

## **PART 2. RESOURCES AND FACTORS OF DEVELOPMENT**

### **2.1 Moldovan geo-politics – options for the future**

#### Geographic advantages

Approximately half of all European countries fall under the category of small countries. Moldova is one of them. By the size of its territory (33,700 km<sup>2</sup>) and population (4.3 million people), it is close to Denmark, Ireland, Slovenia or Estonia and has an economic potential comparable to these countries. A high density of population (~130 pers./km<sup>2</sup>) and a relatively developed infrastructure guarantees a good integration of Moldova's economic and administrative system.

The nearest foreign capitals – Kiev and Bucharest – are located at approximately the same distance from Chişinău (about 350 km by air). The second circle of accessibility (up to 1000 km) encompasses Vienna, Budapest, Warsaw, Belgrade, Sofia, Istanbul; and the third circle (1000-1500 km) – Moscow, Berlin, Rome, Athens, Tbilisi. Chişinău is 1,800 km away from Brussels, the capital of the European Union, the same as Helsinki and Lisbon.

Two strategic routes traverse Moldova. The Russia-Balkans rail and road connections and a gas pipeline supplying Romania, Bulgaria, Adriatic countries and Turkey. A North-South route, from Scandinavia to Balkans, is envisaged in a EU project for reconnection of Central and Eastern Europe – the A-9 rail and road transport corridor. The second important transit route, most important internally, is the Central Europe – Black Sea track that passes through Bălţi – Chişinău – Tiraspol.

Moldova has a very special geographic location for several reasons. First, it lies at the confluence of three geo-political zones: Southeastern Europe, Central Europe and Eastern Europe, that together make up Central and Eastern Europe. After the countries of the first two zones opted for integration with the European Union, Moldova also started negotiations over an association agreement with the EU. Upon reaching a political stability and economic growth, all these countries will eventually join the EU, albeit at different times. In the foreseeable future (10-15 years), Moldova, Ukraine and Belarus will find themselves bordering the EU. Even if the present open door policy towards the associated countries will change, the single fact will lead to a border effect not less important than that observed now in Central Europe.

Second, economically Moldova counts on the proximity of one of three world centers – Western Europe. At the same time, Moldova seeks to become a gate channeling the trade from the CIS, EU and Middle East. At the regional scale, Moldova gravitates towards three geo-economic ensembles: Eastern European (encompassed by the CIS), Central European (CEFTA) and the Black Sea (BSEC) and would benefit from expanding relations in all three directions, including through free trade agreements. Together with its neighbors – Ukraine and Romania, Moldova makes up a market of 80 million consumers, an important incentive to increase cooperation with the neighbors.

Third, from security perspective Moldova continues to be a borderland between NATO (Romania could become its member in 5 to 10 years) and the CIS/Almaty Treaty states (part of which is the Ukraine). Moldova's goal is to avoid a revision of the frontier between East and West by supporting the process of European integration, preserving its neutrality and supporting the OSCE and PfP efforts to fill the security vacuum in the region.

The entire region spread from the Black to the Baltic Sea is going through a profound political, economic and security transition. A new paradigm of cooperation in Central and Eastern Europe is being built under the aegis of enlarged European Union, NATO and other structures of Western liberal democracy – a process that has involved most countries in the region. ***Being geographically and historically a part of Europe, Moldova resolutely opted for the path of integration to Europe.***

#### A small country, open to the world

Moldova tends to assert itself as a small country, open to the world by expanded cooperation with all the countries of the world, while increasing its international prestige. The geography of Moldova's external relations tends to reflect this new pattern in evolution. Chişinău airport links Moldova to more than 30 cities in Europe and beyond. Fourteen countries set up their Embassies in Chişinău while Moldova established Embassies and Consulates in 17 countries.

The country lies at the crossroads between the Balkans, Central Europe and the Black Sea region. Such a geographical location favors Moldova as a interface not only in the economic, but also political relations between the Ukraine and Romania, Poland and Turkey, CEECs and Caucasus. The recent status of a Soviet Union' Southwestern outpost can be benefited from by connecting the CIS members with the Balkans, Turkey, Cyprus, Israel. At the same time Moldova is the easternmost country of the Latin world. The pan European transport corridors envisaged by the European Commission best illustrate the future trade routes in the region.

The undercapitalization of the region compels to look for foreign investment as the main source for long term development and create the best possible environment for foreign companies. Moldova could become a place for strategic investment targeting the regional markets of Bulgaria, Romania, Ukraine and even Russia. The ***polylingual*** labor force of Moldova offers an opportunity of easy access to regional markets. The existence of abundant and inexpensive labor which is relatively well trained and disciplined can be an incentive for them to do so. Another advantage of having a surplus of labor force would be its exports. Moldovans working outside the country will be an important source of capital, especially for investment.

Moldova does not have important natural resources, except for construction and food industries, therefore 60% of the country's imports are raw materials (especially fuel and energy). The nearest coal basins are: the Donetsk region in Ukraine, Petroşani in Romania and Silesia in Poland. Oil is produced in Romania, a little in Ukraine and is available for importation from Russia and the Gulf countries. The Caspian Sea region emerges as a potential large exporter of oil. Transportation of imported oil can be done via rail or road. Moldova is building its own oil terminal on the Danube riverside at Giurgiuleşti. The main gas supplier for the region is Russia (Yamalo-Nenets basin), imports from Uzbekistan or Turkmenistan also having to transit via Russian pipelines. But, as Romania joined European Union gas networks through Hungary, there will be a possibility for Moldova to secure its gas supplies by a back-up link with the West.

The present unidirectional orientation of Moldovan fuel imports is imposed by its export markets, 46% of which were in Russia in 1996. Expanding exports to new markets is the only way to relieve the present energetic serfdom. According to the geographic gravitational model, Moldova's potential *major trade partners* could become, apart from the existing Russia and Ukraine, another 4 large European nations – Germany, France, Italy and Great Britain. The group of secondary important trade partners would include Romania, Poland, Austria, Switzerland, Spain, Belgium, Sweden, the Netherlands and Bulgaria. It is these countries that can become the main importers of Moldovan goods. Therefore, a combined diplomatic and commercial effort is required to penetrate and retain these markets.

Reliance on agriculture is the main characteristic of the region. Not only Moldova produces over half of its GDP in agriculture, but also Ukraine – 39% and Romania – 20%. In medium term Moldova will remain an important food producer, and due to high protection of EU agricultural markets, the potential targets for Moldovan exports could become large food importers of South-East Asia (especially China) and the Middle East, as well as the gigantic markets of North America. The application for WTO membership is an important step Moldova has made in this direction.

### New paradigm of cooperation in Central and Eastern Europe

Moldova has the advantage of a cooperative, non-confrontational neighborhood. Both Ukraine and Romania do not exhibit potential threats to Moldova's security, having proved their commitment to regional stability in their mediation of the Transnistrian conflict settlement. Moreover, Moldova's cultural affinity with Romania and deep-rooted multi-faceted links with the Ukraine (important is the fact that there is a large Ukrainian community in Moldova and Romanian community in the Ukraine) lay ground for a special relationship between the three countries. The established trilateral dialogue have beard first results: "Prutul de sus" and "Dunărea inferioară" *Euroregions* and the Reni-Giurgiule<sup>o</sup>ti-Galaş *ifree trade zone*. This institutional framework has to be supplemented by specific projects with primarily economic output. The basic treaty was signed with Ukraine and is being finalized with Romania.

Following the declaration of independence, Moldova entered the stage of European integration by joining the OSCE, the Council of Europe and other European organizations. In November 1994, our country signed a Treaty on Partnership and Cooperation with the European Union and is ready to start negotiations on an Association Agreement. Moldova shares multiple common traditions and values with other European nations.

The linguistic affinity with en-Latin countries eases the bilateral economic exchanges. Italians and Spaniards invest in garment, glass enterprises; French businessmen – in energy and cement production. A lasting tradition of good neighborhood relations and the presence of a small ethnic community strengthen our links with Poland, now substantiated by intensified trade relations. German, Swiss and even French communities used to live in Basarabia, and now Germany is becoming one of the major economic partners and donors for Moldova. The Greek businesses could increase their involvement due to traditional links and a Greek minority spread throughout the region, the first big common project being the Giurgiule<sup>o</sup>ti oil terminal. The Bulgarian community of Moldova (Taraclia, Tvardiţa) maintain a working relationship with Bulgaria. Vienna, Prague, Budapest expand their role of meeting points in Central Europe. The Danube-Rhine waterway is a direct link to Rotterdam and an opening to the Atlantic. Based on this potential network of relations, a *CEFTA membership* would benefit Moldova in its pre-accession strategy.

*It is worth mentioning that the new scheme of regionalization in Europe attributes Moldova to the 9 states of South-East Europe (5 countries of former Yugoslavia, Bulgaria, Romania, Albania, Moldova). The World Bank also included Moldova into its group of non-CIS countries (Czech and Slovak Republics, Slovenia, Hungary, Moldova) with headquarters in Budapest.*

The Moldovan-Russian relationships evolved mostly in the economic field, while the major political treaties still awaiting their ratification by the Russian Duma. Moldova wants to establish a new type of relations with Russia based on mutual respect and economic cooperation beneficial to both sides while Russia, having reiterated its support for an independent Moldova, declares its geo-political interest in "the near abroad".

Moldova is involved in a set of regional cooperation arrangements: the Commonwealth of Independent States (CIS), the Black Sea Economic Cooperation (BSEC), the Danube Conference, the Balkan Conference, etc. The transit of Caspian oil will enliven the economic activity in the Black Sea region and Moldova's links with the Caucasus countries. Trade with Turkey is beneficial for both sides. Israel has established ties with Moldova, as one of the Middle-East main financial and trade centers, but also due to its large community originated from Moldova.

Moldova's attitude toward the USA and China is based on recognition of their status in the world affairs and vast potential markets for Moldovan exports. The US is the main donor for the Moldovan economy. Moldova received the *Most-Favored-Nation Status* from the United States on July 2, 1992, and joined the General System of Preferences (GSP) in 1995. A bilateral Investment Agreement with the US was signed on April 21, 1993.

A new initiative was launched recently to institute a Polish-Ukrainian-Romanian trilateral cooperation framework. These are the three biggest countries in the region that could constitute the skeleton for a new structure of cooperation in Central and Eastern Europe. When for a long time the decision centers for this region were situated outside, namely in Moscow, Istanbul, Berlin or Vienna, the proposed co-operation will constitute an internal counterbalance to these traditional external factors that will still play their role, albeit in new ways.

Nine nations of South-East Europe have set out the South-East European Cooperation Initiative (SECI) aiming to fill the vacuum of structuring in the Balkans. This new politico-economic framework could provide the guarantees needed for the major business enterprises to engage in the region-wide development efforts.

### Regional infrastructure development

The three pillars of Moldovan economic recovery will be: investment, exports(re-exports) and transit. In order to benefit from these factors, the *modernization of infrastructure*, especially transportation, telecommunications and services, is required.

Moldova, making use of its non-confrontational neighborhood, strengthens its ties with regional economic and trade centers: Iași, Bacău, Galați, Constanța in Romania; Odessa, Cernăuți, Vinîța in Ukraine. The closest sea ports are Constanța and Odessa and several river-ports: Reni, Ismail, Galați, Brăila – could be also transited by Moldovan goods. While lacking access to the Black Sea, Moldova considers building a *Danube port at Giurgiulești*. Another possibility would be building of a Moldovan port on the Ukrainian Black Sea coast under a long lease agreement.

The inherited Moldovan **rail network** can satisfy only a limited share of internal and external transportation needs. Setting up high speed connections between main regional urban centers (Chi<sup>o</sup>in<sup>ã</sup>u, B<sup>ã</sup>l<sup>o</sup>i, Tiraspol, Odessa, Vin<sup>o</sup>u<sup>o</sup>a, Cern<sup>ã</sup>u<sup>o</sup>i, Ia<sup>o</sup>i, Gal<sup>o</sup>u<sup>o</sup>i) would cause a considerable increase in passenger traffic and would boost overall economic development throughout the region. The **Intercity train** travels at a speed of 200-250 km/hr, so that the distance from Chi<sup>o</sup>in<sup>ã</sup>u to B<sup>ã</sup>l<sup>o</sup>i would be covered in less than an hour. Different gauges (narrow-gauge in Romania and wide-gauge in Moldova and Ukraine) restrains this development. A mid-term solution could be the upgrading of the Ungheni-Ia<sup>o</sup>i (~20km) and the Giurgiule<sup>o</sup>ti-Gal<sup>o</sup>u<sup>o</sup>i (~10km) segments to double-gauge. Thus, the Intercity passengers traveling from the Republic of Moldova could change trains in Ia<sup>o</sup>i or Gal<sup>o</sup>u<sup>o</sup>i to any destination in Romania and Europe. The reopening of S<sup>ã</sup>ngera tunnel would shorten the Chi<sup>o</sup>in<sup>ã</sup>u-Gal<sup>o</sup>u<sup>o</sup>i itinerary by almost a 100 km.

The **European roads** passing Moldova will follow the same logic of improving connections among the above mentioned regional economic centers. The priority works will be conducted on the Chi<sup>o</sup>in<sup>ã</sup>u-B<sup>ã</sup>l<sup>o</sup>i motorway with a link to Soroca and a new bridge replacing the ferry on the way to Vin<sup>o</sup>u<sup>o</sup>a. A new link to the South will be opened by cutting a motorway through Comrat, Giurgiule<sup>o</sup>ti to Gal<sup>o</sup>u<sup>o</sup>i. In the final stage, the roads to Ia<sup>o</sup>i and Odessa will be renovated.

Building of a North-South route is envisaged by the European Commission as part of its plan of priority corridors in Central and Eastern Europe. The **A9 European Corridor** that passes through Helsinki-St.Peterburg-Pskov-Vitebsk-Kiev-Ljubasivka-Chi<sup>o</sup>in<sup>ã</sup>u-Bucure<sup>o</sup>ti-Plovdiv with offshoots to Odessa, Moscow, Klaipeda, Kaliningrad. Moldova can benefit from this project by having its Poltava-Balkans motorway and the Tiraspol-Ungheni rail-road renovated or by tracing new sections on the Kiev-Chi<sup>o</sup>in<sup>ã</sup>u-Bucharest connection.

The air traffic is booming in the zone. Moldova has a total of 26 runways, including 8 paved. Chi<sup>o</sup>in<sup>ã</sup>u has already established air links with about 30 cities of the world. Moreover, Chi<sup>o</sup>in<sup>ã</sup>u airport is used as a transit point by the CIS passengers (especially Ukrainians) on their way to the West and back. Transforming Chi<sup>o</sup>in<sup>ã</sup>u into a **regional air hub** serving to bordering zones in Ukraine in Romania could raise interest of both sides. The B<sup>ã</sup>l<sup>o</sup>i and Tiraspol air bases have a developed infrastructure and could be used for freight transit.

The fiber **telecommunications network** of Moldova was recently linked to the Romanian one at Gal<sup>o</sup>u<sup>o</sup>i and that of the Ukraine in Cern<sup>ã</sup>u<sup>o</sup>i. New sections – B<sup>ã</sup>l<sup>o</sup>i-Ia<sup>o</sup>i and Chi<sup>o</sup>in<sup>ã</sup>u-Odessa – are now under construction. Moldovan electricity supplies are jeopardized by a narrow connection to the outside. Presently the grid is connected only to Ukraine which is in a state of crisis. A planned B<sup>ã</sup>l<sup>o</sup>i-Boto<sup>o</sup>ani line will include Moldovan grid into the **European power network** ensuring the energy security of the country.

Improved transportation networks and developed telecommunications constitute, along with other factors, a prerequisite for transforming Moldova into an attractive small and open economy.

## 2.2 Population, labor force and employment. Gender in development

Sustainable development of the country is greatly dependent on human resources. During the transitional stage, substantial changes, and not always positive ones, occurred in the overall process of human development. Theoretical premises and intentions to rebuild the functioning mechanisms of the social organism in order to align our society to standards of a modern democracy are not always in correlation with the constraints, distortions and complications of the current situation. The Human Development Index (HDI) used in international practice includes three basic elements: life expectancy, education and living standards. The HDI, as main indicator of human development in the Republic of Moldova, was estimated at 0.757 in 1992, that ranked the country 81st among the 175 assessed countries and 18th among the "medium human development" countries. In the following period the HDI of Moldova slumped further down.

Thus, in 1994 the HDI equaled 0.612 placing Moldova 110th of all and 46th of the "medium human development" countries – the second last in the CIS, leaving behind only Tajikistan. The inaccuracy of statistical information on the Purchasing Power Parity (PPP) in US dollars compromise a thorough and full estimation of HDI for 1996 and 1997. According to evaluations, the HDI could not have an increase, but rather continued the decreasing trend.

The annual calculation of HDI and the analysis of problems and processes of human development unveils a number of important aspects that determine the investment in human capital and its long-term consequences.

**Demographic pattern.** The population of Moldova is 4.334 million (01.01.1998). Population density in the country is 128 pers/km<sup>2</sup>. The latest demographic changes reflect the influence of numerous economic and social factors. First of them is the stagnation and reduction of demographic population growth rate. Since 1989, population growth rate has been declining steadily. If in the 1980-1984 period a substantial increase of population occurred – 326,000, followed by a slow-down of the growth rate in 1985-1989 – only 165,000, then, starting in 1990, a slight decrease of population is observed: between 1990-1994 – by 11,500, and between 1995-1997 – by another 13,500. The second trend observed is the decrease of natural population growth rate. The number of children born in 1996 was 33% lower than in 1990. Fertility rate declined from 17.7% to 12.5% between 1990-1997. Third factor is the acceleration of demographic aging and increase of the pensioners/active population ratio which leads directly to increasing pressure on the social security system.

Since 1990, each 100 workers had to support 80-82 social assistance recipients, of whom 51-52% – under working age and 28-29% – over working age limit (pensioners). These are the results of decreased fertility rate and increase in infant mortality.

The family is also affected: during last 5-6 years, the number of marriages per year has dropped by 20%, while the divorce rate has gone up 11-12%.

A reduction in external migration is also observed: from 35,000-36,000 people in the 1980s to 12,000-14,000 migrants in 1997.

The negative demographic trends after 1990 necessitate the adoption of demographic and family programs that could revert this negative tendencies and bring about an economic and social equilibrium.

**Dynamics of population, 1980-1997**

Year (beginning of)	Population, thousand			% of total	
	total	urban	rural	urban	rural
1980	3968.2	1586,5	2481,7	40	60
1997, by January 1st	4334.4	2004,1	2330,3	46	54
1989-1997 evolution	+366.2	+417,6	-151,4	+6	-6

**Dynamics of population age structure, %**

	1959	1996
Total population	100	100
including:		
0-9	25.9	16.4
10-19	16.1	18.2
20-29	17.3	14.1
30-39	14.8	15.5
40-49	10.8	13.8
50-59	7.9	8.8
60-69	4.8	7.9
70 and more	2.9	5.3
Total population		
under working age	34.7	27.8
working age	55.3	56.3
over working age	10.0	15.9

**Demographic and economic distribution of population**

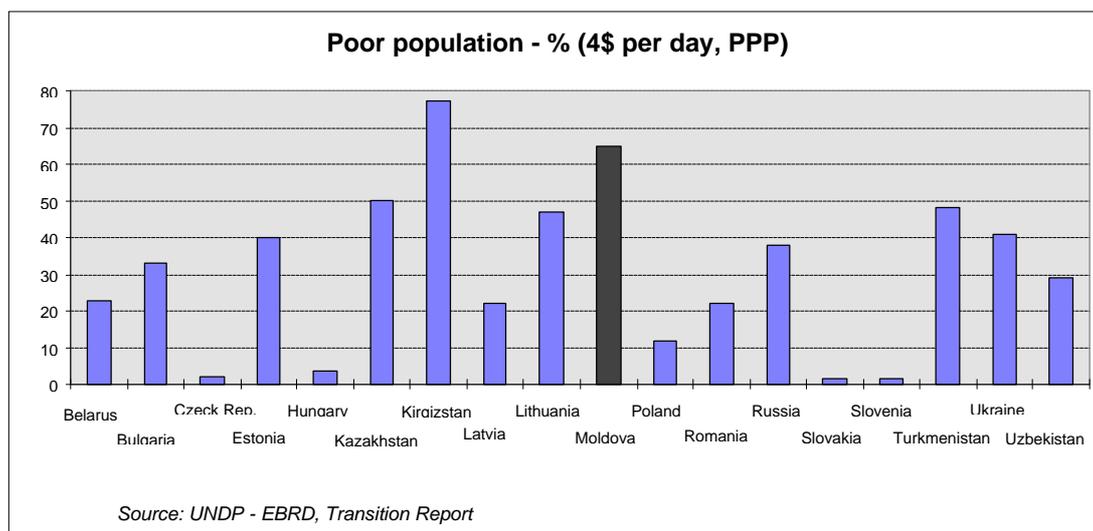
	1970	1980	1990	1996
1. Number of dependents per 100 persons of working age				
Total	87.9	73.1	82	77.8
a) children under 15 years (per.)	64.4	49.5	54	49.5
b) persons aver working age limit	23.5	23.6	28	28.3
2. Distribution, %				
a) children under 15 years (pers.)	73.3	67.7	65.9	63.6
b) persons over working age limit	26.7	32.3	34.1	36.4
3. Number of dependents per 100 persons of working in agriculture				
Total persons	92.4	82.8	94.8	99.5
a) children under 15 years	67.7	56.1	62.5	63.3
b) persons over working age limit	24.7	26.7	32.3	36.2
4. Distribution, %				
a) children under 15 years	73.3	67.7	65.9	63.6
b) persons over working age limit	26.7	32.3	34.1	36.4

**Life expectancy at birth** – a complex indicator accounting for living standards, health, development of medical institutions, and population's access to them, etc. – dropped from 68.1 years (1959) to 65.8 years (1995) and is 5 to 10 years less than in the rest of Europe. The healthcare sector is overwhelmed by an avalanche of serious problems. The situation of people's health in Moldova is alarming. The incidence of infectious and parasitic diseases, tuberculosis and cancer is increasing. A serious problem since 1996 is the spread of AIDS. Access to medical assistance for the population decreased dramatically.

**In the area of education Moldova has a solid heritage:** the literacy rate of population is 96.4% (1989); the number of persons with secondary and higher education is 75-80% among the 25-40 years old; the rate of persons with special professional education stands at 25% of the employees of the national economy, including 11% – with higher education and 14% – with secondary special education (1989). The educational process has gone through significant changes during the transition phase. The education system was restructured at all levels. Along with this, there were also negative consequences with long term effects: the decrease of enrollment for secondary education; drop-outs which in 1995-1997 were estimated at 6.8%; the overall degradation of education system due to underfinancing and pauperization. An ascendance occurred in the University education.

Giving a generally positive evaluation to the labor resources with general and professional education, it is necessary to mention, though, that with regard to public mentality, economic and social behavior, only a small portion of population was receptive to transition, accustomed themselves to new market conditions and see a bright future before them. The majority of the people are not ready to take on their own destiny, do not manifest initiative nor interest in reforms. Privatization did not yet become an economic exercise. Such a situation puts the reform under a real jeopardy. A wide program of economic, social and moral education would be of great help in this situation.

**Living standards** continue to fall. The purchasing power of the population has eroded substantially. Compared to 1990, real incomes went down 3.5 times, salaries decreased 3.7 times, while pensions were reduced 5 times in real terms. The erosion of purchasing power occurs also because of chronic delays in salary payments.



In 1996, for the first time, the rate of salary growth outran the rate of price growth. Measures for protection of low income groups of population were implemented. In 1997 the nominal income of population had a 14.0% increase and the real income grew 1.8%. Nevertheless, poverty – an expression of social inequality – currently affects near 80% of the country's population. The poverty warning was not received in time: the degree, extent and focus of the phenomenon are not identified. The "subsistence minimum", the "poverty threshold" are not yet officialized. New groups of the poor appeared: civil servants, teachers, doctors, scientific researchers, artists, etc.

The capacity of the state to ensure social protection of the population was greatly reduced. Between 1993 and 1996, when the GDP declined by 38% and the social needs exploded, allocations to social sector (education, healthcare, social aids, unemployment allowances, pensions etc.) were reduced from 60.9% to 48.3% of the budget. However 1997 was the year to stop the decline and to increase GDP by 1.3%.

**Employment.** Total labor force of Moldova accounts for 2.4 million persons (1996), of whom 1.7 million are employed in the national economy, including 49% – in agriculture and 11.3% – in industry. The share of employed by the state sector dropped from 70% (1989) to 39,3% (1996); currently the majority of workers are employed by the private sector.

The official *unemployment* data offered by labor centers (01.01.98) showed 28,000 unemployed which equals 1.55% of the active population. According to alternative estimations, the unemployment (registered and hidden, except seasonal unemployment in agriculture), reached 17% of physically active population by the end of 1997. The crisis of employment seems to be long lasting and is characterized by a high share of long term unemployment, along with the growing share of low income sectors and branches in the structure of overall employment. Unemployment and uncertainty represent a waste of human capital, source of depression, discouragement and social indolence, factors of increased social inequity and exclusion, an overall fragmentation of the society.

The age structure of the unemployed is dominated by the most productive periods of life – 30-40 years and the youth of 16-24 years – with a combined share of 70%. A fifth of the unemployed have higher and special secondary education, a fact that means a serious waste of human capital.

During the difficult process of transition to a market economy, the issues of flexibility and efficiency of the labor market had not yet found adequate solutions, though it is under a permanent focus of the government and trade unions. The state run programs of labor employment are not functional. The legal and institutional regulations have not yet produced a substantial impact on stabilization and proper functioning of the labor market.

The degradation of the productive capacity and function of the economy, the sharp reduction of investment are the factors that continuously disrupt the functioning of labor markets. As a social end economic element, the rate of employment has a major impact on the equilibrium (disequilibrium) of the society. The state will have to intervene more actively, promoting adequate policies in this field, capable of extending employment opportunities (selective stimulation of investment based on the efficiency of job creation; lifting the barriers in front of small and medium businesses, fiscal policies etc.) and providing professional retraining responsive to demand and supply trends.

**Gender in development.** Gender equality and development in Moldova is one of the most important social and economic issues for the country. The economic crisis and the collapse of social protection mechanisms of the population had a negative impact on the condition of women in the society.

The main problems are:

- The low rate of participation of women in decision making at all levels. Even if women account for 52% of population, making up 51% of the labor force and contributing 50% to GDP, there are currently only 4% of women MPs, none of them holds a ministerial portfolio or heads a regional (raional) government. This representation lags far behind the world and European average.
- Poverty and destitution caused by Moldova's deep economic, social and political crisis affected first of all women. During the transition to a market economy, women are the first to be laid off under the programs of stabilization and restructuring of the economy. Women make 63%

of the unemployed and have a longer term of unemployment than men. Having the same level of education as men, women account for three fourths of unqualified employees and have an average salary 70-80% lower than men, while the amount of labor hours for women is, in fact, double that of men (including work in the household). As a consequence, women's pensions are also lower than those of men, and they are the first ones to suffer from poverty;

- The degree of women's involvement in productive activities is much higher than their involvement in decision-making in the economic policy (4%). Women have lesser access to resources, credits, income distribution, therefore it is not by accident that there are very few business-women in management of medium and large enterprises, while in the small business women account for 10%.

- Access to medical services is affected by the crisis of the healthcare system. Birth rate has decreased lately from 17.76 to 12.5, natural growth has dropped from 8.0 to 0.8. At the same time, mortality outruns birthrate in the majority of raions of the country, while infant mortality has soared in last 5 years from 19.0 to 21.2 for each 1,000 new-born. Also, the number of women suffering from anemia during pregnancy has grown to 44.3%, while the level of infant mortality at birth is 3-5 times higher than in the rest of Europe (in 1995 – 40.8%, 1996 – 40.2% of overall infant mortality).

- A problem that can not be silenced is the violence against women. Rape, beating, psychological aggression, forcement to prostitution, sexual harassment – all these problems – well wide spread in society – fail to be resolved due to lack of state intervention. There are no statistics on the above-mentioned abuses, or if any, they poorly reflect the existing situation. Instead, a growing rate of suicides, moral decay and alcoholism among women – phenomena encountered in all societies in crises – is observed. Even more serious is the fact that violence against women has high gravity repercussions for the future of the nation, which is impossible to assess statistically.

- In spite of their participation in political and social life, women are not promoted to managing boards of political parties. There are parties where women make up half of the members. But at both local and national levels they are not promoted to decision-making posts. As a consequence, women are not represented in electoral lists and lack the chance to influence the decisions made by the given party. Existence of several women's socio-political movements come only to confirm the rule. They usually participate in electoral blocks, together with other parties, and this is the only way to promote a number of women into elected bodies.

The strategy of the country will be unfinished without a viable system of women protection. To elaborate it, it is necessary to:

- collect statistical data on paid and unpaid work of women, health and educational status by gender and age, the share of women in decision-making bodies of all levels;

- change the organization of work, taking into consideration various activities performed by women, implementation of training and education programs, ensuring participation of women in the social security system reform.

- continue studies of gender and development issues (involving sociologists, economists, lawyers, demographs, medical researchers).

The problems of transition could be resolved within the 2000-2005 period in a constructive manner with women participating as active and equal partners. While the productive activity of women is regulated by the market laws (demand, supply, competition), then the household activity (maternity and children education) is a function of the family and society which requires support of the state. National objectives and policy measures to promote gender equality in development are further elaborated upon in Part 5 of this document.

## 2.3 Natural resources

The Strategy of sustainable development of Moldova has to include as one of its basic elements the rational use of natural resources and protection of the environment.

The current issues of *natural resources management* are: high density of economic network and population; the key-role of land and water resources in the ecological and economic complex of the country; lack of mineral and energy resources of economic value; high degree of soil erosion and water pollution; limited forest reserve areas; institutional fragmentation of the state natural resources administrative bodies (land, water, mineral resources and environment – are assigned to different departments).

There are two categories of natural resources for the social and economic development of Moldova available in sufficient proportions. The first encompasses the pedo-climatic resources that favor the overall development of a highly efficient agriculture. The second includes the non-metal mineral resources that can be used as building materials, or as raw material to produce those (cement, gypsum, glass, limestone, brick, etc.). As to oils and metals, they are missing almost altogether. The lack of energy resources, characteristic of some other countries in South-Eastern Europe as well, is a restrictive factor in diversifying the economic activities and consumption that implies an adequate economic policy.

The global environmental crisis imposes on nation-states the obligation of a sustainable management and development of natural resources, including energy sources. Such management is only being developed in the Republic of Moldova and is still far from being adequate and efficient. Even if the legal framework of environmental protection and use of natural resources is being upgraded according to international norms, inertia of the old economic and social behavior and obsolete technologies and norms still persist in the practical use of natural resources, manufacturing and consumption. Taxes and fines established for the use of resources and environmental pollution have not yet delivered expected results.

*Soils* are the most precious national treasure of Moldova. Geographically, the country possesses exceptionally fertile soils. There are 745 categories of soils. Near 75% of national territory and 80% of agricultural lands are covered by *black earth* – the most fertile type of soil. The rest of the territory is covered with brown and half-brown forest soils. The agricultural assets of Moldova are seriously affected by direct (unrecoverable) land losses, a common situation among countries with high density of population and intensive agriculture,

In the pre-transition period, when the real land value did not have a cost estimation, the land had no price (could not be sold on the market), rational use of land was no more than a declaration. The degradation of agricultural land reached threatening proportions. Between 1953 and 1993, the area covered by agricultural lands shrank by 10%, and that of arable land – by 18%. During last 25-30 years, the arable land per person ratio has decreased from 0.53 to 0.39 hectares per person (by a third). In the same period, 205,000 hectares of fertile lands were withdrawn from agricultural use to private housing, roads, extension of villages and towns, and 133,000 hectares of low or reduced fertility were reverted to agriculture. 1,500-2,000 hectares of agricultural land are being "conquered" by human settlements each year.

The major problem concerning agriculture in Moldova is the decrease in natural regenerating capacity of soils and degradation of soil quality.

The increased risk of periodical large scale erosion of soils (e.g. 1994) has not being included in calculations for territorial planning in agriculture. Near 82% of these lands (2 million hectares) are located on slopes. The arable lands faced with serious erosion threat equals 1.86 million hectares. The soils affected by all forms of erosion, including destroyed ones, are estimated at 886 mil ha or 26% of national territory (1993). The eroded soils are expanding annually by 0.86% losing 40-60% of initial fertility.

An increased proportion of linear erosion occurs. Annually, 700-800 ravines appear covering near 300,000 hectares. The land slides progress fostered by the valorification (terracing) of geo-technically unstable slopes and by dam building on the slopes.

Soil erosion has become a national calamity. It is evident that many surfaces will have to be recognized as "unrecoverable resources". During last 30 years, the balance of humus in soils has been worsening, a fact directly linked to use of fertilizers. The upper horizon of Moldovan soils has lost one third of humus in the last century. The situation was further aggravated during the transition: in 1996, one hectare of land received, compared to 1990: organic fertilizers – 8.5 times less, chemical fertilizers – 11 times less.

Even though the use of chemical fertilizers and pesticides has decreased in the last 10 years, soils contain sizable amounts of heavy metals, pesticides and toxic residue of chemical fertilizers.

Degradation of soils is a result of destructive action of several factors: natural, political, institutional and, especially, managerial.

***In a country possessing such valuable land assets as Moldova, the issue of conservation, regeneration, fertility and ecological value of soils is a national priority. Current situation of soils raises concerns in many aspects.***

***Water resources.*** Moldova has a hydrographic network that includes a part of hydrographic basins of the Nistru and Prut rivers. 90% of the 3,621 tributaries of the Nistru and Prut rivers have a length shorter than 10 km and only 8% – longer than 100 km. The majority of these tributaries dry out in summer time. The Nistru and the Prut rivers start from Carpathian mountains and only transit the territory of the Republic of Moldova. Moldova has access to the Danube at its confluence with the Prut river.

There are 3,500 artificial water reservoirs and lakes in Moldova, of which 90 are 1 million m<sup>3</sup> and over. The largest ones are Costești-Stâncu on the Prut (735 million m<sup>3</sup>) and Dubăsari on the Nistru (277 million m<sup>3</sup>).

The transit flow of the Nistru river at the exit point from Moldovan territory has an annual outflow of 10.7 km<sup>3</sup>, and the Prut river at its pouring into the Danube – 2.9 km<sup>3</sup>.

The annual rainfalls on Moldovan territory bring accumulation of 1,34 km<sup>3</sup> of water, that is 320 m<sup>3</sup> per person. If taking into calculus the transit flows of the Nistru and the Prut rivers, this index reaches an annual of 3,150 m<sup>3</sup>/person.

Subterranean water resources of sweet and saline water are estimated at 3.0-3.2 million m<sup>3</sup> in 24 hours. 53% of this quantity is potable water. The distribution of this resource in the country is uneven, with major concentrations along the Nistru valley. Currently, ground water use stays at 40%, lower than in other countries. Nevertheless, their hydrostatic level is falling in some localities.

The water of the Nistru and Prut basins, as well as in lakes and water reservoirs, has an overall acceptable quality for insuring the aquatic living environment. According to its physical, chemical and biological characteristics, the Nistru water on Moldovan territory has Degree 2 of quality – "moderately polluted water" with several limited areas of Degree 3 – "polluted". The

Prut water is generally of Degree 2 quality, with some segments of Degree 3 and 4 of pollution. Smaller rivers are usually Degree 3 and 4 of water quality.

Of all ground water resources, only 35% have an economic value, because of high concentration of minerals and the natural chemical composition (fluorine, ammoniac nitrogen, hydrogen sulfate and methane).

Unlike the deep waters, the freatic aquifers are more or less polluted by nitrates. The main sources of pollution are the cattle farms, rural settlements that, as a rule, lack sewage systems, improperly managed dumps, uncontrolled use of chemical fertilizers.

Water consumption, according to 1996 statistical data, stood at 1,766 million m<sup>3</sup>, or two times less than in 1985, which correlates with overall drop in production of the national economy. The uneven distribution of water resources, low quality of waters in some areas and settlements, seasonal and local droughts have a serious economic and social impact.

In 14 out of 56 settlements with central water systems, the water quality does not correspond to the "drinking water" standard, due to excess contents of fluorine, hydrogen sulfates, nitrates, metals, etc. Over 60% of water wells in the rural areas do not comply with the mentioned standard as well. It is evident that the water management is one of the priority issues in the short term.

**Forests** of Moldova cannot be regarded as a resource of an important economic value. The size, quality and distribution of forests do not completely satisfy even the requirements of an ecological infrastructure. Statistics recorded a forested surface of 318,000 hectares, or 9.4% of national territory. The State Environment Inspectorate confirms only 274,000 hectares (8,1%). Fuel supply shortages and improper management of forests led to random cuts, a real devastation of resources. The situation requires an immediate deep restructuring of forest management.

**Mineral resources.** The geological layers are explored to 3-4 km depth. The exploration targeted mainly water resources and building materials. the exploration of hydrocarbon reserves reached relatively minor depths (1.5-2.5 km) and uncovered insignificant resources of oil, gas and brown ore. The exploration works were halted in 1972. At present, exploration of uncovered reserves is carried out by the American company "Redeco" in Cantemir-Vulacâne<sup>o</sup>ti area at 4-5 km depths.

There are 377 explored deposits of mineral non-ferrous resources. 122 of them are being exploited, 95 have been prepared for exploitation and the rest of 160 constitute the reserve fund. Extraction of building raw materials employs obsolete technology producing large amounts of losses (30%).

The consideration of ecological factor for the sustainable development of the country in the immediate future implies:

- increasing the state's role in management of natural resources through legal instruments and increase of ecological factor in the economic mechanism;
- implementing energy and natural resource saving technologies in the production sphere, introducing the system of ecological certification of production;
- Implementing the system of payment for use of natural resources attracted into economic use, with directing a part of resulting funds to protection of natural resources.

Moldova needs to extend its participation in international projects of collaboration on environment protection in South-Eastern Europe, also implementing joint projects with neighboring Romania and the Ukraine.

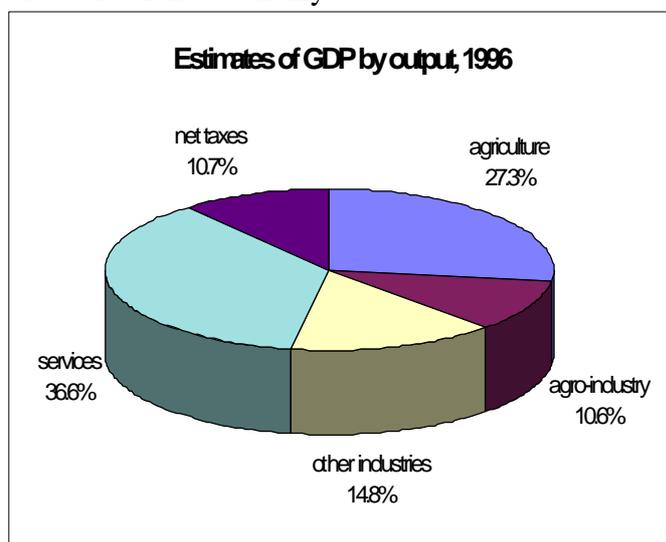
## 2.4 Production capacities and infrastructure

The perspectives of Moldovan development are based on current level of production and infrastructure development. In line with GDP and investment growth, the economy develops from the simple to more sophisticated forms, high technologies, characterized by higher capital intensity.

It is important to determine at which stage of economic development Moldova is, what is its production capacity, in order to give best possible argumentation for the way out of crisis and development of a highly efficient economy. According to World Bank classification, based on GDP/capita index, Moldova belongs to low income economies. The structure of production sectors and infrastructure of Moldova corresponds to this category of countries.

The economy of Moldova, as a small country, is involved in international division of labor. Moldovan export equals roughly 50% of the GDP. While continuing its activity on CIS market, the Republic of Moldova has established trade links with more than 80 countries of the world, that accounted for near 40% of the total exchanges of Moldova in 1997.

The current structure of Moldovan economy derives both from its pre-reform heritage (as a part of the Soviet economy) and the outcome of transformations of transitional period. The unique natural and climatic conditions, the fertile soil and the traditions of the population have determined a specialization of the country in the agri-food industry. An abundance of labor have favored the development of labor intensive sectors – machine building and light and construction industry, based on local resources. In the '90es Moldovan economy was affected by a crisis, one of the outcomes being a partial loose of traditional markets. The spontaneous search by Moldovans for new niches in the world market have provoked the transformation of the sectoral structure of the economy.



Starting with 1990, during the crisis, the economic potential of Moldova diminished: GDP fell 65%, the industry – 60%, agriculture – 43%. The imposed deindustrialization of the country has moved the focus on agriculture (as a share of budgetary revenues, degree of labor efficiency etc.); this sector employs 46% of the working population and produces 27.3% of GDP. Such a high share of agriculture lowers the overall immunity of the economy in front of unfavorable natural conditions (as much as 70% of agriculture accounts for crops).

### Agriculture

Nowadays in the structure of crops of Moldova – the grain cultures, fruits and grapes (about 60% of plants production) prevail. The expansion of grain cultures production is not represented as rational for Moldova in spite of the fact, that it conducts to expansion of export. To concentrate attention on manufacture of fruits, vegetables and grapes with the subsequent industrial processing and export of final production is much more effective. For this purpose it is necessary to improve essentially the technology and marketing of the processing enterprises. The growth of sun-flower,

vegetables and sugar-beet is contingent upon the processing plants' demand. and that of tobacco – by foreign demand ( the local facilities can process 8-10 tons annually).

There are reserves for improvement of the structure of agricultural production, since over 50% of the arable land is used for wheat production. Once the yield rate increases, the freed areas could be used for more efficient types of crops.

The cattle production is oriented to the internal market. The reduction of the output is caused by the decrease of leaving standards of the population, obsolete technologies and the dismissal of large meat and milk producing plants, that functioned on imported fodder. The situation is also aggravated by the destruction of genetic fond of poultry and breeding cattle.

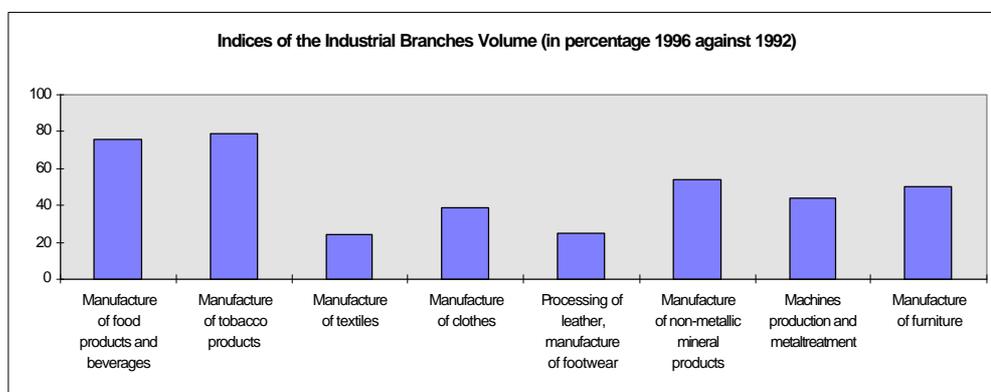
Nowadays the agrarian sector collides with the following problems:

- a large part of agricultural engineering is morally and physically obsolete, for the last 5 years the machinery park practically was not updated;
- the cost of credit resources is high(credit rate of Moldovan banks equals to about 35%), that in conditions of low speed of return on capital in agrarian sector makes these resources practically inaccessible for agricultural enterprises;
- the centralized system of deliveries of mineral fertilizers, chemical means of protection of plants, spare parts for engineering, seeds and fuel-lubricant materials is destroyed, and a new, one based on market and competition, is not created yet;
- the infrastructure of realization of ready production is poorly advanced;
- practically there is no system of insurance of agricultural production.

### *Industry*

Transition to market economy in the first half of 90's, collapse of economic links, the loss of external markets of production sales, crisis of the country's domestic market caused destabilization of industrial enterprises, a sharp decline in outputs of industrial enterprises.

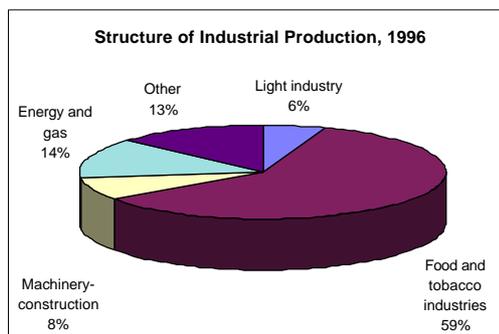
The least decrease of production has been ascertained at enterprises, working on local raw material (food and construction materials industry), and the greatest – in light industry and mechanical engineering. The main internal reasons of production fall are obsolete technologies, poor quality of production and absence of experience in marketing activity.



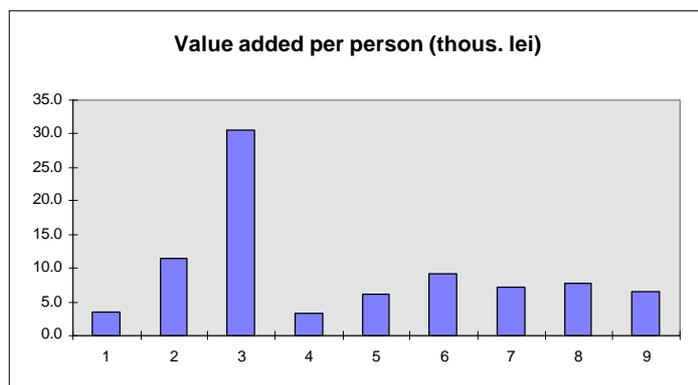
Industry is the main sector of economy, which provides stability of the country's development. In structure of Moldova's industry prevails the food industry, however it cannot become the stabilizer of economy, as it directly depends on fluctuations of production in agricultural sector. The majority of the machine-building enterprises worked before on the

military – industrial complex of USSR. After its disintegration they lost the markets of production sales and now their large sizes and high level of costs do not practically offer them chances to survive. The share of mechanical engineering in total volume of industry production has decreased from 14.8% in 1992 to 8% in 1996, and there remained just manufacture of relatively simple production.

Moldova's enterprises of light industry are equipped with average level engineering, but in the last years they have lost the markets of production sales, and insufficiency of working capital makes them dependent on suppliers of raw material (light industry basically works on imported raw material and materials). The enterprises commonly work on the base of subcontracting, where the raw material supply and retail is assumed by the foreign contractor. The share of the light industry in the total industrial output has dropped from 10.6% in 1992 to 6% in 1996.



The work efficiency of the enterprises of industrial sector is determined by various factors and varies between branches. One of basic parameters of development of enterprises – creation of value added (VA) per person in various industrial sectors – is displayed in the chart:



*Chart legend:*

1 – Machinery-construction, medical and metal products, 2 – manufacture of food products and beverages, 3 – manufacture of tobacco products, 4 – textiles and apparel, 5-tanning and dressing of leather, 6 – publishing, printing and paper products, 7 – chemicals and chemical products, 8 – other non-metallic mineral products, 9– manufacture of furniture.

The tobacco branch is the most effective among other industries, in 1996 on one worker it was necessary more than 30 thousand lei VA. To the following group of branches, according to parameter of efficiency, refer manufacture of food products and beverages, publishing, printing and paper products, chemicals and chemical products, other non-metallic mineral products, manufacture of furniture (from 6.6 up to 11.5 thousand lei VA per worker). The average number of workers at the enterprises of these branches is 100-400 persons, the small and average size of these enterprises promotes increase of their mobility's level, operative reorientation on changing needs of market.

The enterprises of machinery-construction, medical and metal products, textiles and apparel create on the average VA on the level of 3.3-3.5 thousand lei, that practically means their degradation and bankruptcy in prospect. The high level of number of workers at the enterprises of these branches (on the average – 500-600 persons, and at some enterprises the number reaches 2-3 thousand persons) makes them inert, that means vulnerable in conditions of market economy. In this sphere of industry the enterprises require immediate restructuring, and assistance in their adaptation to requests of the market.

The financial and economic situation of industry enterprises continues to remain a difficult one. The stock of finished products still very high. At the same time a number of enterprises, which became adapted to market and work profitably, and others, which lost the achieved

positions, have come to light. In manufacturing industry 36,1% of the enterprises have finished 1996 with losses

Foreign investments are still limited mainly by food-processing industry. At the beginning of 1996 International Finance Corporation has introduced \$2m direct investments in the “Incon” company and, besides, has granted to the company \$8m of credit on favorable terms. These investments will be directed to canning industry (Ungheni, Florești and Cupcini factories), and also to increasing of level of vegetables and fruits production, in making new gardens, purchasing of means of chemical protection of plants.

The latest industrial investment has targeted mainly the food and building materials industries. 10 canneries were modernized, resulting in improvement of product and packaging quality. The restructuring and modernization of 9 wineries and the construction of a bottle factory will ensure better development of wine industry.

### Transportation

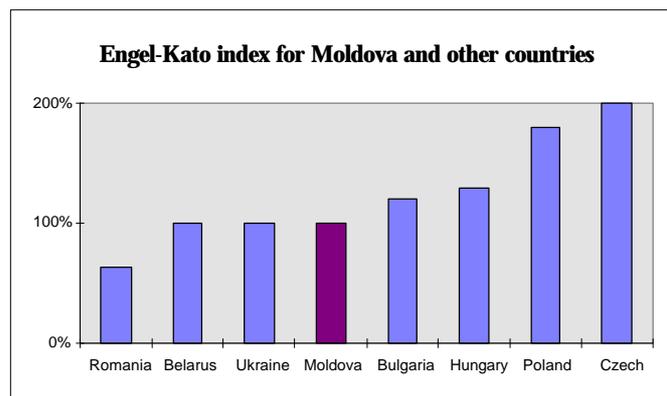
Moldova has developed networks of road, rail and air traffic. The rail accounts for some 88% of freight traffic in Moldova while the vehicles of enterprises transport 11% of the freight on the market. In its external economic relations Moldova is a net importer of transportation services (near \$40 million in 1996 and \$33 million in the first half of 1997).

The length of *roads of general use* in Moldova equals 9,200 km, including 2,800 National roads and 6,400 communal roads. This general use road network, built in the last decades represents the largest capital investment in the transportation sector and constitutes a considerable part of national assets. Their value reach the amount of 7 billion lei, which, according to the experts, accounts for a 40-50% share of the assets in the general use transportation.

Some 95% of the roads have rigid cover, where 50% – on a concrete base. Due to lack of financial resources for maintenance and repairing of roads, only half of the total length corresponds to technical standards for traffic safety.

According to Engel-Kato index of the density of road networks with rigid cover to the territory and population, Moldova can be compared with Belarus and Ukraine, but is overpassed by Central European countries.

The general use road network belongs to the state, the maintenance and repairing of National roads is financed from the Roads Fund, and the rest – from local budgets. If the National roads are being kept in a satisfactory state (even though the allocated funds are not fully sufficient), the communal roads, due to luck or chronic insufficiency of funds, are deteriorating. Even though Moldova lies in the middle of Europe, the country lacks motorways capable of servicing the increasing East-West transit traffic, and therefore losing a potential important source of revenues.



Comparing to 1991, the investment in this sector dropped 8 times. For the rehabilitation of Northern road corridor, the Ministry of Transportation and Road Management has received in 1997 a BERD credit.

The lorry's park of Moldova accounts for 75,000 units, with prevailing share of trucks manufactured in the former USSR: MAZ, KAMAZ, GAZ. They have higher consumption of

fuel and do not comply with “Euro” environmental standards. The process of modernizing the structure of the park has started, the middle size Intercity units are quickly increasing in number. Also the park of heavy trucks has begun to receive modern DAF, MAN, Mercedes, Volvo trucks etc.

The length of Moldovan rail network equals 1302 km, including 1151 km on national territory. The double way railroads have a length of 221 km, or about 17% of the total. The length of access ways to enterprises and organizations accounts for 45% of the national network, which is 1,5-2 times less than the average for transitional countries in Central and Eastern Europe.

The economic situation of state own Moldovan Rail Roads is considered to be catastrophic. According to estimations, some 110 million lei are required to modernize the mobile park, which is morally and fiscally worn-out. The circulation of trains becomes dangerous because of the high degree of use of rails. Around 30% of ties need to be replaced, 270 km of railroads require repairs. The difficult financial situation of Moldovan Rail Roads is toughened by booth: the inefficiency of management and the large number of passengers benefiting of waivers for rail traffic.

### Telecommunications

Currently Moldova has some 600,000 telephone lines, 75% of which are located in urban areas and around 4,000 public phones. Only 5% of telephone stations work on digital equipment (for comparison, in Slovenia – 60%). There are also 200,000 unsatisfied applications for new phones. Currently Moldova has direct connections with Romania, Bulgaria, Greece, Canada, Denmark, CIS and Baltic states, and wit the rest of the world, through the international switch center in Montreal and Copenhagen. The tender, conducted in 1997, for development of GSM-900 mobile phone network was won by a consortium headed by “France Telecom”. The whole territory of the country is expected to be covered by this service in the next 10 years.

“Po<sup>o</sup>ta Moldovei” (Moldovan Mail) has 37 mail centers, 1,167 postal offices, out of which 86% are located in rural areas. There are 4367 mail boxes spread around the country. Po<sup>o</sup>ta Moldovei is one of the largest employers of the country with a 6,493 large stuff trained at the Chi<sup>o</sup>in<sup>o</sup>u Communications College. The delivery standards in use by PM is 3 working days maximum (D+3). the fast mail services are provided by two international competitors– DHL and TNT.

The informatics sector is developed by 170 economic agents and subsidiaries (computer centers, laboratories, departments, university chairs) that use 4,000 computers and near 200 local networks, 15 large-scale networks, including 4 public networks. The computerization has reached more advanced stage in financial and banking sectors, telecommunications, Ministry of Interior, Ministry of Social Security, Customs and Statistics Departments, higher education, prosperous businesses. The computer sales amounted to 44 million lei in 1996 or 0.6% of the GDP. The Internet is developing fast in Moldova. Currently 5 companies offer access to Internet for Moldovan users.

## 2.5 Banking system and capital markets

### Background and legal framework of the banking system

Moldova's banking system evolved as part of the transition from an administrative and command system towards market economy. During this transition, public finances deteriorated and budget deficit increased, the trade deficit widened and a substantial amount of foreign debt was accumulated. There was a real danger of macroeconomic collapse accompanied by uncontrolled inflation, but due to the tight monetary policy performed by the National Bank of Moldova and supported by the IMF since the introduction of the national currency, Moldova managed to avoid such a crisis. This, along with other positive factors that will be discussed further, made it possible for the banking system to evolve towards stabilization and strengthening.

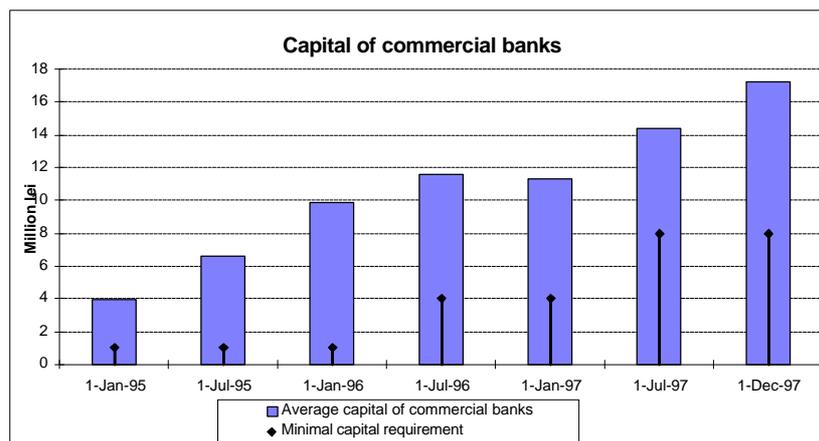
In 1991 the Parliament of Moldova approved the laws "On the National (State) Bank of Moldova" and "On Banks and Banking Activity", which established the basis of the actual banking system of the country. In July 1995 Parliament adopted the new banking laws "On National Bank of Moldova" and "On Financial Institutions", elaborated by NBM in accordance with international standards, upon recommendation and with the assistance of IMF. These laws include new and modern elements directed towards strengthening the role of NBM in drawing up and implementing monetary and foreign exchange policy, and contain the legal basis for a healthy and reliable banking system.

- Banking system of Moldova operates on two levels: on the first level is the National Bank of Moldova (NBM), as the central bank and sole money issuing authority. NBM sets the monetary, credit and foreign exchange policy, and supervises the activity of commercial banks. It is responsible to the Parliament, and is exercising its functions independently of the executive bodies. The second level is represented by commercial banks, which attract and place the investments, servicing of the flows of credit resources.

### Structure of the commercial banking sector

Decentralization and demonopolization of the banking system are contributing towards the establishment of a market oriented sector, after decades of concentration of financial resources and credit in the hands of the state. Finally, the monopoly of former central banks and state specialized banks has come to an end.

The number of commercial banks of Moldova has grown during 1991-1997, but in a relatively moderate way. At the end of 1991 there were operating 15 commercial banks, and their number reached 22 by the end of 1993. Since then this figure did not vary much. As of end-1997 out of the existing 23 commercial banks, 5 originated from the reorganization of the former state specialized banks, and 18 are new banks.



There are three basic types of licenses granted by the NBM to commercial banks, subject to different capital requirements and granting different operating possibilities. Starting from 1 January 1997 NBM increased the minimal capital requirement (for receiving also a type-A license) for newly created banks, to 8 million Moldovan lei (in 1995 it was 1 million lei, and from 1 January 1996 it was set at 4 million lei). Taking into account the tendency of banks' merging, as well as foreign banks' branches entering the Moldovan market, we can forecast an increase of minimal regulatory capital to the equivalent of 3 million US dollars by the year 2000 and 4 million dollars till 2002-2003.

According to the Law "On Financial Institutions", in order to obtain a type-B license a bank needs to have a total regulatory capital equal to 2 minimal capital requirements, and for obtaining a type-C license capital has to equal 3 times the minimum capital requirements.

Currently:

- 5 banks hold type A licenses, which allows them to perform basic banking operations, as well as cash foreign exchange transactions on the domestic market;
- 10 banks have type B licenses, which alongside the above mentioned operations enables them also to perform international banking operations;
- 8 banks have type C licenses and may perform all types of domestic and international banking operations, including dealing in foreign exchange and investment activities.

#### Main indicators of banks' activity

Total regulatory capital of commercial banks has been increasing, and at 1 December 1997 it was 534.5 million lei, or 17% bigger than at 1 January 1997, and 2 times bigger than at 1 January 1996.

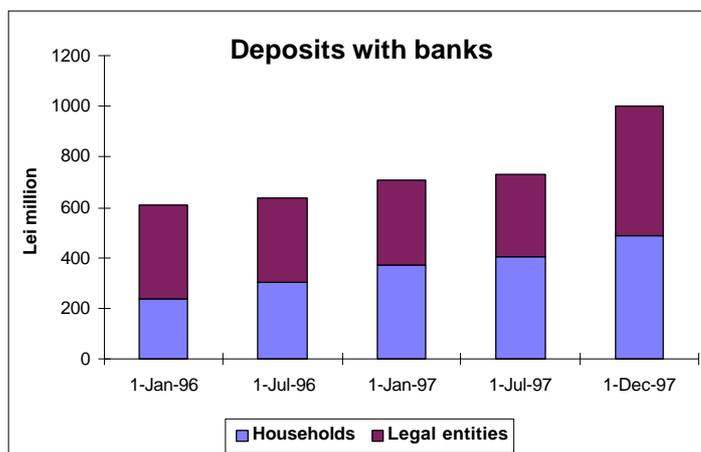
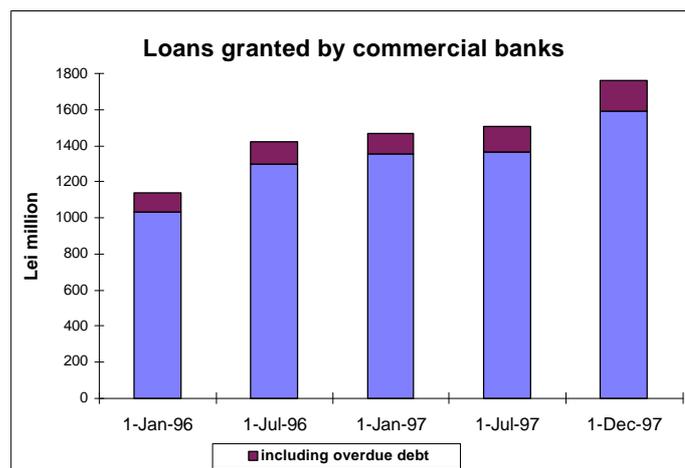
Total banks' credit investments (loans granted) as of 1 December 1997 were 1592 million lei, or 17.8% more, as compared to 1 January 1997. Share of overdue debt was 10.6% and 8.4% respectively.

During 1996 and 1997 the confidence of the population in banking system has grown, and this is reflected by the continuous increase of households' deposits with commercial banks. As of 1 January 1997 the amount of funds deposited with banks has increased by 56 per cent, compared to the same period of the previous year, and at 1 October 1997 households' deposits have grown further by 31% compared to 1 January 1997.

Deposits of legal entities have been constant from the middle of 1996 till the middle of 1997, showing a growth in the 2<sup>nd</sup> half of 1997.

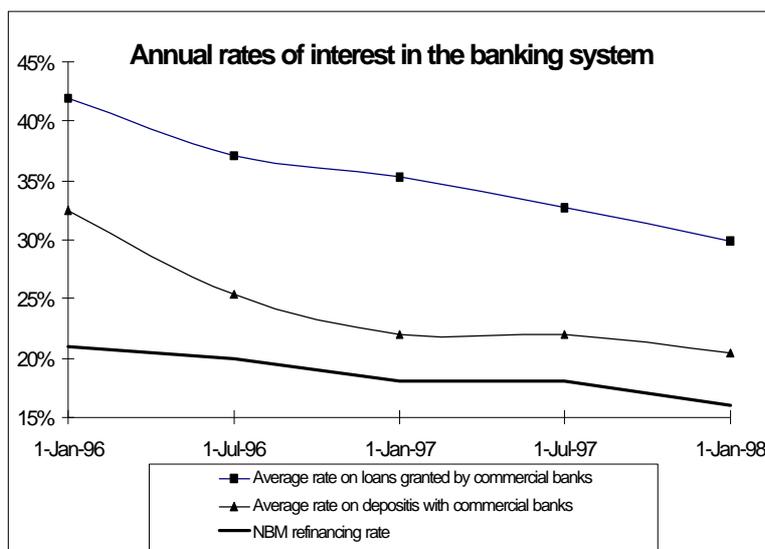
Average interest rates in the banking system have declined continuously during 1997:

- for deposits – from 22% to 20.4% p.a.;
- for loans granted – from 35.3% to 29.9% p.a..



For the bigger part of 1997 the National Bank's annual refinancing rate remained almost stable at 18%.

The movement in interest rates in 1996 shows that there has been some widening of spreads between deposits and loans. Average spreads appear to have increased from 9.4 per cent to 13.3 per cent from 1 January 1996 to 1 January 1997, indicating lack of a real competition between banks, as well as the fact, that some banks tried to increase their profits granting risky loans. Nonetheless during 1997 the spread had a downward trend, which is a favorable sign for banks' clients, who already pay quite high *real* rates of interest on loans received.



### Efficiency improvements and international presence

Advances in the efficiency and reliability of commercial banking operations in Moldova is testified by an increasing confidence of foreign banks which have opened lines of credit in foreign currency for the Moldovan banks. Moldovan commercial banks opened correspondent accounts with a number of well known international banks worldwide.

In May 1996 the banking system moved to an electronic settlement system which now covers the majority of current transactions. In addition to other significant operational advantages for the commercial banks and their customers, this system allows NBM to monitor more efficiently banks' liquidity and their financial standing. Twelve commercial banks became members and have been connected to SWIFT. Banks are diversifying their international activity and are setting up groups of dealers in foreign exchange on international markets. A very important role in this context has information base: eleven banks subscribed to REUTERS and one out of them was connected to REUTERS Dealing.

A number of banks are servicing travelers cheques, as well as plastic cards. Some banks have issued VISA and other types of cards. In May 1997 Victoriabank became member of VISA International, and through its processing center all VISA cards are now serviced here in Moldova. Still, at this time plastic cards have not gained a wide access in Moldova. However, it should be mentioned, that this direction should be addressed as a strategic priority, particularly because servicing of plastic cards demands 4-5 times less resources comparing to servicing the cash in circulation.

### Main problems with the system

Also, commercial banking system had to face, and still faces a number of problems, such as:

- insufficiency of qualified personnel with experience in modern banking operations, and capable of dealing with international counterparts;
- lack of experience of local bankers;
- weak technical and material base;
- bad communications.

Significant efforts are made by most banks to overcome these constraints. Despite investments for the acquisition of computers and modern banking equipment, as well as training programs for their staff both locally and abroad, it is clear that proper training of a sufficient

number of staff is a long process. The areas that appear to suffer most from this shortage are those of credit allocation, loan supervision and legal settlement of problems related to debt reimbursement.

Banks should be oriented towards maximization of profit, at the same time knowing and applying the information and technology of risk minimization, seeking the most convenient spheres for injecting capital.

Analyzing banks' crediting activity, it should be stressed out, that there is a problem of availability and cost of credit, partly resulting from insufficient development and limited competition in the commercial banking sector, which continues to keep the real cost of credit at a quite high level.

Generally speaking, the low share of long term loans in banks' portfolio is a typical problem in case of transition economies. One of the main functions of banks is efficient usage of credit resources. On the other hand, the main goal of banks is profit maximization, but at the same time the banks should be careful. Because of big risks (economic instability and imperfection of collateral mechanisms), commercial banks refuse to make long term investments in national economy (that in fact could ensure an economic growth). There is also another detail: household bank deposits in Moldova are typically short term, accounting for about 60 per cent. Thus, Moldovan banks' loan portfolios are about 75 per cent short term. However, a positive tendency is that the share of long-term credits is growing continuously during 1997.

On the other hand, one of the main causes of insufficient crediting of production sector is not just the acute lack of financial resources, but lack of efficient investment projects and small number of solvent economic entities, which could efficiently use the credits, and reimburse them in due time. In fact, correctness of the mentioned argument is confirmed by existence of excess of banks' reserves: at end-1997 banks' reserves accounted for over 20%, while NBM's reserve requirement is at 8%.

Another specific aspect of the situation in Moldova's banking system is as follows: no international banks have yet opened branches in the country. This is a worrying sign, which reflects a generalized lack of momentum in foreign investment in the national economy, despite the relatively low inflation, firm exchange rate, positive real refinancing rate, modern banking legislation etc. Western bankers are unwilling to invest their capital in Moldova, and this proves that there still are important factors that keep them away from our country. These are, for instance, the small size of the country and the small size of its capital market, along with its underdeveloped productive sector – reasons discouraging investment decisions on the part of foreigners.

*Conclusion:* overall, the situation in banking system of Moldova is stable and did not suffer from any major shocks similar to those that occurred in Romania, Russia, Latvia or other European countries in transition. However, from the financial prospective, banking system cannot be considered a strong one because of lack of funds, and this imposes a firm prudential accent to banks' behavior in the market, as well a need in competence and responsibility in taking decisions. Otherwise banks risk to go bankrupt, as it already happened with 3 commercial banks of Moldova. As in most cases of bankruptcy that happened in industrial countries, in transition countries, including Moldova, the main cause of this phenomenon is banks' mismanagement, as well as fraud and abuse in personal interest, that generated an unjustified concentration of risks in specific branches or economic entities, at the same time banks' management allowing crediting of insolvent clients.

### Capital markets

In Moldova securities market is still in an incipient state and is relatively small (both bonds and shares), however it plays a very important role in the following directions:

- process of privatization;
- non-inflationary way of financing the budget deficit through issuing state securities;
- development of capital market in a competitive environment both for local and foreign investors;

### State securities

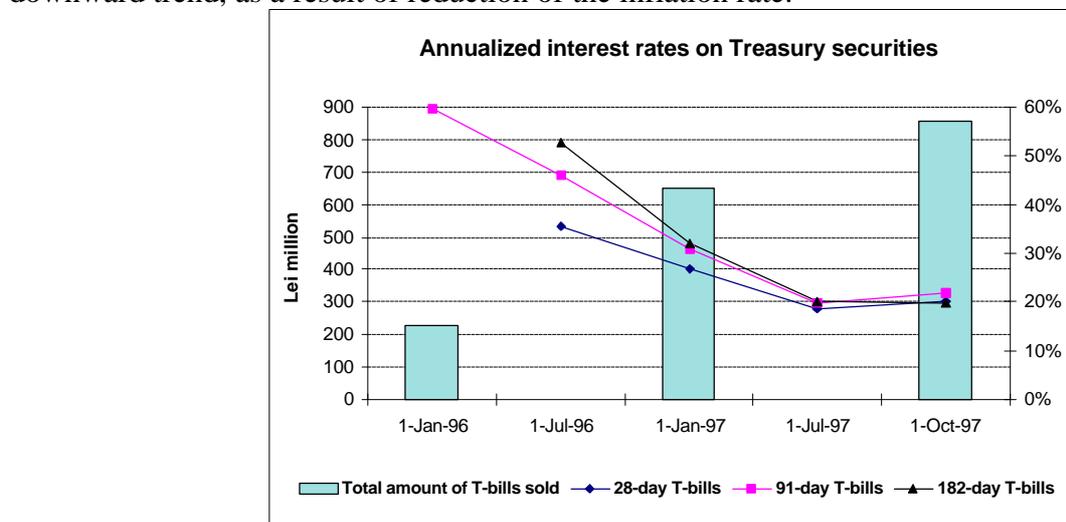
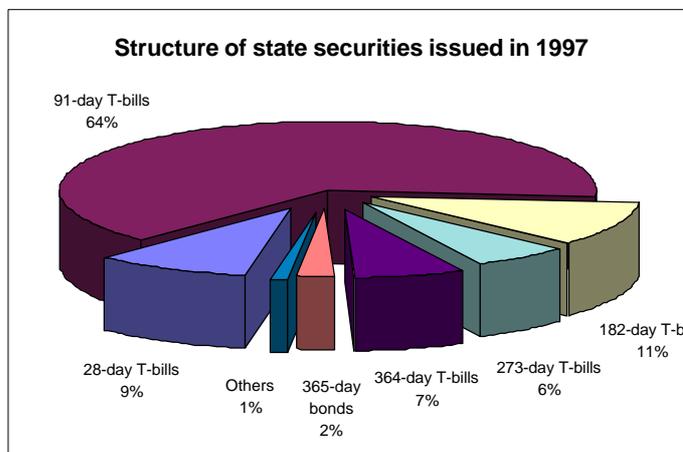
The Government debt market commenced in March 1995 and has resulted in a reduction in the practice of borrowing money from the NBM through regular issuance of Treasury securities by the Ministry of Finance, which are traded at auctions held at NBM.

Moldovan Treasury securities take the form of short-term Treasury bills sold at a discount and Treasury bonds. The T-bills issued have 28-day, 91-day, 182-day, 273-day and 364-day maturity, most liquid being 28-day and 91-day bills. In December 1997 state bonds have been launched, having a 2-year maturity (at a fixed interest rate of 12%, paid twice per year), previously being issued a 365-day T-bond (with a 15% interest rate).

At end-1997 the coverage of budget deficit by issuance of Treasury securities accounted for 35%. Main buyers of treasury securities were commercial banks (about 50%), the remaining part being sold to non-banking agents and foreign investors (38%). To mention is, that in March 1997

the system of primary dealers was created, as dealers acting 17 commercial banks selected on the basis set by NBM. In 1997 banks have acquired in the primary market state securities amounting to 636m lei. In the structure of these securities there is a growing share of the ones with longer maturity, and this actually proves the increasing confidence with respect to the state securities market.

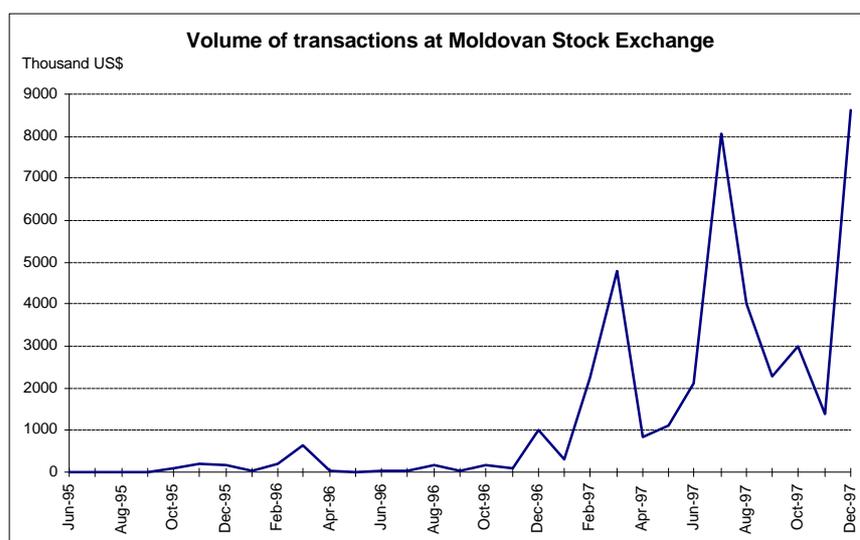
Looking at the interest rates on Treasury securities, it should be noted, that they had a downward trend, as a result of reduction of the inflation rate.



### Moldovan Stock Exchange

Trading of equity securities in Moldova takes place through the Moldovan Stock Exchange, which began to operate in June 1995. Bourse's transactions are dominated by investment companies. In 1996, 154 trading sessions took place on the Stock Exchange, amounting to over 3.5 million shares, representing a value traded worth 11.5 million lei, or approximately 2.5 million US dollars. Trading volume during 1997 fluctuated substantially, the picks being reached in July and December, when the value traded was worth over 8 million USD. Total amount traded at the Bourse in 1997 was 78.5 million lei, or 38.2 million dollars (22.6 million shares).

At present there are 118 large companies (having over 300 shareholders) registered at the Bourse. Sixteen out of them are quoted in the market. Moldovan shares portfolio calculated as nominal capitalization of the market is over 5 billion lei. More than 90% of this number are shares of private companies, and the remaining part – are securities issued by the state or banks.



### ***Regulation of the capital markets***

The Government established the State Commission on Securities Markets, which has the status of a Government Ministry, in 1992. The State Commission on Securities Markets has the primary responsibility for regulation of the Moldovan securities market, and it has been granted powers to examine the activities of security brokers, investment funds, trust companies and independent share registrars.

NBM oversees treasury securities transactions (as an instrument of monetary policy), foreign investment (as a matter of currency control), and securities transactions and offerings by banks (as the primary regulator of banks).

Law “On Securities and Stock Exchanges”, adopted by Parliament in May 1993, regulates issuance and circulation of securities. Pursuant to the law, companies listed at Stock Exchange must publicly report information on quarterly basis. The law also regulates activities of professional securities market participants and aims to strengthen protection for investors by imposing rules on market professionals. Investment funds are regulated pursuant to the law “On Investment Funds”, adopted by Parliament in February 1994.

*Conclusion:* it is clear, that the development of capital markets in transition economies is in an incipient state, they having little liquidity due to at least two motives: small dimension and reluctance of potential investors to invest in companies with an unclear perspective. A massive privatization and a concentration of capital in hands of owners having well defined rights, should definitely accelerate the development of capital market and its impact on national economy.

### **Insurance markets**

An important element of market economy is insurance market. During transition in the Republic of Moldova a number of economic entities emerged, which operate on their own risk.

Insurance of commercial risks, of eventual losses caused by natural calamities, or other material losses, represents, in any area of activity, the goal of insurance companies' activity.

Insurance activity in Moldova is based upon the Law On Insurance, approved by the Parliament in 1993. At the end of 1997 there were more than 50 insurance companies registered in Moldova.

Viability of this market could serve as a benefit for the state too, since would become available budget funds, that are allocated yearly for compensation of losses of economic entities and individuals, which obviously alter the principles of market economy.

As short term objectives for insurance activity, the following could be outlined:

- modernization of legal basis regarding insurance activity, which would ensure a stability and competitiveness in the insurance market;
- globalization of Moldova's insurance market with international insurance market;
- establishing a moderate set of mandatory insurance (according to the international practice) and a number of voluntary types of insurance;
- preparation and training of insurance personnel.