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INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT

FOR A

PROPOSED SECOND POVERTY REDUCTION SUPPORT CREDIT

IN THE AMOUNT OF

SDR 6.1 MILLION

(US$ 10 MILLION EQUIVALENT)

TO THE

REPUBLIC OF MOLDOVA

April 11, 2008

Poverty Reduction and Economic Management Unit
Europe and Central Asia Region

CURRENCY EQUIVALENTS
(Exchange Rate Effective March 31, 2008)
Currency Unit = Leu
US$1 = 10.6054 Lei

FISCAL YEAR
January 1 to December 31

WEIGHTS AND MEASURES
Metric System

ACRONYMS AND ABBREVIATIONS

AER	Annual Evaluation Report
BEEPS	Business Environment and Enterprise Performance Survey
CAS	Country Assistance Strategy
CEM	Country Economic Memorandum
CFAA	Country Financial Accountability Assessment
CIS	Commonwealth of Independent States
COA	Court of Accounts
CPAR	Country Procurement Assessment Report
CPIA	Country Performance Indicator Assessment
CRS	Control and Revision Service
DFID	UK Department for International Development
EBRD	European Bank for Reconstruction and Development
EGPRSP	Economic Growth and Poverty Reduction Strategy Paper
EU	European Union
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Services
FSAP	Financial Sector Advisory Program
FSU	Former Soviet Union
GDP	Gross Domestic Product
HIF	Health Investment Fund
IAS	International Accounting Standards
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFC	International Finance Corporation
IFI	International Finance Institutions
IMF	International Monetary Fund
I-PRSP	Interim Poverty Reduction Strategy Paper
JSAN	Joint Staff Advisory Note
LDP	Letter of Development Policy
MDGs	Millennium Development Goals
MOE	Ministry of Economy
MOF	Ministry of Finance
MOU	Memorandum of Understanding
MTEF	Medium-Term Expenditure Framework
NBM	National Bank of Moldova
NDS	National Development Strategy
NGO	Non-Government Organization
NPV	Net Present Value
O&M	Operations and Maintenance
PAD	Project Appraisal Document
PAR	Poverty Assessment Report
PEFA	Public Expenditure and Financial Accountability Assessment
PEMR	Public Economic Management Report
PER	Public Expenditure Review
PFM	Public Financial Management
PFR	Public Financial Review
PIP	Public Investment Program
PPF	Project Preparation Facility
PPG	Public and Publicly Guaranteed
PRGF	Poverty Reduction Growth Facility
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
PSIA	Poverty and Social Impact Analysis
QAG	Quality Assurance Group
RISP	Rural Investment and Services Project
SAC	Structural Adjustment Credit
SCAs	Savings and Credit Association
SDR	Special Drawing Rights
SIDA	Sweden International Development Agency
SME	Small and Medium Enterprise
SOE	State-owned Enterprise
TA	Technical Assistance
TTFSE	Trade and Transportation Facility for Southeast Europe
UNDP	United Nations Development Program
VAT	Value-Added Tax
WTO	World Trade Organization

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REPUBLIC OF MOLDOVA

PROPOSED SECOND POVERTY REDUCTION SUPPORT CREDIT

CREDIT SUMMARY

Borrower:	Republic of Moldova
Amount:	SDR 6.1 million (US$10 million equivalent)
Terms:	Standard IDA Terms, with 40 years maturity, including a 10-year grace period

Objectives: The proposed Second Poverty Reduction Support Credit (PRSC2) for the Republic of Moldova is intended to bolster and deepen the reform efforts supported by the first PRSC (PRSC1). The proposed credit aims to support Government's efforts to accelerate shared economic growth and improve governance by addressing the efficiency of its expenditure programs and public administration – key elements in poverty reduction. To this end, the proposed PRSC2 will continue to support selective areas of the Government's reform agenda, as outlined in the National Development Plan (NDS) – the successor to the Economic Growth and Poverty Reduction Strategy Paper (EGPRSP) – and the European Union (EU)-Moldova action plan. The proposed PRSC2 also complements and reinforces other Bank Group programs in Moldova, the International Monetary Fund (IMF)-supported Poverty Reduction Growth Facility (PRGF) and other donor activities. The PRSC2 will support the Government's objectives of:

Improving the Investment Climate. Sustaining and accelerating future growth and poverty reduction in Moldova will depend on increases in domestic productivity which, in turn, will depend on the extent to which firms and farms address current low levels of investment and innovation. This, in turn, depends on the quality of governance and the business environment. The Government's reform agenda focuses on further improving the investment climate for private sector development. These efforts will also directly contribute to Government efforts to improve governance and reduce corruption. An important element of Moldova's efforts to accelerate economic growth and poverty reduction will be improving the performance of the agriculture sector. Similarly, reducing destabilizing economic impacts of external energy price shocks will require improvements in energy efficiency.

Improving the Efficiency and Management of Public Resources. Better governance and public institutions are central to growth and poverty reduction. The Government is conscious of the constraint imposed by the insufficient functional and institutional adaptation of the public administration to the requirements of a market economy. Advancing reforms that establish a modern and efficient public administration is necessary in order to achieve the country's longer-term development outcomes. Increased public investment spending, particularly in public infrastructure, will be needed in order to support Moldova's private-sector led growth. This will require enhancing the strategic allocation of public resources by improving the Medium-Term Expenditure Framework (MTEF) process, public procurement practices and including better public investment management. Reforms in a number of key sectoral areas can also improve the efficiency of public resource use, allowing for spending reallocation towards public investment.

Strengthening Pension and Social Assistance Systems. While the recent slowdown in poverty reduction - as well as the impact of the drought on rural poverty - highlights the need to improve the quality of growth in Moldova, it also points to the need to strengthen existing social safety nets. The second PRSC would support the Government's efforts to strengthen the effectiveness and future fiscal viability of the pay-as-you-go pension program by supporting efforts to complete the 1999 pension reform, including efforts to unify the pension system for all types of pensioners. With higher energy and food prices likely to persist for some time to come, improving targeting efficiency of social assistance programs and gaining efficiency in program administration will be necessary elements of Moldova's poverty reduction efforts.

Benefits: Benefits are: (i) improved business environment and investment climate, which directly contributes to changing the quality of growth and poverty reduction in Moldova by stimulating the development of a stronger privates sector supply response; (ii) a more professional civil service combined with increased transparency and accountability of public finances with improved public expenditure management and strategic allocation of resources enabling an increase in current low levels of public sector investment, particularly in rapidly deteriorating public infrastructure; (iii) strengthening existing social safety nets for vulnerable groups by completing the 1999 pension reform and improving the targeting efficiency of social assistance programs.

Risks: Primary risks to the proposed PRSC2 include: (i) looming elections which may rupture the political consensus that has developed behind the Government's ambitious reform program; (ii) low implementation capacity at the central and decentralized level, though dovetailing the PRSC2 with other Bank Group operations and donor activities that provide support to capacity building helps mitigate this risk; (iii) destabilizing external shocks, such as another drought, volatile energy and food prices as well as trade restrictions imposed on Moldova exports, could affect economic growth, undermine public finances and delay implementation of poverty reduction measures in the Government's reform program. The PRSC2's support to prudent fiscal policy and medium-term budget planning, combined with an IMF PRGF program and increased donor support, help mitigate these risks.

Schedule of Disbursements: The proposed credit, SDR 6.1 million (US$10 million equivalent) will be disbursed in total upon effectiveness of the credit.

Poverty Category: This is a poverty focused operation.

Rate of Return: N/A

Project ID Number: MD-PE-P103941

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REPUBLIC OF MOLDOVA
POVERTY REDUCTION SUPPORT OPERATION

PROGRAM DOCUMENT

I. INTRODUCTION

1. This program document proposes a single-tranche Second Poverty Reduction Support Credit (PRSC2) to the Republic of Moldova for SDR 6.1 million (US$10 million equivalent) on standard International Development Association (IDA) terms. The PRSC program is an integral part of the Bank's strategy to support the implementation of Moldova's National Development Strategy (NDS) – the successor to the Economic Growth and Poverty Reduction Strategy Paper (EGPRSP) - as well as the EU-Moldova Action Plan. The continued support for poverty reduction through programmatic lending is consistent with Moldova's level of institutional, economic and political development and acknowledges the country's strong and sustained economic and policy performance in recent years. The PRSC program is intended to support the Government's efforts to improve the quality of governance and promote the efficiency of public expenditures and public administration. PRSC2 is the second in a series of three single tranche operations that would continue to support the implementation of cross cutting reforms aimed at improving the living conditions of the Moldovan population.

2. Recent developments highlighting Moldova's undiversified economy and its vulnerability to external shocks – a Russian ban on Moldova wine imports, a doubling of energy prices, and a crippling drought - have reinforced the Government awareness that the quality of economic growth and poverty reduction needs to be changed. To accelerate economic growth and poverty reduction, the three pillars of the PRSC program support the Government's efforts to: i) improve the investment climate so as to stimulate a greater private sector supply response; ii) increase the efficiency and improve the management and allocation of public sector resources to create fiscal space for increased public investment spending; and, iii) strengthen social protection systems to better protect the poor and vulnerable groups.

3. Bilateral and multilateral donor assistance will continue to play an important role in supporting the implementation of the NDS and EU-Action Plan. The PRSC program is also an important step to further the principles of harmonization, by providing a framework for policy dialogue and decisions linked to progress in the implementations of the critical areas of the NDS. In support of the NDS, the PRSC2 has created the momentum for a significant group of donors to align their budgetary support under a common framework. As with the first PRSC, the second PRSC will be supported by financing from the United Kingdom Department for International Development (DFID) and the Dutch Government. There has been a high degree of coordination with the EU in the context of the European Neighborhood Policy Initiative.

II. Country Context

A. Recent Economic Developments

4. ***External Shocks and Economic Performance***. Growth has averaged around 5.5 percent per annum since the economic recovery began in 2000. Moldova's economic performance over the last two years, however, has been dampened by a number of external shocks. In early 2006, Russia banned the import of wine from Moldova. As wine exports to Russia represent some 25 percent of Moldovan exports (or about 10 percent of GDP), this ban had a negative impact on the real sector of the economy. Over the same period, the economy, which is completely dependent on imported energy, has also had to cope with the doubling of natural gas prices by Russia's Gazprom. Most recently, in the summer of 2007, the Moldovan agricultural sector – representing 14 percent of GDP - was severely affected by a drought with losses in the sector estimated at nearly 30 percent of production. As a result of these shocks, real GDP growth slowed to 4 percent in 2006 and it is expected that growth will remain around 5 percent in 2007.

5. Since the recovery began in 2000, GDP growth in Moldova has largely been driven by domestic household consumption and construction fueled by massive inflows of workers' remittances – estimated at 37 percent of GDP in 2007. There are encouraging signs, however, that the earlier model of consumption-driven growth is changing with private investment growing as a share of GDP – reaching over 22% of GDP in 2007. While public investment has also increased in recent years, it remains low with the result that public infrastructure, particularly roads, has continued to deteriorate. Over the medium-term, the NDS recognizes that Moldova will need to generate a stronger and more robust domestic supply response with future gains in productivity requiring increased private and public investment.

6. The large inflow of remittances has contributed to appreciation pressure on the real and nominal exchange rate. The National Bank of Moldova (NBM) has actively intervened in the foreign exchange market and has been rapidly accumulating foreign exchange reserves. To rein in the monetary impact of these interventions – and inflationary pressures – the NBM has sharply increased its sterilization efforts since 2005 to slow reserve money growth. The significant increase in energy prices since 2005 and the impact of the drought on domestic food prices has complicated the NBM goal of reducing inflation to single digits. Inflationary pressures in the economy have persisted over the last two years with average prices increasing by nearly 13 percent in both 2006 and 2007.

7. **Prudent Fiscal Policy**. Despite the external shocks, the Government has demonstrated a strong commitment to maintaining its prudent fiscal stance. General Government revenues and expenditures have increased by close to 2 percentage points of GDP in each of the last two years reaching around 43 percent of GDP in 2007 (much higher than most countries with similar levels of income). Robust revenue performance and expenditure constraint resulted in a small budget surplus (0.2 percent of GDP) in 2006 and a small fiscal deficit (-0.3 of GDP), above the IMF program targets of a -0.5% deficit.

8. In early 2007, the Government undertook a major reform of its corporate income tax (CIT) regime with purpose of stimulating investment. Starting in 2008, companies are exempt from corporate tax on reinvested profits (i.e. a zero rate for the CIT, except for dividends and non-business expenses). At the same time, the package of measures also granted a fiscal amnesty

for the tax debts of companies up to the start of 2007, a liberalization of capital repatriation rules. Personal income taxes have also been reduced, with the highest marginal rate declining from 32 percent to 20 percent.

9. On the expenditure side, spending on health, education and social protection comprise nearly two-thirds of total government expenditures - increasing by nearly 8 percentage points of GDP since 2000. While fiscal surpluses and debt rescheduling has allowed the public interest burden to decline considerably (interest payments have fallen to 1.3 percent of GDP in 2007 compared to 6.4 percent in 2000), increases in public sector wages (from 8% of GDP in 2004 to 9.5% in 2007) have put pressure on the budget. After many years of neglect, public expenditures on capital and operation and maintenance of basic infrastructure are still insufficient to prevent the continued deterioration.

Table 1. Moldova: Macroeconomic Framework, 2004–2009

	Actual			Estimated	Projected	
	2004	2005	2006	2007	2008	2009
Real GDP growth (%)	7.3	7.5	4.0	5.0	7.0	8.0
CPI Inflation (average, %)	12.5	11.9	12.7	12.6	11.4	7.9
Exchange rate (average, MDL/$)	12.3	12.6	13.1	..	..	..
Real effective exchange rate, %	13.1	-1.3	0.0	11.0	16.3	8.5
Revenues and grants, % of GDP	35.4	38.6	40.5	43.3	41.1	40.5
Expenditures and net lending, % of GDP	34.7	37.0	40.3	43.6	41.6	41.0
(of which): % of GDP						
Education	6.8	7.2	8.2	8.3	8.4	7.9
Health	4.2	4.2	4.8	5.1	5.6	5.7
Social Fund	8.7	9.8	9.9	10.2	10.7	10.6
Wages	7.8	8.2	9.4	9.5	9.4	9.2
Interest Payments	1.9	1.2	1.0	1.2	1.2	0.9
Primary balance (cash), % of GDP	2.6	2.6	1.3	0.9	0.7	0.4
Overall balance (cash), % of GDP	0.7	1.3	0.2	-0.3	-0.5	-0.5
Current account balance, % of GDP	-2.7	-10.3	-12.0	-9.7	-10.3	-10.8
Gross official reserves (months of imports)	2.1	2.2	2.2	3.0	3.2	3.6
Total External debt/GDP, %	63.8	56.2	57.4	58.8	55.0	53.4
External Arrears (millions $US)	50.6	56.0	0.0	0.0	0.0	0.0
Debt service/Exports of GNFS, %	21.0	16.5	18.7	8.8	11.2	13.3
Public Debt service/central govt. revenues, %	5.4	8.6	8.8	6.2	6.3	5.0

Sources: Moldovan authorities and IMF and Bank Staff estimates and projections. Fiscal accounts are for those of the general government.

10. **Remittances Dominate External Sector**. Moldova is a very open economy with exports and imports amounting to nearly 50 and 100 percent of GDP respectively. Nearly 60 percent of Moldova's exports are in the form of agricultural products (including from the agro-processing industry) and predominately from the wine and beverage sectors. Though the direction of trade has been slowly redirected towards the EU (and this trend accelerated with the recent expansion of the EU), this transformation has been much slower than in other transition countries.

Moldova's vulnerability to external trade shocks has been amply demonstrated in the last two years, as has the ability of the economy to adjust to those shocks.

11. The remittance-fueled increase in consumption as well as higher energy prices have resulted in a rapid growth of imports (averaging nearly 25 percent since 2005). Export growth has averaged only 14 percent since 2005, reflecting the impact of Russia's ban on Moldovan wine in 2006 (exports grew at 0.5 percent in 2006). While this ban persisted into 2007, exports rebounded growing at nearly 25 percent. The trade deficit, exceeding 50 percent of GDP in 2007, has largely been offset by the large inflows of workers' remittances. As a result, the current account deficit has been more modest, averaging slightly less than 6 percent of GDP since 2000. Capital inflows have permitted a rapid growth in international reserves, increasing from 2.1 months of reserves in 2001 to 3.0 months in 2007 (the IMF program target).

B. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

12. A satisfactory macroeconomic framework has remained in place. The IMF Executive Board concluded the third review of the three-year arrangement under the SDR 110.9 million Poverty Reduction and Growth Facility (PRGF) on March 12, 2008.

13. Despite consecutive external shocks (wine ban, energy prices increases, drought), the economy has done remarkable well. While these shocks have contributed to an economic slowdown compared to the performance experienced over the 2001-2005 period, real GDP growth has remained positive and the economy is expected to rebound in 2008. Nonetheless, the economy will be subject to a number of continuing pressures:

- *Global uncertainties*. Moldova has become increasingly integrated with the global economy with remittances flows dominating the external sector. The heavy reliance on remittance flows exposes Moldova to greater risks in the event of an external downturn. These risks are compounded by the lack of product and market diversification in external flows.
- *Energy and food prices*. As per the agreement reached with Gazprom, energy prices will continue to increase over the next five years until they are at market (i.e. European) levels. The coming increases in natural gas prices will force further adjustments in an economy that still is inefficient in its energy use. While Moldova is a net food exporter, higher international food prices could increase poverty rates among net food consumers and insofar as Government policy discriminates against net food producers, could undermine agricultural development.
- *Climate Change*. The 2007 drought had a significant impact on agricultural producers. While the sector has been declining in relative importance (shrinking as a share of GDP), it has generally underperformed relative to other sectors and, hence, it has been a drag on overall economic growth. While the drought will have some lingering effects on the sector in the first part of 2008, the effect of the drought on real GDP growth is expected to be relatively short-lived. Nevertheless, future weather-related events pose a continuing risk to the sector and, hence, overall economic growth.

14. Despite these risks, strong consumption growth and the expansion of investment activity suggest an improvement in medium-term growth prospects with real GDP growth of 7 percent expected over the 2008-2009 period. Over the longer term, there is a risk that, with nearly a

quarter of the labor force already working abroad, Moldova's remittance driven growth will be difficult to sustain. Further, it will become increasingly difficult to generate past growth in labor productivity since the opportunities provided by labor shedding and factor reallocation in the economy are gradually being exhausted. The vulnerability to external shocks highlights the need to generate a stronger domestic supply response and resource reallocation by increasing investment, innovation and exports. There are encouraging signs that Moldova's model of consumption-driven-growth is already beginning to shift. Domestic private investment has increased from 14 percent of GDP in 2003 to roughly 22 percent of GDP in 2007. Foreign direct investment has also accelerated from 3 percent of GDP in 2003-2004 to 6-7 percent of GDP in 2005-2006. The preliminary estimates for 2007 suggest that this figure is now over 10 percent of GDP.

15. The macroeconomic framework which underpins the authorities' program aims at gradual disinflation in the coming years. The fiscal program has the objective of supporting disinflation efforts of tighter monetary policy while allowing the Government some room to meet the country's extensive developmental needs. The strong inflow of foreign exchange complicates the conduct of monetary policy, given the reluctance of the authorities to see the exchange rates appreciate. Further real appreciation, however, appears unavoidable in the face of growing foreign exchange inflows and, hence, more exchange rate flexibility will be needed to ease inflationary pressures. Given that the exchange appears to be undervalued, there is some scope for further appreciation without raising significant concerns about price competitiveness.

16. On the external front, higher energy prices, the consumption-driven increase in imports and the impact of the wine ban on exports have resulted in a significant widening of the current account deficit in since 2005, reaching 12 percent of GDP in 2006. In the first part of 2007, export growth has been quite resilient (growing by 32 percent) which, along with the significant increase in workers' remittances, has resulted in some moderation of the current account deficit. More moderate economic growth - which will slow import growth – combined with the development of alternative export markets will help improve the current account deficit in the next few years. Sizable capital and financial inflows have enabled the NBM to build international reserves towards the program target of 3 months of imports. The second PRSC along with financing from the IMF, the European Union (EU) and other multilaterals and bilateral donors will provide Moldova with sufficient external funding to meet its financing needs.

17. **Debt Sustainability**. Moldova's debt situation has continued to improve. Prudent fiscal policy, rapid economic growth, appreciation of the US dollar with respect to other currencies (SDR, Euro, Yen), net repayment to creditors and favorable rescheduling operations (covering about 33 percent of the debt stock) have resulted in a rapid decline in the ratio of total external debt to GDP – falling from 124 percent of GDP in 2000 to around 59 percent in 2006. Public and Publicly Guaranteed debt (PPG) amounted to around 24 percent of GDP at end-2006 (down from 65 percent of GDP in 2001). External public debt is largely on concessional terms with the preponderance of debt owed to multilateral lenders. Domestic currency public debt is modest at less than 9 percent of GDP. Private debt has been growing, with loans associated from FDI becoming important – disbursements from FDI-linked loans comprise over 67 percent of new

private borrowing. As of end-2006, private sector debt and energy arrears are approximately 33 percent of GDP.[1]

18. A recent debt sustainability analysis (see Board Document Number IDA/SecM2008-0141, February 13, 2008) suggests that Moldova's debt outlook remains favorable, with a low risk of debt distress. Public debt and debt-service to revenue ratios are well below the appropriate thresholds in both the baseline and "historical" scenarios. In the face of some severe external shocks, the Moldovan authorities have maintained policies that have not allowed the debt situation to deteriorate. Commitments by the Consultative Group and the Millennium Challenge Corporation show improved the prospects for official donor assistance thereby bolstering debt sustainability.

Table 2. Public Debt Burden Indicators

	Thresholds /1			
	Weak	Medium	2007	2008-27 /2
NPV of external debt in percent of				
Exports	100	150	46.8	16
GDP	30	40	21.8	8.4
Revenues	200	250	54.2	26.2
External Debt Service in percent of				
Exports	15	25	3.9	1.1
Revenues	25	30	7.5	2.4

1/ Policy-dependent thresholds as used in the joint IMF-World Bank LIC DSA framework for weak or medium performers. Moldova's ratings have recently improved to medium, with classifications based on three-year moving averages
2/ Simple average.
Source: Joint Bank –IMF Debt Sustainability Analysis, February 13, 2008

C. Poverty Profile

19. Moldova's economic recovery since 2000 has led to a massive movement out of income poverty, though poverty reduction has recently stalled. Between 1999 and 2004, over 40 percent of the population moved out of poverty representing the largest absolute decline in the ECA region over this period. The fall in absolute poverty was broad-based, as poverty decreased throughout all locations.

20. Between 2004-2005, however, overall poverty increased despite sustained economic growth, underpinned by rising rural poverty. The increase in rural poverty coincided with stalled farm restructuring characterized by a slight reversal of the amount of land used by individual farms in 2002 and 2003. The delay in restructuring farms and getting land into the hands of individual farmers—which have been shown to be more efficient than large, corporate farms—has had an adverse affect on agricultural output and farmer incomes. By keeping 50% of land tied up in inefficient corporate farms, the land available to family farmers is reduced, which in turn reduces their income-generating opportunities and often restricts them to practicing subsistence agriculture. With few opportunities, many smallholders have no alternative but to rent their land at low rates to corporate farms, which usually pay in kind, and often do not pay at

[1] These energy arrears reflect the stock of historical debt from unpaid energy bills that accumulated in the 1990s between Moldovagaz and suppliers. It totals $320 million at the end-2006.

all. This further constrains incomes of smallholders. In addition, distortions and imperfections in agricultural output and input markets reduce the scope for farm restructuring and rural poverty reduction. Analysis shows that agricultural producers are receiving less for their outputs and paying more for their inputs relative to international parity prices than they should.

Table 3 – An Overview of Poverty in Moldova

	2000	2001	2002	2003	2004	2005	2006*
Poverty headcount	67.8	54.6	40.4	29.0	26.5	29.1	30.2
Poverty gap	27.0	19.3	12.4	7.3	6.8	8.0	7.9
Poverty severity	13.7	9.1	5.2	2.7	2.5	3.2	3.0
Large Cities			16.5	12.8	6.9	5.9	20.6
Small Towns			46.8	42.4	34.9	34.2	30.1
Rural Areas			45.1	31.1	31.2	36.0	34.1

Source: National authorities.

*These numbers are not strictly comparable with data from previous years as explained in the main text.

21. Poverty data for 2006 drawn from the Household Budget Survey (HBS) have recently become available. However, methodological improvements and revisions to the HBS prevent the analysis of poverty trends through 2006.[2] Nonetheless, the 2006 data indicate that a third of the population still lives in poverty and poverty remains very much a rural phenomenon. In urban areas, for example, the poverty headcount is 20.6 percent while in rural areas it is 34.1 percent.[3] The data also indicate that poverty rates among pensioners, farmers and agricultural workers are higher than other groups. While 2006 data are not comparable with earlier data, the sustained rural character of poverty is not surprising given recent economic developments. The ban on Moldovan wine imports in Russia, for example, clearly affected agricultural livelihoods adversely (wine production is around 10 percent of GDP). It is also not surprising given the continued underperformance of the agri-food sector. Government policy has also continued to discriminate against smaller farmers.

22. Data on poverty in 2007 are not yet available. This makes it difficult to assess the combined poverty impact of the recent drought, the wine ban, and the continued rise in energy prices. Staff calculations suggest that the large reduction in agricultural output—if translated to a fall in farmers' incomes—could have significant poverty implications. For example, a 15 percent fall in real income could lead to a 4-percentage point increase in poverty among agricultural

[2] The sampling frame, sampling methodology and the questionnaire of the HBS, the main source of data for measuring living standards, were all substantially revised in 2006 to make the survey more representative and improve the measurement of consumption.

[3] The 2006 urban poverty rate is much higher than those previous years. This may be due mostly to the methodological break in the series. In part, this may also be due to the poverty impact of the 2006 energy price increases, which are likely to have affected mostly urban households connected to energy sources. The rural poor, in contrast, were likely to have greater access to cheaper, and dirtier, sources of fuel.

households. However, the reduction in output is also offset by rising grain prices, underpinned both by the drought and by higher international grain prices. On the consumption side, there are similar offsetting developments. Food price inflation in Moldova last year amounted to about 15.5 percent; however, overall inflation was 13.1 percent, thus suggesting that the relative price of food did not increase substantially. Given food shares of expenditure, staff calculations suggest a modest fall in purchasing power among the poor of just over 3 percent. Meanwhile, real wages have been growing by over 20 percent and transfers have grown equally rapidly, suggesting that the net poverty impact of higher food prices may be muted to date. Finally, Moldova is estimated to have experienced a 5 percent growth in real GDP in 2007. While poverty is generally expected to fall in response to economic growth, results of the cross-country analysis of the elasticity of poverty reduction to growth suggest that at modest levels of economic growth, the responsiveness of poverty can vary substantially.[4]

III. THE GOVERNMENT'S NATIONAL DEVELOPMENT STRATEGY

23. The National Development Strategy (NDS), the successor to the EGPRSP, was adopted by the Moldovan Parliament on December 21, 2007 and was endorsed by the Boards of IDA and IMF, along with the Joint Staff Advisory Note (JSAN) on March 20, 2008. The NDS is the main medium-term strategic planning paper which defines the developmental objectives over the period 2008-2011 and will guide the budgetary process over this period. Under the NDS, the Government will seek to better prioritize Governmental policies and establish a clear mechanism for their funding from both domestic and external sources. As with the EGPRSP, the NDS was developed in broad-based consultations with stakeholders and civil society, and benefited from a participatory process that was organized under the supervision of a Participation Council comprised of representatives of all stakeholder groups.

24. The NDS addresses the Government's objective of reducing poverty in a comprehensive development perspective. It seeks to improve the overall competitiveness of the economy while at the same time promoting access to and quality of human resource development. The Government's longer-term objective is to assist the structural transformation away from the agriculture sector into industry and services, facilitate these sectors' absorption of agricultural sector workers, and create the basis for sustained, private sector-led growth. Toward this end, its priorities are to improve the business environment, promote the SME sector, improve the efficiency of enterprises, promote research and innovation, and rehabilitate/develop physical infrastructure. With respect to human resource development, the NDS lays out a broad program for strengthening pre-school, secondary and vocational education, increasing access to health services, and improving the quality of services provided. Because the poverty rate is highest among households headed by those without primary education, the NDS the emphasis human resource development is fully warranted. Improving social safety nets by better targeting also figures prominently in the Government's strategy. The NDS also seeks to move closer to European integration by adjusting national policies so that they are more closely aligned with European norms.

[4] World Bank (2005) *Growth, Poverty and Inequality: Eastern Europe and the Former Soviet Union.*

25. Consistent with the EGPRSP and the EU-Moldova Action Plan, the NDS is constructed around five medium-term cross-sectoral priorities (with macroeconomic stability and improved public administration capacity viewed as prerequisites for the achievement of these priorities):

- *Strengthening democracy based on the rule of law and respect for human rights principles.* This pillar focuses on building trust in the decision making bodies of government. It aims to improve the participatory process in decision-making; modernizing and increasing the efficiency of the judiciary and the police; taking further reforms to prevent and combat corruption; and improve state border management
- *Settlement of Transnistrian conflict and reintegration of the country.* The reintegration of the country has always been a high priority of the Government. This pillar seeks to address both the political and economic dimensions of the problem by promoting the development of stronger civil society linkages, demilitarization, and creating the conditions for further economic cooperation between the two banks of the Nistru by eliminating barriers to commerce.
- *Enhancing competitiveness of the national economy.* Covering a number of cross-cutting issues, this pillar focuses on policies to improve the business environment so as to encourage more investment activity, technological innovation and modernization; promote the expansion of the SME sector; increase labor productivity; improve state asset management; address Moldova's deteriorating physical infrastructure; and, reduce its energy vulnerability.
- *Human resource development, enhancing employment and promoting social inclusion.* Policies under this pillar seek to improve the quality and access to education services as well as the efficiency of public spending on education; enhance the quality of health services through further infrastructure optimization and expanding the coverage of health insurance; promote the efficiency of the labor market, including efforts to reduce discrimination; enhance the efficiency and targeting of social assistance; and strengthen the financial stability of the pension system.
- *Regional development.* With most of Moldova's poor residing in the rural areas, this pillar seeks to promote the development of small towns as "poles of growth"; enhance the performance of the agricultural sector; increase investment in rural infrastructure; and, improve the policy framework in the area of the environment and natural resource use.

26. The NDS builds upon the institutional framework for monitoring and evaluation developed under the EGPRSP. It develops a comprehensive results framework by including a number of key targets and indicators. In particular, the NDS lays out country-specific Millennium Development Goals (MDGs) with targets to be achieved within the NDS implementation period. As noted in the Joint Staff Advisory Note (JSAN), the large number of indicators presented in the NDS will likely stretch the capacity of the Government to collect and analyze the data and highlights the need for further prioritization of these monitoring indicators.

27. In addition to the monitoring and evaluation framework, the JSAN highlighted the need to continue strengthening the capacity of the line ministries to develop and implement actions plans and integrate these plans in the medium-term expenditure framework. Staffs recommended that greater emphasis be placed on the need to develop robust civil service management capacity; continue efforts to reduce administrative and regulatory barriers since Moldova is falling behind on a number of indicators of competitiveness; accelerate efforts to halt the deterioration of

physical infrastructure; and continue education and health reforms since a competitive labor force is key to future development and the attainment of the MDGs.

28. Table 4 illustrates the broad consistency between the NDS, the EGPRSP, EU-Moldova Action plan and the PRSC program.

Table 4. Linkage between the NDS, the EGPRSP/EU Action Plan and PRSC programs

NDS Pillars	EGPRSP/EU Moldova AP	PRSC program
I. Enhancing competitiveness of the national economy	I. Promotion of sustainable and inclusive economic growth	I. Improving the Investment Climate
II. Building a modern democratic state based on the rule of law	EU-Moldova Action Plan	I. Improving the Investment Climate
III. Development of human resources, increasing employment and social inclusion	II. Improved human development	II. Improving the Efficiency and Management of Public Resources; III. Strengthening Social Protection Systems
IV. Regional development	I. Promotion of sustainable and inclusive economic growth and II. Improved human development	I. Improving the Investment Climate; II. Improving the Efficiency and Management of Public Resources;
V. Settlement of Transnistrian conflict and reintegration		

29. The PRSC program is supporting the Government's NDS. The PRSC2 is reinforcing measures to improve the business environment, promote the development of agricultural markets, and facilitate greater international trade. In view of the macroeconomic risks and vulnerabilities faced by Moldova, the PRSC2 is also helping to promote energy efficiency and strengthen the targeting efficiency of the social assistance system. The next section discussed the components, and implementation progress, of the PRSC program more fully.

IV. BANK SUPPORT TO THE GOVERNMENT'S PROGRAM

A. OBJECTIVE AND SCOPE OF THE PRSC PROGRAM

30. The 2004 Country Assistance Strategy (CAS) opened the possibility of the move to a *High Case* lending scenario provided that the Government ownership of the reform program was demonstrated in a good implementation track record. Over the 2004-2006 period, the Government was able to demonstrate a track record of reform by fully or substantially meeting most of the reform benchmarks established under the CAS. Achievement of these benchmarks unlocked the provision of financing under the PRSC instrument.

31. The PRSC program takes forward the reform agenda previously measured under the high-case triggers and is aligned with key elements of the reform agenda as articulated in the Government's first and second PRSPs (the EGPRSP and NDS). Cooperating closely with other donors, the program provides the opportunity to explicitly support structural reforms needed to promote improved governance, deliver sustained inclusive growth and to manage vulnerabilities. The PRSC program has also increased the certainty of resource flows to the Government.

Assessment of results to date under the PRSC program (PRSC1 and PRSC2)

32. The first PRSC was approved by the Board on October 19, 2006 and became effective on March 20, 2007. The credit is fully disbursed. All actions required for Board approval were fully met. Over the period of reforms supported by the PRSC program, macroeconomic gains have been largely sustained and prudent fiscal and monetary policies have been maintained. The gains have created the conditions and the resources for the successful pursuit of structural reforms. In addition to moving its institutional and legal framework closer to international and European norms, the reform effort in Moldova has begun to produce concrete results on the ground. The results achieved under the three PRSC program pillars are summarized below (and in Annex 3).

33. Under the first pillar of the PRSC program, **Improving the Investment Climate**, the Government has undertaken a systematic review of country's normative acts (so-called Guillotine 1 exercise), with the objective to modify or remove by-laws that create unwarranted obstacles to business operations. At the same time, the Parliament has adopted a framework law (Law 235), laying down the principles of regulating entrepreneurial activities by public authorities. Business registration procedures have been simplified and average firm licensing and authorization costs have declined from 54 to 38 percent of per capita GDP. Nevertheless, numerous surveys, including the World Bank's Doing Business, highlight the need to accelerate this reform process. The Government efforts directed at improving trade facilitation are also beginning to bear fruit. The number of physical inspections and average clearance times at customs have improved with clearance times dropping from an average of 471 minutes to 120 minutes, while the physical inspection rate has dropped in half – to around 50%. It is recognized that reform efforts started under PRSC1 will take time to bear fruit and that these efforts are being deepened and continued under PRSC2. There are, however, signs that private sector confidence in the economy is growing with private investment increasing from 14 percent of GDP in 2003 to over 22 percent in 2007. Foreign confidence in the economy has also grown with FDI accelerating from 3 percent of GDP in 2003-2004 to an estimated 10 percent of GDP in 2007. Developments in the financial system also point to growing confidence in the economy with deposits as a share of GDP doubling since 2003.

34. The Government has taken steps to liberalize agricultural exports by making use of the Universal Commodities Exchange voluntary. However, the drought in mid- 2007 moved Moldova from a net exporter of food to a net importer. The Government's policy response favored domestic food consumers and, thus, for some key crops (what maize, sunflowers) domestic farmers still receive lower prices domestically compared to international parity prices through the first part of 2007. While the Government reduced the testing times required for seed imports, these measures have not yet proved adequate to stimulate the formal importation of new seed varieties. Similarly, the government has started developing a market information system, but much need price information often doesn't reach farmers in a timely or frequent fashion.

35. Under the second pillar of the PRSC program, the Government has also pursued reforms aimed at **Improving the Efficiency and Management of Public Sector Resources**. The Government set out an ambitious reform agenda aimed at modernizing its civil service to European standards. While only 30 percent of new civil servants were appointed through a competitive merit basis in 2007, the adoption of civil service law should accelerate this trend. The Government has also taken steps aimed at addressing the problem of low pay in the civil

service and increasing the transparency and equity of civil service remuneration system. Civil servant salaries have increased, while still preserving the prudent fiscal stance, and the base component of pay has increased from 25 to 50 percent to total remuneration. The development of a new civil service wage system, though delayed, is underway. The establishment of policy analysis and coordination units has helped strengthen the linkages between the Government's policy priorities and the budgetary process.

36. The Government has also taken steps to further the restructuring of the farm sector. While the government reintroduced a 5 hectare requirement for vineyards, for other farm products the size and ownership restrictions on access to subsidies and support programs have been largely eliminated. Still, the share agriculture subsidies going to peasant farms has remained small (12% of total), with much of the aid under the Government's drought relief efforts going to larger, corporate farms. Similarly, the drought delayed the Government's efforts to shift spending away from recurrent spending toward investments.

37. Recognition of the importance of the need to halt the deterioration in Moldovan transportation infrastructure has led to a significant increase road maintenance financing. The approved land transportation strategy provides for a sizeable increase in road maintenance spending (funded by the fuel excise tax) starting in 2009. Efforts to optimize the school network have started to gain momentum. A draft education optimization strategy is currently being discussed with stakeholders and will be piloted in two rayons in the coming school year. Spending on primary health care has increased to 30 percent of total health care spending and with procedure for direct contracting with primary health care centers now in place, it is expect that 25 percent of rayon level primary health care centers (i.e. 9 out of 35) will be managed by competitively selected managers. Public procurement has been made more competitive, with a significant drop in the number and value of public procurement contracts awarded using sole source (from 45 to 8.9 percent of contracts) and a steady increase in the number and value of contracts awarded through open tendering (from 19 to 70.4 percent of contracts).

38. Under the final pillar of the PRSC program, **Strengthening Social Protection Systems**, the Government has taken steps towards completing the pension reform program launched in 1999. Individual records for all know pension contributors (outside individual farmers) have been now been inputted. However, the current database includes data on calculated or expected contributions and not on actual contributions. This has complicated efforts to pay pensions based on actual contributions paid as opposed to earning. The Government has moved faster than expected in reforming the targeting of its social assistance program. Parliament is expected to adopt the new Law on Social Assistance with the Ministry of Social Protection issuing regulations that describe the proxy-means targeting method, a more efficient method to ensure that public resources reach the poor.

B. COLLABORATION WITH THE IMF AND OTHER DONORS

39. IDA partnership with the IMF in supporting Moldova's development strategy has been excellent over the past few years. Bank and IMF staffs have executed joint work and have continued to carry out joint missions at least twice a year for macroeconomic policy dialogue with the Government. The IMF policy dialogue with the Government takes place in the context of the ongoing Poverty Reduction and Growth Facility (PRGF), covering the 2006-2008 period.

The PRSC2 has been prepared in conjunction with the PRGF to ensure the consistency of the macroeconomic and structural policy reforms supported by both programs. The IMF is taking the lead on macroeconomic issues while IDA takes the lead on structural and social issues. In a number of areas where the mandates of the two institutions overlap, such as public finance, the work is being closely coordinated to ensure that consistent advice is provided to the authorities. The existence of an IMF program is an important input for the determination of the adequacy of the macroeconomic policy framework.

40. Donor support plays an important role in supporting the implementation of the EGPRSP and PRSC programs. Coordination between IDA, the United Kingdom (DFID), Sweden (SIDA), and the Netherlands has been especially strong since all these donors have been collaborating in the preparation of the policy framework supported by the PRSC program. Both UK and Dutch Governments have provided cofinancing (in excess of $6 million) to the first PRSC. The PRSC program was catalytic in starting improved donor harmonization in Moldova. During PRSC1 and PRSC2 preparation process, DFID, SIDA, and IDA carried out joint missions in consultation with the European Union. This harmonization process was carried forward through a Development Partnership Framework signed between the Government, IDA, the Netherlands, the United Kingdom (DFID), Sweden (SIDA), the UN, IMF, EU and others entitled "Co-ordination and Harmonization of Government and Donor Practices for Aid Effectiveness in the Republic of Moldova" signed in Chisinau on May 29, 2006. This Partnership Framework commits the parties to joint reviews, harmonization of indicators, and prior actions and synchronization with Government budget cycles with a view to reducing transaction costs of assistance to the Government.

C. Analytical Underpinnings and Relationship to Other Bank Operations[5]

41. *Analytical Work.* The PRSC programmatic series rests on a wide program of analytic work carried out by the Government, the Bank, and other donors that have helped inform the program's design. The studies underline the need to change the quality of growth in Moldova, moving away from the current consumption-led, remittance-fueled growth paradigm. They highlight the need to raise domestic productivity, particularly in the agricultural sector, by improving the business environment so as to encourage greater investment and innovation as the most direct means to accelerate growth and reduce poverty in Moldova. This body of analytical work also examines public expenditures in the social sectors – education, health, social assistance, and pensions – and highlights the need to improve the strategic allocation of public resources by increasing efficiency of spending so as to free public resources to increase much needed public investment and ensure that targeted social safety nets are adequately funded. The studies also underscore the need to establish a modern and efficient public administration, necessary in order to achieve the country's longer-term development outcomes.

42. *Bank Operations.* The PRSC program remains the main instrument of the Bank for providing support to the implementation of the NDS. The complementarity of efforts between programmatic support under the PRSC program and investment lending is key to making efficient use of Bank resources. A number of investment projects support institutional reforms

[5] See Report No 37358-MD, the program document for the first Moldova Poverty Reduction Support Credit, September 20, 2006, for more detailed listing of the past analytical work and bank operations underpinning the PRSC program.

and capacity building to help the government realize its vision of a private sector led economy. These investment projects promote reforms in the areas of business environment, trade facilitation and the agricultural and rural sectors. The Bank also supports a number of projects aimed at improving the efficiency of public sector resource use including more effective and transparent management of public finances as well as broader public administration reform efforts. Bank operations have also focused on improving resource use in specific sectors, including water, sanitation and road infrastructure. In the social sectors, Bank support is provided in the context of social development programs in health, education, and social protection as well as support the government in scaling up efforts to improve the targeting efficiency of social assistance programs.

D. LESSONS LEARNED

43. The formulation of the second PRSC draws on lessons learned from the Government's implementation of the first PRSC, previous development policy operations and the overall IDA support to the reform process in Moldova. Recent policy dialogue between IDA and the Government of Moldova has had a strong public sector reform and governance content. These issues form the overarching reform areas encompassed by the PRSC-supported reform program.

44. The following four lessons have been derived and applied to this PRSC2:

- *Government ownership is key.* The anchoring of the first PRSC in the EGPRSP (the pre-cursor to the NDS) was essential to the progress that was achieved. PRSC2 takes this forward by remaining anchored in the Government national development strategy and the various sectoral strategies. This ensures the consistency of the reform program and strengthens its irreversibility.
- *Program flexibility is important.* External shocks and weaknesses in program implementation mean that the sequence, speed and implementation of reforms may change. The PRSC program needs to be flexible to that eventuality. This is reflected in the modification to a number of anticipated triggers and benchmarks that are proposed in this program document.
- *Donor coordination strengthens program performance.* The PRSC program was prepared in parallel to the IMF's PRGF program and many of the actions supported by these programs are complementary. The Bank has maintained close coordination with the IMF. The PRSC1 was cofinanced by DFID and the Dutch government and has been extensively discussed with the EU in the context of the EU Moldova Action plan. Staffs from these have participated in joint discussions with Government around the common PRSC program policy framework. This coordination has allowed donors to respond more effectively to the needs of Government (i.e. for technical assistance) and by better harmonizing the various assistance programs has reduced the transaction costs imposed on Government.
- *Results framework is important.* Focusing on results makes it easier to take full stock of what has been achieved during program implementation particularly if policy performance is uneven. Towards this end, developing a good set of indicators facilitates the assessment of progress, helps with policy dialogue and allows for appropriate adjustment in program triggers and benchmarks.
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Box 1. Good Practice Principles on Conditionality

Principle 1: Reinforce Ownership.

The PRSC program is based on the Government's own reform program as articulated in the Government's Poverty Reduction Strategy (the EGPRSP and NDS) and the EU-Moldova Action plan. These PRSPs benefited from a broad based participation process aimed at developing consensus behind the reform program. Under the PRSC program, a number of sector strategies have been developed, in concert with stakeholders and other donors, and the PRSC program relies on measures derived from these strategies which have also been endorsed in the NDS. Analytical work undertaken with support of the Bank and other donor partner (i.e. the PER, and PEFA), has assisted the Government in the formulation of policy. With regards the political economy of reform, on sensitive issues, such as the optimization of the school network, the approach taken by the PRSC series has been to encourage the Government to undertake consultation with interested stakeholders as it develops it sector strategy so as to ensure broad ownership of the strategy.

Principle 2: Agree up front with the government and other financial partners on a coordinated accountability framework.

The Bank's support is summarized in an agreed policy matrix (and adopted by the Cabinet) which outlines actions over the medium term with clear and well defined outcome goals. The First Deputy Prime Minister coordinates the program for the Government and assigns specific responsibility for implementing and monitoring the program to various Government agencies. This is supplemented by the monitoring and evaluation efforts of the Government apparatus itself. Sustained discussions and joint staff visits with donors that are providing budget or macroeconomic support (the European Commission, IMF, DFID, SIDA and the Dutch Governments) are helping improve the alignment of support to Moldova's reform program. This harmonization process has been carried forward through a Development Partnership Framework signed by the Government and key donor partners. A number of these partners have financing technical assistance to support the design and implementation of the reform program and DFID and the Dutch Government have provided significant cofinancing for the PRSC program.

Principle 3. Customize the accountability framework and modalities of Bank support to country circumstances.

The cross-cutting reform program supported by the PRSC program is based on and part of the Government's own development strategy (as articulated in the EGPRSP, NDS and EU-Moldova Action Plan). It reflects the key structural reforms needed to align Moldova's institutions closer to EU norms, to complete the country's transition to a well-functioning market based economy and develop the domestic sources of sustained economic growth and poverty reduction. The budget support provided under the PRSC series aims to be disbursed early in Moldova's fiscal year. The sensitive policy reforms included in the PRSC program (civil service, education, pension and social assistance reform) reflect the Government's objectives as states in its poverty reduction strategy and comprise a subset of reform already under implementation by the Government. As part of its broader reform program aimed at eventual EU integration, the subset of reforms supported by the PRSC program has broad support across the political spectrum. A wide range of analytical work including PSIAs, done in collaboration with the Government, underpins the reform agenda and policy choices.

Principle 4. Choose only actions critical for achieving results as conditions for disbursement.

The PRSC program focuses on actions that are deemed critical in terms of achieving the overarching development objectives. The prior actions and conditions are drawn from the Government's own policy framework and the resulting policy matrix is agreed with the Government. Where the Government's policy framework is weak or non existent (i.e. civil service, education and transportation), the PRSC program sequences reform measures, first supporting the Government's efforts to develop a sector strategy and then a reform action plan. The first PRSC consisted of 9 triggers (the CAS High Case benchmarks) and 7 benchmarks. The proposed second PRSC consists of 7 triggers and 17 benchmarks.

Principle 5. Conduct transparent progress reviews conducive to predictable and performance-based financial support.

Progress made with implementation of reforms and achievement of outcome goals is monitored on a regular basis, both under the PRSC program rubric as well as other associated Bank investment operation. The Government, drawing upon inputs from the various ministries and agencies, prepares a bi-monthly progress matrix which outlines the status of reforms and outcomes indicators. The proposed PRSC2 lending volume, including Donor cofinancing, has been taken into account in the latest Medium Term Expenditure Framework which underpins the 2008 budget under preparation.

V. THE PROPOSED OPERATION AND POLICY ACTIONS

A. OVERALL DESCRIPTION

45. The objective of the proposed second PRSC is to support the Government's anti-poverty strategy (as articulated in the EGPRSP, the NDS and the EU-Moldova action plan). The Government is pursuing a comprehensive development strategy focusing on accelerating Moldova's transition from a command to a market-based, private sector-led, economy; from an economy largely dependent on agriculture to one based on manufacturing and services (both in the urban and rural areas). Towards this end, the Government is promoting improvements in the quality of governance and strengthening the efficiency of public expenditures and public administration.

46. The proposed second PRSC - largely unchanged from the first PRSC - selectively supports those areas of the Government strategy where the sustainability of the key reforms requires consolidation, prioritization, cross-cutting support, and deepening to make real progress on the growth and poverty reduction agenda:

1. *Improving the Investment Climate,* through key policy actions to improve the investment climate and foster a more competitive enterprise and farming sector.

2. *Improving the Efficiency and Management of Public Resources*, by helping the government build a meritocratic civil service, improve the strategic allocation of public finances, improve the efficiency of public resource use thereby yielding increased fiscal space for more public investment spending without crowding out the private sector.

3. *Strengthening Pension and Social Assistance Systems* by supporting further reforms to pension and social assistance systems, including better targeting of vulnerable groups by these programs.

Table 5. PRSC2 Triggers

PRSC2 Trigger (as in PRSC1 Program Document)	PRSC2 Trigger	Comment
Maintain satisfactory macroeconomic framework.	Unchanged.	
Implementation of the transitional provisions of the Law on Basic Principles and Mechanisms of State Regulation of Business Activity.	Implementation of the transitional provisions of the Law on Basic Principles and Mechanisms of State Regulation of Business Activity through the Government adoption and submission to Parliament of a draft law covering amendments to 80 laws.	Government has completed the critical stage of adopting and submitting to Parliament the amendments. Parliament has broadened this reform effort. As a result, more time was needed for final Parliamentary approval and promulgation.
Begin implementation of an action plan to cover, inter alia, liberalization of the import regime for seeds and seedlings; improvements in agricultural product standardization and certification system; and development of a Market Information System, including scaling up dissemination of cereal and oilseed prices to cover prices on domestic markets.	Unchanged.	
Adopt new Civil Service Law that defines the scope of the civil service, contains guiding principles for competitive merit based appointments and promotions, posts classification and grading and institutional responsibilities civil service management	Government approves and submits to Parliament draft Civil Service Law that defines the scope of the civil service, contains guiding principles for competitive merit based appointments and promotions, posts classification and grading and institutional responsibilities civil service management.	Government has completed the critical step of adopting and submitting to Parliament the draft Civil Service Law. The law has gone through the first reading. Government has indicated that Parliamentary approval and promulgation is expected by mid-year.
Prepare strategy for transport infrastructure management and financing, with emphasis on road maintenance, reconstruction and capital repairs that includes (i) mechanisms for reform of road financing; (ii) introduction of competition in the execution of road maintenance contracts; and (iii) participation of road users in the oversight of road maintenance financing.	Government adopts strategy for transport infrastructure management and financing, with emphasis on road maintenance, reconstruction and capital repairs that includes (i) mechanisms for reform of road financing; (ii) introduction of competition in the execution of road maintenance contracts; and (iii) participation of road users in the oversight of road maintenance financing.	Government approved the strategy ahead of schedule and budget for road maintenance has been substantially increased.
Strategy to optimize school networks, based on completed school mapping, identifies schools for optimization, defines efficiency target indicators and pilots new funding formula.	Draft strategy to optimize school networks, initiate consultations with stakeholders, prepare to pilot the strategy in 2 rayons.	Trigger modified to allow time for broad consultations necessary for developing consensus behind this reform effort
Pension law amended to enable pension payments to be made based on individual pension contributions.	Government adopts and submits to Parliament the draft amendments to the pension laws to enable pension payments to be made based on	Government has taken critical step of adopting and submitting to Parliament the draft amendments to pension laws. Government has

	individual pension contributions.	indicated that final Parliamentary approval and promulgation is expected by mid-year.

Table 6. Proposed PRSC3 Triggers
1. Maintain satisfactory macroeconomic framework
2. Adopt and submit to Parliament amendments to the Law on Protection of Competition to: (i) provide clearer definitions of various types of unfair competition by market participants, and (ii) clarify the powers of NAPC in enforcing fair competition
3. Adopt and submit to Parliament new energy law and start implementing new market rules that would provide solutions to: (i) cross-border electricity trade and congestion management; (ii) balancing market and settlement rules; and (iii) gradual power market opening.
4. Adopt regulations and secondary legislation required for implementation of new Civil Service Law, including: (i) regulation on Classification and Grading of civil service posts, (ii) regulation on the Automated CS Register; and, (iii) procedures for competitive recruitment.
5. The amount allocated in the National Budget for Road Maintenance and transferred to the Road Maintenance Fund will represent at least MDL450 million in 2009 (with an upward trend in the years to come). This will be ensured at the initial stage (2009) through the allocation of equivalent of 80% of revenues from the fuel excise tax to the Road Maintenance Fund
6. Approve Strategy to Optimize School Networks and begin implementing in 2 pilot rayons including simulation of the use of a revised funding formula.

Pillar I: Improving the Investment Climate

47. This pillar of the PRSC program seeks to help Moldova confront business environment challenges to economic growth identified in the NDS by focusing on the critical areas of regulatory and administrative barriers, trade facilitation, the development of agricultural markets and reducing energy vulnerability.

A. Reducing Regulatory and Administrative Costs of Business Regulations

48. During the last few years the Government has launched a comprehensive effort to improve the business environment by establishing the framework and priorities for implementing regulatory reform, including curbing business inspections, simplifying business licenses and tax administration, and limiting mandatory reporting for statistical purposes. With support under PRSC1, the Government has undertaken a comprehensive review of executive regulations (by-laws) and eliminated those regulations that were no longer needed or did not have legal basis. Despite these efforts, further deregulation is needed to make Moldova's economy more competitive and more attractive for local and foreign investors, as reflected in the country's

standing in Bank's DB report.[6] The NDS recognizes the importance of: (i) further streamlining of business registration, and post-registration procedures of issuing permits, licenses and similar documents; (ii) continuing of the process of reducing the number of state controls and inspections; and (iii) increasing the efficiency of paid regulatory services offered by public authorities, by setting fees for these services at cost recovering levels or providing services for free whenever there are no additional costs.

49. The Government implemented the transitional provisions of the Law on Basic Principles and Mechanisms of State Regulation of Business Activity (Law 235) through the adoption of Government decision No. 690, dated June 18, 2007 and submission to Parliament of a draft law covering amendments to 80 laws. This second phase of the regulatory "Guillotine" entailed a comprehensive review of legislative acts affecting business entry, exit and operations. Underscoring the importance placed on this effort, Parliament established a special commission, assisted by independent experts and the Business Advisory Board to review and extend this reform effort. Two legislative packages - Law 280, covering amendments to some 80 laws proposed by the Government; and Law 281, covering additional amendments to a number of laws proposed by Parliament (at Speaker's initiative), including crucial amendments to Law on Licensing – have been approved by Parliament in December 2007 and sent for promulgation to Presidential Administration.. Starting with January 2008, Regulatory Impact Assessment (RIA) has become mandatory for all new regulations affecting business.

50. *PRSC3* would further support the Government's efforts to improve the business enabling environment by strengthening the legal and institutional framework for protection of competition. The National Agency for Protection of Competition (NAPC) was established in February 2007 and has now become fully operational. The very first actions by NAPC, however, have revealed that the framework law on protection of competition, passed in 2001, requires substantial amendments in order to bring it closer to Moldova's changed economic realities and EU good practices. With TA provided by the Bank, the authorities are now working on a set of amendments to the law aimed at: (i) providing clearer definitions of various types of unfair competition by market participants; and (ii) clarifying the powers of NAPC in enforcing fair competition. Following extensive public consultation process, currently underway, these amendments are expected to be enacted by Parliament by mid-2008.

B. Improving Trade Facilitation

51. Inefficient and costly border procedures exacted a significant cost on businesses, undermine export competitiveness, making the country less attractive to foreign investment, and reduced the ability of domestic firms to participate in global production networks. The Moldova Customs Service (MCS) has significantly improved its performance over the past several years, aligning legislation and regulations to EU standards, as well as automating the Customs declaration processing in the course of implementing ASYCUDA-World as well as establishing

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[6] In *Doing Business 2008*, Moldova's overall global standing on the ease of doing business has declined compared to the past year, slipping from 90th to 92nd. Although the decline is relative, reflecting the fast pace of reforms in other economies and the expanded coverage of the report, the deterioration is also due to remaining inefficiencies in Moldova's business environment, particularly in the field of construction licenses and permits. The report also makes note of Moldova's recent progress with implementation of regulatory reform, which due to the timing of the report has not been fully reflected in the Doing Business rankings.

a dedicated risk analysis and post release audit units. This has contributed to the simplification and rationalization of procedures while increasing compliance by the business community. The MCS has established a system for collecting Customs border and clearance performance indicators and reporting, previously maintained under the TTFSE project.

52. Under *PRSC3* the number of control agencies at the border will be reduced in line with EU practice. There are currently up to nine agencies present at border crossing points. It is estimated that one-third of the border entry processing time is rightly attributed to the Customs Service, another one-third is taken by the other agencies that are present at the border (often just to collect fees). A significant portion of the remaining time reflects the poor organization of traffic flows resulting from the high number of agencies present at the border. Consolidation of these efforts would contribute to greater efficiency and improved trade facilitation.

C. Developing Agricultural Markets

53. Moldovan farmers generally receive less for their outputs and pay more for their inputs relative to international parity prices than they should. This has squeezed farmer incomes, limited investment in the sector, reduced the scope for farm restructuring, and decreased returns to factors such as land and labor. The causes for this are various policy distortions and market imperfections that vary by sub-sector. Under *PRSC1*, the Government eliminated the requirement that commodities (particularly, cereals and oilseeds) pass through the Universal Commodities Exchange. This requirement restricted exports and contributed to a wedge between international and farmgate prices. To better inform agricultural producers on international market opportunities and trends in commodity prices, the Government has begun disseminating, with the help of agricultural NGOs, information on regional prices for cereals and oilseeds in the local media, as a precursor to the development of its own market information system. However, Government has continued to demonstrate a worrying tendency to interfere in the normal functioning of agricultural markets, including by supporting restrictions on grain exports, restricting exports of bulk wine and creating a state-sanctioned monopoly for sales to Belarus, and restricting imports of livestock products through a cumbersome and opaque permitting system.

54. Under PRSC2, the Government approved an action plan - as part of its overall agriculture strategy - that starts the process of liberalizing the import regime for seeds and seedlings, improving the agricultural product standardization and certification system, and developing a market information system to include the collection and dissemination of information on domestic cereal and oilseed prices. The Government also conducted a review of the impact of its export market liberalization efforts, with an emphasis on cereals and oilseeds. The 2007 drought, which destroyed a large part of Moldova's cereal crops, complicated the analysis since Moldova moved from being a net food exporter to a net importer. Confronted with rising cereal prices the Government temporarily suspended the VAT on imported wheat. This policy action contributed to the continued price discrimination against domestic farmers. One of the challenges confronting the Government in undertaking this technical price analysis on a regular basis is the lack of capacity and absence of good price data. In addition, the Government undertook a study entitled "Food Security and Grain Price Stabilization". The study highlighted the inefficiencies and distortions stemming from Government's "cheap bread" policy. Given the way this policy has been implemented, it has contributed to lower farmgate prices, financial pressures on private

bakeries, inefficient and non-transparent use of public resources in the operation of the state grain reserve, and poor targeting of beneficiaries. Influenced largely by the study, the Government prepared an "Action Plan" for reforming part of the current system of social bread prices and the material reserve. The "Action Plan" is positive and largely consistent with the study, but is more a statement of principles rather than an actual action plan. The Action Plan touches issues such as revising current operational rules for the Strategic Grain Reserve, equal access to the grain provided for public and private enterprises, and the maintaining of a favorable trade climate for cereals. Finally, the Government adopted a law on Savings and Credit Associations that provided for multi-level licensing and reporting and supervisory requirements.

55. It is clear that the agricultural sector would benefit from an acceleration and deepening of reforms in a number of these areas. Improving farmer's access to new seed varieties, and adjusting Government seed regulations and regulatory practices toward EU practices would be desirable. Similarly, while price information is being provided to farmers with the help of two local NGOs, this information is still being offered on a piecemeal basis, through a variety of channels that are not widely accessible to farmers (i.e. internet), are not provided with sufficient frequency, and often only reach farmers after a long delay. Finally, concrete actions need to be developed, agreed, and implemented to improve cereal and bread market policies.

56. For *PRSC3*, the Government will continue implementation of the Action Plan, including: scaling up of the market information system to cover all basic commodities accounting for at least 5 percent of value of agriculture production. Dissemination will be expanded to include radio and local newspaper, and price data will be disseminated more frequently; improving the transparency and effectiveness of the Government grain policy, by establishing transparent rules defining how and when the Strategic Grain Reserve should intervene (i.e. define "food emergency") and begin implementing those rules, and making public the finances of the State Grain Reserve.

D. Reducing Energy Vulnerability

57. Due to the near total dependence on imports in meeting its primary energy needs, Moldova will continue to be vulnerable to energy price shocks. Natural gas prices have increased from $80 per thousand cubic meters (mcm) in 2005 to $190 as of January 2008 and further phased increases will take place over the next five years to reach levels comparable to those charged to Europe. In addition, the cost of electricity imports, previously maintained at a relatively low level by Ukraine, have also started to increase as the price of natural gas confronting Ukraine approaches the European parity price. Moldova has dealt with the energy price shocks by passing the full cost of higher imported energy onto the final consumers. Recognizing that these higher costs have poverty implications, the Government has significantly increased transfers to households (by over 1 percentage point of GDP). Since existing transfer mechanisms suffered from significant targeting leakages, the Government is reforming its social assistance program by introducing a means testing mechanism thereby allowing scarce fiscal resource to be more efficiently targeted at vulnerable households.

58. Under PRSC2, a new comprehensive energy efficiency strategy was adopted that includes measures to (i) adjust and maintain energy tariffs at full cost recovery level; (ii) maintain the high cash collections rates for natural gas and electricity; (iii) return Termocom and

Combined Heat and Power plants to financial viability; (iv) develop incentives and other measures to promote and facilitate investments in energy efficiency, energy savings, and alternative (renewable) energy resources; and (v) improve institutional capacity in the government and ANRE for contingency planning and rapid response to an uncertain evolution of energy prices in the medium-term.

59. Under *PRSC3*, the Government will enact a new energy law and start implementing new market rules that would provide solutions to: (i) cross-border electricity trade and congestion management; (ii) power system balancing and settlement; and (iii) gradual power market opening.

Pillar II: Improving the Efficiency and Management of Public Resources

A. Building a Meritocratic Civil Service

60. Moldova aspires to improve the quality of the public administration as a measure to deepen the impact of the government policies and raise quality of services to the citizens. While Moldova has been introducing elements of a modern civil service, there remains a significant shortage of highly skilled civil servants capable of performing analytical work, developing modern legislation, and providing high quality policy advice to the policy-making officials. Raising civil service professionalism in Moldova will require improved civil service training, performance management, and adequate incentives. It is also important to establish sound legal protection for unbiased performance of the civil service duty as required by law, without interference and undue influence. Under *PRSC1*, The Government of Moldova has adopted a Strategy of Central Public Administration Reform which set out an ambitious agenda aimed at modernizing its civil service to European standards. Competitive merit based recruitment and a sound system of remuneration lie at the core of the civil service reform.

61. The draft civil service law that was adopted by Government and submitted to Parliament establishes merit principles in recruitment, defines responsibilities to act in accordance with the law, obligations to raise professionalism, and rights for legal and social protections of civil servants. During drafting, the Government sought inputs from various internal and external stakeholders. The draft civil service law was been examined by SIGMA/OECD to ensure the compatibility with EU standards on professional civil service. Final approval of the draft law is expected to take place by mid-year.

62. Under *PRSC3*, following the approval of the law, the government will adopt regulations and secondary legislation required for implementation of the new law. This includes: adopting regulation on classification and grading of civil service posts; approving a regulation on the Automated CS Register; and revising and approving procedures for competitive recruitment. A new civil service register is currently being designed and will be used as a tool for monitoring of competitive hiring and promotions. The responsibility for the central civil service management function will be assigned to the Government Office.

B. Implementing a Transparent and Uniform Remuneration System

63. Low public sector wages makes it difficult to attract and retain skilled civil servants, particularly for those positions that require new public management skills. Under *PRSC1* the Government began increasing basic salaries for civil servants. The public sector system of remuneration still suffers from a number of unresolved problems: high pay compression; high share of additional payments (base pay is less than 50 percent of take home pay); weak guidance for managers on how to implement performance related benefits; and a lack of a central payroll database across the various ministries/agencies. As increments between the salary grades are very small, remuneration does not play a role in career motivation. The difficulty of introducing a modern motivating pay system in the civil service stems from an ineffective system of job classifications and absence of an analytical basis to establish equitable pay. The factors determining the size of remuneration for civil service jobs are not defined. This prevents the decision on salary levels from using sound analytical basis, giving rise to perceptions of imbalance between the pay and job demands and obligations.

64. The Government has started to develop a modern and efficient system of classification of the civil service posts, including criteria for assessment of posts against a system of criteria characterizing the job (e.g., required level of knowledge and skills, managerial and decision-making responsibility, the value of job outputs, etc.). Further, the Civil Service Law that was submitted to Parliament defines the scope of the civil service to cover permanent administrative positions in the public administration.

65. Under *PRSC3*, the Ministry of Economy and Commerce in cooperation with the civil service management body, will complete drafting civil service classification and grading system based on revised job descriptions; develop (amend existing) legislation which introduces new affordable, transparent, and uniform pay system for civil servants. Responsible line ministries and institutions will develop and adopt a public employment action plans which aim at improving pay conditions in the public service while gradually optimizing the structure of the public employment to better match government programs. Concurrently, the Government Office initiated a process of strategic planning in line ministries which envisages that medium-term strategies, aligned with the National Development Strategy, will inform institutional restructuring and better allocation of staff. Indirectly, the work of NDS will support more strategic sector policy planning, which will lay the basis for employment rightsizing.

C. Improving the Strategic Allocation of Public Resources

66. Allocating public resources to policy priorities to achieve decisive impacts with government programs is the hallmark of efficient governments. Towards this end, Moldova has been strengthening its resource allocation processes by expanding the coverage of sectors included in the MTEF. A project identification form database to enable better prioritization, preparation and appraisal of public investment projects has been introduced. These efforts have contributed to better public expenditure planning, thereby facilitating the more effective allocation of resources to meet stated policy objectives.

67. The Government has strengthened the central policy coordination capacity to facilitate agreement on the policy priority framework early in the MTEF process by establishing a central

policy unit in the Government Apparatus reporting directly to the Cabinet of Ministers. In addition, policy units have been established in eleven key line ministries and will soon be established in all the remaining ministries. While policy coordination capacity in the Government Apparatus will take time to develop (with the support provided under the Multi-Donor Trust Fund), the Ministry of Economy and Trade in coordination with the central policy unit and the Ministry of Finance has been leading the work with line ministries to improve result focus of government programs and improve realism of planning by imposing budget constraints.

68. By *PRSC3*, the central policy unit, in coordination with the Ministry of Economy and Trade, is expected to prepare a proposal on policy framework - based on the NDS - to be approved by the Cabinet of Ministers as a guiding document for MTEF. As the capacity of the Central Policy Coordination unit in the Government Office reaches adequate level, this unit will provide strategic and day to day support to the Government policy decision-making, as well as will contribute to the national development planning process. The Government will continue implementing the project identification database for sector investment priorities.

C. Restructuring Public Expenditures

69. Since 2000, the Government has placed a heavy emphasis on increasing social spending – pensions, social assistance, education, and health spending comprise over 65 percent of total general government expenditures. With fiscal resources scarce, improving the efficiency and targeting of social spending, particularly in the education and health sector, will be required if the Government is to achieve the growth and poverty reduction objectives of the NDS. Sustained economic growth will also require more pro-growth public investment spending, particularly on the transportation infrastructure, and an improved allocation of agriculture spending to enhance long run capacity in that sector.

C.1 Agricultural Spending

70. Approximately 50 percent of agricultural land being used by large, corporate farms that are largely unreformed since the Soviet collective farm period. While these corporate farms are less efficient than individual (peasant) farms, the Government has channeled the majority of Agricultural public expenditures and subsidies to these large farms. To facilitate continued farm restructuring, the PRSC program has supported the Government's efforts to create a level playing field for individual farms. At the same time, the PRSC program has supported the Government's efforts to redirect inefficient spending on recurrent subsidies towards growth enhancing public services and investments - such as development of standards, research, extension, agricultural education and training, and investment in market infrastructure - required to increase the competitiveness of the new class of independent family farmers.

71. While, under *PRSC1* the Government refrained from providing any debt relief targeted at agricultural enterprises/producers, as part of its wider corporate tax reform effort, the Government wrote off all tax debts for all economic agents as of January 1, 2007. The Government also removed all restrictions on access to subsidies and supports based on farm ownership structure or size – an important step towards reducing the spending bias towards large farms, increasing opportunities for individual farms, and further promoting farm restructuring. In recent months, however, the Government reintroduced a minimum 5 hectares farm size requirement for vineyards subsidies.

72. The Government was to begin restructuring agriculture expenditures by significantly increasing expenditure on growth-enhancing services (as a percentage of total agriculture expenditures) and reducing the corresponding share of subsidies. Further, within the diminishing expenditure share for subsidies, priority was to be given to measures that demonstrably enhance the long-run productive capacity of the sector by supporting the creation of long-lived assets, for example, new vineyards, orchards, new genetic livestock strains, etc. The share of purely recurrent subsidies, such as product or input subsidies, was to be correspondingly reduced.

73. However, the Government's urgent response to the 2007 drought led the Government to deviate from its intended objective of reallocating these expenditures. Responding to political pressure, the government passed a mid-year budget amendment allocating an additional 200 million lei to support the agriculture sector (i.e. to finance the purchase of destroyed seeding materials, pay for electrical power for irrigation, fuel, fertilizer etc.). For the most part, these additional expenditures were directed to existing beneficiaries and as a result, most individual (peasant) farms did not receive needed public assistance (though a sizable amount of direct foreign assistance – both in cash and in kind - was made available to these farmers). As a result, in 2007, Agricultural subsidies in general and recurrent subsidies in particular, increased in share. The 2008 budget, which was approved at the end of last year, substantially increases the share of spending going to services and investment subsidies, putting the Government back on track towards meeting the PRSC program outcome indicators.

74. The Government also undertook an evaluation of the existing anti-hail rocket system. While the evaluation did not result in a change in expenditure policy, the recently developed Agricultural Sector strategy revealed the Government's intention to explore other risk mitigation measures. Further, the Government has completed a study on streamlining and modernizing the agricultural research, training, and education system. The adoption of an action plan, will follow extensive consultations with other stakeholders, including the Public Academy of Sciences.

75. For *PRSC3*, the government will continue reallocating agricultural expenditures (in any FY08 mid-year budget amendments and in the preparation of the FY09 budget) to growth enhancing measures. It will also finalize and begin implementing the Action Plan to streamline and modernize the agricultural research, training and education system. The Government will increase the share of subsidies going to individual (peasant and household) farms, with the objective of increasing by at least 5 percentage points each year (assuming sufficient applications). It will also collect data on beneficiaries of subsidies (including VAT output, MTS, and vineyard) by farm type and farm size.

C.2 Transportation Infrastructure

76. The rapid deterioration of Moldova's transportation infrastructure over the transition period has significantly increased the cost and reduced the quality of transportation services with a particularly strong impact on the country's poor. Recent annual budgets for road maintenance represent only a small fraction of the expenditures needed to prevent further deterioration.

77. The Government has prepared and adopted ahead of schedule a Land Infrastructure Transportation Strategy that includes reform of road financing, introduction of participation of road users in the oversight of road maintenance financing, and increased competition in the execution of road maintenance, repair, and rehabilitation contracts. With financial support of the Bank, EBRD and EIB, the Government's road program has been launched and a significant

increase in resources is being directed towards road maintenance. Starting in 2009, some 80 percent of the fuel excise tax will be channeled into road maintenance. This percentage is scheduled to increase to 100 percent in subsequent years. In the 2008 budget, spending on road maintenance, reconstruction and capital repairs will amount to $58 million.

78. Under *PRSC3* the amount allocated in the National Budget for Road Maintenance and transferred to the Road Maintenance Fund will represent at least MDL450 million in 2009 (with an upward trend in the years to come). This will be ensured at the initial stage (2009) through the allocation of equivalent of 80% of revenues from the fuel excise tax to the Road Maintenance Fund.

C.3 Spending on Education

79. While Moldova's public spending on education is comparable to OECD and upper-middle income countries, there are a number of inefficiencies and inequities confronting this sector. In terms of access, Moldova is lagging behind many of its neighbors. Inequities between income groups are pronounced, with the problem even more pronounced if one makes the distinction between urban and rural students. Inefficiencies, mainly resulting from the slow adaptation of education expenditures and norms to changing demographics, are reflected in the fall in average pupil/teacher ratios over recent years. A continuing anomaly in Moldova's education system is the large number of non-teaching relative to teaching staff.

80. The Government prepared a draft strategy to optimize school networks that identifies schools for optimization, defines efficiency target indicators, and has plans for developing a new funding formula. Given the challenging political dimension of this task, the Government has undertaken consultations with stakeholders. Preparations for piloting the strategy in the upcoming school year have already started.

81. For *PRSC3*, the Government will approve the Strategy. Optimization results will require alignment of the planned Decentralization Law with the revised Law of Local Public Finance and the Education Law. The Government will pilot implementation of the optimization strategy in two rayons, including the simulation of the allocation of school budgets under the revised funding formula.

C.4. Spending on Health

82. Efforts at reforming the Moldovan health sector include closing unnecessary health infrastructure and emphasizing more cost-efficient service delivery at primary care settings. The reform agenda however is still incomplete and has not yet achieved the original aims of equitable coverage of the country with good quality primary care. With the launch of mandatory public health insurance in 2004, public health expenditures, particular those focused on primary health case have increased sharply.

83. The Government has increased allocation to primary care from the Health Insurance (HIC) budget to over 30 percent. Further, procedures for the direct contracting with autonomous primary care providers are now in place which will allow for further increases efficiency and transparency in the health sector. Indeed, since direct contracting has been extended to all regions in the country as of January 1, 2008 and since 17 primary care centers are already under

such direct contracts, the Government has already achieved the 5% target that were expected to be achieved under PRSC3.

84. In light of the advancing reform agenda in this sector, the MOH has indicated that twenty-five percent (25%) of rayon level primary care centers (i.e., 9 out of 35) will be managed by competitively-selected managers. Pilot projects indicate increased patient satisfaction and an increase in motivation and accountability as a result of decentralized management. In addition, there is evidence that autonomous primary health care centers have employed the flexibility offered by such contracting arrangements to use the funds provided by the NHIC to better meet the needs of their catchment population. The MOH, therefore, passed a resolution to separate the management of primary care centers from rayonal hospitals (effective January 1, 2008). Rayons can choose among several options: have one manager for all primary care facilities, have few facilities grouped together with several managers in one rayon, or direct contracting for a facility. Under this new scheme, primary health care managers will be selected on a competitive basis.

D. Public Procurement

85. The Bank has been actively involved in supporting public procurement reform in Moldova since 1997. Throughout this time a steady improvement in aspects of public procurement has been observed while, at the same time, a distinct deterioration in the institutional framework has occurred. Under *PRSC1*, competition for public procurement contracts was increased with a significant drop in the number and value of public procurement contracts awarded using sole source and a steady increase in the number and value of contracts awarded through open tendering.

86. A new Public Procurement Law was enacted that brings Public Procurement in line with international standards and practices and addresses many of the weaknesses identified in the previous 1997 law. The more positive aspects concern the decentralization of procurement function to the spending entities, a greater degree of separation in responsibilities within public procurement and increased transparency. The law is clearly oriented towards approximation of EU Directives and Regulations. However, despite the positive progress there are still a number of shortcomings. The new law has not satisfactorily addressed the institutional framework, namely the independence of Procurement Agency. It places public procurement in the Agency for Material Reserves, Public Procurement and Humanitarian Aid. While this agency is itself independent, but does not guarantee full independence of public procurement as the Agency still carried out other conflicting functions. Whereas the Director (responsible for material reserves and humanitarian aid) and Deputy Director (responsible for public procurement) are both nominated by the Prime Minister the Deputy Director still remains answerable to the Director which does not provide nor guarantee the full independence of the procurement function.

87. Under *PRSC3*, the Government will address institutional reporting arrangements to avoid conflict of interest in the public procurement supervisory function. Further, the Government has indicated it would like to undertake a benchmarking exercise of public procurement along the lines of the OECD/DAC indicators. The Government will also begin undertaking its Action Plan for implementation of Public Procurement Law as well as the develop a medium-term Action Plan for the development of the public procurement function that ensures adequate staffing and funding for the Procurement Agency.

Pillar III: Strengthening Pension and Social Assistance Systems

A. Completing Pension System Reform

88. Although the administration of the social insurance system has improved in recent years, pension reform, however, remains incomplete and the general pension law (1999) is not being fully implemented. To fully implement the reform program, the Government aim to: (i) implement the contribution-based pension payment benefits; and (ii) unify the pension system for all types of pensioners (non-farmers, farmers and privileged). Toward these ends, under PRSC1, the Government has reduced data entry back log of individual contribution in the computerized contribution database and developed an agricultural pension reform strategy.

89. Amendments to Law on the State Social Security Pension (Law 156) and Law on Public Social Insurance System (Law 489) were adopted by Government and submitted to Parliament clarifying that *individual* pension contributions are the basis for pension calculations. In addition, the Government has prepared a strategy to unify the pension system for all types of pensioners (non-farmers, farmers and privileged).

90. Despite progress on these fronts, other measures need to be in place—such as clarifications to Article 29 of Law 489 - to ensure the proper functioning of a Moldova's contribution-based pension benefits system. In addition, the transition to such a system may entail some short-term social costs as some employees, for example, may find that their employers have not been paying their contributions fully. A mechanism is required to facilitate the verification of the accuracy of the contributions record. Furthermore, the current database includes data on calculated contributions only; instead data on the actual contributions should be entered into the new system to enable calculations of pensions based on actual contributions. The Amnesty Law that became effective at the beginning of this year also served to weaken the incentives to participate and contribute to the system.

91. Under *PRSC3*, the Government aims to begin paying pensions based on actual contributions registered in the individual accounts. For this to take place, the Government will: complete the draft strategy to unify the pension system. The strategy should address the need to equalize benefit calculation/entitlement rules for all categories of contributors following a period of transition, eliminate privileges and strengthen the link between contributions and benefits including changing the second part of the benefit formula to include revaluation of wages; amend the Law on Public System of Social Insurance (Law 489, Article 29) to specify that pension benefits are based on actual contributions paid; Adopt and submit to Parliament an amendment to make mandatory the issuing annual statement providing summary information on individual pension contributions to date to all individual insured contributors to ensure that accurate information is kept in the contribution database and that social fund contributions are properly collected.

B. Enhancing the Distribution Efficiency of Social Assistance Benefit

92. Moldova's social assistance system today consists of some 13 types of cash benefits. In light of recent and projected increases in energy and food prices, these programs need to play a

critical role in reducing the adverse shock on the poor and the vulnerable. However, Moldova's social assistance system suffers from poor targeting efficiency with a large part (45 percent) of the benefits of these programs accruing to the non-poor. In addition, social assistance programs are administered by several government agencies each of which has independent beneficiary registries and payment databases. The existing arrangements make it very difficult to assess the overall impact and effectiveness of social assistance programs to the government. They also make it more difficult for the poor and the vulnerable to access social assistance programs.

93. Given the extent of in-kind and informal income in Moldova, any type of income targeting is likely to lead to substantial errors of inclusion; thus some type of categorical targeting may be a necessity. Nonetheless, it is still necessary to improve the targeting of social assistance programs to ensure that they are focused on the poor and the vulnerable. To improve targeting of social assistance programs and gain efficiency in program administration, the Government's reform agenda focuses on: (a) developing and adopting a strategy for improved targeting for social assistance programs; (b) undertaking a financial and impact assessment of social assistance programs; (c) developing and implementing an information system for improved record keeping and information sharing; and (d) consolidating/rationalizing the administration of social assistance programs.

94. The Government has approved a draft Law on Targeted Social Assistance, which establishes the legal basis for targeting poor Moldovans. The Government has also completed the system concept design for a unified database of the beneficiaries of cash-equivalent social assistance program.

95. Under *PRSC3*, the Government will develop regulations for implementation of the Law on Targeted Social Assistance in order to begin implementing the law upon promulgation. It will also develop a computer system for the administration of targeted poverty benefits and for the provision of the consolidated social assistance database (development and approval of technical specifications).

VI. OPERATION IMPLEMENTATION

A. POVERTY AND SOCIAL IMPACT ANALYSIS

96. The first PRSC endeavored to assess the likely distributional consequences of key policy reforms, including the Government's efforts to maintain cost recovery energy tariffs by continuing to allow full-pass through of energy price increases and the implementation of the strategy for optimizing school networks. The likely poverty and social consequences of macroeconomic shocks—such as the recent drought and rising international food prices—have been a cause for concern.

97. In light of the potential social consequences of reform, analytical work on the social impact of rising energy prices, options for reform in the education sector, and mitigation measures for easing the reform process informed the PRSC program preparation process. As the second PRSC moves forward, the introduction of a better targeted social assistance system for the most vulnerable groups in the economy is a major step toward mitigating the likely social consequences of any policy reform, as well as the poverty consequences of macroeconomic

shocks more broadly. With respect to the network optimization program in the education sector, the PRSC2 team has encouraged a more cautious approach and has supported the Government's effort to undertake consultation on the strategy.

B. IMPLEMENTATION, MONITORING AND EVALUATION

98. The administration of this credit will be the responsibility of the Ministry of Finance. To facilitate program implementation and the coordination of activities, the Government has appointed an Inter-ministerial Steering Committee chaired by the First Deputy Prime Minister. This Committee is composed of representatives of key Ministers. The Steering Committee will be assisted by a Technical Committee comprising high level staff from various line ministries, including the Ministries of Agriculture and Food Industries, Economy and Trade, Education, Finance, Industry and Infrastructure, Health and Social Protection, Transportation and Telecommunications, and the Moldova Customs Service.

99. A multi-donor supervision effort will be aligned with the existing government-led monitoring and evaluation system for the EGPRSP, the Moldova-EU Action Plan and the MTEF. The Government's PRSC program Steering Committee will be responsible for monitoring the PRSC program and all benchmark and outcome indicators. These benchmarks and indicators can be found in the PRSC Policy Matrix in Annex 2. The specific benchmarks and outcomes to be monitored have been drawn from the Government's overall development program, thus providing significant benefits in reducing transaction costs for the Government. The overall reform effort will be reviewed by the Government in close coordination with regular multi-donor missions to ensure continued implementation of the program within an adequate macroeconomic policy framework. Given satisfactory progress, Moldova's reform program will be supported by subsequent PRSCs under the programmatic lending framework, subject to the approval of the Board of Executive Directors.

C. FIDUCIARY ASPECTS

100. *Public Financial Management (PFM).* Strengthening public financial management is a Government's priority under National Development Plan 2008-2011. The priority areas of activity include: (i) improving public resource allocation by introducing modern budget preparation practices; (ii) strengthening financial discipline by modernizing the treasury system and budget execution procedures; (iii) improving public debt management to minimize debt service costs; (iv) improving fiscal administration and increasing the effectiveness of financial controls; (v) increasing the efficiency of budget management through introduction of an integrated financial management information system; and (vi) harmonizing the budget and fiscal legal framework with European Union standards. The weaknesses in the current PFM system in Moldova are mainly due to institutional capacity issues typical for a country in transition. The fiduciary risk assessment annex of the most recent PEFA report (2006) notes that Moldova remains a high risk country but has good chances to improve its rating to "medium" risk provided ongoing reforms are implemented effectively and efficiently. The progress achieved in the main areas of PFM reforms and the remaining weaknesses are summarized below.

101. *Budgeting*. The Government has been undertaking noticeable efforts to consolidate the budget formulation process. The remaining weaknesses in the budgeting area include the need to maintain adherence to the existing budget calendar and improve expenditure planning at the line ministry level linking it to sectoral policy priorities. Under the NDS, efforts to better link policy priorities through the use of annual NDS action plans are underway. Further strengthening of budget formulation methodologies is a component of the PFM project currently under implementation.

102. *Internal controls over budget execution*. Moldova has made important progress in developing the national treasury system. Controls over budget execution have been significantly strengthened through gradual expansion of the treasury coverage that started in 1997. Weaknesses in treasury operations are largely being addressed under the PFM project through creation of a comprehensive FMIS. Significant improvements were made in 2007 in functioning of the treasury single account, cash management and forecasting.

103. *Procurement*. A new public procurement law, which entered into force in October 2007, has largely brought Moldova legislation in line with international good practices. The new law contains some weaknesses: (i) the issue of independence of the Procurement Agency still remains (i.e. the procurement agency function will remain part of Agency for Material Reserves, Public Procurement and Humanitarian aid responsible for procurements for State reserves); and, (ii) the complaints procedures and mechanisms are not adequate, particularly institutional arrangements (i.e. the same Agency is responsible for complaints resolutions). Overall procurement outcomes are favorable - the practice of single source tendering has been significantly reduced while the percentage of contracts awarded using open tender procedure has increased.

104. *Accounting and reporting*. Under the PFM project, the Government is preparing for important changes in public sector accounting and reporting. The new integrated budget classification and chart of accounts system is being developed on the basis of the GFS2001 standards to be launched with the new FMIS. It is expected that in the medium-term the Government will maintain cash-based accounting for the treasury and modified cash based accounting for the budget institutions. The new FMIS will enable the Government to produce consolidated financial statements showing financial position of the Government, and not only the budget execution reports, as is the practice at the moment.

105. *Internal auditing*. The internal auditing function of the Government is still at an early stage of its development. Small internal audit units have been established in the Ministry of Finance (MOF), State Tax Service, Customs and National Social Insurance House. In addition, there is a Control and Revision Service (CRS) under the Ministry of Finance. In most cases, the CRS is performing ex-post verification of budget execution. Development of a modern internal audit function within the Government is a component of the PFM project.

106. *External auditing*. Audit methodologies require further improvements despite introduction of a number of internal manuals and guidelines. Modern audit concepts were introduced into the Court of Accounts Law through 2005 amendments but there is still a need for the Parliament to pay sufficient attention to the audit reports. The current system of nominating members to the top management body of the Court of Account (COA) does not guarantee independence and there is an element of political influence in the working of the COA. The COA

has indicated its willingness to develop into a modern external audit institution. Technical assistance is being provided by the Swedish and British national audit offices to support the implementation of the COA's Strategic Development Plan.

107. *Reforms to strengthen the public financial management framework.* Weaknesses in the Moldovan public financial management system are well understood and a broad PFM reform program is under way. As a result of these efforts, the credibility of the Moldova PFM framework has been enhanced. Major assistance is already being provided by the Bank under the the PFM Project, co-financed by SIDA and the Dutch Government. The PFM project is supporting improvements in: (i) budget preparation and execution; (ii) accounting and reporting; (iii) development of FMIS and cash management; (iv) internal auditing; and, (v) PFM related training. In coordination with the PFM project, DFID is providing support to the strengthening of the MTEF process, and TA for the Court of Accounts has been launched. Several high priority reform measures are included in the IMF's PRGF and the proposed second PRSC (as indicated in the sections above). The existing instruments already mobilized through a concerted multi-donor effort appear to be sufficient to support the critical PFM agenda. No additional fiduciary risk mitigation measures are considered necessary for the present PRCS2.

108. *Central Bank and Foreign Exchange Management.* The IMF updated its safeguards assessment of the NBM in 2006 and found that while the NBM has made progress in strengthening its safeguards framework, certain weaknesses remain. To further improve the NBM's safeguards, the updated assessment recommended: (i) the IMF program data compilation procedures be formalized delineating responsibilities of the involved departments, and the Internal Audit Department should include regular audits of the process in its audit plans; and (ii) the NBM Law be amended to better align profit distribution rules with recapitalization requirements, and formalize the financial relationship between the NBM and the Ministry of Finance. NBM financial statements have received unqualified (clean) audit opinions from international auditors for the past three years (2004, 2005 and 2006). In view of this, there are no additional fiduciary safeguards considered necessary as far as management of the foreign exchange is concerned.

D. DISBURSEMENT AND AUDITING

109. *Disbursement and Funds flow.* The proposed Credit, SDR 6.1 million (US$10 million equivalent), will follow the Bank's disbursement procedures for development policy lending. The Credit will be disbursed in one tranche immediately upon effectiveness and is not tied to any specific purchases and no procurement requirements will be needed. The funds will be deposited at the existing treasury USD account used for receiving support from donors and for making external payments opened by Ministry of Finance/State Treasury with the NBM, which forms part of the official foreign exchange reserves. If, after depositing the Credit proceeds, the proceeds are used for ineligible purposes as defined in the Credit Agreement, the Bank will require the recipient to refund the amount directly to the Bank, cancelling an equivalent un-disbursed amount of the credit.

110. *Accounts and Auditing.* The administration and accounting of the Credit proceeds will be the responsibility of the State Treasury of the Ministry of Finance. The standard country rules will be followed by treasury for administration and accounting. The Government will maintain

accounts and records, or ensure that such items are maintained, showing that credit disbursements were in accordance with provision of the Financing Agreement. Such accounts and records will be maintained in a form acceptable to the Bank. The MOF will be responsible for the PRSC2's administration and for preparing the withdrawal application. The PRSC2 will be subject to ratification by Parliament before it becomes effective. The MOF, with the assistance of the NBM, will maintain records of all transactions under the PRSC2 in accordance with sound accounting practices. Within 30 days of the NBM being credited, the MOF will provide to the Bank a confirmation that the amount of the PRSC2 has been credited to an account that is available to finance budgeted expenditures.

E. ENVIRONMENTAL ASPECTS

111. The PRSC program has made an effort to assess and address the likelihood of significant effects of policies supported by the program on the environment, natural resources, or forests including assessment of the government's systems for reducing adverse effects and enhancing positive effects. Among the areas requiring further attention with respect to its environmental aspects are the following policy interventions: (i) reduction of the regulatory burden; (ii) removal of agricultural export restrictions; and (iii) passing the full cost of energy price increase to customers. The PRSC program identified measures to mitigate some of the potential adverse consequences of these interventions. Moreover, as the PRSC program moves forward, a number of ongoing projects financed by the World Bank are serving to mitigate the likely effects of increased agricultural activity. For example, among the components of the Bank's "Persistent Organic Pollutants (POPS) Stockpiles Management and Destruction Project" are those aimed at institutional strengthening, the modernization of current legislation (i.e., those related to the Stockholm Convention), and the introduction of broader chemical safety approach in the country consistent with European Union legislation. The project also has a special activity under Component 2 (Prevention of new Stockpiles of Obsolete Pesticides) that aims to provide support in promoting best practices in Pest Management in crop production, including Integrated Pest Management. Furthermore, the GEF "Agricultural Pollution Control Project" is expanding the use of environmentally-friendly agricultural practices by farmers and agricultural enterprises to reduce nutrient discharge from agricultural sources to the Danube River and Black Sea.

112. A specific policy area supported by PRSC2 that may have environmental effects is the promotion of road maintenance, repair, and reconstruction. Such a program conceivably could have implications for land acquisition or encroachment of forested lands. A complementary, World Bank-assisted investment project ("Road Sector Program Support Project"), however, is helping ensure that there are no significant environmental effects from this road rehabilitation program. In fact, the investment project's environmental assessment concludes that the project involves the rehabilitation of existing road networks, and will not require any new road construction or widening. The common, localized effects of road reconstruction (e.g., dust and noise, disposal of materials) can also be managed by existing capacity. The investment project also confirms that materials used in the rehabilitation program will meet international standards for environmental safety.

F. RISKS

113. The risks for this PRSC2 include (i) fiduciary risks; (ii) implementation capacity at the central and decentralized level; (iii) external shocks; and (iv) political economy risks.

114. *Fiduciary risks.* The Government's continued efforts to strengthen public financial management and procurement systems are reducing fiduciary risks with regard to the use of public funds. The PRSC program, as well as the Bank's and donor's work in these areas, is providing assistance to the Government in this endeavor.

115. *Implementation capacity.* The Government has limited institutional capacity which could delay the implementation of its ambitious reform agenda. Most line ministries still have limited capacity for the systematic selection and appraisal of projects, implementation, and evaluation and this may lead to the sub-optimal allocation of budgetary resources. To mitigate these risks, all the reform areas benefit from Bank and donor-supported TA and capacity building programs or investment operations. In areas where donor engagement is limited, implementation risk will likely remain high.

116. *Destabilizing external shocks.* Greater integration into the global economy, both respect to trade and labor flows (i.e. remittances), makes Moldova more vulnerable to external market developments. The price of natural gas imported in Moldova will rise to European levels over the next five years. Higher electricity prices from Ukraine are also forthcoming. Higher energy prices may have significant poverty implications with the burden of the price increase falling disproportionately on the poor and on households with limited alternative sources of fuel. Rising food prices, stemming from either domestic or international sources, if they outstrip income growth, could have a disproportional impact on poor households. Under this PRSC2, the Bank is promoting reforms to improve the efficiency of the energy and agricultural sectors as well as the Government's social assistance system. As demonstrated at the Consultative Group meeting, Moldova will be the recipient of considerable donor financing in the coming years. The Bank, the IMF and other donors, have shown flexibility in the amount of available financing to respond, if needed, to external shocks.

117. *Political economy.* Under the EGPRSP and the NDS, Moldova has articulated an ambitious reform program. Over the last few years, the Government has established a steady track record of reform, albeit with some efforts proceeding faster than others. The extensive consultations surround the development of the NDS indicate that a high degree of political consensus has been established behind this reform program. Along with the reaffirmation of Moldova's EU aspiration, this give comfort that the agenda laid out in the NDS will be pursued. However, a number of reforms – civil service, education and agricultural reform - will be politically challenging particularly as next year's elections draw closer. These looming elections may rupture the political consensus that has developed behind the Government's reform program. The close linkage between the PRSC-supported reform agenda and substantial donor assistance (DFID, SIDA, the Netherlands and EU) planned for Moldova continues to be a mitigating factor.

Annex 1 - Letter of Development Policy

GUVERNUL
REPUBLICII MOLDOVA

GOVERNMENT OF THE
REPUBLIC OF MOLDOVA

Nr. 2606 - 103 Chişinău 02 April 2008

Letter of Development Policy

Attention:
Mr. Robert B. Zoellick
President
World Bank
1818 H St., N.W.
Washington D.C., 20433

Poverty Reduction and Economic Growth Reform Program in Moldova

Dear Mr. Zoellick:

The actions undertaken by the Moldovan authorities in line with the Letter of Development Policy of 2006 have contributed to the improvement of the economic situation: foreign and structural vulnerabilities were reduced considerably as a result of monetary and austere fiscal policies and implementation of structural reforms. The present letter reviews the policies highlighted in the previous letter, updated in light of semi-annual evaluation of Moldova's performances in the framework of the poverty reduction program supported through a tri-annual PRSC Credit.

The Government's key priorities for 2007 were highlighted in the Economic Growth and Poverty Reduction Strategy Paper (EGPRSP) and the EU-Moldova Action Plan, the implementation timeframes of which are expiring at the end of 2007 and early 2008 respectively. The implementation of objectives contained in these two strategic documents has only been partially accomplished, due to external factors such as the 2006 shocks (double increase of natural gas prices and wine ban imposed by the Russian Federation), as well as internal factors such as the 2007 drought, the limited capacity of public administration to fulfill policy obligations and its dependence on Legislative prerogatives in approving the proposed reforms, in addition to the limited resources available for carrying out expensive reforms. In order to extend the resource framework and thus speed up the pace of successfully accomplishing the proposed objectives, the Government had successfully secured financial assistance in the amount of 1.2 bln. US dollars in the framework of the Consultative Group, which took place in Brussels, in December 2006.

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In order to ensure policy continuity after the expiration of EGPRSP and the EU-Moldova Action plan, but equally to create an improved framework for prioritizing public policies, the Government has launched a process for the development of a new medium-term strategic planning document in early 2007 – the National Development Strategy (NDS) 2008-2011. NDP moves away from sectorial approach to a model of limited intersectorial priorities - „horizontal" approach. As such, the draft NDS strategy contains five key priorities:

- Consolidating a democratic system based on the rule of law and respect for human rights;
- Transnistrian conflict settlement and the reunification of the country;
- Increasing the competitiveness of the national economy;
- Developing human resources, increasing employment and promoting social inclusion; and
- Regional development.

One of the main goals of NDS is the aggregation of Moldova's key foreign commitments into a comprehensive strategy (without substituting bilateral policy documents) and the creation of a unified system to monitor the successful implementation of these commitments.

Another important activity pertaining to strategic planning, which was completed in 2007, was the development of a sectorial and economic growth constraints analyses. These documents were developed in order to identify the intervention areas targeted for the compact program of the Millennium Challenge Corporation. Similarly to the NDS draft, the draft sectorial and economic growth constraints reports were supported by a broad participatory process. The reports identified a range of issues related to investment climate and lack of adequate infrastructure, which represent the current key constraints hindering economic growth.

Overall, the key Government priorities for 2008 remain unchanged: poverty reduction through ensuring macroeconomic stability and sustainable economic growth. We hope to fulfill these objectives through a modernization of the public service and preventing state interference in economy, in addition to developing a sound financial system, creating a favorable investment climate, small and medium business development, infrastructure rehabilitation, export promotion, job creation in Moldova and provision of social protection to socially vulnerable groups. These objectives, which include the accomplishment of the Millennium Development Goals, are reflected in the NDS and other policy documents.

A. Context

I. Poverty profile and evolution

Starting in 2006 the National Bureau of Statistics has made substantial changes to the Household Budget Survey (HBS) , which measures poverty. These modifications involve changes to the benchmark framework, improving the data collection tools and creation of a unified network of data collection for social research purposes.

It is worth mentioning that changes applied to HBS in 2006 have **improved data quality** and contributed to the harmonization of applied poverty measurement methodology to international standards. At the same time, these changes are contributing to the fact that indicators for measuring poverty levels in 2006 **are not comparable** with those in previous years. As such, data for 2006 is a reference point for analyzing poverty levels in the following years.

According to statistical data for 2006, 30.2% of the population was below poverty level, with 4.5% below extreme poverty levels. The incidence of extreme poverty is low, a factor which demonstrates that food-driven poverty will soon be of little relevance for the Republic of Moldova. Therefore, we are highlighting the need to introduce evaluation indicators, which meet higher standards and towards which Moldova should strive, such as a more generous level of poverty analysis, the quality and culture of nutrition.

In 2006, similar trends of poverty profile as in previous years can be noticed. In Moldova, the large households, with many children, employed in the agricultural sector and older people are most heavy influenced by poverty. Also, there are huge differences between rural and urban areas, those living in rural areas being exposed to a higher degree of poverty. Poverty among children is also an unfortunate reality.

II. Economic growth

During 2000-2007, real GDP grew at an average annual rate of 5.7%, with cumulative growth totaling 55.1% compared to 1999. At the same time, in 2007, Gross Domestic Product (GDP) reached a nominal value of 53.4 bln. Lei and a real growth rate of 3% compared to the similar period of last year.

Inflation was maintained at a reasonable level, falling down from 18.4% in 2000 to 1 13.1% in 2007.which is one percentage point less than the level registered in 2006.

The national currency rate of exchange was gradually appreciating, with National Bank reserves increasing significantly to reach 1.3 billion US dollars.

Real GDP growth in 2008 is expected to stand at 6%, as a result of industrial and agricultural output increase, as well as a result of significant growth of investments in the national economy. Also, efforts will be undertaken in order to maintain the rhythm of inflation growth below 10%.

Growth rates and economic development indicators will be contingent largely upon the investment and entrepreneurship activities, both at the national and local levels. In the medium term, the Government will undertake measures to substantially improve the investment and business climate through promoting stable, transparent and efficient regulatory policies, through competitiveness enhancement and small and medium enterprise development. This will mobilize the economy's investment potential, made up of remittances coming from Moldovan workers from overseas, the banking sector resources and the underground economy, concessional international assistance and direct foreign investment.

III. Establishment of fiscal space

A moderate increase of public expenditures is planned for the forthcoming years as a consequence of the relatively high level of public sector consumption as share of the gross domestic product. The estimations of the medium term resource framework reveal that medium term financing opportunities of new expenditures is limited. Therefore, the medium term budgetary policy highlights the need to focus on efficiency and effectiveness of existing public expenditure programs and underscores the importance of redirecting existing allocations from less priority programs to high-impact economic-oriented programs aimed at reducing poverty.

The need to improve the manner of using existing resources, thus making available resources for new policy initiatives becomes ever more stringent in the context of concentrating existing resources in support of key priorities highlighted in the 2008-2011 National Development Strategy.

V. A viable macroeconomic framework

Fiscal policies

The fiscal policy for 2008 will remain austere given the high rate of inflation and the need to ensure macroeconomic stability and consolidate the overall people's trust in the program. In this context, the Government will maintain a budgetary deficit at 0.5% of the GDP.

In order to promote foreign and domestic investments, we have announced a major overhaul of the tax system for legal entities, as well as a fiscal amnesty for all outstanding debt and a liberalization of regulations pertaining to capital legalization. The corporate tax rate was set to zero, with the exception of dividend payments or such instances when other expenses, except business ones, are registered. The reform also foresees a write-off of all fiscal debt accumulated prior to 2007 (including fines and associated penalties not paid prior to the law's entry into force). We understand that such reforms imply certain risks, especially with regard to budget revenues, therefore, we have adopted a series of compensation measures in order to respect the fiscal and macroeconomic indicators included in the program.

Given that fiscal amnesty is a one-time thing, which will not be repeated, we intend to accelerate the implementation of the fiscal administration consolidation strategy. Hence, following the implementation of the plan approved in September 2007, we will improve the system of fiscal debt management in order to ensure debt repayment after its accumulation. We will be introducing a set of prompt and unconditional measures to forcefully collect debt, we will be amending the current legislation in order to shorten and simplify the procedures for annulment of fiscal debt which can't be collected and we will consolidate all domestic fiscal activities for evaluating and collecting debt under the umbrella of one consolidated agency.

Budgetary policy has in fact been focused on rationalizing and making more efficient public expenditures, as well as reallocating existing resources from less important to priority programs, which have a substantial impact on economic growth and poverty reduction. Medium term forecasts will continue to serve the key tool of matching Government policy priorities with available resources. Through MTEF, proposed sectorial policies will be evaluated by means of their financial implications, also taking into account potential reserves available in the process of resource management.

Treasury system development was continued as a means to consolidate financial discipline, including improvement of budget execution procedures.

As a result of undertaken measures, the revenues of the national public budget in 2007 have increased by 25% compared to the previous year.

The expenditures of the national public budget have increased by 24.7% compared to 2006. The policies related to public expenditures remained socially-oriented, as such 62.6%

of the national public budget was directed towards the social sphere and 16.7% of the total public budget was directed towards economic-related expenditures.

Monetary and exchange rate policies

In 2008 the National Bank of Moldova will continue to promote an austere and prudent monetary and currency policy in order to achieve the planned 10% annual inflation rate. The program foresees a monetary base increase of 25% by the end of 2008, with interest rates on a positive trend in real terms. This goal will be reached through the application of indirect instruments of monetary policy and will be facilitated by the improved situation of the National Bank of Moldova, as well as the transfer of remaining deposits from the National Social Insurance House and the National Medical House into the National Bank of Moldova's consolidated account by end of 2007. Also, by the end of 2007, the remaining resources of territorial administrative units will be transferred into the National Bank of Moldova's account.

1. The fundamental objective of the monetary and currency policy is ensuring and maintaining price stability. Thus, the National Bank of Moldova will continue to maintain a floating regime of national currency exchange rate and will intervene on the currency market in order to prevent excessive national currency fluctuations, which according to our expectations will allow an increase of international reserves to a level equivalent with three months of forecasted imports.

B. Main Program Pillars

I. General provisions

Taking into account the motivation to adopt profound and radical reforms, the Government has assumed the leading role in the implementation of a Program, with financial support from the poverty reduction support credit, which contains the following three major pillars:

(a) improving the investment climate;

(b) increasing the efficiency and management of public sector resources; and

(c) strengthening social protection systems.

From among the twenty established objectives and policy benchmarks undertaken under PRSC I, the Government has managed to achieve different results. In such sectors as health, energy and social assistance, the reform program has overcome the expectations included in PRSC II. All the prior actions under PRSC II have been fully met. Of these actions, the legislative acts related to regulatory reform, civil service, and amendments to the pension law have been submitted to Parliament. The Government is committed to ensuring their full promulgation by May 2008.

The description of results and plans for the next implementation year is described below.

I. Improving the Investment Climate

With regard to **Improving the investment climate**, it shall be noted that the Parliament of Moldova is in the process of adopting a Law on the amendment and completion of certain legislative acts nr. 111 of 24.04.2007, which lays down the basis for a broad and ambitious reform promoted by central public authorities, aimed at contributing to liberalizing the economy through promoting three different activities:

- capital legalization
- fiscal amnesty
- reform of the corporate tax system

Also, it shall be noted that in 2007 a number of activities were continued with regard to the implementation of legislative provisions on the principles and basic mechanisms for regulating entrepreneurial activities.

In the context of regulatory framework efficiency the Government will continue the implementation of the following activities in 2008:

- Finalizing the full analysis of laws which regulate business activity on the basis of the Law on the principles and mechanisms of regulating entrepreneurial activity.
- Adopting the Law on credit history bureaus
- Adopting the Law on private-public partnerships
- Implementing the provisions of the Law regarding industrial parks 164-XV of 13.07.2007
- Implementation of the **2008** provisions of the Strategy on investment attraction and export promotion, particularly: the signature of the asymmetric trade agreement with the EU, developing country branding and promoting domestic product brands, organizing and hosting investment forums, including dissemination of analytical and informational materials about the investment climate in Moldova.

i. ***Regulatory framework reform***

The Law on the basic principles of state regulation of entrepreneurial activity – adopted last year – contained a series of provisions, which came into force on the date of publication. The other ones – transitory provisions – were scheduled to enter into force within 12 months following the adoption of the Law.

Out of the transitory provisions, those which relate to the introduction of Regulatory Impact Assessment have already been implemented: RIA methodology was developed and approved by the Government, Ministries/Agencies have established RIA units and currently work is being carried out to build the capacity of these institutions.

A general revision of legislation has been undertaken, which resulted in a number of recommendations to amend over 80 laws. The legislative package to be amended included planned amendments in the area of licensing, due to the fact that cutting red tape in obtaining licenses constitutes a key element of regulatory reform and aims to improve a major area of concern for Moldova's private sector, one which has been on the agenda for many years.

Over the course of 2008, the ongoing reform of the business regulatory framework will be implemented and aimed to simplify and optimize registration, operation and liquidation of businesses, thus reducing, by far, the human / administrative factors in these processes. We will continue the implementation of procedures for Regulatory Impact Analysis and examination of normative acts in the framework of the Working Group of the State Commission for Regulation of Entrepreneurial Activity. Starting with 2008, informative notes, which accompany newly developed official acts, will contain a regulatory impact assessment.

At the same time, the Government will undertake activities to improve the institutional structure and functions of state control bodies, directing their work mainly towards oversight of enterprise activity without the need for on-site visits, with verifications taking place only in such cases when there are clear indications that enterprises are violating legislative provisions.

The need to harmonize the national legislation related to protection of competition to EU standards is imperative. It is essential to better define the various aspects of unfair competition by market partners and clearly spell out the prerogatives of the National Agency for Protection of Competition in enforcing an environment of fair competition.

ii. ***Trade facilitation***

Over the course of the first year of PRSC implementation the Government of Moldova has managed to complete, with support from a World Bank credit, a project related to facilitation of trade and transport in south-east Europe.

All foreign economic transactions are examined under ASYCUDA WORLD in order to evaluate risk factors and the possible impact on the economy. This includes a reduction of the number of document checks and physical inspections, a factor which could lead to export competitiveness enhancement, attraction of foreign investments and a better integration in the global economy.

The Customs Service has taken over the responsibility of collecting, processing and monitoring performance indicators related to customs work and goods processing.

The Customs Department has initiated and coordinates the implementation process of the "one-stop-shop" concept at the border crossings, which represents a component of an integrated state border management system. This factor highlights the ongoing reform of services and agencies responsible for state border controls, their efficient collaboration, the simplification of procedures and a reduction of the amount of time necessary for customs procedures, through an application of the "one-stop-shop" principle, in accordance with the recommendations of international organizations. At the same time, a series of changes and legislative amendments, which aim to harmonize Moldovan laws with European Union standards have been initiated. At 4 customs offices in Moldova an element of the "one-stop-shop" concept has been put into practice, which pertains to transmission of all customs procedures to one inspector. The first results of this change are highlighting an increased efficiency through a substantial reduction of the time necessary for completion of customs procedures.

In accordance with an action plan approved by the Government, the Customs Service has started the implementation of WCO Framework Standards regarding the Security and Facilitation of World Trade. The accomplishment of the above actions, the strengthening of the capacities and integrity of customs bodies, the simplification of customs procedures and harmonization of the legislative framework with EU legislation will remain, for the future, key priority areas for the Customs Service.

C. Development of agricultural markets

Despite the importance of the agricultural sector for the country's economy, it continues to display modest performances in comparison with the rest of the economy. Whilst cumulative economic growth for 2000-2006 totaled approximately 40%, the growth rate in agriculture din not exceed 10% for the same period of time. Year 2007 was particularly difficult for the Moldovan agriculture due to severe drought in the summer months, which consequently had a devastating impact on crops and livestock.

The critical situation registered in 2007 demonstrated the vulnerability of the agricultural sector of Moldova to weather factors and determined the Government to develop a new sector strategy – The National Strategy for sustainable development of the agro-industrial sector for 2008-2015, as well as the Action Plan regarding its implementation[1]. The document was approved by the Government in December 2007.

Strategy's main objectives are: - Increasing the competitiveness of the agro-industrial sector - Increasing productivity through investment attraction and sector innovations - Creating favorable conditions for value chain development - Developing agricultural markets - Adapting domestic standards to EU standards and ensuring food safety - Increasing the quality of life of people in rural areas - Ensuring the country's food security - Soil quality conservation

The Government is reiterating its commitment to promoting a sustainable development of the agricultural sector through enhancing the competitiveness and productivity of the sector, development of agricultural markets, eliminating market distortions including export restrictions as well as attraction of private investments in the private sector. The export of all agricultural products through the Universal Commodities Market is completely voluntary. The Ministry of Agriculture and Food Industry is monitoring the impact of eliminating the above restriction through a continuous analysis of prices for grains and oil seeds on domestic and international markets, particularly in neighboring countries such as Romania, Ukraine, Russia. The recently completed study on food security and grain price stabilization will serve as analytical base for taking informed decisions in shaping future state policies of supporting the grain sector in the context of food security and poverty reduction.

The Action Plan regarding the implementation of the Strategy for the development of the agro-food sector incorporates, among others, those actions planned under the matrix policy for PRSC II.

As such, the Government has carried out over the course of 2007 the following actions, which are relevant to policy matrix commitments in terms of the plant variety registration system: (i) the testing period was reduced to 2 years for seeds and 5 years for planting material; (ii) the membership of the National Council was reviewed and interested parties excluded; (iii) the right to appeal the refusal to register a variety was introduced. The number of new varieties registered in 2007 will approximate 80-90, which will represent a 5-6% increase compared to 2006. In 2008 the Government plans to broaden the spectrum of activities in this area.

With regard to the certification and standardization of products, the activities carried out in 2007 included, but were not limited to[2]: (i) increasing the degree of convergence of national legislation pertaining to food products with EU principles on food safety and the general requirements on food product marking; (ii) reorganization of veterinary labs in a consolidated network of regional labs and initiating their renovation and re-equipping with modern equipment; (iii) establishment and equipping of a unique and modern centre for alcohol product testing; (iv) creation of an animal register and initiation of implementation of animal identification and traceability systems.

Development of an agricultural markets information system requires a broad approach and a linking to existing informational systems in the IT network, in line with the National Strategy on Building an Informational Society. As an intermediary measure for better informing the domestic agricultural producers, the Government is collaborating with two

[1] With the entry into force of the new strategy for 2008-2020, the previous strategy for 2006-2015 (including the Action Plan) will be abrogated.

agencies – ACSA and Agroinform – in order to collect and disseminate prices for grains and oils seeds, and starting in 2008 the range of monitored products will diversify to include all basic agricultural products.

The Action Plan regarding the implementation of the new strategy and actions thereof include: (i) creation of an efficient and sustainable market information system; (ii) improvement of the certification and standardization system for agricultural products and (iii) liberalization of seeds and planting material imports.

One of the biggest concerns of Government and the public over the past two years has been the potential impacts of rising prices for food staples—particularly grains. During this time, Government has periodically used the Strategic Grain Reserve to keep the price of bread constant by providing wheat and wheat flower to bakeries. Government recognizes that to minimize market distortions, it is important for the Strategic Grain Reserve to operate in a transparent and objective manner, while at the same time using it to avoid food emergencies. To this end, the Government completed Government hired experts within PHRD for PRSC, which recently completed a *Food Security and Grain Price Stabilization Study*. In 2008, Government will begin implementation of an Action Plan based on the recommendations of the study, including to (i) approve regulations defining how and when the Strategic Grain Reserve should intervene (i.e., define "food emergency")..

The Government is convinced that all measures undertaken in the framework of PRSC aiming to develop agricultural markets are substantially contributing to enhancing the competitiveness and efficiency of the agricultural sector and equally to poverty reduction, and would like to express its commitment to further continue and enhance efforts in this area in order to reach sustainable growth in the agricultural sector, which is of vital importance for the country's economy and a large part of the population.

D. Reducing energy vulnerability

Minimizing Moldova's energy vulnerability to external shock prices remains a major challenge for the Government. The increase in energy prices, especially natural gas, has once again highlighted the importance of increasing energy efficiency and diversifying the types of energy sources and suppliers. Without progress in diversifying energy sources and suppliers, the increase in energy prices could have a negative impact on the competitiveness, already quite poor, of local products, as well as the general living conditions in the country.

Recently, (August 2007) a new energy strategy was adopted through 2020, which foresees a series of goals and measures to move towards a more efficient, competitive and safe energy sector, modernization of the existing energy infrastructure, increasing energy efficiency, making use of renewable energy resources and integration into the European energy market.

Over the course of 2007 a series of measures were undertaken to adjust tariffs to energy resources in order to cover the increase in energy resource prices. The rates of cash collection are maintained at over 90% for natural gas, whilst power plants are paying in a proportion of 83% for natural gas and 95% for electricity.

For the forthcoming period of poverty reduction program implementation the Government will review the existing legal and regulatory framework in order to adopt and implement an Action Plan for ensuring the legal correlation of the domestic natural gas and energy markets with the norms established by the South-East Europe Energy Community. As such, the focus will be placed on the development and initiation of new legislation and new market rules.

In order to promote state policy in the area of energy efficiency and renewable sources of energy, the creation of an Agency for Energy Efficiency is planned. At the same time, in order to implement programs and measures to increase the energy efficiency and promote new technologies with higher productivity and lower consumption levels the legislative-normative basis will be put in place in order to stimulate these activities and work will be carried out to further raise awareness of this issue among companies in the sector.

The success of these measures will facilitate the attraction of investments in energy efficiency projects in the public and private sectors, contributing to the reduction of the energy intensity of the economy. Tariff policies will serve as a cornerstone for the energy sources efficiency program, which the Government will develop and implement in order to improve the financial viability of enterprises in the energy sector, including Termocom company.

II. Increasing the Efficiency and Management of Public Sector Resources

The general objectives of the fiscal policy for 2008-2010 will be: (i) ensuring fiscal equality, stability and transparency; (ii) optimizing fiscal pressure and extending the fiscal basis; (iii) systematization and simplification of fiscal legislation; (iv) harmonization of principles underlying the national fiscal legislation with EU legislation.

The analysis of public expenditures reveals the balanced relationship between real expenditures and budgetary planning. In general, the control and monitoring of budget execution are good and have clearly established procedures. In order to create and implement an efficient and modern internal public control and audit, and in order to ensure compatibility with EU requirements, a strategy for the development of internal public financial control has been developed. At the same time, work is being carried out in order to approve a reform concept of record-keeping in the public system.

The Government agenda in 2008 will include a set of structural measures aimed at strengthening the economy's resistance to external shocks and create a solid base for a robust and inclusive economic growth. In this context, the reform of central public administration and the business regulatory framework will be ongoing. At the same time, a set of measures will be undertaken to improve the performance of the agricultural sector, through the revitalization of irrigation systems. In order to enhance the competitiveness of domestic products on the internal and external markets a special attention will be given to improving the quality infrastructure.

Increasing the population's access, especially the vulnerable groups, to basic medical services through developing the primary medical sector, ensuring access to quality education, consolidating the financial stability of the social insurance system, as well as the improvement of the social services system by making them pro-poor oriented are some of the essential challenges faced by the Government in the medium term framework. The policies proposed in the framework of poverty reduction support credit are aimed at improving the efficiency and management of public resources.

A. Meritocratic public service

The objective of the reform started in the second half of 2005 is the creation of a modern and efficient system of central public administration in line with the European Union principles of good governance. The reform implies the modernization of public administration in the Republic of Moldova through the reorganization of central public administration, optimization of the decision-making process and improving the management of human resources in the public service.

The implementation of the central public administration reform for 2007 was oriented towards the reorganization of the central executive branch, elaboration of development plans, increasing the efficiency of the policy document analysis and coordination system.

In September 2007, the Directorate for analysis of policy coordination was set up within the Government Apparatus, which aims to support the Cabinet of Ministers in defining the policy priorities and intersectorial coordination in the medium term.

The draft of the Law on public service and the status of the civil servant was approved by the Government and submitted to the Parliament for review.

Over the course of this year the adoption of secondary legislation is planned, which is necessary for the implementation of the new law, the completion of the classification and grading system in accordance with reviewed job descriptions, as well as the adoption of legislation regarding the new system of remuneration for civil servants, which should be accessible, transparent and uniform.

B. Remuneration

Here, it should be noted that work has been undertaken in order to develop the concept of financial motivation and determination of individual salaries for certain categories of civil servants. Work has been carried out also in job performance evaluation methodology for civil servants.

The process of improving the motivation system of civil servants will be continued over the course of this year. In 2008, particularly, a new system of remuneration for civil servants will be developed, which will consolidate salary bonuses and premiums into the base salary, in accordance with the new system of classification and grading of civil service functions. The variable part of the monthly salary will include the payment awards for qualifications and awards for individual and group performance of civil servants.

C. Medium-Term Expenditure Framework (MTEF)

The development of MTEF in the Republic of Moldova, as an instrument for medium term strategic planning, over the course of the past five years was the cornerstone, which guided the reforms of the methods and procedures that regulate budgetary planning. Amendments were made to budgetary legislation in order to ensure that MTEF is an indispensable part of the budgetary cycle. MTEF serves as the strategic framework for the national budget and facilitates the process of preparation and examination of the annual budget. The implementation of MTEF has increased the transparency and the understanding of the budgetary process within the Government and civil society.

Over the course of 2007 the Government has launched a process of identifying major investment projects. The lack of necessary information has made it difficult to finalize this exercise. Draft strategies have been recently developed in two pilot sectors and identified over the course of project scanning – water and sewage and roads.

Starting in 2008, the National Development Strategy (NDS) will represent the main document which sets the objectives and priorities of Government policy in the medium term (2008-2011). It will require a concentration and targeting of existing resources. In order to ensure a strong correlation between the NDS and MTEF, the annual update of the NDS action

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plan will be aligned with the MTEF drafting schedule and the annual budget. Also, these processes will be correlated in terms of the decision making mechanism with regard to priority resource allocation.

In order to improve the method of correlating the strategic policy formulation, especially the National Development Strategy (2008-2011) and the Action Plan for the implementation of the Strategy with the budgetary process, the Prime-Minister issued an instruction (February 2008) regarding the Concept of policy priorities in the context of MTEF development 2009-2011. The provisions setforth in this Concept will serve as the basis for the development of the MTEF 2009-2011 draft and the draft on fiscal policy for 2009.

D. Agricultural spending

The Government is reiterating its commitment to continue its efforts to optimize and enhance the agricultural support system, aiming to increase the competitiveness and growth in the sector, as well as reduce poverty in rural areas. In this context, the Government has eliminated, in 2007, existing restrictions to access subsidies conditional upon the size of agricultural enterprises. Currently, only subsidies for vineyard plantations remain conditional[3] and the Government will make efforts to eliminate these remaining restrictions.

Elimination of restriction criterias to access subsidies based on farm size has led to the increase of share of subsidies received by individual farms (comprised of peasant farms and rural households) up to 17% in 2007. Currently individual sector is using 40% of agricultural land, produce 70% of agricultural production and represent 99% from the total number of agricultural farms. Therefore the Government recognizes the necessity to do more in order to increase the access of this sector to programs of public support. The efforts will be made to increase the share of subsidies obtained by individual sector starting from 2008.

In order make more efficient use of limited budgetary resources the Government has developed a new Concept on subsidizing agricultural producers for 2008-2015, which spells out the objectives, principles, key directions, eligibility criteria as well as the institutional functionality of this new system of agricultural support. These principles will represent the basis of legislative amendments which relate to state support for the agricultural sector.

The severe drought of 2007 has caused considerable losses in the agricultural sector leading to a 23,1% decrease in agricultural production compared to 2006. In order to minimize the negative consequences of drought the Government has undertaken a series of measures, including an increase of the subsidies amount (mainly current subsidies) by 200 million lei. This factor prevented the accomplishment of PRSC commitments pertaining to the reallocation of agricultural expenses towards services and investment subsidies.

In this context, the Government aims to cover these gaps in 2008 in the framework of the Regulation regarding the manner of resource utilization from the subsidy fund for agricultural producers for 2008. In accordance with the existing legislation, in 2008, provided the budget for 2008 remains unchanged, the share of services as part of the total agricultural budget will reach 37%, which will represent an increase of 11% compared to 2006 figures (14% compared to 2007 figures). Investment subsidies will constitute 73% as share of total subsidies, 27% is respectively the share of current subsidies. As such, the share of investment subsidies will increase by 21% compared to the levels registered in 2006 (42% compared to 2007 figures). The Government has reconfirmed its commitment to direct the agricultural allocations towards activities which generate sustainable growth, such as services (which

[3] Subsidies for vineyards plantations available to agricultural producers are conditional upon the size of the plantation, which is 5 ha for technical grape varieties and 1 ha for desert varieties.

represent public goods) and investment subsidies (aimed to encouraging private sector investments). It is obvious that in order to reach these objectives it will be necessary to strictly follow the budgetary allocations.

The Government recognizes the need to reform the system of research and education in agriculture, which unfortunately loses touch with the real sector of the economy. In this respect, the „Evaluation of the research and education system in agriculture" was developed, which focused on the identification of problems in this area and formulation of practical solutions to overcome the above issue. On the basis of this study's recommendations, the Ministry of Agriculture and Food Industry, in collaboration with the Academy of Sciences of Moldova and agricultural research institutions, are currently developing an Action Plan regarding the reform of the research-innovation sphere and improvement of the financing of scientific research in the agricultural sector. Also, over the course of next years the Government will develop a concept of modernization of scientific research and education in the agricultural sector.

Also, in 2007 an evaluation of the efficiency of the special service for active influence on hydro-meteorological processes was carried out. We would like to mention that the Government is open to a long-term collaboration with the World Bank in the framework of the Regional Program on Reducing the Risk of Natural Calamities for south-east European countries, which was recently launched.

E. Transport infrastructure

In accordance with the Government's goals, the reform of road transportation includes the implementation of a commitment program aimed to stop the degradation of the road fund and commence their gradual renovation, create a sustainable system for sector financing, modernize the technical evaluation of roads and negotiate with international financial institutions in order to obtain loans for projects targeted for rehabilitation of national roads of European importance.

In order to accomplish these reforms, the Government has engaged in a series of road network rehabilitation projects with support from foreign creditors (World Bank, European Bank for Reconstruction and Development, European Investment Bank). The Land Transport Infrastructure Strategy was developed and approved. It covers all essential aspects of management and financing of roads and railways and in particular: (i) road maintenance financing reform; (ii) gradual introduction of competition in road maintenance contracts commissioning and (iii) participation of road users in the oversight of road maintenance financing. The Strategy also contains a prioritized investment Plan for roads and railways infrastructure.

As a measure of accomplishment of the approved Strategy, an overhaul of the legal framework related to road maintenance financing will be carried out.

The creation of a sustainable and transparent system of road financing is a priority on the agenda of local and central public administration. In this context, the Government plans to invest more in this sector, also by means of increasing annual budgetary allocations, equally focusing on maintenance and repairs of roads in order to reduce the volume of national roads in a precarious state. In 2007, the total volume of financing from various sources reached 50 mln. USD. For the next year we forecast a gradual increase of the allocation for road maintenance. At the same time, the Government will respond to issues of inefficient expenditure in the sector through a gradual improvement of the capacity of State Roads Administration body, in addition to improving the quality of competition in contract commissioning for road maintenance and rehabilitation.

F. Educational system

Recognizing the decisive role of education, and taking into account the constitutional provisions and other commitments, the Government has included in the National Development Strategy the objective drafted in EGPRSP: ensuring access to quality education services and an efficient and sustainable functioning of the educational system, increasing its role in economic and human resource development. At the same time, one of the main objectives of the Millennium Development Goals (MDG) for Moldova is provision of universal access to basic education.

The project „Quality education in rural areas" has already started with support from the World Bank. The Ministry of Education, Youth and Sports has developed the Strategy for optimization of secondary education school networks in the Republic of Moldova on the basis of an analytical report, which contains information about the current situation and trends with regard to institutional networks, capacity, numbers of students, professors, administrative staff etc.

The draft strategy is elaborated based on school mapping exercise, proposals of local public administrations and its goal is to make more efficient use of financial resources, capacity of education institutions , of capital investments and functional structures of education system and not in the last instance to ensure access to quality education for all children from our Republic

This year, the piloting of strategy is planned to be launched in two pilot rayons among schools identified for optimization.

At the same time, we will be reviewing the current financing formula for secondary education institutions - piloted in the framework of the „Quality education in rural areas" project. The new financing formula, combined with school autonomy and network optimization, will contribute to the improvement of quality through a better efficiency, thus freeing resources for teaching staff salary increases and other items pertaining to quality in education, such as teaching materials, equipment and refresher trainings.

G. Health sector reform

In the past few years Moldova has achieved a significant progress in health sector reform.

First stage of reforms was oriented towards stopping the decline of the health system, caused by the financial crises of the 1990s.

Second stage, was largely characterized by the introduction of mandatory medical assistance insurance, which made medical care more affordable financially, yet the financial protection offered by health insurance made the sanitary system become more receptive to population's needs. The level of people's satisfaction with the quality of health services has also increased prior to the introduction of this substantial reform. Currently, 77.8% of the population is covered under the mandatory medical insurance scheme, with 56% of the resources in the medical assistance insurance fund coming from budgetary sources allocated for categories of beneficiaries covered by the state. The mandatory medical assistance has not managed to include among its beneficiaries self-employed people of working age.

Next stage of reforms foresees the mobilization of all resources towards structural changes, which would result in an improved efficiency and quality of the health system and a broader coverage of the population by mandatory medical assistance.

The Government is in the process of developing the new elements of health insurance, in order to extend the coverage of population, especially in rural areas, with mandatory

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medical assistance insurance policies. Additionally, in order to increase the medical insurance coverage, the Government aims to introduce a benefits scheme, which involves the reduction of the insurance premiums by 50% for those beneficiaries who pay for the insurance within 3 months following the introduction of the Law on mandatory medical assistance insurance funds for 2008.

In order to develop the financial autonomy of the primary medical assistance service a direct contracting procedure of primary medical institutions has been piloted. As such, in 2007, 19 direct primary medical service providers were contracted, which represents 5.1% of the total number of Health Centers, thus reaching the indicator planned for 2009 (*according to the Policy Matrix for PRSC).* Starting in January 2008, primary medical service providers (100%) shall be directly contracted by the National Medical Insurance House.

This year it is planned that at least 25% of family doctors centers with autonomous legal status from the public sector will be managed by people selected on an open-competition basis.

For the next years the Government will maintain the financing at a minimum level of 30% of allocations for primary medical assistance from the budget for mandatory medical assistance insurance.

At the same time, the Government has committed itself to improving the management of the health system. Current reforms in the health sector have given a greater autonomy to public medical institutions. In order to make the new model of health functional it is necessary to train the managers and there is a need for programmatic training of administrators who have modern views and outlooks.

H. Public procurement

The creation and maintenance of an efficient public procurement system could assist in securing savings of public expenditures. In this respect, starting January 1st 2005, the decentralization of public procurement system was initiated, which clearly established the mandates and responsibilities in the process of procurement of public goods, works and services. This measure has contributed to increasing the transparency in the process of public procurement through placement of ads, publication of relevant information, results, reports, template files, projects, etc., both in the informative note for public procurement, as well as on the corporate website.

Public procurement statistics (single source and public tenders) have maintained a positive trend even in 2005. For the first 6 months of 2007, 8.98% of single source and 70.74% of public tenders were registered by the Agency. The Government intends to carry out an exercise of evaluating public procurement using OECD/DAC indicators.

In order to adjust the legal framework, which regulates public procurement, the Government of Moldova, with support from foreign experts, has developed a new law on public procurement that provides for creation of independent procurement agencies with staffing and budgetary resources in accordance with the provision of central public administration reform. The Law came into effect in October 2007.

The Government will be responsible for monitoring the implementation of the Law on public procurement and shall examine the need and possibilities to ensure de jure independence of the public procurement oversight function.

In order to facilitate the implementation of the law, the Government has approved an action plan which includes, among others, the drafting of legislative acts, consolidation of capacities and training of persons involved in the process of public procurement, increasing the transparency and responsibility in public procurement.

III. Strengthening Social Protection Systems

A. Finalizing the pension system reform

The 1999 pension system reform has reached its objectives in the medium term: on time payment of pensions, in the context of limited budgetary transfers. However, despite this fact, the pension system reform remains unfinished business, whilst the Law on pensions has not been fully implemented.

The measures undertaken by the Government have included the development of individual reports which would allow the calculation of pensions based on current individual contributions. The National House has individual reports from 1999 for all current taxpayers, with the exception of individual farmers. We are currently finalizing the implementation process of individual record-keeping of taxpayers and social insurance contributions.

Attempts were made to improve the medium and long term forecast practices of revenues and expenditures in the social insurance budget. In order to estimate the economic and social costs of pension system reforms, a set of actuarial models was applied. The use of such an instrument will allow for an analysis of the evolution of social expenditures in different economic situations and different reform scenarios, increasing the efficiency of decisions, identification of social needs and priority planning in MTEF and NDS.

The improvement of social protection policies, particularly the pension system is on the Government agenda and includes programs and measures to create unique conditions of retirement for all categories of pensioners through the implementation of the principle regarding the correlation between the size of the pension and the individual contribution for each insured person.

The Government has approved and sent to Parliament the amendments to legislative acts which confirm the principle of pension imbursement on the basis of individual contributions.

The unification strategy for all categories of taxpayers/pensioners is currently being finalized. Due to the complexity of this reform there is a need for a broad consultation of this document and the incorporation of best practices to secure the successful accomplishment of the strategy. In order to improve the social insurance system the laws on state social insurance pensions and public system of social insurance will be further amended.

B. Increasing the distribution efficiency in the social assistance benefits system

In 2007, the Government has undertaken a series of actions in order to consolidate the multiple social assistance programs. As such, during the Government seating on 3rd October 2007, the draft Law on social assistance was approved, which aims to provide a minimum monthly income for socially vulnerable families through provision of social assistance, in accordance with the average global monthly income of the family and the real need for social assistance. The draft law will be submitted to Parliament for approval.

Ministry of Social Protection plans to approve in 2008 the regulations regarding the implementation of the law and target criteria, in order to start the implementation of the law by September 2008. The Ministry has to recruit and adequately train the additional personnel necessary for the management of the targeted social assistance program.

The design concept of the database system was completed. The regulations regarding the implementation of the Law on social assistance will require the collection of additional information, a factor which will require an adjustment of technical and functional specifications of the consolidated social assistance database.

Finally, I would like to use this opportunity to assure you that the Government is fully determined and dedicated to its continuous reform commitments, which are necessary for economic growth and poverty reduction, improving the overall standards of living through increasing performance in priority areas, such as good governance, infrastructure, health, education and social services. It is equally committed to provide an impetus to private sector development through provision of quality services for the country's citizens and ensuring the country's sustainable growth. I am convinced that the country can count on your personal and the World Bank's continuous support.

ZINAIDA GRECIANÎI

PRIME MINISTER

ANNEX 2. PRSC POLICY MATRIX

Objective/Issues	PRSC-I (Actions Taken)	PRSC-II (Actions Taken)	PRSC-III) (Proposed Triggers in Bold)	Outcome/Monitorable Indicators
Pre-requisite: Maintain Macroeconomic Stability	**Maintained a satisfactory macroeconomic framework**	**Maintained a satisfactory macroeconomic framework**	**Maintain satisfactory macroeconomic framework**	GDP growth of at least 4% in 2007 and 5% thereafter; inflation kept at 10.5% in 2007 and in single digits thereafter; fiscal stance consistent with macroeconomic framework; total PPG debt levels at sustainable levels.
Pillar I. Improving the Investment Climate				
A. Reducing regulatory and administrative costs of business regulations	**Adopted a Government decision on Establishment of a Registry of Official Acts Regulating Business Activity based on regulatory review.** **Adopted Law on Basic Principles and Mechanisms of State Regulation of Business Activity.**	**Implemented transitional provisions of the Law on Basic Principles and Mechanisms of State Regulation of Business Activity through the Government adoption and submission to Parliament of a draft law covering amendments to 80 laws.**	**Adopt and submit to Parliament amendments to the Law on Protection of Competition to: (i) provide clearer definitions of various types of unfair competition by market participants, and (ii) clarify the powers of NAPC in enforcing fair competition.**	Reduced of regulatory compliance costs - CODB survey shows percent of management time spent on meeting regulatory requirements reduced from 17% in 2004. Average firm licensing and authorizations costs reduced from 52% of per capital GDP in 2004 to 30%). Frequency of inspections at or regional average.
B. Improving trade facilitation	**Introduced risk-based selectivity using Asycuda selectivity module at the Chisinau Customs terminal.**	Decision approved on sustainable Customs border and clearance performance indicators and reporting system.	Reduce number of agencies at the border crossing points (in line with the EU practice on border organization and structure) and customs collects fees at the border on behalf of other agencies.	Physical inspection by MCS not to exceed 30% of total declarations on a monthly basis. Reduce average monthly import clearance time at the inland terminal of Chisinau and average monthly border crossing entry time to 30 minutes.
C. Developing agricultural markets	**Liberalized agricultural exports by issuing and publishing a Government**	Conducted review of impact of export liberalization on cereals and oilseeds prices	Continue to review export liberalization of cereals and oilseeds by monitoring farmgate	The gap between prices received by farmers and international parity prices for cereal and

	decision making the Universal Commodities Exchange purely voluntary for all commodities. Developed terms of reference for a study on the impact on grain price, covering the use of profit margin ceilings on bread, management of state grain reserves, and external trade policies. Began dissemination of information on international prices for cereals and oilseeds in local media.	Completed Food Security and Grain Price Stabilization Study **Began implementation of an Action Plan to cover, inter alia, liberalization of the import regime for seeds and seedlings; improvements in agricultural product standardization and certification system; and development of a Market Information System, including scaling up dissemination of cereal and oilseed prices to cover prices on domestic markets.** Adopted law on Savings and Credit Associations (SCAs) providing for multi-level licensing with corresponding reporting and supervisory requirements, and proper enforcement tools.	prices relative to international parity prices. Approve and begin implementing Action Plan based on completed study that includes regulations defining how and when the Strategic Grain Reserve should intervene. Continue implementation of Action Plans, including: (i) scaling up of market information system to cover all basic commodities that account for at least 5% of value of agriculture production; and (ii) reducing testing periods for annual and perennial crops in the EU common catalogue to 1 year and 4 years, respectively. Conduct review of impact of accelerated testing.	oilseed crops as measured by nominal protection coefficients (NPCs) at the factory (processor) gate has been reduced by 25% relative to 2005. Improvement in rural poverty headcount. Price information on all basic commodities representing at least 5% of value of agriculture production for both domestic and international markets reported in local media at least weekly. New varieties registered have increased by 25%. Maximum time to evaluate and test seeds reduced to 1 year, and 4 years for seedlings. Implementation of SCA law.
D. Reducing energy vulnerability.	Regulator increased domestic gas tariffs in response to the increase of price of imported natural	Adopted a new Energy Strategy aimed at legal, regulatory and technical compliance of the energy	**Government develops and adopts a new energy law that enables new market rules that would provide solutions to,**	Increase energy efficiency by reducing by 10% energy intensity measured by the total primary energy use (toe) per

	gas (from 80 to 160 $/mcm) passing full cost increase to consumers.	sector in Moldova with the Energy Community Treaty (ECT) and the EU energy directives.	**inter alia: (i) cross-border electricity trade and congestion management; and (ii) gradual power market opening.**	$1000 of GDP at PPP rate, in comparison to the base value in 2005. Cash collection ratios above 90% for natural gas and above 95% for electricity. Cost recovery of gas, electricity and heat tariffs for all categories of consumers (including households and budgetary institutions) approaches 100%. The regulatory framework in the electricity market compatible with relevant provisions of the ECSEE Treaty and the EU electricity directives. Energy as a share of household expenditures as reported by Household Budget Survey.
Pillar II. Improving The Efficiency and Management Of Public Sector Resources				
A. Building a meritocratic civil service	**Approved a strategy to ensure competitive merit based recruitment of civil servants including procedures for open competition for vacant positions, appointments and a system of civil service appeals.**	**Adopted and submitted to Parliament a draft Civil Service Law that defines the scope of the civil service, contains guiding principles for competitive merit based appointments and promotions, posts classification and grading and institutional responsibilities civil service management**	**Adopt regulations and secondary legislation required for implementation of new Civil Service Law, including: (i) regulation on Classification and Grading of civil service posts; (ii) regulation on the Automated CS Register; and, (iii) revised procedures for competitive recruitment.**	New civil servants to administrative posts in ministries and central agencies appointed through an open, competitive, merit- based selection process as specified in new civil service law.
B. Implementing a transparent and	**First phase of the remuneration reform**	Began work on developing a new civil service classification	Develop legislation to introduce a new affordable, transparent,	Base salary makes at least 75-80% of the total take-home pay

uniform remuneration system for civil servants	**implemented increasing base salary for civil servants.**	and grading system. The Government approved a 3-year strategy to optimize the public sector employment. Sector ministries have been tasked with developing their action plans to rationalize employment in respective public sectors.	and uniform pay system for civil servants based on new civil service classification and grading system Responsible line ministries and institutions develop and adopt public employment action plans which aim gradually rationalizing employment in respective public sectors.	and adequately reflects the value of job of the position-holder. Information on the public sector pay is centrally available for review and analysis
C. Improving the Strategic Allocation of Public Resources.	MTEF framework for 2007-2009, including a technical annex on public investment spending, is approved by the Government and submitted to Parliament for information in advance of the 2007 budget.	Established a central policy unit to support the Cabinet of Ministers in defining medium-term policy priorities. Government approved a decision to integrate a medium-term policy priority statement into the MTEF. Introduced Project Identification Form (PIF) database to aid the prioritization of projects against alternative scenarios	Based on the Government's national programs, the Government issues a policy statement defining the list of policy priorities as guidelines for the preparation of the MTEF for 2009-2011. Continue implementation of the Project Identification Form (PIF) database for the sectoral investment priorities.	Strategic policy focus of annual budgets improved through a stronger linkage between the MTEF and annual budget laws. Improvements in the quality of public investment projects selected for funding; Increased use and awareness of economic cost-benefit analysis in the public sector.
C.1. Agricultural Spending	No provision of post-1999 debt relief for agricultural enterprises/ producers, except in the case of one-off relief for firms undergoing privatization. **Created level playing field for all agricultural support programs by**	Began reallocating agricultural expenditures by: increasing the share of services and reducing share of subsidies over the next three to five years. Drafted an Action Plan to streamline and modernize the agricultural research, training	Continue reallocating agricultural expenditures to growth enhancing measures. Finalize and begin implementation of an Action Plan to streamline and	No new debt write-offs for agricultural enterprises/ producers have occurred. Share of agriculture expenditures on subsidies reduced by 3 percentage points in 2007, and 5 pp every year thereafter. Peasant farmers' share of

	removing all restrictions on access to subsidies and supports based on farm ownership structure or size and developing objective and transparent eligibility criteria.	and education system that includes: international benchmarking; rationalization requirements; land and funding needs. Evaluated efficiency of special service for the active influence of hydrometeorological processes and alternatives.	modernize the agricultural research system; complete concept to modernize the agricultural training and education system. Increase the share of subsidies going to individual (peasant and household) farms, with the objective of increasing by at least 5 percentage points each year (assuming sufficient applications); collect data on beneficiaries of subsidies (including VAT output, MTS, and vineyard) by farm type and farm size	Agricultural Subsidies.
C.2. Transportation Infrastructure		**Adopted strategy for transport infrastructure management and financing, with emphasis on road maintenance, reconstruction and capital repairs that included (i) mechanisms for reform of road financing; (ii) introduction of competition in the execution of road maintenance contracts; and (iii) participation of road users in the oversight of road maintenance financing.**	**The amount allocated in the National Budget for Road Maintenance and transferred to the Road Maintenance Fund will represent at least MDL450 million in 2009. Sustainability will be ensured through the allocation of revenues from the fuel excise tax to the Road Maintenance Fund.**	Actual funding from all sources for road maintenance, reconstruction and capital repairs reaches the amount of US$50 million in 2007 and US$90 million in 2009. 80% of the additional funding for road maintenance (beyond the 2006 funding level) is used for road maintenance contracts awarded through competitive bidding.
C.3. Education Spending		**Drafted strategy to optimize school networks, consultations initiated with stakeholders, prepared for piloting the strategy in 2 rayons.**	**Finalize draft strategy to optimize school network and begin piloting in 2 pilot rayons including simulation of the use of a revised funding formula.**	Student/Teacher and Student/Non-teacher ratios increased from 12.7 and 24.9 (2005) for public general schools. Share of expenditures on non-

				wage quality related items increased.
C.4. Promote efficiency of health care spending		Adopted procedures for direct contracting with primary health care centers. HIC directly contracts with at least 5% of primary health care centers.	Twenty-five percent of rayon level primary health care centers (i.e. 9 out of 35) managed by competitively selected managers.	Share of health insurance budget allocation to primary health care increased to 30%.
D. Public Procurement	**Increased competition for public procurement contracts (decline in single source procurement from 51% to 45% of the value of contracts awarded; increased use of open tendering from 28% to 40% of value of contracts awarded)**	Enacted new Public Procurement Law.	Address institutional reporting arrangements to avoid conflict of interest in the public procurement supervisory function. Undertake Action Plan for implementation of Public Procurement Law. Prepare a medium-term Action Plan to ensure adequate staffing and funding for the Procurement Agency.	No more than 10% of number contracts and 10% of the total value of contracts awarded by single source procurement. At least 50% of number contracts and 70% of the total value of contracts awarded by open tender. Publication of an Annual public report on the conduct and results of public procurement.
Pillar III. Strengthening Social Protection Systems				
A. Completing Pension System Reform Program	**Continue implementation of individual account system by ensuring integrity of 2005 contribution data in NSIH database.** Development of	**Adopted and submited to Parliament draft amendments to pension laws enabling pension payments to be made based on individual pension contributions.**	Adopt and submit to Parliament amendments to Article 29 of the Law on Public System of Social Insurance (Law 489) to clarify that pension benefits are based on actual contributions paid. Adopt and submit to Parliament an amendment to make mandatory the issuing annual statement providing summary information on individual pension contributions to date to all individual insured contributors.	Individual accounts established for 100 percent of all known pension fund contributors. Increase correlation between contributions and expenditures for all types of pensioners.

	Agricultural Sector Pension Reform Strategy.	Developed strategy to unify the pension systems for all types of pensioners (i.e. non-farmers, farmers and privileged).	Complete draft strategy to unify the pension system that includes equalization of benefit calculation/entitlement rules for all categories of contributors (following a period of transition); eliminates privileges and strengthen the link between contributions and benefits including changing the second part of the benefit formula to include revaluation of wages.	
B. Enhancing the distributional efficiency of social assistance benefit system		Approved and submitted to Parliament draft Law on Social Assistance, establishing the legal basis for poverty targeting. Designed a unified database of the beneficiaries of cash-equivalent social assistance programs	Develop implementing regulations for improved poverty targeting. Development of a computer system for the administration of targeted poverty benefits and for the provision of the consolidated social assistance database (development and approval of technical specifications).	Share of poverty-targeted (i.e. means tested) social assistance program budget in the total social assistance program budget increased from 17.7% in 2005.

ANNEX 3. PRSC RESULTS MATRIX

Objective/Issues	PRSC program Outcome Indicators	Results to date
Pre-requisite: Maintain Macroeconomic Stability	GDP growth of at least 4% in 2007 and 5% thereafter; inflation kept at 10.5% in 2007 and in single digits thereafter; fiscal stance consistent with macroeconomic framework; total PPG debt levels at sustainable levels.	GDP growth estimated 4.8% in 2006, 5% in 2007; inflation exceeded 13% in 2006-2007 as result of external shocks; fiscal stance has exceeded IMF program targets; PPG debt levels have fallen from 27.4 % of GDP in 2005 to an estimated 21.2% in 2007.
Pillar I. Improving the Investment Climate		
A. Reducing regulatory and administrative costs of business regulations	Reduced regulatory compliance costs – CODB survey shows percent of management time spent on meeting regulatory requirements reduced from 17% in 2004.	Management time spending complying with Government regulations reduced to 16%.
	Average firm licensing and authorizations costs reduced from 52% of per capita GDP in 2004 to 30%. Frequency of inspections at or regional average.	Average licensing and authorization costs at 38% of GDP per capita in 2007.
B. Improving trade facilitation	Physical inspection by MCS not to exceed 30% of total declarations on a monthly basis.	Physical inspection rate reduced from 99.9% in 2004 to 50%5 in 2007.
	Reduce average monthly import clearance time at the inland terminal of Chisinau and average monthly border crossing entry time to 30 minutes.	Clearance times reduced from 471 minutes in 2004 to 120 minutes at inland customs terminal.
C. Developing agricultural markets	The gap between prices received by farmers and international parity prices for cereal and oilseed crops as measured by nominal protection coefficients (NPCs) at the factory (processor) gate has been reduced by 25% relative to 2005.	Gap for wheat/maize/sunflowers reduced from -28% / -48% / -18% average in 2000-2004 to 5%/-13%/-27% in 2006-2007.
	Improvement in rural poverty headcount.	Revisions to HBS make comparison between 2005 and 2006 headcount (34.1%) difficult. Poverty profile is largely similar with past surveys.
	Price information on all basic commodities representing at least 5% of value of agriculture production for both domestic and international markets reported in local media at least weekly.	International grain price information collected and disseminated with assistance of NGOs.
	New varieties registered have increased by 25%. Maximum time to evaluate and test seeds reduced to 1 year, and 4 years for seedlings.	Testing period for seeds and seedlings has been reduced to 2 and 4 years respectively. No new registered varieties for important crops such maize, sunflower, vegetables or fruits in 2007.

D. Reducing energy vulnerability.	Increase energy efficiency by reducing by 10% energy intensity measured by the total primary energy use (toe) per $1000 of GDP at PPP rate, in comparison to the base value in 2005.	PPP data only available for 2005. Energy intensity, as measured by total energy consumed/ real GDP (lei)/ has decreased by 6.0% between 2004 and 2006.
	Cash collection ratios above 90% for natural gas and above 95% for electricity.	
	Cost recovery of gas, electricity and heat tariffs for all categories of consumers (including households and budgetary institutions) approaches 100%.	Tariffs set at cost-recovery levels.
	The regulatory framework in the electricity market compatible with relevant provisions of the ECSEE Treaty and the EU electricity directives.	Regulatory framework under revision.
	Energy as a share of household expenditures as reported by Household Budget Survey.	Energy represents 7.9 percent of household expenditures (2005 HBS)
Pillar II. Improving The Efficiency and Management Of Public Sector Resources		
A. Building a meritocratic civil service	New civil servants to administrative posts in ministries and central agencies appointed through an open, competitive, merit- based selection process as specified in new civil service law.	In 2007, in the absence of the new civil service law, 30% of new civil servants were appointed through a competitive, merit-based process.
B. Implementing a transparent and uniform remuneration system for civil servants	Base salary makes at least 75-80% of the total take-home pay and adequately reflects the value of job of the position-holder. Information on the public sector pay is centrally available for review and analysis.	Base salary increased from 25% of total remuneration to 50% in 2007. Further increases planned during the course of the ongoing pay reform effort.
C. Improving the Strategic Allocation of Public Resources.	Strategic policy focus of annual budgets improved through a stronger linkage between the MTEF and annual budget laws.	Policy Analysis and Coordination Unit created in the Government apparatus. MTEF Concept document for 2009-2011 contains medium-term policy priorities consistent with National Development Strategy. This has been approved by the Prime Minister to guide budget planning process.
	Improvements in the quality of public investment projects selected for funding. Increased use and awareness of economic cost-benefit analysis in the public sector.	For transport, water and sanitation sectors, project database established to aid the prioritization of projects against alternative scenarios.
C.1. Agricultural Spending	No new debt write-offs for agricultural enterprises/ producers have occurred.	As part of the Government overall strategy, all liabilities (for all sectors) to the Government prior to 2007 were eliminated.

	Share of agriculture expenditures on subsidies reduced by 3 percentage points in 2007, and 5 pp every year thereafter. Peasant farmers' share of Agricultural Subsidies.	Driven by drought related spending, subsidies increased by 2 percentage points in 2007 (recurrent spending subsides increased by 17 percentage points). Peasant farmers received 12% of subsidies in 2007, up from 11% in 2006. With exception of vineyards, minimum farm size requirements reduced to 0.5 hectares.
C.2. Transportation Infrastructure	Actual funding from all sources for road maintenance, reconstruction and capital repairs reaches the amount of US$50 million in 2007 and US$90 million in 2009. 80% of the additional funding for road maintenance (beyond the 2006 funding level) is used for road maintenance contracts awarded through competitive bidding.	Adopted Transportation Strategy provides for 80% of the excise tax on fuel in 2009, and 100% subsequently, to be channeled into road maintenance: about MDL 450 million ($40 million) in 2009; and gradually reaching MDL 800 million ($72 million) per year. Foreign financing will push those figures still higher.
C.3. Education Spending	Student/Teacher and Student/Non-teacher ratios increased from 12.7 and 24.9 (2005) for public general schools. Share of expenditures on non-wage quality related items increased.	Ratio of pupils/teachers was 13 in 2006-2007; ratio of pupils/non-teachers was 22. Public consultation on Education optimization strategy underway
C.4. Promote efficiency of health care spending	Share of health insurance budget allocation to primary health care increased to 30%.	Primary health care spending increased from 17% to 30.9% of total health spending. Direct contracting with primary health care centers allowed as of January 1, 2008.
D. Public Procurement	No more than 10% of number contracts and 10% of the total value of contracts awarded by single source procurement. At least 50% of number contracts and 70% of the total value of contracts awarded by open tender. Publication of an Annual public report on the conduct and results of public procurement.	For first part of 2007, opening tendering accounts for 70.4 percent of contracts (up from 19% in 2003); 8.9% of contracts awarded via soul sourcing (down from 45% in 2003).
Pillar III. Strengthening Social Protection Systems		
A. Completing Pension System Reform Program	Individual accounts established for 100 percent of all known pension fund contributors. Increase correlation between contributions and expenditures for all types of pensioners.	All post-2005 data has been recorded in individual accounts for all known pension fund contributors.

B. Enhancing the distributional efficiency of social assistance benefit system	Share of poverty-targeted (i.e. means-tested) social assistance program budget in the total social assistance program budget increased from 17.7% in 2005.	Mean-tested social assistance spending will be introduced in September 2008. Transfers to households have increased from 0.6% of GDP in 2003 to 1.9% in 2007.

IMF Executive Board Concludes 2007 Article IV Consultation with the Republic of Moldova

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On March 12, 2008, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Moldova.[1]

Background

Moldova is doing well, despite a series of consecutive shocks, which included the doubling of the price of imported natural gas and Russia's ban on imports of Moldovan wine in 2006, and a severe drought in 2007. Growth is estimated at 5 percent in 2007 and is projected to increase to 7 percent in 2008. Investment is picking up, and is beginning to replace remittances as the main source of growth—an encouraging sign that the earlier model of consumption-driven growth is changing.

Moldova increasingly faces the challenges experienced by other transition economies. Improved growth prospects have come with strong appreciation pressures from foreign exchange inflows, and a widening trade deficit. Foreign direct investment (FDI) has picked up and is estimated to have reached 12 percent of GDP in 2007, compared with 7 percent in 2006.

The main macroeconomic concern is inflation, which at 13 percent remains high for the region.

A deterioration in the merchandise trade balance due to strong import growth has been offset by improvements in net income and transfers, with a small improvement in the current account deficit to 12 percent of GDP. A resumption of wine exports to Russia in October was a major positive development, although volumes are likely to recover slowly.

Fiscal policy remained tight, ending 2007 with a modest deficit of 0.3 percent of GDP. Strong revenue performance was driven by robust VAT on imports, while expenditure was kept in line with the budget. However, the tax cuts introduced in 2008 may undermine the favorable fiscal position.

Monetary tightening in 2007 was complicated by the strong inflow of foreign exchange. The National Bank of Moldova increased reserve requirements from 10 to 15 percent, and raised policy interest rates by 2.5 percentage points. Nevertheless, the possibility of second-round effects from the drought, liquidity pressures from growing remittances and FDI, and the continued strong growth in credit and broad money suggest that upside risks to inflation are not yet fully contained.

Executive Board Assessment

Executive Directors welcomed the improved growth prospects and decline in poverty in Moldova, and commended the authorities for their reform efforts and balanced macroeconomic policies. Developments in Moldova appear to mirror increasingly those in other transition economies, with large capital inflows, appreciation pressures on the national currency, and a widening trade deficit. Directors underscored the importance of maintaining macroeconomic stability and improving the business environment to support private sector development and to help reverse the emigration of labor.

Directors considered that inflation remains high relative to that in other countries in the region, even after accounting for the drought. They cautioned that with strong foreign exchange inflows and rapid credit and reserve money growth, upside risks to inflation remain. The recent monetary tightening by the National Bank of Moldova (NBM) was welcomed, as was its commitment to establish price stability as its sole monetary policy objective. Directors noted that with considerably lower labor costs and higher productivity growth in Moldova compared to the region, there is scope for further exchange rate appreciation without undermining competitiveness. They urged the central bank to allow greater exchange rate flexibility.

Directors commended the authorities for their disciplined fiscal policies. Modest deficits are an appropriate compromise to balance development and disinflation objectives. Directors welcomed the authorities' efforts to strengthen tax administration and to increase social and investment spending, while maintaining the deficit target. At the same time, they stressed that the budget should remain tight until low single-digit inflation is firmly reestablished, and that any spending related to potential overperformance on the revenue side should be conditional on achieving the inflation objective.

Directors welcomed the authorities' plans for reducing the size of the public sector, introducing a transparent and competitive remuneration system for the public service, and consolidating education and health care networks. These were seen as important steps toward a leaner government structure to ensure efficient management of scarce public resources, and to allow more room for pro-poor and pro-growth spending.

Directors welcomed the authorities' commitment to bolster structural reforms aimed at improving the investment climate and clarifying the role of the state in the economy. They were particularly encouraged by the efforts to streamline the business licensing and registration procedures, to improve the transparency of regulatory agencies and reduce red tape, and to strengthen bankruptcy procedures and competition legislation. Directors supported the government's decision to revitalize the privatization process, including the intention to sell remaining large state enterprises, which would help to reduce the weight of the state in the economy and provide a catalyst for private sector growth.

Directors considered modernization of the energy sector as a high priority. They welcomed the strengthened independence of the energy regulator and establishment of heat tariffs at a cost recovery level, which will be critical for the financial viability of the utilities. At the same time, they stressed that timely introduction of a new targeted social assistance scheme will be essential to ease the burden of higher tariffs on the poor.

Directors noted that the financial sector is stable, and urged the authorities to be vigilant in addressing the remaining vulnerabilities in the sector. Strengthening the supervisory and regulatory framework and increasing the transparency of bank ownership will be crucial to ensure the soundness of the banking system. Directors welcomed the authorities' efforts to accelerate privatization of Banca de Economii, which will help to enhance competition in the banking sector and attract additional banking expertise. They urged the authorities to ensure that the new Anti-Money Laundering/Combating the Financing of Terrorism law is implemented effectively.

Republic of Moldova: Selected Economic Indicators, 2005-10 [1]/

	2005	**2006**	**2007**	**2008**	**2009**	**2010**
		Prel.	Proj.	Proj.	Proj.	Proj.
I. Real sector indicators	(Percent change; unless otherwise indicated)					
Real growth rate	7.5	4.0	5.0	7.0	8.0	7.5
Nominal GDP (billions of lei)	37.7	44.1	51.3	58.8	68.2	76.0
Nominal GDP (billions of U.S. dollars)	3.0	3.4	4.2	5.3	6.5	7.4
Consumer Price Index (average)	11.9	12.7	12.6	11.4	7.9	6.5
II. Fiscal Indicators (general government)	(In percent of GDP)					
Primary balance (cash)	2.6	1.3	0.9	0.7	0.5	0.2
Overall balance (cash)	1.3	0.2	-0.3	-0.5	-0.4	-0.5
Stock of general government debt	38.0	34.6	29.2	22.3	18.8	16.5
III. Financial indicators	(Percent change; unless otherwise indicated)					
Broad money (M3)	35.0	23.6	39.8	21.5		
Velocity (GDP/end-period M3; ratio)	2.4	2.3	1.9	1.8		
Credit to the economy	35.0	37.8	51.7	22.0		
IV. External sector indicators	(In percent of GDP, unless otherwise indicated)					
Current account balance (percent of GDP)	10.3	-12.0	-9.7	-10.3	-10.6	-11.3
Remittances and compensation of employees (net)	29.1	33.3	36.6	37.6	35.9	32.8
Gross official reserves (months of imports)	2.2	2.2	3.0	3.2	3.6	4.0
External debt/GDP (percent)	56.2	57.4	58.8	55.1	53.6	53.3

Sources: Moldovan authorities; and IMF staff estimates.
[1/] data exclude Transnistria.

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

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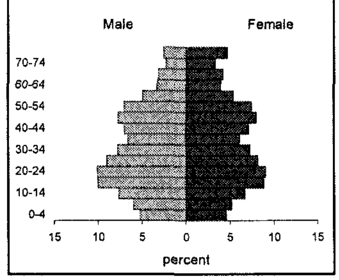
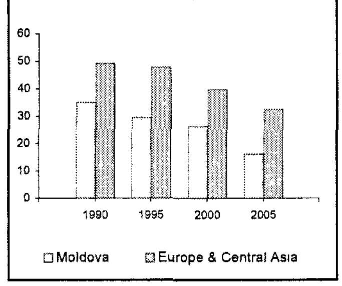
Moldova at a glance

4/9/08

Key Development Indicators	Moldova	Europe & Central Asia	Lower middle income
(2007)			
Population, mid-year (millions)	3.4	460	2,276
Surface area (thousand sq. km)	*34*	24,114	28,549
Population growth (%)	-0.1	0.0	0.9
Urban population (% of total population)	*47*	64	47
GNI (Atlas method, US$ billions)	4.3	2,206	4,635
GNI per capita (Atlas method, US$)	1,140	4,796	2,037
GNI per capita (PPP, international $)	*2,880*	9,662	7,020
GDP growth (%)	3.0	6.8	8.8
GDP per capita growth (%)	4.1	6.8	7.9
(most recent estimate, 2000–2007)			
Poverty headcount ratio at $1 a day (PPP, %)	5	1	..
Poverty headcount ratio at $2 a day (PPP, %)	21	10	..
Life expectancy at birth (years)	68	69	71
Infant mortality (per 1,000 live births)	11	28	31
Child malnutrition (% of children under 5)	4	5	13
Adult literacy, male (% of ages 15 and older)	100	99	93
Adult literacy, female (% of ages 15 and older)	99	96	85
Gross primary enrollment, male (% of age group)	93	103	117
Gross primary enrollment, female (% of age group)	92	100	114
Access to an improved water source (% of population)	92	92	81
Access to improved sanitation facilities (% of population)	68	85	55

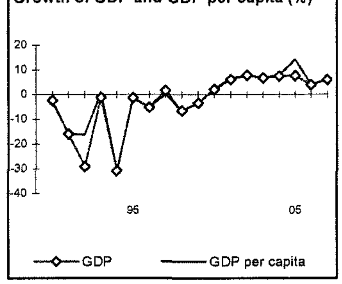


Age distribution, 2006



Under-5 mortality rate (per 1,000)

Net Aid Flows	1980	1990	2000	2007 [a]
(US$ millions)				
Net ODA and official aid	..	*10*	123	192
Top 3 donors (in 2005):				
United States	..	..	35	30
France	..	..	1	26
Sweden	..	..	2	9
Aid (% of GNI)	..	*0.4*	9.4	5.7
Aid per capita (US$)	..	*3*	34	56



Growth of GDP and GDP per capita (%)

Long-Term Economic Trends	1980	1990	2000	2007	1980–90	1990–2000	2000–07
					(average annual growth %)		
Consumer prices (annual % change)	..	*788.5*	31.2	12.3			
GDP implicit deflator (annual % change)	..	13.5	27.3	11.2			
Exchange rate (annual average, local per US$)	..	0.0	12.4	12.1			
Terms of trade index (2000 = 100)	..	..	..	..			
Population, mid-year (millions)	4.0	4.4	3.6	3.4	0.8	-1.8	*-1.0*
GDP (US$ millions)	..	3,593	1,288	4,396	2.7	-9.6	*6.6*
		(% of GDP)					
Agriculture	..	36.1	29.0	9.9	..	*-11.2*	*1.7*
Industry	..	36.7	21.7	14.8	..	*-13.6*	*1.1*
Manufacturing	..	*36.0*	16.3	14.8	..	*-7.1*	*5.1*
Services	..	27.2	49.2	61.1	..	*0.7*	*9.4*
Household final consumption expenditure	..	*57.5*	91.4	112.6	..	*9.9*	*10.5*
General gov't final consumption expenditure	..	*15.1*	10.3	21.1	..	*-12.4*	*8.3*
Gross capital formation	..	24.9	23.9	38.2	..	*-15.5*	*10.4*
Exports of goods and services	..	48.2	49.8	45.3	..	*1.0*	*13.8*
Imports of goods and services	..	50.6	75.4	96.1	..	*5.9*	*15.9*
Gross savings	..	*58.1*	16.3	23.8			

Note: Figures in italics are for years other than those specified. 2007 data are preliminary. Group data are through 2006. .. indicates data are not available.
a. Aid data are for 2005.

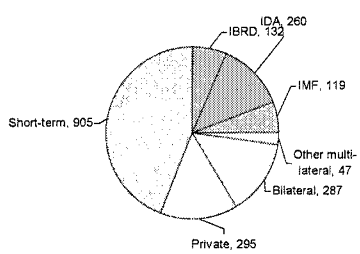
Development Economics, Development Data Group (DECDG).

Balance of Payments and Trade	**2000**	**2007**
(US$ millions)		
Total merchandise exports (fob)	477	1,342
Total merchandise imports (cif)	793	3,690
Net trade in goods and services	-331	-2,348
Current account balance	-98	-410
as a % of GDP	-7.6	-9.7
Workers' remittances and compensation of employees (receipts)	179	*1,548*
Reserves, including gold	218	1,334

Central Government Finance		
(% of GDP)		
Current revenue (including grants)	31.9	39.4
Tax revenue	25.0	32.9
Current expenditure	34.7	33.1
Overall surplus/deficit	-2.6	-1.1
Highest marginal tax rate (%)		
Individual	..	*20*
Corporate	..	*15*

External Debt and Resource Flows		
(US$ millions)		
Total debt outstanding and disbursed	1,692	2,045
Total debt service	138	208
Debt relief (HIPC, MDRI)	–	–
Total debt (% of GDP)	131.3	48.1
Total debt service (% of exports)	16.6	5.9
Foreign direct investment (net inflows)	127	*243*
Portfolio equity (net inflows)	117	*-5*

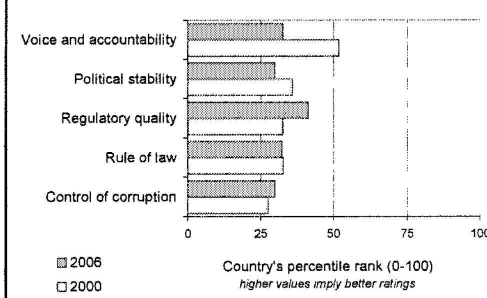
Composition of total external debt, 2007



US$ millions

Private Sector Development	**2000**	**2006**
Time required to start a business (days)	–	*23*
Cost to start a business (% of GNI per capita)	–	*11.5*
Time required to register property (days)	–	48
Ranked as a major constraint to business (% of managers surveyed who agreed)		
Access to/cost of financing	..	*40.4*
Tax rates	..	*37.2*
Stock market capitalization (% of GDP)	30.4	*22.1*
Bank capital to asset ratio (%)	30.6	*17.0*

Governance indicators, 2000 and 2006



Source: Kaufmann-Kraay-Mastruzzi, World Bank

Technology and Infrastructure	**2000**	**2005**
Paved roads (% of total)	86.1	*86.2*
Fixed line and mobile phone subscribers (per 1,000 people)	174	521
High technology exports (% of manufactured exports)	4.1	2.7

Environment		
Agricultural land (% of land area)	77	77
Forest area (% of land area)	9.9	10.0
Nationally protected areas (% of land area)	..	*1.4*
Freshwater resources per capita (cu. meters)	..	258
Freshwater withdrawal (% of internal resources)	*231.0*	..
CO2 emissions per capita (mt)	1.6	*1.8*
GDP per unit of energy use (2000 PPP $ per kg of oil equivalent)	2.0	*2.2*
Energy use per capita (kg of oil equivalent)	692	*862*

World Bank Group portfolio	**2000**	**2006**
(US$ millions)		
IBRD		
Total debt outstanding and disbursed	191	151
Disbursements	6	0
Principal repayments	5	14
Interest payments	11	7
IDA		
Total debt outstanding and disbursed	103	242
Disbursements	30	23
Total debt service	1	2
IFC *(fiscal year)*		
Total disbursed and outstanding portfolio	35	33
of which IFC own account	19	33
Disbursements for IFC own account	1	3
Portfolio sales, prepayments and repayments for IFC own account	0	10
MIGA		
Gross exposure	3	61
New guarantees	3	0

Note: Figures in italics are for years other than those specified. 2007 data are preliminary. 4/7/08
.. indicates data are not available. – indicates observation is not applicable.

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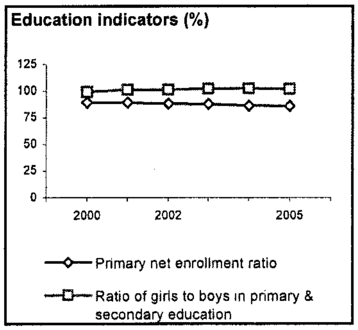
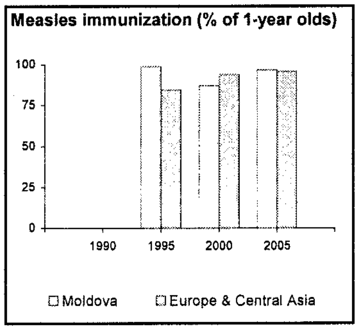
With selected targets to achieve between 1990 and 2015
(estimate closest to date shown, +/- 2 years)

	Moldova			
Goal 1: halve the rates for $1 a day poverty and malnutrition	**1990**	**1995**	**2000**	**2005**
Poverty headcount ratio at $1 a day (PPP, % of population)	*7.3*	*8.2*	*21.8*	<2
Poverty headcount ratio at national poverty line (% of population)	..	..	*62.4*	..
Share of income or consumption to the poorest qunitile (%)	*6.9*	*6.5*	*7.1*	7.8
Prevalence of malnutrition (% of children under 5)	..	3.2	..	4.3
Goal 2: ensure that children are able to complete primary schooling				
Primary school enrollment (net, %)	89	..	89	86
Primary completion rate (% of relevant age group)	..	94	90	92
Secondary school enrollment (gross, %)	*80*	..	83	82
Youth literacy rate (% of people ages 15-24)	99	99	100	100
Goal 3: eliminate gender disparity in education and empower women				
Ratio of girls to boys in primary and secondary education (%)	105	..	99	102
Women employed in the nonagricultural sector (% of nonagricultural employment)	49	50	53	*55*
Proportion of seats held by women in national parliament (%)	..	*5*	9	22
Goal 4: reduce under-5 mortality by two-thirds				
Under-5 mortality rate (per 1,000)	35	30	26	16
Infant mortality rate (per 1,000 live births)	29	25	22	14
Measles immunization (proportion of one-year olds immunized, %)	92	99	87	97
Goal 5: reduce maternal mortality by three-fourths				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	..	36	..
Births attended by skilled health staff (% of total)	..	*99*	..	100
Goal 6: halt and begin to reverse the spread of HIV/AIDS and other major diseases				
Prevalence of HIV (% of population ages 15-49)	..	..	..	1.1
Contraceptive prevalence (% of women ages 15-49)	..	*74*	62	68
Incidence of tuberculosis (per 100,000 people)	64	91	138	138
Tuberculosis cases detected under DOTS (%)	..	..	*40*	65
Goal 7: halve the proportion of people without sustainable access to basic needs				
Access to an improved water source (% of population)	..	92	92	92
Access to improved sanitation facilities (% of population)	..	68	68	*68*
Forest area (% of total land area)	9.7	..	9.9	10.0
Nationally protected areas (% of total land area)	..	..	..	*1.4*
CO2 emissions (metric tons per capita)	5.4	2.6	1.6	*1.8*
GDP per unit of energy use (constant 2000 PPP $ per kg of oil equivalent)	*1.4*	1.4	2.0	*2.2*
Goal 8: develop a global partnership for development				
Fixed line and mobile phone subscribers (per 1,000 people)	105	129	174	521
Internet users (per 1,000 people)	0	0	13	*103*
Personal computers (per 1,000 people)	..	2	15	*29*
Youth unemployment (% of total labor force ages 15-24)	..	..	*15.2*	18.8

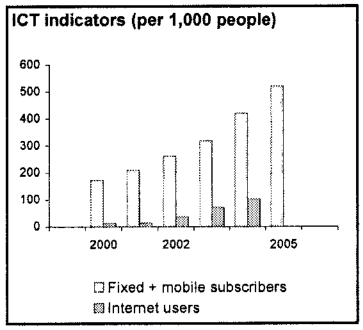
Education indicators (%)



Measles immunization (% of 1-year olds)



ICT indicators (per 1,000 people)



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