: Technical Assistance Provided by the Fund, 1997–2002

Department	Subject/Identified Need	Timing	Counterpart
LEG	Bankruptcy law	March 1997	MoE
MAE	Monetary policy; foreign exchange operations; banking supervision; and legal issues.	May 1997	NBM
STA	Monetary accounts	June/July 1997	NBM
MAE	Ongoing modernization of central bank operations: monetary operations, accounting and auditing, and banking supervision	March/April 1998	NBM
FAD	Public expenditure policy; expenditure priorities.	July 1998	MoF
MAE	Monetary and foreign exchange operations; and banking, accounting, and auditing issues.	April/May 1999	NBM
STA	Government financial statistics	August 1999	MoF
FAD	Tax administration	May 2000	MoF
FAD	Customs Administration	June 2000	MoF
MAE	Monetary policy management; payment system; foreign exchange operations; and banking supervision.	September 2000	NBM
LEG	Banking legislation	October 2000	NBM
LEG	Free economic zone legislation	Jan/Feb 2001	MoE
FAD	Expenditure policy	May 2001	MoF
LEG	Bankruptcy law	June 2001	MoE
LEG	Banking legislation	June 2001	NBM
MAE	TA assessment/evaluation	October 2001	NBM
MAE	Payments system; liquidity projection and monetary policy framework; central bank accounting and internal audit; and bank supervision.	May 2002	NBM

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

<sup>9</sup> For technical assistance before 1997, see previous reports.

**MOLDOVA—RELATIONS WITH THE WORLD BANK GROUP**

*(As of June 5, 2002)*

1. The Republic of Moldova joined the World Bank on August 12, 1992. Moldova was made IDA eligible (blend status) in May 1997, and became an IDA only country in May 2000.
2. The first loan to Moldova was an Emergency Drought Recovery Loan (\$26 million), approved in March 1993. The loan was used to finance purchase of key agricultural inputs and was fully disbursed. A Rehabilitation Loan (\$60 million), approved in October 1993, financed essential imports in support of the structural reform program; it is fully disbursed. In 1995 a Pre-export Guarantee Facility (\$30 million) was established to promote the attraction of working capital loans from abroad. However, it was cancelled in July 1997, owing to lack of progress.
3. In 1996, a series of investment loans were approved: (i) a first Private Sector Development Loan (PSD I) (\$35 million), designed to establish a support mechanism and credit line for restructuring; (ii) the First Agriculture project (\$10 million), aimed at export promotion, institution building, investment support and providing aid for agricultural research; (iii) an Energy project (\$10 million), which intended to put gas and electricity sales on a commercial basis, and establish the state-owned gas company (Moldovagas) and the power generation and distribution company (Moldenergo) as financially viable enterprises; and (iv) a first IFC investment (\$10 million in INCON, a major agro-processor).
4. Expansion of investment lending continued under mixed IDA/IBRD and then IDA terms: (i) the General Education project (IDA \$5 million, IBRD \$16.8 million), aimed at improving curriculum in schools, training teachers and establishing a textbook rental scheme; (ii) the PSD II project (IDA \$9 million) for the training of business managers; (iii) the Cadastre project (\$15.9 million IDA credit); (iv) the Social Investment Fund project (\$15 million IDA credit); (v) the Social Protection Management Project (IDA \$11.1 million), aimed at reform of Moldova's pension system; and (vi) Health Investment Fund project (IDA \$10 million and with \$10 million co-financing from the Dutch government), approved in August 2000, designed to modernize emergency services and primary health care, reduce excess capacity in the health sector, strengthen institutional capacity, and guarantee universal access to basic health services.
5. Since 1994, three structural adjustment operations have been carried out, which aimed at supporting structural reforms in the areas of financial discipline, cash privatization, de-monopolization and privatization of the energy sector and telecom, and urban and rural land markets. The First Structural Adjustment Loan (\$60 million) was approved in December 1994. The Second Structural Adjustment Loan and Credit (\$100 million, of which IDA credit of \$45 million) was approved in 1997. The first two tranches (\$35 million each) disbursed in September 1997 and May 1999 while the third tranche was cancelled and replaced with a \$40 million Structural Adjustment Credit (approved on June 24, 1999). The first tranche was disbursed in August 1999 and the second in December 2001. The second tranche of the SAC was accompanied by a \$10 million budget support grant from the Dutch Government. The SAC closing date was extended from March 31, 2000 to September 28,

2001, and a supplement of \$5 million disbursed in December 2001 to help the Government fill a financial gap created by ice storm damages of November 2000.

6. A third Structural Adjustment Credit (SAC III)<sup>10</sup>, in the amount of \$30 million to be disbursed in three equal tranches, will be presented to the Bank's Board on June 20, 2002. Release of the credit tranches will depend upon maintenance of a satisfactory macroeconomic framework and adherence to and implementation of measures specified in the Letter of Development Policy, as well as maintenance and continued progress of overall pro-market structural reforms.

7. The SAC III will be presented to the Bank's Board together with the Moldova Country Assistance Strategy Progress Report (CAS PR) as well as the first phase of an Adaptable Program Credit for a Rural Investment and Services Project. The CAS Progress Report reviews developments since the last CAS for Moldova in May 1999, summarizes the experience in implementing its strategy, and presents the interim operating plan and lending and analytical priorities for FY02–03. The interim lending for FY03 includes: (i) a first Public Sector Reform Credit to initiate support for the Government in this area; (ii) a credit for Energy II to help modernize the transmission network, commercialize sector operations and implement an investment program to improve energy efficiency; (iii) a Trade and Transport Facilitation in South Eastern Europe project designed to modernize customs, border controls and cross border cooperation as well as minimize smuggling and corruption; and (iv) a pilot Water Supply and Sanitation project to test approaches to maximize the poverty reduction impact and enhance prospects for community-driven development initiatives in villages and small towns. A Poverty Reduction Strategy Paper (PRSP) is also planned in FY03 and will be followed by a full CAS.

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<sup>10</sup> The program continues the main elements of the previous SAL/SAC programs and contains the basis for a medium-term public sector reform program.

**MOLDOVA—RELATIONS WITH THE EBRD**  
*(As of May 31, 2002)*

1. The EBRD's strategy in Moldova is aimed at supporting private sector activity in agribusiness, critical infrastructure projects, and the financial sector through providing project financing and technical assistance to SMEs and micro-enterprises as well as offering privatization and post-privatization support. To date the global value of projects supported, in whole or in part, totals around €318 million.
2. Twenty-five projects have been signed totaling €190.6 million of EBRD resources. Of this amount, €154.4 million has been disbursed, including to: (i) a wine export promotion project, which is targeting the upgrading of the main Moldovan wineries and the restructuring of the wine sector (€28.7 million), equity investment under this project into a glass producer (€7.9 million); (ii) an energy efficiency project for upgrading the heating distribution networks in major Moldovan cities (€8.8 million); (iii) several credit lines and equity investment for Moldova-Agroindbank for on-lending to small and medium enterprises (€28.9 million in total); (iv) several credit lines and equity investment for Victoria Bank (€7.4 million in total); (v) a project for linking Moldovan satellite earth stations to the Eurovision Network (€1.1 million); (vi) a road rehabilitation loan (€12.3 million); (vii) partial financing for construction of a new oil terminal at Giurgulesti (€11.9 million); and (viii) credit facilities for micro enterprises through four local banks (€3.4 million); (ix) rehabilitating Chişinău's water services (€16.6 million); (x) Chişinău Airport Modernization (€9.5 million); (xi) trade facilitation program for Victoriabank, Moldova-Agroindbank, and Moldindconbank (regional TFP); (xii) equity participation in and a loan to the micro-lending company (€1.1 million); and (xiii) equity participation and loan financing for three privatized power distribution companies (€16.6 million).
3. Several projects totaling around €13 million are currently being prepared and reviewed including a number of \$1–4 million transaction with private companies and banks are at the exploratory stage. In addition, some 74 Technical Cooperation projects have been completed or approved (totaling €10 million).

**MOLDOVA—STATISTICAL ISSUES**

1. **Although generally adequate** for surveillance and program monitoring, Moldova's official statistics still have shortcomings, especially regarding the national accounts. Data for monitoring macroeconomic developments are provided by the Moldovan authorities in a timely manner (see page 50).
2. **National accounts statistics** are prepared following the *1993 SNA* methodology. Estimates do not include the Transnistria region for which data have not been collected since 1991. GDP is estimated from the production and the expenditure sides, on both an annual and quarterly basis. The data are prepared in current and constant (previous-year) prices, and annual data are revised—in two stages—as updated information becomes available. However, the quarterly data remain unadjusted, thus limiting their consistency with the revised annual data. In all, the national accounts statistics need improvement in the following areas: (i) compiling annual and quarterly GDP in constant prices; (ii) coordinating annual and quarterly data; (iii) estimating the consumption of fixed capital in line with international standards; and (iv) estimating the share of the “non-observed” economy from source information such as regular surveys and other, ad hoc, documentation.
3. **Price statistics** still have various shortcomings. Price collection for the CPI is limited geographically and missing data are not imputed following a standard procedure. However, the weights of the CPI basket were adjusted as of January 1999, based on a World Bank-supported update of the household budget survey. This update was conducted in 1997.
4. **Labor market statistics** remain inadequate for analyzing macroeconomic developments: (i) unemployment data following ILO methodology are not available; and (ii) wage data do not include fringe benefits, which form an important part of workers' compensation.
5. **Fiscal statistics.** A 1999 GFS statistical mission assisted the authorities in resolving data issues and provided technical assistance in the classification of accounts. Mission recommendations that still need to be implemented are: (i) improving the consolidation of general government data; (ii) reclassifying the financing data by type of debt holder and by type of debt instrument; and (iii) reporting to STA for inclusion in *International Financial Statistics* of discrete monthly fiscal data, based on correspondent accounts at the NBM, by the MoF. In addition, World Bank technical assistance was provided to improve the budgetary reports of local authorities as well as the Social Fund.
6. **Balance of payments.** The compilation methodology follows the fifth edition of the *Balance of Payments Manual*. Problems remain related to: (i) under-reporting of imports and exports; (ii) collection of data on services; (iii) measurement of private capital inflows, including direct investment data; and (iv) treatment of transactions with Transnistria. Moldova disseminates quarterly international investment position statistics.
7. **Money and banking statistics** have improved, following a series of technical assistance missions from the Fund. A new chart of accounts for the NBM was introduced in 1996 and commercial banks adopted a new chart of accounts and moved to IAS with effect

from January 1, 1998. Following completion of the first IAS-based external audit in the early months of 1999, the NBM's accounts were moved to a full accruals basis as at end-December 1998, and regular accruals were commenced since then. This process was assisted by MAE technical assistance in accounting. Subsequent IAS-based external audits were carried out for end 1999, 2000, and 2001, respectively. Apart from a technical qualification in 1999 regarding omission of a cash flow statement, the NBM accounts have been unqualified. The NBM is currently in the process of further refining its chart of accounts and implementing new accounting software consistent with best international practice. The accounting function has also recently been restructured to better suit the needs of a modern central bank.

**MOLDOVA—SURVEY OF REPORTING OF MAIN STATISTICAL INDICATORS**  
(As of June 7, 2002)

	Exchange Rates	Inter-National Reserves	Reserve Money	Central Bank Balance Sheet	Broad money	Interest Rates	Consumer Price Index	Exports/Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt
Date of latest observation	5/31/02 (M)	5/31/02	4/30/02	4/30/02	4/30/02	6/5/02	4/30/02	3/31/02	3/31/02	3/31/02	3/31/02	3/31/02
Date received	6/02 (M)	6/02	5/02	5/02	5/02	6/5/02	5/02	5/02	5/02	5/02	6/02	5/02
Frequency of data	D; M	W	W	W	W	W	M	M	Q	Q	Q	D
Frequency of reporting	D; M	M	M	M	M	M	M	M	Q	Q, V	Q	Q
Frequency of publication	D; M	O	O	O	O	M	M	M	Q	O	Q	O
Source of update	A (M)	A	A	A	A	A	N	A, C	A, C	A	A	A
Mode of reporting	e-mail (E)	e-mail (E)	E <sup>1</sup>	E <sup>1</sup>	E <sup>1</sup>	E	E, M	E <sup>1</sup>	C <sup>1</sup>	E, V	C, V	E
Confidentiality	A (M)	A	A	A	A	C	C	C	C	A	C	C

<sup>1</sup>Received through the resident representative office.

Explanation of abbreviations:

Frequency of data: D=daily, W=weekly, M=monthly, Q=quarterly, A=annual, or O=other;

Frequency of reporting: D=daily, W=weekly, M=monthly, Q=quarterly, A=annual, V=irregularly in conjunction with staff visits, or O=other;

Source of data: A=direct reporting by central bank, ministry of finance, or other official agency, N=official publication or press release, P=commercial publication, C=commercial electronic data provider, E=EIS, O=other;

Mode of reporting: E=electronic data transfer, C=cable or facsimile, T=telephone, M=mail, V=staff visits, or O=other;

Confidentiality: A=for use by the staff only, B=for use by staff and the Executive Board, C=for unrestricted use, D=embargoed for a specified period and thereafter for unrestricted use, or E-Subject to other use restrictions.

Chisinau, June 24, 2002

Mr. Horst Köhler  
Managing Director  
International Monetary Fund  
Washington, D.C. 20431

Dear Mr. Köhler:

First, we would like to express our gratitude for the continued support that the International Monetary Fund (IMF) is providing to Moldova under the Poverty Reduction and Growth Facility (PRGF). Furthermore, we would like to assure you of our commitment to the policies outlined in the Memorandum of Economic and Financial Policies (MEFP), signed in late 2000, which formed the basis for Moldova's three-year arrangement under the PRGF. The attached Supplement to the MEFP reports on the implementation of policies during 2001 and so far during 2002 and describes our policies for the remainder of this year and for 2003.

Regrettably, the 2001 elections resulted in delays in the implementation of measures needed to advance the transformation process to a market economy. Financial policies remained on a sound footing, however, and in the past several months we have taken strong measures to regain the momentum in the reform process, including the prior actions described in Section VI of the attached Supplement. We have also agreed with the World Bank on a set of structural measures that aim at reducing poverty, strengthening social protection, and improving the business environment. In light of this, we request that the IMF consider our request for continued support under the PRGF and that the IMF complete the first review under the arrangement. Given the delay in completing this review, we also request a rephasing of the disbursements, so that the remainder of the loan provided for under the arrangement could be made available in equal amounts of SDR 9.24 million on a quarterly basis, except for 2002, when disbursement would be higher to take into account the high debt service payments during this year.

We furthermore request that waivers be granted for the non-observance of (i) the end-March 2001 performance criterion for the National Bank of Moldova's (NBM) net international reserves and (ii) the continuous performance criterion on the non-accumulation of external arrears. The net international reserves target was missed because projected privatization proceeds failed to materialize. The margin by which the target was missed was very small. We have accumulated some external arrears on commercial debt because of shortfalls in external financing. We have been negotiating to reach a collaborative agreement with creditors and expect to resolve this issue by the end of 2002.



We believe that the policies and measures set forth in the attached Supplement are adequate to achieve the objectives of our economic program for 2002–03. The Government and the NBM stand ready, however, to take any additional measures, in consultation with the IMF staff, that may become necessary to ensure that the objectives of the program can be achieved. The Government and the NBM will also provide the IMF with all the information needed to assess progress in implementing the policies and reaching the objectives of our program. Moldova will conduct discussions with the Fund for the second review of its program under the PRGF arrangement before December 15, 2002.

Sincerely yours,

/s/  
Vasile Tarlev  
Prime Minister  
Republic of Moldova

/s/  
Leonid Talmaci  
Governor  
National Bank of Moldova

/s/  
Zinalda Crecianîi  
Minister of Finance  
Republic of Moldova

Attachment

**Supplement to the Memorandum of Economic and Financial Policies  
of the Government and National Bank of Moldova  
(June 24, 2002)**

**I. INTRODUCTION**

1. Following parliamentary elections in late February 2001, a new president was elected and a new government appointed in April. The government's work program for 2001–05, approved in April 2001, places emphasis on fighting corruption, strengthening the legal framework, and promoting sound financial policies. In addition, we are developing a full-fledged poverty reduction strategy in close cooperation with the presidency, parliament, local governments, nongovernmental organizations, and the international donor community.
2. The government intends to continue to pursue market-oriented policies and provide the necessary environment for private entrepreneurship and private-sector-led growth. We are committed to reducing administrative interference in the economy and maintaining a liberal exchange and trade regime. We will continue to pursue sound financial policies and move forward with the privatization program and other market-oriented reforms, including in the agricultural sector; these policies are needed to attract investment and spur growth. We realize that growth is imperative in order to make headway with an anti-poverty program consistent with our social priorities.
3. This supplement to the Memorandum of Economic and Financial Policies (MEFP) signed on November 30, 2000 summarizes our policy objectives and priorities for 2002–03. The emphasis in the MEFP on economic stability and structural policies conducive to private sector growth and poverty alleviation is well placed. Accordingly, we intend to adhere to the policies outlined in that memorandum. If it becomes necessary to modify this supplement, we will first consult with Fund staff to reach a common understanding.

**II. RECENT DEVELOPMENTS**

4. Economic and financial indicators since end-2000 have been encouraging. Real GDP growth picked up from 2 percent in 2000 to 6 percent in 2001. Preliminary information for early 2002 points to continuing growth, with industrial production in January through April up 18 percent compared to the previous year. CPI inflation dropped significantly from 18½ percent in 2000 (end of period) to 6 percent in 2001; twelve-month inflation in April 2002 was 6½ percent. The current account deficit improved to about 7½ percent of GDP in 2001 from 8½ percent of GDP in 2000, in large part due to higher transfers from Moldovans working abroad. The exchange rate has moved broadly in line with relative inflation.
5. Fiscal policy remained tight in 2000 and 2001. The general government commitment balance (excluding project loans) improved to a surplus of ½ percent of GDP in 2001 from a deficit of 0.8 percent of GDP in 2000. All fiscal performance criteria and indicative targets for end-December 2000 and end-March 2001 under the PRGF-supported program were observed. The indicative targets for end-June and end-September were also met. However,

while domestic expenditure arrears were cleared in excess of program targets in 2000, new arrears of 0.3 percent of annual GDP were accumulated in the fourth quarter of 2001. While the general government continued to post a small surplus on a commitment basis during the first quarter of 2002, external arrears were accumulated.

6. Monetary policy was tightened in 2000 and remained appropriately cautious through March 2002. All monetary performance criteria and indicative targets for end-December 2000 through end-September 2001 were observed, or missed only by very small margins. As demand for domestic currency recovered forcefully, broad money grew by 18 percent in real terms in 2000 and by 28 percent in 2001. Credit to the economy grew at a similar pace, the first such increase in several years. The NBM's gross international reserves, which had risen to about \$220 million by end-2000, remained broadly unchanged through end-April 2002, despite sizable external debt service obligations and lower-than-expected external financing.

### III. FISCAL POLICY

7. Fiscal policy will aim at achieving a primary budget surplus (excluding project loans) of about 2 percent of GDP in 2002. Our objective is to stabilize and subsequently reduce Moldova's heavy external debt burden, while at the same time ensuring sufficient financing for social expenditures and a steady clearance of arrears on domestic expenditures and external debt payments. Meeting these objectives requires: (i) further strengthening of revenue collection; (ii) rationalizing noninterest expenditures; and (iii) securing support from the international financial community.

8. Under current projections, general government revenues (including grants) are expected to reach MDL 6,305 million in 2002, while the projected available financing allows for a cash deficit of MDL 380 million. With the domestic budgetary expenditure arrears projected to decline by MDL 120 million in 2002, the budget deficit on a commitment basis would be limited to MDL 260 million, or about 1 percent of GDP. We will seek an amendment to the 2002 Budget Law to take into account recent developments, including unbudgeted wage increases recently granted to some categories in the social sector as part of our efforts to retain high-quality staff. We expect that these payments will be offset by lower-than-expected interest payments and cuts in capital expenditure.

9. We have started to develop preliminary projections for the 2003 budget. The broad parameters of the budget for the general government were formulated in consultation with the Fund staff. It is our intention to achieve a primary budget surplus of 3.2 percent of GDP. Therefore, we will limit the general government cash budget deficit to about 1.2 percent of GDP. In order to avoid undermining financial discipline, we intend to steadily clear domestic expenditure arrears. As a result, we expect the commitments deficit to be about 0.2 percent of GDP. To reach these goals, we will limit wage increases to an amount that can be accommodated in the 2003 budget without sacrificing capital expenditures further. If necessary, we will scale down/postpone the additional wage adjustment planned for September 2002, in order to ensure that the 2003 wage bill grows in line with the available financing.

10. Expenditure savings will be achieved by rationalizing expenditures in key sectors, including health and education, in line with the recommendations of the World Bank. In particular, no debt restructuring or forgiveness will be granted in the agricultural sector outside the National Land Program and the Law on Restructuring of Agricultural Enterprises. We will draft a new law on deposit indexation targeting only the poorest segments of the population, in line with IMF recommendations. In view of the cost of the scheme to the budget, we will spread the payment of benefits over a period of at least 15 years, and only if sufficient budgetary revenues are available (structural benchmark). Privatization proceeds will be used to reduce the stock of external and internal government debt (including credit from the NBM) and budgetary arrears, as well as to boost capital expenditure, in proportions decided in consultation with Fund staff.

11. Strengthening revenue collection will be done primarily through improving tax and customs administration. The large taxpayer unit (LTU) has been given exclusive responsibility for key aspects of large taxpayer compliance; further steps will be taken to make the LTU fully operational by September 1, 2002 (structural benchmark). We remain committed to eliminating netting operations and in-kind collections of current taxes, social fund contributions, as well as of arrears on taxes and social contributions. We will refrain from introducing any new tax exemptions, holidays, amnesties, or deferrals of any kind. In particular, we will not introduce any changes to the tax system without reaching an understanding with the IMF. To avoid jeopardizing revenue collection in the short term, any reductions in income tax rates, as well as other changes in tax policy, would be done in consultation with the IMF.

12. Since taxes on imports (VAT, excise, import tariff) are crucial for attaining our revenue targets, we attach great importance to improving the effectiveness of customs administration. We have recently implemented a preshipment inspection (PSI) program for imported goods. We will ensure that the program remains effective by closely monitoring its implementation and by strictly limiting any exemptions from PSI in coordination with the company providing PSI services. In particular, we will maintain PSI on pharmaceuticals and will not introduce any new exemptions beyond those applied as of May 21, 2002, until the completion of a full assessment of the program is made (after June 30, 2002).

#### **IV. MONETARY POLICY AND FINANCIAL SECTOR REFORM**

13. The government recognizes the importance of a strong and independent central bank. Thus the NBM will retain its current legal status as an independent public legal entity in accordance with the Law on the National Bank of Moldova, which will not be amended. The NBM will continue to follow a policy of allowing the leu to float freely, with interventions limited to smooth out short-term exchange rate fluctuations and to meet reserve targets.

14. The monetary policy of the NBM will continue to be directed at achieving and maintaining low inflation. We will target inflation at 8 percent in 2002 and 2003. Consistent with this objective, base money is programmed to increase by about 15 percent in these two years. The monetary program also aims at restoring gross international reserves to a level of

about \$250 million by end-2002, equivalent to 2.5 months of imports. Reserves are projected to increase further to \$315 million, or 2.9 months of imports, by end-2003.

15. The increase in central bank net credit to the government will be limited to MDL 81 million in 2002, to be used to help finance the government's external debt service obligations. While we do not envisage use of NBM credit in 2003, it can be extended to the government to smooth cash flow fluctuations during the year. In view of the credit expansion projected for this year, the reserve requirement ratio will remain unchanged in 2002. At the same time, the NBM will use the deposit facility introduced in February 2002 to absorb excess liquidity. The NBM will continue to act as the fiscal agent for the Ministry of Finance regarding the issuance of treasury bills. Treasury bills will not be required to be registered at the National Securities Commission or traded at the Stock Exchange.

16. The NBM will continue its efforts to strengthen banking supervision. Significant progress in the consolidation of the banking sector was achieved following the increase in minimum capital requirements for existing banks in December 31, 2000. In accordance with Article 14 of the Law on Financial Institutions, which will not be amended, the NBM will remain solely responsible for the granting and revoking of commercial bank licenses. In that capacity, the NBM will revoke the banking license of all banks that continue to fail to meet the minimum capital requirements one month after the noncompliance has been established.

#### **V. EXTERNAL SECTOR ISSUES**

17. The high external debt stock (about 90 percent of GDP in 2001) continues to be a problem, especially in view of dwindling external financing. Accordingly, we are seeking to restructure Moldova's commercial debt (Eurobond and Gazprom promissory notes). We will also ask for Paris Club rescheduling if warranted by an unexpected balance of payments need. In the meantime, we are continuing negotiations with Gazprom to restructure our debt service obligations.

18. The government and NBM will refrain from contracting nonconcessional external debt except for a limited amount yet to be determined for the workout and termination of the Gurguliesti oil terminal project and for administrative expenses related to the restructuring of commercial debt. We will also refrain from issuing guarantees on nonconcessional terms for commercial ventures, whether state-owned or private.

19. We will continue to maintain a liberal exchange and trade regime. The continuous structural benchmark regarding import tariffs will remain as specified in paragraph 33 of the November 30, 2000 MEFP. We will also refrain from introducing export bans, quotas and licenses.

## VI. STRUCTURAL POLICIES

20. While significant progress has been achieved in financial policies, the implementation of structural reforms has accelerated only recently. The following structural measures that were included in the November 2000 MEFP have been completed:

- **Insolvency Law.** Parliament approved a new Insolvency Law in November 2001, consistent with Fund and World Bank technical assistance recommendations. The new Insolvency Law established uniform bankruptcy/reorganization procedures for commercial enterprises in Moldova and provided for the time frame and procedures for repealing the Law on Restructuring of Enterprises. The new law also transferred responsibility for appointing bank liquidators and monitoring progress of the liquidation process to the courts.
- **Law on Free Economic Zones (FEZs).** In line with Fund technical assistance recommendations, parliament approved a law that restricted FEZs to export-oriented production and transshipment, limited privileges, and established a time frame and mechanism for the liquidation of FEZs in November 2001. Since early 2001, no new FEZs have been established.
- **Tax administration chapter of the Tax Code.** With USAID assistance, we have been working on introducing a modern tax administration system that conforms to best international practices and should significantly improve tax compliance. The tax administration chapter (Title 5) was approved by parliament in July 2001.
- **Law on Financial Institutions.** Parliament approved amendments to the Law on Financial Institutions in November 2001, consistent with Fund technical assistance recommendations. These amendments ensure consistency of this law with the new Insolvency law.
- **Law on Licensing.** In July 2001 Parliament approved a new law that streamlined licensing procedures. The number of activities that require licensing were reduced to about 50, while leaving the authority of licensing for strategic industries—telecommunications, energy and banking—to independent regulatory agencies.
- We introduced a **preshipment inspection** program for imported goods in December 2001.
- All **export bans, quotas, or licenses** have been eliminated.
- Following some technical delays in extending coverage to local government expenditures, a full-fledged **treasury** system was put in place in the fall of 2001.
- An **Anti-Money Laundering Law**, prepared with assistance of the U.S. Treasury Department, was approved by parliament in November 2001.

21. We have also recently reached agreement with the World Bank on a timetable for the **privatization** of major state-owned enterprises, including Moldtelecom, two electricity distribution networks, and major wineries.

22. In light of recent developments in the energy sector, we emphasize the importance of maintaining a manageable level of **energy-related external debt**. We undertake not to enter into international agreements that could lead to an increase in energy sector-related external debt, unless it is consistent with the understandings in our program of economic reform that is supported by the Fund, World Bank and other relevant international financial institutions. To underscore the priority afforded to this issue we have adopted and published a cabinet decision outlining our undertaking (prior action).

23. Parliament approved a new civil code broadly in line with a market-based approach, specifically in the areas of properties, contracts, and secured transactions. The civil code was promulgated by the President on June 11 (prior action).

24. By September 1, 2002, we will complete additional structural measures, as described in Table 1 (structural benchmarks).

## VII. PROGRAM MONITORING AND REPORTING

25. Program monitoring for the period of July 1, 2002 to December 31, 2002 will be carried out on the basis of quarterly quantitative performance criteria and structural benchmarks established for end-September and end-December 2002, and a semi-annual review based on performance as of September 30, 2002 expected to be completed by December 15, 2002; in addition, a subsequent semi-annual review expected to be completed by June 15, 2003 will be based on performance as of March 31, 2003. In line with the current policy regarding lending into arrears, and while outstanding official arrears to private creditors persist, Fund disbursements in 2002 will be subject, in the context of financing assurances reviews, to satisfactory progress towards agreement in restructuring commercial debt. The quantitative performance criteria and indicative targets are listed in Table 2; details on the levels, definition, and monitoring of quantitative performance criteria and indicative targets are provided in the updated Technical Memorandum of Understanding (Appendix to this document). The Ministry of Finance and the NBM will report all data necessary for the effective monitoring of the program in a timely manner to the Fund.

Table 1. Moldova: Prior Actions and Structural Benchmarks

**Prior Actions**

- Adopt and publish a cabinet decision outlining the government's commitment not to enter into international agreements that could lead to an increase in energy-related external debt, as described in paragraph 22 of the MEFP supplement.
- Approval by Parliament and signing by the president of a Civil Code broadly in line with a market-based approach, specifically in the areas of properties, contracts, and secured transactions.

**Structural Benchmarks<sup>1</sup>**

*Continuous*

- Refrain from raising the unweighted average import tariff from its 1999 level, and from increasing the maximum tariff rate from its current level of 15 percent.

*September 1, 2002*

- Approval by Parliament and signing by the president of a Law on Income Declaration and Property Control for State Officials that is consistent with IMF staff recommendations.
- Prepare a draft Deposit Indexation Law that will target only the poorest segments of the population, in line with IMF staff recommendations. Payments under this law will be made only if sufficient resources are available.
- Ensure that the large taxpayer unit (LTU) is fully operational, with exclusive responsibility for all aspects of large taxpayers compliance and exclusive authority for monitoring and controlling large taxpayers. In particular, its functions will include all types of collection enforcement, audit, taxpayers' service and appeals.

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<sup>1</sup> Two structural benchmarks that had been previously included in the Supplement to the MEFP proposed in November 2001 have been dropped because they are now part of the World Bank SAC III program: (i) the preparation of necessary documentation (bidding package) for the privatization of Moldtelecom, and (ii) the conclusion of an agreement with a qualified financial advisor for the preparation for sale of key wineries to strategic investors.



Table 2. Moldova: Quantitative Performance Criteria and Indicative targets, March 31 - December 31, 2002

	March 31, 2002 Actual	June 30, 2002 Projected	September 30, 2002 Performance Criteria	December 31, 2002
<b>1. Quantitative performance criteria</b>				
				(millions of lei)
1.1 Ceiling on NBM's net credit to the general government	1,747	1,758	1,810	1,869
1.2 Ceiling on NBM's reserve money	2,527	2,599	2,692	2,856
1.3 Ceiling on the general government's cash deficit cumulative from December 31, 2001	-46	33	117	380
1.4 Ceiling on domestic expenditure arrears of the general government	760	730	691	642
				(millions of dollars)
1.5 Floor on net international reserves of the NBM	82	84	81	88
1.6 Ceiling on non-concessional external debt of the general government, the NBM, or any other agency acting on behalf of the government, cumulative from December 31, 2001 1/	0	0	0	0
Maturity Sub-ceilings:				
1.6.1 With maturities of 1 year or less (net disbursements)	0	0	0	0
1.6.2 With maturities of over 1 year (contracted or guaranteed)	0	0	0	0
1.6.3 With maturities of over 1 up to and including 5 years (contracted or guaranteed)	0	0	0	0
1.7 External payment arrears, cumulative from December 31, 2001 2/	6	12	0	0
<b>2. Indicative targets</b>				
				(millions of lei)
2.1 Ceiling on net domestic assets of the NBM	1,457	1,502	1,635	1,707
2.2 Ceiling on general government wage and pension arrears	172	154	132	104
				(millions of dollars)
2.3 Floor on gross international reserves of the NBM	223	221	224	251

Sources: Moldovan authorities and Fund staff estimates.

1/ Except for up to \$18 million for the workout and termination of the Giurgiulesti oil terminal project.

2/ In addition, a continuous performance criterion applies regarding the non-accumulation of external arrears.

## Technical Memorandum of Understanding

### A. Program Assumptions

- Disbursement to the general government budget of: \$10 million under the World Bank's SACIII operation by end-July 2002 (first tranche), \$10 million under the World Bank's SACIII operation by end-December 2002 (second tranche), and a Euro 5 million grant from the European Union by end-December 2002.<sup>2</sup>
- Receipt to the budget of privatization proceeds for two remaining energy distribution companies (RED north and RED northwest) in the amount of \$9 million by end-December 2002.
- Fund disbursements of SDR 9.24 million by end-July 2002 and SDR 18.48 million by mid-December 2002.
- Government commitment to abstain from (i) guaranteeing any commercial borrowing, including that funded by international financial institutions, and (ii) accumulating payment arrears on external debt contracted or guaranteed by the government (including debt converted into government debt).
- In the event that privatization receipts exceed the program assumptions, this will trigger consultations with Fund staff to agree on their use. The excess privatization proceeds will be used to reduce the stock of budgetary arrears, external and internal government debt— including credit from the NBM— and to increase capital expenditures, in proportions to be agreed in consultation with the Fund staff.
- 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 Moldova leu to the U.S. dollar has been set at MDL 13.0909/US\$ and the exchange rate of the U.S. dollar against the SDR dollar has been set at \$1.25673/SDR (being the prevailing exchange rates at December 31, 2001). Amounts denominated in other currencies will be converted for program purposes into U.S. dollar amounts using the cross rates prevailing at December 31, 2001.

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<sup>2</sup> The use of any additional funds will be determined in consultation with Fund staff in the context of the second or third review under the program.

**B. Program Targets**Table 1. Floors on the Stock of Net International Reserves (NIR) and  
Gross Reserves in Convertible Currencies of the NBM

(In millions of U.S. dollars)

Position on	Minimum Levels	
	Net international reserves (Performance criterion)	Gross international reserves (Indicative target)
March 31, 2002 (actual)	82	223
June 30, 2002 (indicative)	84	221
September 30, 2002	81	224
December 31, 2002	88	251

**Definitions and adjustors**

1. **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, including holdings of securities denominated in convertible currencies issued by governments or central banks of OECD member states. Excluded from reserve assets are capital subscriptions to foreign financial institutions, long-term nonfinancial assets, funds disbursed by the World Bank assigned for onlending and project implementation, assets in nonconvertible currencies, and foreign assets pledged as collateral or otherwise encumbered. 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.

2. **The net international reserves and gross reserves targets** will be raised, *pari-passu*, by the equivalent of any external budgetary financing exceeding the amounts specified under the program assumptions (Section A) and lowered for shortfalls resulting from temporary delays in any disbursements beyond the assumed dates, respectively.

3. The targets will be monitored from the accounts of the NBM. Data in the agreed format will be reported to the Fund within seven days of the end of each month by the NBM.

Table 2. Ceilings on the Net Domestic Assets (NDA)  
and Reserve Money of the NBM

(In millions of lei)

Position on	NDA (Indicative target)	Reserve Money (Performance criterion)
March 31, 2002 (actual)	1407	2477
June 30, 2002 (indicative)	1502	2599
September 30, 2002	1635	2692
December 31, 2002	1707	2856

### Definitions and adjustors

4. **Net domestic assets of the NBM** are defined as the difference between reserve money (defined as the sum of currency issued, total required and excess reserves of banks<sup>3</sup>, and nonbank nongovernment deposits) and net foreign assets of the NBM, (net international reserves of the NBM as defined in Table 1 plus the net position of the NBM correspondent accounts with the central banks of the Baltics, Russia, and other countries of the former Soviet Union (BRO), all expressed in Moldovan lei). Net international reserves shall be valued as noted in Section A.

5. **The targets for reserve money** are based on a programmed reserve requirement ratio of 10 percent of total deposits subject to reserve requirements and will be adjusted for any deviation of the actual reserve requirement ratio from the programmed ratio, based on the following formula: (actual ratio—programmed ratio) \* reservable base. The reservable base includes all commercial bank liabilities subject to reserve requirements.

6. **The NDA targets** will be adjusted upwards by 100 percent of the Moldovan lei equivalent of temporary delays in any of the disbursements specified under the program assumptions (Section A), except for Fund disbursements. The targets will be lowered by the Moldovan lei equivalent of the receipt of external budgetary financing (not including grants, but including rescheduling and restructuring of official debt) exceeding the amounts specified under the program assumptions (Section A).

7. **The targets for the net domestic assets of the NBM and reserve money** will be monitored from the accounts of the NBM. Data in the agreed format will be reported to the Fund within 7 days of the end of each month by the NBM.

<sup>3</sup> As recommended by the MAE mission of May 2002, auctioned bank deposits should not be included in reserve money.

Table 3. Limits on Net Credit to General Government from the NBM

(In millions of lei)

Position on	Net Credit to Gen. Governm't (Performance criterion)
March 31, 2002 (actual)	1747
June 30, 2002 (indicative)	1758
September 30, 2002	1810
Dccember 31, 2002	1869

**Definitions and adjustors**

8. The **general government** is defined as comprising the consolidated budget (the republican and local government budgets) and the Social Fund. Any new extra budgetary funds created will be included in the general government. Excluded are any government-owned entities with separate legal personality. Net credit to general government is defined as outstanding claims of the NBM on the general government exclusive of accumulated interest, including overdrafts, direct credit and holdings of government securities, less deposits of the general government.<sup>4</sup>

9. The **targets on net credit to general government** will be adjusted upwards by 100 percent of the Moldovan leu equivalent of temporary delays in any of the disbursements specified under the program assumptions (Section A), except for Fund disbursements. The targets will be lowered by the Moldovan leu equivalent of the receipt of external budgetary financing (not including grants, but including rescheduling and restructuring of official debt) exceeding the amounts specified under the program assumptions (Section A).

10. The limits will be monitored from the accounts of the NBM. Data in the agreed format will be reported to the Fund within 10 days of the end of each month by the NBM.

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<sup>4</sup> Accumulated interest is included under "Other Items Net".

Table 4. Limits on the Overall Cash Deficit of the General Government

(In millions of lei)

	Cash Deficit (Performance criterion)
Cumulative change from December 31, 2001	
March 31, 2002 (actual)	-46
June 30, 2002 (indicative)	33
September 30, 2002	117
December 31, 2002	380

**Definitions and adjustors**

11. **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<sup>5</sup>, the general government's net placement of securities outside the domestic banking system, other net credit from the domestic nonbanking sector to the general government, the general government's receipt of disbursements from external debt<sup>6</sup> for direct budgetary support (i.e., excluding disbursements from external loans 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.

12. **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.

13. **Commodity loans** will be treated as financing items in the fiscal accounts, at the value of the loan in foreign exchange converted into Moldovan lei at market exchange rates the date of the receipt of the loan. The amounts on lent to domestic enterprises minus domestic counterparts received from these enterprises will be recorded in net lending. Interest payments by the government on these loans to external creditors will be recorded as interest payments on foreign debt and interest paid by domestic enterprises to the government on these loans will be recorded in non-tax revenues. Repayments of principal from domestic

<sup>5</sup> Net credit of the banking sector to the general government includes net credit to the National House of Social Insurance.

<sup>6</sup> Debt will have the meaning set forth in Point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000 (see paragraph 16).

borrowers to the government will be treated as negative net lending and repayments of principal by the government to foreign creditors will be recorded as amortization.

14. For monitoring these limits, data in the agreed format will be reported to the Fund within 30 days of the end of each quarter by the Ministry of Finance of Moldova.

**Table 5. Limits on Nonconcessional External Debt  
with Original Maturities Indicated Below by the General Government of Moldova,  
the NBM, or any other Agency Acting on Behalf of the Government**

(In millions of U.S. dollars)

Maturity Subceiling:	Maximum Limits (Performance criteria) <sup>7/</sup>		
	1 year or less	Over 1 year	Sub-ceiling: Over 1 year up to and including 5 years
Cumulative change from December 31, 2001			
March 31, 2002 (actual)	0	0	0
June 30, 2002 (indicative)	0	0	0
September 30, 2002	0	0	0
December 31, 2002	0	0	0

### Definitions and adjustors

15. 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)<sup>8</sup>.

<sup>7</sup> Excluded from this limit is up to \$18 million for the workout and termination of the Giurgiulesti oil terminal project.

<sup>8</sup> The definition of debt set forth in point No. 9 of the guidelines reads as follows: "(a) For the purpose of this guideline, the term "debt" will be understood to mean 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. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has

(continued...)

16. 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.
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. **Concessionality** 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. **External-debt limits** apply to the net disbursement of short term nonconcessional external debt (with an original maturity of up to and including one year) and contracting or guaranteeing of nonconcessional medium- and long-term debt with original maturities of more than one year, with sublimits on the contracting or guaranteeing of such debt with original maturities of up to and including five years. Short-term debt includes all short term obligations, excluding IMF disbursements to the NBM and import trade credits. Short term debt denominated in currencies other than the U.S. dollar shall be valued in U.S. dollar 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 the exchange rate prevailing at the time of contracting or guaranteeing.
20. The performance criterion on **external arrears** includes all arrears to multilateral and official bilateral creditors and applies on a continuous basis. The program assumes that the Eurobond and Gazprom promissory note will be rolled over; payments due but unpaid after the expiration of the grace period will not constitute arrears.

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the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property. (b) Under the definition of debt set out in point 9(a) above, 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.”



Table 6. Ceilings on Domestic Expenditure Arrears of the General Government

(In millions of lei)

Position on	Maximum Levels	
	General government (Performance criterion)	Wages and pensions (Indicative target)
March 31, 2002 (actual)	760	172
June 30, 2002 (indicative)	730	154
September 30, 2002	691	132
December 31, 2002	642	104

**Definitions and adjustors**

21. **Expenditure arrears** are defined as the difference between obligations for goods and services for which an invoice has been received and actual payments made. Obligations include, but are not limited to, wage, pension, and energy payments. Arrears between the republican budget, local governments and all extra budgetary funds are not counted toward the ceiling.

22. For monitoring these limits, data in the agreed format will be reported to the Fund within 30 days of the end of each month by the Ministry of Finance of Moldova.



INTERNATIONAL MONETARY FUND

*Public Information Notice*

EXTERNAL  
RELATIONS  
DEPARTMENT

Public Information Notice (PIN) No. 02/93  
FOR IMMEDIATE RELEASE  
August 26, 2002

International Monetary Fund  
700 19<sup>th</sup> Street, NW  
Washington, D. C. 20431 USA

## **IMF Concludes 2002 Article IV Consultation with the Republic of Moldova**

On July 10, 2002 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Moldova.<sup>1</sup>

### **Background**

After many years of decline, economic activity has turned around. Boosted by a good harvest and continued industrial growth, real GDP increased by 6 percent in 2001, up from 2 percent in 2000. At the same time, end-of-period inflation was cut to 6½ percent in 2001 from 18½ percent in 2000. These developments, which continued through the first quarter of 2002, reflected sound financial policies and a revival in external demand for exports. Nevertheless, Moldova remains one of the poorest countries in the region.

Fiscal policy was tightened markedly following the 1998 Russian crisis. The general government commitments deficit (excluding project loans) was cut to 2½ percent of GDP in 1999 from 8½ in 1998, and narrowed further to less than 1 percent in 2000. A surplus of ½ percent of GDP was achieved in 2001 mainly through a sharp compression of expenditures,

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<sup>1</sup> Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the July, 10, 2002 Executive Board discussion based on the staff report.

and domestic arrears were not cleared as fast as expected. Low foreign financing led to budget sequestration and accumulation of new external arrears during the second half of the year. The budget continued to record a small surplus in the first quarter of 2002, but unbudgeted wages for social sector employees contributed to weaken the fiscal program.

With inflation receding, money demand recovered steadily in 2000–01. Broad money (including foreign currency deposits) grew by 40 percent in 2000 and 36 percent in 2001, resulting in some financial deepening. The rapid growth of deposits allowed a sharp expansion in bank credit to the economy. For the first time in several years, credit grew by 18 percent in real terms in 2000, and 27 percent in 2001. Although the average lending rate stood as high as 25 percent in April 2002, banks apparently had difficulties in finding additional lending opportunities with an acceptable risk-return profile. Ample liquidity in commercial banks enabled the government to lengthen the average maturity of newly issued treasury bills at interest rates as low as 4 percent in May 2002.

From end-2000 to end-March 2002, the Moldovan leu depreciated by 9 percent in real terms relative to Moldova's trading partners. The recent strong performance of exports suggests that the level of the real exchange rate has been broadly adequate for maintaining competitiveness. At end-March 2002, the National Bank of Moldova's (NBM) gross international reserves stood at US\$223 million (2½ months of imports), broadly unchanged from the end-2000 level, despite dwindling external financing flows, lower-than-expected privatization proceeds, and sizable external debt service payments. A sharp increase in earnings of Moldovans working abroad to about US\$221 million allowed the NBM to purchase substantial amounts of foreign exchange without putting pressure on the exchange rate and contributed to a narrowing of the current account deficit to 7½ percent in 2001 from 8½ percent of GDP in 2000. Exports also increased in 2001 by around 19 percent in dollar terms. Moldova joined the World Trade Organization in mid-2001.

Moldova's public and publicly-guaranteed external debt contracted to \$940 million in 2001, reflecting a drop in new disbursements, including by IFIs. In terms of GDP, the external debt burden eased to 58 percent, from 69 percent in 2000. Negotiations for more favorable terms on Moldova's commercial debt (outstanding amounts of the 1997 Eurobond and Gazprom notes) are under way.

Progress on structural reforms was slow in 2001, partly due to the change in government early in the year. In early 2002, however, structural reforms received a major impetus with the agreement between the authorities and the World Bank on a structural adjustment credit (SAC-III). The government has begun to implement a wide range of measures aiming at reducing poverty and improving the business environment, including through agricultural reforms and privatization.

In late 2001, Moldova adopted two laws to combat money laundering and the financing of terrorism.

## **Executive Board Assessment**

Executive Directors noted that monetary and fiscal policies have remained sound since the 1998 crisis, and that it is now crucial to promote structural reforms more vigorously to achieve sustainable growth. They therefore welcomed the regained momentum of structural reforms that has occurred in the context of the SAC III negotiations with the World Bank.

Directors noted that the budgetary position remains vulnerable, although fiscal policy has been prudent. They urged the authorities to keep policy tight, and undertake the fiscal reforms necessary to put the budget position on a sustainable footing. Directors cautioned that

improvements in tax collection, in addition to lower domestic interest payments, will be needed to support the projected level of non-interest expenditures in 2002. They called on the authorities to refrain from tax rate cuts without prior identification of offsetting measures. Directors expressed concern that expenditure arrears have again started to edge up since late 2001, although these arrears declined during the first five months of 2002. They also stressed that the unbudgeted wage hikes for social sector workers would need to be accommodated within the programmed spending envelope.

Directors supported the NBM's continued tight monetary policy in support of price and exchange rate stability. They noted that the exchange rate has been broadly stable and money demand has strengthened—reflecting lower inflation, the resumption of growth, and some financial deepening. They agreed that a floating exchange rate regime continues to be appropriate for Moldova, given the country's vulnerability to external shocks, and they recommended that the NBM limit its interventions in the foreign exchange market to smoothing sharp exchange rate fluctuations. Directors commended the NBM for its resolve in enforcing prudential regulations and ensuring a sound banking system, especially through raising capital requirement standards and addressing the issue of non-performing loans.

Directors noted that exports still have not regained their pre-1998 level, in spite of the recent recovery. They were particularly concerned that trade diversification remains limited, and that access to key export markets is constrained. Directors encouraged the authorities to resist incipient pressure for protectionist measures and maintain the current liberal trade regime; they underscored that any contingent protection should be strictly in line with WTO provisions.

Directors were concerned about Moldova's heavy external debt burden and emphasized that financial support from the international community—including the private sector—is essential for the success of Moldova's economic program and the sustainability of its external position. In this regard, they were encouraged that the authorities are negotiating actively with holders of the Eurobond and Gazprom notes to reach a mutually satisfactory agreement on the rescheduling of these instruments. Nevertheless, given the structure of Moldova's external debt, Directors stressed that the main impetus toward achieving external sustainability—and fully normalizing relations with creditors—should come from strengthening the fiscal accounts and improving debt management and economic performance in general.

Directors welcomed the recent adoption of several laws that would strengthen the institutional infrastructure for a market-based economy, including the insolvency law and the civil code. They urged the authorities to persevere with structural reforms in other key areas, including privatization, and to improve the business environment for foreign as well as domestic investors. Directors welcomed the recent strengthening of the legal basis for combating money laundering and the financing of terrorism.

**Public Information Notices (PINs)** are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2002 Article IV Consultation with the Republic of Moldova is also available.

Republic of Moldova: Selected Economic Indicators, 1999–2003

	1999	2000	2001	2002	2003
			Prel.	Proj.	Proj.
<b>1. Gross Domestic product and Inflation</b>					
Real growth rate (percent change)	-3.4	2.1	6.1	4.8	5.0
Nominal GDP (in billions of lei)	13.8	17.8	20.8	23.2	26.4
Inflation (CPI, period average, percent)	39.3	31.3	9.8	6.6	8.4
Inflation (CPI, end of period, percent)	43.8	18.5	6.4	8.0	8.0
<b>2. General government</b> (In percent of GDP)					
Revenues	27.1	27.6	26.7	27.2	27.1
Expenditures	32.5	30.2	27.2	30.0	29.3
Balance (commitments)	-5.3	-2.0	-0.7	-2.3	-1.2
Balance (excluding project financing)	-2.6	-0.8	0.5	-1.1	-0.2
<b>3. Monetary and Exchange Rate Indicators</b>					
Reserve money (percent change)	41.4	29.8	27.9	14.7	14.7
Broad money (M3; percent change)	32.9	40.3	36.3	20.1	20.8
Velocity (M3, end-of period)	5.5	5.1	4.3	4.0	3.8
Exchange Rate (Lei per US dollar, end of period)	11.6	12.4	13.1	...	...
<b>4. External indicators</b> (million U.S. dollars, unless noted otherwise)					
Exports of goods	475	477	569	619	673
Import of goods	610	783	882	984	1,082
Current account balance	-47	-121	-119	-124	-144
In percent of GDP	-3.6	-8.4	-7.4	-7.2	-7.8
Gross international reserves	181	218	227	251	319
In months of imports of GNFS	2.8	2.6	2.5	2.5	2.9
Public and publicly guaranteed debt	933	992	940	980	991
In percent of GDP	71.1	69.2	58.3	57.0	53.9

Source: Moldovan authorities and IMF staff estimates and projections, based on data available as of June 26, 2002.

**NEWS  BRIEF**

FOR IMMEDIATE RELEASE

News Brief No. 02/62  
FOR IMMEDIATE RELEASE  
July 10, 2002

International Monetary Fund  
700 19th Street, NW  
Washington, D. C. 20431 USA

**IMF Completes First Review of Moldova's PRGF-Supported Program,  
Approves US\$12 Million Disbursement**

The Executive Board of the International Monetary Fund (IMF) completed today the first review of Moldova's performance under a three-year, SDR 110.88 million (about US\$147 million) Poverty Reduction and Growth Facility (PRGF) arrangement. This decision entitles Moldova to the release of a further SDR 9.24 million (about US\$12 million), which will bring total disbursements under the program (see Press Release No. 00/72) to SDR 27.72 million (about US\$37 million).

In approving the disbursement, the Executive Board granted waivers of Moldova's non-observance of the end-March 2001 quantitative performance criterion on net international reserves, as well as of the performance criterion on non-accumulation of new external arrears.

Following the discussion of the Executive Board, Shigemitsu Sugisaki, Deputy Managing Director and Acting Chairman, said:

"In considering the conclusion of the First Review of Moldova's Three-Year PRGF Arrangement, the authorities are to be commended for largely pursuing prudent fiscal and monetary policies during the past 18 months, in line with the staff's advice. Most financial targets under the 2001 program were met—or missed only narrowly—and waivers of Moldova's non-observance of the end-March 2001 quantitative performance criteria on net international reserves, as well as of the non-accumulation of new external arrears, were granted. Progress on the development of the PRSP, as evidenced by Moldova's PRSP Preparation Status Report, has been satisfactory and provides a sound basis for continued access to

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Fund concessional assistance; the authorities are committed to complete the PRSP in early 2003.

“The budgetary position remains vulnerable, although fiscal policy has been prudent. Improvements in tax collection, in addition to projected lower domestic interest payments, will be needed to support the projected level of non-interest expenditures in 2002. It is a source of concern that expenditure arrears have again started to edge up since late 2001; and unbudgeted wage hikes for social sector workers will need to be accommodated within the programmed spending envelope.

“Continued tight monetary policy is essential to ensure sustained price and exchange rate stability—fostering a further strengthening of money demand, and financial deepening. The authorities have shown commendable resolve in enforcing prudential regulations and ensuring a sound banking system. The recently completed safeguards assessment of the central bank noted significant progress over the past few years, and identified some remaining inadequacies in procedures. The authorities are urged to continue implementing the recommendations of the safeguards report.

“Moldova’s heavy external debt burden is a source of concern. Financial support from the international community, including from the private sector—complementing sustained fiscal consolidation—is essential for the success of Moldova’s economic program and for the sustainability of its external position. The authorities are encouraged to negotiate actively with holders of the Eurobond and Gazprom notes to reach a mutually satisfactory agreement on the rescheduling of these instruments.

“While monetary and fiscal policies have remained sound since the 1998 crisis, it is now crucial to promote structural reforms more vigorously to achieve sustainable growth. There has been recent progress through the adoption of several laws that would strengthen the institutional infrastructure for a market-based economy, including the insolvency law and the civil code. It is now important for the authorities to persevere with structural reforms in other key areas, including privatization, and to improve the business environment for foreign as well as domestic investors,” Mr. Sugisaki said.