Center for Strategic Studies and Reforms

Moldova in transition

ECONOMIC SURVEY

No. 4, 1999

Chişinău, December '99

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PREFACE

Ten years ago, soon after the fall of the Berlin Wall, significant political and economic changes began in Central and Eastern Europe. Now, more than 20 European countries, which in the late 80's still belonged to the "world socialist system", have a decade of experience with transition to the democratic political system and a market economy.

Can we mention here some concrete results of this experiment? Too little time has passed. In some countries in transition evident progress has been made. But there are only few countries like these –Poland, the Czech Republic, Hungary, Slovenia, Estonia. Most countries in transition have stagnated for most of the decade; their output and living standards continue to decline, breading chronic political instability.

Unfortunately Moldova is also one of the stagnant countries. We admit this as citizens of Moldova. This follows clearly from the evaluations of various international institutions, in whose ratings Moldova ranks among outsiders.

Today, after a ten-year experience, the following questions are justified: what is the balance between success and failure? How correct proved to be the rapid liberalization of economy? How macroeconomic, structural, and social policies were coordinated? What were the trends of the main elements of welfare in this state? What political factors should be taken into account in determining the pace and the sequence of reforms? And finally, what needs to be done?

The contents of the present edition of "Moldova in Transition" spells out the country's profile of the 90's transitional decade, including political, human development, and economic factors. Special attention is given to the 1999 year - the year of contrasts and stresses in the economic and social development, the year of three (!) governments, the year of soaring the political uncertainty in the country.

The present issue of the survey has been prepared by the Center for Strategic Studies and Reforms within the framework of the UNDP/WB Project "Strategy for Development". Official data (from the Ministry of Economy and Reforms, Ministry of Finance, National Bank of Moldova, Ministry of Labor, Family and Social Protection, and the Department of Statistical Analysis and Sociology) were used in our analysis. At the same time, the opinions and conclusions presented in this study are entirely those of the authors and do not necessarily express the viewpoint of the state structures and the organizations which finance the research. Cooperation of the Center for Social and Economic Research Foundation (CASE – Warsaw, Poland) is also acknowledged.

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1. TRANSITION: A LONG WAY TO WELL-BEING

It has now been ten years since the time when the Republic of Moldova, amongst other Central and East European (CEE) nations and countries of the former Soviet Union (FSU), adopted the course towards transformation of its political and economic systems. Then - a decade ago – the principal goal of reform efforts was to ensure transition from an authoritarian political system and centrally-planned economy to a democratic state with a market economy and civil society.

So far, these efforts have produced only partial and mixed success. Positive results are few and most of these are in the area of economic and political freedoms – openness of the country, democratization of public life (multi-party parliamentary and local elections, freedom of religion, mass media, NGOs, etc.). Social implications of transition, on the other hand, have been dramatic and essentially signaled a transition to poverty. Economies of most of the countries in the region find themselves in deep recession, with only a few that registered growth of output.

In 1998, only Poland, Slovenia and Slovakia had higher output levels relative to the year 1989 – or the last pre-transition year. On average, by 1998 CEE countries have recovered at least 90% of their measured output relative to the pre-transition year of 1989, while the corresponding figures for FSU countries are about 60% to 70% *(See Table 1.1)*.

Social and economic performance amongst the transition countries of CEE and FSU has varied substantially. But now, ten years after, in all these countries including Moldova questions are raised on the matters concerning both the transition strategy and the political factors that determine the choice of economic policy.

As common sense goes, all reforms are designed for the better. In the beginning of the 90's, economic reforms in the region were aligned with the neo-liberal economic thought and included three main components: economic liberalization (including price liberalization and liberalization of trade and enterprise activity), privatization and macro-economic stabilization.

Albeit each with individual result depending on the country's background conditions (i.e. level of overall development, structure of the economy, national specifics of life, etc.), practically all countries in transition including Moldova have fulfilled these tasks by the mid-90's.

Yet, the miracle was not to occur. Despite the differences in methods of implementation of the reform strategy based on neo-liberal approach, they have not brought about significant improvements in the real sector of the economy and seriously affected the living standards in nearly all countries of the region.

Table 1.1. **Transition Economies: Output Performance, 1989 – 1998**

Country	Cumulative output decline (1989=100)	Year in which output was lowest	Cumulative output growth since lowest level	Year in which output was highest	Ratio of output in 1998 to output in 1989
Albania	39.9	1992	43.0	1989	0.96
Armenia	65.1	1993	29.7	1989	0.53
Azerbaijan	63.1	1995	17.8	1989	0.50
Belarus	36.9	1995	24.0	1989	0.81
Bulgaria	36.8	1997	4.0	1989	0.72
Croatia	37.7	1993	30.8	1989	0.82
Czech R.	15.4	1992	12.8	1989	0.97
Estonia	36.4	1994	25.7	1989	0.89
Georgia	74.6	1994	30.6	1989	0.48
Hungary	18.1	1993	16.3	1989	0.95
Kazakhstan	40.0	1998	0.0	1989	0.69
Kyrgyz R.	50.4	1995	20.1	1989	0.66
Latvia	52.8	1993	17.0	1989	0.64
Lithuania	40.8	1994	19.8	1990	0.71
Macedonia, FYR	46.6	1995	7.4	1989	0.57
Moldova	***66.3***	***1998***	***0.0***	***1989***	***0.42***
Poland	13.6	1991	42.6	1998	1.23
Romania	26.7	1992	3.4	1989	0.82
Russia	45.1	1998	0.0	1989	0.61
Slovak R.	24.7	1993	32.9	1998	1.00
Slovenia	20.4	1992	25.4	1989	1.00
Tajikistan	74.0	1996	7.1	1989	0.45
Turkmenistan	59.5	1997	4.5	1989	0.45
Ukraine	63.8	1997	0.8	1989	0.42
Uzbekistan	14.4	1995	7.0	1990	0.88
All Transition Countries	***41.8***	***1993***	***17.0***	***1989***	***0.7***
All CEE	***28.0***	***1992***	***21.9***	***1989***	***0.9***
Baltics	***21.6***	***1994***	***20.8***	***1989***	***0.7***
Other FSU countries	***37.5***	***1995***	***11.8***	***1989***	***0.6***

Sources: IMF. Database incorporating national statistics, World Economic Outlook, 1999.

It should be stated that during all these years social aspects of reforms have been constantly neglected as a secondary priority. Efforts in the social sector have customarily been of a fragmentary nature. According to World Bank estimates, the number of people in CEE and FSU countries living on less than 4 dollars per day rose from 14 million in 1989 to 147 million in mid-90s. By some estimates, in Moldova, about 66% of the population live below the poverty line, while 20% of the "newly rich" enjoy 50.3% of national income and the 20% of the "newly poor" are left with only 3.4% (1998).

As in the countries of Latin America and Africa, rapidly growing foreign debt has become another common problem for the CEE and FSU countries. By the end of 1999, Moldova's external debt is standing at about US$ 1 billion – or over 100% of GDP - and the possibility for default may become reality.

All transition countries employed identical reform strategies recommended from abroad. Should it not lead to the conclusion that while sharing in the benefits of transition of some countries, Western nations should also take part of the responsibility for failures of the others?

In this respect, the remark made by Mr. James Wolfensonn, President of the World Bank, is well worth being noted: "It is that if you want to have stable growth, then it is important to deal with the social and poverty issues, because if you do not deal with the social and poverty issues and structural issues attendant to it, then you find that your growth is not stable. You have social and other eruption in society."[1]

Radical criticism of the neo-liberal model and its social implications countries can be found in the UNDP's 1999 Human Development Report for CCE and CIS countries: "Before the 1990s, countries of Central and Eastern Europe and CIS were notable for providing their population with a high degree of basic security… The transition period has drastically altered this situation."[2]

More criticism is also voiced within the Republic of Moldova of the social consequences of transition.[3] Such criticism is well supported by factual evidence. In the past decade, there has been a considerable worsening of all indicators of living conditions. In 1998, the Human Development Index (HDI) for the Republic of Moldova, according to the estimations of the Department of Statistical Analysis and Sociology, was equal to 0.697 (in 1993 it was 0.718). The main components of HDI for Moldova today are: global domestic product per capita at purchasing power parity – US$ 2,042; life expectancy at birth – 67.0 years; literacy for adult population – 94.6%.

The Republic of Moldova, in spite of the worsening of HDI in the last years, still remains within the group of states with a "medium level of human development". Among 174 countries included in the UN rating list (Human Development Report 1999), Moldova is situated at the 104th place, having as neighbors Albania, Tunisia, Indonesia, El Salvador and other developing countries.

Transition has brought a great deal of disappointment. In Moldova, as in other countries of the region, social costs of market transformation turned out to be significantly greater than originally assumed by reform designers. This has contributed but to the narrowing of the social base of support for reforms. It appears that yet another attempt (repeated in the same part of the world!) to deliver to the people a 'brighter future' through forceful measures proved ineffective.

How does one explain what happened? There exist various explanations. One admits that the theory is viable, but implementation is often weak or erroneous. Another explanation points out to differences in nations' backgrounds, people's mentality, etc.

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1 IMF Institute Conference on Second Generation Reforms, Washington, D.C., 1999

2 Human Development Report for Central and Eastern Europe and the CIS , UNDP, 1999

3 "Republic of Moldova 1999", National Human Development Report, UNDP Moldova, 1999; P. Ronnas, N. Orlova, "Twice Hit – Badly Wounded: The Devastating Cost of an Inadequate Transformation in Moldova", SIDA 1999; "Moldova: Strategies for Pover ty Reduction", World Bank 1999; N. Orlova, "Moldova: Transition to Poverty", MA thesis, The Hague Institute of Social Studies, 1998

However, one of the most plausible explanations of failures of the transition period lies in the weakening of the role of the state, lack of consistence and coordination in between different political, economic and legal institutions (or the so-called “institutional weakness”). No matter how paradoxical it may seem, both adepts and critics of transition reforms support this explanation.

The state and its institutions stepped forward as initiators of reforms. However, most of transition countries, including Moldova, were in the beginning under the illusion that it was possible to effectively combine, during the transition period, socialist paternalism (statism) with market self-regulation.

The weakness of the state and the low level of political consent in Moldovan society did not allow permit the required regulatory role of the state in implementing reforms. In particular, state systems, undergoing a deep crisis, proved to incapable of initiating timely structural reforms, of collecting taxes as needed and of ensuring budgetary support of the poor strata of population.

Since crises usually aggravate inequality, the Government should have stimulated private sector development to function as a shock absorber for unemployment, should have reorganized the system of social assistance and should have undertaken measures in order to protect the poorest from economic shocks. Thus far this has not happened.

Disappointment was generated also by the property reform, based on rapid mass-privatization by vouchers, oriented towards granting everybody “equal starting opportunities." In reality, it did little more than turn poor-quality assets over to a large number of poor owners and channel high-quality assets to the “agile and connected."

The populist privatization method and slow pace of reforms in the agro-industrial sector (a key sector of the national economy!) did not facilitate the turnover to efficiently working owners or good corporate governance of enterprises, which in its turn had an extremely negative influence on the real sector dynamics, its exporting possibilities and the level of employment.

On the macroeconomic front, the efforts to reduce inflation and the state budget deficit were not so sustainable. Much of the success attained by Moldova by the mid-90s in the area of macroeconomic stability was subsequently, especially after the financial crisis in Russia in 1998, reversed.

Non-compliance with the laws and decisions of courts has also led to the state's inability to rein in the underground economy, which has greatly expanded (not less than 50% of GDP), leading to a vicious circle of corruption, hidden firm activity, reduced public revenues, and a dramatic widening of the population's income inequality.

Low quality of governance reflected in spread of corruption, the incidence of which in Moldova puts the country amongst the 25 of the most corrupt countries in the world. [4] Corruption and poverty are the two sides of the same coin. Corruption not only causes severe stress in the everyday lives of the country’s people but also stifles private economic initiative and the development of entrepreneurship as a driving force in a market economy and a means of “self rescue” during periods of hardship.

[4] 1999 Transparency International Corruption Index, “Transition”, October 1999, p.2

The low social efficiency of the reforms, the sharp income discrepancy and drawbacks in distributing the fruits of economic development ("newly rich" against "newly poor") have led to deepening and to a critical shortage of state funds for the support of public services, particularly for primary health care and basic education.

Table 1.2.

MAIN MACROECONOMIC INDICATORS

	1994	1995	1996	1997	1998	1999f
Real GDP growth rate	-30.9%	-1.4%	-7.8%	1.6%	-8.6%	-2.5%
Nominal GDP (excl. Transnistria), lei million	4737	6480	7658	8917	8804	11926
Nominal GDP, USD million	1164	1443	1665	1933	1630	1131
GDP per capita, USD	322	400	463	538	454	315
Export (fob), USD million	618	739	823	890	644	470
Export, yr/yr	156.5%	119.6%	111.4%	108.1%	72.4%	73.0%
Import (fob), USD million	672	794	1075	1235	1043	540
Import, yr/yr	126.8%	118.2%	135.4%	114.9%	84.5%	51.8%
Trade balance, USD million	-54.0	-55	-252	-345	-399.0	-70
Current account, USD million	-92	-115	-188	-269	-333	11
as % of GDP	-7.9%	-8.0%	-11.3%	-13.9%	-20.4%	1.0%
Foreign direct investments, USD million	18	73	23	71	86	80
as % of GDP	1.5%	5.1%	1.4%	3.7%	5.3%	7.1%
Stock of foreign debt, USD million	627	765	921	1008	954	841
as % of GDP	53.8%	53.0%	55.3%	52.1%	58.5%	74.4%
NBM gross forex reserves, USD million	180	257	314	366	144	202
NBM reserves in months of imports of GFS	2.87	3.04	3.00	3.07	1.40	3.46
Internal debt, million lei	270	477	737	940	1500	1700
Budget balance as % of GDP	-5.9%	-6.7%	-7.6%	-7.8%	-3.4%	-5.2%
Annual inflation rate (end period)	104.6%	23.8%	15.1%	11.2%	18.3%	40.4%
End-year exchange rate, lei/1USD	4.27	4.50	4.65	4.66	8.32	11.69
Average exchange rate, lei/1USD	4.07	4.5	4.6	4.6	5.4	10.5
Nominal end-year appreciation(+)/depreciation(-), MDL/USD	–17.3%	–5.4%	–3.4%	–0.2%	–78.6%	–40.5%
Nominal end-year appreciation(+)/depreciation(-), USD/MDL	–14.8%	–5.1%	–3.2%	–0.2%	–44.0%	–28.8%
Real end-year appreciation(+)/depreciation(-)	+74.4%	+17.5%	+11.4%	+10.9%	–33.8%	–0.1%

The degree of success of the implementation of the neo-liberal plan in Moldova can be assessed by way of analyzing the dynamic of main macro-economic indicators *(See Table 1.2)*. More detailed assessment of trends and effectiveness of transition in different sectors of the national economy is given in subsequent chapters of the survey - quality of governance, finance sector, structural reforms, private sector development, investment climate, social dimensions, regional aspects, effects of political factors, etc.

Looking back on the past decade, at least five conclusions are important for solution modeling for the future.

First: It is necessary to ensure *a society-wide consensus* with respect to the content of reform and inter-relationships between its different components. Political stability and new economic order can only be sustainable if supported by the population.

Second: The country requires *a strong and effective government* that is able to enforce law and to maintain institutions, norms and practices essential for genuine market economy and sustainable human development. Weakness of government structures increases non-compliance with laws and official regulations, and in particular tax evasion. Weak government is more likely to be corrupt.

Third: To break the vicious circle of recession is possible only through increased attention to the *real sector of the economy*. This essentially requires creation of an effective system of incentives benefiting both businesses and the state; improvement of corporate management of newly privatized enterprises; effective protection of the rights of investors and ensuring transparency of commercial tenders; support for the small and medium enterprise sector which serves as a basis for the development of the middle class – the main social force behind reforms. Concomitant with these efforts should be the measures aimed at eliminating the gap between the banking and manufacturing sectors of the economy, through reducing the *influence of certain lobbies and special interest groups* on the decisions concerning import/export transactions, energy sector, privatization, and demands for higher budgetary outlays.

Fourth: In the course of transition from centrally-planned to market economy, the state has retained its *social responsibilities*. Management methods in the area of social security, however, need to be changed. Of primary importance for Moldova are now the issues of poverty eradication, reform of social insurance system, health care reform, education and labor market formation. The principal difficulty associated with the social sector reform lies in the need for the new arrangements to be both socially just and economically balanced.

Fifth: Success of transition is directly related to the extent to which its *political and economic components* are effectively combined. The experience of Moldova, both positive and negative, including the reality of 1999, demonstrates explicitly the connection between the reforms progress and political stability. Political risks and disordered policies of the state pose a serious obstacle on the way of reforms.

Better informed citizenry will more likely take an active part in political decision-making. Social unrest, mass strikes and street protests constitute an extreme form of expression of popular will. In this light, it is vital to promote in all possible ways *the transparency of government* through an effective system of public information dissemination. Equally important is to promote all forms of education, including retraining and enhancing professional qualifications, legal, medical and ecological education to supply the population with knowledge and skills necessary to guarantee effective social transformations. Thus, conditions will be created for the emergence of a stronger *civil society* capable of solving key political, economic and social problems.

All this is ever more important, considering that at the end of 1999, the country finds itself in a critical situation marked by lack of confidence in power structures exhibited by the populace and high volatility and unpredictability of future developments.

The lessons of the transitional decade have freed the country from illusions. Both for the government and for the population it has become clear that the way towards a socially oriented market economy and well-being – both for the population and for the state – will not be short. The question has emerged about the need for a new policy that would better fit the interests of human security now and sustainable development of the Republic of Moldova in the near future.

2. MACROECONOMIC TRENDS: DEFERRED STABILIZATION

As it was comprehensively described in the CISR Economic Survey 2, Moldova, like other post-communist economies, joined the transition process having a high rate of inflation and massively decreasing production. After the surge in administered prices in early 1992, sharp price increases followed, leading to hyperinflation (in 1992 – 1280%). In such environment, the so needed budget deficit reduction, along with reforms in real sector, have not been started. Moreover, the deficit was financed by extensive money printing, as well as preferential centralized loans, which ultimately generated a non-productive consumption, since the loans were frequently absorbed by inefficient state enterprises that should have been either restructured or bankrupted.

The currency stabilization environment had to be built up from scratch since in 1991, when Moldova became an independent state, the foreign exchange and gold reserves were zero, and there was neither a foreign exchange market, nor even a central bank of the state.

Introduction of the National Currency

On November 29, 1993 Moldova introduced its national currency, the Moldovan leu. A floating currency regime was adopted, or more exactly – a managed floating regime, since the country had no gold or significant hard currency reserves and a fixed exchange rate or a pegged regime could at a larger extent expose the economy to shocks.

The program of financial stabilization and structural reforms, adopted along with the introduction of the leu, was supported by the IMF through stand-by arrangements (in fact if no IMF financial support followed, than it would have been impossible for Moldova to introduce its national currency, given the existing circumstances). The IMF program, which covered the period through March 1995, was designed to secure a stable leu through the adoption of tight financial policies. The program also sought to advance economic restructuring through the liberalization of domestic and international trade and payments systems and the introduction of key structural reforms. In addition to IMF support, the program received support from other bilateral and multilateral donors, including the World Bank.

Banking Environment

In June 1991 the Parliament of Moldova approved the banking laws, which established the basis of the actual 2-tier banking system of the country. The NBM being the sole money issuance authority of the state - drawing up and implementing monetary, credit, and foreign exchange policies, setting the regulatory framework for commercial banks and supervising their activity. At the end of 1991 fifteen commercial banks were operating in Moldova, and their number reached 22 by the end of 1993. Since then this figure did not vary too much. As of November 1999 out of the existing 22 commercial banks, 5 originated from the reorganization of the former state specialized banks, and 17 are new banks, including branches of some foreign banks. Aimed at regulating banking activity and insurance of banks' stable financial standing, as well as for protecting banking creditors and depositors, starting with 1992 the NBM put in place prudential regulations for all banks which set standards for the Moldovan banking system compatible with international standards (the Basle provisions).

The situation in banking system of Moldova has been stable during 1993-1997 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 several 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.

Credit Allocation

Before 1993 the central bank was providing directed and centralized loans in the amounts requested by the Government. Since August 1993, when the first refinancing auction took place and till mid-June 1998, the main type of credit allocation was credit auctions held at the NBM. In 1994 NBM's preferential credits have been phased out. However, the Government itself continued to provide state guarantees for commercial banks' loans to some economic agents. Starting with the issuance of state T-Bills in 1995, NBM's direct credits for financing state budget were granted by the NBM against state's T-Bills. However, so far servicing of these loans by the Government has been continuously rescheduled.

Interest Rates

The annual refinancing rate established at credit auctions increased significantly through late 1993 reaching a peak of 377% in February 1994 (Figure 2.8). Then, as inflation declined, the auction rate began to drop. The decrease of inflation rate has had a positive effect on NBM refinancing rate that became positive in real terms starting with January 1994. Real refinancing rate rose significantly in 1994 and peaked by mid-1994 (which brought the first symptoms of suffocating economy and urged NBM to start a decrease in interest rates).

By the end of 1997 the refinancing rate reached its lowest level of 16%. On the other hand, average interest rates in the banking system have declined continuously during 1997 (Figure 2.22). The movement in interest rates shows that there has been a widening of spreads between rates on deposits and loans, indicating lack of a real competition between banks, as well as the fact that some banks tried to increase their profits granting risky loans.

Real interest rates in the banking system always remained quite high as high borrowing requirements of the Government combined with low supply of domestic savings led to the high interest equilibrating the financial market. At the same time, international savings could be attracted only at the interest rate inclusive of significant risk premium (due to the high country risk rating of Moldova) so that domestic real interest rate remained high above the world level. High interest rates on T-bills caused an increase in the opportunity cost of lending, thus crowding out credit investments to the private sector and leading to a situation when a portfolio of major part of banks consisted mainly of profitable and relatively risk-free government securities. On the other hand, high systemic risk, driven by the weakness of court and legal environment (for instance lack of legal basis for land collateral and mortgage loans) further reduced the incentives for search for profitable lending opportunities. As a result, the lack of serious competition between banks, as well as their undercapitalization, meant that private lenders had to bear the excessive cost of credits, at the same time not being allowed to borrow from foreign banks, due to the capital account restriction imposed by the central bank.

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. On the other hand, the main goal of banks is profit maximization, but at the same time the banks should be very cautious, especially in such an environment. 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 the economic growth). And they obviously cannot provide long-term loans having a mainly short-term deposit base.

At the same time, 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, that could efficiently use the credits and reimburse them in due time.

State Securities

Starting with 1995, the budget deficit is covered mainly by issuance of state securities (Treasury bills and bonds) and not only by direct lending from the central bank. Thus, the needed budget funds are attracted from the financial market, avoiding additional money issuance by NBM.

The initially high interest rates decreased steadily (Figure 2.11), while inflation rate was brought down close to 10%. Between 1995 and 1997 the NBM strict monetary policy and the commitment to stabilize the exchange rate induced significant credibility to domestic and foreign investors. The rates on T-bills fell with the increasing maturity of the debt: 182 days T-bills were introduced in 1996 and 273 days treasury securities in 1997. Moreover, the hump shaped yield curve suggests that investors anticipated a slow depreciation (successful dis-inflation) of the currency in long run. The volume of T-bills sales doubled both in 1996 and 1997. The average market rates halved between 1995 and 1997, which reduced the dependence of the budget on the direct credit from the Central Bank. Still, the rates were often high enough (also comparing with deposit rates) to allow commercial banks to use available funds for buying T-Bills and getting easy and guaranteed profits instead of crediting the economy.

First Anchor - Control Over Monetary Supply

With the introduction of the Moldovan leu, a tight monetary policy was implemented, which proved to be one of the most successful (along with the one of the Baltic States) in the FSU. The following monetary instruments were used: reserve requirements, refinancing auctions, interventions in the foreign exchange market, and open market operations with securities. The last one is certainly most recommended, but it started to be utilized only after August 1997, when the securities market was sufficiently developed.

The rate of inflation decreased sharply in 1994. While in 1993 annual inflation was higher than 2000%, then at the end of in 1994 it came down to 105%, in 1995 it was already 23.8%, in 1996 – 15.1%, and in 1997 – 11.2% (Figure 2.7).

However, even having an adequate volume of broad money, or an adequate monetary policy of the central bank, this does not implicitly mean the total control over the inflation, since the inflation rate could go up influenced by indirect, non-monetary factors, such as administrative increases in prices and tariffs (housing services, transport, energy etc.), or some seasonal tendencies.

Looking at the structure of broad money (Figure 2.12), one can notice that the volume of deposits in the banking system was increasing continuously (the biggest share being of those in lei), clearly showing the increase in confidence in the leu (supported by the stable exchange rate and the rapid decline in inflation) and the increasing reliance on foreign currency deposits to finance current transactions rather than as a store of value.

Table 2.1. Monetary aggregates

End-year:	Inflation	M0 growth	M3 growth	RM growth
1994	104.5%	191.9%	87.6%	136.1%
1995	23.8%	84.9%	65.1%	41.8%
1996	15.1%	14.5%	12.8%	8.4%
1997	11.2%	33.0%	37.0%	35.9%
1998	18.3%	-12.0%	-8.7%	-5.5%

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.

Second Anchor - Exchange Rate

During 1993 the coupon depreciated by 900%, while already in 1994 the Moldovan leu depreciated against the US dollar only by 14%. Further on, leu showed a remarkable stability, and the yearly nominal depreciation index (US$/MDL) was: 5.1% in 1995, 3.2% in 1996, and 0.2% in 1997 (Figure 2.5). The stable exchange rate was used as a second anchor (apart from control over money supply) for keeping the inflation in place. However, over a medium and long-term period, only one anchor, i.e. monetary policy, should be sufficient.

Along with the reduction of inflation, the Moldovan leu started to appreciate in real terms against the Russian ruble, Ukrainian karbovanets, US dollar and other currencies. Thus, the real exchange rate index indicated an appreciation of leu against US dollar by about 74% in 1994, by 17.5% in 1995, 11.4% in 1996, and 10.9% in 1997 (Figure 2.18).

This continuous appreciation of the leu, in the presence of huge and rising Balance of Payments disequilibria (current account deficit to GDP ratio was 14% in 1997), has generated many objections (especially in 1997) from the exporters' side, which claimed that an overvalued leu made Moldovan exported goods too expensive, thus deteriorating their competitiveness. At the same time, a devaluation of leu would cut the massive imports, especially of commodity goods. But, on the other hand, the devaluation would not solve the problem, since almost one third of imports were energy resources. Besides, depreciation would have caused problems to the Government in terms of external debt service, and also would cause the reduction of households' real incomes.

Analyzing the path of the exchange rate during 1994-1997, it may be seen that there were some common tendencies generated by seasonal fluctuations of the supply and demand for hard currency in the forex market. The seasonal character of Moldova's economy, which is strongly relying on the agriculture sector, explains them.

Foreign Exchange Regime

The NBM has been gradually implementing a policy of foreign exchange market liberalization. NBM's foreign exchange reserves at the end of 1993 stood at US$77m. On January 17, 1994 NBM approved the new Regulation on Currency Control, which authorized buying of hard currency for current account operations. From November 15, 1994 the surrender requirement was cancelled, thus economic agents being able to freely dispose of their export earnings, kept with banks. This was a strong evidence of leu's stability.

The building up of reserves evolved further (Figure 2.17). Thus, at the end of 1994 gross reserves already reached US$180m, 1995 - US$256m, 1996 - US$314m. At end-1997 gross reserves reached - US$366m (covering 3.1 months of imports of goods and services), out of which US$132m represented net reserves.

Rules of export-import of hard currency in Moldova have been simplified, while quite liberal regulations have been set regarding keeping hard currency on deposits with Moldovan banks. These actions led to a growing confidence in leu from population and economic entities. Consequently, the exchange rate of leu has stabilized, the volume of lei deposits with banks increased, while the "street" activities and black currency market phenomena have practically wiped out.

The above-mentioned measures and results obtained served as a good reason for the NBM to accept on June 30, 1995 the Article VIII, sections 2, 3, 4 of the IMF Articles of Agreement. This represented *de jure* the convertibility of Moldovan leu for current account operations, and for some capital account operations. As a result, any resident or non-resident individual or legal entity have been allowed to exchange with no limits lei into hard currencies and *vice-versa*. Foreign investors were granted the right to freely repatriate capital to their country of origin. Residents, working abroad, can freely transfer their earnings to relatives in Moldova. However, individuals residents of Moldova are not allowed to transfer abroad the money from their hard currency accounts with local banks, with a few exceptions such as for medical care, studies and other.

Unsustainable Fiscal Policy

Moldovan fiscal policy in recent years was driven by inertia and pressure from groups of interest. The slow path of structural reforms and the general weakness of the state reflect this statement. Loose fiscal policy in turn reduced the determination in reforming the state structures. Arrears and netting-out operations led to the development of a non-payment culture. At macroeconomic level, expansionary fiscal policy led to high absorption in the economy that was not met by the supply side response due to the impeded restructuring process. It fuelled imports and the trade balance steadily deteriorated. At the same time, capital inflows necessary to finance the budget deficit, combined with domestic restrictive monetary policy, prevented the depreciation of the currency. The ultimate result of the policy mix was the rapid accumulation of external debt and expenditure arrears. The unsustainability of both internal and external position of the state led to the inevitable financial crisis.

It is well established that transition countries that implemented tight fiscal policy resumed the growth sooner and it was both more stable and higher in comparison to countries with large and unsustainable budget deficits and associated high levels of government spending. The reduction of state budget deficit is the most important condition for medium-term stabilization and growth of Moldovan economy. The fiscal policy could not sufficiently be disciplined by a restrictive monetary policy.

Macroeconomic developments in Moldova in last years exhibits striking contrast between consequent tight monetary policy and loose, arguably unsustainable fiscal policy. While inflation and monetary aggregates show an impressive dynamics, not yet achieved even by the most advanced transition economies, budget deficit share in GDP exhibited almost double-digit values.

Fiscal policy can be changed only with significant time lags and also it takes years until its full impact on economic development is observed. Monetary policy, on the other hand, can be adjusted more rapidly and the response of the economy is prompter. Namely, even under fiscal policy that is unsustainable in the longer run, the short-term monetary stabilization can be achieved. Effects of inflation and exchange rate pressures, combined with high interest rates will accumulate slowly, with the adverse influence not only on the price stabilization but also on the economic growth in the medium term horizon. Only programs that combined both fiscal and monetary tightening brought long lasting stabilization in Latin American countries. Programs that ignored the fiscal component yielded only temporary results at best. Non-inflationary sources of budget deficit financing cannot substitute for real fiscal adjustment. Although most of the countries that reduced significantly the budget deficit financing from money emission achieved short-lived price stability, the scale of fiscal adjustment was the factor that differentiated recent macroeconomic developments in CIS countries and other countries of Central and Eastern Europe.

In Moldova, internal imbalances have been persistently converted into external problems. The domination of demand over supply of goods has not produced inflation, as it was settled through imports. Similarly, the budget deficit was financed without monetization through foreign capital inflows. Financing twin deficits through external borrowing was relatively easy since Moldova started its independent economic life in 1992 without foreign debt.

Unsustainable fiscal policy put all the responsibility of maintaining stabilization on the monetary policy, which leads directly to the necessity for further monetary tightening. Monetary policy could not, however, compensate for the weakness of fiscal budget in a longer time period. Moreover, the fiscal policy in Moldova was constantly undermining the credibility of the stabilization, making required monetary policy still harsher. Possible results of such policy mix are listed below:

i) High real interest rates held by the deficit borrowing requirements, with reduction of the capital available to the growth-generating private investments;

ii) High costs of financing the budget deficit (high interest rates, tight credit control, low inflation, hence low inflation tax), emergence of expenditure arrears, raising costs of public debt service;

iii) Falling competitiveness with large trade deficit and the accumulation of external debt;

iv) Deterioration of liquidity in the economy, leading to the emergence of inter-enterprise arrears, and barter and netting-out operations.

All the above effects have deeply marked the Moldovan economy. As the government relied excessively on foreign borrowings, in the presence of money scarcity the third effect proved to be probably the most disastrous. The absence of hard budget constraint should be viewed as a component of loose fiscal policy that prevented restructuring, which led to non-cash transactions.

Budget Deficit and Aggregate Demand

In the standard Keynesian macroeconomics, fiscal deficit is the tool of stimulating economy during the period of recession. If the failure of private agents to consume and invest enough to meet the production capabilities is the cause of the decline in the output, fiscal expansion can stimulate the economy by enhancement of aggregate demand, leading to the reversal of the economy towards the full employment equilibrium. This result is obviously valid only if the output is under its full employment level and if recession can be indeed viewed as the consequence of a weak demand. The evolution of Moldovan GDP exhibits 70% fall within the period 1990-1998 (Figure 2.1). Did it constitute the case for the fiscal expansion? It might be difficult to argue that the economy needed a fiscal contraction. The analysis of the composition of Moldovan GDP brings the response to this question (Figure 2.3).

As it can be seen, the share of final consumption in GDP was steadily growing and increased from 80% of GDP in 1995 up to 102% of GDP in 1998. However, the rate of investment in the economy did not fall significantly and fluctuated around 25% of GDP throughout the period. This was possible only through substantial external borrowings that offset domestic dis-saving.

Clearly, throughout this period Moldova was significantly credited by its trading partners, which is reflected by the increasing trade deficit (8% in 1995, versus the near-collapse level of 28% in 1998). Such trade imbalance induced an extreme risk to the external position of Moldova and made it very vulnerable to changes in the pattern of capital flows. It is interesting to see what is the role of government consumption in this process (Figure 2.4).

Somehow surprisingly, it was the private consumption that was growing very fast (as measured as the share of GDP) in recent years. In 1995 private consumption amounted to only 55% of GDP, while in 1998 this figure raised to 85%. Meanwhile, public consumption remained stable (27%) until 1997, but it dropped sharply to 18% (it is also possible that public wages and other expenditures related to the provision of in-kind social benefits for population are included in private consumption, which means that public consumption is actually under-evaluated) in 1998.

Developments of 1998 can be interpreted as the substitution of consumption of public services and goods (as education or health care) with private consumption of similar services. However, the rapid growth of private consumption between 1995 and1998 can be explained by the massive drop in savings and the declining ability of state to collect taxes (leading to the raise in the share of disposable income in GDP).

There is one clear message from this analysis: the recovery of Moldovan economy will not be possible by stimulating the aggregate demand. The Keynesian solution to the current recession is completely inapplicable since the rapid growth in final consumption fuels exclusively the increasing trade deficit.

Central Bank Credit to the Government

According to the basics of the economic theory, the fiscal deficit should be limited to the level at which:

a) its financing through domestic capital market does not distort the allocation of resources;
b) does not require direct credits from the Central Bank for financing it;
c) does not lead to excessive external borrowings.

In Moldova, direct NBM credits to the Government represented the main source of deficit financing in 1992 and 1993. As it is shown in Figure 2.15, the volume of those credits amounted to 6 % of GDP in 1993. The next two years this source of budget financing decreased (2.3% and 1.7% of GDP, respectively) while in 1996 it became negative, when the state started to pay back the credit to NBM. In 1997 the recourse to this source reappeared (1.6% of GDP) but in 1998 the Budget Law prohibited explicitly such a procedure. In practice, NBM gives direct credits to the government for short-tem coverage of its financial needs, but such credits must be in the form of T-bills purchase by NBM.

Table 2.2. NBM direct credit to government

	1993	1994	1995	1996	1997	1998
as % of:						
reserve money	60	58	55	43	46	126
broad money	40	42	35	26	27	76
as % of growth of:						
reserve money	NA	56	49	-85	53	-1342
broad money	NA	43	23	-32	29	-498

NBM credits to the government amounted to 60% of the supply of reserve money in 1993, but this share was reduced up to 43% in 1996. Similarly, the share of credits in broad money was reduced from 42% to 23% during the same period. Until the end of 1995 the extended credit to the government caused more than half of the growth of reserve money. In 1996 the stock of money increased independently from the evolution of NBM credits. In 1997 the situation was similar to that from 1993 and 1994, with significant money growth resulting from direct deficit financing. 1998 brought more spectacular changes with plunging foreign assets of the Central Bank, which offset an important part of growth of NBM credits to the government.

It should be noted that in September-October 1998 NBM was forced to massively credit the government in order to avoid its default on treasury securities, which resulted in a very high ratio of credits to GDP (9.3%). In the spring of 1999 NBM granted 75 million lei for the agriculture works. In general the role of direct NBM credits for deficit financing was mainly determined by the availability of cheap international financing.

Domestic Borrowings: Shallow Markets

Financing the budget deficit through borrowings on the domestic capital market is favorable because it facilitates the development of the financial sector, as T-bills are usually the main instruments traded on the emerging markets. There are, however, some necessary preconditions for the development of domestic T-bill market: apart from institutional arrangements, curbed inflation, confidence in the domestic currency and a sound banking sector is required.

As it was already mentioned earlier, the Moldovan government started to place the debt instruments on the domestic market since April 1995 with the annual yield of 90% that were lowered to 20% towards 1997, as a result of the achieved stabilization. Moldova, with a level of monetization higher than in other CIS countries, had more chances to finance budget deficit through the T-bill market. Still, the domestic sources were quickly saturated, non-resident participation being allowed in order to increase the financing base. Since the beginning of 1998 the economic agents started to realize that the fiscal policy was not anymore sustainable, and therefore the interest rate spiked to 40%. Obviously, it was in part the result of the general decrease of confidence in emerging markets after the Asian crisis in 1997. In the wake of the Asian crisis the foreign participation on the Moldovan T-bills market decreased, but the importance of external factors should not be overestimated: the financial pyramid built by the government since 1995 could not be sustained, even if the sentiment of foreign investors did not change so rapidly.

The Moldovan government, through the conducted policy, entered the indebtedness vicious circle. High costs of servicing outstanding debt requiring higher borrowings at higher interest rate (increased risk premium). In 1998, the net financing from domestic capital markets remained negative.

Table 2.3. The evolution of domestic debt (% GDP)

	NBM Loans	Treasury Securities	Total
1994	5	0	6
1995	6	2	7
1996	6	4	10
1997	6	5	11
1998	11	6	18

It should be stressed again, that excessive government borrowings on the domestic markets diverted the nature of banking activities, directed almost exclusively towards servicing the state debt. High interest rate provided banks with safe profit, which discouraged their credit portfolio diversification.

External Borrowing: Towards a Debt Crisis

The budget deficit of described size, with under-developed capital markets, would usually put significant pressure on the Central Bank for increased money supply. But NBM has rejected such pressures. The exceptionally good situation in the world capital markets allowed Moldova to finance even very high deficits from external borrowings. Alternatively, it may be judged that the credibility of NBM was built on the basis of foreign financing of the deficit. Indeed, in 1996 net financing from abroad amounted to 5% of GDP in Moldova, while between 1994 and 1997, more than half of net average borrowing requirements were financed by external sources. The availability of external financing reflected the hope of international investors in the recovery of Moldovan economy, which outweighed even the fears related to the unsustainable internal and external positions. The interest rate paid on debt issued to external agents was significantly lower than on domestic markets, which led to excessive external borrowings.

The capital inflow also represented the mirror image of the constantly deteriorating trade balance of the country. As it was argued in the previous section, the trade balance is driven by the high share of private consumption in GDP. The major part of this consumption is the result of the budget deficit, most of the current account deficit being covered by external borrowings. The resulting debt accumulation is the main characteristic of Moldovan economy. The indebtedness rose from 14% of GDP at the end of 1993 up to 64% at the end of1998 (excluding energy debt). However, the most important sign of the unsustainability of macroeconomic policy is the speed of debt accumulation. While the rapid increase of indebtedness in 1998 was the result of currency devaluation, in 1997 this was theresult of shortsighted policies regarding the external indebtedness. Since the consumption is the driving force in this process, the share of FDI in capital inflow is insignificant. Foreign participation on the T-bill market was close to 40% at the end of1997. Obviously, this means also a pressure on the exchange rate, leading either to currency appreciation, or increased money supply (Central Bank buying currency in the forex market).

Table 2.4. External Debt by Creditors (million US$)

	1993	1994	1995	1996	1997	1998
Total debt (IMF included)	173.8	505.9	665.1	800.4	1030.1	999.4
Total public debt	86.4	343	434.7	552.6	796	823
Direct public debt	86.4	343	416.9	506	710.2	716.3
Multilateral creditors	59.3	158.4	203.4	221.1	257.1	293.4
World Bank	28.6	95.7	145.8	145.8	185.7	216.9
EBRD				0.3	5.2	6.1
EU	30.7	62.7	57.6	75	66.2	70.4
Bilateral creditors	19.8	162.7	177.3	173.9	155.7	157.4
Japan		29.7	37.8	33.4	30	33.7
Russia		93.4	90.3	78.8	64	62
USA	19.8	39.6	49.2	61.7	61.7	61.7
Commercial creditors			15	90.7	277.3	245.2
Commercial banks			15	60.7	32.3	30.2
Eurobonds				30	105	75
Gazprom					140	140
Commodity loans	7.3	21.9	21.2	20.3	20.1	20.3
Publicly guaranteed debt			17.8	46.6	85.8	106.7
Multilateral creditors			8.4	33.1	45.7	53.4
EBRD			8.4	33.1	45.7	53.4
Commercial creditors			9.4	13.5	40.1	53.3
IMF	87.4	162.9	230.4	247.8	234.1	176.4

As it can be seen from the above tables, Moldova is confronted not only with an increasing debt, but also with an unfavorable structure of that debt. Since Moldova repeatedly failed to achieve the conditionality criteria, IMF stopped disbursements in the mid 1997 and this decision was followed by the World Bank, which suspended its Structural Adjustment Loan II. Since 1994 the debt towards bilateral creditors has been fairly constant. In this situation the part of debt that was increasing at the fastest pace since 1996 was the short-term commercial debt. The proceedings from Eurobonds launched in 1996 (US$30m) and in 1997 (US$75m) were used only to cover the budget deficit. However, the most important and least controllable source of debt accumulation is the energy sector debt. Lack of restructuring inthis sector resulted in a large debt towards Gazprom (US$140 million in 1997 and US$90 million in 1998).

Additionally, the dependence on external financing induces a greater threat on macroeconomic stability than domestic financial obligations, as it makes the economy increasingly vulnerable to changes in perceived creditworthiness. Namely, the external debt payment stream is subject to:

- the risk of currency depreciation, which increases the debt burden;

- the risk of a shift in market sentiment, which determines the lenders to require higher interest rates to extend new credit for rolling over the existing debt (e.g. several treasury bills spikes across CIS that reflected the failing confidence preceding the Russian crisis);
- the risk of a negative impact of external financial crisis.

The risk of devaluation is extremely high when the external debt is high. The Asian crisis in the 1997 and especially the deterioration of the economic situation in Russia led to an explosive path of public debt. As a result, the financial adjustment burden for Moldova was getting higher and higher.

Servicing the Debt

The assessment about the volume of external borrowing must not be conducted separately from its utilization in terms of future income generation. The growth potential of Moldovan economy was not enhanced, as the funds were not directed to productive investments, but to the inefficient state sector. Moreover, borrowed money was not spent on structural reforms that would have limited the primary deficit of the budget. Externally financed government consumption possibilities undermined the incentives for reform implementation. Such a policy led to increasing difficulties of debt servicing. The cost of servicing the debt increased to 4.8% in 1998, from 4.2% in 1997.

Table 2.5. Debt Service versus Exports and State Revenues

Ratio between debt service and:	1993	1994	1995	1996	1997	1998
Exports	1	2	10	6	17	28
Government Revenues	2	6	18	9	25	42

Indeed if Moldova would have met all its obligations, the external debt service would have consumed 7.5% of GDP in 1997 and 8.7% in 1998. Serious problems with servicing the external debt appeared already at the end of 1997 (Figure 2.25). While social expenditures prove to be rigid, the increase of debt servicing costs leads to the collapse of the budget and to financial instability.

Moldova had to reschedule two credits from Russia (US$ 30 million) at the end of 1997, but in the course of 1998 it failed again to meet its obligations on this debt. The government also failed to honor some external guarantees. Payment arrears on energy supplies were developing particularly quickly and there is always the possibility that they will be converted into state debt under the pressure of energy resource suppliers. It is expected that repayments in future years will be so substantial that external financing will remain negative. As an indicator of country external exposure, the spread on Moldovan Eurobonds increased from 380 basic points to 800 at the end of 1997.

In fact, the external exposure of Moldova was already unsustainable in the first half of 1998, as the country ran into in a debt trap and liquidity crisis. Similar cases appeared in other transitional countries. The Hungarian crisis from 1994, for instance, led to the rebound of inflation. This situation came after 1993 difficulties, when the budget deficit grew to 7.6% of GDP, the public debt accounted for 17.9%, current account deficit increased to 9%, interest payments reached 4.5%, and external debt went to 64%. The 1995 crisis in Bulgaria had also its indirect roots in the accumulation of debt. The National Bank of Bulgaria tried to decrease the interest rates in order to alleviate the burden of debt service. In Russia, during the pre-crisis situation from 1997 the interest payments accounted for 5% of GDP, while public debt in GDP exceeded 60%. In Ukraine, in the eve of the crisis, the public debt represented around 30% of GDP.

The Crisis of 1998: Consequences and Policy Response

The first immediate effect of 1998 crisis for Russia was the loss of confidence of foreign investors because of government inability to service the accumulated public debt. However, the crisis had much deeper roots in the lack of structural reforms, and slow pace of privatization and restructuring. These drawbacks are an expression of the permanent weakness of the state with respect to its public finances. Consequently, the negative impact of Russian crisis was more severe in case of those countries where the same underlying problems have been present.

For Moldova, the lack of structural reforms translated into unsustainable internal and external positions at the end of 1997. Such a situation leads almost always to a financial crisis, unless rapid policy adjustments are undertaken. The turmoil that followed in 1988 the Russian crisis was for Moldova a catalyst that speeded up the collapse of its fragile monetary stabilization. The capital account losses (capital flight) brought the country to the verge of default. Unfortunately, the Russian crisis had actually a deeper impact on Moldovan economy, through the abrupt and probably persistent loss of major export markets, a situation that may affect the real economic activity over a longer time period.

Pressures on Balance of Payments

Moldova is a small open economy that is very sensitive to changes in its current account developments and international terms of trade. Unfortunately, the country's exposure increased in recent years, as one partner – Russia – intensifies its domination on foreign trade. In 1997, the exports to Russia accounted for more than 60% of total Moldovan exports, compared to only 35% at the beginning of the decade. This involution is the direct consequence of a slow process of restructuring in the economy, expressing at the same time the absence of any effort to diversify the export markets. Traditionally, Moldovan producers have benefited from a privileged access to relatively low competitive Russian markets. However, this situation has impeded the development of marketing skills of Moldovan enterprises, as well as the quality adjustment of goods. On the other hand, the exports to Russia have been politically promoted in order to cover the import of energy from this country. In-kind operations having a large share in total transactions with Russia induced further negative consequences on the investment possibilities of Moldovan producers. As a result, the dependence of the economy has been rising, which allowed Russia to enhance its terms of trade against Moldova; a significant part of negative shocks faced by Russian enterprises during the transition has been therefore transferred to Moldovan firms. Consequently, the 1998 crisis determined not only a fall of exports to Russia, but also lower prices paid by Russian importers for Moldovan products. Furthermore, the price decrease reduced the profit margins of Moldovan exporters. At the same time, the Russian supply of energy is done under less favorable conditions.

With this respect, the collapse of Russian demand for Moldovan products had a devastating medium-term impact on the economy. The crisis came unexpectedly and practically froze the exports to Russia, although the situation of exporters has deteriorated since the beginning of the year1998. In September 1998 alone the exports fell by almost 80% in comparison to the same month of the previous year and the situation did not improve until the end of the year. For the first time since early 1996, Moldova reported a negative trade balance with Russia.

As a result, the current account deficit accounted for 20% of GDP in 1998 in comparison to 14% in 1997 (Figure 2.28). The current account imbalances between 1995 and 1997 were coupled with surging capital inflows that increased twofold over the period. The change in the market sentiment following the Asian crisis, combined with the growing concern about economic developments in CIS countries, reversed the positive trend. As a consequence of Russian crisis, all countries in the region experienced dramatic outflow of private financing, with rising interest spreads on treasury bills. Private capital available to European emerging markets (especially CIS countries) shrank significantly. In response to the crisis, foreign investors in Moldova withdrew their funds, converted them into dollars, and left the market. Domestic entrepreneurs were ready to fake external trade contracts, in order to buy dollars, while Moldovan commercial banks became involved in speculations against national currency.

Such a rapid reversal was possible due to the improvement of capital account in recent years, fuelled exclusively by portfolio inflows. These inflows increased by more than 4 folds in 1997 compared to 1996, although this was an effect of only two large transactions done in the second quarter of 1997: Eurobond placement and securitization of the debt to Gazprom. Besides, non-resident played a significant role on the T-bill market. However, the portfolio investment proved to be very volatile. The reluctance to credit the Moldovan government started at the beginning of 1998 and culminated with the massive outflow of funds after the outbreak of Russian crisis. The withdrawal from the T-Bill market was estimated at US$ 30 million, followed by the redemption by NBM of US$30 million of the first Moldovan private placement, issued in 1996. The receipts from IMF (quite substantial in 1995 and 1996) dropped almost to zero in 1997 and 1998, due to the halt of EEF credit line. The difficulties with respect to the loan agreements led to negative financing from the World Bank in that period. New disbursements from IMF were not made until January 1999. At the same time, foreign debt payments to IMF alone required about US$70 million both in 1997 and in 1998.

As in many other countries, foreign direct investors proved to be the most stable source of capital inflow. In the first half of 1998 the growth of foreign direct investments in Moldova remained positive, although at a lower rate. In 1998 FDI was 20% higher than in 1997 (FDI increased threefold in 1997 in comparison to 1996). However, it should be noted that so far Moldova failed to attract substantial FDIs (only US$ 90 million in 1998) and even their steady inflow does not compensate the flight of portfolio investment.

The deterioration of the balance of payments induced a serious financial instability in Moldova, forcing the authorities to adjust their policy accordingly. Fostering such adjustments, while avoiding social reactions has been the major objective on the agenda of the new Government in 1999.

Exchange Rate and Foreign Reserves

The BOP deterioration has determined a strong pressure on the national currency. The crucial dilemma that NBM had to consider was whether to defend the currency or to allow the market forces to determine a new equilibrium exchange rate. Two main reasons drove NBM initial decision to maintain at any cost the stability of leu in nominal terms until November 1998. Firstly, the already substantial external debt: the high cost of servicing this debt would have risen above the financial capabilities of the government. Secondly, a stable national currency was the only visible sign of successful economic reforms in Moldova: the last five years NBM managed to gain credibility through exchange rate stability. The decision to devalue the currency was therefore seen as a risk to compromise the whole financial system, which could have led to massive sales of domestic currency and therefore to the collapse of the system.

Initially, NBM tried to maintain the exchange rate through substantial interventions on the foreign exchange market (Figure 2.16). Until November 1998 the leu was maintained at an artificially high level with very harmful impact on the stock of international reserves. Despite the huge amount of hard currency sold by NBM in September – October 1998, the exchange rate (leu/ US$) increased from 4.7 in August to 5 in mid October.

Such a policy response determined a widely spread criticism, as it was argued that the scale of Russian crisis made it impossible to maintain the existing exchange rate level. It should be also noted that between mid-August and the beginning of November the Russian ruble was devalued by 170% and the Ukrainian hryvna by 65%. A strong Moldovan leu meant therefore a real appreciation of leu against ruble, which contributed to the loss of Moldovan competitiveness on Russian and Ukrainian markets. In such a situation, the NBM policy proved to be unsustainable: the bank ignored the warnings expressed *inter alia* by IMF and continued its efforts to support of national currency, translated into substantial losses of international reserves. Even before the Russian crisis, an alarming sign was represented by the massive sales of hard currency on the Inter-Bank Foreign Exchange. For the first time since the introduction of the national currency, NBM net transactions at the Bourse were negative for seven months (January - July 1998). During this period, NBM sales exceeded by US$ 41million the overall amount bought on the market. Moreover, even after the crisis NBM intervened massively to defend the leu: only between August and October 1998 NBM wiped out of its reserves other US$ 81million. Consequently, gross NBM reserves (Figure 2.17) decreased from US$ 366 million at the beginning of 1998 to US$ 144 million at end of the year, i.e. by US$ 222 million (the difference comes from external debt service payments).

In the second half of October 1998 NBM decided to make another attempt to stabilize the leu raising the banks' reserve requirement from 8% to 25%. By this measure, NBM wanted to limit the demand for hard currency of the banks by diminishing their liquidity in national currency. NBM expected that the lack of lei cash would determine the commercial banks to sell hard currency on the Inter-bank market. But this did not happen and the currency continued to depreciate, approaching 6 lei per US dollars by the end of October. Consequently, starting with November 2nd, the NBM decided to stop selling hard currency at the Bourse, letting the commercial banks to determine the exchange rate by themselves. The withdrawal actually meant that NBM failed to meet the growing demand for hard currency. Since then, the official exchange rate is being set as a weighted average of the rates resulting from banks transactions for the previous day.

Facing the impossibility of commercial banks to meet the reserve requirement, NBM reduced the compulsory level to 15%, also requiring that 10% of total assets of the banks to be in the form of T-bills. Meanwhile, the national currency depreciated sharply from 6.40 lei/US$ on November 1st to 9.71 lei/US$ on December 1st, 1998. The exchange rate became then rather stable, mainly due to NBM strong enforcement of reserve requirements. Moreover, the leu knew a slight appreciation (8.32 lei/US$ on January 1st, 1999) and NBM managed to buy some US$ 16million. Then the depreciation started again, but at a slow pace. During 1999, the exchange rate overpassed 10 lei/US$, a new equilibrium of the market being set (Figure 2.6). The non-intervention policy of NBM proved therefore to be successful. This policy should be maintained in the future, since the main concern of the Central Bank need to be building-up of its foreign exchange reserves.

Deposits in the Banking System

The commercial banks passed relatively well through the crisis because there was no substantial currency forward exposure and the debt was not largely denominated in foreign currency. Still, many months after the outbreak of crisis the banking sector faced a serious lack of funds. The initial confidence in the leu, reflected by the high level of households' deposits in domestic currency was drastically reversed at the end of August 1998, when the Russian banking sector collapsed. This event induced strong depreciation expectations in case of Moldovan population: deposits in lei decreased from 746.7 million in January 1998 to 492.6 million in January 1999, while dollar deposits doubled during the same period, meaning that a large part of savings in lei were converted into hard currency deposits (Figure 2.19). Between August and October 1998, more than lei 250 million were withdrawn from banks, while lei 120 million were converted into foreign currency. The dollarization ratio of deposits has increased from 20% in 1997 to 44% in the end of 1998.

The Inflation

In 1998 the inflation rate showed a significant shrink compared to previous years, with four months of deflation that brought the inflation rate to only 0.97% within the period January-October. The deflation had a seasonal nature (falling prices of food), but also a monetary explanation. The cash in circulation shrank by about 25% in 1998, due to massive NBM withdrawal of lei in exchange of hard currency. However, the ulterior depreciation of leu re-fuelled the inflation. High dependence of Moldovan economy on imports, as well as the high level of dollarization, induced inflationary effects through the exchange rate movements. Prices of imported goods increasing proportionally to the exchange rate, the resulting inflationary impulse (substitution of foreign goods with domestic products, higher costs of manufacturing) increased the prices of domestically produced goods. The lower level of competition in the market - the higher the response of prices to the depreciation, so the monopolistic structure of Moldovan market made the price response immediate. Finally, depreciation induced higher tariffs for imported gas and electricity. It is important to note that a significant component of 1998 inflation was the money growth related to the NBM direct credit to the government in the fourth quarter of 1998 and at the beginning of 1999.

The T-Bills Market

As it was mentioned earlier, the volume of T-bills sales was continuously rising, but these developments were mainly the result of a wider participation of foreign investors on the market, rather than the growth of domestic financial resources. The crisis induced the collapse of demand for state securities. Foreign investors left the market despite the high attractive price of securities offered by the state. Traditionally, out of the total number of T-bills issued, 35% were bought by foreigners, 5% by local enterprises, and the remaining 60% by domestic commercial banks. As the sovereign rating of Moldova has been downgraded from "stable" to "negative", the external financing of the budget became impossible.

The returns on T-bills started to be converted into US dollars (also by domestic banks). The low demand for treasury securities induced serious difficulties in rolling-over the outstanding debt. No long-term securities were demanded, while the interest rate on shorter maturity increased sharply. In September, for instance, only 25% of T-bills offered for sale were bought. In order to alleviate the crisis of confidence, the government proceeded to a new issue of 7, respectively 14 days maturity T-bills (Figure 2.9). For the first time since 1995, the government was unable to redeem all T-Bills, and therefore unable to finance its outstanding commitments. The country was on the verge of default, no new loans from abroad being available.

In this situation, NBM had to direct a credit to the Ministry of Finance, with obvious negative impact on monetary aggregates. Since commercial banks were forced by NBM to hold a part of their reserves in T-bills (10% of total assets, later on - 5%), this helped the T-bill market to regain momentum. Year 1999 showed a slow recovery of demand for short maturity T-bills.

The External Debt Service

Devaluation means the raise of the external debt burden (i.e. dollar-denominated debt). Such a debt trap led in Latin American countries to the "lost decade" of economic stagnation. Similarly, such a considerable external debt generated the Russian crisis. In case of Moldova, where the devaluation is equivalent to a proportional increase of indebtedness, all interest and amortization payments that government needs to make require more domestic resources. This is because the tax revenues are denominated in lei, and they are not likely to rise in response to devaluation. The massive outflow of foreign investors from the market of securities (which makes impossible the rolling over of obligations), combined with the necessity to make payments in dollars, leads to a situation that is not far from the international default. The accumulated stock of external debt (including energy debt) reached US$ 1.4 billion on January 1st 1999, which represented more than 80% of country's GDP (Figure 2.24). The share of debt service to exports rose from 14% in 1997 to 23% in 1998, and this ratio could jump to 57% in 1999. In practice, Moldova is unable to service its external debt without a strong support from international organizations.

The Impact on Real Sector

According to the official forecast, 1998 was supposed to be the second year of economic growth in Moldova, with a real GDP increase of more than 3%. However, negative tendencies started to appear in the economy since the beginning of 1998. The bad harvest in agriculture, combined with the crisis that hit the economy in the second half of the year, led to a decline of real GDP by 8.6% in 1998 (Figure 2.1).

While in the first eight months of 1998 the industrial output fell by 2%, compared to the same period of 1997, in September the decline represented 32.5%. This fall was determined by the abrupt decline of Russian demand for Moldovan products. Virtually, all industrial sectors were damaged, including the leading agro-industrial complex, which shows unfavorable prospects for the future. Since the exports to Russia are not likely to recover to the level reported in 1997, this sector will not be able to stimulate the economy in the upcoming years. On the other hand, the reorientation of exports towards Western markets will require certain time. The same time constraint applies for quality improvement of exported goods and for adopting corresponding marketing strategies.

However, the impact of financial instability on the real economy will not be large, although high interest rates impede bank lending to the private sector and discourage fixed investments. Currency and banking crises implied, on average, an accumulated loss of 14% of GDP in 26 cases of crises in the emerging economies in the period 1975-1997 (IMF, 1998 data). In case of Moldova these effects will be limited by the less significant role of bank credits and low leverage of corporate sector. Moreover, a large share of transactions is conducted on a non-cash basis. However, if the development of financial markets slows down, the inefficiency in supplying the funds that are necessary for restructuring purposes may hamper the long run growth of the economy.

Impulses for Further Reforms

It might seem odd, but the Russian crisis had some positive influences on the economic reforms in Moldova. The crisis forced the authorities to start thinking about solving the fundamental problems of the country, mainly related to the lack of structural reforms. A critical situation makes the public more likely to accept the painful measures that are necessary to revert the negative tendencies accumulated in recent years. The fact that the state failed to deliver basic services is a credible reason for radical reforms; the population may indeed believe that the government has no other choice but to change immediately the situation. The large external debt makes the country fully dependent on the co-operation with international organizations, especially the IMF. It should be also noted that the developments of the crisis in Moldova were more similar to those in Ukraine rather than in Russia. Specifically, Moldova did not announce the default and the banking sector remained relatively stable. It may be therefore possible that the post-crisis evolution in Moldova will be close to the Bulgarian experience, where the financial crisis from 1997 induced the adjustment of economic policy with restrictive fiscal stance. The acceleration of structural reforms allowed Bulgaria to restore the growth in 1998, unlike Russia where the fiscal policy was further loosened, financial discipline weakened, and structural reforms abandoned.

A window opportunity for accelerating Moldovan reforms emerged therefore from the crisis, and the Sturza government approached more seriously the budgetary problems. The government adopted a relatively more austere (but not fully feasible) budget for 1999, prepared under the IMF recommendations. Significant institutional changes were also envisaged. The custom offices with Transnistria were introduced in order to fight the smuggling phenomenon. The unification of VAT regimes has been introduced since January 1st, 1999. At the same time, the Moldovan government committed to abolish non-cash tax payments.

Somehow surprisingly, the crisis may have also a positive impact on FDIs in a medium term perspective. Although the fall in confidence contributed to the deterioration of the economic situation, the cash stripped budget and the general fall in industrial production forced the policy makers to speed up the privatization process. As a result, the state started to seek for more reasonable prices for enterprises offered for sale, which determined the successful execution of some transactions. Previous governments were very reluctant to sell the state property and therefore only 20% of planned privatizations were concluded in 1997 and 1998.

Similarly, the decline of exports to Russia forced Moldovan enterprises to search new export possibilities. At the same time, the devaluation of national currency facilitates the penetration of non-CIS markets. Indeed, many companies are trying to enter non-traditional western markets, struggling to enhance its competitiveness and finding market niches. The Moldovan economy reports an improvement of trade with non-CIS countries and a declining significance of the exports to CIS-countries.

Table 2.6. Exports of Moldova to Selected Countries (US$ million)

	1998 Q1	1999 Q1	% change
Russia	104.6	32.2	-69%
Ukraine	12.6	7.2	-43%
Romania	13.0	9.4	-28%
Other Non-CIS CE economies	3.3	10.4	215%
Non-transition economies	31.0	31.4	0%
Total	176.0	100.6	-43%

Evolutions in 1999

Economic situation in the first nine months of the current year has been characterized by tendencies of stabilization, although a weak one, both at macro and micro levels.

According to CISR forecasts, real GDP is expected to fall by some 2.5% in 1999, resulting in a more than 40% drop in GDP since 1993. Thus, global domestic product recorded a 7.8% decrease in the first quarter, while for the first half of the year it was already 5.3%. It means, that the second quarter realized a real growth, which allowed to lower the drop in the first quarter. In January-September 1999 the decline in industrial production was 12.8% comparing to the same period of 1998 (for the first 3 months of 1999 the decline was 27%). Similarly, for the same period the agriculture production has diminished by 7% (for the first 3 months it was 11%).

Trade balance deficit of Moldova has significantly reduced in January-September 1999 reaching US$80.8m (for the same period of last year it was US$328m). For the first time in last years the second quarter showed a US$2.32m surplus in the BOP current account. CISR estimates indicate a US$70m trade balance deficit for 1999 (Figure 2.29) with a current account surplus at some US$10.

However, both exports and imports have shrunk considerably. Total exports in the first half of 1999 have decreased by 44% as compared with the same period of 1998. But the structure of exports does not show anymore a prevalence of a single market i.e. the Russian one. In 1998 exports to Russia accounted 59% of the total. At present, share of Russian market is only 38.4%, while 53.9% are exports to Central and East Europe. Now we can see that after the financial crisis the Moldovan exports managed hard to reorient towards more stable markets (Figure 2.30 and Figure 2.31). Export to the EU countries grew by 17.2%, to the Central and Eastern European countries – by 23%, while export to CIS countries decreased by 55%.

Essential changes showed the imports as well. During first six months of 1999, total imports have decreased by 56.3 %. In the structure of import there is no longer domination of CIS (40.1% of the total import). It is obvious that, although the total volume of import is decreasing, the structure of import shows a growing share of energy imports.

The new government managed to restore the collaboration with international financial institutions. In 1999 Moldova has received new loans from the IMF (US$35m+US$35m) and World Bank (US$30m+US$20m). Along with successful repayment of foreign obligations, there were also negations held regarding the rescheduling of some foreign debt. An extremely important step was the redemption by the government of securities issued to Gazprom, annihilating US$140m of the country's external debt.

Although the general expectations were more pessimistic, the steady evolution of leu in 1999 (letting alone the usual seasonality of leu, influence of political factors, or currency speculations), and particularly the remarkable stability of leu in June-September, proved the credibility of the monetary policy implemented by BNM. Thus, the bold CISR forecast of the end-year exchange rate as 11.58 lei/1 dollar (optimistic scenario, Economic Survey No. 3) set in April 1999 proved to be quite close to the reality. The nominal exchange rate showed a depreciation from 8.32 (1 January 1999) to 11.64 (21 December 1999) lei per 1 US dollar (Figure 2.6), therefore the end-year rate could well be at 11.7 lei per 1 US dollar. The evolution of the real exchange rate of leu followed the same path as the nominal one. Depreciation of leu in real terms is estimated to be close to zero in 1999.

Cumulative level of inflation for January-November 1999 was 36.9%, thus we could expect for 1999 an inflation rate at about 40%. Monetary aggregates started to increase again (Figure 2.12), after the considerable fall in the 4th quarter of 1998. Cash in circulation grew from 855 million lei at 1 January 1999 to 1074 million lei at 1 October 1999, i.e. by 25%. The inflationary part of this increase was as usual driven by NBM's loans to the Government, while the non-inflationary component was driven by purchases of hard currency surplus in the market done by NBM - US$54m during January-September. It should be stressed, that these interventions did not have a harmful impact on the exchange rate.

Broad money has increased by 40% in January-September, reflecting a 53% growth in deposits with banks. The share of deposits in foreign exchange continued to increase – dollarization of banks' deposits rose from 44% to 52% at the end of September (Figure 2.19). This shows still strong depreciation expectations in case of Moldovan population, which prefers to hold deposits in dollars. But this loss of confidence in leu is not accompanied by a similar attitude towards the banking system – a real proof to it is the overall increase in deposits.

With the beginning of 1999 a slow recovery of demand for T-bills (mainly short maturity ones) started. With the new Government in place since March 1999 and the new path of reforms, the confidence in the government's securities market has increased. Thus, there has been a continuous increase in the volume of T-Bills sold, along with the gradual decrease in interest rates. The volume of sales of T-bills during the first 9 months almost doubled – from 93 million lei in January to 195 million lei in September (Figure 2.11). During September-October the tendency of decreasing interest rates on T-bills took a firm stance, and only during 2 weeks the average rate fell two-folds reaching the level of 14.2%. The government took a bold stance refusing to increase the amounts of sold T-Bills (in spite of the growing demand for them in the market) and aiming at reducing the internal debt. Obviously, this could in the end lead to a more active involvement of commercial banks in crediting the real sector of the economy.

Table 2.7. Main Macroeconomic Indicators

	1994	1995	1996	1997	1998	1999e
Real GDP growth rate	**-30.9%**	**-1.4%**	**-7.8%**	**1.6%**	**-8.6%**	**-2.5%**
Nominal GDP (excl. Transnistria), lei million	4737	6480	7658	8917	8804	11926
Nominal GDP, USD million	**1164**	**1443**	**1665**	**1933**	**1630**	**1137**
GDP per capita, USD	322	400	463	538	454	316
Annual inflation rate (end period)	**104.6%**	**23.8%**	**15.1%**	**11.2%**	**18.3%**	**40.4%**
Average inflation rate	487.0%	30.0%	24.0%	12.0%	7.7%	38.9%
Consolidated general govt. revenues, lei million	1848	2556	2835	3473	3505	3607
Consolidated general govt. expenditures, lei million	2348	2993	3418	4165	3804	4230
Budget balance, lei million	-281	-437	-583	-692	-299	-623
Budget balance as % of GDP	**-5.9%**	**-6.7%**	**-7.6%**	**-7.8%**	**-3.4%**	**-5.2%**
Internal debt, million lei	270	477	737	940	1500	1700
Internal debt, USD million	63	106	158	202	180	145
Stock of foreign debt*, USD million	**627**	**765**	**921**	**1008**	**954**	**841**
Stock of foreign debt as % of GDP	53.8%	53.0%	55.3%	52.1%	58.5%	74.0%
New borrowing*, USD million	247	196	195	197	85	180
Debt servicing (principal+interest)*, USD million	24	65	54	141	174	324
NBM gross forex reserves, USD million	**180**	**257**	**314**	**366**	**144**	**202**
NBM reserves in months of imports of GFS	2.87	3.04	3.00	3.07	1.40	3.46
NBM net forex reserves, USD million	17	29	71	132	-27	28
Cash in circulation M0, million lei	**345**	**639**	**731**	**972**	**855**	**1100**
M2, million lei	676	1107	1292	1739	1357	1780
Broad money M3 (at current exchange rate), million lei	749	1244	1439	1929	1756	2502
Money multiplier	1.36	1.59	1.68	1.72	1.66	1.73
Dollarization of deposits	**18.2%**	**22.6%**	**20.7%**	**19.8%**	**44.2%**	**51.4%**
Monetization of the economy	15.8%	19.2%	18.8%	21.6%	19.9%	21.0%
End-year exchange rate, lei/1USD	**4.27**	**4.50**	**4.65**	**4.66**	**8.32**	**11.69**
Average exchange rate, lei/1USD	4.07	4.5	4.6	4.6	5.4	10.5
Nominal end-year annual appreciation(+)/depreciation(-), MDL/USD	–17.3%	–5.4%	–3.4%	–0.2%	–78.6%	–40.5%
Nominal end-year annual appreciation(+)/depreciation(-), USD/MDL	–14.8%	–5.1%	–3.2%	–0.2%	–44.0%	–28.8%
Real end-year annual appreciation(+)/depreciation(-)	+74.4%	+17.5%	+11.4%	+10.9%	–33.8%	–0.1%

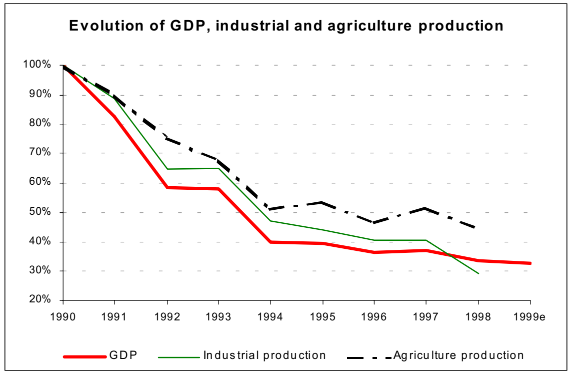
** Included loans from IMF, WB, EBRD, EU, USA, Russia, other creditors, Eurobond issues, but energy debt is not present here*

Table 2.8. Balance of Payments

USD million

	1994	1995	1996	1997	1998	1999e
Current account	**-92**	**-115**	**-188**	**-269**	**-333**	**11**
Current account, as % of GDP	-7.9%	-8.0%	-11.3%	-13.9%	-20.4%	1.0%
Trade balance	**-54**	**-55**	**-252**	**-345**	**-399**	**-70**
Exports (fob)	618	739	823	890	644	470
Exports, yr/yr	--	119.6%	111.4%	108.1%	72.4%	73.0%
Imports (fob)	672	794	1075	1235	1043	540
Import, yr/yr	--	118.2%	135.4%	114.9%	84.5%	70.0%
Services, net	-46	-96	-64	-62	-73	-60
Income, net	-16	-29	55	62	41	21
Current transfers, net	24	65	73	76	98	120
Capital and finance account	93	71	170	324	-2	-26
Direct Investment	18	73	23	71	86	80
Foreign direct investments, as % of GDP	1.5%	5.1%	1.4%	3.7%	5.3%	7.1%
Portfolio investment, net	0	0	54	237	-55	-131
Eurobonds	0	0	30	75	-30	0
Gazprom	0	0	0	140	0	-140
T-Bills	0	0	24	14	-35	5
Medium and long-term loans, net	157	73	101	11	40	25
Disbursement	175	131	133	101	83	110
World Bank	67	50	0	38	32	50
EBRD	0	5	34	23	15	20
Other official (EU, USA, Rus.)	108	49	46	13	21	20
Private creditors	0	27	53	27	15	20
Amortization	-18	-58	-32	-90	-43	-85
Other capital flows, net	-82	-75	-8	5	-73	0
Errors and omissions	-105	-10	17	11	24	0
Overall balance	-104	-54	-1	66	-311	-15
Financing	110	56	1	-66	311	15
Use of IMF credit	72	65	25	1	-64	3
disbursement	72	65	32	21	2	70
amortization	0	0	-7	-20	-66	-67
Change in NBM's gross reserves	-102	-77	-57	-52	222	-58
Debt arrears and rescheduling	140	68	33	-15	153	70

Figure 2.1



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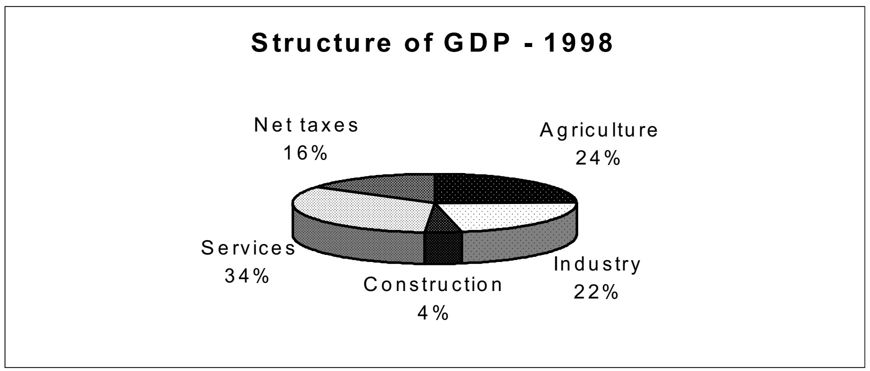

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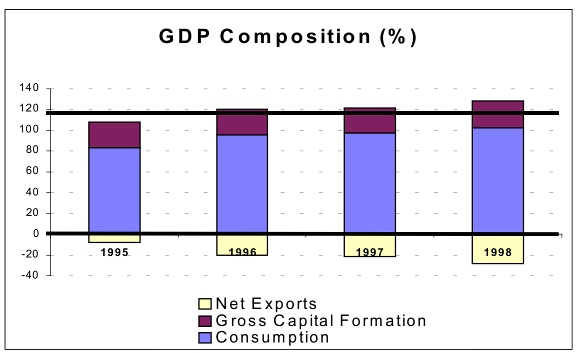

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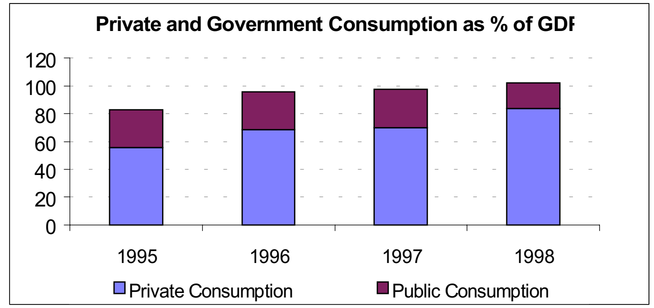

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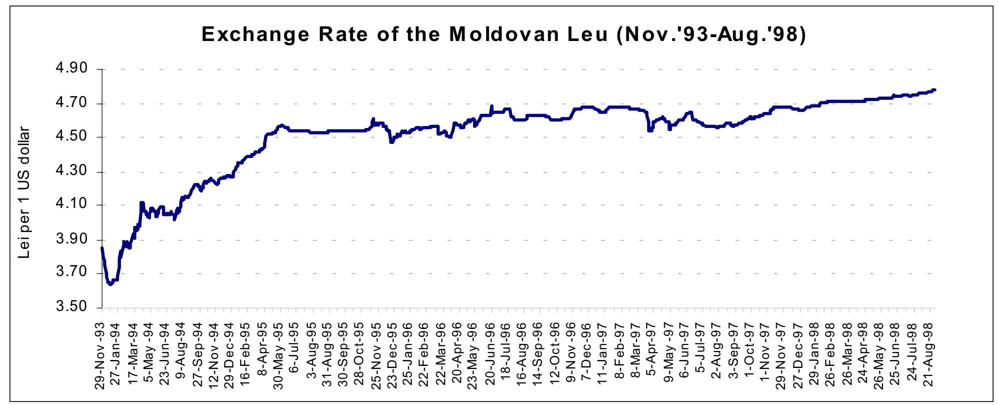

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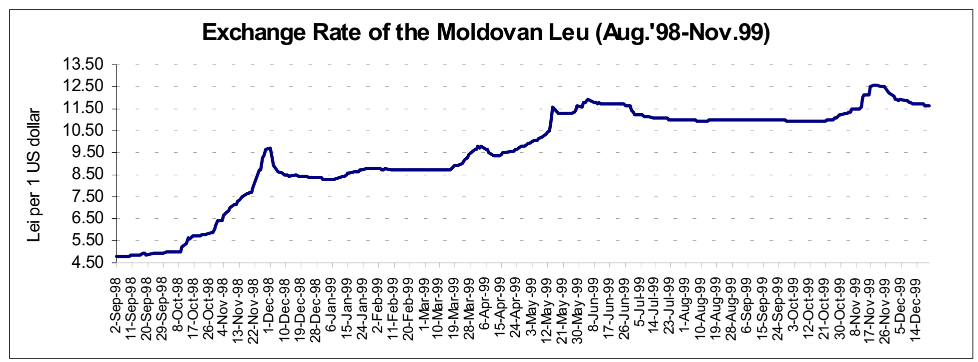

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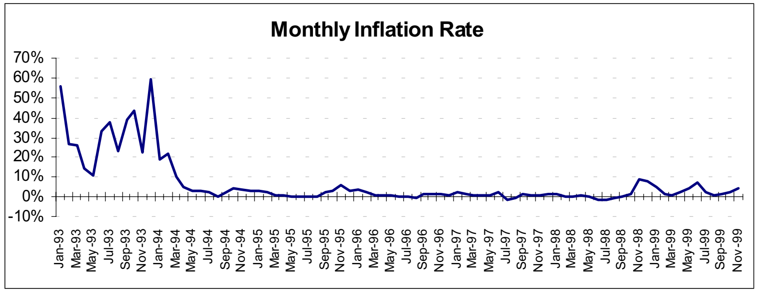

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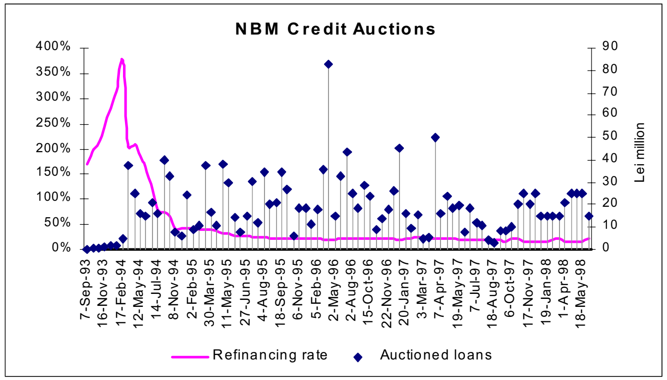

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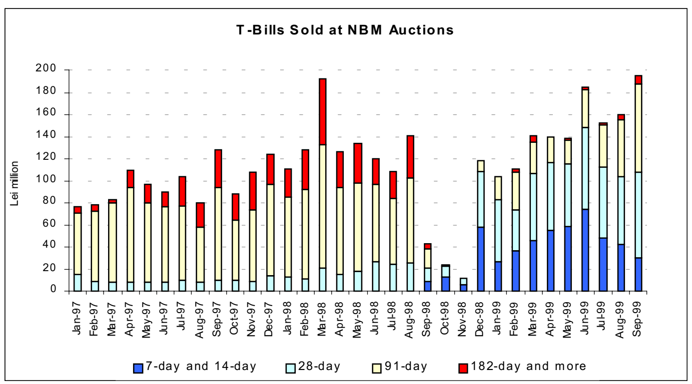

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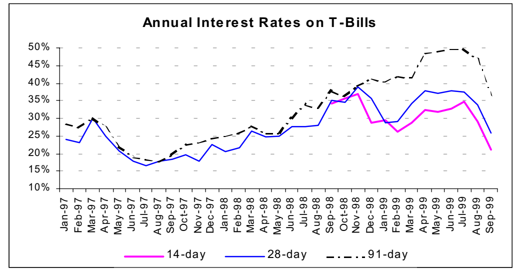

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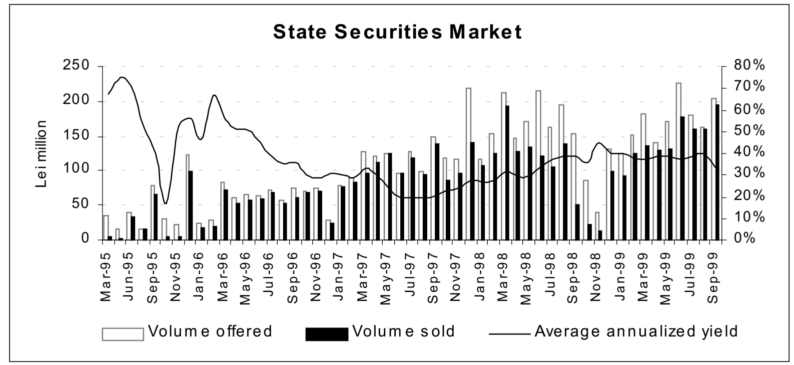

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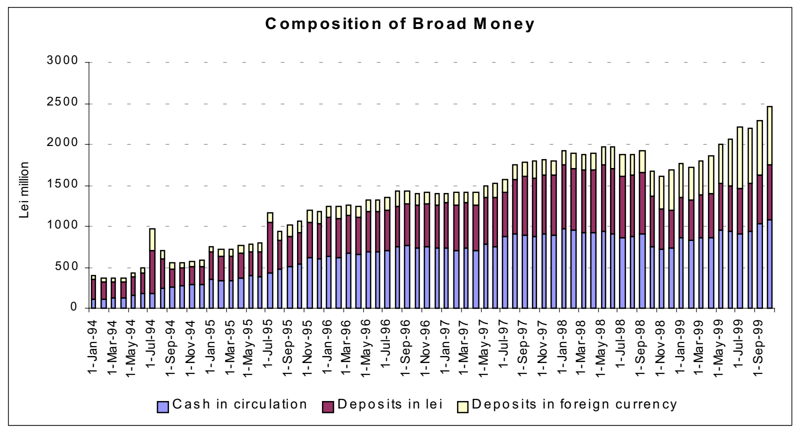

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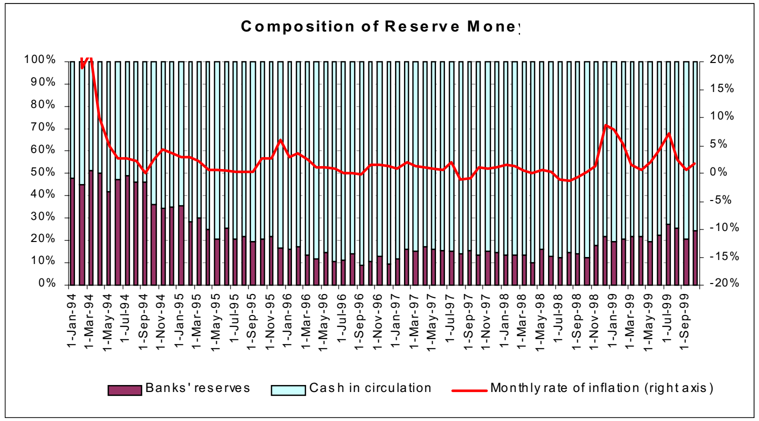

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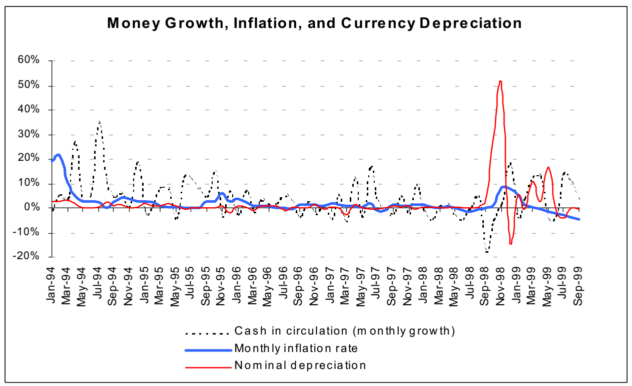

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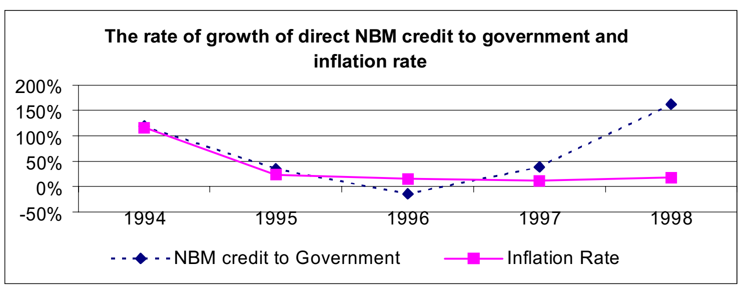

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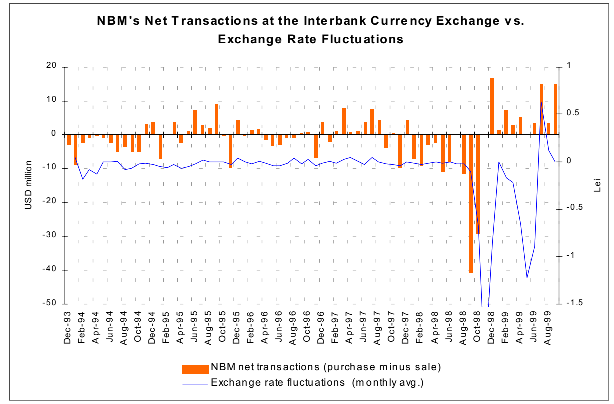

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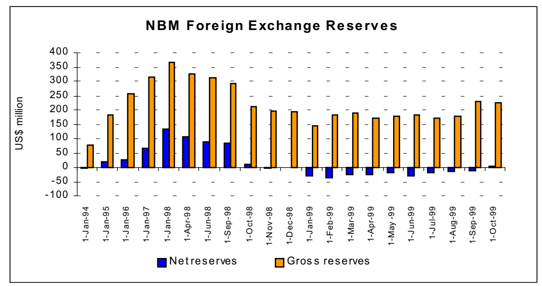

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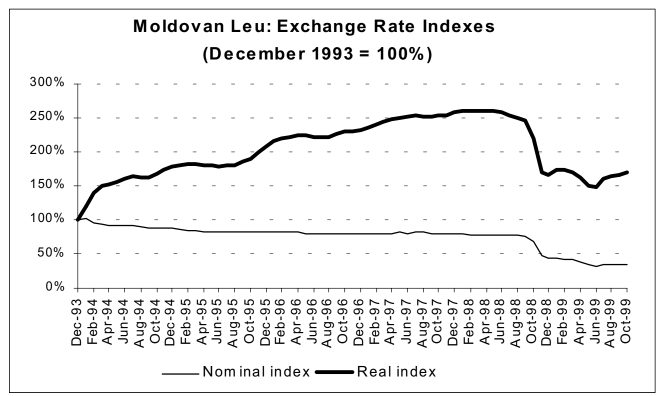

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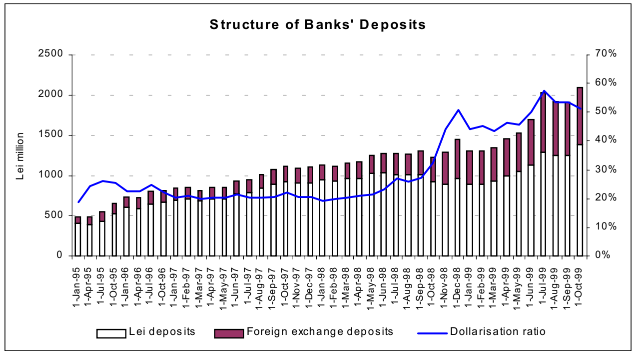

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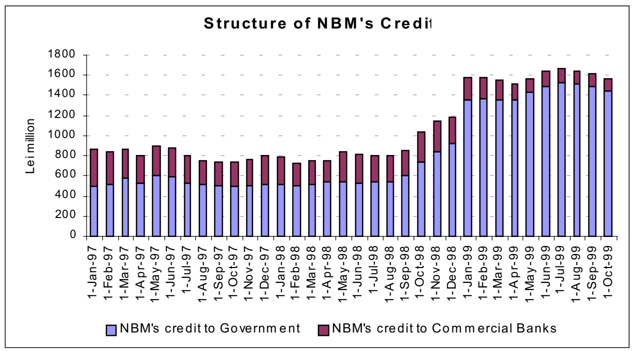

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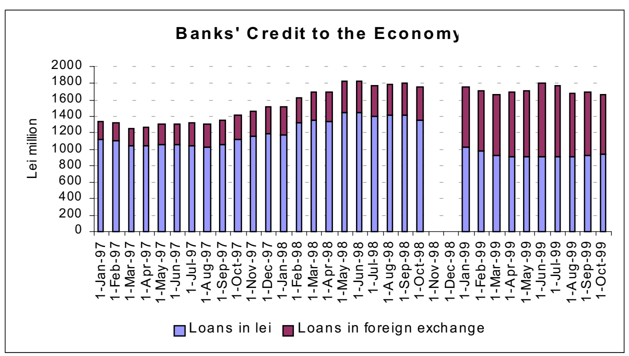

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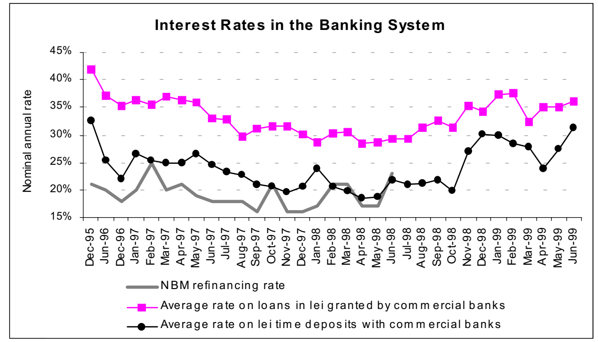

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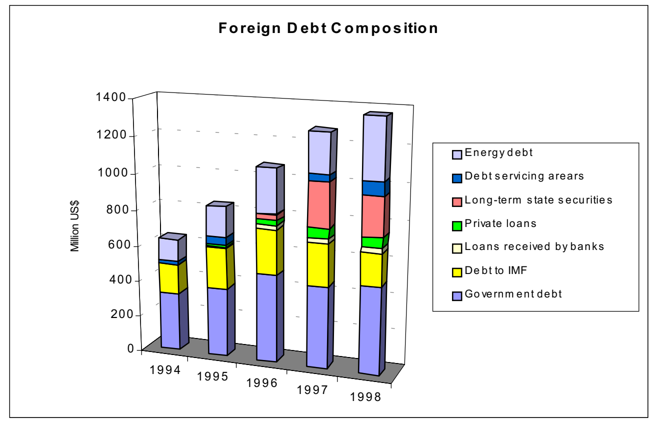

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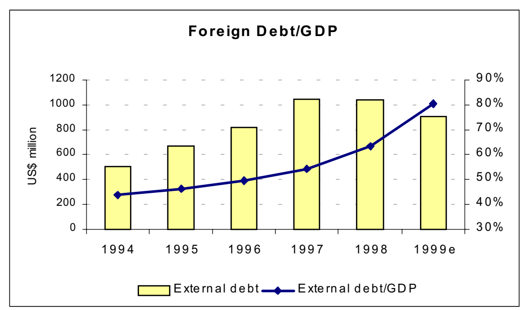

Figure 2.25

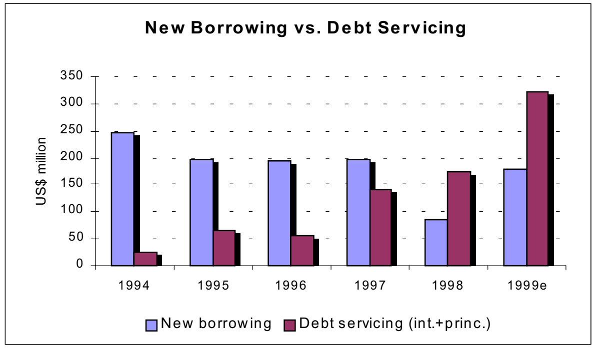

Figure 2.26

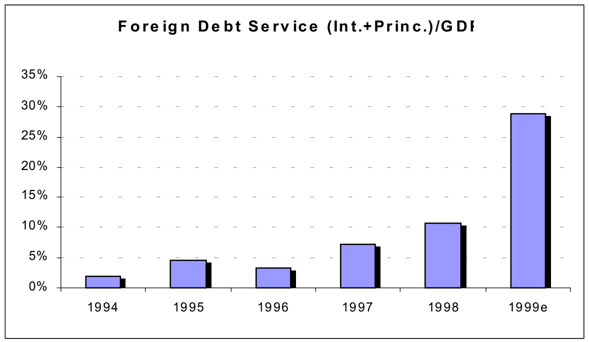

Figure 2.27

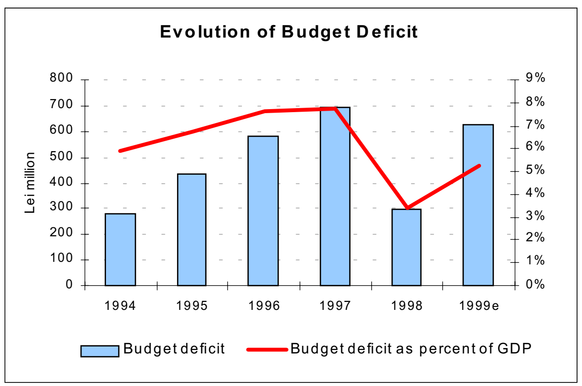

Figure 2.28

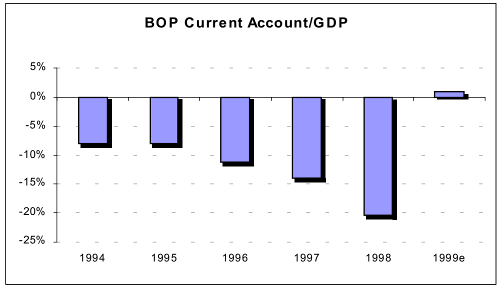

Figure 2.29

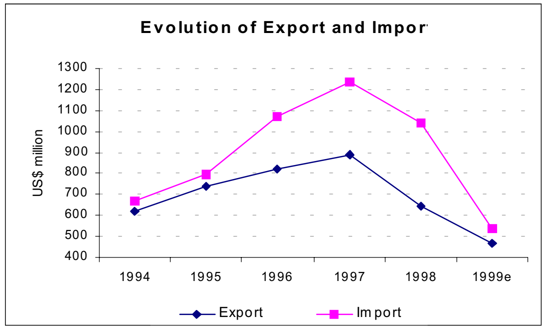

Figure 2.30

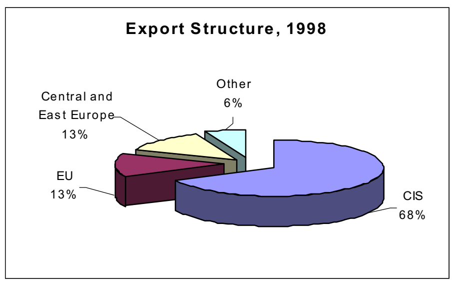

Figure 2.31