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REPORT AND RECOMMENDATION
OF THE
PRESIDENT OF THE
INTERNATIONAL DEVELOPMENT ASSOCIATION
TO THE
EXECUTIVE DIRECTORS
ON A
THIRD STRUCTURAL ADJUSTMENT CREDIT
IN THE AMOUNT OF SDR 24.1 MILLION
TO
THE REPUBLIC OF MOLDOVA

May 23, 2002

Currency Equivalents
(Exchange Rate Effective May 20, 2002)

Currency Unit	= Leu
Leu 1	= US$ 0.074
US$ 1	= Leu 13.6

Government Fiscal Year

January 1 to December 31

ARIA	-	Agency for Restructuring and Enterprise Assistance
ASF	-	Agricultural Support Fund
CAS	-	Country Assistance Strategy
CIS	-	Commonwealth of Independent States
CPRM	-	Communist Party of the Republic of Moldova
DMP	-	Debt Management Plan
EBRD	-	European Bank for Reconstruction and Development
EFF	-	Extended Financing Facility
FSU	-	Former Soviet Union
FY	-	Fiscal Year
GDP	-	Gross Domestic Product
GTZ	-	German Technical Assistance Agency
IDA	-	International Development Association
IBRD	-	International Bank for Reconstruction and Development
IFC	-	International Financial Corporation
IMF	-	International Monetary Fund
INCON	-	Joint Stock Company - Agricultural Produce (Moldova)
JSC	-	Joint Stock Company
LDP	-	Letter of Development Policy
LIBOR	-	London Inter-Bank Offer Rate
MIGA	-	Multilateral Investment Guarantee Agency
MTC	-	Moldtelecom
NBM	-	National Bank of Moldova
PP	-	Privatization Plan
PRGF	-	Poverty Reduction Growth Facility
PSD	-	Private Sector Development
PSRC	-	Public Sector Reform Credit
RAO Gazprom	-	Joint Stock Company - Natural Gas (Russia)
SDR	-	Special Drawing Rights
SGRF	-	State Grain Reserve Fund
SOE		State-Owned Enterprises
SSC		Strategic Studies Center
TACIS		Technical Assistance for the CIS (European Union)
UNDP		United Nations Development Programme
USAID		United States Agency for International Development

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REPORT AND RECOMMENDATION OF THE PRESIDENT OF THE INTERNATIONAL DEVELOPMENT ASSOCIATION TO THE EXECUTIVE DIRECTORS ON A PROPOSED THIRD STRUCTURAL ADJUSTMENT CREDIT TO THE REPUBLIC OF MOLDOVA

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MOLDOVA
THIRD STRUCTURAL ADJUSTMENT CREDIT

CREDIT AND PROGRAM SUMMARY

Borrower:	Republic of Moldova
Amount:	SDR 24.1 million (US$30 million equivalent)
Terms:	Standard IDA terms, payable in 40 years
Commitment Fee:	Standard
Service Charge:	0.75 percent of the credit amount disbursed and outstanding.
Objectives and Description:	The proposed operation will support reforms within two broad agendas to help ensure sustained growth in Moldova over the medium term: (i) reforms to reduce poverty through improving monitoring and evaluation of poverty reduction measures, improvement of the education system and the efficiency of health care delivery, and strengthening social protection; and (ii) reforms to improve the business environment through implementation of hard budget constraints and improvement of fiduciary management, maintaining liberal market policies in the agriculture sector and further development of land and credit markets, securing the financial viability of the power sector by completing change of ownership/management control of the power companies and assuring the independence of the energy regulator, reducing administrative barriers to business entry and exit, reforming the institutional framework and procedures governing privatization, and the liberalization/privatization of the telecom and winery sectors.
Benefits:	The credit will provide budgetary support to help the Government consolidate economic stabilization, bolster foreign reserves, and service external debt. The program supported by the Credit will lay the foundation for sustainable resumption of growth, especially through a focus on structural reform in key areas – agriculture, energy, reducing barriers to new enterprise formation and telecom and winery privatization. At the same time the program will engender improvements in the public sector to help ensure that the benefits of the structural reforms are broadly received. Ensuring delivery of quality social services to the broadest possible population, and establishing a well-targeted social protection system are the most effective ways to increase the inclusiveness of growth.
Risks:	The operation has three major risks: (a) weak political consensus for reform; (b) insufficient implementation capacity; and (c) macroeconomic. The Government is supported by a strong majority party in Parliament with over 70 percent of the votes. However, while the Government continues to enjoy the support of the President and Parliament, internal disagreements within the majority party could weaken the Government's mandate to implement the proposed program. These risks are mitigated

through the front-loading of core reforms that require decisions by the Government, the Parliament and the President as Board conditions, and more generally through adopting a three tranche design with front-loading of reforms and backloading of financing. These risks are also mitigated through the continuing public dialogue, including through the PRSP preparation process, to build support for reforms.

The Government's reform program is necessarily relatively broad in coverage given the range of Moldova's pressing problems. Mindful that the Government's reform program is potentially too ambitious for its institutional capacity, the proposed SAC III focuses on the highest priority reforms. Nonetheless, the Government's institutional capacity may well still be stretched under SAC III implementation. To mitigate this risk the Bank Group is providing Technical Assistance to the Government in several SAC III-related areas and IDA is also actively mobilizing and coordinating donor support through the PRSP process. The Public Sector Reform program, currently under preparation, will also help build stability, incentives and implementation capacity in Moldova's public service.

The reform program supported by the proposed SAC III is designed to lay the foundations for a sustained resumption of economic growth. But there is a clear risk that early signs of growth may not continue, if reform implementation is slow, or if Moldova suffers an exogenous shock affecting production (for example bad weather) or income (for example a deterioration in the terms of trade). Sustained economic decline could weaken reformers in Government and erode public support for the program. Moldova's loss of its predominant export market, its reliance on imported energy inputs, and its existing debt service requirements could all lead to lower growth prospects. To help mitigate these risks, SAC III contains strong actions to improve the structural foundations for sustained growth, for example through improvements in the business environment. In addition, IDA will be closely monitoring in close collaboration with the IMF the macroeconomic and structural program of the Government to ensure it stays on track over a sustained period. There is also enhanced international scrutiny in the context of the recently launched international initiative for the CIS-7. IDA is working with bilateral and multilateral partners to help mobilize sufficient concessional resources to help Moldova manage its debt burden, and is closely monitoring efforts in the Paris Club. A debt sustainability analysis has been developed jointly with the IMF. IDA, the IMF and the Government will continue to explore other avenues for Moldova achieving long run debt sustainability.

Schedule of Disbursement:	SDR 8.1 million 1st tranche – June 2002 SDR 8.0 million 2nd tranche – November/December 2002 (estimated) SDR 8.0 million 3rd tranche – March/April 2003 (estimated)
Poverty Category:	Poverty Focused
Project ID Number:	MD-PE-P065163
Map:	IBRD 24285R3

REPORT AND RECOMMENDATION OF THE PRESIDENT OF THE INTERNATIONAL DEVELOPMENT ASSOCIATION TO THE EXECUTIVE DIRECTORS ON A PROPOSED THIRD STRUCTURAL ADJUSTMENT CREDIT TO THE REPUBLIC OF MOLDOVA

1. I submit for your approval the following report and recommendation on a proposed Third Structural Adjustment Credit (SAC III) to the Republic of Moldova for SDR 24.1 million. The proposed credit would be on standard IDA terms, with a maturity of 40 years including a grace period of 10 years. The Credit would be disbursed in three tranches: SDR 8.1 million equivalent upon effectiveness of the credit, SDR 8.0 million equivalent upon satisfactory completion of second tranche policy measures (expected November/December 2002), and SDR 8.0 million equivalent upon satisfactory completion of third tranche policy measures (expected March/April 2003).

2. The proposed SAC III will support critically important areas of the Government's reform agenda, thereby supporting the implementation of the first phase of the Government's Interim Poverty Reduction Strategy Paper (I-PRSP) presented to the Board on December 19, 2000 (IDA-SecM2000-695). SAC III would also complement the IMF's Poverty Reduction and Growth Facility. In particular, the proposed SAC III will support reforms to:

- Reduce poverty and improve the effectiveness of the social protection system; and
- Improve the business climate.

I. ECONOMIC AND POLITICAL CONTEXT

A. BACKGROUND

3. Moldova's transition to a market economy has been difficult. It inherited an obsolete and misaligned industrial sector, a land-locked territory, highly variable weather conditions and weak institutions. In addition, it suffered external shocks, including a severe terms of trade deterioration, which accompanied trade and price rationalization at the end of the Soviet era, a Transnistrian separatist movement that increased Moldova's dependence on agriculture and energy imports, and the regional financial crisis of 1998. At the beginning of the transition, Moldova experienced a dramatic decline in output, higher inflation, worsening public finances and a deterioration of public service delivery as revenues plummeted while the state struggled to maintain its role as a care-taker.

4. Moldova made relatively good early progress in market, price and foreign exchange liberalization. It was among the first CIS countries to achieve financial stability, and by 1996 had embarked on a deeper structural reform agenda. However, progress on this agenda has been mixed. Relatively good progress has been made in fiscal consolidation, pension reform, agricultural policy, land privatization and energy sector reform, but until recently it was not sufficient to generate a sustained supply response. While consecutive privatization programs have significantly divested state-owned enterprises, many viable enterprises were kept in state control, limited steps have been taken to encourage improved corporate governance among privatized enterprises, and a generally poor business climate has persisted. On the fiscal front, while a consolidation has been achieved, deep structural reform of social service delivery has not.

Many of these problems are attributable to the political instability which has resulted in stop and go policy implementation.

5. Despite delays due to political instability, previous governments were ultimately successful in implementing the economic reform programs supported by SAL II and SAC. Since at least 1998, debate surrounding these programs was near the core of the political discourse which culminated in amendments to Moldova's constitution. In July 2000, Moldova changed to a Parliamentary form of Government and the President is now elected by Parliament. Parliamentary elections held in February 2001 resulted in a decisive victory for the Communist Party of the Republic of Moldova (CPRM) which won a 70 percent majority of seats. The new Parliament elected the CPRM leader, Vladimir Voronin, as President and he appointed Vasile Tarlev, a non-party businessman, as Prime Minister. Economic Ministers were retained from the previous largely technocratic Government. CPRM members hold key ministries, including agriculture, privatization, and the social sectors.

6. Despite the legacy from early years of Moldova's transition and hardships resulting from the 1998 regional crisis, Moldova has pursued prudent macroeconomic policies and structural reforms. Moldova experienced its first year of economic growth (1.7 percent) in 1997. However, the prospects for continued growth evaporated as the country was hit by the Russian financial crisis. A sharp devaluation of the leu in 1998 worsened the terms of trade and increased public debt and debt service. Inflation accelerated as energy prices increased. Output declined sharply and as a result, public revenues shrank. This, combined with limited external financing forced the Government to significantly cut public spending. While the crisis contributed to increased social hardship and poverty, it was cathartic for the State. Between February 1999 and February 2001, just prior to the election, a significant number of reforms were implemented. These included reform of the energy sector (e.g., significant debt restructuring, privatization of Moldovagas, and the sale of two thirds of the power distribution companies to a strategic foreign investor, and imposition of hard budget constraints on budgetary institutions and enterprises); increased cash collection of taxes; prudent fiscal management through rationalization of public expenditures, pension reform and clearance of pension arrears; continued progress in agricultural policy and farm privatization; and good progress in privatization of other state enterprises, joint stock companies and land under enterprises.

7. The remaining structural reform agenda is considerable and the current Government is committed to working closely with its international partners, especially the World Bank Group and the IMF, to implement its economic and social reform program.

B. Recent Economic Developments

8. Moldova's economic performance during the past two years has been positive, benefiting from favorable external factors, prudent fiscal and monetary policies, and structural reforms in the agricultural and energy sectors. Increased investment and demand for exports (especially from Russia) contributed to an acceleration of GDP growth from –3.4 percent in 1999 to 2.1 and 6.1 percent, respectively, in 2000-01. Prudent management of financial policies combined with good agricultural output (despite a severe drought and ice storm) lowered pressure on the general price level. Consequently, end-year inflation fell from 44 percent in 1999 to a single digit rate of 6.4 percent in 2001. This combined with increased workers' remittances and direct investments helped stabilize the exchange rate which stood at 36 percent of its 1997 level. The leu depreciated by 3.7 percent in real terms during 2000-2001.

9. The current account balance has stabilized, although its vulnerability to external shocks remains high as the economy is highly dependent on a few export commodities and markets and on energy imports. Aided by the real exchange rate depreciation combined with strong foreign demand for exports and a relatively good harvest in 2001, merchandise exports increased, especially agricultural and manufacturing products (to 52 percent of GDP), while imports declined to 73 percent of GDP in the same year. This, together with continued inflows from workers' remittance, lowered the current account deficit to 8.0 percent of GDP in 2001. Due to limited foreign financing, the deficit was financed by direct foreign investment. Gross international reserves in 2001 increased to US$227 million, equivalent to 2.3 months of imports of goods and services.

10. Management of financial policies has remained relatively good, although there was slippage in some areas of fiscal policy as arrears on external debt service increased due to lower tax collection combined with limited foreign financing and lowered privatization revenue. In light of these developments, the Government further cut expenditures, and as a result, the overall cash fiscal deficit (including project loan spending) fell to 0.5 percent of GDP in 2001 (from 2.9 percent of GDP in 2000), while new on debt service to private creditors accumulated. The deficit was financed by an increase in net domestic credit from the Central Bank. Domestic real interest rates continued to decline further due to a reduction in the public sector's borrowing requirement from the domestic credit market in line with the lower fiscal deficit and due to prudent monetary policy. This contributed to an expansion of commercial banks' credit to the private sector during this period.

11. **External Indebtedness.** The 1998 regional financial crisis significantly exacerbated Moldova's external indebtedness. Total external debt increased from virtually zero at the beginning of the 1990s to over US$1.2 billion (or 83 percent of GDP) at end-2001, of which 77 percent was public and publicly guaranteed debt. Additionally, there remains outstanding external arrears on energy imports to foreign suppliers (mostly Gazprom) estimated at US$298 million (20 percent of GDP). About 60 percent of total public and publicly guarantee debt is owed to multilateral institutions including the IMF, the World Bank, and the EBRD. About 27 percent is owed to private creditors, including the outstanding balance from a US$90 million Eurobond issued in 1997 with a bullet repayment in June 2002, US$90 million securities issued to Gazprom of Russia, and a number of direct and publicly guaranteed credits from foreign banks. The remaining public and publicly guaranteed debt (13 percent of total) is owed to bilateral creditors. Private non-guaranteed debt accounted for 22 percent of total external debt stock in 2001, which has increased in recent years due to increased private sector borrowing from foreign credit markets. A relatively small part of the current government debt portfolio was contracted on concessional terms.

C. MEDIUM TERM ECONOMIC OUTLOOK

12. Moldova's growth now seems sustainable. Positive developments during the 2000-01 period were the results of progress in fiscal consolidation, sustained output through adverse weather conditions (severe drought and ice storm), reduced energy consumption through energy sector restructuring, and export growth in sectors such as textiles, light industry, manufacturing, wine-making, communications and other services. At the same time, inflation has been brought down significantly relative to 1998 despite higher import costs; the public has regained confidence in the leu and this has contributed to exchange rate stabilization; and tax revenue collection remains stable at around 25 percent of official GDP. Real interest rates have begun to

decline, thereby increasing the demand for credit from the private sector. These are promising trends which could continue to generate higher growth and therefore additional resources to address Moldova's social and capital investment needs over the medium term.

13. **Growth Prospects.** The macroeconomic framework underpinning the proposed SAC III envisages that sustainable economic growth in Moldova is achieved through the maintenance of prudent financial policies aimed at lowering inflation and maintaining a competitive exchange rate, and continued deepening of structural reforms to improve the business environment and investment climate. These factors would provide the basis for a continued rebound of GDP growth driven by investment and exports. The current scenario assumes moderate growth averaging 5 percent per annum during the 2003-2005 period, with 2002 slightly lower at 4.8 percent due to a slowdown in the world economy and Moldova's exceptionally high debt servicing requirements. Inflation is expected to slowly increase toward the end of 2002 and will remain at around 8 percent in 2003 due to expansionary fiscal and monetary policies associated with increased public employees' wage and pensions and an increase in monetary financing of the fiscal deficit. Thereafter, inflation is projected to decline and stabilize at around 6 percent over the medium-term as monetary policy is expected to tighten somewhat and central bank credit to the government will be limited to smoothing cash flow fluctuations. The real exchange rate is projected to appreciate slightly by 0.5 percent during 2003, before depreciating by 1.5 percent by end-2005. More details on macroeconomic projections over the 2002-05 period are provided in Annex 1.

14. **External Position and Financing Gap**. Moldova faces a financial liquidity shortfall over the next few years but the situation is expected to improve over the medium-term. In 2002, export growth is expected to slow down due to weak demand for exports, while imports remain strong as a result of increased income and investment. The trade deficit is expected to widen but will be partially offset by an increase in workers' remittances and foreign transfers. The current account deficit is projected to decline slightly to 7.4 percent of GDP. 2002 will be a difficult year as a bullet repayment of the Eurobond falls due in June. Meanwhile, direct foreign investment will likely be lower due to the need to align the privatization of Moldtelecom with an improvement in the world's telecommunication sector. This will generate a financing gap estimated at about US$87 million - in the absence of IDA's adjustment operation (SAC III) and disbursement of the IMF's PRGF. However, this gap is envisaged to be fully financed if the Government successfully reschedules its debts with bilateral and private creditors, restructures the remaining Eurobond, secures a disbursement under the Fund's PRGF, and disbursement takes place under SAC III.

15. Over the medium-term, the external balance is projected to improve as the current account deficit declines to 6.0 percent of GDP by 2005 (due to a reduction in the resource balance associated with an increase in exports relative to imports). The Government's commitment to deepening structural reforms will encourage strong inflows associated with direct foreign investment and net medium and long-term credit, especially from the private sector to finance the current account deficit. The external financing gap for 2003-04 will be smaller, averaging US$42 million (Annex 1). The stock of gross international reserves is projected to increase to 3.1 months of imports of goods and services by 2005.

16. **Fiscal Policy.** To meet high external debt service obligations, including reduction of domestic expenditure arrears and external arrears on debt service, and to ensure sufficient

financing of social sectors, fiscal policy will aim to maintain a primary surplus at around 1.5 percent of GDP over the medium-term. This would be achieved through hardening budget constraints by eliminating subsidies to productive sectors, further strengthening tax and customs administration, rationalizing social expenditure in the context of a strengthened medium-term expenditure framework, and better execution and monitoring of local government budgets. Financial programming of the social sector reform program calls for equal or increased allocations for health and education as efficiency improves, and better targeting of resources available for direct social assistance. In 2002, the overall cash fiscal deficit (including project loan spending) is projected to increase to 3.0 percent of GDP because of an increase in expenditures on pension and salaries, a gradual clearance of domestic arrears, and high interest payments. The deficit will be financed by privatization revenues, credit from the Central Bank, and foreign sources. Thereafter, improved revenue performance, continued strong but realistic fiscal consolidation, and gradually lower interest payments after 2002 are expected to lower the deficit to 1.3 percent by 2005. This will contribute to the declining trend of real interest rates and increased credit flows to the private sector.

17. **Debt Sustainability Analysis.** Moldova's ability to sustain and strengthen its economic growth over the medium term will strongly depend on the resolution of the external debt problem. A large share of non-concessional debt contracted throughout the 1990s has begun to put pressure on the government budget and the balance of payments. Over the past few years, the Government of Moldova has successfully reached debt rescheduling agreements with bilateral (Russia) and commercial creditors (mainly German banks). This has contributed to clearance of budgetary arrears and slightly reduced some pressure on the balance of payments and the budget; however, they did not provide long-term relief as most of the rescheduling agreements are based on non-concessional terms.

18. Under the current scenario, Moldova's debt sustainability is projected to improve steadily to reach manageable levels over the long-term horizon. Key indicators for the debt sustainability analysis, which assumes a rescheduling of the Eurobond balance and the Gazprom promissory notes, are provided in Annex 1. The NPV of total external debt to GDP and to exports of goods and services are projected to reach satisfactory levels by 2010, declining to 36 percent and 65 percent, respectively. Total external debt service to exports of goods and services is expected to decline to 11 percent by 2011. For fiscal sustainability, the NPV of public and publicly guaranteed debt to central government revenue would decline sharply to 96 percent in 2010 (from a peak of 320 percent in 2002) and total debt service of public and publicly guaranteed debt is expected to decline to about 19 percent of central government revenues by 2010. However, both fiscal and external liquidity will be significantly constrained over the short-term. Total external debt service to exports of goods and services will remain above 20 percent during 2002-2005 while debt services of public and publicly guaranteed debt will begin declining below 30 percent of central government revenue only in 2006.

19. Moldova's ability to achieve a sustainable debt situation will be constrained and it will take a longer period of time should it experience external shocks, adverse weather conditions, or lower than expected private sector contribution. A hypothetical low case that assumes lower GDP growth due to weak exports and investment and a sharp depreciation of the exchange rate provides a less optimistic picture of Moldova's debt situation. Total debt service to exports of goods and services ratio will stay over 20 percent until 2006. In terms of the fiscal position, debt servicing will exercise strong pressure on the budget, thus, demanding for more fiscal resources

envisaged for the next 3-4 years. Debt service will absorb on average 42 percent of central government revenues over the 2003-05 period.

20. **Addressing the Debt Burden.** The above projected macroeconomic scenario cannot be achieved without addressing Moldova's liquidity crisis over the 2002-2005 period. The authorities' strategy to address the high debt burden consists of the following elements: (i) continuation of tight fiscal policies aimed at maintaining a primary budget surplus of about 1½ percent of GDP; (ii) earmarking privatization proceeds (including for Moldtelecom) for servicing or retiring domestic and external public debt and clearing government wage arrears; (iii) refraining from new borrowing on non-concessional terms and issuing guarantees on non-concessional terms for commercial ventures, whether state- or privately-owned; (iv) where possible, using market-based methods to reduce debt; (v) improving the management of external and domestic public debt; and (iv) approaching creditors for debt restructuring. The Government is currently seeking to restructure its external debt with bilateral and private creditors.

II. THE REFORM PROGRAM

A. OVERVIEW

21. After a decade of deteriorating economic performance, Moldova has successfully stabilized the economy and launched structural reforms to stimulate growth, and begun the process of establishing an effective social protection system. While the Government has made notable progress in the macroeconomic and structural reform process in the last two years, a significant agenda reform remains. Today, Moldova is the poorest nation in Europe, having started out at independence as a middle-income country. With economic recovery only in its second year, poverty is still very high. Simultaneously, Moldova has become one of the region's most heavily indebted countries. Moldova's leadership is committed to identifying and implementing a program to sustain growth and reduce poverty. With the assistance of IDA and the IMF, the Government has developed a reform program as a means to achieve these objectives.

22. The program supported by the proposed SAC III will focus on reforms in two areas:

(i) actions to ***reduce poverty and strengthen social protection*** through improving the monitoring, analysis and evaluation of poverty and poverty-reduction measures; reforming the education system; enhancing the efficiency of health care delivery; and strengthening the system for social assistance and pensions; and

(ii) reforms ***to improve the business environment*** through implementing stronger fiscal discipline and fiduciary management; improving the administrative framework to facilitate new business development; maintaining liberal market policies in the agriculture sector and further developing land markets; competitively restructuring the energy sector; and reforming the institutional framework and procedures governing privatization, including the liberalization/privatization of the telecom and winery sectors.

23. The overall reform program supported by the proposed SAC III is described in detail in the Government's ***Letter of Development Policy*** **(LDP)**, signed by the Prime Minister on May 10, 2002, and reproduced in Annex 4 of this Report. All the tranche conditionalities of the

program, including agreed SAC III measures undertaken prior to submission of this Report to the Association's Board, are outlined in the ***Matrix of Core Policy Actions*** contained in Annex 5 of this Report. The Matrix of Core Policy Actions also outlines key reform measures that the Moldovan authorities have implemented since the last SAC.

B. POVERTY ALLEVIATION AND IMPROVED SOCIAL SERVICE DELIVERY

24. Moldova's GDP per capita in 2001 was about US$ 400, or about one half of the 1995 figure, which is significantly below the average for CIS and Central European countries. In 1999, approximately 55% of Moldovans lived on less than $2.15 per day.[1] Poverty incidence increased by about 20 percentage points between 1997 and 2000, and since then, appears to have leveled off or even fallen slightly. Income inequality is high as are the disparities between large cities and the rest of the country (Box 1). Despite recent improvements in health status that followed a decline in the early years of the transition, outcomes compare poorly with European averages and with other low income CIS countries. There is an emerging threat of communicable diseases, particularly TB and AIDS. Similarly, and despite data deficiencies, there has been a deterioration in educational achievements. Moreover, serious inequities are emerging in health and educational outcomes and in access to social services by different segments of the population.

BOX 1: POVERTY IN MOLDOVA

Poverty has increased substantially in Moldova during the transition and today Moldova is one of the poorest transition countries in Europe and Central Asia. A recent Bank study shows that the poverty rate in Moldova increased from about 47 percent in 1997 to about 68 percent in 2000 with the sharpest increases immediately after the Russian crisis. Along with the recovery in growth, the increase in poverty began to level off at the beginning of 2000 and by the end of 2000, the head count index declined. However, poverty in Moldova remains deep, with the shortfall between the average expenditures of the poor and the poverty line at about 37 to 40%. Income inequality is also high, with a gini coefficient of about 0.42 in 1999.

The profile of poverty is not dissimilar to that in other countries in the region. In 1997-2000, poverty rates were highest for agricultural workers, households living outside of the large cities (other towns and rural areas), and households with 2 or more children They were lowest for households where the head had higher education, those living in large cities, and in single person households or households with no children. Generally, pensioners are not at an especially high risk of being poor. Reflecting poverty rates but also their higher share in the population, the poor were predominantly the rural households, households where the heads had secondary education and were non-elderly, and hired workers. While these groups constituted the largest share of the poor in all four years and also contributed to most of the increase in poverty over the four years, the poverty risks of other groups, especially households living in large cities and those whose heads had higher education increased significantly between 1997 and 2000.

25. Given these developments, the Government has emphasized poverty alleviation as one of its main policy objective. On April 21, 2002, the Government approved an updated Interim Poverty Reduction Strategy (I-PRSP) that emphasizes a three-pillar strategy: (i) sustainable and inclusive economic growth, (ii) improved human development through better delivery of social services, and (iii) strengthened and better targeted social protection. This reinstates the new

[1] In 1996 purchasing power parity.

Government's commitment to the PRSP process. The Government has extended the completion date of the full PRSP to March 2003 to ensure good quality of the participatory process.

26. The proposed SAC III builds on earlier reform efforts and extends the reforms in support of all three pillars that are at the foundation of the Government's I-PRSP. At the same time, it supports the Government's plan to improve its capacity to monitor and analyze poverty and to design policies aimed at improving the living standards of the poor. On the one hand, the continuation of structural reforms toward a market economy are crucial to stimulate and sustain higher growth and to reduce absolute poverty. In view of the predominance of the rural population among the poor, moving ahead with the reforms to stimulate agricultural growth, through continued liberalization of the agricultural sector, are key. Improved access to land and credit markets, particularly in the rural areas, would enable to poor to take advantage of market opportunities. The improvements in the overall business environment are essential to facilitating restructuring and generating productive employment. Of particular importance is the improvement in the business environment for small and medium enterprises which can serve as an important engine for job growth, particularly among the poor.

27. Higher incomes and increased resources from growth will improve the ability of individuals to invest in their human capital in the future. To prevent further erosion of the human capital stock, particularly among the poor, however, the operation supports the continued restructuring of the health and education sectors to improve their efficiency and quality. Finally, the operation supports the strengthening of the social protection system by supporting continued reform of the pension system to improve its efficiency and fiscal sustainability while reducing people's vulnerability to old age, and ensuring that social assistance programs and utility subsidies are well targeted to the poorest and assist them in meeting immediate consumption needs while protecting their accumulation of human, physical and social assets.

B.1. Poverty Analysis, Monitoring and Evaluation

Context

28. Several institutions have historically been involved in the collection and analysis of information on living standards in Moldova. These include the line ministries which collect administrative data from their institutions, the Department of Statistics and Sociological Research (DSS) which has been collecting survey data from households and enterprises (including agricultural surveys), and the Ministry of Finance which collects data related to budgetary expenditures on different social programs.

29. Although each institution prepares regular publications and some limited analysis, there are several problems that impede the use and usefulness of these data in policy analysis and deliberations and particularly in the design of poverty focused policies. First, the Government lacks the capacity needed to evaluate the available information to strengthen the strategic orientation of its overall policy agenda. There is little internal expertise and inter-agency coordination within the Government to undertake the requisite analysis and to, in turn, feed back into improving the relevance of the data.

30. The lack of coordination between institutions within the Government is particularly problematic in the case of measurement of poverty indicators. No clear agency has been assigned the responsibility for developing the methodology for poverty measurement A poverty monitoring unit has been established in the Ministry of Economy, with some financing from UNDP. This represents a needed initiative to start inter-agency coordination on poverty issues. However, because the group was set up in addition to other groups that were already involved in poverty measurement, and because roles and responsibilities were not clarified, the extent and nature of inter-agency collaboration is less than desired. As a result, different agencies (Ministry of Economy, Ministry of Labor and Social Protection, and the DSS) are developing their own measures of consumption based welfare for individuals and households and different poverty lines are in use. Poverty estimates in-country, therefore, vary widely. The lack of consensus on methodology complicates the identification of the poor, the monitoring of poverty, the analysis of impacts of policies on the poor, and the development and design of policies targeted at the poor.

31. There is need to improve the quality and the relevance of existing data sources. Available administrative data are not of uniform reliability or relevance and often cover only the people receiving services while excluding those who miss out. There is also need to ensure that the data are available at the needed levels of disaggregation by programs and geographical location. The DSS household surveys (HBS, LFS) also need to be improved in various ways. The sample lists from which they are drawn are seriously outdated and are in need of replacement. In view of the major demographic changes since the previous census, a new census should be used for sample refreshment. Although plans were underway to implement a new census in 2002, it has now been delayed to April 2003. The existing household data also do not adequately cover key areas (e.g. health care utilization, labor market outcomes among the poor, coverage of different social protection programs, etc.). Improvement of the quality and relevance of existing data once again calls for improved coordination between agencies and departments involved in the collection of data and policy making units in line ministries. There is also limited use of the available data outside the Government which limits the availability of new analyses by innovative researchers that could be useful to policymakers. It further limits feedback that could improve the quality and relevance of the data. There is also limited meaningful exchange with the public or with groups outside the Government on the progress on poverty outcomes and on the success, or lack thereof, of policies aimed at improving living standards.

Reform Objectives and SAC III Measures

32. The objective of this component of the SAC III program is therefore to (i) strengthen capacity in the monitoring, analysis and evaluation of policies aimed at improving living standards, both inside and outside the government (ii) to facilitate inter-agency coordination in this area while clarifying roles and responsibilities, (iii) to improve the quality of the information base to monitor changes in poverty and the impact of policies on living standards, and (iv) to improve the exchange of information and consultation on poverty outcomes and policies with the public or groups outside of the Government, including regular dissemination of poverty indicators and data.

33. In recognition of the importance of this component to monitoring progress on the current policy agenda and to the future design of policies, the Government is preparing and has approved a three year plan (to be implemented between June 2002 and May 2005) to strengthen capacity in

poverty monitoring and analysis. The plan identifies a set of core poverty indicators to measure the income and non-income dimensions of poverty. It specifies the data sources for the identified indicators, and, based on an evaluation of their adequacy, outlines steps to be taken to improve the system of data collected (households and other surveys, administrative data, etc.). It establishes the working groups and identifies the institutions, within and outside the Government, involved in the implementation of the plan with specification of roles and responsibilities. It clarifies the steps to be taken and the process to be followed in the development and adoption of the methodology for poverty analysis. It outlines a dissemination strategy for the poverty indicators as well as for raw data used in analysis.

34. The plan is accompanied by a financing plan which specifies the costs associated with each step to strengthen capacity and improve the information base, and the associated financing plan. The Government's own budget is an important source of financing for this plan. Several donors have also expressed interest and some (DfiD, UNDP) have made funds available to support the Government's poverty monitoring and analysis efforts. The Government intends to use this plan to ensure that the most critical needs in strengthening its poverty monitoring efforts, over the medium term period, are fully financed.

35. To improve inter-agency collaboration, the plan assigns clear responsibility to ministries and agencies within the Government. It also specifies a consultative group to include representation from key groups outside the Government. The institutions and working groups coincide closely with those involved in the preparation and implementation of the PRSP. The reform program particularly emphasizes the collaborative development of and consensus on the methodology for consumption based poverty and the establishment of a poverty line. The collaboration and consensus will be between *all groups within the Government* involved in the development and implementation of sectoral poverty reduction strategies as well as in the collection of the poverty monitoring data, and will include line ministries (such as agriculture, health, education, labor and social protection), the DSS, as well as the core central ministries (MOF, MOE). Key groups outside the Government, including donors and local researchers will also be consulted on this methodology. Once such a methodology, consistent with international practice, is developed, it will be approved by the Government, by the fourth quarter of 2002, and will become the basis of regular poverty monitoring.

36. To improve the quality of the data, and in particular, the quality and relevance of the information from the household surveys, the reform program emphasizes the implementation of (i) a new population census (ii) urgent improvement of the sample for the household surveys based on sound technical recommendations; (iii) improvement in the information on access to health care and education as well as to social protection programs through piloting and full introduction of revised modules. The plan also incorporates regular information needs assessments to continuously increase and improve the information available to policymakers as well as its quality.

37. To facilitate the sharing of information on poverty outcomes with the public and civil society, the reform program supports the regular dissemination of key poverty indicators. The Government has also undertaken to make unit record data available to the public in order to facilitate independent policy relevant analysis and to obtain further feedback on the quality of the data.

B. 2. Improved Social Service Delivery: Education Reform

Context

38. Like other countries of the Former Soviet Union, Moldova inherited generally favorable human capital indicators. Like many of these countries, with increase in poverty and the fiscal crisis during transition, Moldova has seen an erosion in its human capital stock. Despite data deficiencies, as measured by enrollment rates, Moldova is building less human capital than at the time of transition. Excluding pre-school, by 1999/2000, the years of education that the average five year old Moldovan child could expect to complete had declined by almost three years relative to 1990/91. Enrollment rates appear to have declined at all levels, except primary (grades 1 to 4), and university. There are increasing reports of children dropping out of basic education and of absenteeism in schools.

39. There are also serious concerns about the quality of the human capital. As in the case of many of its neighbors, Moldova faces the challenge on modernizing its education system and adapting it to prepare people for a modern market economy. Further, the sharp declines in real expenditures, especially between 1999 and 2000, were not been accompanied by systematic rationalization of expenditures. Instead there were ad hoc adjustments. Thus, key inputs such as basic teaching and learning materials and laboratory facilities have been under-funded. Teachers salaries are often not paid for months, and even when they are paid, are so low that teachers have to find second or third jobs. Arrears have also been built up in utility payments. The under-funding of maintenance and major repairs have contributed to deteriorating physical facilities. The poor condition and energy inefficiency of the physical infrastructure imposes significant demands on resources that are difficult to meet. At the same time, they threaten the safety and quality of the schools and classrooms, and therefore the quality of the pedagogical process. Instructional hours have been reduced and, not infrequently, further reductions occur in instructional days due to school closures in winter or other reasons. A recent international assessment in which 38 countries participated, showed that relative to OECD countries, and the 10 other transition economies, Moldovan eighth grade students did not perform well in mathematics and science.

40. At the same time, the declines in public expenditure have been accompanied by a shifting of costs to families through formal (e.g. cost recovery at higher education and pre-school levels) and informal means (e.g. side payments to teachers). Unfortunately, the formal cost recovery has not been accompanied by adequate protection for the poor. Along with the fall in fall in incomes, this has contributed to increasing inequities in the ability of different segments of the population to access education. Children from the wealthiest quintile of the population are 60% more likely to be enrolled in upper secondary education and 350% more likely to be enrolled in higher education than those from the poorest income quintiles. Urban children have a significant participation advantage at the upper secondary and especially at the tertiary level where urban youth are seven times more likely to be enrolled than rural youth. emerging serious inequities in the system. These lower participation rates at upper secondary and higher levels leads to a bias in public expenditures at these levels in favor of urban areas and he wealthy.

41. Higher education financing is further biased against the poor in policy and practice. Publicly financed university slots are allocated on the basis of merit, without taking family income into account. On the other hand, other (more than full cost recovery) slots are available to those with the ability to pay. Applicants from rural or poor families tend to score below those from wealthier families on the entrance examinations and are therefore further unable to benefit from public subsidies at this level and their families are also less able to pay fees. Competition for entrance into university has also encouraged unofficial payments at the secondary and tertiary levels that poor families cannot afford.

42. The Government has been implementing, with assistance from the World Bank, a general education reform program to improve and modernize the quality of primary and lower secondary education. Although major changes, such as those envisaged in the reform program, typically take several years, the reforms are beginning to have a clear impact on the ground. New curricula have been developed by a new and more inclusive institutional structure and in accordance with a more coherent framework. Improved national assessments have been carried out in grades 4 and 9. Textbooks are being provided for core subjects and are being financed through an innovative textbook rental scheme that makes textbooks more affordable to parents. The local publishing industry is developing well and has been supplying textbooks on the basis of competition. Teachers are receiving in-service training in the new curricula, teaching methods, and assessment. These reforms are having a very positive impact on the quality of basic education system and on the process of teaching and learning in the classroom and have been well received by all stakeholders in the education system.

43. Moving forward, it will be important to sustain and build on the reforms that have begun in the education system. More comprehensive structural reform of the education system is also called for, the preserve and improve quality, equity and access at all levels. The reform strategy for the education sector will need to be financially sustainable. As a result of the dramatic demographic changes, and in particular, the declines in birth rates, the population numbers for grades 1 to 12 are expected to fall by 40%. It will therefore be important to rationalize physical infrastructure and consolidate and close down facilities, while improving the condition and energy efficiency of existing facilities. There will also be need to reappraise the supply and demand for teachers and ancillary staff, to adjust the size and skills of the teaching force . This in turn calls for a review and subsequent change in the systems for pre-service and in-service training.

Reform Objectives and SAC III Measures

44. The SAC III program has the following objectives: (i) to support the continuation of the ongoing reforms to improve quality and to build on these achievements; (ii) to improve the information base and capacity to support future rationalization of the system by addressing the demand and supply side for information; (iii) support the preparation and the adoption of a strategy to address emerging inequities at all levels of the education system. The critical downstream needs emerging from these actions, such as improved organizational structure and capacity to implement the reforms, and the implementation of the rationalization and improvements in physical plant and staffing will be supported by the forthcoming public sector reform project and a follow up education project.

45. In the SAC III program, the Government has committed to continue the reforms to improve and modernize the quality of basic education. It will monitor their outcomes, and make continuous improvements, and ensure that all aspects of the reform are coordinated with each other. To sustain and build on the achievements to date, and recognizing the importance of good quality basic education, it has committed to funding these quality improvements in the coming years. It has also committed to preserving and building upon the positive institutions and practices that have been established under the General Education Project. These include the National Council for Curriculum and Evaluation and the professional and consultative processes for curriculum revision, an independent and adequately staffed Department of Evaluation and Assessment, and the use of transparent and competitive methods for the procurement of textbooks. The latter will be facilitated by autonomous management of the Textbook Rental Fund by an inter-ministerial Steering Committee.

46. To meet the future strategic challenges of the education system, and particularly the need to rationalize while continuing to improve quality and equity, the Government recognizes the need to develop capacity and capability for policy analysis and strategic planning within the Ministry of Education in the medium and longer term. The SAC program supports thus change by supporting intermediate steps in the establishment of an Educational Management Information System. This will eventually ensure that managers have access to the relevant data and information for decision-making. The Ministry has already initiated improvements in the existing database. In particular, it has created detailed information for three judets. The analysis of these databases demonstrates many of the short, medium and longer term challenges facing the educational system. Recognizing that a good information system will need to address both the demand and supply side of information, the SAC program supports the use of the existing databases as a foundation for moving ahead with the development of a national EMIS. To this end, it supports a series of actions including the finalization and dissemination of the analyses on the basis of existing databases, a review of the legal framework governing educational management (including implications for employment relations), and the creation of a working group to start the initial planning of an EMIS, based on an assessment of information needs. The Government will also carefully examine the experiences of other transition countries with improvements in infrastructure efficiency and system optimization, and improving management of education.

47. In addition to the actions to build capacity in poverty monitoring, evaluation and analysis described above, the reform program includes additional studies and surveys on selected topics to better inform the development of the strategy to improve the quality and equity of primary and secondary and to address the inequities that have emerged in the education system. These include a study on finances available to schools, as well as informal payments by families for pre-tertiary education, on the state of the physical infrastructure and improving energy efficiency, and teacher staffing needs and the role of pre-service and in-service training institutions. The Government will thus prepare and approve an education reform strategy to address, among other inequities, the (a) reduced attendance and completion of basic education, particularly among poor children; and (b) unequal access to higher education by students from poorer households, through changes to the existing higher education selection and financial support mechanisms.

B. 3. Improved Social Service Delivery: Health Reform

Context

48. Moldova has made steady progress since the mid 1990s in reversing the decline in life expectancy and in restoring health status to levels unseen since before the economic crisis. The most dramatic reversals is in terms of life expectancy, which increased from 65.9 years in 1995 to 67.4 years in 2000. Infant mortality declined from 22 per 1,000 live births in 1994 to 18 deaths in 1998; maternal mortality declined from 50 to 27 deaths per 100,000; standardized mortality decreased from 1,613 deaths per 100,000 in 1995 to 1,456 in 1999.

49. Despite these improvements, the Moldovan health system continues to lag far behind the outcomes achieved in other European countries. In most cases, the outcomes for Moldova are at least 50 percent worse than the European average. Even in comparison to other CIS countries and other countries with similar incomes per capita, Moldova lags behind in all but life expectancy, infant and maternal mortality. Moldova is the second worst of all European and CIS countries in terms of the incidence of breast and colon cancer, with the exception of Armenia and Lithuania. The prevalence of tuberculosis rose to 89/100,000 in 2001, a 98 percent increase as compared to 1990. The steepest growth in HIV/AIDS rates in the world is observed in the region, and Moldova is amongst the four regional countries with highest prevalence of the infection. In sum, the health system faces the added complexity that the dual epidemiological profile, characterized by diseases of poor countries, like infectious diseases, and diseases of rich countries, like cancer and cardiovascular diseases, poses a serious challenge in the resource constrained environment that is the Moldovan health sector.

50. Over the past few years, the Government has made substantial progress in confronting the emerging crisis in the sector. The national health system reform program has been centered on four key pillars: a) strengthening the primary care network, b) improving the allocation of resources to ensure a more equitable and efficient orientation of healthcare resources, c) restructuring the health system at the national and judet levels, and d) strengthening the quality of health care staff.

51. The Government has aimed at allocating 35 percent of the health resources to national public health priorities and primary health care, and the Health Investment Fund has been instrumental in reactivating investment in primary care and emergency care. Most judet health authorities are preparing or implementing detailed strategies for investing on primary and emergency care and reducing excess capacity at the hospital level under the Bank-financed health project. The Government, the Municipality of Chisinau and the Judet Health Authorities have already taken concrete steps to reduce excess capacity since 1998: (i) the number of hospitals decreased from 253 to 65; (ii) the number of hospital beds decreased by 50 percent; (iii) 8 Republican and Municipal Hospitals in Chisinau were either closed or consolidated; and (iv) more than 100 ancillary facilities have been closed.

***Reform Objectives and SAC III Measures*[2]**

52. Improving the allocation of resources to ensure a more equitable and efficient orientation of healthcare resources will enable the Government to achieve a better utilization of finances and to appropriately meet the health needs of the population. Given the current economic crisis facing the country, the budgetary resources allocated to healthcare system have been reduced to a minimum. The Government's intention is to ensure that the majority of these funds are allocated to guarantee access to a minimum package of essential services and pharmaceuticals. Toward this end the Government plans to develop a diagnostic mechanism that would provide a basis for informed policy decisions in health sector finance through analysis of (i) the use of financial resources spent on various levels of health care services (e.g., primary care, hospitals, and public health), (ii) sources of financing, and (iii) the effectiveness of the utilization of resources. The Government will address the outstanding financing issues within the existing macroeconomic framework, with the use of best practice for health insurance design and through a better understanding of what has worked and what has not in other CIS countries.

53. Restructuring the health system at the national and judet levels will allow better use of public funds by reducing expenditures on maintenance of infrastructure and unnecessary energy costs while refocusing them on essential health services. Thus the reform focuses on restructuring the medical services provider network with a consolidation of the existing infrastructure and a reorientation of resources from the curative, specialized level care, towards basic primary care. Under the SAC III the Government will implement a time-bound Hospital Restructuring Plan for further elimination of excess capacity at the 17 Republican Hospitals and the Chisinau Municipality Hospitals.

54. The territorial reforms introduced in 1999 develop a decentralized framework for the management of the healthcare delivery system. As part of the implementation process associated with the decentralization, the Government will separate the healthcare providers and financing functions (purchaser-provider split) to optimize medical care and to increase the accountability at the local level. At the same time, changes will be required at the central level to improve the policy making and regulatory capacity of the central level Ministry of Health. The development of these policies will help ensure the following actions are taken: (i) publicly funded healthcare services will be purchased from accredited medical facilities on a contract basis between health authorities (the purchaser) and health facilities (the provider); (ii) over the next several years, the majority of all health care providers will become autonomous entities and will no longer be financed from the Government budget; the legislative framework will be a critical element to guarantee the success of this activity; (iii) efforts will be made to sell non-productive assets that have resulted from the dramatic downsizing that has taken place over the past several years; (iv) the Ministry of Health will strengthen its policy making and regulatory capacity to improve oversight in the system and to develop the strategic vision required to guide the sector through

[2] The Bank is also assisting the Government to identify funding for, and implement TB/AIDS pilot projects and activities, and initiate the preparation of a TB/AIDS Project. The Government, UN agencies and NGOs have established a Country Coordination Mechanism, which has just obtained a $1.7 million grant from the Global Fund on AIDS, Tuberculosis and Malaria.

the difficult reform process; (v) the Government will restructure health service providers to allow them to be financially and managerially autonomous and run by professional managers; and (vi) the Government will revise its drug purchasing policy to allow wholesale procurement through a competitive tender mechanism and to ensure the provision of a basic package of pharmaceuticals to all citizens.

55. The Government will also strengthen the quality of the workforce through actions aimed at improving the clinical management of illness with the introduction of modern protocols, strengthening institutional capacity through training physicians and improving management to improve value for money in the healthcare system. Taking into account the present infrastructure and the social-economic situation of public health sector, these measures will be urgently initiated to ensure that the most pressing needs are met within a period of two to four years. The Government will carry out and approve a human resource restructuring plan that will undertake an inventory of the existing staffing levels and conditions in all health facilities, provide a clear framework and estimate financing needs for further downsizing. The plan will promote the reassignment of staff to underserved areas, ensure changes in medical education - including policies and standards for training specialist physicians - to provide for an adequate supply of medical professionals in accordance with the population's needs and resource levels. It will also introduce alternative contracting mechanisms that combine fixed salary with variable salary based on performance indicators and productivity. Second, development of primary care and improving efficiency at the hospital level will require the development of new skills. The Government will support retraining of physicians and professional staff, and improvements in their management capacity.

B. 4. Strengthening Social Protection: Pension Reform

Context

56. Moldova's current system of social protection remains weak and ineffective. The existing social assistance programs rely on categorical and discretionary targeting approaches, and Moldova lacks a policy and strategy to identify and target the poorest in society. The Government recognizes and tries to address this issue. Some success in improving targeting of nominal compensations for energy costs was achieved in 2000. The Government also lacks a coherent strategy to protect the unemployed and disabled. The numbers of children taken into institutional care is rising and there is no policy and strategy for de-institutionalization or provision of alternative community-based care services.

57. The capacity of the Ministry of Labor and Social Protection to design and implement social protection policies is limited. The policy-making responsibilities are unclear and fragmented among several ministries (MLSPF, MOER and other line ministries) and social protection costs are divided between national and local government. The Government needs to identify and assign institutional responsibility for the design of social protection (and social assistance in particular) policies and programs, including those institutional care programs that currently fall under other ministries (e.g. to Ministry of Labor and Social Protection).

58. In the area of pension policy the Government of Moldova began a reform of pension system in 1998 and is in the process of its implementation. The 1998 reform rationalized the

pay-as-you-go pension system by establishing a strong linkage between individual contributions made and pensions received. The 1998 Law set a policy for the gradually increase in retirement age (to reach by the year 2008 the age of 60 for female and 65 for male population); incentives for individuals to work longer were introduced in pension benefit formula. The reform eliminated most privileges and significantly improved the transparency and equity of the state pension system.

59. The early years of implementation have produced some positive outcomes. From a position of high and increasing arrears, and significant in-kind contribution and benefit payment, the system improved and recorded a small surplus in the social fund budget in 2001. All payments were made in cash and on time. With the assistance of the World Bank, the Government is building institutions to strengthen administration and enhance accountability.

60. Nevertheless, the policy adopted since 1999 deviates from what was envisaged in the reform strategy in several important ways. One is the treatment of farmers. Instead of introducing a flat contribution scheme, linking farmers' pensions to contributions, for various reasons, the old scheme was carried forward. As a result, significant redistribution to farmers remains in the system, inconsistent with the principle of the reformed pension policy.

61. The lack of pension indexation according to inflation is another major deviation. Although required in the adopted legislation, for various reasons, pensions have not been indexed regularly. As a result, pensions dropped significantly in real value, leaving pensioners unprotected. The recent increase of pension adopted by the Government suggests re-calculating the pensions instead of increase by straight percent is inconsistent with the pension reform principal. In the absence of continued implementation of pension reform and without clearly defined indexation mechanism, the pensioners will face the risk of falling into poverty. Ad hoc adjustment of pension level will leave the system nontransparent and inequitable, as well as subject to financial disequilibrium.

Reform Objectives and SAC III Measures

62. In light of the above, the reform program under the SAC III will support the continuation of the pension reform to ensure sustainable and adequate old-age protection. The Government will continue implementation of the pension reform based on the fundamental principles introduced in the 1998 Pension Law including: (i) compliance with pension formula; (ii) gradual increase in retirement age; and (iii) gradual elimination of pension privileges.

63. To do so, a set of amendments to the 1998 pension law will be enacted including: (i) integration of pension privileges into the general pension law with gradual withdrawal of elements inconsistent with the general pension law; and (ii) specification of a clear financially viable indexation mechanism with which to determine all future pension increases.

64. The Government will also develop and approve multi-year financial projections, demonstrating the financial impact of these, and any other proposed legislative changes, on the pension system and on future pensioners.

65. In the absence of further reform in farmers pensions, Moldova's pension scheme will face a serious setback. The financial situation will deteriorate, risking further arrears and delayed payments, which in turn would increase the burden of the state budget. Under the SAC III

program, the Government will prepare and approve a medium-term strategy to further reform pension policy for farmers and the self-employed consistent with the reformed pension structure.

C. IMPROVING THE BUSINESS CLIMATE

66. The sustainable growth of the Moldovan economy – and the ability of Moldovan enterprises to compete in international markets – requires a business environment conducive to private sector investment (from both domestic and foreign sources) and new enterprise development. Official statistics indicate that at present, the share of private sector business in Moldova accounts for 75 percent of GDP, 70 percent of employment and 59 percent of exports. However, the sizeable role played by the Moldovan private sector in the economy is more a sign of the great resiliency of struggling entrepreneurs than of a supportive business environment. As shown by a recent cross-country cost-of-doing-business survey funded by IDA, Moldovan enterprises are subject to excessive State regulation, and the official and unofficial costs of doing business in Moldova are much higher than in a number of other FSU countries and Bulgaria.[3]

67. The Government believes adherence to, and further implementation of market-oriented policies will send a strong signal to the business community, both at home and abroad, that it is serious about structural reform and that Moldova is a good place to do business. In part, this means pursuing a sound macroeconomic framework, including servicing external debts, to maintain low levels of inflation and to continue to bring down real interest rates. It also means taking steps to strengthen fiscal and fiduciary discipline, including through administering sound tax policy and rationalizing expenditures, easing barriers to new business entrants, and continuing competitive restructuring and privatization efforts of strategic sectors.

68. The proposed SAC III program supports the Government's efforts in strengthening economy-wide structural reforms towards a market-friendly business environment and refraining from any actions that would jeopardize this objective. In agriculture, a key sector in Moldova, SAC III would support liberal market policies and further development of private land markets.[4] In energy, the primary focus will be to make the power sector financially viable by privatizing or changing management control of the power companies and assuring the independence of the energy regulator; this will pave the way for the financial viability of the energy sector.[5] In the other key enterprise sectors, SAC III will provide the support needed to refine the rules and procedures regarding the privatization process to make it more competitive and transparent, and to accelerate the restructuring and/or liquidation of large loss-making enterprises. It will also facilitate the privatization of strategic assets – Moldtelecom and the wineries.

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[3] The business climate in Moldova was compared with that of Armenia, Belarus, Georgia, Ukraine and Bulgaria, where the same survey instrument was used.

[4] This will be complemented by the proposed Rural Investment and Services Project (RISP) designed to improve access of private farmers and rural businesses to knowledge, markets and finance.

[5] A proposed Energy II project would strengthen the power transmission network.

C. 1. Hardening Budget Constraints and Improving Fiduciary Management

Context

69. Strong fiscal discipline and fiduciary management are keys to improvement of Moldova's economic competitiveness. To improve financial management, a single treasury system to service the State Budget has been established. In 2001, a Cash Management Unit was created in the Treasury to improve cash flow forecasting and management. Public debt management has also been strengthened by consolidating foreign and domestic debt departments into a single unit while improving its front, middle, and back office functions that provide support to senior managers in developing and implementing a comprehensive and proactive public debt strategy based on the country's debt sustainability analysis.

70. A continued strong macroeconomic framework is needed to ensure the full benefits of the structural reforms. With IMF support under the PRGF arrangement, the Government is taking steps to maintain budgetary discipline and low inflation, lower interest rates and ensure external sustainability. In this regard, the PRGF arrangement calls for a primary budget surplus on a commitment basis of 1½ percent of GDP over the coming years to stabilize and subsequently reduce the debt burden, increase revenue collection, and pay down budgetary arrears. Monetary policies aim at further reducing inflation and maintaining foreign reserves equivalent to 3 months of imports. Social entitlements will be maintained at levels commensurate with available resources and paid on a timely basis. The structural reforms supported by the proposed SAC III aim to strengthen the supply response and sustain stabilization.

71. At the local level, a territorial administrative reform was implemented in 1998 which reduced the number of administrative units (judets) and staffing levels, and an effort was made to decentralize the fiscal system. USAID and the Bank (through a PHRD Grant) are providing technical assistance for Public Sector Reform. The government has taken significant steps for the computerization of the budgeting and treasury operations. However, the computerization was done on a piece-meal basis and there is no integrated financial management system. It is important to set-up an integrated financial management system.

72. To strengthening financial accountability in Moldova, it is important to improve the internal and external audit functions. Currently both the external and internal audit capacities are very weak and need significant improvement. The Government is aware of the problem and recognizes that the auditing function should be strengthened within government bodies, and at the level of the Ministry of Finance for internal audits across government bodies. At the same time, external audits are currently conducted by Court of Accounts (CoA). The Court of Accounts was set-up in 1994 and does not have the adequate expertise in carrying out a modern audit. While the founding acts of the CoA give it broad and nearly unchecked authority, the Government recognizes that the CoA does not have appropriate guidelines for operation, exerts its power in areas which should be outside its mandate (i.e., outside the use of public funds), and does not have adequate skills and expertise. Indeed, the CoA is interfering in many joint venture enterprises and damaging the business environment in the country. The CoA has about 140 staff, of which 70 staff are in the central office and remaining staff are in regional offices. Most of the staff are not qualified and lack adequate skills and expertise in carrying out a quality audit. The

audit reports are mostly of compliance nature. The CoA does not have the capacity to carry out value-for-money audits or performance audit. The CoA submits its reports directly to the Parliament, but the Ministry of Finance, which is an auditee of CoA, allocates the budget of the CoA. This raises conflicts of interest.

Reform Objectives and SAC III Measures

73. The Government recognizes that subsidies for specific sectors do not promote efficient use of budgetary resources, especially under tight fiscal pressure, and that limited resources should be prioritized based on the efficiency and effectiveness of sectoral programs. To this end, the Government will take steps to eliminate all public sector financial support for the wine and tobacco sectors by (i) issuing a Government Decree which stipulates measures for the elimination of all public sector financial support, including investments, loans and credits, and subsidies, related to raw material production, processing and trade in the tobacco and winery sectors, beginning with enactment of the 2003 Budget and thereafter, and/or modification or elimination of any other related existing mechanisms; and (ii) enacting legislative amendments to eliminate earmarking of all tax revenues to the wine and tobacco sectors, including those specified in Art. 18(2) of the Law on Tobacco and Tobacco Products (No. 386-XV) and Art. 22 of the Law on Vineyards and Wine (No. 1166-XIV).

74. Recognizing the importance of the wine sector for the Moldovan economy, the Government recently approved a decision to establish a Wine Department that will engage in export promotion activities. However, the Government will ensure that the activities of this Department will not undercut functions of the market system through the provision of direct and indirect financial support to private wineries. Further, the Government will not introduce any earmarked taxes to create new extra budgetary funds for this purpose.

75. Building on its past achievements and recognizing that fundamental change will require forward planning and commitment, the Government is moving to a Medium Term Expenditure Framework (MTEF) based on improved macroeconomic forecasts and realistic resource framework. This will help to improve resource allocation to strategic priority policy areas, provide for increased commitment to predictability of policy and funding, and also will provide line ministries with hard budget constraints and a measure of fiscal autonomy, but within a clear accountability framework. In parallel with development of the MTEF and social sector reform strategies, the Government plans to amend the Law on Local Government Finance and improve tax-sharing arrangements in an effort to ensure accountability and fiscal autonomy at the local level. This effort will be complemented critically by the new local treasury offices, where efforts are ongoing to improve software, hardware and information-connectivity with the central Treasury office in the Ministry of Finance in Chisinau.

76. To reform the Court of Accounts, the Government will seek enactment of amendments to the law on the CoA so that the CoA's mandate is limited to audit the use of public funds. To further strengthen internal control for use of public resources, the Ministry of Finance will reorganize the internal audit system as to increase independence and capacity. To ensure the independence of the CoA, its budget will be approved by the Parliament. This arrangement will require the proper independent review of its accounts and performance by an independent external organization. The Government will initiate action to reach agreement with a similar CoA of a European country to carry out such an audit of the financial statements and review its

performance. This arrangement will facilitate improvement in the quality of audit of CoA and also review of its budget and expenditures. Through SAC III, the Government will streamline the auditing function to avoid continued reputational risk to Moldova's business environment.

77. To further improve fiduciary management, the Association is supporting other critical government actions in this area. Building on an earlier IDF grant to improve the Government's institutional and legal framework for procurement and a Law on Procurement that was approved by Parliament in 1997, a Country Procurement Assessment will be carried out in FY03. Additionally, through technical assistance supported by a PHRD grant for Public Sector Reform, work is ongoing to improve the system of intergovernmental finance. A Public Expenditure Review is also being carried out, to be completed in FY03. The Association has initiated a Country Financial Accountability Assessment (CFAA) and intends to completed it in CY 2002. As part of the CFAA, the Government will prepare an analysis highlighting the strengths and weaknesses of major users of public resources. Under SAC III the Government will adopt and implement an action plan recommended by the CFAA to improve the financial accountability in Moldova both in the central government and also in the local government institutions.

C. 2. Reform of Business Administrative Framework

Context

78. Burdened by a myriad of regulations, many businesses have resorted to operating in the gray economy. Unpredictable changes in commercial legislation and administrative barriers of all kind, including licensing, inspections, certification and customs procedures, impose the major constraints for business entry and sustainable growth. Over the past several years, the Government has taken several steps to reduce administrative barriers to business, including a stronger rules-based policy framework and improved legal systems and institutions. The Parliament adopted a new Law on Licensing of business activities, consolidated the licensing authority in the newly established Licensing Chamber and adopted rules to help cut rent-seeking opportunities in about 25 ministries and departments that previously used to issue licenses. The number of activities requiring licenses was reduced from 106 to 55, while leaving authority for licensing for strategic industries - telecommunications, energy and banking - to independent, qualified regulatory agencies.

79. Reforms to streamline the system governing business inspections have been underway. Among other actions, the Law on Creation of an Office of the Ombudsman was passed on October 17, 1997. The office was established and three lawyers are elected by the Parliament for a five year term. However, under the provisions of the current law the mandate of the Ombudsman is focused primarily on settlement of claims brought in by individuals. As the recent cost-of-doing-business survey shows, Moldovan businesses still complain of the intrusiveness and arbitrariness of the State inspection and regulatory system and thus further reforms are needed.

80. The Government has taken further steps in improving the legal framework for bankruptcy by enacting a new Law on Insolvency, which came into effect on February 15, 2002. The law provides for out-of-court (restructuring) and court-led (plan and liquidation) procedures, and introduces improvements based on experience and lessons learned in the past few years. Furthermore, the improvement of the legal framework is to be complemented by the efforts to strengthen the capacity of the economic courts dealing with bankruptcy cases.

81. In order to further enforce financial discipline on legal entities and persons, the Parliament passed a series of laws including the Law on Prevention and Combating of Money Laundering. The Law on Ratification of the Convention on Money Laundering, Identification, Sequestration and Seizure of Revenues from Criminal Activity[6] was adopted on March 15, 2002. The Law on Financial Disclosure of Public Officials has passed the first reading in the Parliament.

82. The new Law on Pledge was passed on July 30, 2001. The Law provides clear provisions on the pledge procedure of movable and immovable property, along with the needed regulation on relations between the pledgor and pledgee. The law sets up the concept of a Pledge Registry for movable property, which is to be implemented under the guidance of the Ministry of Justice. The regulations related to the introduction of the Pledge Registry comes into effect on July 1, 2002.

83. As one of the first CIS countries to accede to the World Trade Organization (WTO), in 2001, Moldova has made its commitment to the rules-based world trade regime. In order to fulfill its WTO membership commitments, the Government plans to carry out substantial work on harmonization of appropriate legislation and regulations in several areas. The Government has started customs reform in order to combat corruption and smuggling, including through the introduction of new customs seals and the rotation of senior customs officers. The Government is committed to further reform the customs procedures.

84. A new, market-oriented Civil Code will become a cornerstone of the Moldovan legislative system. The work on it started in 1994 when a working group was set up by the Parliament. In the fall of 2000 the draft Civil Code presented by the working group was voted on by the Parliament as a basic draft. The Parliament then created a special commission to finalize the draft Civil Code, and the special commission presented the proposed Code for the second reading in the winter of 2002 during which the draft underwent substantial changes. That draft passed the second reading in March 2002, and in April 2002 the entire Civil Code was—surprisingly and quickly—approved in the third reading. Assessment of the passed Civil Code is still underway to see what amendments might be necessary to bring it in line with international standards.

Reform Objectives and SAC III Measures

85. While substantial progress in improving Moldova's business environment has been made, a challenging reform agenda remains. The Government reform strategy aims at further deregulation and upgrading the legal foundations and institutional capacity for a sound business environment. The main objectives of these reforms are: acceleration of economic growth and job creation, with a particular focus on SME development; promotion of foreign and domestic investment; and reduction in size and scope of the gray economy by reducing disincentives for business to enter the formal economy. To this end, SAC III will support the priority reforms to: (i) remove administrative barriers to entry, exit and efficient operations of business; (ii) reduce barriers to restructuring and redeployment of assets; (iii) provide a modern, market-oriented framework for business legislation and commercial transactions; (iv) facilitate institutionalization of the business-government consultative mechanism.

86. To reduce barriers to entry and exit the Government is committed to decrease further the

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[6] Strasbourg Convention of November 8, 1990.

number of licenses and simplify the licensing procedures. To this end, it will review the procedures and practices of the Licensing Chamber after the first year of operations and introduce necessary modifications to the Law on Licensing. In order to decrease the cost of exit the Government will develop a program to streamline the procedure of exit and de-registration, including a one-stop-shop procedure and automatic de-registration following a set period of business in-activity. The Government will analyze the respective legal documents, including but not limited to the Law on State Registration of Enterprises and the Concept of Legal Entities Registry, in order to ensure exit simplification and will amend the documents accordingly.

87. The Government has a clear perception of the scope of reform of the inspection system in order to reduce business harassment and increase the efficiency of inspections through transparency and accountability. The Government is committed to conduct a radical reform of the business inspection system to reduce impediments to business activity. This will entail creation of stronger checks and balances, enhanced coordination among the inspecting institutions for the proper filtering of inspections, modification of the enterprise inspection log requirement and establishment of a publicly accessible centralized registry of enterprise inspections. As of today, the Ministry of Economy has presented an initial draft of a Governmental Resolution on the reform of the inspection procedure.

88. To enable the efficient redeployment of physical and financial assets to more productive uses, the Government has eliminated stipulations in the Tax Code for VAT which levy VAT on fixed assets brought in as statutory capital of an enterprise. This measure will eliminate a source of discrimination against business reorganization in a low-liquid market, thus encouraging better allocation of productive resources while reducing the costs of doing business. It will facilitate enterprise restructuring, establishment of joint ventures and attraction of foreign investments.

89. The market-oriented Civil Code is to include a clear stipulation of property rights and of other real rights; norms on mortgages and pledges (subsuming the provisions of the Law on Pledges enacted on July 30, 2001); and is to completely define the regulation of a set civil matter, including all general and special norms. The new Civil Code (which will come into effect on January 1, 2003) will require that all other laws be brought into conformity with it.

90. The Government is strongly determined to institutionalize the business-government consultative mechanism, including the establishment of an Ombudsman Office within the Presidential Apparatus that will be instrumental in addressing concerns and appeals raised by entrepreneurs in respect to administrative barriers to business. The Government is committed to review and amend the existing Law on Creation of an Office of the Ombudsman in order to assure that legal entities can address their business concerns and petitions to the Ombudsman Office.

91. The Government is committed to conduct continuous benchmarking of the business environment: measuring changes through regular business surveys and using their results to raise awareness and create a common inter-ministerial platform for de-regulation and reduction of administrative barriers. In particular, the Government will complete the second "Cost of Doing Business" survey and develop a policy program to implement findings; the findings of the survey are to be published and disseminated widely.

C. 3. Reform of the Agricultural Sector

Context

92. Agriculture remains the mainstay of the Moldovan economy, accounting for about 33 percent of GDP, over 40 percent of employment and 65 percent of exports. Since Independence in 1991, Moldova's agricultural sector has performed poorly with declines in production, productivity and exports. According to official statistics, agricultural production declined by about 35 percent in the first half of the 1990s and by a further 20 percent in the second half and is now less than half of its 1989-91 level. Most of the decline is the result of lower productivity levels, as total agricultural area has not changed significantly. Yields are about 20-60 percent lower, depending on crop, than the 1989-91 levels and labor productivity has also declined, as the agricultural labor force did not contract at the same rate as production. This has led to the significant contraction of aggregate agricultural exports.

93. Some of this sectoral contraction can be explained by the extreme terms of trade shock following independence, and the reduction in the highly subsidized nature of production experienced in the pre-reform period. Farm products were procured by the state at prices much higher than world prices while inputs, such as fertilizers and fuel, were provided to state and collective farms at a fraction of the world price. This level of support was clearly unsustainable, and increased concerns in the Former Soviet Union (FSU) in the late 1980s, about the size of the subsidy and the increasing level of indebtedness required to keep farmers in business. In 1990/91, along with the other Commonwealth of Independent States (CIS) countries, Moldova set out on a path of reform and restructuring in a move to a more sustainable market-based economy. Unfortunately, the magnitude of these past distortions was so large that it created extreme terms of trade shock. Moldova's general terms of trade were estimated to have declined by between 40-50 percent, depending on the measures used, and were estimated to be more severe than in any other CIS country. In 1992, the cost of petrol and natural gas increased 40-fold and the cost of coal increased 100-fold. The input adjustments following these price changes, particularly for fertilizers and fuel, are a key factor to explaining the subsequent output decline

94. Despite the poor performance of the agricultural sector, the late 1990s heralded progress on policy reform and marked improvements in the speed and depth of land privatization which had provided an emerging platform for future recovery and growth. The reform process commenced from the mid 1990s and has been prolonged but by the end of the decade had finally begun to address the fundamentals of land privatization and farm restructuring, that has substantively occurred during the last three years. In particular, the land privatization process is now virtually complete after several years of delays and false starts. There have also been several important positive aspects to the land reform program, including: the resolution of the farm indebtedness through a one time write-off under the National Debt Program; the creation of possibilities for a range of farm sizes and types to emerge through land market transactions; and the development of options to lease out land to provide a way of allowing pensioners and others to leave farming without burdening the surviving farms with uneconomic levels of labor. Of the more than 1000 state and collective farms in 1990 all but 40 have been privatized and about 3 million individual titles have been issued, and by 2001, there were about 440,000 private farms. About 80 percent of land is farmed in some sort of leasing arrangement.

95. The progress made on policy reform provided a foundation for the reduction in the pace

of decline in agricultural output and even for it to bottom out with sporadic signs of early growth appearing. After a promising start, key agricultural reforms failed to gain momentum since mid 2000 mainly as the result of the continuous struggle between pro-reform and conservative forces within the Government. This hampered and delayed the implementation of a consistent set of policies required to properly address the critical issue of transformation. The result has led to the inhibition of new enterprise entry, a poor investment climate, sporadic introduction of export bans such as the timber export ban, increased licensing requirements (e.g. on walnuts) as well as minimum reference prices for exports. All these measures have contributed to greater levels of the uncertainty faced by the majority of agricultural producers.

96. Despite these difficulties there has over the past six months been a period of active dialogue between the Government and its development partners, particularly IDA. This dialogue has resulted in the Government reconfirming its commitment to implement agricultural policies and support agricultural institutions aimed at developing a vibrant market-oriented rural economy, and is pushing forward a strategy for recovery concentrating on the unfinished fundamental reform agenda. It has already made significant steps to realign past policies especially regarding the cancellation of reference pricing for key commodities such as wheat, further removal on trade restrictions and licenses such as the tobacco export ban, and streamlining subsidies within the sector and limiting them to a more focused and targeted program through the Agricultural Support Fund. The Government has also reiterated that its commitment not to become a direct facilitator of trade for the private sector. In this respect it has already annulled a recent decree on creating procurement centers (which would have been prone to capture by public officials) and discontinued debt write-offs through the State Grain Reserve Fund (SGRF) and a differential pricing scheme for grain.

Reform Objectives and SAC III Measures

97. Given this background, the SAC III provides a new beginning for World Bank Group cooperation with the Government of Moldova in the sector, which has significant potential for recovery, but whose growth will remain suppressed unless renewed efforts are made to overcome the remaining obstacles. In order to reaffirm its commitment to the systemic transformation of the sector and a liberal agricultural policy framework, the Government has prepared jointly with IDA a Memorandum of Understanding (MoU) of Agricultural Policies. The memorandum was signed by the Prime Minister and the Minister of Agriculture and provides the foundation on which SAC III policy actions can be further developed.

98. The actions proposed under SAC III will help to better allocate productive inputs (including land) while reducing the costs of operation for farmers, thus improving productivity in the farming sector and helping farmers to increase financial returns, remain solvent, and grow. These reforms will provide the basis for the proposed RISP which is designed to provide much needed post privatization support through improving access of new private farmers and rural businesses to knowledge, markets (including for services and inputs), and affordable finance. Thus the reform program under SAC III contains 3 key objectives that include: (i) preservation of farmers' rights during the farm re-organisation phase; (ii) rationalization of subsidies to the sector; and (iii) maintaining a liberal incentive framework for the agricultural sector.

99. *Preservation of Farmers' Rights*. The farm sector remains in a fluid state after the land privatization program. In the coming two to three years, many farms will undergo major changes

as existing leases are reviewed and as the efficiency of different farm structures and sizes becomes more apparent to farm households. This will, however, be a market-driven process with the role of Government not to prescribe farm structures but to facilitate the rapid evolution of that market-driven process. Therefore, the development of a functioning land markets is essential. The Government has confirmed its commitment to the basic tenets of the Land Code of 1991, with IDA assistance is preparing amendments to facilitate cadastre and land transactions. The key issues that the Land Code will address include: a clear definition and protection of land owners' rights; facilitating and supporting secure transactions of property rights, backed by formal contract procedures; and limiting to exceptional circumstances, Government restrictions on transaction.

100. The Government will develop a program to measure and reduce the costs of land notarization and land transactions. In parallel (supported by the proposed RISP), a unified commercial and pledge register system will be established covering the entire right bank of Moldova and land owners will be informed of their rights, as well as standardized terms and conditions of lease and sales contracts. To help resolve land disputes, with IDA support, the Government will develop a system of legal dispute arbitration through the rural network of Legal Advisory Centers.

101. In order to strengthen private landowners' rights the Government has agreed to review the draft Law on Production Cooperatives, and incorporate the key principals of voluntary membership, freedom to exit at any time, with the member's original, physically demarcated plot of land, and to the principal that land should not be subscribed as equity into Production Cooperatives.

102. To prevent large farmers from registering as Peasant Farms (thereby avoiding the standard 5 percent VAT), Parliament amended the Peasant Farm Law requiring peasant farms to convert to other forms of organisation if more than 50 percent of labor is hired from outside the immediate farming family. To complete this reform, the Government will introduce a legal definition for private individual farms that considers other benchmarks, such as the gross value of production or the number of hectares, as more accurate indicators of size.

103. *Rationalization of Subsidies.* The agriculture sector has in the past received significant State support/subsidies. However, these subsidies have become unsustainable and helped to hinder movement towards a market orientated rural economy. Thus the Government is committed to ensure that any future agricultural subsidy must benefit primarily the poor, be fiscally affordable and transparent, minimize distortions and be targeted, favoring post-privatization restructuring of agriculture along efficiency lines. Thus significant steps have been taken to eliminate agricultural subsidies, directed credits and off-budget programs to the sector, outside of the Agricultural Support Fund (ASF).

104. In 1999 and 2000, the ASF provided a one-time-only cash subsidy per hectare to all new landholders. This subsidy program remained in place through two budget cycles and reached the majority of new private farmers. The Government is now proposing an evolution of the program. The ASF will now provide matching grants to commercial banks upon repayment of principal by farmers to the banks. This will reduce borrowing costs for small private agro-producers while minimizing distortions in market interest rates. The ASF, when properly implemented, will help small borrowers establish a credit history, leading to more intermediation and investment in small and medium farms. The 2003 Budget will include provision for the ASF only with no

other agricultural subsidies. The Government has agreed to implement the 2002 ASF with terms, conditions and implementation regulations acceptable to IDA.

105. *Maintaining a Liberal Incentive Framework.* In order to liberalize price and trade policies and encourage sustainable agricultural growth, the Government has already: (i) eeliminated all remaining export bans, licenses and controls (including for timber, walnuts and tobacco) and (ii) discontinued the practice of issuing reference prices for agricultural products

106. The Government has pledged to ensure that line ministries and other government bodies desist from procuring, storing and trading agricultural commodities beyond levels implicit in their functional mandates. The Government is also taking steps to better define the operating rules for the State Grain Reserve (SGR) regarding purchasing and sales, so as to limit and make more predictable their impact on market prices, eliminate in-kind grain loans or debt write off, and shift some storage to private facilities thereby improving quality of storage and encouraging private warehouse development. The Government has annulled several parliamentary decisions which facilitated in-kind contributions of grain for the SGR in return for tax arrears, and in parallel will discontinue differential prices for in-kind versus cash-based sales. Prior to second tranche release, the Government will prepare a plan to operate the SGR according to the principles set out in the Memorandum of Understanding.

C. 4. Reform of the Energy Sector

Context

107. Over 90% of energy demand in Moldova is met by imports. Energy imports represent sizable portion of the country's balance of payments. Commercialization of energy supply and improved efficiency of energy consumption are, therefore, critical for ensuring orderly financing of the imports, protecting the government from accumulating external liabilities, reducing quasi-fiscal deficit, and providing reliable and affordable energy supply to the economy and population.

108. With adjustment and investment support from IDA, Moldova has achieved good progress in energy sector reforms. Achievements include: (a) a new, market-oriented legal framework; (b) unbundling of vertical monopolies; (c) the establishment of an independent energy regulatory agency (ANRE) and sustained increases in energy tariffs (electricity and gas) recovering full costs, or in the case of the privatized power companies, as stipulated in the Purchase and Sale Agreements; and (d) bringing subsidies for energy consumption in line with resources and improved targeting. Good progress has been made in privatizing and restructuring energy companies. The majority of shares in Moldovagas – the country's monopoly gas supplier – have been sold to Russia's Gazprom (and as a result, debt accrual to Gazprom by Moldovagas is no longer a State liability), and three of five electricity distribution companies (covering more than two thirds of the market) have been sold to a strategic investor. Also, the district heating networks have been transferred from the State to municipal governments.

109. These reforms have already yielded significant benefits. Electricity prices to the privatized companies are dropping and they are supplying electricity practically without interruption in the center and south of Moldova, thus helping improve economic performance in those regions. The performance of Moldovagas has improved and gas supplies have become

more reliable and secure. The Government has stopped accumulating external debt for gas and electricity imports, except in non-privatized areas.

Reform Objectives and SAC III Measures

110. The objectives of the energy sector reforms at this stage are to further commercialization of the sector and to sustain reform benefits already achieved. The priority measures for achieving these objectives include: privatization of the remaining state-owned power distribution companies, RED Nord and Nord-Vest; strengthening legal basis for prosecution of theft of energy; restructuring of large historical debts in the energy sector; further strengthening sector regulation; and maintaining affordable and well-targeted system of benefits to help the needy families pay their energy bills.

111. Privatization of RED Nord and Nord-Vest to a strategic investor with long-term interest in the business and with the necessary financial and managerial resources would help commercialize the electricity industry, reverse its physical decline, and make the industry financially sustainable. Total losses in these two enterprises are in the range of 30-40%, which is clearly unsustainable. Reducing the losses requires significant investments in metering, billing and collection systems, and in rehabilitation of power lines and substations. The private sector is in a better position to fund these investments and operate the business efficiently.

112. Completing privatization of electricity distribution would have positive cascading effects on the rest of the electricity sector, as well as on other energy industries and on public finances. In the electricity sector, it would improve the financial viability of the transmission and dispatch company, which is critical for maintaining the integrity of the entire electricity system and enabling Moldova to facilitate power trade in the region, between Ukraine and Russia and the rest of Europe, enhancing energy security of the country. The privatization will also strengthen the financial position of the combined heat-and-power (CHP) plants, improving the prospects for their eventual privatization. This, in turn, would help the gas industry collect their payments from the CHP plants, and the heating industry get better service from them. This would harden budget constraints for the heating companies, increasing the pressure on them to restructure their business and improve financial and technical performance. Finally, privatization of RED Nord and Nord-Vest would eliminate the state's contingent liabilities which are being accumulated by the two companies.

113. The Government has hired an investment bank to help with the privatization. It has adopted a privatization plan which focuses on transferring management of the companies to strategic investor(s), with good incentives for bringing better management, capital and technology. The Government is also taking a number of other actions prior to the privatization. The energy regulatory agency (ANRE) has brought electricity and gas tariffs to cost recovery levels, and formerly unfunded energy privileges and entitlements have been streamlined, targeted and fully funded in the State budget. The Government is dealing with problems related to privatization of the other three distribution companies to a strategic investor in February 2000. Over the past 18 months, going beyond its mandate, the Court of Accounts (CoA) has repeatedly reviewed compliance with the Purchase and Sales Agreement, creating undue discomfort for the private operator. More recently, these reviews have subsided. But—as noted above—to ensure a permanent solution, the Government will draft and submit to Parliament amendments to the founding acts of the CoA to limit its activities to its role as external auditor of public

expenditures. This will improve the business climate overall and send a strong positive signal to prospective investors. Also, the Government recently took decisive action to facilitate the strategic investor's efforts to mobilize US$50 million in investment finance through EBRD and IFC loans. The loans are on significantly better terms than would have been available from commercial banks. Over the short run, it signals that similar credits may become available to any strategic investor in Nord and/or Nord-Vest, thus increasing their market value. Over the medium-to-long run, it will result in lower tariffs for end-users. In addition, a number of legislative amendments have been adopted to facilitate privatization.

114. The Government has prepared legislative amendments to strengthen criminal and administrative prosecution of theft of energy and materials and equipment of energy companies. With the level of losses of 30-40% -- 2-3 times higher than the industry standard -- energy theft is now the main financial drain in the electricity sector, where collections and tariffs have been brought to the requisite levels. The amendments are expected to be adopted by Parliament by the fourth quarter of 2002.

115. Restructuring of large historical debts in the energy sector would help the Government spread the financial obligations for servicing the debts and reduce the risk of creditors enforcing the repayment of the debts through disconnection of current supplies. An audit of these debts has been completed by international auditor (Deloitte, Touche, and Tohmatsu). An energy debt restructuring plan on the basis of this audit will be completed by the first quarter of 2003. The Government will also amend by the same time the Charter of Moldtranselectro with the aim to revise its responsibilities as to ensure proper handling of the debts.

116. The Government is committed to maintaining and strengthening the independence of ANRE while requiring it to maintain a high quality of professional competence and integrity in controlling monopoly power, setting tariffs and establishing and monitoring other appropriate regulations.

117. The Government will continue to ensure that the Law on Nominal Compensations (which replaced formerly unfunded and poorly targeted household energy compensations) is being implemented well and that its entitlements remain fully funded by the budget and paid on time. The USAID-supported social assistance program, designed to help needy families pay their energy bills and provide energy saving investments on affordable terms, will help mitigate the social costs of increased financial discipline in the sector.

C.5. Privatization Program: Legal Framework, Telecom, and Wineries

C.5.1. Legal Framework for Privatization

Context

118. The Government's enterprise privatization program is designed to improve restructuring, investment, corporate governance and job creation. Between mid-1999 and mid-2000, significant progress was made in the area of enterprise reform. The privatization program resulted in the sale of three power distribution companies and other relatively large enterprises, such as leather products and grain elevators, as well as more than half of the joint stock companies owned by the state. These sales brought flows of foreign investment and promised further flows from investments of new owners.

119. Since mid-1999, enterprise privatization has included the land under enterprises, and significant progress has been made in re-associating the ownership of land and assets which were separated by earlier privatization programs. Also, methods were adopted to generate demand for enterprises which otherwise were unattractive because of high debt. As of January 2002, the Government had sold 1638 leased premises, 1364 plots of land under enterprises that had earlier been sold without their associated land, and residual shares in 863 enterprises out of a total of 1480.

120. In July 2001, the 1999/2000 Privatization Program was extended through 2002, and its scope was expanded by including all state-owned wineries and the tobacco companies. Its strategy includes: (a) continuing rationalization of ownership of land under enterprises; (b) divesting ownership of small residual State shareholdings in joint stock companies; (c) creating jobs and promoting new entry through the sale of small assets; and (d) attracting technology, capital and foreign market access through the sale of strategic enterprises to strategic investors, particularly in energy, communications and agro-processing.

121. After mid-2000, progress in the area of privatization slowed dramatically as a result of impending elections. Even after elections, there were only some small sales of shares through the stock exchange towards the end of 2001. An indication of the deceleration of the privatization effort can be gauged by the fact that revenues in 2001 have been 80 million lei, compared to 426 million lei in 2000, and these have been largely installment payments from earlier privatization.

122. The legislative framework for privatization needs to be streamlined in order to improve the quality and speed of privatization. For example, management of state assets has been transferred to line ministries and this has potential for hindering privatization decisions. Although Parliament has approved a list of almost 482 enterprises and other assets for privatization, there remains some lack of clarity as to the decision-making process for when and how individual objects within this list will be handled.

123. A number of rules and procedures dramatically slow the quality and speed of the process. These include auction/re-auction and price setting procedures for successive auctions which are far too conservative, leaving enterprises in limbo for years on and off the auction block. While regulations for auction by symbolic price have been approved, there are too many limitations to the procedure. Requirements of investment commitments often leave enterprises in a poor *ex poste* privatization position when it becomes apparent that the promised level of investment does not make financial sense. In many cases, either where the investment commitment is not met or in the presence of foul play, court battles are initiated by competing bidders which often end in re-nationalization of the assets.

124. One of the most-cited barriers to profitability of JSC enterprise owners is interference by state officials exercising State residual ownership as leverage for rent seeking activities. Following earlier privatization, the State holds such residual share-holdings in a large number of enterprises. In the past, Government regulations established a committee in the Privatization Department to sell residual shares at calculated prices. In many cases successful transactions did not occur, even after multiple attempts to sell. In order to reduce opportunities for rent seeking and improve concentration of ownership, some means should be found to quickly and efficiently allow divestiture of the shares.

125. Finally, sale of land under enterprises has also been dramatically slowed because normative prices of land are too high, while rent due to municipalities are based on the normative prices.[7] This makes land both too expensive for the enterprises to purchase (often an enterprise is associated with large tracts of land and there is currently no clear mechanism for dividing it), and too valuable for municipalities to give up in terms of rent proceeds.

Reform Objectives and SAC III Measures

126. *Further progress on implementation of the privatization program.* Under new streamlined privatization procedures, the Government will focus attention on implementation. The Government will prepare an action plan for the 2001/2002 Privatization Program (01/02 PP) with dated targets and proposed methods of privatization for the transfer of all 482 enterprises identified in Annex 1 of the Privatization Program. The authorities also plan to do a stock-taking of all remaining state property, including enterprises subordinated to state agencies and/or funds and any other assets which could operate commercially. Based on this analysis and progress achieved under the 200120/02 PP, the Government plans to formulate a privatization program for 2003-2004 which will include all remaining joint stock and state owned companies that can operate in commercial spheres.

127. *Simplifying and streamlining auctions and tenders.* Amendments to the Privatization Law and other applicable legal acts will be enacted as to: (i) eliminate reserve prices for properties to be auctioned at the third auction, (ii) eliminate barriers to sale of at a single English or Dutch auction to the highest bidder, (iii) in tenders, except in special cases, as determined by an independent financial advisor transparently selected through an internationally competitive process for each tender, eliminate investment pledges and requirements, and (iv) where the Government is shareholder/creditor, it will act to initiate liquidation proceedings for properties that have not been sold after three auctions. The Government is also drafting amendments to the Law on Privatization to clarify the roles and responsibilities of responsible government agencies to ensure that the privatization process is not impeded by the reassignment of the management of state assets from the Department of Privatization to line ministries. In addition, the new draft law on privatization will clarify the role of the Post Privatization Agency *vis-à-vis* applicable regulatory agencies in respect of investment obligations made in connection with privatized enterprises in regulated industries, such as telecommunications.

128. *Elimination of barriers to sale of land associated with enterprises.* The Government will address the problem of plot indivisibility and price rigidity which create barriers to land sales, especially in cases where enterprise assets are associated with large tracts of land which are not needed by the firm and are expensive to purchase.

129. *Divesture of minority shares held by the State in privatized enterprises.* The Government will write-off through a transparent process the State's share-holdings in privatized enterprises where such shares represent 10% or less of the total shares outstanding and the book value of state-held equity is USD50,000 equivalent or less.

[7] In Moldova, land is typically owned by municipalities and assets by the State. The SAC required that for all new privatizations the land be privatized with the assets. This discussions refers to land under enterprises privatized before the SAC program which led to rent seeking opportunities for local governments officials.

C.5.2. Telecom De-Monopolization and Privatization

Context

130. The Government is committed to reforming the communications sector to develop a better business environment and encourage the development of a web economy in Moldova. Moldova has undertaken a variety of key steps in reforming the legal and regulatory aspects of the reform process in the telecom/ICT sector. These reform actions are both important in their own right and will contribute to a successful privatization transaction of MoldTelecom, Moldova's state-owned telephone operator.

131. The sale of a majority of shares (together with transfer of effective management control) MoldTelecom to a strategic investor will improve communications services, augment investment, attract technology and create jobs. Privatization proceeds will be used to retire domestic arrears and foreign debt. Completion of the various regulatory reforms in a timely fashion is necessary as it relates to creating certainty in connection with the privatization of Moldtelecom.

132. As part of its accession to the WTO, Moldova has committed to liberalize the telecommunications market by 2004 and has submitted a schedule of commitments regarding telecommunications services, including the "Reference Paper". Moldova is in the process of implementing those commitments in its national legal and regulatory framework. In particular, rules and procedures regarding interconnection will be promulgated, and ANRTI's independence will be strengthened.

133. The Government has established an independent regulatory agency (ANRTI). ANRTI is building capacity with support from USAID. Its main accomplishments include the issuance of two mobile licenses to strategic foreign operators[8], publication of a telecommunications policy, and adoption of the tariff rebalancing plan agreed by IDA, described below.

Reform Objectives and SAC III Measures

134. The Government is in the process of clarifying and consolidating in ANRTI regulatory competencies applicable in the telecommunications/ICT sector to ensure legal/regulatory certainty and the credibility of the regulatory function in the sector as part of its effort to enhance the business enabling environment.

135. A new Tariff Regulation has been adopted. Also, the first phase of a cost-based tariff rebalancing plan (to be completed by 2004) for Moldtelecom will be effective in July 2002. It is also expected that the tariff rebalancing plan will increase the value of Moldtelecom and attract information-telecommunications service providers to do business in Moldova. A new Interconnection Regulation, which was the subject of broad consultation by ANRTI, has been completed and is expected to be published soon.

136. The Government is committed to ensuring the de-monopolization and competitive provision of voice telephony services over the internet (VoIP). To give full effect to the Government's commitments to de-monopolize VoIP, the Government has taken all measures

[8] ANRTI and one of the mobile licenses were established under the SAC-supported program.

necessary to give effect to its commitment to de-monopolize VoIP, including amending the Telecommunications Law and decrees abrogating all other decisions, regulations, normative acts, etc., that granted MoldTelecom a monopoly over VoIP services, as well as such other acts as may be necessary.

137. Through an international, competitive procurement process, the Government, using its own resources, has hired a financial advisory consortium to privatize MoldTelecom. The advisors will assist in the process of privatizing MoldTelecom through an open, competitive and transparent international tender for the sale of a majority of shares in MoldTelecom (together with the transfer of management control) on the basis of objective selection and evaluation criteria. The launch of the tender for this transaction is expected by mid-2002.

C.5.3. Winery Privatization

Context

138. Privatization of most of the wineries has already been completed, but ten important properties, accounting for nearly one-half of all production by volume and a higher proportion by value, are still owned by the State (Cricova, Barza Alba, Călăraşi-Divin, Bălţi, Aroma, Vismos, Nis-Struguras, Cojuşna, Briceni, and Vinuri Ialoveni). In general, the transition policies in the wine industry were extremely contradictory and were influenced by the strong lobby of interest groups. Under a slogan of preserving national wealth, constant pressure was exerted to keep these companies out of the privatization process, to deny access for foreign investors, and to maintain at least formal state control over them. The privatization of these companies has been delayed for years despite the lack of public funds for investments and a rapidly deteriorating financial situation of the companies.

139. All of these companies have now been included in the current privatization program. Moreover, in 2001, the Government made an attempt to sell two of these companies. However, the lack of advertising of the tender internationally, the absence of financial advisers and the deficient bid evaluation process did not allow to complete the privatization.

Reform Objectives and SAC III Measures

140. The Government's strategy is to hire a financial advisor to market the sector as a whole as a potentially divisible package of trademarks, land and production facilities to strategic investors. The aim is to attract investors with market access to help develop raw material producers (with information, technical assistance and finance) and to create a market for Moldovan wine, including for the other 140-odd private wineries.

141. The Government will conclude an agreement with a qualified financial advisor, under competitive and transparent procedures, for the marketing of the remaining wineries. With the assistance of the financial advisor, detailed bidding documents for the sale of wine properties will be prepared. An investors' conference will be organized for interested and potentially interested strategic investors in the Moldovan wine sectors.

142. Subsequently, using the services of financial advisor, the Government will offer for sale through international tender at least 33% of the total value of the existing state wineries to achieve majority private ownership of a number of wineries. In parallel, the Government will

reorganize the Vinification Institute and the Fruit and Vegetable Institute to split their commercial processing plants from their research centers with the aim to privatize the former.

III. THE PROPOSED CREDIT

A. LINKS TO THE CAS AND OTHER BANK OPERATIONS

143. The proposed SAC III is consistent with the strategy set out in the last CAS which was discussed by the Board on May 6, 1999. The CAS set out three priority objectives: (a) helping to create a foundation for long-run macroeconomic sustainability, growth and poverty reduction by stimulating the supply response; (b) supporting private sector development; and (c) launching reform of the public sector. ***A CAS Progress Report is being presented in parallel with this Report.*** It takes stock of progress and summarizes the Bank Group's assistance strategy over the near term. The policy and institutional reforms supported by SAC III are essential to place Moldova firmly on the growth path leading to integration within the global economy. With respect to future IDA assistance, implementation of SAC III will enable policy reforms in agriculture to lay the basis for the proposed Rural Investment and Services Project (RISP). SAC III's privatization of the power distribution companies will set the stage for the proposed Energy II project, which focuses on improvements in the transmission network. The reforms in the pension and health sectors, together with the ongoing IDA-financed Social Protection Management and Health Reform projects will help upgrade social protection and health care on a sustained basis.

B. OBJECTIVES, RATIONALE AND DESIGN

144. **Objectives.** SAC III is designed to support and deepen the reform process and help achieve the objectives of the I-PRSP. Accordingly, it would support: (i) establishment of an effective social protection system, including delivery of quality social services, sustainability of the pension system, and improved targeting of social assistance; and (ii) improvements in the business environment through competitive restructuring of the agriculture, energy, telecommunications and other strategic industries, and improvements in the economy-wide incentive and institutional framework governing private sector business entry and exit and privatization.

145. **Rationale for an Adjustment Credit.** The economic justification for the proposed SAC III is essentially twofold:

(a) *Budgetary Support and Facilitating Debt Servicing and Fiscal Adjustment.* Even with strong efforts at fiscal consolidation, the Government will continue to have considerable financing needs in the medium term, as discussed earlier (under the section "Medium Term Outlook"). The proposed Credit will provide budgetary support to help the Government consolidate economic stabilization, bolster foreign reserves and service external debt. Moreover, maintaining price stability will require continued tight domestic credit. The Government is thus seeking financing from external, non-inflationary sources, including multilateral institutions. As part of this financing package, SAC III would provide some additional non-inflationary budgetary support during the next stage of economic transition, providing breathing space while structural and institutional reforms help strengthen the Government's revenue base and reduce expenditure pressures.

(b) *Accelerated Economy-Wide Structural Reforms.* The authorities' structural reform program appropriately covers a cross-sectoral agenda. An adjustment operation that helps exploit reform inter-linkages to marshal economy-wide growth is the most effective instrument for supporting such a process.

146. **Credit Design.** The proposed SAC III is designed as a three-tranche operation. A three tranche structure was deemed as most appropriate to ensure that the necessary institutional reforms blocks for further structural adjustment in Moldova were implemented in a sustained lock-step fashion, within a continuous reform roadmap. Nonetheless, to mitigate the risks of stop-and-go policy implementation, the conditionality is front-loaded while planned disbursements are back-loaded: SDR 8.1 million equivalent would be disbursed upon effectiveness for the first tranche, and the balance of SDR 16.0 million equivalent would be disbursed as SDR 8.0 million equivalent for the second and third tranches each. The credit is designed around the I-PRSP and coordinated closely with the IMF's PRGF arrangement, as well as assistance from Moldova's other development partners (see below).

C. PROPOSED CONDITIONS UNDER SAC III

147. SAC III focuses on Moldova's highest structural reform priorities. The overall reform program supported by the proposed SAC III is described in detail in the Government's ***Letter of Development Policy*** (Annex 4 of this Report). All of the tranche conditionalities of the SAC III program, are outlined in the ***Matrix of Core Policy Actions*** (Annex 5 of this Report). The Matrix of Core Policy Actions also outlines key reform measures that the Moldovan authorities have implemented since the last SAC.

148. **First Tranche Conditions.** During Negotiations it was agreed that a set of actions, which would constitute the first tranche conditionalities, would be completed:

(a) before submission of the proposed Credit to the IDA Board:

(i) **Strengthening Poverty Analysis and Evaluation.** Government approval of a 3 year plan to strengthen capacity in poverty monitoring and evaluation.

(ii) **Enhancing Fiscal Discipline / Hardening Budget Constraints.** Eliminate all public sector financial support for the wine and tobacco sectors by, (i) issuing a Government Decree which stipulates measures for the elimination of all public sector financial support, including investments, loans and credits, and subsidies, related to raw material production, processing and trade in the tobacco and winery sectors, beginning with enactment of the 2003 Budget and thereafter, and/or modification or elimination of any other related existing mechanisms; and (ii) enacting legislative amendments to eliminate earmarking of all tax revenues to the wine and tobacco sectors.

(iii) **Improving Fiduciary Management.** Enactment of amendments to the Law on the Court of Accounts (CoA), which limits CoA audits to use of public funds.

(iv) **Easing Entry for New Business Development.** Elimination of double VAT on fixed assets brought in as statutory capital of enterprises.

(v) **Agricultural Reform**. Satisfactory implementation of the Memorandum of Understanding on Agriculture.

(vi) **Energy Sector Restructuring.** Enactment of the necessary amendments, as stipulated in the agreed privatization plan to the Individual Power Privatization Law, the Energy Sector Debt Restructuring Law, and other laws as necessary to enable successful implementation of the Privatization Plan of the energy sector.

(vii) **Privatization.** Write-off of the State's share-holdings in privatized enterprises where such shares represent 10% or less of the total shares outstanding and the book value of state-held equity is USD50,000 equivalent or less.

(viii) **Telecom De-Monopolization.** In order to de-monopolize VoIP telephony, issuance of a Government Decree (i) specifying the necessary amendments to the legal and regulatory framework, including normative acts, required to de-monopolize VoIP and committing the Government to submit by the earliest possible date, as prescribed by Parliamentary and administrative procedures, these amendments to the Parliament; and (ii) specifying measures to be undertaken by the Government and Moldtelecom, effective upon issuance of the decree, for the competitive provision of VoIP (for example through concessions or otherwise) pending enactment of the amending legislation.

(b) before effectiveness of the Credit: the Government would have in place a macroeconomic framework consistent with the objectives of the SAC III program, as determined on the basis of indicators agreed with IDA. It was agreed that, among the indicators the Association would base its judgment on, would be a satisfactory IMF assessment of Moldova's macroeconomic policies that provides a basis for Moldova's access to Fund resources.

D. BENEFITS AND RISKS

149. **Benefits**. SAC III would provide budget financing needed to sustain macroeconomic stability, thus providing the financial underpinning for the Government's reform program. SAC III addresses poverty in Moldova and is synchronous with the objectives of the I-PRSP. It will encourage inclusive growth, improve social service delivery and contribute to better targeting of direct social assistance and a sustainable pension system. To encourage growth, SAC III supports a sound macro-fiscal program, which, combined with improvements in the business environment, will encourage entry of small and medium enterprises. SAC III-supported agricultural reform, energy reform and privatization will sustain increased exports, generate long term growth and improve labor markets. Agricultural growth is especially important, since Moldova's poorest strata is the working rural family. The deep structural improvements in social services and social protection, which make up the lion's share of the consolidated budget, will be better aligned to reach the poor. The energy sector and privatization programs will also reduce corruption, improve corporate governance and strengthen budget constraints in the economy. This will help to improve resource allocation and attract needed foreign investment and technology.

150. **Risks**. The operation has three important groups of risks – political, implementation capacity, and macroeconomic (See Box 2).

BOX 2: PROJECT RISKS AND MITIGATION MEASURES	
Risks	**Mitigation Measures**
POLITICAL: • Delays in policy implementation and/or policy reversals due to insufficient ownership of the program and/or disagreements within the ruling party, CPRM. • Political instability and/or social unrest due to continued economic hardship for the public and dissatisfaction with the pace and direction of policy changes and implementation.	• The front-loaded core reforms require decisions by the Government, the Parliament and the President as Board conditions. • Adoption of three tranches with front-loading of reforms and backloading of financing. • Continuing public dialogue, including through the PRSP preparation process, to build support for reforms. • Ensuring that budgetary arrears are reduced and creating a basis for improved public service provision.
IMPLEMENTATION CAPACITY: • Weak implementation capacity of Government agencies	• Essential technical assistance is in place with support from IDA and bilateral donors to help implement key elements of the program (including post privatization agricultural support, telecommunications and energy regulation, privatization, health care reform, poverty monitoring and targeting, etc.) • IDA plans to continue intense supervision throughout the implementation period. • Close coordination of ESW by IDA in parallel with the implementation of SAC III.
MACROECONOMIC: • External shocks, particularly among Moldova's main trading partners or which affect exchange rates and/or trade. • Lack of sufficient foreign and domestic investment, even in the presence of good policies, due in part to a reputation hangover. • Severe liquidity problems associated with the June 2002 Eurobond repayment and large external debt service in 2002. • Long run non-sustainability of growth due to large debt service.	• Close monitoring of the macroeconomic framework, in cooperation with the IMF. • Efforts to work with bilateral and multilateral partners to provide Moldova with sufficient concessional resources, as well as efforts with the Paris Club. • Demonstration effect of improvements in the business environment along with supportive statements by the IFIs provided reform implementation stays on track. • A debt sustainability analysis has been developed jointly with the IMF. • Enhanced international scrutiny in the context of the recently launched international initiative for the CIS-7.

151. *Political Risk.* The Government is supported by a strong majority party in Parliament with over 70 percent of the votes. However, while the Government continues to enjoy the support of the President and Parliament, internal disagreements within the majority party could weaken the Government's mandate to implement the proposed program. These risks are mitigated in SAC III through the front-loading of core reforms that require decisions by the Government, the Parliament and the President as Board conditions, and more generally through adopting a three tranche design with front-loading of reforms and backloading of financing. These risks are also mitigated through the continuing public dialogue, including through the

PRSP preparation process, to build support for reforms.

152. *Weak Implementation Capacity.* The Government's reform program is necessarily relatively broad in coverage given the range of Moldova's pressing problems. Mindful that the Government's reform program is potentially too ambitious for its institutional capacity, the proposed SAC III focuses on the highest priority reforms. Nonetheless, the Government's institutional capacity may well still be stretched under SAC III implementation. To mitigate this risk the Bank Group is providing Technical Assistance to the Government in several SAC III-related areas (see below) and IDA is also actively mobilizing and coordinating donor support through the PRSP process. The Public Sector Reform program, see below, will also help build stability, incentives and implementation capacity in Moldova's public service.

153. *Macroeconomic Risk.* The reform program supported by the proposed SAC III is designed to lay the foundations for a sustained resumption of economic growth. But there is a clear risk that early signs of growth may not continue, if reform implementation is slow, or if Moldova's suffers an exogenous shock affecting production (for example bad weather) or income (for example a deterioration in the terms of trade). Sustained economic decline could weaken reformers in Government and erode public support for the program. Moldova's loss of its predominant export market, its reliance on imported energy inputs, and its existing debt service requirements could all lead to lower growth prospects. To help mitigate these risks, SAC III contains strong actions to improve the structural foundations for sustained growth, for example through improvements in the business environment. In addition, IDA will be closely monitoring in close collaboration with the IMF the macroeconomic and structural program of the Government to ensure it stays on track over a sustained period. There is also enhanced international scrutiny in the context of the recently launched international initiative for the CIS-7. IDA is working with bilateral and multilateral partners to help mobilize sufficient concessional resources to help Moldova manage its debt burden, and is closely monitoring efforts in the Paris Club. A debt sustainability analysis has been developed jointly with the IMF. IDA, the IMF and the Government will continue to explore other avenues for Moldova achieving long run debt sustainability.

E. COLLABORATION WITH THE IMF AND OTHER DONORS

154. IDA and the IMF are cooperating closely on Moldova. The macroeconomic framework, as well as inputs to consolidated budget formulation, including the social fund budget, are consistent and closely coordinated among the Government, the IMF and IDA. After the EFF expired in May 2000, IDA and the IMF worked closely with the Government to help prepare an I-PRSP and a joint IMF/IDA Debt Sustainability Analysis (DSA) as pre-requisites for an IMF PRGF arrangement. A Joint Staff Assessment of the I-PRSP was approved by the respective Boards of the IMF and IDA in December 2000. At the end of December 2000 the IMF approved an SDR 110.88 million three year operation under the Poverty Reduction and Growth Facility (PGRF). The unexpected general elections held in February 2001 and the subsequent change in government caused the first review of the Fund program to be delayed. After the new Government took office, two joint IMF/IDA missions took place between July and September 2001 to reach agreement on a Supplemental Memorandum of Economic and Financial Policies. The first review of the PRGF was to have been completed in December 2001, but when the Moldovan authorities signed an agreement with Russia on gas deliveries that included State guarantees, the Fund Board meeting for the first PRGF was cancelled. A February 2002 IMF mission failed to resolve these issues.

155. In mid-May 2002 an IMF staff team visited Chisinau (working in collaboration with IDA staff) to resolve the outstanding PRGF issues and agree with the Moldovan authorities on macroeconomic policies for the remainder of the year so that the IMF could proceed with the first review of the PRGF in early July 2002. Discussions were successfully concluded with an agreement on the basis of which IMF staff will proceed with the first review of the PRGF. In light of the fact that the Fund program is on track and expected to be shortly approved by the IMF Board and that Moldova has pressing external debt financing needs, SAC III will be presented to the IDA Board prior to the IMF review of the PRGF. Based on the agreement reached between the Moldovan authorities and IMF staff, all PRGF prior actions for the first review are to be met before the proposed SAC III will be discussed by the IDA Board. However, if the PRGF prior actions should not be fulfilled before the scheduled Board date for the proposed SAC III, management will postpone IDA Board consideration of SAC III and the accompanying CAS Progress Report. Moreover, as indicated above (under the section "first tranche conditionalities"), a condition of SAC III effectiveness linked to Moldova's maintenance of an appropriate macroeconomic framework, as indicated, inter alia, by access to IMF resources, mitigates risks associated with the sequencing of the SAC III Board date.

156. **PRSP.** As noted earlier, the Government has prepared a PRSP Preparation Status Report indicating progress made in several areas including setting out a new PRSP institutional arrangement, improving poverty monitoring indicators, and implementing a medium-term expenditure framework (MTEF). The staffs of the Association and the Fund are currently preparing the Joint Staff Assessment (JSA) of the PRSP Preparation Status Report to assess the progress and government effort in developing a full-PRSP in coordination with civil society and external partners. The PRSP Preparation Status report and the accompanying JSA will be circulated to both the Association and Fund Boards at the same time when the IMF Board discusses the First Review of the PRGF, currently expected in July.

157. In moving forward, the Government intends to develop a full PRSP through broad-based participation and consultation with key stakeholders and external development partners. This approach will build consensus and ownership among key stakeholders who participate in the development of a PRSP and thus increases the probability of success in poverty alleviation over the medium-term. Toward this end, the Government will move quickly to finalize the PRSP institutional arrangement and to select members of Council of Experts so that it could begin to play role in organizing participation and consultation. The Government will also clarify the organizational structure of the Technical Committee and its roles and responsibilities in order to strengthen coordination among working groups on poverty analysis, monitoring and evaluation and others working groups on sector strategies. With assistance of IDA and other external development partners, the Government will develop and implement a detailed participation plan to ensure adequate consultation and participation of key stakeholders in providing inputs and feedbacks to the PRSP from the very beginning of the process. To enhance the quality of the participatory process, the Government has extended the completion date of the full PRSP to March 2003.

158. With respect to Moldova's other development partners, while the Bank Group plays a key role in Moldova, we try to ensure complementarity of roles among the partners based on respective comparative advantage. Working with other public and private sources of development assistance has become essential to our work given the magnitude of the agenda, the constrained Bank Group budget, and most importantly, the need to ensure that Moldova's

development partners provide consistent policy advice and complementary financial support. We are working closely with bilateral agencies, including USAID, the Netherlands, SIDA, GTZ, and DFID. Expanding the quantity and scope of bilateral assistance to Moldova will be one of IDA's objectives during the period of SAC III implementation. The Association is also working closely with the EBRD, the IMF and the ADB on, among other efforts, the recently launched CIS-7 initiative, as well as with private foundations and the UN family. In addition, as noted above, through the PRSP process the Association looks forward to greater participation of NGOs.

IV. FINANCIAL AND FIDUCIARY MANAGEMENT ARRANGEMENTS

159. The proposed credit of SDR 24.1 million (US$30 million equivalent) would be made to the Republic of Moldova, represented by the Ministry of Finance.

160. The Credit will be on standard IDA terms, with a maturity of 40 years, including a grace period of 10 years, and would be disbursed in three tranches. The first tranche, SDR 8.1 million, would be disbursed immediately after effectiveness (estimated in June 2002); SDR 8.0 million would be disbursed upon fulfillment of the second tranche conditions (estimated November/December 2002); and SDR 8.0 million would be disbursed upon fulfillment of the third tranche conditions (estimated March/April 2003).

161. Disbursements under the proposed credit will be made to an account ("Deposit Account") of the Ministry of Finance established at the National Bank of Moldova (NBM). The credit will be disbursed according to the Bank's simplified disbursement procedures for adjustment operations. Thus disbursements will not be linked to specific purchases and there will be no procurement requirements. If the credit proceeds are used for ineligible purposes, IDA will require the Borrower to either: (a) return that amount to the account for use for eligible purposes; or (b) refund the amount directly to IDA, in which case IDA will cancel an equivalent undisbursed amount of the credit.

162. Upon the Association's request, the Borrower shall (a) have the Deposit Account audited in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Association; (b) furnish to the Association as soon as available, but in any case not later than four (4) months after the date of the Association's request for such audit, a certified copy of the report of such audit by said auditors, of such scope and in such detail as the Association shall have reasonably requested; and (c) furnish to the Association such other information concerning the Deposit Account and the audit thereof as the Association shall have reasonably requested. IDA will require an audit of the deposit account by an auditor, with terms of reference acceptable to the Association. The required audit reports would be submitted to IDA no more than two months from the closing date of the Credit. The expected closing date of the proposed Credit is September 30, 2003.

163. The Government intends to use the credit proceeds to meet its general budget expenditures, including debt service payments. The Ministry of Finance and the NBM have in place the basic financial management systems, in terms of accounting, reporting, auditing and internal controls. The NBM adopted IAS in 1995 and is audited by internationally recognized auditing firms.

164. To date, IDA's country strategy and program have supported improvements in financial

management capacity. An IDF grant to improve the Government's institutional and legal framework for procurement was implemented in 1996 and 1997, and a Law on Procurement was approved by Parliament in 1997. A CFAA has been initiated, with the main mission planned for July 2002 and completion by end 2002, and the adoption of a satisfactory action plan to streamline and strengthen the Government's internal and external auditing capacity will be a condition of SAC III. In addition, under a PHRD grant for the preparation of a proposed Public Sector Reform project, work is ongoing to improve public expenditure management. In addition, a Public Economic Management Review is underway in close cooperation with the Government and is expected to be completed in FY02.

V. ENVIRONMENTAL ASSESSMENT

165. In accordance with the Bank's Operational Directive on Environmental Assessment (OD 4.01, Annex E), the proposed operation has been rated in category "C" and does not require an environmental assessment.

VI. RECOMMENDATION OF THE PRESIDENT

166. I am satisfied that the proposed credit would comply with the Articles of Agreement of the Association and I recommend that the Executive Directors approve it.

James D. Wolfensohn
President

by Shengman Zhang

Washington, DC
May 23, 2002

Table 1
Moldova – Key Macroeconomic Indicators

	Actual					Estimate		Projected		
Indicator	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
National accounts (as % of GDP)										
Gross domestic product a/	100	100	100	100	100	100	100	100	100	100
Agriculture	31	30	30	28	29	26	25	25	24	24
Industry	31	29	23	23	22	24	24	24	25	25
Services	38	41	46	49	49	50	50	51	51	51
Total Consumption	94	96	100	91	103	98	105	104	101	98
Gross domestic fixed investment	20	20	22	18	15	14	15	17	19	21
Government investment b/	2	3	5	4	2	2	2	2	3	3
Private investment	18	17	17	15	13	11	13	15	16	18
Exports (GNFS) c/	55	55	47	52	50	52	51	53	54	55
Imports (GNFS)	74	74	72	66	77	73	76	78	78	77
Gross domestic savings	6	4	0	9	-3	2	-5	-4	-1	2
Gross national savings d/	13	10	6	19	15	19	14	14	15	18
Memorandum items										
Gross domestic product (US$ million at current prices)	1695	1930	1699	1171	1289	1479	1573	1685	1812	1980
GNP per capita (US$, Atlas method)	650	590	470	410	390	400	460	500	530	580
Real annual growth rates (%, calculated from 1995 prices)										
Gross domestic product at market prices	-5.9	1.6	-6.5	-3.4	2.1	6.1	4.8	5.0	5.0	5.0
Gross Domestic Income	-4.2	6.7	-4.7	-7.3	2.1	9.8	3.7	4.9	5.5	5.5
Real annual per capita growth rates (%, calculated from 1995 prices)										
Gross domestic product at market prices	-5.7	1.9	-6.3	-3.2	2.3	6.3	5.1	5.3	5.3	5.4
Total consumption	5.5	12.0	-1.7	-15.9	16.5	9.2	8.3	4.1	3.2	3.3
Private consumption	12.6	28.1	4.7	-14.8	18.5	8.5	6.0	4.3	2.1	1.6
Balance of Payments (US$ millions)										
Exports (GNFS)c/	937	1058	793	612	640	739	795	885	983	1092
Merchandise FOB	823	890	644	475	477	569	618	686	760	842
Imports (GNFS)c/	1253	1434	1228	778	990	1101	1201	1314	1409	1533
Merchandise FOB	1075	1238	1032	610	783	882	984	1089	1176	1290
Resource balance	-316	-376	-435	-167	-350	-362	-406	-429	-427	-441
Net current transfers	73	54	64	87	157	152	163	168	190	199
Current account balance	-188	-275	-334	-47	-121	-119	-116	-134	-124	-119
Net private foreign direct investment	23	78	76	39	128	149	95	139	140	154
Long-term loans (net)	126	285	20	90	116	-23	-21	-1	13	1
Official	38	52	40	87	36	3	1	-16	-12	8
Private	88	233	-20	3	80	-26	-22	15	25	-7
Other capital (net, incl errors & ommissions)	71	-36	76	-46	-72	4	57	23	21	20
Change in reserves e/	-32	-52	162	-36	-51	-12	-16	-26	-51	-56
Memorandum items										
Resource balance (% of GDP)	-18.6	-19.5	-25.6	-14.2	-27.2	-24.4	-25.8	-25.5	-23.5	-22.3
Real annual growth rates (YR95 prices)										
Merchandise exports (FOB)	16.5	5.5	-13.7	-16.8	13.0	13.0	6.1	8.3	8.0	8.1
Primary	34.3	-13.5	-12.3	-19.9	13.8	44.3	7.3	9.0	8.5	8.5
Manufactures	12.0	-47.5	4.8	-25.2	3.6	4.8	0.9	5.3	5.6	6.0
Merchandise imports (CIF)	9.7	9.2	-10.3	-62.5	15.3	13.3	12.5	7.4	6.0	7.6

(Continued)

Moldova - Key Economic Indicators
(Continued)

Indicator	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
		Actual			Estimate			Projected		
Public finance (as % of GDP at market prices) f/										
Current revenues	35.9	38.5	37.6	30.4	30.7	29.1	29.7	29.6	30.0	30.8
Current expenditures	43.7	45.9	39.1	33.0	31.4	27.4	30.7	30.2	29.1	29.0
Current account surplus (+) or deficit (-)	-7.8	-7.5	-1.5	-2.6	-0.7	1.7	-1.1	-0.6	0.8	1.8
Capital expenditure g/	0.2	3.1	4.9	3.5	2.2	2.3	2.0	1.8	2.5	3.2
Foreign financing h/	5.8	3.3	-1.0	3.5	1.0	-2.0	0.7	-0.4	0.2	-0.5
Monetary indicators										
M2/GDP	18.4	21.6	19.2	20.3	21.9	25.2	27.1	28.7	29.9	30.8
Growth of M2 (%)	15.3	34.1	-8.7	42.6	40.3	36.3	20.1	20.9	15.7	15.0
Private sector credit growth / total credit growth (%)	107.0	33.8	25.8	-107.9	90.7	79.8	70.1	85.8	137.7	131.1
Price indices(YR95 =100)										
Merchandise export price index	100.0	102.6	86.0	74.0	67.8	71.5	73.2	75.0	76.9	78.8
Merchandise import price index	100.0	100.1	97.5	144.3	174.7	171.6	170.2	175.4	178.7	182.2
Merchandise terms of trade index	100.0	102.5	88.2	51.3	38.8	41.7	43.0	42.7	43.0	43.2
Real exchange rate (US$/LCU) i/	100.0	108.0	109.2	102.1	89.2	85.9	86.7	87.2	87.2	85.9
Consumer price index (% change)	23.5	11.8	7.7	39.3	31.3	9.8	6.6	8.4	6.0	6.0
GDP deflator (% change)	27.9	12.5	9.5	39.8	27.3	11.9	6.6	8.4	6.0	6.0

a. GDP at factor cost
b. Includes project loans spending.
c. "GNFS" denotes "goods and nonfactor services."
d. Includes net unrequited transfers excluding official capital grants.
e. Includes use of IMF resources.
f. Consolidated general government (State + Local + Social Fund).
g. Includes spending on projects financed by foreign sources.
h. Includes disbursement of IDA credits.
i. "LCU" denotes "local currency units." An increase in US$/LCU denotes appreciation.

Table 2
Moldova – Key Exposure Indicators

	Actual				Estimate			Projected		
Indicator	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Total debt outstanding and disbursed (TDO) (US$m)[a]	848	1083	1071	1025	1246	1226	1278	1313	1357	1348
Net disbursements (US$m)[a]	153	286	-42	93	103	-3	59	48	44	-9
Total debt service (TDS) (US$m)[a]	84	134	204	211	139	162	209	213	217	240
Debt and debt service indicators (%)										
TDO/XGS[b]	79.9	94.0	120 0	145.9	162 5	132.0	126.6	119 1	114 4	103 5
TDO/GDP	50.0	56.1	63.0	87.5	96 7	82 9	81 3	77 9	74.9	68 1
TDS/XGS	8.0	11.6	22.9	30.0	18.1	17 4	20.7	19.3	18 3	18.4
Concessional/TDO	19.6	17.6	19.1	22 7	19.5	18.1	24 3	29 7	35 0	39.6
IBRD exposure indicators (%)										
IBRD DS/public DS	12.5	7.6	5 4	8 6	15 7	14.0	14 4	16 7	16 3	16 9
Preferred creditor DS/public DS (%)[c]	42.6	38 6	55.0	57 6	71 6	50 4	52 8	58.2	51 6	49.8
IBRD DS/XGS	0 9	0.8	1.1	2 1	2.1	1.8	1.9	1.9	1.7	1.6
IBRD TDO (US$m)[d]	142	135	169	199	191	181	175	167	160	148
Of which present value of guarantees (US$m)										
Share in total IBRD portfolio (%)	0.13	0 12	0.14	0 16	0.16	0 15	0 14	0.14	0 13	0 12
IDA TDO (US$m)[d]	0	35	38	77	103	113	149	189	228	270
IFC (US$m)										
Loans		3 8		8.7	2 6	29 /e				
Equity and quasi-equity /f		2		6 6	0 5					
MIGA										
MIGA guarantees (US$m)					3	64				

a Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital and excludes energy arrears.

b. "XGS" denotes exports of goods and services, including workers' remittances.

c. Preferred creditors are defined as IBRD, IDA, the regional multilateral development banks, the IMF, and the Bank for International Settlements.

d. Includes present value of guarantees.

e. Include loan to Union Fenosa ($25 million).

f Includes equity and quasi-equity types of both loan and equity instruments.

Table 3
Moldova – External Financing
(in millions of US$)

	2002	2003	2004	2005
1. Financing Need	149	188	191	156
(a) Current Account Deficit	116	134	124	119
(b) Increases in Gross International Reserves	33	54	68	37
2 Financing Source	62	134	162	171
(a) DFI and Portfolio Investment	95	139	140	154
(b) Net Foreign Inflows	-13	-5	22	17
Disbursement	133	133	157	188
of which				
World Bank 1/	15	18	22	28
EBRD	17	22	21	21
IFAD	2			
Other Bilaterals	5	6	5	6
Amortization	147	138	135	171
(c) Other capital flows	-20			
3 External Financing	87	54	29	-16
of which:				
(a) SAC III	20	10		
(b) Other 2/	67	44	29	

1/ Excludes IDA adjustment credit.

2/ Includes disbursement under the IMF PRGF arrangement and possible debt restructuring with bilateral and private creditors

Table 4
Moldova – Debt Sustainability Analysis

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Base Case											
Total external debt, mil. US$	1226	1278	1313	1357	1348	1333	1333	1330	1345	1356	1359
Government and government guaranteed debt , mil US$	961	981	982	995	980	944	909	881	883	883	856
External debt to GDP, percent	83	81	78	75	68	62	58	54	51	48	45
NPV to GDP, percent	78	75	70	65	58	52	48	44	40	36	34
NPV to exports of goods and services, percent [1]	175	163	146	133	116	102	91	82	73	65	58
TDS to exports of goods and services, percent	21	26	24	22	22	18	15	14	14	13	11
NPV of public debt to central government revenues, percent	320	290	258	231	197	170	147	127	111	96	83
TDS of public debt to central government revenues, percent	42	44	38	37	33	27	23	22	20	19	16
Low Case											
Total external debt, mil. US$			1313	1365	1403	1431	1452	1484	1528	1576	1625
Government and government guaranteed debt , mil.US$			982	1002	1035	1042	1027	1036	1066	1103	1121
External debt to GDP, percent			89	88	85	83	80	78	76	75	74
NPV to GDP, percent			79	64	63	60	57	54	53	53	51
NPV to exports of goods and services, percent [1]			150	141	130	119	111	105	98	92	89
TDS to exports of goods and services, percent			26	24	25	21	18	18	19	18	17
NPV of public debt to central government revenues, percent			295	269	244	220	198	180	164	150	138
TDS of public debt to central government revenues, percent			44	43	39	33	30	28	27	27	23

Note: Energy arrears are not included into the above calculaitons.

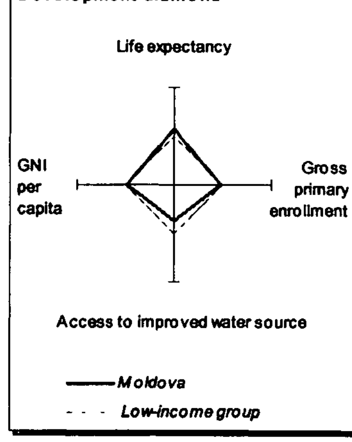
1/ 3 years average (centered on the previous year) exports have been used

Moldova at a glance

5/24/02

POVERTY and SOCIAL	Moldova	Europe & Central Asia	Low-income
2001			
Population, mid-year *(millions)*	4.2	475	2,459
GNI per capita *(Atlas method, US$)*	400	2,010	420
GNI *(Atlas method, US$ billions)*	1.4	956	1,030
Average annual growth, 1995-01			
Population *(%)*	-0.2	0.1	1.9
Labor force *(%)*	-21.8	0.6	2.4
Most recent estimate (latest year available, 1995-01)			
Poverty *(% of population below national poverty line)*	55	..	..
Urban population *(% of total population)*	50	67	32
Life expectancy at birth *(years)*	67	69	59
Infant mortality *(per 1,000 live births)*	18	21	77
Child malnutrition *(% of children under 5)*	..	..	..
Access to an improved water source *(% of population)*	56	90	76
Illiteracy *(% of population age 15+)*	2	3	38
Gross primary enrollment *(% of school-age population)*	92	100	96
Male	90	101	102
Female	93	99	86

Development diamond*

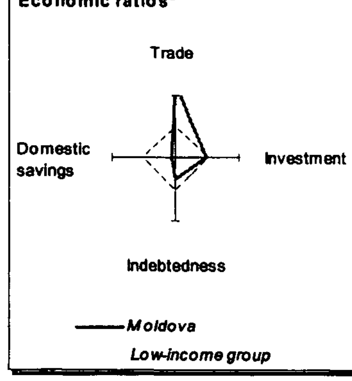


KEY ECONOMIC RATIOS and LONG-TERM TRENDS

	1981	1991	2000	2001
GDP *(US$ billions)*	..	..	1.3	1.5
Gross domestic investment/GDP	..	29.0	23.9	20.1
Exports of goods and services/GDP	..	32.4	49.7	51.7
Gross domestic savings/GDP	..	27.4	-3.2	2.4
Gross national savings/GDP	..	..	14.9	18.9
Current account balance/GDP	..	..	-9.4	-8.0
Interest payments/GDP	..	..	3.6	3.2
Total debt/GDP	..	..	96.7	82.9
Total debt service/exports	..	..	18.1	17.4
Present value of debt/GDP	..	..	91.7	79.9
Present value of debt/exports	..	.	154.2	127.3

	1981-91	1991-01	2000	2001	2001-05
(average annual growth)					
GDP	1.6	-7.0	2.1	6.1	5.0
GDP per capita	0.7	-6.2	2.3	6.3	5.3
Exports of goods and services	..	1.2	9.5	14.7	7.8

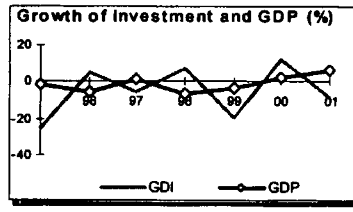
Economic ratios*



STRUCTURE of the ECONOMY

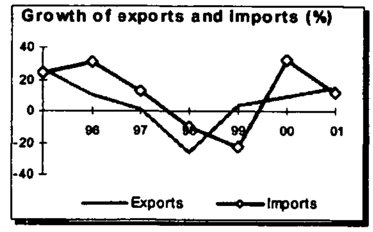
	1981	1991	2000	2001
(% of GDP)				
Agriculture	..	42.7	29.0	26.0
Industry	..	33.3	21.7	24.1
Manufacturing	..	..	16.3	18.2
Services	..	23.9	49.2	49.8
Private consumption	..	57.1	92.9	88.9
General government consumption	.	15.1	10.3	12.3
Imports of goods and services	..	34.0	76.8	73.0

Growth of investment and GDP (%)



	1981-91	1991-01	2000	2001
(average annual growth)				
Agriculture	..	-9.5	2.3	4.3
Industry	..	-11.5	6.6	17.5
Manufacturing	..	-3.4	15.9	17.8
Services	.	0.3	-3.8	-0.5
Private consumption	..	9.1	18.3	8.2
General government consumption	..	-11.4	2.0	15.6
Gross domestic investment	..	-14.1	11.9	-8.8
Imports of goods and services	..	5.6	32.6	10.9

Growth of exports and imports (%)

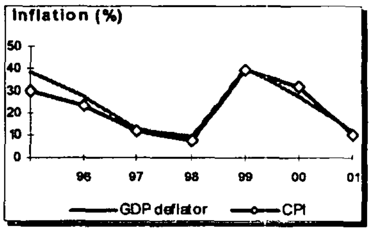


Note: 2001 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

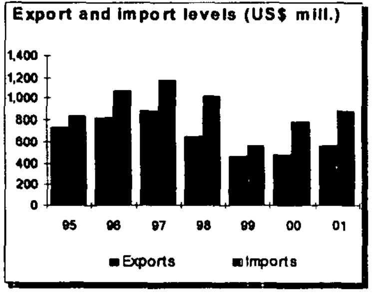
PRICES and GOVERNMENT FINANCE

	1981	1991	2000	2001
Domestic prices				
(% change)				
Consumer prices	..	..	31.3	9.8
Implicit GDP deflator	..	142.8	27.3	11.9
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	24.7	30.7	29.1
Current budget balance	.	3.1	-0.7	1.7
Overall surplus/deficit	..	0.4	-2.9	-0.5



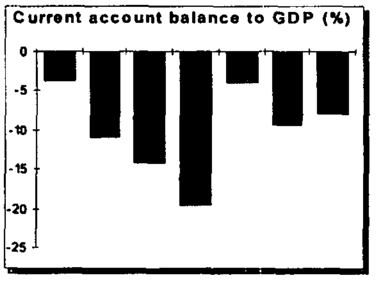
TRADE

	1981	1991	2000	2001
(US$ millions)				
Total exports (fob)	..	..	477	569
Live animals and animal products	..	..	23	30
Vegetable products	..	..	66	86
Manufactures	..	..	96	104
Total imports (cif)	..	..	793	882
Food	..	..	23	26
Fuel and energy	..	.	192	201
Capital goods	..	..	97	102
Export price index *(1996=100)*	.	..	68	69
Import price index *(1996=100)*	..	..	175	170
Terms of trade *(1996=100)*	..	..	39	41



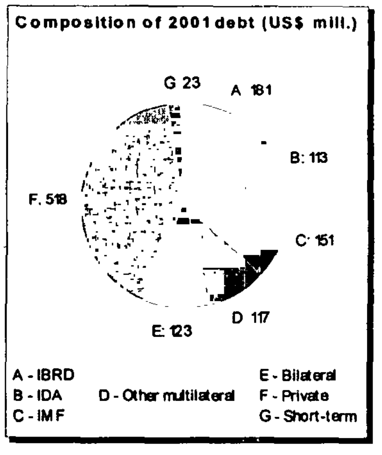
BALANCE of PAYMENTS

	1981	1991	2000	2001
(US$ millions)				
Exports of goods and services	..	..	640	739
Imports of goods and services	..	..	990	1,101
Resource balance	..	..	-350	-362
Net income	..	..	76	92
Net current transfers	..	..	157	152
Current account balance	..	..	-121	-119
Financing items (net)	..	..	172	130
Changes in net reserves	..	..	-51	-12
Memo:				
Reserves including gold *(US$ millions)*	..	..	218	227
Conversion rate *(DEC, local/US$)*	..	..	12.4	12.9



EXTERNAL DEBT and RESOURCE FLOWS

	1981	1991	2000	2001
(US$ millions)				
Total debt outstanding and disbursed	..	..	1,246	1,226
IBRD	..	..	191	181
IDA	..	..	103	113
Total debt service	..	..	139	162
IBRD	..	..	16	17
IDA	..	..	1	1
Composition of net resource flows				
Official grants	..	..	75	132
Official creditors	..	..	36	3
Private creditors	..	..	80	-4
Foreign direct investment	..	..	128	149
Portfolio equity	..	..	3	0
World Bank program				
Commitments	..	..	10	5
Disbursements	..	..	36	18
Principal repayments	..	..	5	7
Net flows	..	..	31	11
Interest payments	..	..	12	11
Net transfers	..	..	19	0



Moldova
Operations Portfolio (IBRD/IDA and Grants)
As of May 6, 2002

Closed Projects 9

IBRD/IDA *	
Total Disbursed (Active)	63.7
of which has been repaid	1.4
Total Disbursed (Closed)	284.3
of which has been repaid	19.2
Total Disbursed (Active + Closed)	347.9
of which has been repaid	20.5
Total Undisbursed (Active)	41.3
Total Undisbursed (Closed)	0.8
Total Undisbursed (Active + Closed)	42.2

Active Projects

		Last PSR Supervision Rating			Original Amount in US$ Millions				Difference Between Expected and Actual Disbursements a/	
Project ID	Project Name	DO	IP	Fiscal Year	IBRD	IDA	Cancel.	Undisb.	Orig.	Frm Rev'd
P008561	Private Sector Development I	S	S	1996	35.0			0.1	2.7	2.7
P008558	General Education	S	S	1997	16.8	5.0	5.5	8.4	8.5	4.3
P035811	Private Sector Development II	S	S	1997		9.0		3.3	3.8	
P035771	First Cadastre	S	S	1998		15.9		7.1	4.5	
P044840	Social Investment Fund	HS	S	1999		15.0		4.9	-1.2	
P051173	Social Protection	S	S	1999		11.1		8.3	3.5	
P051174	Health Investment Fund	S	S	2001		10.0		9.2	3.5	
					51.8	66.0	5.5	41.3	25.3	7.0

MOLDOVA

Statement of IFC's
Held and Disbursed Portfolio
As of March 2002
(In US Dollars Millions)

		Held				Disbursed			
FY Approval	Company	Loan	Equity	Quasi	Partic	Loan	Equity	Quasi	Partic
1997	INCON	3.76	2.00	0.00	0.00	3.76	2.00	0.00	0.00
2000	MECF Moldova	0.00	0.10	0.90	0.00	0.00	0.10	0.70	0.00
2000	Moldindconbank	3.00	0.00	0.00	0.00	3.00	0.00	0.00	0.00
2001	UF Moldova	25.00	0.00	0.00	0.00	10.00	0.00	0.00	0.00
2001	Victoriabank	4.00	0.00	0.00	0.00	2.70	0.00	0.00	0.00
1999/00/01	VoxTel	10.00	0.00	6.62	25.00	8.71	0.00	6.62	21.79
	Total Portfolio:	45.76	2.10	7.52	25.00	28.17	2.10	7.32	21.79

Approvals Pending Commitment

		Loan	Equity	Quasi	Partic
2000	Fincombank	1.5	0	0	0
	Total Pending Commitment:	1.5	0	0	0

REPUBLIC OF MOLDOVA
STRUCTURAL ADJUSTMENT CREDIT

Timetable of Key Processing Events

1.	Time Taken to prepare:	10 months
2.	Prepared by:	Government assisted by IDA staff
3.	Preparation missions:	May 7 - June 23, 2001
4.	Pre-Appraisal:	July 30 - August 15, 2001
5.	Pre-Appraisal (2nd mission):	October 2 - October 19, 2001
6.	Appraisal:	March 11 - 19, 2002
7.	Negotiations:	April 22 – 26, 2002
8.	Planned Board presentation:	June 18, 2002
9.	Estimated date of effectiveness/first tranche:	June 2002
10.	Estimated date of second tranche:	November/December 2002
11.	Estimated date of third tranche:	March/April 2003
12.	Expected program completion:	September 30, 2003

Staffing

Vice President:	Johannes F. Linn (ECAVP)
Country Director:	Roger W. Grawe (ECC07)
Sector Director:	Cheryl Gray (ECSPE)
Sector Manager:	Samuel Otoo (ECSPE)
Responsible Staff:	Mark Davis (Team Leader, ECSPE), Harry Broadman (Team Leader, ECSPE), Larry Bouton, Maya Sandu, Elena Nikulina, Jariya Hoffman, Nancy Davies-Cole (ECSPE), Hoonae Kim, Anatol Gobjila (ECSSD), Vladislav Vucetic, Sandu Ghidirim (ECSEG), Roy Pepper (PSAPP), Andrew Ewing (Consultant), Gareth Locksley (EMMTI), David Satola (LEGOP), Irina Astrakhan, Lucia Buzdugan (ECSPF), James Cercone (Consultant), Joana Godinho, Anush Bezhanyan, Reema Nayar, Alexei Ionascu (ECSHD), Viorica Strah (ECCMD), Hans Jurgen Gruss, Zoe Kolovou (LEGEC)
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Peer Reviewers:	Kevin Cleaver (RDV), Christiaan Poortman (ECC04)

May 10, 2002

To: James D. Wolfensohn,
President, The World Bank

GOVERNMENT OF THE REPUBLIC OF MOLDOVA

LETTER OF DEVELOPMENT POLICY

1. Moldova's economic development during the last two years has been encouraging. Macroeconomic stability has been maintained and structural reforms have started to show positive results. Real GDP increased by 2.1 percent in 2000 and over 6 percent in 2001. Inflation dropped from 18 percent in 2000 to under 6.4 percent in 2001. Real interest rates are falling. The budget deficit on a commitment basis accounted for only 0.82 percent of GDP in 2000 and has decreased by over 7.3% of GDP since 1998. Pension arrears have been eliminated and general budgetary arrears are being reduced. However, a large stock of external debt has accumulated over the last decade, and especially after the 1998 exchange rate devaluation. Debt service now represents a serious threat to these macroeconomic achievements and may impede and further delay the resilience of our economy.

2. We believe that adherence to market oriented policies will send a strong signal to the business community, both at home and abroad, that we are serious about reform and that Moldova is a good place to do business. We are thus committed to maintaining a sound macroeconomic framework, including servicing our external debts and realizing a sustained growth dynamic. We are taking steps to maintain a good tax policy, simplify and streamline tax administration, refrain from tax offset operations and to collect taxes in cash. This is being done in parallel with other measures, such as continued restructuring and privatization efforts in the energy sector which will help increase budget discipline. Our macroeconomic policies aim to maintain low levels of inflation, continue to bring down real interest rates, ensure external sustainability and attract much needed domestic and foreign investment. In the fiscal area, we have already eliminated formerly unfunded energy compensations to the population and we will continue to eliminate other unfunded expenditure commitments. We will also continue to rationalize expenditure commitments more broadly. The 2002 Budget of the General Government stipulates a primary surplus of 3 percent of GDP and a commitments deficit of 1.2 percent of GDP. Improvements in fiscal policy is creating conditions that will continue to bring down interest rates and increase project lending by banks, while increasing our access to greater concessional financing.

3. The Government is committed to maintain and continue progress on economy-wide structural reforms toward a market economy and refrain from any actions that would jeopardize this objective. We recognize that this is the only path towards achieving improvements in medium- and long-term prospects of sustained development. Improvements in growth performance would necessarily come from increased private sector activity in agriculture, agro-processing and other export-oriented production units, the services sector, and through the creation of new markets for Moldovan exports which benefit from our comparative advantages such as in agricultural land and human capital.

This requires us to attract increased levels of private and foreign investment in the above-mentioned sectors, and rationalize investment away from inefficient and unproductive uses to more productive ones. To achieve this, we will strive towards creating an enabling environment, by increasing macroeconomic stability, improving business conditions, further liberalizing the economy, and deepening privatization, to generate greater incentives for increased private and foreign investment.

4. The Government is determined to continue its reform efforts, to ensure economic progress, financial stability, and protection of the vulnerable. The Government believes that the structural reform program has yet to build the critical mass of reforms necessary to achieve a tangible change in the economy, and is committed to the continuation and completion of the program to fully achieve its goals. Therefore, the objective of the activities of the Government, in cooperation with the World Bank, is to promote structural adjustment of the national economy and creation of the conditions for stable growth, focused on the stimulation of private sector development, while preserving financial viability of the economy. In achieving these goals, we have identified a set of fundamental policy measures aimed at generation of inclusive and sustainable economic growth.

5. Broadly, these policies focus on two areas: poverty alleviation and improvement of the business environment. The reform programs to alleviate poverty encompasses (i) improvement of poverty analysis, monitoring and evaluation, (ii) improving social service delivery in education and health, and (iii) strengthening social protection and the pension system. Regarding improvement of the business environment, the Government reform program includes measures to (i) harden budget constraints and improve fiduciary management, (ii) reform the business administrative framework, (iii) reform the agricultural sector, (iv) reform the energy sector, and (v) improve and accelerate the privatization process (legal framework, telecom, and wineries). The following sections outline the Government program and measures that we intend to implement supported by the SAC III operation.

A. Poverty Alleviation and Improved Social Service Delivery

6. Moldova is one of the poorest countries in Europe despite progress in maintaining a stable macroeconomic environment and implementing structural reforms. Its GDP per capita in 2001 was about US$ 400, or about one half of the 1995 figure, which is significantly below the average for CIS and Central European countries. Poverty indicators reflect increased and persistent poverty incidence, especially after the 1998 Russian Crisis. The World Bank Poverty Dynamic Study shows an increase in poverty from 47 percent in 1997 to 67.6 percent in 1999 and 68 percent in 2000. Social indicators (as measured by life expectancy, infant mortality, death rate, and literacy rate) lag behind those in European and CIS countries and point to a deteriorating standard of living in Moldova. The health status of the population has declined considerably and the quality of education has also suffered.

7. Given these developments, the Government is committed to poverty alleviation. An Interim-Poverty Reduction Strategy Paper was approved in 2000 which outlines a three pillar strategy: (i) sustainable and inclusive economic growth, (ii) improved human development through better delivery of social services, and (iii) strengthened and better targeted social protection. At that time, it was envisaged that the preparation of a full

PRSP would be completed by end 2001. However, a parliamentary election in early 2001 resulted in a sea-change of Government which led to implementation delays, The process has since resumed. A "PRSP Coordination Council" has been established and is chaired by the President which oversees the development and implementation of a full PRSP. Together with the Coordination Council, we will prepare and adopt an updated interim PRSP and develop a full PRSP in collaboration with domestic and external partners.

8. The Government appreciates that all three pillars are essential to reduce poverty. Growth is essential for expanding economic opportunities for poor people. To achieve inclusive and sustainable growth, it will be particularly important to pay attention to market reforms targeted to poor people. Such reforms include improvements in the business environment, especially for small and medium enterprises, which are key to creation of employment opportunities. It will also be important to help people accumulate wealth, build the human capital and improve access to good quality basic social services. We recognize that strategic decisions are necessary to better allocate and improve efficiency of our very limited resources in the delivery of social services. Toward this end, we are developing strategies to deepen structural reforms of our health and education sectors. This will lay the foundation for a financially sustainable long term investment strategy in the sector. Finally, it will be important to reduce people's vulnerability in old age by improving the effectiveness and fiscal sustainability of the pensions system, and ensuring that social assistance programs are well targeted to the poorest and assist them in meeting immediate consumption needs while protecting their accumulation of human, physical and social assets.

A. 1. Poverty Analysis, Monitoring and Evaluation

9. In the process of developing a full-PRSP we have learned that an important barrier to developing informed poverty-focused policies is our lack of capacity to collect information, monitor poverty and conduct poverty analysis. Another important barrier is the lack of consensus on methodology to identify the poor and therefore to analyze the impacts of policies on the poor. As a practical step, we plan to improve the quality of data and analysis pertaining to poverty. We have initiated the preparation of the medium-term plan which will clarify the roles and responsibilities and improve the capacity of different agencies involved in poverty analysis, monitoring, and evaluation. This plan will identify the core indicators that will be used to measure the different dimensions of poverty including consumption, but also human and physical assets. It envisages a clear assignment of responsibility for data collection and data sharing. It also calls for the creation of an institutional framework for monitoring poverty that coincides with that for the design of poverty reduction policies - including within economic sub-sectors. The plan will be approved by the Government by May 17, 2002.

10. We will implement steps in the medium term to improve the quality of existing data sources and to introduce the new surveys needed to provide accurate and reliable information on the different dimensions of poverty. We will improve the existing household surveys (HBS, LFS). In particular, we will improve the sampling frame for these surveys based on sound technical recommendations. We have already developed revised questionnaires that will improve our information on access to health care and education. We will implement these modules as well as improved modules on social

protection programs. We appreciate that the quality of the poverty monitoring database (including the household surveys) depends crucially on the availability of an updated demographic census and we will carry out an updated census and allocate the required funding for this.

11. At present, different agencies (MOE, MLSP, DSS) are developing their own measures of consumption-based poverty for individuals and households. As a result, these poverty estimates in-country vary widely. Therefore, we will emphasize the collaborative development of and consensus on the methodology for poverty measurement, including the establishment of an absolute poverty line. The collaboration and consensus will be between *all groups within the Government* involved in the development and implementation of sectoral poverty reduction strategies as well as in the collection and implementation of the poverty monitoring data, and will include key line ministries including agriculture, health, education, social protection, the DSS, as well as the core central ministries (MOF, MOE). Key groups outside the Government, including donors and local researchers will also be consulted on this methodology. Such a methodology, consistent with international practice, will be approved by the Government by the fourth quarter of 2002, and will become the basis of regular poverty monitoring. The inter-ministerial group defined above, together with non-governmental researchers will constitute a "users group" and will undergo training on creation of analytical quantitative measures of poverty, as well as design and assessment of poverty-focused policies.

12. We will regularly disseminate the results on the identified indicators on the different dimensions of poverty. We will also release the household data used for poverty monitoring and analysis, to the public including non-governmental researchers.

A. 2. Improved Social Service Delivery: Education Reform

13. The Government has been implementing, with assistance from the World Bank, a reform program to improve the quality of primary and lower secondary education. A new institutional structure for curriculum has been established and the curriculum revised, learning assessment has been improved and new national examinations have been introduced at grades 4 and 9. Textbooks for core subjects are being provided for basic education grades and are being financed through an innovative textbook rental scheme that makes textbooks more affordable to parents. Additionally, teachers are receiving in-service training in new curricula, teaching methods, and assessment. These reforms are having a positive impact on the quality of basic education system and on the process of teaching and learning in the classroom. We appreciate, of course that we will need to continue these reforms, monitor their outcomes, and make continuous improvements, and ensure that all aspects of the reform are coordinated with each other. To sustain and build on the achievements to date, and recognizing the importance of good quality basic education, we will continue to fund these quality improvements in the coming years. We are also committed to preserve and build upon the positive institutions and practices that have been established. These include the National Council for Curriculum and Evaluation and the professional and consultative processes for curriculum revision, an independent and adequately staffed Department of Evaluation and Assessment, and the use of transparent and competitive methods for the procurement of textbooks. The latter will be facilitated by

autonomous management of the Textbook Rental Fund by an inter-ministerial Steering Committee.

14. We realize, at the same time, that a more comprehensive structural reform of the education sector is needed in order to protect and improve quality. While our schools continue to struggle to maintain education standards, chronic financial difficulties have given rise to distortions in the sector. In particular, we are concerned about the growing inequities in the access for children from low income families and the lack of poverty-targeting of budget students by our universities.

15. The Government recognizes that a realistic reform strategy for the education will need to be financially sustainable. On the one hand we face the challenges of rapidly deteriorating and energy inefficient physical infrastructure. These impose significant demands on resources that are difficult to meet. At the same time, they threaten the safety and quality of the schools and classrooms, and therefore the quality of the pedagogical process. On the other hand, the consequences of dramatic demographic changes, and the decline of the birth rate to below replacement levels, poses serious investment and system rationalization choices. Each of these also calls for a reappraisal of the supply and demand for teachers and ancillary staff, and for adjustments to the systems for pre-service and in-service training.

16. To meet these challenges, with profound social and strategic consequences, the Ministry of Education will develop the capacity and capability for policy analysis and strategic planning in the medium and longer term. This change will be supported by an Educational Management Information System (EMIS), that ensures that managers have access to the relevant data and information for decision-making. We have already initiated improvements in our existing database; in particular, we have already created detailed information for three judets. The analysis of these databases demonstrates many of the short, medium and longer term challenges facing our educational system. We recognize that a good information system will need to address both the demand and supply side of information, and would also like to use the existing databases as a foundation *for* moving forward on the development of a national EMIS. We will therefore undertake, by the fourth quarter of 2002, a series of actions, including the finalization and dissemination of the analyses on the basis of existing databases, a review of the legal framework governing educational management (including implications for employment relations), and the creation of a working group to start the initial planning of an EMIS. We will also carefully examine the experiences of other transition countries with improvements in infrastructure efficiency and system optimization, and improving management of education.

17. At the same time, we will undertake studies and surveys on selected topics to better inform the development of our strategy to improve the quality and equity of basic education and to address the alarming inequalities that have arisen in our education system in recent years. These include a study on finances available to schools, as well as informal payments by families for pre-tertiary education, on the state of the physical infrastructure and improving energy efficiency, and teacher staffing needs and the role of pre-service and in-service training institutions. Toward this end, by the first quarter of 2003, we will prepare and approve an education reform policy paper which addresses, among other inequalities, the (a) reduced completion rates and poor attendance in basic education,

particularly among poor children; and (b) higher education selection and financial support mechanisms to ensure the access to higher education of students from poor households.

A. 3. Improved Social Service Delivery: Health Reform

18. The overall objective of the reform program in the health sector is to obtain better equity, improved health status and value-for-money in the health care system through improvements in the efficiency, quality and effectiveness of the services provided. Over the past few years, the Government has made substantial progress in confronting the emerging crisis in the sector. To address budget constraints, excess capacity and quality concerns, the number of hospitals and hospital beds was reduced, and judet health authorities have proceeded to downsize ancillary buildings that were under-utilized in order to use resources previously spent on infrastructure and energy more effectively. Further, many judet health authorities are preparing and implementing detailed strategies for investing on primary and emergency care and consolidating excess capacity at the hospital level.. To address the challenges ahead, the Government will maintain firm support of the reform process that has been started at the regional level by implementing a national health system restructuring program centered on four key pillars: a) strengthening the primary care network, b) improving the allocation of resources to ensure a more equitable and efficient orientation of healthcare resources, c) restructuring the health system at the national and judet levels, and d) strengthening the quality of health care staff.

19. Strengthening of the primary care network will enable us to meet most of the population's health needs, simultaneously increasing the quality of medical services provided and shifting staff and financial resources from hospitals to family medicine. Toward this end the Government has already established a Health Investment Fund which has been instrumental in reactivating investment in primary care and we envisage several follow-up phases of investment to build a top-quality primary care network. To strengthen the primary care sector our program focuses on: (i) ensuring an adequate and increasing financing of the public health sector basic services from the budget; (ii) reallocating some medical staff from hospital to primary care after they have been accordingly retrained to fit the required activity; (iii) providing the primary care sector with an adequate level of funding for an appropriate provision with essential drugs and necessary equipment; (iv) improving and up-dating treatment standards in line with international norms; (v) strengthening emergency services as a key element of improving the primary health care; and (vi) strengthening and consolidating emergency care centers in regional hospitals.

20. Improving the allocation of resources to ensure a more equitable and efficient orientation of healthcare resources will enable us to achieve a better utilization of finances and to appropriately meet the health needs of the population. Given the current economic crisis facing our country, the budgetary resources allocated to healthcare system have been reduced to a minimum. The Government's intention is to ensure that the majority of these funds are allocated to guarantee access to a minimum package of essential services and pharmaceuticals. It is our intention to develop a healthcare system that will ensure free access to these services for the entire population. Toward this end the Government plans to develop by the first quarter of 2003 a diagnostic mechanism that would provide a basis for informed policy decisions in health sector finance through analysis of (i) the use of financial resources spent on various levels of health care services (e.g., primary care,

hospitals, and public health), (ii) sources of financing, and (iii) the effectiveness of the utilization of resources. Work on such a mechanism is crucial for informed discussion of health finance reforms, including revenue generation and equity/redistribution across judets, as well as informed decisions on a health insurance scheme. We plan to adjust the essential minimum health services to the resources available in the budget. We also propose to allow local authorities flexibility in providing additional services to those agreed in the basic package and to finance care for specific risk groups. Furthermore, we will allocate at least 35 percent of the health budget resources to cover the essential services, focused on primary care and national public health priorities. We will also explore ways to implement alternative sources of financing health care including, and the introduction of a hospital reimbursement mechanism based on patients treated and results obtained reversing the traditional budgeting process based on inputs (e.g., patients treated versus beds and staff). However, greater focus will be placed on the design issues related to developing a sustainable health insurance system: finding equilibrium between the real resources available and the benefits to be provided, rather than on the preparation of regulations and statutes. The Government will address the outstanding financing issues within the existing macroeconomic framework, with the use of best practice for health insurance design and through a better understanding of what has worked and what has not in other CIS countries.

21. Restructuring the health system at the national and judet levels will allow better use of public funds by reducing expenditures on maintenance of infrastructure and unnecessary energy costs while refocusing them on essential health services. Thus the reform focuses on restructuring the medical services provider network with a consolidation of the existing infrastructure and a reorientation of resources from the curative, specialized level care, towards basic primary care. The Government, the Municipality of Chisinau and the Judet Health Authorities have already taken concrete steps in this direction: (i) the number of hospitals decreased from 253 to 65; (ii) the number of hospital beds decreased by 50 percent; (iii) the Republican Health-Sports Dispensary has been closed, (iv) Chisinau Municipal Hospital Number 2 has been closed, (v) the Chisinaus Narcological Institute has been consolidated with the Republic Narcological Institute; and (vi) more than 100 ancillary facilities have been closed. The Government has continued the consolidation of Republican Hospitals and the Chisinau Municipal Hospitals by adopting a decree to eliminate 90 beds at the Republican Trauma Hospital and 65 beds at the Children's Hospital; an additional 70 beds from Children's Hospital services available at the Institute of Maternal and Child Care, which will allow for further downsizing. This will improve the efficiency of public expenditures as it eliminates low value-add facilities through rationalization. By the fourth quarter of 2002, we will approve a time-bound Hospital Restructuring Plan for further elimination of excess capacity at the 17 Republican Hospitals and the Chisinau Municipality Hospitals We will then initiate its implementation.

22. The territorial reforms introduced in 1999 develop a decentralized framework for the management of the healthcare delivery system. As part of the implementation process associated with the decentralization, the Government will separate the healthcare providers and financing functions (purchaser-provider split) to optimize medical care and to increase the accountability at the local level. At the same time, changes will be required at the central level to improve the policy making and regulatory capacity of the central level Ministry of Health. The development of these policies will help ensure the following actions are taken: (i) publicly funded healthcare services will be purchased from accredited

medical facilities on a contract basis between health authorities (the purchaser) and health facilities (the provider); (ii) over the next several years, the majority of all health care providers will become autonomous entities and will no longer be financed from the Government budget; the legislative framework will be a critical element to guarantee the success of this activity; (iii) efforts will be made to sell non-productive assets that have resulted from the dramatic downsizing that has taken place over the past several years; (iv) the Ministry of Health will strengthen its policy making and regulatory capacity to improve oversight in the system and to develop the strategic vision required to guide the sector through the difficult reform process; (v) the Government will restructure health service providers to allow them to be financially and managerially autonomous and run by professional managers; and (vi) the Government will revise its drug purchasing policy to allow wholesale procurement through a competitive tender mechanism and to ensure the provision of a basic package of pharmaceuticals to all citizens.

23. We will strengthen the quality of our workforce through actions aimed at improving the clinical management of illness with the introduction of modern protocols, strengthening institutional capacity through training physicians and improving management to improve value for money in the healthcare system. Taking into account the present infrastructure and the social-economic situation of public health sector, these measures will be urgently initiated to ensure that the most pressing needs are met within a period of two to four years.

24. Without substantial increases in the capacity of our healthcare professionals it will be difficult to carry out the aforementioned reforms. We propose two parallel activities. First, we will carry out and approve a human resource restructuring plan that will undertake an inventory of the existing staffing levels and conditions in all health facilities, provide a clear framework and estimate financing needs for further downsizing. The plan will promote the reassignment of staff to underserved areas, ensure changes in medical education - including policies and standards for training specialist physicians - to provide for an adequate supply of medical professionals in accordance with the population's needs and resource levels. It will also introduce alternative contracting mechanisms that combine fixed salary with variable salary based on performance indicators and productivity. Second, development of primary care and improving efficiency at the hospital level will require the development of new skills. We will support retraining of physicians and professional staff, and improvements in their management capacity.

A. 4. Strengthened Social Protection: Social Assistance and Pension Reform

25. The current system of social protection continues to suffer from weak targeting of the poor. The Poverty Assessment of the World Bank (1999) found that targeting of existing programs is poor, and there is a positive relationship between income level and the social protection transfers received by members of the population. The Government recognizes that Moldova cannot afford this inefficiency - social protection transfers need to be well targeted to the poorest strata of the population if they are to have their desired impact on poverty. Some success was achieved in 2000, in improving the targeting efficiency of utility and energy compensations. The Government recognizes that the targeting efficiency of these subsidies needs to be further improved. In part the targeting of social protection programs is poor because the Government is currently using categorical based targeting methods to identify and target the poorest in society and these do not work well in

Moldova. Available household data needs to be improved and used more effectively for monitoring the targeting efficiency of social assistance programs and for improving the design of these programs. Moving forward we will improve collection and analysis of data that can be used to target the poor as outlined in section A.I. above. Also, assisted by better data and analytical capacity, and as part of the PRSP process, the Government intends to develop a medium term strategy to improve the targeting of social assistance to protect the poorest and must vulnerable sections of the population.

26. Under the 1998 pension reform, significant progress has been made in rationalizing the pay-as-you-go system by establishing a strong linkage between individual contributions made and pensions received and gradual increase of retirement age. Moreover, most of the privileges have been eliminated and the transparency and equity of the state pension system has been improved. These reforms have already produced significant results: pension arrears have been eliminated, cash collections have been increased, and the Social Insurance Budget has recorded a small surplus. However, the Government is concerned about the still very low general public pensions received by the majority of pensioners as well as the large discrepancies in the pension levels between different categories remaining in the system.

27. The Government is committed to continue implementation of the pension reform by following the fundamental principles incorporated in the 1998 State Social Security Pension Law, including the originally agreed pension formula, a gradual increase in retirement age, and elimination of pension privileges. At the same time, we are planning to introduce necessary minimum amendments to that legislation intended to further improve the system. Our program will focus on two sets of amendments. The first set will introduce a transparent and affordable pension indexation rule to be applied to all future pension increases which maintains the reformed pension structure. The second aims to further improve transparency and fairness of the pension system through incorporating a pension provision for selected professional categories currently pensioned under separate legislation. To inform design of these amendments, we will prepare by May 17, 2002, long-term financial projections to evaluate the impact of the proposed legislative changes on the pension system and future pensioners. Our program also envisages further development of the pension reform policy for farmers and the self-employed consistent with, but not necessarily identical to, the reformed pension structure. We will prepare a strategy paper by the first quarter of 2003. At the same time, we will put greater emphasis on improving the pension system administration.

B. Improvements in the Business Environment

B. 1. Hardening Budget Constraints and Improving Fiduciary Management

28. To achieve sustainable and accelerated economic growth and poverty alleviation over the medium and long-term, the Government is committed to maintaining fiscal discipline and improving fiduciary management. We have successfully restrained the fiscal deficit while also increasing tax collection; expenditure arrears have also been reduced substantially. Netting operations have been progressively eliminated. In 2001 cash collection of State budgetary revenues reached 98%, and of the Social Insurance budgetary revenues, it was 121%. Domestic expenditure arrears of the consolidated budget have been

brought down significantly during the past few years, and the National Pension House has fully eliminated its social insurance budget arrears in 2001. To improve financial management, we established the single treasury system to service the State Budget. In 2001, we established a Cash Management Unit in the Treasury to improve cash flow forecasting and management. We also strengthened public debt management by consolidating foreign and domestic debt departments into a single unit while improving its front, middle, and back office functions that provide support to senior managers in developing and implementing a comprehensive and proactive public debt strategy based on the country's debt sustainability analysis.

29. We have completed the extension of the treasury system to the local government levels, marked by the inclusion of Chisinau Municipality. This measure enhanced the control of expenditure at the local government levels where the majority of domestic expenditure arrears are accumulated. We will continue to prohibit netting operations in the State and Social Insurance Budgets, and increase cash collection to 100 percent for revenues of the State and Social Fund budgets. We will also prohibit in-kind transfers from the State Budget to Local Governments and to the Social Insurance Budget. We are committed to stop building new and reduce domestic payment arrears of the Consolidated Budget (including the Social Insurance Budget) in order to limit the impact of poverty incidence on the poor.

30. We recognize that subsidies for specific sectors do not promote efficient use of budgetary resources, especially under tight fiscal pressure. Limited resources should be prioritized based on the efficiency and effectiveness of sectoral programs. To this end, by May 17, 2002, we will eliminate all public sector financial support for the wine and tobacco sectors by, (i) issuing a Government Resolution which stipulates measures for the elimination of all public sector financial support, including investments, loans and credits, and subsidies, related to raw material production, processing and trade in the tobacco and winery sectors, beginning with enactment of the 2003 Budget and thereafter, and/or modification or elimination of any other related existing mechanisms; and (ii) enacting legislative amendments to eliminate earmarking of all tax revenues to the wine and tobacco sectors, including those specified in Art. 18(2) of the Law on Tobacco and Tobacco Products (No. 386-XV) and Art. 22 of the Law on Vineyards and Wine (No. 1166-XIV). We will fully implement these measures.

31. Recognizing the importance of the wine sector for the Moldovan economy, the Government has recently approved a decision to establish a Wine Department that will engage in export promotion activities. However, we will ensure that the activities of this Department will not undercut functions of the market system through the provision of direct and indirect financial support to private wineries. Further, the Government will not introduce any earmarked taxes to create new extra budgetary funds for this purpose.

32. Amendments to the Law on Restructuring of Farms Undergoing Privatization will be enacted by May 17, 2002, to ensure that only farmers who have undergone the National Land Program or fully adhere to the principles of the National Land Program will be eligible to have their debts restructured or written off. Furthermore, we will ensure that any other agricultural enterprises debt write off or restructuring will be consistent with the Law on Insolvency. Targeted energy compensations continue to be paid in full and on time.

33. To improve fiduciary management and increase transparency and accountability of the public sector, we will collaborate with IDA to launch a review of the Country Financial Accountability Assessment (CFAA). The CFAA will provide a comprehensive diagnostic and assessment of the country's public financial accountability arrangements, including its systems for public expenditure management, procurement, and financial management. The report will highlight the status of the financial accountability for the use of the public resources in Moldova. To this end, the Government will prepare an analysis highlighting the strength and weakness of major users of public resources. By the fourth quarter of 2002, we will adopt and implement an action plan recommended by the CFAA to improve the financial accountability in Moldova both in the central government and also in the local government institutions.

34. By May 17, 2002, the Government will also seek enactment of amendments to the law on Court of Accounts (CoA) so that the CoA's mandate is limited to audit the use of public funds. The Court of Accounts is an oversight organization and should not have prosecutorial role. The Government is the ultimate controller of public resources and the Court of Accounts will provide its opinion on the public accounts and also the financial statements prepared by each budget organizations. To further strengthen internal control for use of public resources, by the fourth quarter of 2002, the Ministry of Finance will reorganize the internal audit system as to increase independence and capacity.

B. 2. Reform of Business Administrative Framework

35. Many Moldovan firms, whether publicly or privately owned, have been plagued by low profitability, accumulation of arrears (to the budget, to energy enterprises and to each other), and declining production and employment. In part this has been due to an adverse macro-environment, the loss of traditional markets and inadequate access to financial resources. But this is also the result of an institutional framework for business development and investment that is not based on market incentives.

36. Previous governments took steps to establish a legal framework for enterprise reform and restructuring with the passage of laws on bankruptcy and restructuring. A Creditor Council was also established to deal with companies in arrears. In addition the Agency for Enterprise Restructuring and Assistance (ARIA) was established to provide assistance to insolvent enterprises in developing and implementing restructuring and/or liquidation plans. However, only limited progress has been made in restructuring enterprises. The Government recognized that there is an opportunity and an urgent necessity for realigning the production base of enterprises, especially large loss-makers. The Government has taken further steps in improving the legal framework for bankruptcy by enacting a new Law on Insolvency, which contains both liquidation and restructuring chapters for court-led and out-of court proceedings and introduces improvements based on experience gained in the past years. The Government is aware that strengthening of the legal environment must be complemented by explicit efforts to strengthen the capacity of the economic courts and the skills of the judges and court workers to implement the law.

37. At the heart of our efforts to reform the business environment, we believe that it is not possible to develop a market-based economy in Moldova on the basis of the Soviet Civil

Code, which regulated the relations of a planned economy. Therefore, the government is committed to enact, by the fourth quarter of 2002, of a new market-oriented Civil Code which will clearly stipulate the regulation of property rights and other real rights; will include the norms and regulations related to mortgages and pledges (subsuming Law on Pledges enacted on July 30, 2001); and will completely define the regulation of a set civil matter, including all general and special norms. The new Civil Code will require that all other laws will be brought into conformity with it.

38. In order to facilitate business's access to finance, the Government has made a significant effort to enact a new Law on Pledge. The law introduces a new concept of the Pledge Registry and provides the needed regulation of relations between the pledgor and pledgee. In addition, the Government is committed to eliminate, by May 17, 2002, stipulations in the Tax Code for VAT which levy VAT on fixed assets brought in as statutory capital of an enterprise. By eliminating a double taxation, these changes will eliminate a source of discrimination against business reorganization in a low-liquid market, thus encouraging better allocation of productive resources while reducing the costs of doing business.

39. The Government is also committed to the removal of administrative barriers to business entry and exit, which is critical to enhance private sector development, reduce transactions costs for business, especially individual entrepreneurs and SMEs, and encourage foreign direct investment. Significant effort was made by the Government to enact a new Law on Licensing. The authority to issue licenses is now given only to one institution, the Chamber of Licensing. The number of activities requiring licenses was reduced from 106 to 55, while leaving authority of licensing for strategic industries - telecommunications, energy and banking - to independent, qualified regulatory agencies. With this as a start, the Government is committed to further streamlining the number of licenses and the licensing procedure with the aim to complete it by the first quarter of 2003.

40. We will streamline the procedure of exit and de-registration, including a one-stop-shop procedure and automatic de-registration following a set period of business in-activity. A critical reform will be to introduce transparency and accountability into the inspection system to reduce impediments to business activity. This will entail creation of stronger checks and balances, enhanced coordination among the inspecting institutions, modification of the enterprise inspection log requirement and establishment of a publicly accessible centralized registry of enterprise inspections. We are committed to reform inspection procedures in order to reduce business harassment and increase the efficiency of inspections. The Government is committed to complete these reforms by the fourth quarter of 2002.

41. We will institutionalize a business-government consultative mechanism, including establishment, by the fourth quarter of 2002, of an Ombudsman office within the Presidential Apparat to hear and act on complaints about barriers to business. We are also committed to conducting continuous benchmarking of the business environment, by measuring changes through regular business surveys and using their results to raise awareness and create a common inter-ministerial platform for de-regulation and reduction of administrative barriers. In particular, by the first quarter of 2003, we will complete a

second "Cost of Doing Business" survey and develop a policy program to implement findings; the findings of the survey are to be published and disseminated widely.

42. Moldova joined the WTO in June 2001. Following this significant achievement, substantial work is being carried out to harmonize appropriate legislation and regulations in several areas, such as customs. The Government has started the reform of the Customs Office in order to reduce corruption and smuggling. Progressive measures, such as the introduction of new customs seals and the rotation of senior customs officers have been taken. The Government is strongly committed to further reform of customs procedures.

B. 3. Agricultural Sector Reform

43. The agricultural sector contributes 33% to GDP, provides over 40% of employment and constitutes 65% of exports. With beverages added, this figure rises to 80% of the country's total exports. Moreover, 54% of the population lives in rural areas and 68% of the poor are rural residents. Without addressing key issues faced by the agricultural sector, regenerating growth in the overall economy will not be possible and Moldova will not be able to increase critically needed foreign exchange earnings.

44. The Government of Moldova seeks to further promote sustainable growth in the agricultural sector with an aim to create a competitive, private initiative driven sector. To this end, the Government reconfirms its commitment to implement agricultural policies and support agricultural institutions aimed at developing a vibrant market-oriented rural economy. We recognize that in order to achieve these goals, concrete actions are necessary on our part to realign past policies, reevaluate current priorities that are consistent with the overall fiscal conditions, and move forward boldly with more market-based set of policy instruments, institutional and legal support system. In doing so, we are committed to pursue market-based, liberal agricultural policies where synergies between the Government and the private sector can be enhanced for improved performance fiscally, and economically. We will strictly adhere to the liberal agricultural policies during the years ahead as stated in the Memorandum of Understanding on the Agricultural Sector signed in December 2001 with the World Bank.

45. We place an emphasis on development of land and credit markets in agriculture. We recognize that farm restructuring is still unfinished and much more needs to be done to help private farmers to become truly competitive in a market economy. We remain committed to complete privatization of remaining small number of collective farms, and continue the restructuring of existing farm and agro-enterprises. The Government believes that the irreversible solid foundation for developing private agriculture is in place and the next steps would be: (a) to strengthen land ownership rights; (b) to promote development of land markets; and (c) to provide appropriate support services to post-privatization farmers.

46. The Government assures that any new land code or amendments to the existing Land Code will adhere to market-oriented principles that: (a) clearly define and protect land owners' rights, including full autonomy in use/lease of their land; (b) provide for the enforcement of real property rights through efficient institutions and effective courts; (c) facilitate and support market-based secure transactions of property rights, backed by formal contract procedures, and provide a court system that settles any disputes in a timely manner; (d) provide for property rights information to be available to all persons who

request it; (e) limit to highly exceptional circumstances, Government restrictions on transactions, consolidation or use of land; (f) facilitate registration and transactions at low cost with minimum fees and taxes in the shortest possible time after application; and (g) protect land as a resource on environmental and health grounds. Efforts are already being made to reduce notary fees, simplifying documents requirements, reducing multi-notary requirements, and also to make information about land prices more readily available to potential buyers and sellers.

47. Although land privatization has largely been completed, we realize that post-privatized farms, particularly large corporate farms continue to perform poorly. The lack of contract enforcement has both maintained inefficient farm managers through under-payment or non-payment to lessees, and created uncertainty for good managers as lessees exit lease agreements prior to the expiration of lease contracts, retarding on-farm investments. Many landowners have leased out their land to previous collective farm directors and many have not fully realized their rights as landowners, as indicated by the number of disputes registered at dispute resolution centers. The Government will support the system of clear and enforceable ownership rights. It will reduce the transaction costs for property sales, lease, inheritances, and provide confidence to lenders for providing secured credit against real estate. It will also facilitate effective land management, including proper valuation and property taxation.

48. In doing all the above, the Government will: (a) ensure that farming structure and sizes will be ultimately determined by transparent, market based transactions, and not laws, or decrees permitting governmental interventions on consolidation of land without the invitation, participation and approval of all affected land owners; (b) ensure that land transactions can take place freely without any undue administrative interference by Government, local authorities or neighbors; (c) maintain the institutional arrangement for the Cadastre offices, which will have trained manager, staff and institutional and technological capacity; (d) continue to seek donor assistance in providing legal aid services to farmers that cover a broad spectrum of legal services including an information campaign on land owners rights, and dispute resolution and problems regarding land transactions; and (e) carry out an information campaign for farmers about different scenarios of, and alternatives to, land leasing and swapping, procedures associated with these types of arrangements, types of contracts, standardized terms and conditions of lease contracts, etc.

49. The Government is committed to ensure that there is a sound, integrated legal framework for cooperatives based on the principles that: (a) membership should be entirely voluntary without any cohesion by government, local authority or neighbors; (b) land (through lease or otherwise) should not be required to be subscribed as equity into a cooperative nor should be required for membership; (c) employment should not be mandatory for membership in such cooperatives; (d) members should be free to exit at any time, with their original, physically demarcated plot of land; and (e) cooperatives should be subject to bankruptcy and liquidation similar to all other enterprises, without preference.

50. We also recognize that post-privatization farmers need access to know-how, market information, and financial resources to recapitalize themselves with necessary investment which will create the basis for future growth. Learning from the past mistakes, we reiterate our commitment that provision of financial resources to private rural entrepreneurs will be made through commercial financial institutions that have full autonomy in loan risk appraisal, loan approval and rejection. In parallel, we are strongly committed to creating a business environment that will foster development of private businesses in rural areas. Specific measures will include provision of legal and institutional framework to create a legal status for private individual farms, establish advisory services to provide information, knowledge and create a sustainable rural financial system that will channel investment credits.

51. We are committed to maintaining liberal agricultural policies for our agricultural producers, traders and processors. The Government has already taken bold steps to further liberalize the sector. State monopolies - Fertilitate and Cereale - have been largely privatized to promote competition in the input and output markets for farmers. Prices have been formally liberalized, and the system of administrative price setting for producers at all levels of processing and wholesaling was discontinued in 1992. Furthermore, indirect regulation through procurement prices, controlled profit margins for processors and controlled marketing margins for traders have also been removed. The past practices of introducing export bans (e.g. timber) or licensing requirements (e.g. on walnuts) as well as minimum reference prices for exports has been discontinued through official repeals. State involvement in the productive sector, such as development of a vertical monopoly in the tobacco sector, has also been resisted. In sum, the Government is committed to maintaining liberal pricing policies and minimal interference in trade or domestic marketing. We reiterate our firm position that the State will not become a direct facilitator of trade for the private sector.

52. The Government of Moldova, like other governments, plans to maintain for strategic purposes a limited quantity of grain in a State Reserve for Grain. The reserve will be maintained for emergency purposes only, not for market intervention. Procurement of the grain will only be through public auction based on cash payment. We will seek international experience to improve the current system. In particular, we will better define the operating rules for the State Reserve regarding purchasing and sales so as to limit and make more predictable their impact on market prices; gradually reduce the overall size of the reserve stocks; shift some storage to private facilities thereby improving quality of storage and encouraging private warehouse development; and eliminate in-kind grain loans or debt write-off.

53. With regard to the State Reserves, the Government is committed to: (a) limit the state reserves to the maximum level equivalent to one and half months worth of human grain consumption; (b) maintain the level of grain held by the Reserve in line with the country's fiscal situation; and (c) adhere to the following operating principles for the Reserves: (i) the reserves would not be used to intentionally influence prices or quantities of grain on the market and would be held only for "emergency" use; (ii) released based on clear criteria such as domestic prices being more than 15% above GIF prices; (iii) purchases and sales would be effected only in cash through the commodity exchanges; and (iv) there would be no net change in monthly grain balances (i.e., purchases and sales would be offset and

carried out only to ensure stock rotation); and (v) public institution bodies will not engage in commodity trading of any kind, with the exception of the State Reserve Fund.

54. For the framework of the liberal agricultural regime, we will: (a) refrain from direct and indirect price control on agricultural commodities, including any margin or profit control; (b) discontinue all reference prices for agricultural commodities; (c) suspend all export bans, reduce licensing and controls, and simplify procedures for import and export by eliminating as much paperwork as possible; (d) monitor and disseminate to the public the results of all government procurement and their financial results; (e) rely on land tax as the main tax source for the sector; (f) increase gradually agricultural VAT comparable to other sectors; (g) rationalize subsidy programs, favoring post-privatization restructuring of agriculture through a transparent, non-distortionary and well targeted system of agricultural subsidies; (h) seek prior agreement of the World Bank on design, terms and conditions of the Agricultural Support Fund, and for the 2002 ASF to ensure that only private farmers will be eligible and have only one time, without repeated, access to the ASF; and (h) eliminate all other agricultural subsidies, including off-budget programs.

B. 4. Energy Sector Reform

55. The primary objective of the Government's reform program in the energy sector is to provide efficient, reliable and affordable energy supplies and to bring prices in line with costs. This is to be achieved through full commercialization of the sector, buttressed, where necessary, by appropriate regulation, as well as by social policies to protect most vulnerable groups. The efficiency incentives emphasize transparency and competition, and provide opportunities to energy supply companies to benefit from economies of scale. We strongly believe that commercialization, especially imposing and maintaining full cost recovering tariffs, is not only in the interest of energy suppliers, but equally so in the interest of energy consumers, in order to ensure efficient consumption and sustainable supply of energy they need.

56. To avert the rapidly escalating energy crisis which occurred as a result of inadequate policies in response to the rapidly changing conditions in energy supply in the post-independence period, Moldova embarked on an ambitious set of reforms in the energy sector. A new, market-oriented legal framework has been developed, an independent energy regulatory agency—ANRE—established, and the sector's vertical monopolies unbundled. Budget subsidies for energy consumption have been brought in line with budget means and changed to better target those in need. These actions enabled privatization and further restructuring of energy companies in 1999 and 2000. The majority of shares in Moldovagas - the country's monopoly gas supplier - were swapped for debt to Russia's Gazprom, and three of five electricity distribution companies (covering more than two thirds of the market) were sold to Union Fenosa of Spain - a major international investor and electricity operator. The country's district heating networks were transferred from the central state to municipal governments.

57. These achievements have already brought significant benefits. Commercial performance of Moldovagas has improved (although not yet to the level where it should be) and supply of gas became more reliable and secure. Electricity import prices to the privatized companies have dropped and they have been able to supply electricity practically without interruption. The Government stopped accumulating external debts for gas and

electricity imports, except for the electricity supply in non-privatized areas where the state owned electricity distribution companies - RED Nord and RED Nord Vest - continue to accumulate debt to external suppliers. Although the Government does not provide guarantees for their electricity imports, if the performance of these two companies does not improve, the Government may eventually have to step in to bail them out, thus becoming liable for their external debts.

58. We are undertaking intensive efforts to privatize the Nord and Nord West distribution companies. To that end, we hired an investment bank, and supplemented by other assistance, we are completing a financial audit of their debts. We will adopt a privatization plan by May 17, 2002 (on the basis of recommendations prepared by the privatization advisor), with specific actions and schedule for privatization of at least 75%+1 (up to 100%) of the shares of RED Nord and RED Nord-Vest to qualified strategic investor(s). The privatization plan will include strengthening the legal framework for privatization and examining various privatization options in the context of market responsiveness - from the preferred option of selling majority of shares (including all shares) to a strategic investor through a competitive tender or direct negotiations, to privatization with participation of financial investors and international financing institutions in combination with a management contract with a strategic investor (who would be obliged to buy certain amount of shares as well), should market conditions prove not conducive to the first option. The Government will seek enactment of the necessary legislative actions to facilitate flexible approach to privatization and investments in the privatized companies. This will include enactment, by May 17, 2002, of amendments to the Law on the Individual Privatization Project for the Electricity Power Sector Enterprises, Law on the Concept of Privatization of the Electricity Power Sector Enterprises, Law on the Privatization Program, and other laws as necessary to enable successful implementation of the Privatization Plan of the energy sector.

59. We believe that a major injection of private investment capital into the Nord and Nord Vest companies and their improved financial performance and management are the key to commercialization and sustainability of the energy sector. This should largely complete the rehabilitation of the electricity sector, restoring reliable supply of electricity to the economy. It should also lead to a positive chain reaction throughout the energy sector, strengthening financial viability of Moldelectrica, combined heat-and-power plants (CHPs) (improving prospects for their eventual privatization), and Moldovagas. Both through its effect on the CHPs and through better enforcement of payments of electricity by district heating companies, it would facilitate and incentivize restructuring of the heating sector toward a more efficient and more affordable provision of heat. A successful privatization of the North and North-West companies and resolution of Termocom's problems would open the possibility for successful privatization of the CHPs as well. These plants need investments to increase efficiency of their existing assets and possibly expand their electric production capacity.

60. The Government will undertake a number of actions before launching privatization of the Nord and Nord Vest, to assure investors of its commitment to creating business-friendly environment in the country. The most important is to deal with the remaining problems related to the sale of three distribution companies to Union Fenosa (UF) in February 2000. The Government intends to continue to ensure that the objections raised by the Court of

Accounts (CoA) in relation to the Purchase and Sale Agreement (PSA) are resolved and put to rest. In addition, the Government will ensure that the terms of reference for the CoA activities are clarified and redefined in a way which is not unjustifiably intrusive and disruptive to businesses. The Government will continue to improve the policy environment for private investment, including honoring its obligations under contracts with private investors.

61. Although the primary responsibility for promoting development of heating systems will be with local governments, the central government will facilitate building legal, regulatory and institutional framework and creating other conditions conducive to development of efficient and affordable heating, attractive to private capital. The Government will endeavor to improve payment discipline in the gas sector and create conditions for expanding gas supply using private capital. This is important to improve conditions for efficient, decentralized heating systems. The Government will also give priority to installing meters for controlling and recording imports and exports of gas. More specifically, the Government, through its shareholding, will take measures to have Moldovagas complete the metering stations at Causeni (which meters the bulk of the transit gas) and at Hadarauti (which meters the bulk of gas imports for domestic consumption) by the fourth quarter of 2002.

62. The Government will maintain important structural elements of the energy sector which have already been established, and which were designed to enhance transparency, efficiency, and financial discipline, and to facilitate privatization. Such elements include, inter alia, keeping the combined heat-and-power plants as separate businesses from the district heating companies, until district heating companies' financial and management problems are solved. This is especially true in Chisinau, where merging CHP-1 and CHP-2 with Termocom - a bankrupt company with huge debts (relative to the size of the company) and very non-transparent financial management - would only spread the problem. The Government is restructuring Termocom through a bankruptcy process, opening up the company and revealing its financial dealings to the creditors, which will help identify and address the problem. Similarly, the Government will maintain the status of Moldtranselectro (MTE), an energy sector debt-holding company (holding the bulk of the sector's historic debts), which has no operational role in the sector and no source of income other than historic receivables. In particular, the Government will not merge MTE with Moldelectrica, nor otherwise burden Moldelectrica with sector's historical debts or allow pledging Moldelectrica's assets against debts, as this would only unnecessarily burden the current operation of the sector and complicate its financial situation, without any advantages. Rather, the Government will focus on restructuring MTE's debts through negotiations with debtors and creditors. Any additional resources - on top of the recoverable receivables - should come from additional sources.

63. The Government will complete a diagnostic audit of the historical debts on the books of RED Nord, RED Nord-Vest and Moldtranselectro by May 17, 2002, and will produce an energy debt restructuring plan on the basis of this audit by the first quarter of 2003. The plan would include the complete list of debts and a plan how these debts will be dealt with (written-off, restructured/repaid), specifying the sources and the timing. The Government will also amend by the first quarter of 2003 the Charter of Moldtranselectro with the aim to revise its responsibilities as to ensure proper handling of these debts.

64. By the fourth quarter of 2002, the Government will seek enactment of amendments to the Criminal and the Administrative Codes, and any other laws necessary, to facilitate criminal prosecution for theft of energy (electricity, gas, heat, etc.) in any shape or form (including, inter alia, bypassing or tampering with meters) and energy materials and equipment. Such legislation will strengthen sanctions against energy theft and the enforcement of such sanctions. We are also committed to enforce all measures under our control to ensure full cash and timely payments and collections in the energy sector, as well as to reducing commercial losses. The Government will refrain from interference in commercial operations of energy companies, including their rights to enforce payments through disconnections of non-paying customers.

65. The Government recognizes the critical importance of maintaining a proper regulatory environment for the sector. The Government is committed to maintaining ANRE's professional competence, stability, and integrity, as well as ANRE's independence and authority in setting energy tariffs that reflect the full costs of doing business efficiently, as stipulated by current legislation. The Government will also enable ANRE to have adequate premises and budget, sufficient to enable ANRE to carry out its tasks, including contracting out specific tasks, professional development of ANRE's staff, and competitive salaries.

66. Moldova will maintain electricity trading rules which make distribution companies fully responsible for buying sufficient amounts of electricity to meet demand of their customers. ANRE will authorize opening up the electricity end-user market for competition when economic and technical conditions will warrant such a move and in accordance with privatization contracts with investors, and after the necessary metering and dispatch infrastructure, which currently lacking, is in place.

67. The potentially adverse social effects of cost recovery tariffs and enforcement of payments on the poorest segments of the population will be mitigated by better targeted social benefits. The Government will ensure that the Law on Nominal Compensations is being implemented well and its entitlements remain within available financing resources. This social assistance program is designed to help the needy families pay their energy bills and will further help mitigate social costs of increased financial discipline and cost recovery in the energy sector.

B. 5. Privatization Program: Legal Framework, Telecom, and Wineries

B. 5.1. Legal Framework for Privatization

68. The Government understands that enterprise privatization is a key to improving corporate governance and economic performance. Although changes of Government and political uncertainties have slowed the progress of privatization in recent months, we are now committed to revitalizing the process with a view to privatizing all assets engaged in commercial productive activities within a relatively short time. In July 2001, the Parliament extended the 1999/2000 Privatization Program and approved a list of 482 enterprises, including wine and tobacco industries, for privatization in 2001-2002. At present, the Government is developing an Action Plan with dated targets and proposed method of privatization for all the remaining enterprises of the program.

69. Following earlier privatization, the State holds small residual share-holdings in a large number of enterprises. Enterprise managers often cite this as a problem as state officials,

leveraged by only small state residual ownership, sometimes interfere in the running of the business. To address this issue, by May 17, 2002 we will issue a Decree which specifies initiation, 21 days following assessment of the requisite share ownership data, of the write-off, in accordance with Moldovan law and through a transparent process, of State shareholdings in privatized joint stock companies where such shares represent 10% or less of the total shares outstanding and the book value of state-held equity is USD50,000 equivalent or less. The shares should be distributed as treasury stock.

70. By the fourth quarter of 2002, we will complete an inventory of all remaining state property, including Joint Stock Companies, State-owned enterprises and other assets, and will prepare and approve a privatization program for 2003-2004 based on this inventory.

71. Given the lackluster performance and lack of strategic privatizations over the past two years, we intend to streamline some of our processes in order to improve the quality and speed of privatization. By the fourth quarter of 2002, we will amend the Law on Privatization as to clarify the roles and responsibilities of governmental bodies to ensure that the privatization process is not impeded by the reassignment of the management of state assets from the Privatization Department to line ministries. We will also review our procedures for privatization by auctions and tenders to improve practices. This will both accelerate the process and encourage higher bidding overall for state assets. It will also eliminate the need to repeatedly auction some properties for which there is little prospect of sale, and which can more effectively be disposed of by other means. This will involve simplification and streamlining auctions and tenders: (i) eliminate reserve prices for properties to be auctioned at the third auction, (ii) eliminate barriers to sale at a single English or Dutch auction to the highest bidder, (iii) in tenders, except in special cases as determined by an independent financial advisor transparently selected through an internationally competitive process for each tender, eliminate investment pledges and requirements, and (iv) where the Government is shareholder/creditor, act to initiate liquidation proceedings for properties that have not been sold after three auctions.

72. The Government will also undertake specific measures to eliminate barriers to sale plot divisibility and price rigidity of land associated with enterprises by the first quarter of 2003. We will amend the Law on Normative Prices and Land Tradability and other related laws that are designed to allow divisibility of the land in a case where enterprises are associated with large tracts of land that are not needed and are expensive to purchase. We will also seek methods to reduce the prices of land in an environment where privatized enterprises associated with the land are constrained by liquidity.

B. 5. 2. Telecommunications/ICT Sector Reform

73. The primary objective of the Government's reform program in the telecommunications/ICT (Information and Communication Technology) sector is to ensure the competitive provision of the widest possible range of efficient, reliable and affordable communications services to business and the population in a fairly regulated market. This is to be achieved through continued private participation and investment in the sector, encouraging the competitive provision of services and ensuring credible, fair and transparent regulation in the sector, with appropriate social policies addressed at the most vulnerable groups. The reforms are an integrated, comprehensive package. Successful

reforms in this sector, taken together, are pivotal to the overall economic reform process in Moldova. The contribution that reforms in this sector will play is vital in the creation of a modern business enabling environment (encouraging innovation and investment, creating jobs, retaining skills and reducing transaction costs) making Moldovan enterprises more efficient and making Moldova more competitive globally. In particular, we intend to maximize our comparative advantage in human capacity, especially language skills and technical training, and leverage our position in the region.

74. Moldova has undertaken a variety of key steps in reforming the legal and regulatory aspects of the reform process in the telecom/ICT sector, and we will continue to pursue these reforms. We believe that all of these regulatory actions are both important in their own right and will contribute to a successful privatization transaction. To assist in the reform process, consultants have been engaged to assist with the development of the legal/regulatory framework and provide resident advisory services to ANRTI (the body responsible for regulation of the telecom/ICT sector). Completion of the various regulatory reforms in a timely fashion is necessary as it relates to creating certainty in connection with the privatization of Moldtelecom. A number of key actions are underway or planned in this respect.

75. First, as part of Moldova's accession to the WTO, Moldova has committed to liberalize the market by 2004 and we have submitted a schedule of commitments regarding telecommunications services, including the "Reference Paper". We are in the process of implementing those commitments in our national legal and regulatory framework. In particular, by May 17, 2002, rules and procedures regarding interconnection will be promulgated, and ANRTI's independence will be strengthened.

76. Second, Moldova has already established ANRTI and we are clarifying and consolidating in ANRTI regulatory competencies applicable in the telecom ICT sector to ensure legal/regulatory certainty and the credibility of the regulatory function in the sector.

77. Third, a new Tariff Regulation has been adopted. Also, the fist phase of a cost-based tariff rebalancing plan (to be completed by 2004) for Moldtelecom will be effective in July 2002. This plan will make international calls competitive, and introduce cost-based local and long distance tariffs for residential and business users. It is also expected that the tariff rebalancing plan will increase the value of Moldtelecom and attract information-telecommunications service providers to do business in Moldova.

78. Fourth, the Government is committed to seek enactment of the legal and regulatory framework, including normative acts, to ensure the de-monopolization and competitive provision of VoIP telephony. To this end, we will issue a Government Decree , (i) specifying the necessary amendments to the legal and regulatory framework, including normative acts, required to de-monopolize VoIP and committing the Government to submit by the earliest possible date, as prescribed by Parliamentary and administrative procedures, these amendments to the Parliament; and (ii) specifying measures to be undertaken by the Government and MoldTelecom, effective upon issuance of the decree, for the competitive provision of VoIP (for example through concessions or otherwise) pending enactment of the amending legislation.

79. We are well aware that the "stop and go" efforts to reform and privatize Moldtelecom in the past have damaged Moldova's reputation in the international investment community

generally and have decreased the attractiveness of an investment in Moldtelecom on the international market. We also recognize the contribution of the Moldtelecom privatization to the overall sector reform process, and not as an end it itself. Accordingly, we have hired an investment bank to assist in the process of privatizing Moldtelecom through an open, competitive and transparent international tender for the sale of a majority of shares in Moldtelecom (together with the transfer of management control) on the basis of objective selection and evaluation criteria. We expect to launch the tender for this transaction by mid-2002.

B. 5. 3. Winery Privatization

80. Most of Moldova's wineries have already been privatized, but ten of the most important properties, accounting for nearly one-half of all production by volume and an even higher proportion by value, are still owned by the state. All these wineries have been included in the current privatization program approved by Parliament. We are also considering the privatization of the commercial parts of the National Institute for Vine and Oenology and of the Fruit Institute. We recognize that these positions give us an opportunity to not only more effectively market the winery properties themselves, but to also promote Moldova as a much more significant player in international wine markets. We have thus decided on a strategic approach to the further privatization of this sector.

81. By May 17, 2002 we will conclude an agreement with a qualified financial advisor, under competitive and transparent procedures, for the marketing of the remaining important winery properties to strategic investors. With the assistance of the financial advisor, detailed bidding documents for the sale of winery properties will be prepared. The Government will hold an investors' conference in Moldova for interested and potentially interested strategic investors in the Moldovan wine sector and we will conduct international tenders for the sale of all remaining state shares in the winery sector. By the first quarter of 2003, we will offer for sale through international tender at least 33% of the total book value of the existing state wineries to achieve majority private ownership of a number of wineries.

Vasile Tarlev
Prime Minister

MOLDOVA: THIRD STRUCTURAL ADJUSTMENT CREDIT

MATRIX OF CORE POLICY ACTIONS

NB: All of the measures covered by SACIII are specified in the Letter of Development Policy (LDP). This matrix contains only the "core" conditions. The text herein describes the short-hand versions of these "core" conditions; please refer to the LDP for the full exposition of the "core" measure in question.

OBJECTIVES	ACTIONS			
A. POVERTY ALLEVIATION ***Reduce poverty through growth, improved social service delivery and strengthened social protection.***	**Already Taken**	**Prior to Board Presentation**	**Prior to Second Tranche**	**Prior to Third Tranche**
A. 1. POVERTY ANALYSIS AND EVALUATION				
1. Improve poverty monitoring and analytical capacity in evaluating poverty impacts of government policies	Established a Coordination Council to develop a poverty reduction strategy. Updated Household Budget Survey Questionnaire that improves collection of social services information for monitoring and evaluation.	**Government approval of a 3 year plan to strengthen capacity in poverty monitoring and evaluation which includes:** **(i) assignment of responsibility for collection of** **- Survey data to DOS** **- Program data, including at local level, to appropriate line ministries** **- Budget data, including at local level, to MOF**	**Implementation of poverty monitoring and evaluation program including improvements in questionnaire and update of sample for Household Budget Survey (HBS) and its dissemination to public.**	

		(ii) improving the usefulness **of existing survey data including the HBS through** - **improvements in the questionnaire, particularly in social policy areas,** ***in*** **consultation with key line ministries** - **Revision and update of the sampling frame of the HBS** - **Making the survey data available to the public** ***(iii) Creation of a users*** **group that would include line ministries, DOS, MOF, as well as non-governmental organizations to design and assess poverty relevant sectoral policies**		
A. 2. IMPROVE SOCIAL SERVICE DELIVERY: EDUCATION				
2. Continue reforms to improve the quality of basic education and to improve access at all levels in the education system.	The Government has been implementing a reform program to improve the quality of primary and lower secondary education. A new institutional structure for curriculum revision has been established and the curriculum revised, learning assessment has been improved and new national examinations have been introduced at grades 4 and 9, textbooks for core			**Government to approve an education reform policy strategy to address emerging inequities in the system, including (a) drop out of** ***poor children from basic*** **education (b) higher education selection and financial support mechanisms to ensure access of poor students**

	subjects are being provided for basic education grades and are being financed through a textbook rental scheme, and teachers are receiving in-service training in new curricula, teaching methods, and assessment.			
A. 3. IMPROVE SOCIAL SERVICE DELIVERY: HEALTH CARE				
3. Improve efficiency of the hospital-centric infrastructure to deliver adequate health care and provide continued support to the primary care network.	The Government has established Health Investment Fund to increase investment in primary health care. In response to costly overcapacity, the Government has closed 98 percent of all rural hospitals and over 50 percent of the beds and infrastructure in the district hospitals. The Republican Health-Sports Dispensary has been closed. The Chisinau has closed the Municipal Hospital No. 2. Chisinau has consolidated the municipal narcological institute with the Republican narcological institute.		**Government approval of a time bound Hospital Restructuring Plan for further elimination of excess capacity in Chisinau Municipality Hospital and Republican Hospitals.**	
A. 4. STRENGTHEN SOCIAL PROTECTION: PENSION REFORM				
4. Advance implementation of the pension reform to ensure sustainable and adequate old-age protection.	Under the 1998 pension reform, continued progress has been made in toward rationalizing the pay-as-you-go system, maintaining a strong linkage between individual contributions made and		**Enactment of amendments to the 1998 pension law "On the State Social Security Pension", which includes:** **- Integration of pension**	

	pensions received and by gradually increasing the retirement age according to the agreed schedule. In 2001, pensions were made on time and in cash; the National Pension Fund recorded a small surplus.		**privileges into the general pension law with gradual withdrawal of elements inconsistent with the general pension law** **- Specification of a clear financially viable indexation mechanism with which to determine all future pension increases**	
B. IMPROVEMENT OF THE BUSINESS ENVIRONMENT ***Lay the foundations for investment, enterprise development and restructuring***	**Already Taken**	**Prior to Board Presentation**	**Prior to Second Tranche**	**Prior to Third Tranche**
B. 1. HARDEN BUDGET CONSTRAINTS AND IMPROVE FIDUCIARY MANAGEMENT				
1. Strengthen mechanisms to enhance financial and fiscal discipline and to increase transparency and accountability.	The Ministry of Finance established a Cash Management Unit in the Treasury to improve cash forecasting and operational cash management according to recommendations of the Association. The Ministry of Finance established the single treasury account for the State Budget. The Ministry of Finance consolidated foreign and domestic debt management into a single department, and improved front, middle, and back office functionalities	**Eliminate all public sector financial support for the wine and tobacco sectors by, (i) issuing a Government Decree which stipulates measures for the elimination of all public sector financial support, including investments, loans and credits, and subsidies, related to raw material production, processing and trade in the tobacco and winery sectors, beginning with enactment of the 2003 Budget and thereafter,**	**Full implementation of measures to eliminate all public sector financial support, including investments, loans and credits, and subsidies, related to raw material production, processing and trade in the tobacco and winery sectors, beginning with enactment of the 2003 Budget and thereafter, and/or modification or elimination of any other related existing mechanisms.**	**Government to implement the agreed stages of the CFAA's action plan.**

	according to recommendations of the Association. Eliminated netting operations and achieved 98% cash collection of State venues and 91% cash collection of revenues of State and Local budgets. Social Insurance Budget was brought to 100% cash collections. The National Pension House fully eliminated Social Fund arrears in 2001.	**and/or modification or elimination of any other related existing mechanisms; and (ii) enacting legislative amendments to eliminate earmarking of all tax revenues to the wine and tobacco sectors, including those specified in Art. 18(2) of the Law on Tobacco and Tobacco Products (No. 386-XV) and Art. 22 of the Law on Vineyards and Wine (No. 1166-XIV).** **Enactment of amendments to the Law on the Court of Accounts (CoA), which limits CoA audits to use of public funds.**	**Reorganization of the Ministry of Finance's internal audit system so as to ensure increased independence and capacity.**	
B. 2. REFORM BUSINESS ADMINISTRATIVE FRAMEWORK				
1.Improve the business environment and reduce corruption to generate growth, especially of new entrants and small and medium enterprises.	Moldova joined the WTO in June 2001. Parliamentary passage of the tax administration chapter of the tax law. Reform of the Customs administration to reduce corruption and smuggling, including, (a) introduction of new customs seals, and (b) implementation of a program of rotation of senior customs	**Eliminate double VAT on fixed assets brought in as statutory capital of enterprises.**	**Enactment of a new market oriented Civil Code (to take effect January 1, 2003).**	**Government to complete a second "Cost of Doing Business" survey, and development of a policy program to implement findings; the findings of the survey to be published.**

	officers. Parliament adopted and published the Law on Anti-Money Laundering. Parliamentary passage and publication of Law on Pledges. Parliament adopted a new Law on Licenses which consolidated the licensing authority and reduced the number of license from about 106 to about 55, while leaving authority of licensing for strategic industries - telecommunications, energy and banking - to independent, qualified regulatory agencies. Parliament passed and published a streamlined Law on Insolvency.			**Government to adopt reform of the business inspection system to reduce impediments to business activity through creation of stronger checks and balances and increased transparency, including modification of the enterprise inspection log requirement and establishment of a publicly accessible centralized registry of enterprise inspections.**
B. 3. AGRICULTURE SECTOR REFORM				
1. Complete privatization of State and Collective Farms and facilitate the development of land and credit markets.	560 additional State and Collective Farms have undergone debt restructuring procedures and privatization (including issuance of land titles), bringing the total privatization effort to 1050 out of 1100 farms. Parliament passed a Law on Business Cooperatives which establishes a market-oriented legal framework for cooperatives in agriculture.	**Government to adhere to the Memorandum of Understanding on Agriculture.**	**Government to adhere to the Memorandum of Understanding on Agriculture.**	**Government to adhere to the Memorandum of Understanding on Agriculture.**

2. Improve the legislative basis for private agricultural enterprises.	The Law on Peasant farms was amended to stop large individual farmers from seeking tax avoidance by registering as peasant farms.			
3. Continue liberalization of agricultural policies.	Signing by the Prime Minister and Minister of Agriculture a Memorandum of Understanding which calls for consolidation of a fully liberal agricultural policy framework, including (among other measures): - elimination of all remaining export bans, licenses and controls; - no subsidies outside of the Agricultural Support Fund; - elimination of the practice of setting of reference prices for agricultural commodities; - rationalization of Government procurement procedures of agricultural goods. No agricultural subsidies, directed credits or off-budget programs were extended to the agricultural sector in 2001. All remaining export bans, licenses and controls were eliminated (including timber, walnuts and tobacco). The Government cancelled the			

	practice of issuing reference prices for agricultural products in parallel with the opening up of a Moldovan Commodities Exchange.			
B. 4. ENERGY SECTOR REFORMS				
1. Impose domestic financial discipline, hard budget constraints, and improve the quality of energy services for consumers by continuing to liberalize, restructure and privatize the energy sector.	In response to a severe ice storm in the North of Moldova, the State made only necessary repairs to the system to bring consumers back on line, under the recognition that long-term investments should best be made by a private investor/operator. An investment bank was hired with the Government's own funds to assist with the privatization of the remaining two electricity distribution companies RED Nord and RED Nord-Vest.	**Enactment of amendments, as stipulated in the agreed privatization plan, to the Individual Power Privatization Law, the Energy Sector Debt Restructuring Law, and other laws as necessary to enable successful implementation of the Privatization Plan of the energy sector.**		
2. Maintain appropriate regulatory framework in the energy sector.	In response to increased input costs, ANRE increased energy tariffs to full cost recovery levels.			
3. Restore the energy sector's financial equilibrium and reduce energy-related budgetary arrears.	An internationally recognized audit firm was hired to audit the debts of the energy sector.			

B. 5. PRIVATIZATION PROGRAM: LEGAL FRAMEWORK, TELECOM, AND WINERIES				
1. Streamline and implement a high quality privatization process.	Parliament extended the 1999/2000 Privatization Program through 2003 and included all state-owned wineries and tobacco enterprises in the program. The Government published a list of 482 JSCs and SOEs as Privatization Program for 2001 – 2002.	**Write-off of State share-holdings in privatized enterprises where such shares represent 10% or less of the total shares outstanding and the book value of state-held equity is USD50,000 equivalent or less.**	**Simplify and streamline auctions and tenders: (i) eliminate reserve prices for properties to be auctioned at the third auction, (ii) eliminate barriers to sale at a single English or Dutch auction to the highest bidder, (iii) in tenders, except in special cases, as determined by an independent financial advisor transparently selected through an internationally competitive process for each tender, eliminate investment pledges and requirements, and (iv) where the Government is shareholder/creditor, it will act to initiate liquidation proceedings for properties that have not been sold after three auctions.**	**Amendments to the Law on Normative Prices and Land Tradability designed to eliminate barriers, including plot divisibility and price rigidity, to sale of land associated with enterprises.**
2. Improve the regulatory environment for development of the web economy in Moldova in parallel with implementation of a high quality privatization process for Moldtelecom.	The telecom regulatory agency (ANRTI) is improving its capacity and is developing an EU oriented regulatory framework for information and communications technology (ICT) in Moldova, including toward establishing clear rules of the game for Moldtelecom (MTC) privatization.	**In order to de-monopolize VoIP telephony, issuance of a Government Decree (i) specifying the necessary amendments to the legal and regulatory framework, including normative acts, required to de-monopolize VoIP and committing the Government to submit by the**	**Full implementation of the agreed phases of the tariff re-balancing plan for Moldtelecom.**	

	The Ministry of Communications and Transport (MoCT) developed and published a telecommunications policy paper. A contract has been signed with a financial advisor for privatization of MTC and the advisory services are under implementation. The Government paid retainer for financial services out of its own resources, including for an internationally qualified audit of MTC.	**earliest possible date, as prescribed by Parliamentary and administrative procedures, these amendments to the Parliament; and (ii) specifying measures to be undertaken by the Government and Moldtelecom, effective upon issuance of the decree, for the competitive provision of VoIP (for example through concessions or otherwise) pending enactment of the amending legislation.**		
3. Complete privatization in the wine sector to promote foreign market access for Moldova wine and brandy.	All remaining state-owned wineries have been included in the 2001/2002 Privatization Program approved by Parliament, giving the Government the authority to launch a tender process. Diagnostics as inputs to tender "information to investors" documents have been completed for the majority of state owned wineries.		**Satisfactory progress in the privatization of all remaining state-owned wineries listed in the Privatization Program with the exception of the *Onoteca* of Cricova:** **-With assistance of the financial advisor, hold an investors' conference in Moldova for interested and potentially interested strategic investors.** **-Prepare detailed bidding documents for the sale of winery properties.**	**Government will offer for sale through international tender at least 33% of the total book value of the existing state wineries to achieve majority private ownership of a number of wineries.**

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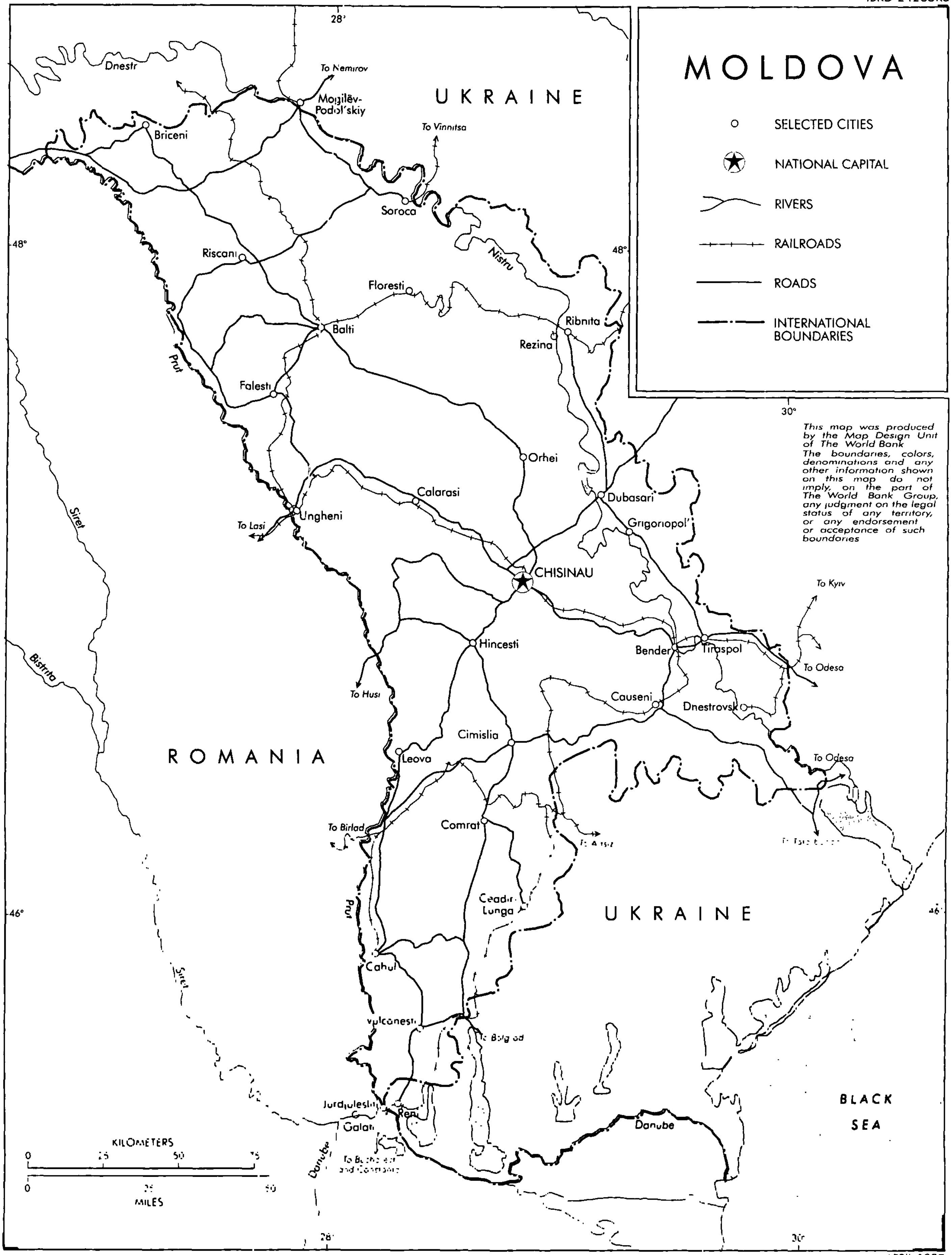

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