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Republic of Moldova: Overview of the Current Macroeconomic Situation (at the beginning of 1997)

- Stages and main directions of the reforms in 1990s, the lessons of 1996.
- Macro analysis, financial sector.
- Sector of real economy (industry, agriculture, infrastructure).
Exports/imports.
- Social area reform.
- Comparative analysis: Moldova and other countries in transition (Central and Eastern Europe).
- Key problems of future development, challenges for national interests.
- Annexes.

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Republic of Moldova: Overview of the Current Macroeconomic Situation (at the beginning of 1997)

The general economic situation in the Republic of Moldova at the beginning 1997 is characterized by complex, multi-dimensional processes. The positive movement, from recession and depression to renewed economic growth, is developing slowly, with contradictions.

After some positive developments during 1993-1995, which resulted in overall macroeconomic stabilization, and despite the forecast of 1.5-3% GDP growth, the year 1996 unexpectedly resulted in a weak performance in a number of key respects: there was a decline in major economic activity indicators, and a heightened budget crisis. Can Moldova return to an economic growth path? The 1997 is going provide an answer to this question.

1. The main directions of reforms in 1990s and the lessons of 1996.

The Initial Period of Reforms (prior to 1996)

Since the beginning of 1990s the Republic of Moldova, a newly founded state in the South-Eastern Europe, has faced a triple task, defined by the Constitution of the Republic of Moldova (1994): strengthening the state, implementing the transition to a socially-oriented market economy, and democratizing society.

The process of economic reforms was identified as the most important factor contributing to national prosperity and stability.

At present, in the seventh year of reforms, despite the transitional difficulties nobody – from the various political parties, trade unions, or the general public – opposes the principle of the market orientation for the economy. However, with the passage of time, perceptions of the actual processes in the transition economy change. General euphoria and expectations of swift success (i.e. “...the transition will take 1.5-2 years.” cit. Program for the Transition to a Market Economy in the Moldova SSR, 1990), turned into disillusion, depression, diminishing credibility of the reform process among the majority of the population.

Moldova is not an exception. Eastern European and CIS countries all experienced the same set of problems during the first years of transition:

- a decreased capacity of the state to regulate economic processes;
- the disruption of traditional economic links, with a resulting decline in production, and payment defaults by businesses;
- radically decreased budget revenues and large-scale tax evasion;
- a decline in savings and investment activity;
- inflation;
- a falling standard of life, growing unemployment, and increasing social differentiation;
- increasing volatility and criminalization of the economy.

Furthermore, the beginning of the transition period in Moldova was complicated by the following factors:

- Political tensions (1990-92) during the military conflict in the Transnistria region and the confrontation in the South (Gagauzia), resulted in the disintegration of territorial economic relations;
- De-industrialization of the country and increasing instability to the national economy resulting from its increased dependence on the agricultural sector and therefore on climatic conditions (i.e. the crop failures in 1992, 1994, and 1996);
- Increasingly negative impact of the energy factor upon the national economic security (i.e. the almost complete reliance upon the foreign supply of the energy, combined with the inefficient (economically non-rational) character of energy consumption).

The starting period of the Reform could be divided into *three stages* according to its contents and results:

⇒ the stage of search; the beginning of the formation of a new legal environment for economic activities; the introduction of cooperatives and leasing ventures; the extreme inflation and crisis conditions that developed in the ruble area (1990-1992);

⇒ the stage of creation of the pre-conditions for macroeconomic and financial stabilization, and the formation of market infrastructure (1993-1995);

⇒ the stage of national economic restructuring, at the sectoral and enterprise levels; and reforms in the social area (1995-...).

The main focus of reform has been on three issues: property reform and privatization; liberalization of enterprises and economic activities in general; and the fight against inflation, which corroded both production and social life.

In parallel, as with the other countries of Central and Eastern Europe, IMF and the World Bank recommendations were implemented, including the introduction of a national currency (November 1993); reduction of the budget deficit; cutback in budget subsidies and officially directed loans; liberalization of prices, of foreign exchange and trade regimes, and of external economic relations in general.

Among *the positive results* of the initial stage of reforms, the following should be mentioned:

- the change in the structure of property;
- departure from the monopoly of the state, as well as from the domination of the agriculture sector by state farms and cooperative property;
- speedy expansion of the private sector, up to 40-45% of GDP and no less than 50% of total employment;
- a decrease in the rate of economic decline (-3% of GDP in 1995, which was the smallest among the CIS countries);
- the emergence of a group of enterprises (in light industry, canning, wine-making, etc.), which have managed to both increase output and exports;
- shifts in the sources of income of the population resulting from the move to the market economy i.e. a decline in the share of salaries and wages in total income from 71.1% in 1993 to 40.5% in 1995, combined with an increase from 12.6% to 43.5% of the share of own-account income generated by households (i.e. double employment, income from sale of household products, services, etc.).

However, achievements in the area of agricultural reform, de-monopolizing of energy sector, transport and telecommunications, as well as in the area of attracting foreign investment have been much *less impressive*.

Although during these years, up to 56-60% of state budget allocations went to meet social needs, the costs of reform for the population turned out to be very heavy: real income of the population decreased by no less than 40% compared to 1990, wage and pension arrears emerged and grew; although the number of official unemployed only reached 20-24 thousand, there is hidden unemployment of about 200 thousand; the birth rate declined (1990 - 8.0%; 1995 - 0.8%); the consumption of basic food products (meat, milk etc.) fell by as much as a half, and the share of food in the consumer expenditure budget rose from 38% in 1990 to 61% in 1995. National budget allocations for health, education and culture decreased substantially. A clear tendency for highly-qualified workers to emigrate developed.

Positive trends on the macro-level have increased the credibility of Moldova amongst the international community, as is illustrated by cooperation in terms of provision of loans and technical assistance by IMF, World Bank, EBRD, TACIS, USAID, GTZ, as well as in terms of UN Programs: UNDP and several bilateral donors.

In general terms, by 1995 the necessary “theoretical” prerequisites had been put in place by Moldova to move from the stage of stabilization to renewed economic growth. Indeed, the EBRD Transition Report (1995, p.11) noted that in relation to the main transition parameters (privatization, price liberalization, trade & foreign exchange system, competition policy, banking reform, securities market, legal reform, etc.) Moldova had surpassed its neighbors – Romania, Bulgaria and Ukraine, and the majority of the CIS countries.

To quote *The Economist*:

“Moldova is the model of right reformism – it has firmly intended to take the road of revival after the economic crisis... Government which possesses the reputation of reformer, as well as compact territory (which make the country a perfect laboratory for reforms), all this deserves positive appraisal and support.”

(“*Economist*”, March 1995)

Such encouraging appraisals of the course of reforms led the President, Parliament and Government to press forward with further concentrated efforts in 1996 which aimed:

- to revive the real economy;
- to accelerate reforms in the agricultural sector;
- to promote enterprise restructuring, including selection and support of reform of specific enterprises – particularly export-oriented “growth points”
- to stimulate investment – foreign and domestic savings;
- strengthening state regulating policy in the social areas.

The year 1996 was to be a turning point, but a number of necessary conditions for improved performance were inadequate, including the coordination of efforts between the legislative and executive authorities (e.g. to promote a more constructive role for the banking sector and commercial courts), inter-departmental coordination in implementing.

1996: General Evaluation of Economic Trends

For Moldova it was the year of “unbalanced financial stability”, of an unsuccessful attempt to regain the growth of industrial output, of contradictory results in the social area. There was also negative influences at work in the non-economic environment: during the presidential election campaign the economy became the hostage of politics.

On the one hand, in line with the performance of last 3 years, in 1996 the country achieved substantial success in the areas of reducing inflation (15.1% per year, 1.2% per month), and exchange rate stability (\$1=4.6 MDL), with the yearly devaluation of Moldovan Lei of only 0.14 units against US Dollar, and a rise in the exchange rate against the currencies of Russia and Romania, Moldova's chief economic partners. Foreign currency reserves increased by 22% during 1996.

At the same time, the year did not show any improvement in the real-economy indicators: the official statistics reported 8% fall in GDP, industrial output falling by 8% and agricultural production by 13%.

In the overall picture of economic life of Moldova, several new processes and phenomena emerged in 1996. From the positive standpoint the following should be mentioned:

- a) Quantitative growth and qualitative evolution of economic enterprises in the country, (the number increased from 84.7 thousand to 143.2 thousand, that is by 69% , including 4.7 thousand joint-stock companies, 19.1 thousand limited companies, 2.5 thousand cooperatives, 1.5 thousand state-owned enterprises, 41.2 thousand sole-proprietorships, 149 leasing entities). Small businesses, employing up to 75 persons, using only 12% of human resources, generated 30% of sales revenues for both goods and services.
- b) An expanding process of enterprise restructuring, both in industry and agriculture. 98 enterprises signed a memorandum with State Creditors Board, including 52 industrial concerns (17 food-processing; 32 engineering, light industry, furniture, and pharmaceutical industry, 3 construction materials) and 46 agricultural entities (former state and collective farms).
- c) Increasing provision for investment from the retained earnings of businesses rather than the State budget. In the total amount of investment (650.4 million MDL) the share of the state decreased to 22%, 72% was funded from retained earnings and personal disposable income, and 6% from external sources. 52% of total investments was in the private sector. In the domain of housing the share of private investments reached 92%.
- d) Some stabilization of the living standards of the population took place, and inflationary expectations declined. Household savings were returning to the banks. Monetary resources of the population in the form of bank deposits increased by 28%, personal insurance premiums by 33.2%, and property insurance by 20.4%. The number of private vehicles grew by 21%, 2/3 of them being Western production cars. Demand for housing went up, as did housing prices.
- e) Despite the fall in official estimates of real GDP of 8% in 1996, household budget data suggest that real disposable income grew. Total households increased and consumer expenditures increased by 24% (Jan.-Sept) in nominal terms, which suggests that real earnings increased by 8%. The difference between the movement in GDP and household incomes is explained in part by the drop in the ratio of investment to GDP and increase in foreign savings, but also probably reflects the undercounting of the informal economy in the GDP data.
- f) Tensions associated with the labor market were minimized. The official unemployment rate during past three years was 1.5-1.8%, that is, 20-24 thousand people registered, but that does not include 166-200 thousand people on unpaid vacation. Despite the difficulty for the population to

adapt to the harsh realities of the new environment, there have not been strikes or other protest actions, except from protests by pensioners and other state-budget dependents.

Negative trends and tendencies:

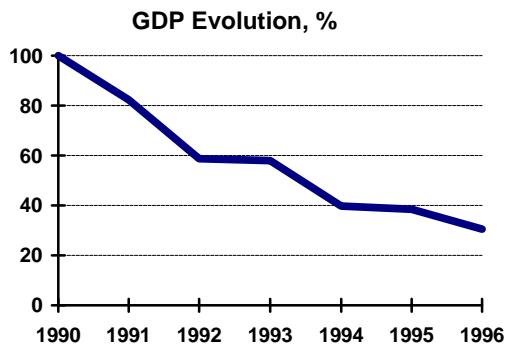
- a) Continued stagnation in the significant part of economy, i.e. at least 40% of enterprises are idle and/or operate at a loss, which causes ongoing difficulties in relation to indebtedness, and the development of the mechanism of indirect compensation for the lack of funds by increasing liabilities to suppliers and personnel and delaying tax payments.
- b) Low degree of observance of budgets, both state and local, i.e. the variance of actual tax collections versus the budgeted one was estimated at 30%, unpaid taxes increased, which caused the non-execution of the budgeted social payments. Debts associated with pensions and wages payable increased.
- c) Revival of industrial output growth was delayed, i.e. after an increase in industrial output in first half of 1996 of 8.7% there was a severe decline, which ultimately resulted in 8.5% decline for the year.
- d) Monopoly in the energy sector, and the absence of supervision and reporting of the use of energy resources had exceptionally negative effects on the external debt, on the prices for products and utilities, and on the general economic standing of enterprises.
- e) Lack of foreign investment, absence of appropriate mechanisms for dealing with foreign partners in relation to export promotion, organizing international tenders (for cement, tobacco, wine, etc.); and low efficiency of customs controls.
- f) Limited financial resources for structural change; the discrepancy between the interests of banks and productive enterprises has not been overcome yet; there is an absence of relevant financial institutions to finance exports and small business promotion, including provision of credit to sole-proprietorships and farmers.
- g) Local public authorities have been passive agents in the reform process, i.e. low initiative in local budget income generation, in small enterprise support, etc.
- h) There is a substantial share of “black economy” (over 18-20% of GDP), caused by legislative weaknesses and failures in administrative and judicial institutions, corruption, leading to uncollected amounts of taxes, including social security payments.
- i) In certain important respects there has been a drop in the life quality of population, i.e. safety, health and life security; the quality of education, health, and culture; growing organized crime.

To be considered are the three most important sectors of national economy: financial sector, real economy, and the social area.

2. Macro analysis, financial sector.

GDP Dynamics and Inflation

Key macroeconomic indicators are reflected in the first table of the Annex.

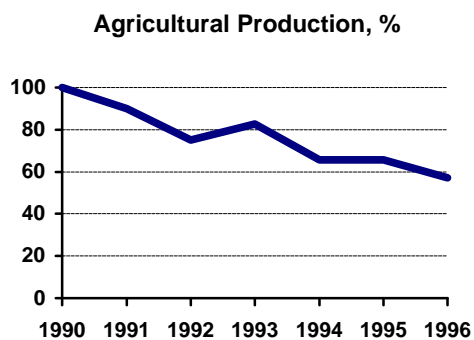
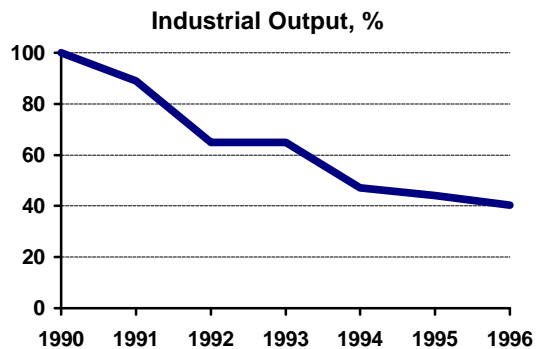


The most unpleasant macroeconomic surprise of the last year was the continuing fall of the national economy. Despite different forecasts, from the most optimistic +8% to the most moderate +2%, and net growth in the first half of the year, GDP dropped at the end of the 1996 by 8 percent in comparison with the previous year's result. GDP per capita calculated at PPP basis crossed the \$2000 mark, less than those of other Eastern European countries in transition and Baltic States and similar to other FSU¹

countries.

Industrial production marked an 8.5 percent decrease, and realized agricultural production dropped by 13 percent in comparison with the previous year.

Agriculture is still having an important share of national economy, providing more than 40 percent of GDP and giving jobs to more than 50% of employed citizens of Moldova, as compared to Romania where respective figures are 20 and 35 percent. Agricultural production is a prevailing part of Moldovan export.



Not surprisingly balance of payments remains very sensitive to different external shocks. As a largely agricultural country, dependent on Russia and the Ukraine for export markets and critical imports of oil, gas and other inputs such as fertilizer and machinery, Moldova is far more exposed to shocks that it would be in a more diversified economy. This vulnerability should diminish over time. For one thing, gas and oil prices are close to world levels and while these may fluctuate, the prospect of a

shock similar to that experienced at the beginning of nineties is remote.

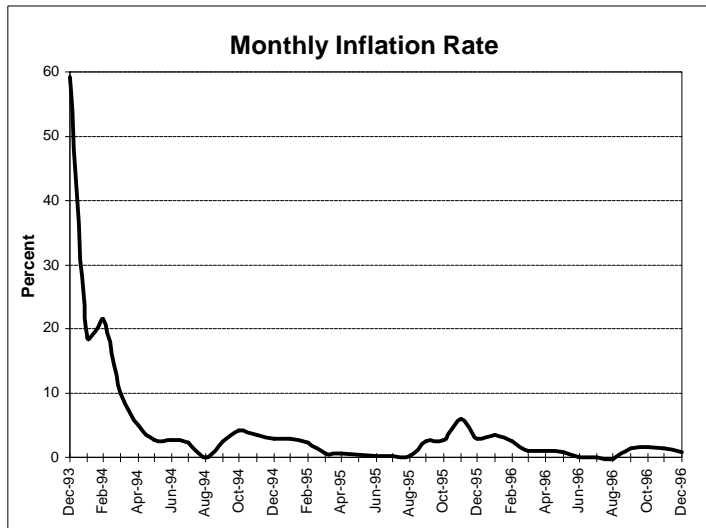
To mention that in the decrease of agricultural production the biggest share has belonged to vegetable production which dropped by 17 percent. Animal production decreased 4 percent.

¹ FSU - Former Soviet Union.

According to the Department of Statistics, in 1996 agricultural production scored only 57 percent of 1990 production.

Three criteria can be used to determine macroeconomic well-being of a society:

- economic growth;
- price stability (low inflation);
- low unemployment (social safety net)



In this context, the only performance achieved by the national economy was a price stability, using tight monetary policy. However, besides a macroeconomic decrease, a substantial deterioration of social safety net has occurred since declaration of independence. Share of consumption basket guaranteed by household income decreased from 90 percent at the beginning of 1992 to 40% in 1996.

From 1990 household income share spent on dairy products increased from 35% up to 65% which means that the income effect prevailed over the substitution effect for dairy products in Moldovan households (Giffen goods effect). Unemployment soar from almost zero to according to some statistical estimates 11% of labor force. Social policy aspects will be reflected more in detail further in the report.

Such a situation can be described as a continuing **depression**.

If $GDP = C + I + G + X - M$,

where

C – consumption

I – investment

G – government expenditures

X – M = NE – net export or exports minus imports,

we have the following real situation:

In an 8% overall decrease of GDP, investment share falling by 15% and continuous balance of trade deterioration by approximately 8% were crucial. At the same time total consumption has risen altogether with government expenditures, although in smaller proportion.

However statistical data interpretation requires a very careful approach because of huge gaps in their collection, as well as an important share of uncounted sector and Transnistria unclear status.

Credit Policy, Investment and Saving

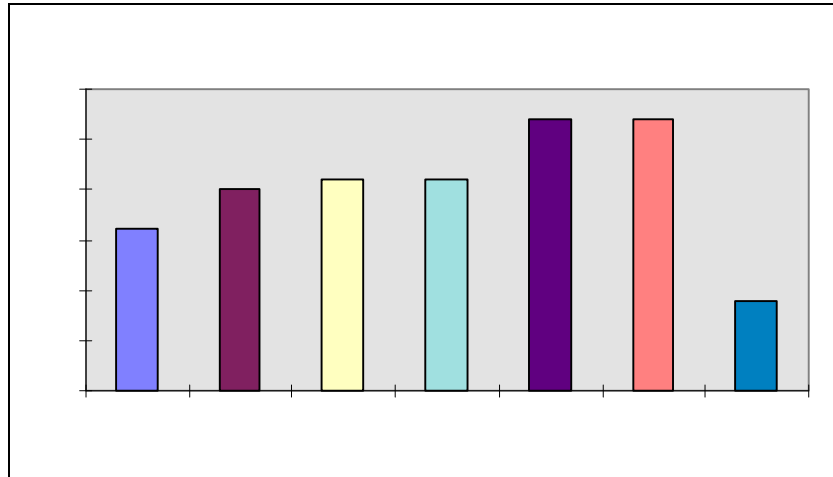
Economic growth requires:

1. rising stocks of productive inputs, including all physical assets;
 2. personal skills and knowledge (human capital);
- and effective use of these assets.

While access to foreign savings can ease the constraint on domestic savings, investment and growth, historically sustained high rates of investment and growth have not been achieved without strong domestic savings.

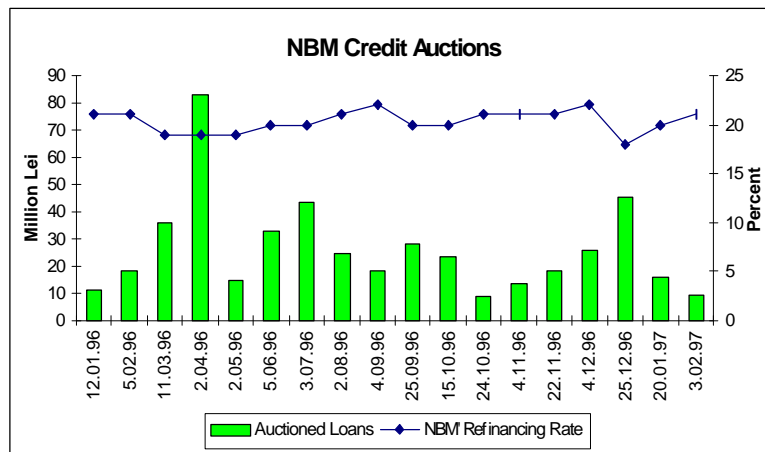
Japan and Germany are two success stories of economic growth. Although today big superpowers, after the end of World War II economies of both countries were in disaster. Capital stocks were reduced enormously. In the years after the war, these two countries experienced however some of the most rapid growth rates on record. Between 1948 and 1972, output per person grew at 8.2 percent per year in Japan and 5.7 percent per year in Germany, compared to “only 2 percent” per year in the United States. Both Japan and Germany save and invest a higher fraction of their output than does the United States.

In this context, investment policy as one of the keys for economic growth is strongly related to domestic savings encouragement and should worry policy makers in Moldova.



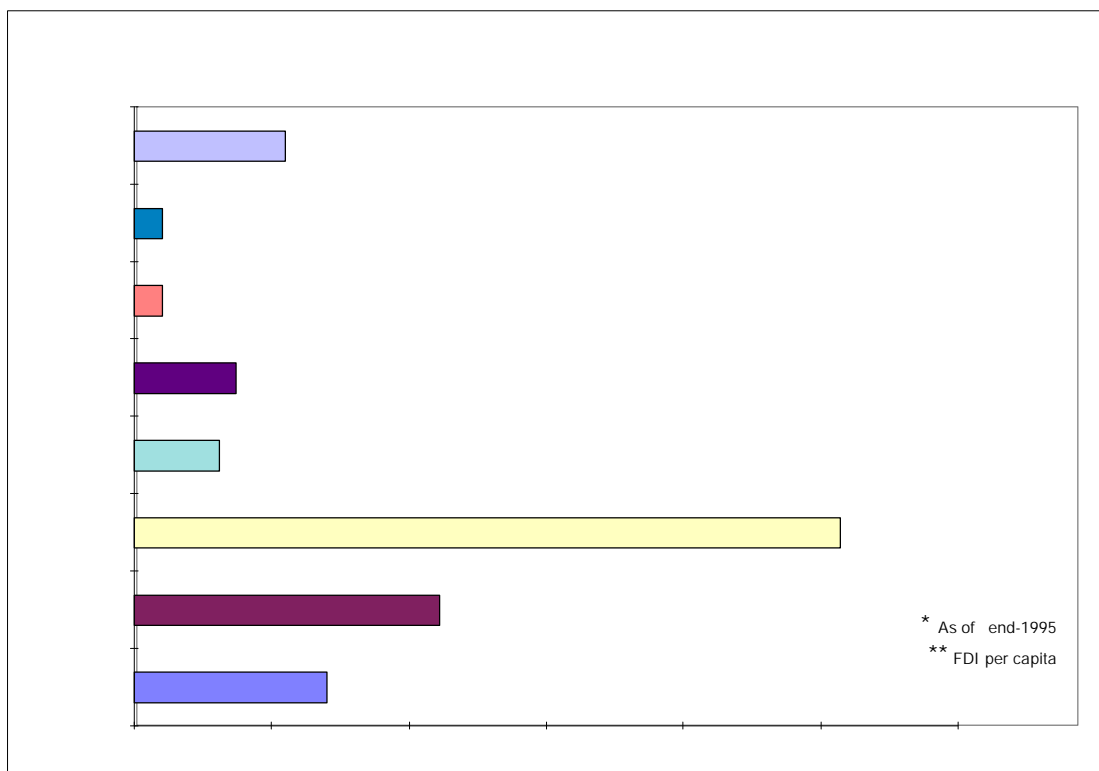
It should be mentioned that savings (S) have dropped drastically through three channels:
 $S \downarrow = GDP \downarrow - C \uparrow - G \uparrow$

Interest rates have been high in 1996. Refinance rate of the National Bank of Moldova has stayed at about 20 percent annually, as shown in the chart below:



However interest rates used by commercial banks have been much higher, because of the premium taken on the commercial risk (this aspect will be reflected in more details further in the Banking System section). In sum, high real interest rates led to a drop of Investment.

Foreign direct investment has risen since 1992-93 in absolute terms, although its share is still not so important in relative figures. Most foreign direct investment has been in the agricultural sector, particularly wine-making. As the table bellow shows, when compared to other transition economies, especially those in the CIS, Moldova's record is quite encouraging, although below those of Eastern European countries in transition and Baltic States.

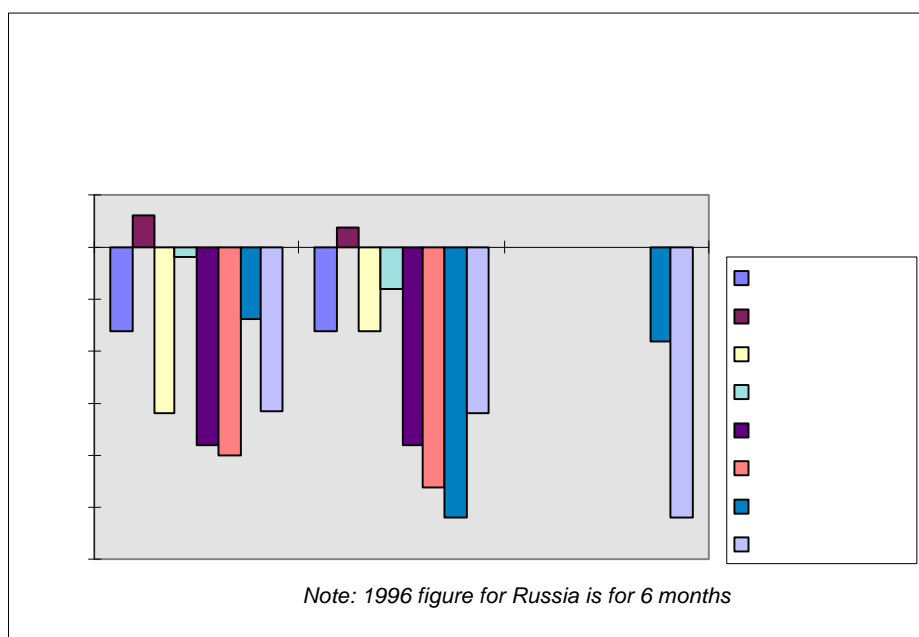


Budget, Fiscal Policy

The government's handling of fiscal policy has been among the most positive features of recent economic developments in Moldova. However, after a budget consolidation from 8.6% deficit in 1993 to less than 5% in 1995, a huge deterioration of 10% deficit occurred in 1996 (all figures are calculated in fraction of GDP). Fiscal situation was aggravated by accumulated arrears' to the budget (more than MDL 600 million), due mostly to problems in payments collection. It is important to stress out that the reported number overestimates budget deficit at least by two reasons:

1. GDP number does not include Transnistria;
2. Because of the existing calculation methodology used by Ministry of Finance.

The World Bank and IMF estimated deficit at approximately 7.2% without Transnistria. In the chart below fiscal situation of other countries in transition is reflected.



Wages, Employment and Real Income

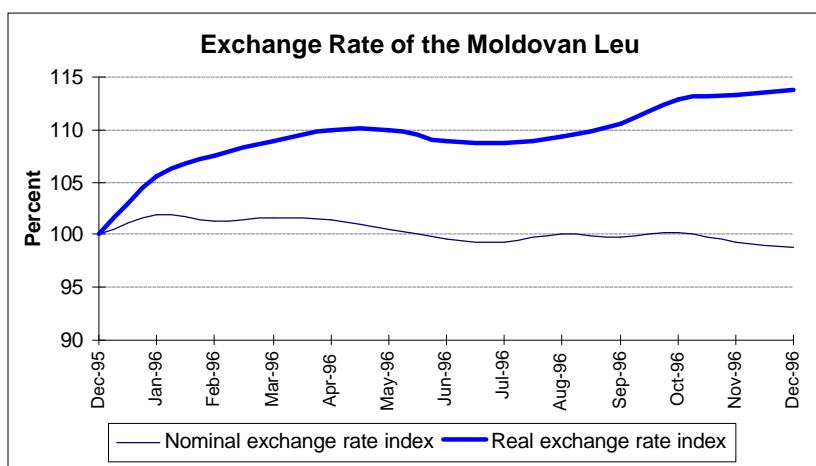
Nominal average monthly wages in 1996 were 186 lei (USD 40), while salary arrears have risen up to 360 million lei.

Years	1992	1993	1994	1995	1996
Wages, MDL	3.5	312	108.4	143	186

Since 1991 the total number of people employed in taxable sector has decreased by 400-450 thousand. Although the official unemployment rate in 1996 was 1.8 percent of the labor force (economically-active population), this number does not take into account hidden unemployment and unreported activities. Actual unemployment is estimated at about 11% of labor force. Labor unit costs have increased in general and specifically in industry of services rising the cost of non-tradable goods as reflected in the real appreciation of leu.

Monetary policy

Since the introduction of national currency in November 1993, Moldova has adopted a tight monetary policy. In 1996 inflation reached the annual level of 15.1%, compared with 23.8% in 1995. Average monthly level of inflation was 1.2% in 1996, while in 1995 it was 1.8%. National Bank of Moldova (NBM) international reserves have grown in 1996 by 22%, and as of January 1, 1997 amounted to 313.7 million USD. In 1996 the nominal exchange rate of Moldovan leu depreciated vis-à-vis dollar by 2.6 percent. In the same time, the real exchange rate calculated at CPI basis appreciated by 12.1 percent.



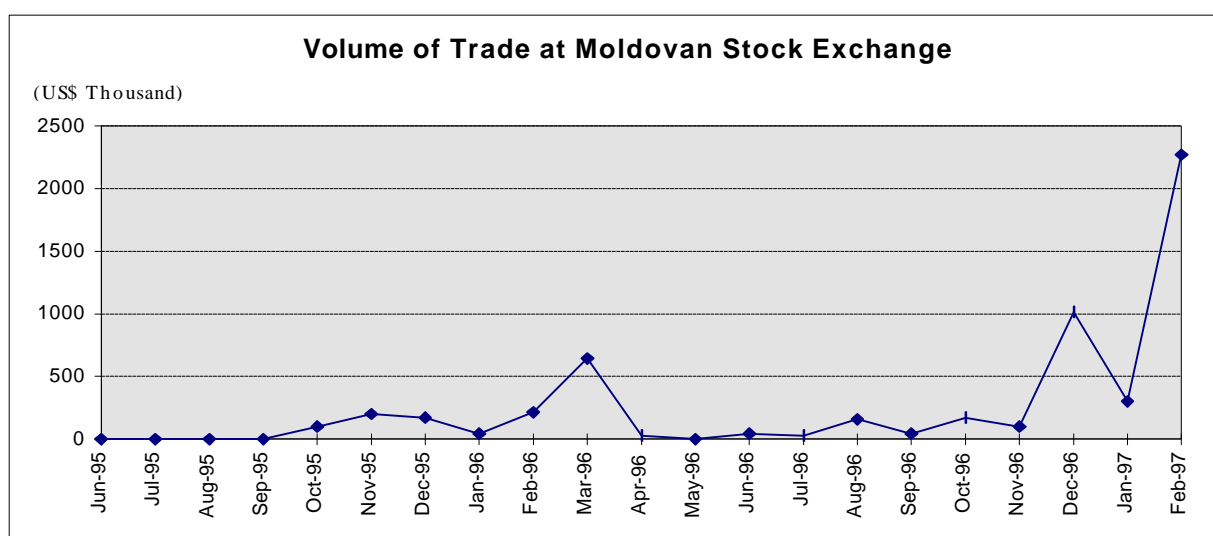
The National Bank of Moldova tried to encourage the use of excessive reserves by commercial banks to provide supplementary credit resources. Centralized credits share oscillated during 1996 between 27 and 30 percent. At January 1, 1997 this ratio was at 27.2 percent.

Reserve ratio applied by NBM did not increase, remaining at 8 percent as a net balance of total deposits in commercial banks.

The most important performance of monetary and credit policy during the last year was the increase of the monetary base by 12.8 percent as compared with 65 percent in 1995.

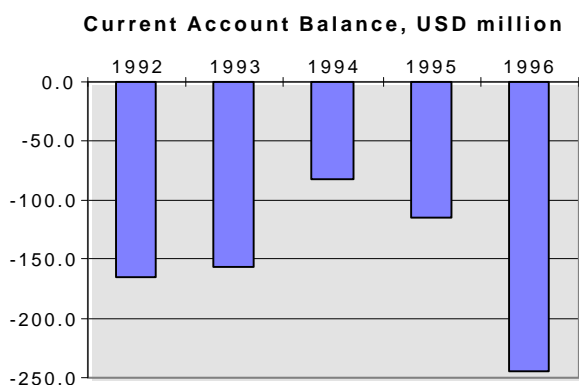
In 1996 an important development in stock-exchange market has taken place. Securities market and especially government T-bills part has marked a tremendous evolution. The total amount of T-bills placed in 1996 was MDL 794.54 million, MDL 565.8 million or 40.4 percent more than in 1995. Out of them MDL 484.58 million has reached maturity. At the 1st of January 1997 MDL 309.96 million were still in circulation. Within this period, the interest rates on T-bills sold at primary market had a decreasing tendency. For instance, interest rate on 91 days maturity T-bills decreased from 44.57% at January 9, 1996 down to 26.06% at December, 24 1996; 28-days T-bills - from 40.32% at March, 21 1996 to 25.25% at December, 24 1996.

Moldovan Stock Exchange started its activities in June 1995 and includes 118 large companies (with more than 300 shareholders). Securities' national portfolio calculated as a nominal capitalization of the market crossed MDL 5 billion. More than 90 percent of this amount are securities issued by private companies, all the rest are securities issued by State or banks.



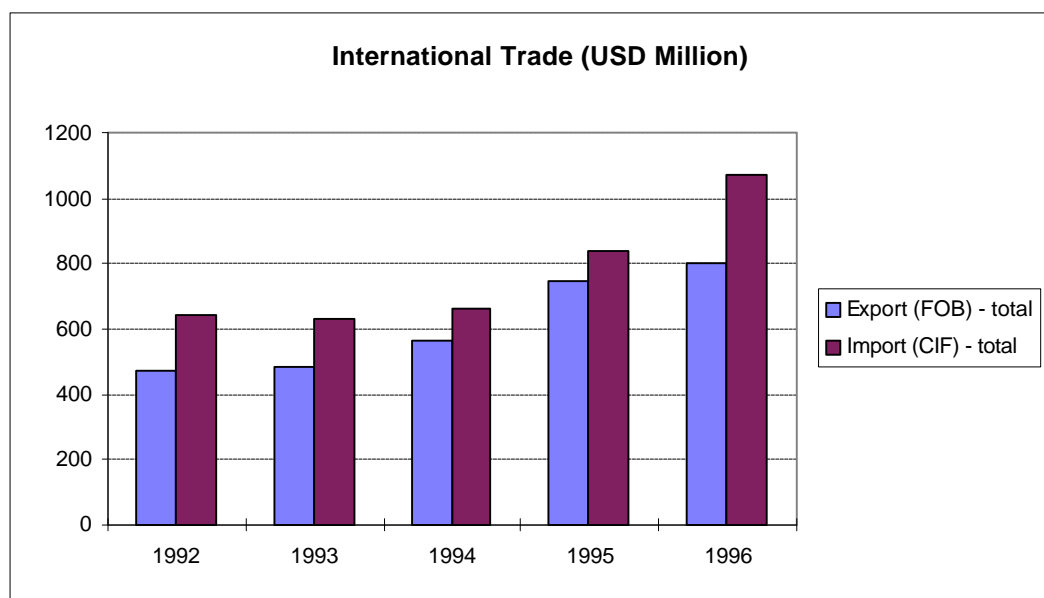
Balance of payments

Being an agrarian country, Moldova depends on its neighbors – Ukraine and Russia regarding commodity markets and import of energy resources. This was expressed during 1991-1993 when the rising import prices and decreasing of external demand on Moldovan exports has lead to a balance of payment deficit of approximately 20% of GDP. Stabilizing (reducing volatility) of balance of payments will be possible only in case of national economy diversification.



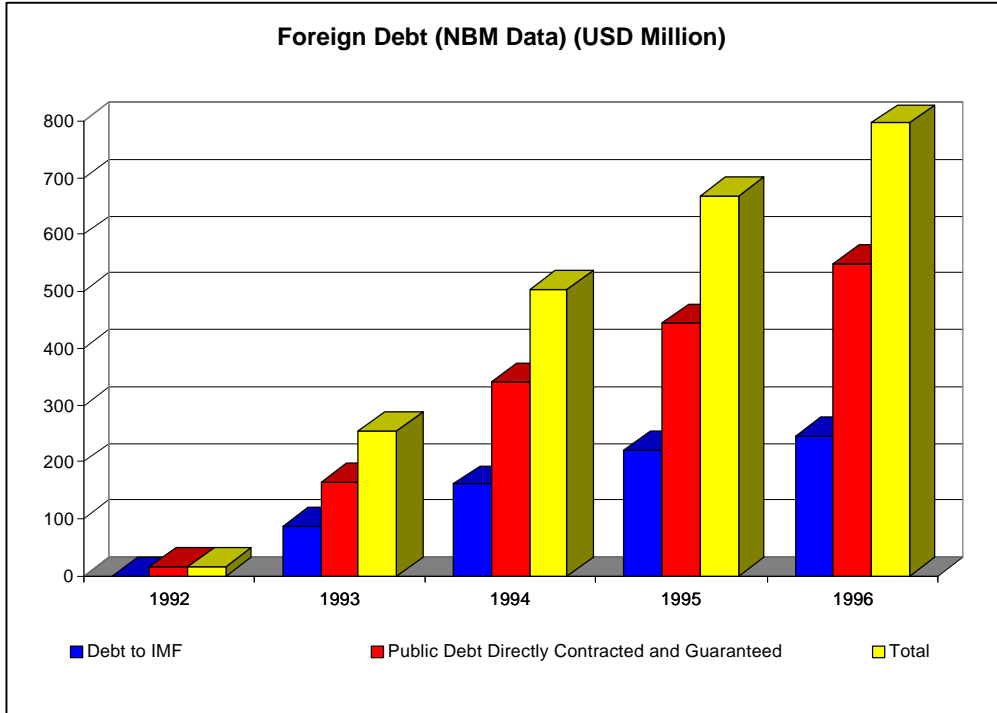
According to preliminary data in 1996 Moldova's trade deficit has grown to about 250 million US dollars. Exports reached 800 million USD (which is an 8% increase comparing to the previous year), while imports showed a spectacular increase up to 1071 million USD (at about 27% comparing to last year).

The increase of the real exchange rate of Moldovan leu against US dollar could be one of the explanations for this phenomenon. Collapse of Moldova's trade balance at the beginning of 90s is explained by a sharp increase in import prices and first of all of energy resources, as well as by disruption of economic links within former Soviet Union which caused a decline in external demand for national products.

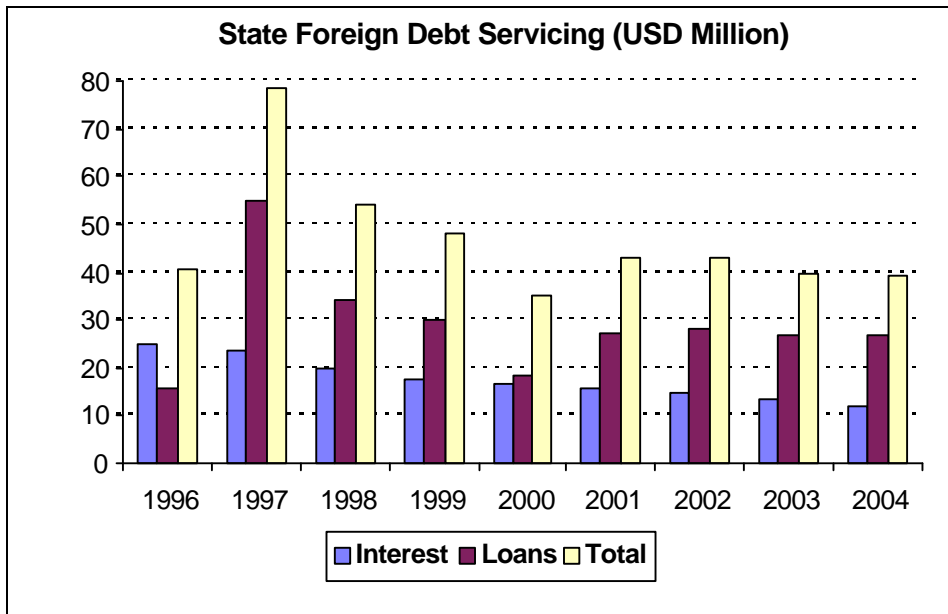


Foreign debt

One of the inherent risks of the transition process is accumulation of foreign debt.



Although not so high according to international standards, burden of foreign debt is growing rapidly, positioning Moldova on the second place after Tajikistan regarding share of foreign debt in GDP. An important part of foreign debt is represented by credits from IMF and World Bank. This trend will be the same in the near future. A big share of foreign debt is long and medium term debt. Anyway, foreign debt servicing becomes an important part of budget expenditures, as shown in the chart below:

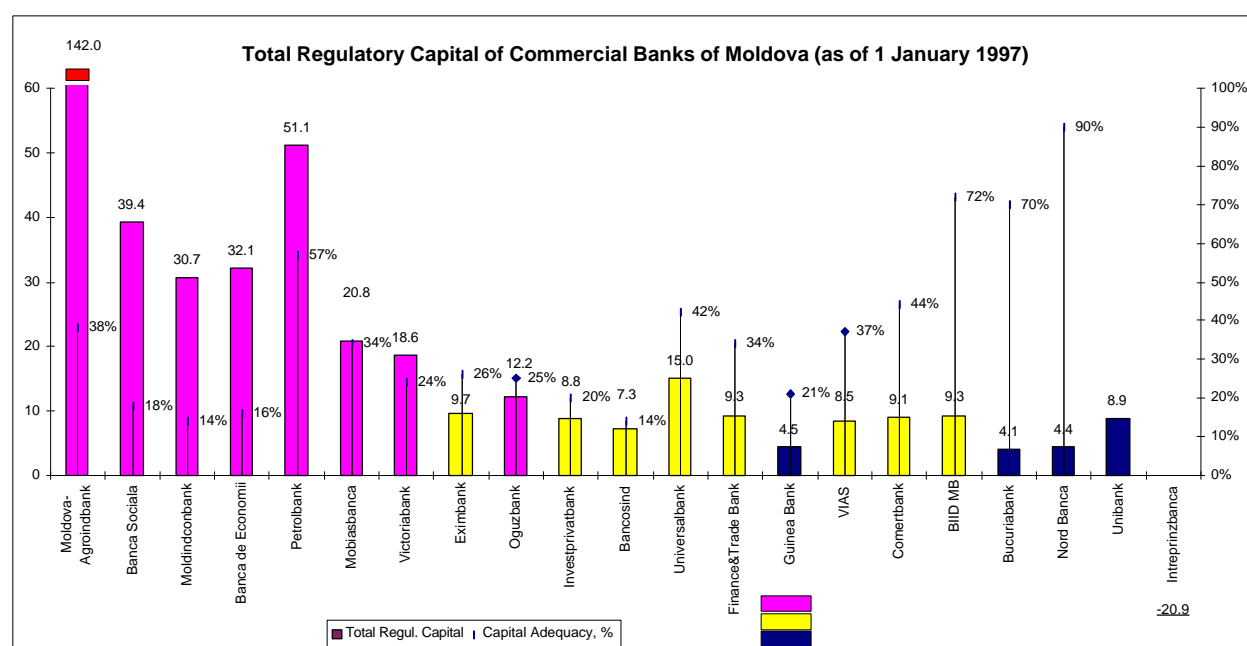


Banking System

As of January 1st, 1997 there were 22 commercial banks operating on the territory of the Republic of Moldova, including the branch of Romanian bank “BankCoop”.

Total regulatory capital of the banking system as at January 1, 1997 reached 434.5 million lei, i.e. comparing with January 1, 1996 it has grown 1.7 times.

Starting 1st of January 1996 the provision of the National Bank of Moldova regarding the minimal amount of the total regulatory capital has grown to 4 million lei (in 1995 it was 1 million lei). At the same time, starting January 1, 1997 the provision for capital adequacy has grown to 6% (in the previous year it was 4%).

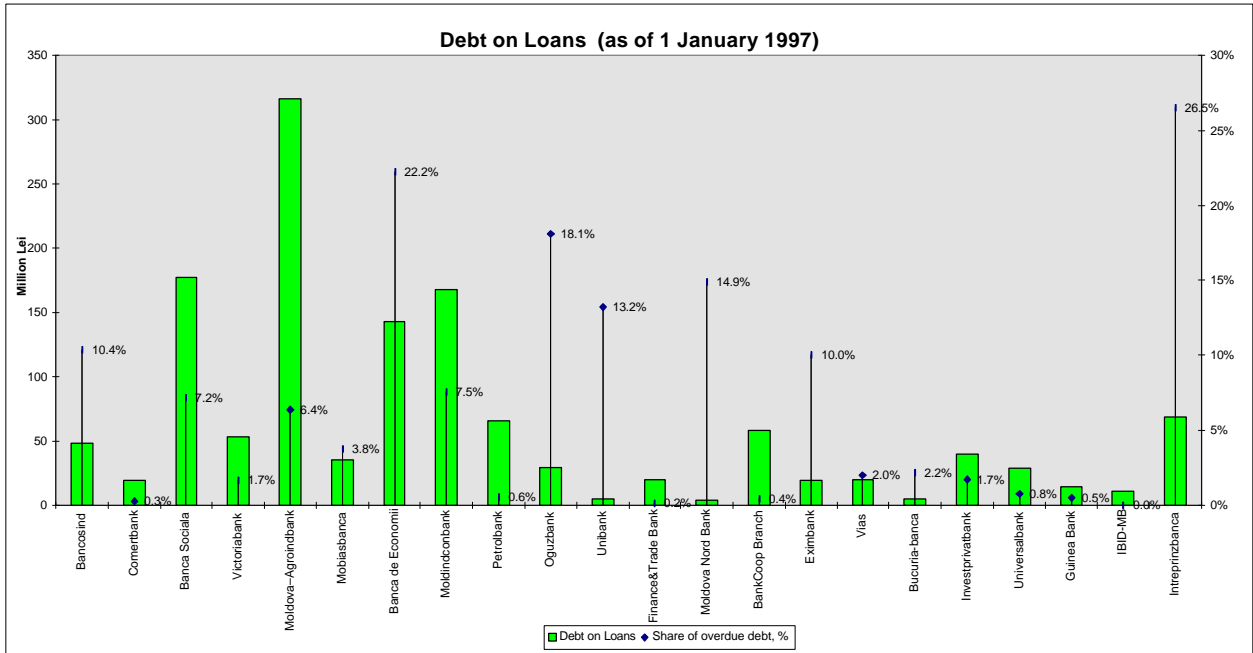


Distribution of commercial banks by types of licenses and total regulatory capital (TRC) weighted by the total amount of TRC in the banking system, which amounts to 455.4 million lei (except Întreprinzbanca):

- type A: 4 banks (i.e. 19%), having a TRC of 21.8 million lei, i.e. 4.8%;
- type B: 9 banks (i.e. 43%), having a TRC of 86.5 million lei, i.e. 19.0%;
- type C: 8 banks (i.e. 38%), having a TRC of 347.1 million lei, i.e. 76.2%.

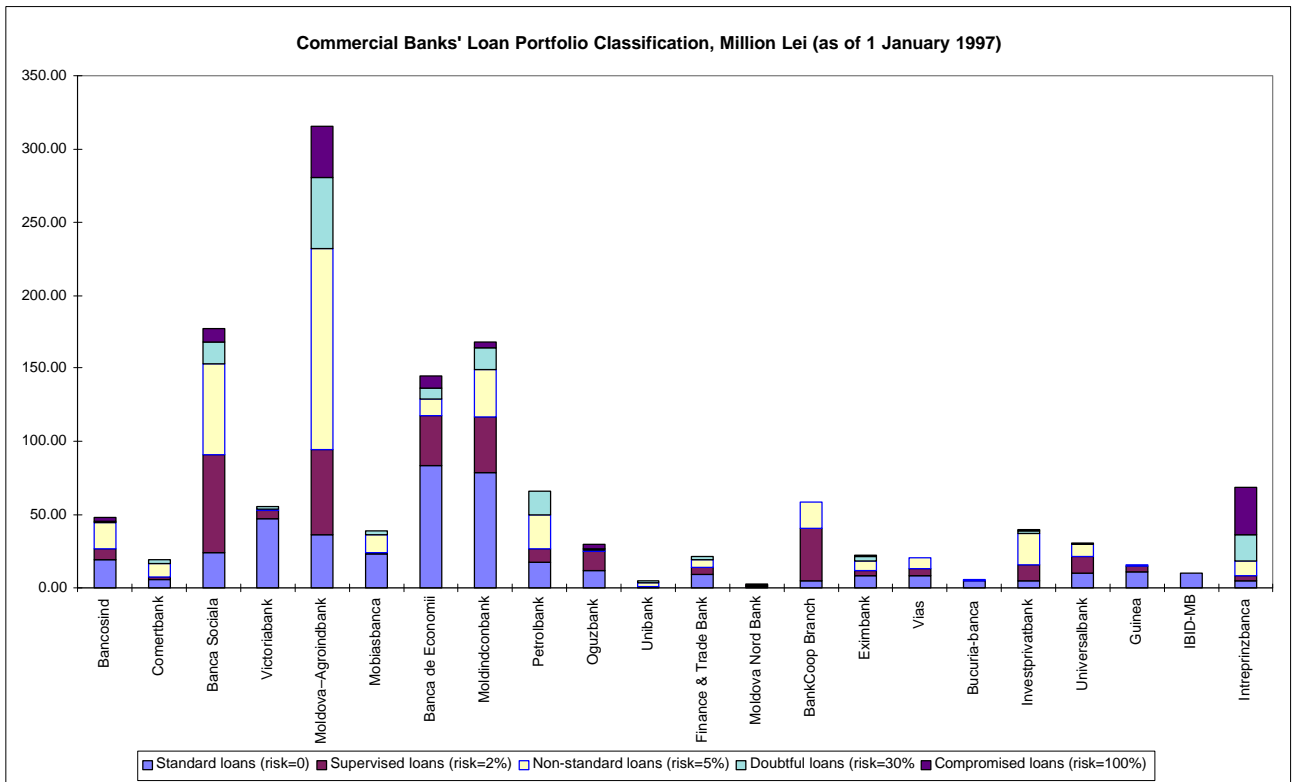
Total amount of credit investments of the banks of the republic as at January 1st, 1997 was 1352.1 million lei, out of which overdue debt was 113.8 million lei or 8.4 percent.

It should be mentioned that during 1996 the share of overdue debt in total debt of the banks has decreased with 15% and this fact proves an increase of safety in banking system.



Starting July 1, 1996 a new provision for the amount of the banks' risk fund was enforced. It should be not less than 75% of the calculated risk fund of the loan portfolio. As of January 1, 1997 the actual percentage for the whole banking system was 79.8%.

Beginning with January 1, 1997 commercial banks must form the entire risk fund, i.e. 100% of risk provisions, and this represents one more step forward in ensuring the safety of banking system.



According to the reported data at December 1st, 1996 the total amount of not effected payments for the loans granted by banks and for delivery of goods was equal to 3489.3 million lei. The main reason of the not effected payments is the reduction of production and worsening of the enterprises' financial standing, as well as lack of funds in sight accounts for the repayment of loans received.

During year 1996 the confidence of the population in banking system has grown, and this is represented by the continuous increase of deposits of individuals in commercial banks. As of 1 January 1997 the amount of funds deposited with the banks has increased with 56 percent, comparing with the same period of the last year. The biggest deposits were made with the banks having a total regulatory capital above 12 million lei.

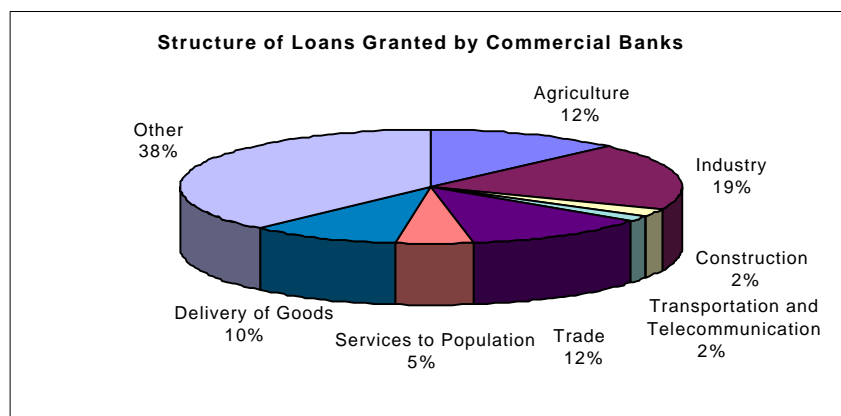
At the same time, the amount of deposits of legal entities did not vary much during last year. At January 1st, 1997 it showed an 8% decrease comparing with the same period of the previous year.

Average interest rate in the banking system has shown during 1996 a continuous decrease:

- for deposits – from 32.5% to 22.0% annually;
- for loans granted – from 41.9% to 35.3% annually.

The National Bank's annual refinancing rate remained stable at 20% as shown in the chapter Monetary Policy above.

It should be mentioned that for the economic agents the interest rates for the loans granted by commercial banks are still too high, especially for the agricultural sector. This proves the high level of credit risk. The problem of insufficiency of loans granted to agriculture is linked with the agrarian reform which includes: resolving the problem of property on land and creating the respective legal framework (including improvement of legislation on collateral), as well as restructuring of inefficient agricultural productions, especially the problem of debt and arrears.



An important role in reviving the situation in crediting small business and agriculture played credit lines of the World Bank and European Bank for Reconstruction and Development directed through the commercial banks of Moldova. For a further improvement of the situation specialized banking institutions could be created – investment banks, farmers' banks, and the international finance institutions would contribute in their capital with a significant share.

Overall, it should be stressed out that banking system of Moldova is stable and did not suffer from any general shocks occurred in Romania or other East European countries. This is greatly owed to the National Bank's of Moldova efforts in stabilizing the situation in banking system and its

strengthening and development, especially by means of a program for implementation an efficient banking supervision, supported by international institutions.

However, relatively small for the whole banking system disturbances occurred in 1996 causing bankruptcy of three local commercial banks and one foreign branch. The main cause of these collapses was bad management of banks' credit portfolio.

The National Bank of Moldova did not use its Lender of Last Resort prerogative because:

1. All banks were neither liquid nor solvent by the time their problems became notorious;
2. Systemic risk for the whole banking system was considered minor.

New accounting and reporting standards are being implemented, as well as regulations on capital and other prudential regulations. NBM introduced the CAMEL rating system for estimating banks' financial standing. Banking system has moved to electronic settlements, a number of banks have adhered to SWIFT – and all these factors as a whole inspire confidence in the continuity and efficiency of the undertaken reforms.

A strategy of transformation of the financial and banking system into a competitive industry, based on international standards, would be welcomed in the framework of the national economy development and attraction of foreign investment.

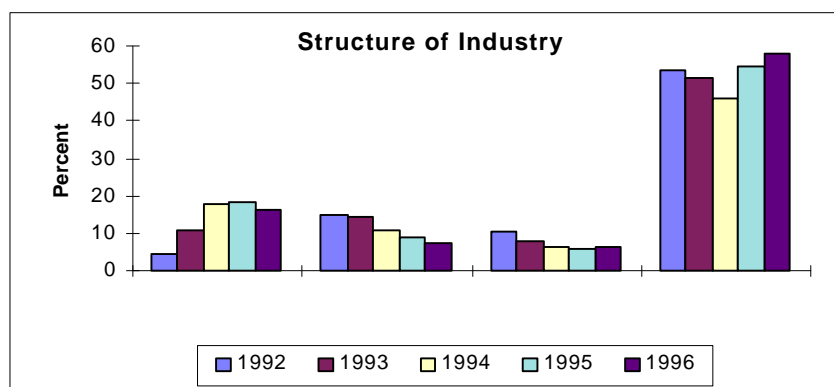
3. Sector of real economy (industry, agriculture, infrastructure). Exports/imports.

Budget and social sphere problems can not be solved without production process animation, without making progress in the sector of real economy.

Industry

The country has not yet enough resources for financing the industrial modernization. Therefore, at the same time with a recession in industry (in 1996 – 41.3% from the level of 1990) in the last 2-3 years a spontaneous restructuring of the sector have begun. Priorities have: the production working on raw materials (food industry, separate enterprises of building materials, industry based on gyps, natural building materials), or the production with small capital or energy capacity, employing cheap labor (production of clothes, shoes, carpets). Large enterprises of machinery-construction which in the past had defensive orientation turned out to be in most difficult situation. The first financial and industrial group in Moldova was created in the furniture industry (14 furniture factories, commercial bank Mobiasbancă, insurance company, transportation company, building and other companies).

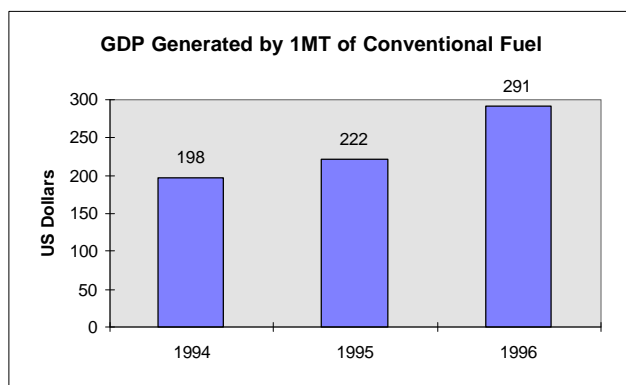
As recession of production and structural changes in Moldova's industry had been the elemental form of "negative adaptation" to the economy realities, in the second half of 90s it was important to implement a targeted state policy for the restructuring of industry. "The conception of the industrial policy of the



Republic of Moldova for 1996-2000 years" was approved by Government in October 1996. Structural changes in industry are taking place rather spontaneous.

Because of abrupt increase in prices for energy products and also accordingly for sector's products, the share of electric power engineering has increased from 4.4% to 16%. However, in the last 2 years the high amortization of sector equipment did not let to fully comply with the requirements of domestic market, and stimulated the increase of import of electricity.

A positive sign: the share of GDP produced by one ton of conventional fuel taken as an input has risen by 47% since 1994 and reached \$291. This growth indicates positive tendencies in the economy and a priority development of the industries with less energy intensity.



Larger sizes of enterprises, obsolete technology and lack of resources for investment do not allow machinery-construction enterprises to be competitive in the market. These enterprises started to work at lower capacity, and their share in industrial production structure has decreased from 15.4 % down to 7.4 %. Lack of

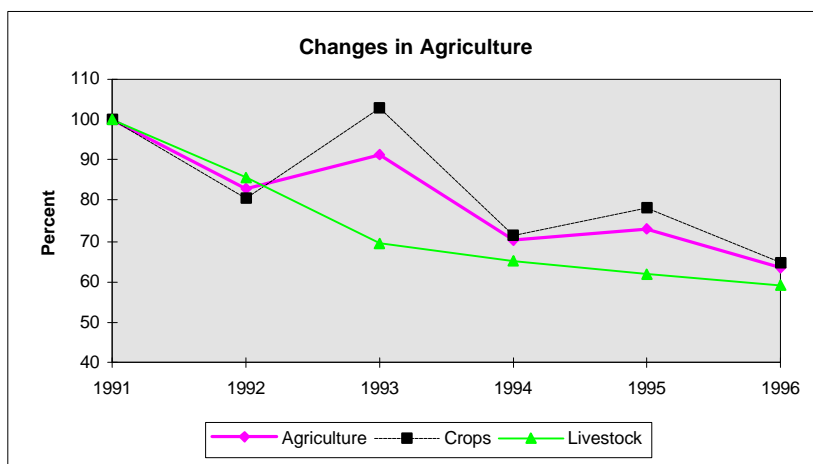
internal savings in the republic does not allow the machinery-construction enterprises to be significantly developed out of their own resources. In most cases restructuring of enterprises depends on attracting a strategic foreign investor.

Based on local raw materials and uniting about 300 enterprises, food industry has a leading position. Since 1994 its share in industrial production structure was continuously growing and by 1996 it constituted 58.1%.

One can predict, that as efficiency of agriculture and processing sectors increases, the production resources will be directed to the other sectors, and first of all, to the light industry enterprises, as they have lower capital capacity. At the present these enterprises work mostly with the raw materials supplied by Western customers (European, American and Canadian companies) at dumping basis. Seeking for expanding the markets, and getting over the hard financial situation – will make the enterprises of light industry able to work more efficiently.

Agriculture

Comparing to 1991 the agriculture production output constituted 63.5 % including plant products – 64.7% and stock raising – 59.2%. A number of factors have conditioned this. On the one hand, unfavorable weather and climate conditions of the last years, on the other hand – lack of intensive land reforms, errors in land and property privatization, loss of traditional external sales markets in the East, insufficient competitiveness of agricultural products of Moldova at the Western markets, lowering demand for agriproducts in the local market.



The agriculture sector is becoming constantly unprofitable, however it remains fed from budget resources. In 1995 the sector got a 231.7 million lei positive balance mainly from allocation of 306 million lei from the budget to compensate losses caused by disaster. So, 490 large agriculture enterprises or 46% out of their total amount finished the year of 1996 with losses. The estimated profitability in agricultural sector is 0.3%. In March 1997 the Parliament – approved a decree on compensation of losses of agricultural enterprises in the amount of 254.3 million lei caused by disasters in 1996.

As of 1 January 1997 the sum of bad debts receivable and unsold products in agriculture was 854.6 million lei, debt payable – 1645.6 million lei. These results show the low level of current liquidity.

Conservatism of local and central administration, as well as personal interests of leaders of enterprises lead to a slow down of the process of land reform and providing peasants with plots, and decayed machine-tractors garages, animal raising complexes and real estate fund.

As of January 1, 1997 peasants' holdings and individual enterprises utilized only 6.9 % of total surface of land to be privatized. As of December 1, 1996 out of 1254 agriculture enterprises 395 (31%) completed the process of privatization. Furthermore, in 158 (13%) companies the privatization process has not begun yet, and the value property shares, due to each participant of privatization, has not been defined.

The proposed way out of the existing situation should be: acceleration of land reform, providing agricompanies' peasants with land, making land an object to buying & selling, support restructuring provided by ARA agency, and USAID, TACIS, GTZ projects, creating a system of seasonal credit facilities on the bases of land pledge and using futures contracts, introducing insurance of harvest and leasing of agrimachines. It is also reasonable to develop the market infrastructure by means of wholesale markets, trade houses, marketing centers and companies.

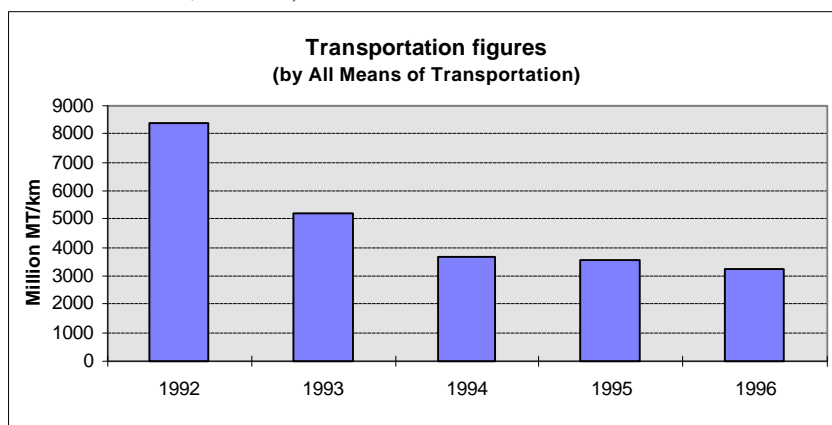
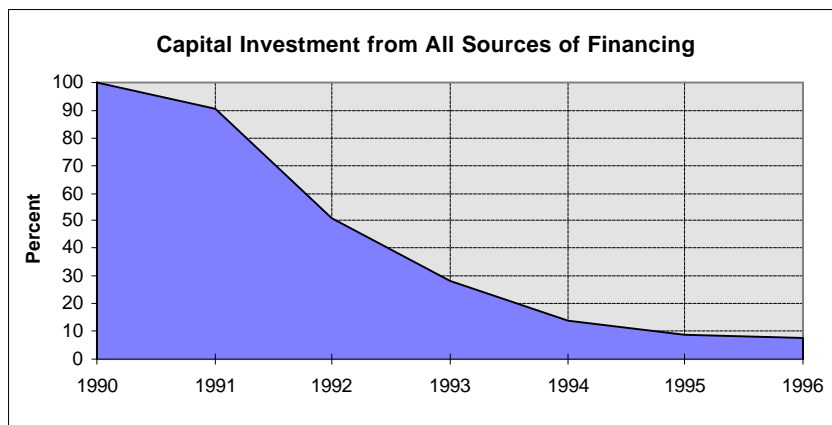
Infrastructure

The fall in production sector output had a negative impact on sectors of industrial infrastructure, first of all those, linked to investment activities.

For the last 7 years this index decreased in construction materials

sectors (cement, iron concrete construction, bricks).

All types of transport (railway, motor-car, river and air services) scored a decrease of production volume by 2.6 times. One of acute problems in energetic complex is renovation of equipment. The loss of energy in wires is 24.3% (1996) which is almost 3 times more than in 1990.



The only branch which got a development was telecommunication. In 1996 enterprises of this sector provided services about 1.4 times more than in 1995 (current prices). In accordance with the set individual program “Moldtelecom” will be privatized in 1997, and this, in its turn would facilitate drawing foreign investment into the country’s economy.

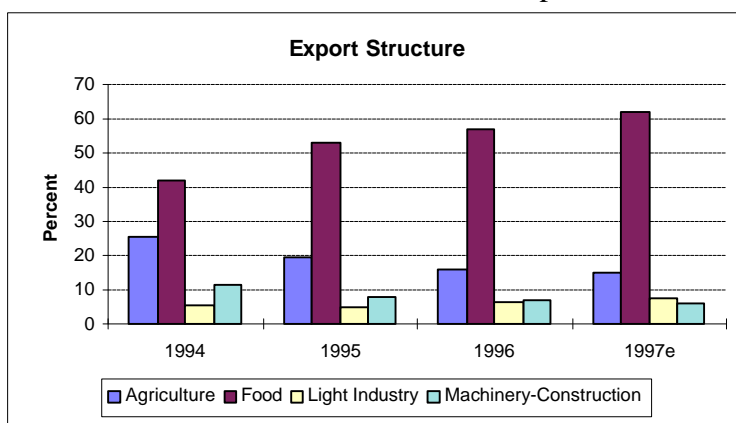
Export/Import

Foreign exchange economic operations are established with more than 90 countries.

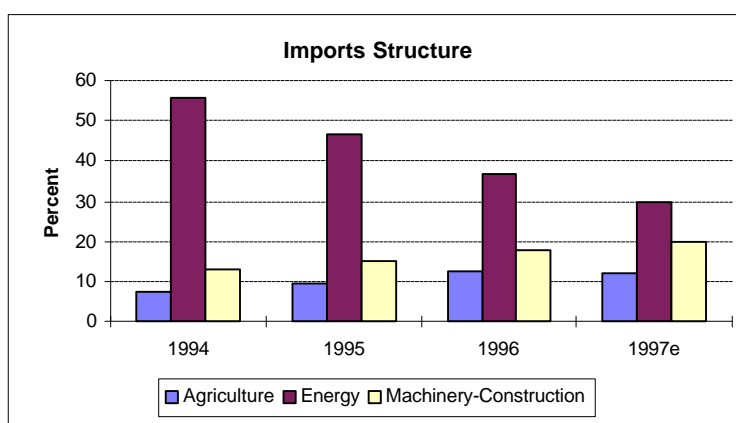
For the period of 1994-1996 (from the first year of circulation of the national currency – leu) the volume of foreign trade turnover of Moldova has increased from 1225 million USD to 1880 million USD, i.e. by 53%. The deficit of trade balance has increased by 2.5 times in 1996 with reference to the last year and compounds 35% of export volume. This had an unfavorable impact on balance of payments of the republic.

Regarding structural changes in exports for the last three years, it is necessary to mention that in this period there was a positive improvement, but still insufficient for the effective development of economy.

The share of agriculture production in the total volume of export has decreased from 25.4 % to 16%, while the share of food production has increased from 42% to 57.2%. Enterprises of light industry managed to increase the share of production only in 1996, which reached 6.7%. As it was expected, machinery-construction enterprises were losing their position on external markets, their share has decreased from 11.5% to 7.0%.



Import structural changes for the last 3 years reflected a positive tendency. It is necessary to mention the increase of the share of machinery-construction production (capital ratio) in total volume of imports – from 12.8% to 17.8%. Also, it should be stressed upon a decrease of the share of the energy products from 55.6% to 36.8%. From our point of view, with the purpose of real improvement of economy, the share of machinery-construction should rise to 30-35% and the share of the energy products has to be reduced to 20-25%.



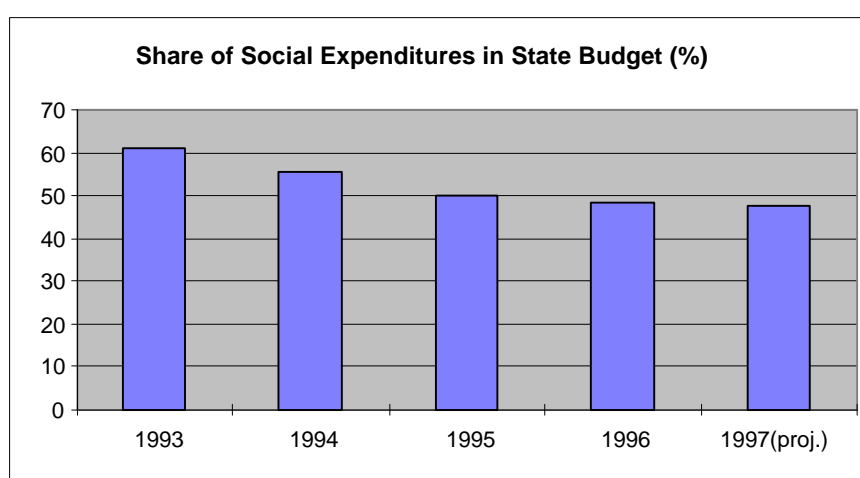
The share of agriculture and food production in the total volume of imports has increased from 7.5% to 12.4%. However, some imported items as alcohol, dairy products as milk and meat of unacceptably low quality are not always first need products from social perspective.

The tendency of Moldova’s integration in the International Community was outlined extremely clearly.

4. Social Area Reform

Endeavors undertaken in Moldova's economy aimed at its adjusting to market mechanisms have affected directly the social sector. Successes attained in the area of macroeconomic stabilization (considerable reduction of inflation, maintaining budget deficit within standard limits, stable exchange rate of the national currency) were not accompanied by radical reformation at the enterprise level. As a result the economic recession has deepened, at the same time the burden of social costs supported by population has become more tough.

Unlike the financial and banking system, as well as production sphere, the social protection system did not experience radical qualitative changes in 90s. Though allocation of financial resources from state budget to social sphere has decreased dramatically during last years (from 60.9% in 1993 to 48.3% in 1996), their share still remains at a comparable level with Western states.



In 1996 there were only 136 million lei of capital investments allocated to the social sphere (68% of the budget planned amount). Because of lack of financial resources the number of built-up social institutions is rapidly dropping. This in its turn considerably reduces the potential of the social sector to provide accessible services to the population with low income.

Building-up Social Institutions

(in % comparing to the previous year)

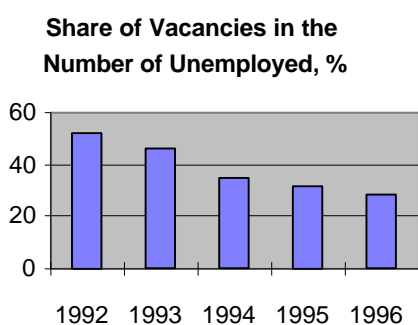
	1991	1992	1993	1994	1995	1996
Dwelling	80	84	81	78	61	73
General schools	84	37	38	92	8	98
Kindergartens	96	41	61	83	16	22
Hospitals	46	95	98	33	45	57
Clinics	38	67	33	67	70	72

Being constrained in allocation of public financial resources (an average of 25% of the needed funds), social institutions have to reduce the range of services provided to the population. At this time more than 1200 kindergartens are closed, the schools' capacity covers only 2/3 from the current needs, and their provisions with manuals is even smaller – 50% of necessities. It is estimated that a significant number of children do not attend schools, because of poverty.

Regarding health care services, the current situation is characterized by a severe deterioration. Public medical institutions are not able to ensure an accessible range of services for the households. Private medical sector is just at the initial stage and therefore the services provided are too expensive. Moreover, the primary medical health care is weakly developed, and this makes quite complicated the actions for prevention, diagnostics and medical rehabilitation. At the same time, the secondary medical assistance is inefficient because of lack of modern medical equipment and insufficiency of public funding.

The strength and time profile of these effects have varied significantly during 1991-1996, reflecting the differences in initial terms and nature of pursued strategies at that moment. Nevertheless, the macroeconomic implications on social sector were particularly experienced in:

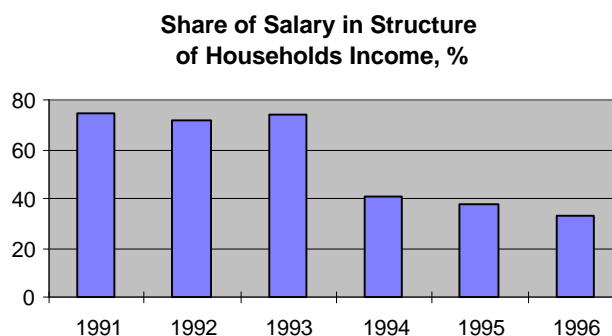
- *Employment of labor force.* During years 1991-1996 the trend of decrease in total number of the employed in national economy has deepened (-30%), being more stressed in the public sector (-50%). Reduction of labor force was encountered practically in all sectors. At the same time there was a tendency of growth of the number of employees in private sector (+18%) and in informal sector (+10%). The last 2 sectors are actually incorporating around 14% of the total active population. The low capacity of economic entities to absorb the labor force is imposing employees to undertake desperate actions in order to find a job. Therefore, 85% of those disengaged are employed in the “street” trade, shadow economy and informal sector. Only 1 of 10 is applying for the employment services. So, at the beginning of 1997 there were registered as unemployed 23.4 thousand people (1.8% of active population). At the same time the hidden unemployment which covers around 235 thousand people conceals the real situation and reduces the effects of enterprises’ personnel turnover. Spontaneous labor migration phenomenon is widening. Many workers are going abroad by their own will hoping to find a job (mainly in Greece, Israel, Germany, Russia), without any social insurance.



- *Living standards of the population.* Frequent increases in salaries, pensions and other nominal retributions, undertaken lately, did not succeed to set off the negative effects of inflation and price liberalization. As a result, the real incomes of the population have decreased dramatically. While in 1993 the average salary in the national economy covered 63.6% of the minimal consumer budget, in 1996 this figure fell to 48%.

- *Ruining of salaries as main source of income.* In 1996 the share of the salary in households’ income structure represented only 33.2%, comparing to 74.5% in 1993. These changes reflect the problem of salary arrears (360 million lei at 1 January 1997), fiscal evasion of employees of the private and informal sector, as well as paying in-kind of the salary, whose share is rising continuously.

- *Households consumption is* damaged as a result of a decline in the real income of the population. At present people have to spend roughly 5 times more for foodstuffs than in 1993, allocating for this purpose 56% from their budget. Meanwhile foodstuffs’ consumption in real terms



fell with an average of 40%. This decrease had an impact almost on all basic foodstuffs, except just for potatoes (+15%) and bread & cereals (+3%).

Average Monthly Salary and Minimal Consumption Budget

	1993	1994	1995	1996
Average monthly salary, lei	31.2	108.4	141.8	186
Minimal consumption budget, lei	49	271	311	388
Share of average salary in minimal consumption budget, %	63.6	40	47	48

- *Reduction of budgetary subventions* for the main food products such as bread and milk, as well as for the municipal services and public transportation has had a negative impact on living standards of social groups with low income. The vulnerable groups of population as main consumers of these goods and services have been provided with compensations much lower than the increase in prices. Therefore they will bear further on the gravity of social costs.

- *Poverty phenomenon* has begun to expand in larger proportions during the last 4-5 years. According to some sociologic estimations about 3/4 of the population are under minimum consumer, budget only 5.5% of the population has earnings over the minimum of consumer budget, while 60% of employees of national economy earn only 46% of subsistence minimum. Around 135 thousand people have monthly income less than 18 lei. As a result of this, social dispersion of population has been extended. In 1993 the correlation of incomes between the richest and the poorest was 1:7, while in 1996 this disproportion was 1:11 (average index in the OECD countries is 1:5).

Deterioration in genetic fond and of human potential is a final result of high social costs of the reforms. During 1995 the morbidity has increased by 15% while birth-rate has decreased dramatically by 27%. As a result of this, natural increase of population was at 0.5 per 1000 person in 1996. This was the lowest rate from postwar period.

The average life expectancy rate has decreased down to 65.1 years being even shorter than in 1959 at 68.1 years. Thus, the republic becomes a state with deteriorated genetic fond, while the mortality overfills the quota of birth-rate and the aging rate of population is net superior to rejuvenation rate. Therefore, today in Moldova the number of population is decreasing.

Demographic Situation of Moldova

Indicators	1991	1992	1993	1994	1995	1996
Total population , million pers.	4.3663	4.3591	4.3478	4.3527	4.3479	4.3190
Birth-rate (at 1,000 pers.)	16.5	16.0	15.2	14.3	13.0	12.1
Morbidity (at 1000 pers.)	10.5	10.2	10.7	11.8	12.1	11.6
Natural increase (at 1000 pers.)	6.0	5.8	4.5	2.5	0.9	0.5
Infantile mortality (at 1000 born)	19.4	19.9	20.3	20.8	21.2	19.1
Born, thous. pers.	69.7				56.4	52.4
Died, thous. pers.	44.5				53.0	50.5
Life expectancy, years	67.7		67.6	66.0	65.7	65.1

Social Protection System in Moldova further remains centralized and has a rigid structure and ineffective management. The social protection is intended to cover a larger social costs impact assuming thus enormous obligations without having an adequate financial protection. According to some preliminary estimates, financial protection of social programs has 2/3 of the necessary volume of resources. In such conditions undertaken actions have a fragmentary nature and are incoherent and inefficient. Social benefits in the republic compensate around 20% of the burden of economic reforms. Since undertaken actions are passive and do not anticipate the consequences of the reforms at macro and micro level, the effects of social programs in most cases do not mitigate the people's situation. The nature of the social protection system in Moldova reflects its origin from the former soviet social security system. The social protection systems of the most CIS states are confronting with the same problems, significant for the former USSR countries.

Social protection in Moldova provides for a wide range of benefits through the following sectors/branches:

- pension benefits;
- indemnities and compensations to the many-children families and low income persons;
- social assistance;
- unemployment benefits;

Financing of social protection programs is provided from three sources: obligatory social taxes paid by legal entities regardless ownership form (30% of payroll in 1997), employees contribution (1% from gross wage) and occasional allocations from the state budget. The distribution of these sources in total social benefits (transfers) budget in two last years as follows:

	1996	1997
Businesses	87.7	72.5
State and local budget	7	25
Employees	2.5	2.5
Other (grants, loans, humanitarian assistance)	2.8	–

Pension benefits constitute the main element of social protection. About 87% of social benefits budget is utilized for pension payments. In diverse pension schemes almost 755 thousand people are being covered, the majority of whom being age-pensioners (562.7 thousand people). Average pension in 1996 was of 78 lei, which is about 42% of average wage in the country, compared to 60% in 1993.

The major problem facing the system of pension benefits is the deficit of financing. As a consequence of failure of payment of social taxes by enterprises, the arrears on pensions in the beginning of 1997 reached 324.1 million lei (equivalent of 4-5 months pension payments).

Social Fund Liabilities Payable and Receivable (million lei)

	as of 1.01.1995	as of 1.01.96	as of 1.01.97
Receivable liabilities	175,2	313,2	572
In % of total revenues	30	48	56
Payable liabilities,	42,1	175	404,1
including:			
due on pensions	30,1	128	324,1
due on compensations	12	47	80
In % of total costs	10	27	31

These debts reflect the gradual diminishing of the social benefits budget and the transfer of responsibility to the Social fund, being not related to the disposable financing. In order to partially solve the problem of payments, an attempt to settle the pension arrears through paying in kind was made in 1996. About 20% of the total number of pensioners were provided with pensions in kind of a total amount of 109.4 million lei (prevalent were: sugar, vegetal oil and consumer goods).

Indemnities and Compensations constitute probably the most sophisticated and disputed domain of social protection. Even offering a large assortment of social benefits without a sufficient financial support, their effect remain to be very low. The range of compensations is representing 1-13 lei, which is practically nothing, comparing to the supported level of prices by families who have low income. In spite of this, in 1996 there were 175 million lei allocated to cover indemnities and compensations accorded to vulnerable sections of people.

Social Assistance is offered in two ways: at institutions and at home. The assistance at institutions is distributed through 10 social institutions (houses for old people, asylums, special schools for children with physical and mental handicaps, sanitariums). Annually around 2400 people benefit from these services. These persons are there totally at state's support (food provision, medicine assistance, etc.). The financial expenditures are covered by state.

Social assistance at home is provided by 1930 civil servants who are distributed in all districts. During 1996 they have provided social services to 17.2 thousand lonely old people and invalids of 1st and 2nd categories. These services consisted of food providing, hot meals, medicines and also some facilities for procurement of firewood, medical assistance, municipal services and others. The total amount of expenditures were of 22.5 million lei and covered totally by local budgets.

Pensioners after 65 years age and invalids have prosthetic orthopedic benefits and means of conveyance. They receive these goods free of charge or favorable conditions depending on the invalidity group and category. The disabled pensioners and invalid children under 16 years have the right to be provided free room or street carriages. During 1996 there were allocated 1.5 million lei for this purpose, while the demand has been of 14 million lei. The war and labor invalids are entitled to get free of charge specialized cars or of privileges in its buying (with essential price reduction). The funds for these purpose are allocated from the state budget. During the period of 1994-1996 there were allocated 179.2 million lei for this purpose, which covered only 7% of the demand.

In addition to benefits received from Social Fund, such as pensions, compensations and indemnities, the vulnerable persons are entitled (have the right) to be provided with social assistance from the Fund for Social Assistance of the Population. Almost 345 thousand (lonely pensioners above 75 years age, disabled persons, families with many children) receive the assistance in kind and in cash at the total amount of 8.7 million lei during 1996.

Unemployed' insurance represents most probably a new way of the social protection system of population. Registered unemployed people represented only 23.4 thousand (1.88% of active population), the expenditures for the assurance of unemployed were very low - around 1% of the total Social Fund's expenditures for 1996. In spite of this, the social protection programs for unemployed must already have sustainable financial support to anticipate the mass lay-off of workers caused by deepening of the agrarian reforms, restructuring of enterprises,

privatization of some infrastructure sectors, such as communications, power engineering, transportation.

Issues and Options for the Social System Reform. The system of Social Protection in Moldova is based mainly on public financing and rigidly-centralized management. Its inefficiency was vividly manifested in the last years when debts on pensions and compensation payments have surpassed 30% of total social transfers budget. It is evident that system of social protection requires profound reforming. Factors contributing to the need of social system reorganization are as follows:

- ◆ Enormous disequilibrium between exaggerated social liabilities and financial possibilities of state;
- ◆ Hard burden of social taxes maintained by businesses, which give way to fiscal evasion, and steady growth of state's social liabilities;
- ◆ Wide distribution of social benefits, lacking coherence and associated with negative effects;
- ◆ Irrational distribution of social funds, not allowing efficient channeling of limited resources for the protection of the most vulnerable social groups;
- ◆ Structure and management of the system of social protection are rigid, obsolete, and inefficient;
- ◆ High operational and administrative costs;

Options of the social protection system reforming can be classified into 2 large groups:

i) *urgent (short-term) actions*, which aim at the liquidation of arrears on pensions, wages, indemnities, and compensations. In this way the activities will be concentrated on:

- liquidation of accrued liabilities of the social fund through enforcement of discipline of social taxes payment;
- timely settlement of current liabilities on pensions, wages, and compensations;
- gradual diminution of debts on pensions, wages, and compensations accrued within last 2 years;
- applying the "means-testing" method for concentration of efforts to protect target groups;
- reduction of privileged social benefits;
- reduction of administrative expenses through increased degree of operationalization and decentralization of social management;

ii) *medium-term actions*, aiming at adjustment of social protection system to the principles and realities of the market economy; the efforts being concentrated on:

- redistribution of financial burden, thus gradually reducing the taxes beaded by businesses and increasing the contributions of employees (as deductions from wages and salaries);
- diversification of social system through starting complementary private mechanisms carried out by the beneficiaries;
- introduction of personal identification system in accounting for social contributions;
- elaboration of respective legal basis for starting private pension funds, voluntary social security and rendering social services for money;
- gradual raise of the pension age.

The problems accumulated in the social sphere are so tremendous, that by postponing their resolution one can endanger the overall success of reforms and will deprive intended reforms of trust and support from the majority of population.

5. Comparative Analysis: Moldova and Other Countries in Transition

Geo-political position, productivity and natural factors of Moldova in the crossroads of Balkans, by the region of Black Sea and the CIS have mainly determined both the current problems facing the country, as well as the perspectives of its development. In terms of “transitional economy” issue, Moldova is related to the region of *South-Eastern Europe*, including 9 countries: Slovenia, Croatia, Serbia, Bosnia and Herzegovina, Macedonia, Romania, Bulgaria and Moldova.

The majority of these countries are parties of the Black Sea Basin Regional Community, and Moldova, the only one of them being the member of the CIS Economic Union, which stands for 60.9% of the country’s imports and 68.2% of exports.

In the region of South-Eastern Europe, besides the reformer-countries like Slovenia, and outsiders like Bulgaria and Albania, the majority are the countries with the similar status of the problems solving in the areas of banking and finance, property reform, enterprise restructuring, creating competition, and legal backing of reforms.

Thus, according to the EBRD classification (Transition Report 1996), Moldova holds the 11th place among the 25 economy in transition countries of Central and Eastern Europe, and the CIS, see the respective table in the Annex, and in the South-Eastern Europe it goes after Slovenia and Croatia.

Progress in transition in the South Eastern Europe:

Country	Enterprises Privatization				Markets and Trade			Financial institutions		Legal reform	Total
	Private sector share of GDP,%	Large-scale	Small-scale	Restructuring	Price liberalization	Trade & foreign exchange system	Competition Policy	Bank reform and interest rate liberalization	Securities markets and non-banking institutions		
Albania	75	2	4	2	3	4	2	2	3	3	24
Bulgaria	45	2	3	2	2	4	2	2	4	4	23
Croatia	50	3	4	3	3	4	2	3	4	4	28
Macedonia	50	3	4	2	3	4	1	3	3	3	24
Moldova	40	3	3	2	3	4	2	2	3	3	24
Romania	60	3	3	2	3	3	1	3	3	3	23
Slovenia	45	3	4	3	3	4	2	3	3	3	29

Common for Moldova and other countries in transition is the creation by the state, represented by legislative and executive authorities, the necessary basis of legal norms of the economy in transition, which consists of the five main elements:

- definition and protection of property rights;
- contract relations;

- order of initiation and termination of economic activity;
- provision of competitive environment;
- procedures of formation of the market institutions specific for the transition period

Less successful compared to “reformer-countries” was the *practical application* of the laws, especially in the areas of protection of property rights, anti-monopoly regulation, contract relations, liquidation/bankruptcy procedures. A long delay was associated with the application of new Civil Code, being already the achievement of the all other countries of the region.

The advantages of Moldova rest in the openness of the economy, swiftly performed mass privatization, the reforming of banking sector and monetary circulation, and liberalization of enterprise activity. Later than was the case with the rest of the region, Moldova entered the enterprise restructuring program, budget reform and overcoming the criminalization of the economy.

A special attention, considering the particularities of the economic structure and demography, is to be drawn on agricultural and social (pension) reforms.

Among the ex-Soviet countries, in terms of the contents and profundity of market reforms, Moldova goes after Baltic States and Armenia. However, economic and social results of these reforms are to be enhanced.

In different international classifications of countries in transition, in terms of economic trends, risks, etc., the 1997 forecasts for Moldova, are generally positive. Thus PlanEcon Review predicts 5.7% GDP growth in Moldova in 1997, being compensated, however, by deteriorated Trade Balance of about -\$324.7 million and Balance of Debts and Payments (to non-CIS) of -\$230 million.

In Euromoney Country Risk rating, Moldova is placed on the 104 position out of 160 countries of the world, following other East-European Countries (except Albania), but leads over Ukraine, Belarus, and majority of the CIS countries (Euromoney, September 1996).

6. Key Problems of Future Development. Challenges for National Interests

According to the program “Stability, Order, Prosperity” (December 1996), of the President P.Lucinschi, the following goals have been established:

- strengthening of the State and restoring the integrity of the country;
- intensification of the reforming process in national economy and in the social area;
- maintaining national security, and advancement of civil unity and legal order.

In accordance to this, the I.Ciubuc’s government program (January 1997) determined the following priorities in the economic area for the nearest period:

- overcoming the budget crisis, formation of domestic savings, and attracting foreign investments for the purpose of structural restructuring of the economy;

- stopping the decline in standard of living of the population, reform in the social area, renewal of the social protection system on new market basis;
- solving the problem of land as a commodity, and speeding-up the agricultural reform;
- demonopolization and restructuring of the energy complex, lowering the energy consumption share of GDP;
- protection of property rights, increasing economic effectiveness of privatization and state property management, encouraging entrepreneurship.

Current Economic Policy and Institutional Reforms

During the reforms of 1991-1996, Moldovan economy underwent the change in two respects:

- a) systemic change, related to the appearance and establishment of market institutions of economic activity,
- b) structural and substance change, i.e. spontaneous modification in the structure of GDP, industry, agriculture and services areas.

The progress in systemic transformation is accompanied by economic crisis. It will be practically impossible to overcome the crisis using the current regulatory means.

More determined actions of the President, the Parliament and the Government are necessary in order to advance the institutional reforms. It is moreover important, given the exhaustion of the financial stabilization policy, which is carried out by means of monetary regulation. Thus, the problem of businesses' payments defaults by can not be solved by the government in absence of bankruptcy procedures, given the high degree of monopolism in the economy, and state-involvement in the social sphere, etc.

The progress in the evolution of legal basis of the market economy came into contradiction with practical application of the laws (contracts), both of vertical character (state - entrepreneur), and of horizontal one (between entrepreneurs).

Enforcement of contracts ought to become the chief function of state in the economy. The weakness of the legal system threatens the position of state, economy and the population at large.

Property vacuum, investment crisis

Paralysis in the area of investment, is mainly caused by the undefined character of property relations, i.e. the category of "effective owners" is just starting to form, the state having abandoned investment area, but the investment capacity of non-governmental financial system is not being sufficiently stimulated.

The state formally remains the chief owner (or co-owner) of the largest enterprises, and practically the sole owner of social funding, but it is not able to provide the former level of financing of industry, agriculture, and social benefits.

Therefore in the second half of 1990s, there was a room for a large-scale real privatization in the agriculture, industry, and energy sphere, as well as for budget and social area reforms.

The non-money (voucher) privatization is no longer attractive for the population. There is a demand for privatizing by means of sale of enterprises, aiming at balancing the budget through replenishing its revenues. The main difficulty is in the attraction of customers for the large non-

profitable (over-employed) enterprises, which play a strategic role for the republic, i.e. tobacco complex, cement plants, a series of machinery-construction enterprises and some of the light industry. Because of the high capital share requirements, foreign investors may probably be key buyers of these enterprises. A clear sales procedure has to be elaborated, giving equal opportunities both to local and foreign investors.

The main threat for Moldova for the upcoming period is the *delay in economic restructuring* process (in the agricultural area, energy complex, industry, and social sector). Therefore, it is vitally important that starting with 1997 structural changes in Moldova to be the result of a goal-oriented policy, and not a form of spontaneous adjustment (negative adaptation) of the economy to the current financial policy and demand limitations.

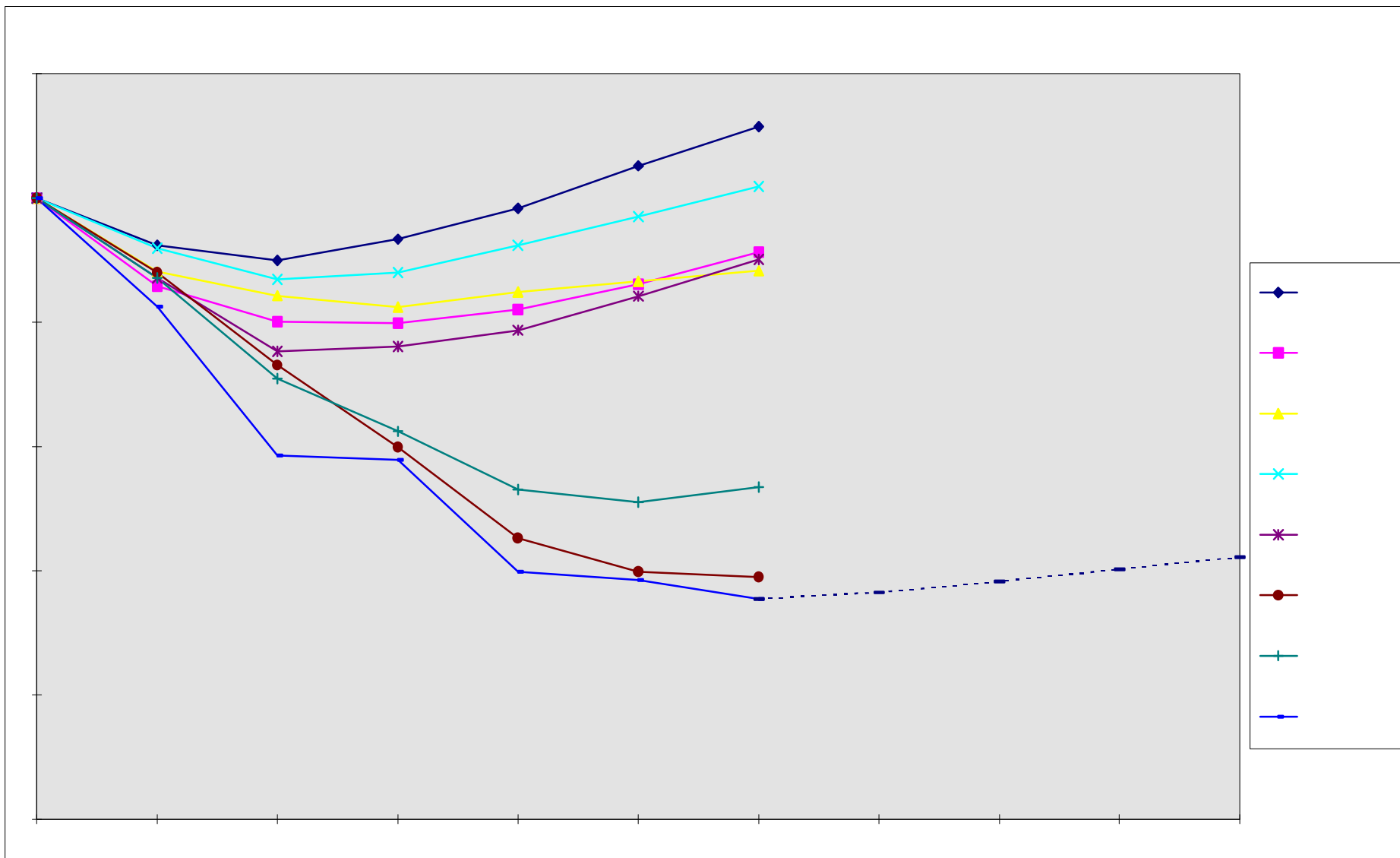
Financial system is under an extreme tension. The hard process of adaptation of economical entities to a low inflation and profitability has lasted too long. A way out would be in deepening of institutional reforms and carrying out of more resolute measures in restructuring of enterprises and branches.

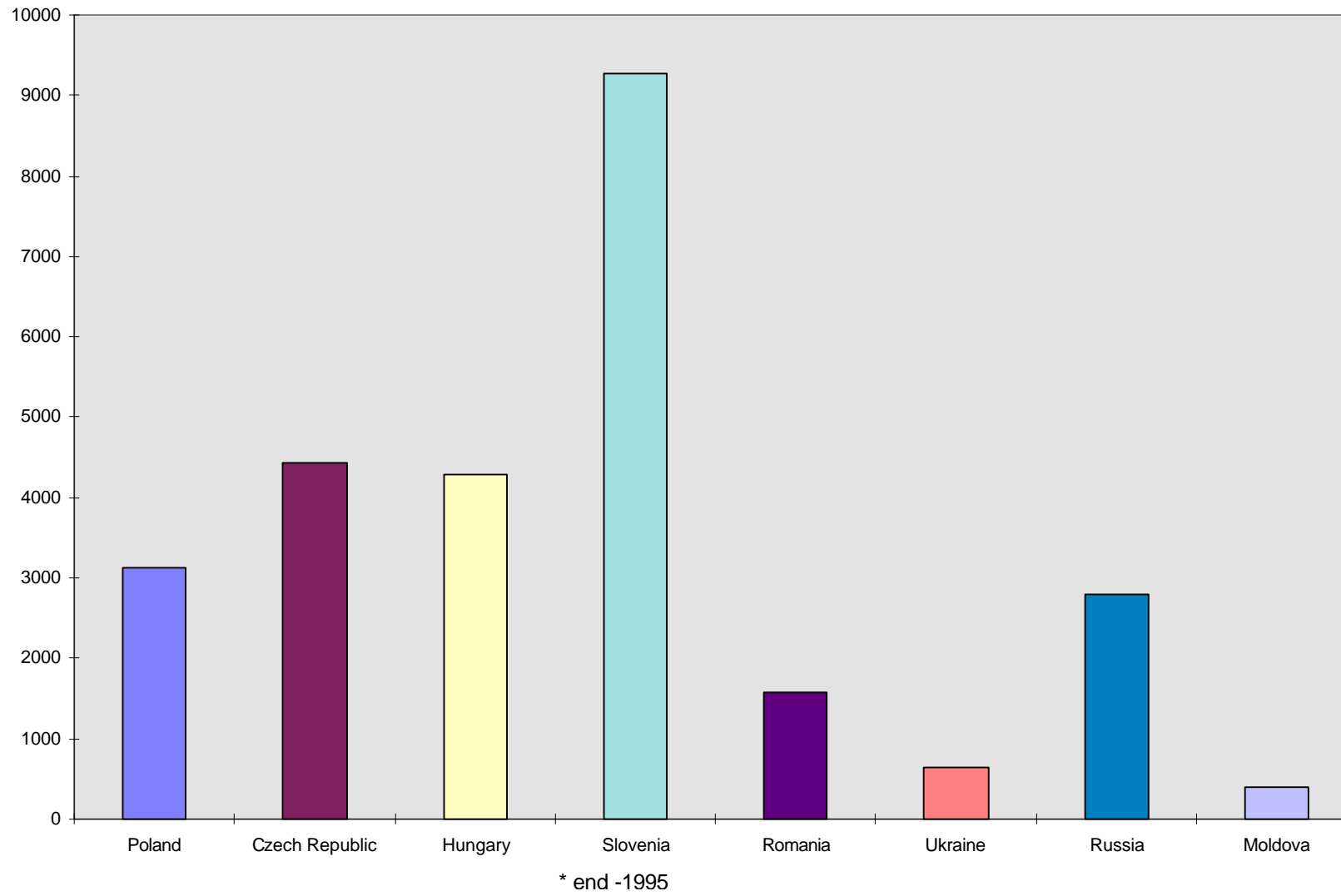
Besides the structural risks, in the conditions of Moldova, acute *regional problem* (separatism) of Transnistria requires resolution, the territory concentrating about 30% of the country's productive potential. Restoring of territorial economic complex will cause the need for modifications in the methods and resources to be provided to this region.

To summarize, the process of reforms in the transition economy is quite painful. Therefore, considering the positive experience of 1994-1995, when the coordinated efforts of the President, Parliament and Government ensured acceleration of reforms in the middle of the election cycle, it becomes vital to create legal, economic and organizational prerequisites, so that the up-coming (after 1997) *cycle of political stability* ensures a further advancement of the country in restructuring of economy and resolution of social problems.

7. Annexes

1. Table: Main Macroeconomic Indicators of Moldova.
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Ratio of State Budget Deficit/Surplus to Budget Expenditures
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GDP per capita, USD *

Rate of Inflation (1993-1997), %	
Month	Monthly Rate
ääê.93	59.2
ÿî.94	18.9
ôâ.94	21.6
làď.94	10
àiř.94	5
làé.94	27
èí.94	27
èë.94	22
àã.94	-0.1
ñái.94	25
îè.94	4.2
řÿ.94	3.5
ääê.94	29
ÿî.95	29
ôâ.95	23
làď.95	0.7
àiř.95	0.6
làé.95	0.4
èí.95	0.2
èë.95	0.2
àã.95	0.2
ñái.95	26
îè.95	27
řÿ.95	6
ääê.95	29
ÿî.96	3.5
ôâ.96	25
làď.96	1.1
àiř.96	1.1
làé.96	0.8
èí.96	0.1
èë.96	0.1
àã.96	-0.3
ñái.96	1.5
îè.96	1.6
řÿ.96	1.4
ääê.96	0.8
ÿî.97	1.9
ôâ.97	1.4

Official Exchange Rate MDL/USD	
Month	Average monthly rate
ääê.93	3.7161
ÿî.94	3.6660
ôâ.94	3.8493
làď.94	3.9260
àiř.94	4.0613
làé.94	4.0670
èí.94	4.0672
èë.94	4.0570
àã.94	4.1427
ñái.94	4.2101
îè.94	4.2304
řÿ.94	4.2433
ääê.94	4.2701
ÿî.95	4.3257
ôâ.95	4.3834
làď.95	4.4154
àiř.95	4.4866
làé.95	4.5393
èí.95	4.5567
èë.95	4.5346
àã.95	4.5332
ñái.95	4.5342
îè.95	4.5355
řÿ.95	4.5652
ääê.95	4.5299
ÿî.96	4.5295
ôâ.96	4.5556
làď.96	4.5443
àiř.96	4.5537
làé.96	4.5920
èí.96	4.6361
èë.96	4.6506
àã.96	4.6121
ñái.96	4.6297
îè.96	4.6067
řÿ.96	4.6522
ääê.96	4.6683
ÿî.97	4.6650
ôâ.97	4.6760

Financial Data of Commercial Banks of Moldova

as of February 1st, 1997 (thousand lei) *

<i>Banks' name</i>	<i>Total on Balance</i>	<i>Founder's Shares</i>	<i>Total Capital</i>	<i>Liquid Assets</i>	<i>Debt on Loans</i>
Bancosind	43 392.3	7 667.5	7 288.4	1 295.2	35 562.9
Comertbank	24 992.0	8 000.0	9 125.0	4 701.1	19 416.3
Banca Sociala	603 975.2	16 000.0	40 043.7	39 031.8	188 654.3
Victoriabank	123 826.6	7 000.0	19 392.9	43 345.4	56 862.0
Moldova-Agroindbank	749 346.7	40 000.0	148 488.9	92 242.3	307 032.2
Mobiasbanca	97 800.2	10 650.0	21 147.8	43 788.4	36 357.3
Banca de Economii	361 742.0	15 000.0	32 260.7	32 291.6	145 553.3
Moldindconbank	378 066.4	15 000.0	31 347.4	26 931.9	160 450.5
Petrolbank	146 038.3	43 500.0	51 538.8	40 656.4	62 363.2
Oguzbank	62 897.7	10 000.0	12 232.3	12 922.6	30 239.1
Unibank	13 932.0	4 484.4	7 840.1	3 103.0	4 906.4
Finance & Trade Bank	47 763.1	7 001.4	9 461.4	21 563.1	21 278.5
Moldova Nord Bank	5 554.1	4 351.5	4 357.6	388.2	4 568.2
BankCoop Branch	67 544.8	8 837.8	9 812.9	38 241.7	59 088.4
Eximbank	77 136.4	9 160.0	9 999.7	45 827.0	18 035.2
Vias	29 104.3	8 160.0	8 581.6	2 644.0	23 777.6
Bucuria-banca	5 896.3	3 966.5	4 030.5	736.1	5 072.6
Investprivatbank	56 587.2	8 500.0	8 924.5	14 613.3	39 056.1
Universalbank	55 450.1	12 000.0	14 497.5	19 318.7	28 106.4
Guinea	37 690.4	4 052.0	4 481.1	18 112.3	14 541.3
IBID-MB	14 789.3	9 120.0	9 491.3	3 356.2	11 430.3
Energbank	4 254.0	4 200.0	4 200.0	4 229.0	0.0
Total	3 007 779.5	256 651.1	468 543.8	509 339.2	1 272 352.2

* Without branches

Breakdown of Social Fund

(in millions of MDL)

	1996		1997
	Budget	Actual	Project
Pension Fund			
<i>Revenues, total</i>	913.5	668.8	859.2
including:			
social taxes	708.1	472.2	596.7
budget allocations	75.3	23.5	262.5
<i>Expenditures, total</i>	934.5	590.1	859.2
including:			
age pensions	634.4	456.5	700.5
military pensions	7.4	7.8	10.2
social pensions	21.3	16.4	23.2
Fund for family and children protection			
<i>Revenues, total</i>	108.5	11.7	92.4
including:			
social taxes	108.5	11.7	92.4
budget allocations	-	-	-
<i>Expenditures, total</i>	108.5	29.5	92.4
including:			
indemn. for children aged up to 1,5 ani	19.7	11.7	27.2
compensations for children aged between 1,5 - 16 years	25.3	13.9	36.1
compensations for children from numerous families	2.1	2.8	23.7
Social Insurance Fund			
<i>Revenues, total</i>	95.1	95.9	82.1
including:			
social taxes	95.1	95.9	82.1
<i>Expenditures, total</i>	96.3	94.3	82.1
including:			
indemn. for temporary loss of work capacity	53.1	56.2	54.3
indemn. for pregnancy and nursing	12.5	11.7	12.1
medical treatment and health recovery	22.7	22.1	10
Unemployment Fund			
<i>Revenues, total</i>	22.9	7.4	18
including:			
social taxes	22.9	7.4	18
<i>Expenditures, total</i>	22.9	7.4	18
including:			
unemployment benefits	10.4	3.7	7.8
vocational training of the unemployees	8.7	1.4	4.2

Breakdown of Social Expenditures

	1992	1993	1994	1995	1996	1997 project
Social Expenditures						
mln.lei	225.4	305.6	967.2	1188	1401	1426
in % of total budget. expendit.	47.7	60.9	55.5	45	51.5	47.5
in % of GDP	13.2	13.8	16.4	15.6	13.5	12.1
Education						
mln.lei	14.9	133.3	408.9	566.8	658.4	660
% from total social expend.	58.7	43.6	42.3	47.7	47	46.3
% from GDP	7.8	6	7.1	7.4	6.4	5.6
Health Care						
mln.lei	7.2	81.6	294.5	374.9	470.7	485
% from total social expend.	28.3	26.7	30.4	31.5	33.6	34
% from GDP	3.8	3.7	5.1	4.9	4.6	4.1
Culture and mass-media						
mln.lei	1.7	10.3	31.5	46.1	66.7	61.7
% from total social expend.	6.7	3.4	3.3	3.9	4.8	4.3
% from GDP	0.9	0.5	0.5	0.6	0.6	0.6
Social Assistance						
mln.lei	1.6	17.7	28.7	42.6	56.6	103.5
% from total social expend.	6.2	5.8	3	3.3	4	7.3
% from GDP	0.8	0.8	0.5	0.6	0.5	0.9

Services provided by the Moldovan Social Protection System

	Benefits	Notes
Pension Fund	<ul style="list-style-type: none"> • retirement pensions (old age, loss of sustain, length of services) • social pensions • disabled persons pensions • military pensions (funded through the state budget) • compensations and allowances to pensioners with many children • thermal bath treatments for pensioners 	about the 87% of the Social Fund revenues are used by the Pension Fund
Fund for Protection the Family and Children	<ul style="list-style-type: none"> • pregnancy and nursing • birth of children • care of children • single mother allowances 	
Social Insurance Fund	<ul style="list-style-type: none"> • temporary loss of capacity to work • burial allowances • medical treatment in a sanatorium or health centre for employees and their families • construction and reconstruction of sanatoria and health centres 	12% of the Social Fund revenues are used by the Social Insurance Fund
Unemployment Fund	<ul style="list-style-type: none"> • unemployment benefits • vocational training allowances to registred unemployed 	the remaining 1% of the Social Fund revenues is used by the Unemployment Fund
State and Local Budgets	<ul style="list-style-type: none"> • military pensions • maintenance of social institutions • energy subsidies transport subsidies to disabled persons • health care (subsidies medicaments by categories) 	262,5 mln. lei are allocated for these purposes in 1997
Social Assistance Fund	<p>annual /occasional allowances to:</p> <ul style="list-style-type: none"> • pensioners • disabled persons • families with many children 	The SAF is funded by an 1% tax on legal entities profits, state budget and privatisation revenues In 1996 the total amount administred by SAF was about 10 mln. lei

Breakdown of Households Income (%)

	1993	1994	1995	1996
Total income	100	100	100	100
Salaries	74.5	40.6	37.7	33.4
Pensions, indemn.,scholarships	16.3	14	13.1	18.2
Income from own produce	6.6	6.6	8.4	8.6
Other income	2.6	27.6	23.9	n/a
Income from foreign currency	0.4	11.1	16.4	19.6

Tax Rates for Social Fund (percent of Remuneration Fund)

	1991	1992	1992	1993	1994	1995	1996	1997
		1st semst	2nd semst					Project
Legal entities regardless to ownership	26	60	45	45	38	35	35	30
Budgetary Agencies and Organisations	26	37	30	30	30	30	35	30

	Private Sector share of GDP	Large-scale privatization	Small-scale privatization	Enterprise restructuring	Price liberalisation	Trade & foreign exchange system	Competition policy	Banking reform & interest rate liberalisation	Securities markets & non-bank financial institutions	Extensiveness & effectiveness of legal rules on investment	Total
Czech Republic	75	4	4.5	3	3	4.5	3	3	3	4	32
Hungary	70	4	4.5	3	3	4.5	3	3	3	4	32
Poland	60	3	4.5	3	3	4.5	3	3	3	4	31
Estonia	70	4	4.5	3	3	4	3	3	2	4	30.5
Slovak Republic	70	3	4.5	3	3	4.5	3	3	3	3	30
Slovenia	45	3	4.5	3	3	4.5	2	3	3	3	29
Croatia	50	3	4.5	3	3	4	2	3	2	4	28.5
Latvia	60	3	4	3	3	4	2	3	2	4	28
Lithuania	65	3	4	3	3	4	2	3	2	2	26
Russian Federation	60	3	4	2	3	4	2	2	3	3	26
Albania	75	2	4	2	3	4	2	2	2	3	24
FYR Macedonia	50	3	4	2	3	4	1	3	1	3	24
Kyrgyzstan	50	3	4	2	3	4	2	2	2	2	24
Moldova	40	3	3	2	3	4	2	2	2	3	24
Bulgaria	45	2	3	2	2	4	2	2	2	4	23
Kazakhstan	40	3	3	2	3	4	2	2	2	2	23
Romania	60	3	3	2	3	3	1	3	2	3	23
Armenia	50	3	3	2	3	4	1	2	1	3	22
Georgia	50	3	4	2	3	3	2	2	1	2	22
Ukraine	40	2	3	2	3	3	2	2	2	3	22
Uzbekistan	40	3	3	2	3	2	2	2	2	3	22
Azerbaijan	25	1	2	2	3	2	1	2	1	2	16
Belarus	15	1	2	2	3	2	2	1	2	1	16
Tajikistan	20	2	2	1	3	2	1	1	1	2	15
Turkmenistan	20	1	1	1	2	1	1	1	1	1	10

MOODY'S RATING

Italy	Portugal					A1	max ↑ min
Cyprus	Malta					A2	
Israel	Slovenia					A3	
Czech Rep.						Baa1	
Poland	Slovak Rep.	Greece				Baa3	
Hungary						Ba1	
Mexico	Venezuela	Lithuania	Russia	Moldova		Ba2	
Turkey	Jordan	Romania				Ba3	
Argentina	Brazil	Pakistan				B1	

Note: this table reflects Moody's country risk rating.

For the Republic of Moldova the rating was announced in January 1997,
in connection with the private placement of Moldovan securities (Eurobonds)