

and protection of producers” and leverage to control prices of imported products for avoiding dumping.

CHAPTER 3. ENTERPRISES' SECTOR: STRUCTURAL REFORMS

3.1 Industrial policy and enterprise restructuring

The implementation of a new, market-oriented industrial policy and enterprise sector restructuring is the key for the sustainability of Moldova's economic growth, which has hitherto heavily depended on the development of a highly volatile agricultural sector, the main sector of the national economy. Only the reform of the enterprise sector can in the long term provide the necessary resources for the economic and social security. Delay of enterprise sector reforming is one of the main reasons for budget deficit, inflation and unemployment. This reform is at the heart of the country's transition on its way to Europe and it basically means enabling and fostering an accelerated restructuring of enterprise sector according to its competitive advantages in the market.

The purpose of the industrial policy is to reach a *growth of competitive industrial output in terms of quality and prices and to expand the markets*. Being a small open economy, Moldova should move towards enhancing its industrial products' competitiveness on foreign markets, otherwise the economy has no chances to survive, and subsequently, the country is doomed to vegetating next to more developed countries of the Central and Western Europe.

The industrial policy is part of economic policy of the state. Unfortunately, the Government's *Concept of Industrial Policy of the Republic Moldova for 1996-2000 (Oct. 1996)* has not received due support by the Parliament (in terms of its legal basis and economic mechanisms). Industrial development is therefore proceeding relatively in a relatively unplanned and undirected manner.

The *Program of the Government for 1998-2001* stipulates, that the “strategic target of the industrial policy is to form a multi-sectoral high-tech and competitive industrial complex, which will provide for a sustainable development and economic independence of the country, for sufficient incomes and integration of Moldova into the system of world economic relationships”. The Government considers the *restructuring and further reform of the enterprises* as mostly important process of its period in the office.

Nevertheless by the middle of 1998 the situation in the industry is still serious. The enterprises are facing a lot of problems related to the following factors: high rate of barter transactions, low quality of products, high expenses per production unit, loss of traditional markets, high stocks of final goods, low level of production capacities use, enormous accounts receivable and payable, bank accounts blockage, high level of fixed assets depreciation after their reevaluation, decrease of working places. Currently 40 percent of the processing enterprises are non-profitable. The enterprise restructuring has become a necessary condition for developing Moldovan industry, because the foreign investors rate very high the risk of investing money in the enterprises that haven't been restructured yet.

The analysis has proved that the following additional conditions are necessary to speed-up and to promote successfully the restructuring process:

- to eliminate the barriers and obstacles related to the economic agents registration;
- to implement promptly the new accounting systems;
- to simplify the assets sales procedures;
- to launch new simple procedures of industrial land sales;

- to make rapid investments in entrepreneurial and managerial capacities through the Marshal Plan implementation, to use efficiently the technical assistance;
- to introduce special curricula related to the entrepreneurship in the universities;
- to reduce considerably the control bodies as well as the controls at the enterprises (nowadays there are about 60 bodies that have control functions);
- to make simpler and to solve the problems related to the access to credit resources (collateral, guarantees, sophisticated business plans), as well as to the examination terms for getting credits.

The stabilization of the situation in the Moldovan industry and the development of the restructuring process and financial recovery of the enterprises are not so fast. Several amendments to the existing laws and legal documents that create legal, social, economic and fiscal obstacles haven't been examined and adopted so far.

Legal

- The Civil Code – it is impossible to offer the state property as collateral and to force the execution of contract stipulations.
- The problem of making out a collateral for a credit (as well as of other documents) through the bodies of the Ministry of Justice.
- The delay in the implementation of the legislation on the privatization and sale of the land under the industrial enterprises.
- The delay of local administrative bodies in implementing the Government and Parliament decision on the transfer of social and cultural objects to the local administration.
- The slow privatization of the state property reduces the enterprise possibility to benefit from the World Bank credit lines that are offered to the private enterprises.
- The lack of a proper legal support in implementing management contracts.
- The procedure of motivating managers through buying a certain percent of enterprise shares is not defined clearly.

Fiscal

- The Value Added Tax (VAT) is applied to goods that are sold at a price lower than the production cost.
- The conditions concerning the use of 50 percent of the VAT to cover the restructuring expenses for the enterprises under restructuring are not executed.
- The enterprises are not stimulated to initiate restructuring activities because in 1997 the Parliament abolished the penalties of some enterprise without taking into consideration the results of their activity.

Finance and Accounting

- The assets are evaluated according to non-objective indicators. As a result the enterprise value is over-estimated.
- The production is delivered without payment on the basis of the indications of the respective Ministries. As a result accounts receivable are generated.

Production

- The Regulations on the Dutch Auctions do not allow commercializing the assets of the state enterprises.

Export and Import

- The customs procedures are too complicate.
- There are import duties for some raw materials.

Social

- The compensations in case of the personnel lay off when the enterprise is liquidated according the Government Decision ¹ 712 as of October 23, 1995 are made from the enterprise resources, not from the Social Fund.
- The unique subventions for the personnel who are laid off (equal to 5 medium salaries) from the resources of the Social Fund and from other sources are paid without any taxes.
- The losses generated by offering non-justified facilities to some representative of social groups are reduced.

In a series of branches (machine-building, light and construction materials construction industries), Moldova inherited from planned economy big large scale enterprises, that do not comply to market economy requirements. Small and middle enterprises are created basically in agricultural, trade and service sectors, whereas in industrial sector this process has not reached yet a proper level of development. For instance in Italy, Germany, France, Great Britain and USA, the enterprises with more than 100 employees absorb about 58% of the manpower of those countries and generate 50-62% of GDP; for Moldova these indicators respectively account for 12 and 15%.

At first stage of restructuring process is based on the principle of large enterprise break-up (by selling some idling assets, by dividing into viable units, which also do not affect the technologic process ("break-ups", "spin-offs"), leasing out and offering on tenancy of industrial sites to private sector, with a view to set up small and middle enterprises (SMEs) and generate new jobs.

In the beginning of 1998, the Government approved the State Program of Small Business Support for 1998-2000, yet it still remains subject to ratification by the Parliament. Also, the expenditures required for small business support are not stipulated in the current budget. Business start-up, operation and liquidation are still discouraged by numerous bureaucratic hindrances and endless directives regulating business activity and often stimulating corruption.

The need to develop small and middle enterprises is determined by a series of advantages: receptivity to constantly changing market requirements, declining production costs, enhancement of management effectiveness, possibility to use for technical reequipment of enterprises relatively low volumes of cash, broadening possibilities to attract foreign investments.

The broadening of small and middle enterprise sector will set up an environment for a competitive market, avoiding monopolistic pricing, whereas the employees of these enterprises create a new social group – the middle class – and to a great extent contribute to social stability in the society.

The initial experience of large enterprise division was accumulated on the basis of joint-stock company "Mashfrigocomplect" (Străeni) and joint-stock company "Alfa" (Chişinău). 25 private enterprises have been created on the basis of joint-stock company "Mashfrigocomplect"; the joint-stock company "Alfa" was the first major manufacturer to which the Law on Bankruptcy was applied, on the basis of which 34 private enterprises have started operations. The "Alfa" joint-stock company will be receiving from these activities about 2.5 million lei annually.

A new and innovative form of small and medium-size business development is industrial technological park. In February 1998, the Parliament enacted legislation on the creation of three free enterprise zones - techno-parks "Vulcăneşti", "Taraclia" and "Otaci-Business", formed on the basis of the loss-making enterprises and their infrastructures.

The Agency for Restructuring and Enterprise Assistance (ARIA) has been created to support Government efforts in accelerating the program of structural changes in industrial and

financial sectors. The Agency has been involved at the implementation of the following enterprise restructuring projects: *Pilot Project*, *Private Sector Development Project (PSD-I)*, and *Assistance to the Enterprise Isolation Project*.

At the beginning of 1998 enterprises of the *Pilot Project* (Stejaur, Spectrul, Farmaco, Nistru, Flamingo, MFC, Zorile, Piele, Moldagrotehnica, Tricon, Incoma°, Bălăneanca) have achieved the following performance.

The above enterprises are acting in the third year of restructuring. Positive restructuring results have been achieved at 9 enterprises and at newly created small companies of the MFC Industrial Park from Străeni. There is an improvement of all economic and financial indicators: growth in output and sales were registered at 9 enterprises (in average by 16% and 30% consecutively). Barter transactions have been reduced (by 9%), export has increased, and labor productivity went up by 30%. 8 of the total number of enterprises managed to significantly decrease costs and energy consumption; stocks reduced at 7 enterprises (by 16-38%). Enterprises are collecting outstanding accounts receivable, are selling unused assets and fulfilling current obligations.

There has been achieved positive results and sales increase at 9 enterprises (except “Spectrul” and “Nistru”, Sorocea, which was proposed to liquidation) from the total number of enterprises of the Pilot Project: output volume increased at 8 enterprises, and as a result turnover indicators are better at the following enterprises: Zorile - by 17%, Piele - by 35%, Moldagrotehnica - by 49%, Incoma° - by 14%, Farmaco - by 30%, Flamingo – by 112%, Tricon – by 17%.

Accounts receivables have been reduced by 1.2 million lei at 8 enterprises as a result of measures for their collection. The majority of enterprises managed to reduce Accounts payable (approximately 16 million lei in total). As a result of fixed assets optimization programs in 1997 9 enterprises sold over 9 million lei of unused assets, and generated cash for debt repayment and working capital.

There are 15 more enterprises restructured by ARIA under *PSD-I Project*, out of which 10 are at a stage of the restructuring plan implementation. At “Alfa-Nistru” S.A. and “Ionel” S.A. the implementation of Management Information System (MIS) is finalized. “Alfa” is reorganized in Industrial Park. Economic Court has initiated a bankruptcy through liquidation procedure against “Chi°inâu Glass Factory” S.A., “Speranța” S.A., from Dondu°eni is also liquidated according to the Law on Bankruptcy. 39 new entities and 59 lease companies have been established at the above mentioned enterprises.

The analysis has been carried out by grouping the enterprises into 3 categories: *1st group* (Ionel, Alfa-Nistru, Conserve-Orhei, Dana, Intreprinderea de colectare (Donduseni), Centrul de moda) – enterprises with substantial results; *2nd group* (Faprochim, ICAM, Elcas, Donduseni-Zahar, Prut-Falesti) – enterprises meeting some difficulties in the restructuring process; *3rd group* (Alfa, Covoare-Ungheni, Chi°inâu Glass Factory, Speranța-Dondu°eni) – enterprises reorganized according to the Law on Bankruptcy.

Economic activity of the enterprises and results of the implementation of the restructuring programs after the first quarter of 1998 showed some good performance.

Growth in output and sales has been observed at the majority of enterprises: for the enterprises from the *1st group* – sales increased by 21%, *2nd group* – by 1% and *3rd group* – a reduction by 75%. Output at the enterprises from the *1st group* has increase in average by 32%. Turnover increased significantly at “Dana” S.A. (2 times), “Ionel” S.A. (by 29%), “Orhei Cannery” S.A. (by 18%), “Alfa-Nistru” S.A. (by 15%).

At the enterprises, which are registering success – new working places are being created – the number of employees increased by 7%, which means 245 new working places (at the enterprises from the *1st group*). At the same time there was registered lay-off of about 442 persons at the enterprises that are meeting problems or liquidated.

Labor productivity at the enterprises from the group 1 increased in average by 42% and from the group 2 by 8%. This indicator improved significantly at 9 enterprises: “Ionel” S.A. and

Centrul de Modă - by 2 times, at "Elcas" S.A. - by 1.5 times, "Alfa-Nistru" - 1.4 times. At 90% of the restructured companies average salaries went up. The most substantial results in this field were achieved by "Ionel" S.A. - from 183 lei to 662 lei, "Conserve Orhei" S.A. - from 182 lei to 597 lei.

Half of the restructured companies are accurately fulfilling current payment obligations and the enterprises from the 1st and some from the 2nd group - repayment of old debt to the creditors. Short term debt significantly decreased by 35 million lei in total, or by 11%, including 2% for the 1st group and 18% for the 2nd. Companies classified in the 1st group are registering profit, which is substantially higher than for the previous period: operational profit accounts over 12 million lei, which mean an increase of more than 7.7 times. Net profit registers an increase of 2.6 times compared to the results of the previous year.

8 enterprises sold during first quarter of 1998 non-utilized assets amounting to 714 thousand lei - during the previous period this indicator was 916 thousand lei. Stocks have been reduced in average by 4%: at "Conserve-Orhei" - by 4.7 million lei, "Elcas" S.A. - by 4.1 million lei, "Donduseni-zahăr" S.A. - by 4.6 million lei, "Prut-Fălești" S.A. - by 0.9 million lei.

The Project Assistance to the Enterprise Isolation Project (financed by TACIS) at 5 enterprises: Macon, Moldcarton, Faconis, Incomlac, Agroma^oina was launched on October 25, 1997. At each of these enterprises around 20 restructuring programs have been implemented. Three companies registered success during the implementation: Macon, Moldcarton and Incomlac. Turnover at Moldcarton has increased by 58%, at Macon - by 15%. Incomlac has implemented a new system of cost management and an advanced network for raw material collection.

With the purpose to improve the efficiency of enterprise management and especially their capability to adjust to demand developments on the domestic and foreign markets, a Competitiveness and Productivity Center has been created, within the framework of the *PSD-II Project*. During the time of project preparation, 22 managers had 2 to 4-month training in UK and Slovenia. Training of another 300-400 Moldovan managers is in the process of being organized.

State support for enterprise restructuring is carried out through the memoranda of the Creditors Board. Since May of 1995, the Board has developed a procedure of isolation for implementation of the restructuring plans, with the deferral of debts, for 132 economic entities. By April 1, 1998, memoranda have been signed with 96 enterprises (about half of them - industrial), debts worth of 669.7 million lei deferred. This makes more than 30% of the total debt of all enterprises and organizations to the budget and extra-budgetary funds.

One of the most baffling problems for enterprises are their long-standing debts. Their accumulation was largely determined by inflation in 1991-1992 and errors in the state management policy. Existing legislation now provides for the write-off of such debts, provided the debtors effect current payments to the budget and Social Fund in a timely fashion.

Financial standing of the majority of the enterprises operating under the terms of the memoranda has improved: the volume of sold production for cash rose and accounted for 52% of the sales volume; more than 62% of profits (131.4 million) have been allocated to development of production; idling assets have been sold in amount of 185.3 million lei, more than 50% of this amount was channeled to complementing the working capital, 49% of the frozen arrears has been paid already to creditors. With a view to release the enterprises from functions not characteristic to them and speeding up the pay-off of their arrears, the Creditors Board approved transition of 88 social-cultural objects, valued at lei 60.5m, to the balance-sheet of the local authorities.

However, a number of enterprises have failed to comply with the terms of these agreements and, since the beginning of 1998, the number of the enterprises under the memoranda decreased to 26 units.

A tremendous qualitative change in Government's approaches to industrial problems - unfeasible, loss-making and debt-accumulating enterprises should undergo through the

procedure of bankruptcy. For the first five months of 1998, the Law on Bankruptcy has already affected some 40 enterprises. However, the shortcomings of this piece of legislation serve as obstacles in restructuring of enterprises: there is no precise definition of the competence and responsibilities of each of the parties involved (e.g. government and ministry); there is no precise regulation and mechanism of relationships between the Creditors Board, the manager and the proprietor-debtor; nothing is said about deliberate bankruptcy and responsibility of the manager in such an event; there is a number of discrepancies between different articles of the Law and some articles stand in contradiction to other legislation. Unrealistically high demands to and responsibilities of the manager and low stimuli in his/her work, the impossibility of sale of buildings and structures without privatization of the land they are located on - all this also interferes with implementation of bankruptcy procedures. Improvement of the mechanism of bankruptcy processing in the shortest possible terms is at this time a key task of the Government and Parliament.

The problem of corporate management remains a serious impediment on the way of successful industrial development. After privatization for Patrimonial Bonds, there is a huge number of shareholders, but not real proprietors. A significant share of privatized property is owned by privatization/investment funds (PIFs), of which at least one third 'lives off' the enterprises.

The Government should support the tendencies toward the concentration of capital. A positive example - PIFs "Agrofond" and "Dividend" together with the enterprises in which they have shares, have created an association of mutual crediting in charge of capital investment.

There is a tendency, on the part of some managers, to keep the 'outside' shareholders outside of running the enterprise. The mechanism of protection of the proprietors' rights remains to be underelaborated, which results in losses in some enterprises. The cases of withdrawing of outsiders' resources from the enterprise to other firms to the detriment of other shareholders and PIFs are at the same time observed. It is necessary to create a system of effective legal protection of the shareholders against actions of the managers that are damaging to the enterprise and the shareholders.

For the nearest future, the main problems in the industrial sector remain to be: increasing of competitiveness and productivity, export promotion, introduction of advanced technologies, and management training.

3.2 Energy sector: restructuring and preparation for privatization

One of the strategic targets of the national economy is to diminish the power-consumption within GNP and improve the energy balance. Starting from 1997, in the Republic of Moldova a complex of measures is implemented aimed at restructuring the energy sector, including:

1. Approving the Restructuring Plan of the energy sector (Government Decision no. 628 from 08.07.1997). The principles of reorganization of the State Company "Moldenergo", objectives, stages and privatization methods of these subdivisions were determined. Elaboration and approving the Regulation of the National Agency for Energy Regulation- ANRE (Governmental Decision no. 767 from 11.08.1997);

2. Approving the Concept of Privatization of the enterprises from the energy sector (Governmental Decision no. 260 from 09.03.1998). The objectives, principles and mechanisms of privatization of 8 energy companies, activities related to their preparation for privatization (methods of patrimony evaluation, preparation of documents for the tender, evaluation and negotiation of the offers).

Approving the regulation of the private companies for collection of accounts receivable of the energy sector (Decision of the Government no. 309 from 19.03.1998) and of quick

measures for paying of debts of budget institutions to the energy enterprises (Decision of the Government no. 1110 from 01.12.1997);

3. Approving the plan of restructuring of debts of energy sector (Decision of the Government no. 547 from 12.06.1997). Mechanism and concrete measures were determined: mutual payments, covering the costs and a part of historical debts based on tariffs' increase, conversion of the expired short-term obligations into long-term debts, decreasing the level of barter transactions, creation of private companies for collection of the debts;

4. Increasing the tariffs for electric, thermal energy and natural gases in order to cover the costs (Government Decisions no. 231 from 05.03.1997, no. 512 from 05.06.1997, ANRE project from 17.04.1998 which was temporary suspended with the Governmental disposition until determination of social protection measures);

5. Creation on the basis of State Company "Moldenergo" of 14 Joint-Stock Companies and of the State Company "Moldtranselectro" (Decision of the Government no. 1059 from 13.11.1997). The result is the improvement in operation of the energy companies, in energy supply and collections of payments for the consumed energy. In 1997 the ratio of collection of payments for the energy consumption overlapped 100%. At the same time accounts receivable decreased with 29% which is 34 million lei (this tendency is not confirmed in 1998);

6. Approving additional measures for monitoring the debts and improving the financial situation of the companies from the energy sector (Decision of the Government no. 325 from 20.03.1998). The terms and conditions of rescheduling the debts, disconnection of the non-payers, stimulation of the managers in order to improve the collections and reduction of the barter operations were established. Approving the mechanisms for monitoring the preparation of the companies for privatization – Governmental Committee (Decision of the Government no. 207 from 27.02.1998) and control on restructuring the debts of the sector – State Committee for supervising the fulfillment of stipulations of Governmental Decision no. 547 from 12.06.1997);

7. Delimitation of the functions and responsibilities of different State bodies and consulting companies (ARIA, Abt Associates and Hagler Bailly) of terms of implementation of privatization project at enterprises from energy sector (Agreement of Co-operation from 02.02.1998). Open public sessions concerning issuing the licenses to the energy companies. There were already issued licenses to 12 companies (3 production companies, 5 distribution companies and 4 independent suppliers).

The above-mentioned activities laid the beginning of the promotion of the restructuring project of the sector, creating legal basis, informational and regulation framework, necessary economic and financial mechanisms. At the same time uncertainty and inconvenience of activities of institutions from public administration, controversial approaches in the stringent problems made, in many aspects, more difficult the process of improving the situation of these enterprises, of their restructuring in the pre-privatization phase.

Economical and the financial situation of enterprises from energy sector. In the financial restructuring the energy sector in May 1998 a detailed diagnostic analysis of the economic and financial situation of 8 enterprises from this sector was done (ARIA). The main objectives of this study were:

Determination in details of the financial and economic status of each enterprise, including accounts receivable and accounts payable (as of January 1, 1998 and April 1, 1998), the structure and trends of these debts and elaboration of a plan for their monitoring;

Detailed examination of the deliveries and collections in the energetic enterprises, including the trends of the barter operations;

Examination of losses, including commercial losses and non-payments, and elaboration of some concrete measures to diminish these losses;

Analysis of company's costs and their trends;

Determination and analysis of the main performance indicators of the company.

The main problems the energy companies are facing at the moment are: drastic decrease of the collections, high commercial losses (energy stealing), inappropriate distribution of the historical debts, high share of barter transactions, non-payments permanently increasing. The financial and economic analysis of the companies included in the project of restructuring of the energetic sector revealed the following.

The situation as of the beginning of 1998 can be described with the increase of the sales volumes (exception – CET 2), accounts payable dramatically increased (+29%), increase of the accounts receivable (+46%) due to a low percentage of payments for the supplied electricity (*see Table 3.2.1*).

The accounts payable of the companies for the first quarter of 1998 also have increased. Some companies have accounts payable 3-5 times higher than accounts receivable and the difference is enlarging (RED Nord, RED Centru, RED Sud). This tendency is alertness and if the increasing difference is not stopped it can put in danger the entire privatization process.

One of the biggest problems of the newly founded Joint Stock Companies is that after the State Company “Moldenergo” suspended its activity all the accounts payable, which occurred as a result of activity in the previous periods were transferred to the balance of the energetic companies (1028 thousand lei at 01.01.1998). Such a burden does not permit to the Joint Stock Companies to become self-sustained.

The companies do not have the possibility to payback these huge historical debts which are to be reallocated before privatization (currently ARIA together with Abt Associates and Energy Department are working on the project of the corresponding Governmental Decision). Because of negative profitability, companies generate additional losses from their operational activity (*see Table 3.2.2*). The main reason of these losses is that the costs for 1 kWh of delivered/recorded energy (delivered energy minus technical and commercial losses and non-payments) are bigger than the tariff.

The general situation at CETs (Thermal-Power Stations) is critical too. It is influenced by the non-payments during the heating period of 1997-1998. At the same time preparation for the heating season of 1998-1999 need big financial resources (CET-I - 40 million lei. CET-2 - 70 million lei and CET Nord - 40 million lei).

Table 3.2.2 Performance indicators of the energy companies, April 1998

Indicator	RED Chi'inău	RED Centru	RED Nord	RED Nord Vest	RED Sud	CET 1	CET 2	CET Nord
Net profit/Loss, Mil lei	1.4	- 21.0	- 22.5	- 13.7	- 18.2	- 9.4	- 9.7	- 12.7
Profitability of Sales, %	0.35	-65.0	- 25.0	- 60.0	- 91	- 24.1	-7.0	- 72.0
Cost of 1 kWh delivered/recorded, bani	23.1	36.3	33.3	35.3	38.7	7.2	9.97	11.2
Tariff for 1 kWh, Bani	24.0	24.0	24.0	24.0	24.0	10.3	13.37	12.6
Costs for 1 leu recorded energy, lei	1.01	1.76	1.25	1.68	1.93	1.24	1.07	1.88
Total Losses, (% from kWh)	14.6	43.8	41.0	40.7	46.8	-	-	-
Commercial losses and non-payers, %	2.9	31.8	29.0	29.7	29.8	-	-	-
Tariff for 1 Gcal, lei	-	-	-	-	-	51.0	51.0	51.0
Costs of 1 Gcal, lei	-	-	-	-	-	72.0	78.8	93.8

Lack of financial resources (due to a very low level of collected payments for rendered services) does not allow to make the normative reparation and to purchase the fuel necessary for the following autumn-winter season.

Basic measures that have to be undertaken in order to decrease the accounts payable:

- collecting in time of the bills for the delivered energy and disconnection of all non-payers starting with June this year;
- minimization of the volume of commercial losses (energy stealing) which influence the costs and cannot be covered by the tariff. In order to solve this problem huge investments are needed. They cannot be generated by the distribution companies;
- application of a common tariff for the electric power for all categories of consumers, in parallel with elimination of privileges and compensations to privileged categories of customers (see Chart 6). Subventions must be nominative – paid directly from the budget to the customers and not through energy companies, like it is done today;
- adjusting the tariff for the thermal energy. The analysis shows that the production cost is 20-25% higher than the existent tariff. This fact causes considerable losses in production of thermal energy, characteristic for the thermal-power stations from the republic. This situation is also influenced by the non-payment of the customers – mediators of thermal energy (ex: RAPDET in case of CET-1 and CET-2). It is proposed that ANRE during one month is adjusting the tariff for the thermal energy in order to cover the expenses generated by the production of this energy. This study was done by ANRE on April 17, 1998 and presented to the Government, which approved a set of measures of social insurance until June 20, 1998.

There are measures proposed to reduce the commercial losses (ex: changing of meters and cables) the effect of which could be the reduction of these losses, but these measures need considerable capital investments. The same situation is with the technical losses, a big part of which appears because the equipment is not used at its nominal capacity. It is proposed to include the investment plans of the distribution companies in the tender documents.

Basic measures related to the decrease of accounts receivable. During the activity of newly created Joint Stock Companies in the period of the first quarter of 1998 the accounts receivable were in a permanent increase. Reasons of this tendency are: insolvency of economic entities, as well as of the individuals, which leads to inability of the above-mentioned to honor their current obligations; collecting the payments for the delivered energy worsened; in spite of the fact that the number of the disconnected consumers increases, rescheduling of the accounts receivable, even in the case of some small amounts leads to postponing the payments for the rescheduled debts, as well as for the current obligations; nowadays the mechanism of collecting the debts using the private companies is used partially (at RED Nord Vest such a company collected 98% with a commission of 4%).

In order to change the current situation the following have to be undertaken:

- disconnecting of 100% of clients which does not pay their bills starting with June this year;
- unconditioned disconnection of the customers which concluded memorandum – agreements for rescheduling the debts to the energy companies, but do not pay the rescheduled or current sums;
- involving in collection of the accounts receivable of the private companies applying the method of pre-established payments for an established quote and extra payments for the additional collections (in accordance with the Governmental Decision no. 309 from March 19, 1998);
- initiating the bankruptcy procedure for the insolvent customers.

The general trend of the barter operations is in decrease. For instance at RED Centru the share of barter transactions went down from 71% in January to 57% in April, 1998. Average for all 8 enterprises is the following: 65.8% in I quarter of 1998 compared to 80.9% in IV quarter of 1997.

Internal measures. In order to change the economic and financial situation in energy enterprises the following additional measures are proposed:

- enforcing contracts relationships between suppliers and consumers;
- implementation of new organizational structures and of new job descriptions for the employees, elaboration of motivation schemes for the company's employees;
- selling of the unused assets;
- elaboration of the schedules for reduction of barter operations up to the full elimination; elaboration and implementation of the programs for the reduction of losses;
- training of the company's staff in new techniques for operation in the new economic environment.

Based on the suggested measures, ARIA is finalizing the restructuring plans (until June 1998), that have to be submitted for approval to the Council of Creditors.

Measures in competence of Parliament, Government, concerned Ministries and Departments. A set on measures related to amendments and additions to the legislative

framework of financial restructuring and privatization of the enterprises from the energy sector should be promoted until August 1998. The mechanisms for the implementation of these measures approved by the Government Resolutions should be adjusted to the new realities. At the same time a set of activities related to the elaboration of the Informational Memorandum for investors, tender documents, conference with the potential investors with announcement of pre-selection, as well as the modalities of creating and operation of new mechanisms for re-distribution and monitoring of the debts have to be examined.

In accordance with this purpose the following is proposed:

a) The Parliament has to adopt the following legislative acts:

Law about electric energy (in second reading);

Law about natural Gases (in second reading);

Decision about the Privatization Concept of the enterprises from the energy sector (was approved by the Government by Decision no. 260 from March 9, 1998);

Decision about the reallocation of the historical accounts payable transferred from the balance of the newly created energy companies to an institution founded under the Ministry of Finance;

Decision about the Individual Privatization Plan for enterprises from the energy sector.

b) The Government adopts the following decisions:

About modifications of Legislative Acts and Presidential Decrees which granted privileges to some groups of consumers (there were amendments included in this project and it was passed to the Government for examination in January 1998);

About modification of Governmental decisions related to establishment of strong financial discipline in budget institutions and State companies debtors of the energy companies (Decision no. 325 from March 20, 1998);

About approval of the statutes for the State Enterprise Moldtranselectro ;

About making official the statutes of the National Agency for Regulation in Energy Sector (ANRE) as an independent institution, as it is stipulated in the project of the Law concerning the electric energy (this decision could help ANRE to carry out its obligations in accordance with its Statutes and without additional coordination.

c) Examination by the Governmental Committee for Supervising the Privatization Process of the companies from the energy sector (Decision of the Government no. 207 from February 24, 1998) of the following documents:

Strategy and modality of privatization of the enterprises from the energy sector;

Mechanisms for consolidation of the financial discipline and responsibilities of decision makers in the implementation of the plans for debts monitoring;

Concerning reallocation of the historical accounts payable from the balance of the newly created enterprises from the energy sector to a new founded institution under the Ministry of Finance;

Informational Memorandum, tender documentation and the agenda of the investment conference.

3.3 Land reform and farm restructuring

Transition adjustments and tendencies

Moldova's specialization in agricultural production has been determined by favorable weather conditions and above average fertility of agricultural land (75% of all soils are chernozioms). Agriculture is indeed the backbone of Moldovan economy, as it holds a 38% share in GDP, provides employment to over 42% of active labor force, and accounts for nearly three quarters of total exports of the country. Taking also into account the size of agricultural area (75% of total) and the high proportion of rural population, there is no doubt that successful land reform along with a correctly determined and clearly defined agricultural policy would lead to the well-being of the population and the overall improvement of the economic performance of the country.

Since the transition the main *macro tendencies* observed within the agricultural sector can be summarized as follows:

- Reduction in production and yields;
- Change in the structure of product mix, as the share of crop production continuously increases since 1990;
- Increase of areas under labor intensive crops with guaranteed markets and low production costs, and decrease of areas under resource intensive crops;
- Movement of production from collective to individual farming;
- Fall in consumption of main food products followed by the problem of production surpluses;
- Clear breakdown in former collection and distribution network and persisting difficulties in establishing new marketing channels for farm inputs and outputs;
- Low (often negative) profitability of large farm enterprises, low tax compliance and highly exaggerated and ineffective state subsidies granted to large scale farms;
- Insufficient access to credits, as well as extension services for small private units;
- No investment in rural social services and extremely low standard of living of rural population;
- Fall in capacity use of processing enterprises;
- Inadequate price structure when production costs exceed producer prices;
- Fall in agricultural export volumes and increased flow of imported food products.

The overall decline was mainly caused by the financial crisis within the agricultural sector, which provoked a sharp drop in the output of large farm enterprises. Thus, between 1990 and 1996 the land in corporate sector declined by 25%, while its gross product dropped by 65%.

The lack of financial resources has made the agricultural enterprises to apply simplified technologies of production and, as a result, their productivity decreased by 30-40%, the soil fertility has reduced: in 1996 chemical fertilizer use has declined 17 times (as compared to top-year 1985), while potassium and phosphorous based fertilizers are almost not used due to high

cost and lack of availability. However, according to European standards, the country disposes of a strong potential for growth in agriculture.

Meanwhile, starting with 1996 the individual sector, holding a 18% share of land area, produces more than half of total agricultural output.

Changes in Land and Asset Ownership

The first task of agricultural reform, which is the *elimination of state monopoly on ownership of land*, had been given a start in 1992 and developed slowly and uncertainly until early 1996, when most of bureaucratic and technical constraints have been removed from the legislation. Now many fundamental changes are taking place in the sector organization, including, first of all, the distribution of land titles ("land shares"), and, in parallel, physical allocation of land plots to individuals and families who exit from the large farms. Thus, by April 1998, 95% of entitled individuals have already received provisional ownership certificates, and 71% of people who applied were allocated land in private ownership. An important issue in this context is that only 27% of entitled individuals have actually applied for physical allocation of land plots (278 thousand out of 1 million beneficiaries)¹. Although the privatization rate² strongly differs across districts, one fact is certain: it steadily rises over time.

Privatization Rate by Zone (%): 1996-1998

	<i>October 1996</i>	<i>October 1997</i>	<i>January 1998</i>	<i>April 1998</i>
North	3.2	7.5	8.4	10.1
Center	24.8	30.0	30.5	33.6
South	4.9	8.9	10.8	12.2
National average	11.2	16.1	17.0	19.2

Source: Department of Department of Statistical and Sociological Analysis

According to cadastral land balance as of January 1, 1998, individual sector in Moldova manages about 21% of agricultural land, and the rest is controlled by various large-scale structures, most of which are not yet restructured. However, the increase of peasant farms' share is quite essential (7.8%,) as compared to the one in 1994 -0.7%.

In addition to that it is necessary to mention of the development of a range of other ownership relations:

- The state holds ownership of 17% of agricultural land (435 thousand ha out of total 2.6 million ha), of which 358 thousand ha is in a reserve fund for future needs (in fact, leased to various producers), and only 77 thousand ha is permanently allocated to state agricultural enterprises.

- Of 2.2 million ha in private ownership (82% of agricultural land), individuals cultivate about 500 thousand ha (or 20%), which includes land in household plots and in independent peasant farms.

- The remaining 61% of agricultural land is managed by large-scale farm enterprises, some of which are still registered as traditional collective farms (387 thousand ha), while others are organized in various new forms, which represent join-stock structures based on collective farming: joint stock companies, agricultural cooperatives, limited liability companies, etc.

Land Tenure 1990-1997 (percent of agricultural land)

¹ This share is, however, higher than the one registered a year ago – 20% or 205 thousand applicants in April 1997.

² *Privatization rate* is the ratio of the number of individuals who received a physical plot to the total number of individuals entitled to land shares in the district.

	1990	1991	1992	1993	1994	1995	1996	1997
State sector	32.3	26.7	25.2	31.2	30.1	16.7	17.3	17.7
State farms	27.0	23.4	20.4	14.6	12.8	0.1	1.0	1.0
Reserve fund	0.0	0.0	0.1	12.7	13.3	13.4	13.6	14.0
Corporate forms	59.4	63.0	63.0	56.2	56.8	67.9	64.8	61.4
Collectives	59.4	63.0	58.8	49.2	45.2	39.3	23.1	15.2
New corporate forms	0.0	0.0	4.2	6.2	8.9	27.6	38.9	43.0
Farmers associations	--	--	--	0.8	2.7	1.0	2.8	3.2
Individual sector	8.3	10.3	11.7	12.6	13.2	15.3	18.0	20.9
Peasant farms	--	--	0.0	0.3	0.7	2.4	4.8	7.8
Household plots	8.3	10.3	11.7	12.3	12.5	12.9	13.2	13.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: *Cadastral land balances* (end of year data)

The state farms have practically disappeared, as almost all of them transformed into collectives and received their land in ownership from the state, and in turn many collectives registered in new organizational forms. Thus, in 1997 state farms have controlled nearly 1% of agricultural land, collectives controlled 15% and the new corporate farms controlled 46% of the agricultural overall land.

The high fragmentation of land plots is an important structural change that occurred along with the process of division of land into small family farms, which are further subdivided into individual plots growing different crops. This phenomenon can have a negative impact on certain types of arable crop production, and besides, it leads to increased costs and inefficient mechanization, especially in the conditions of Moldova where small-scale machinery available for purchase is very limited. Encouraging consolidation of individual land plots in bigger areas under one crop would be welcomed and this can be done through land leasing and land market development.

The privatization of non-land assets takes place at a slower pace as compared to that of land assets. As of April 1, 1998, 53% of individuals entitled to property shares in large-scale farms, which are active and former rural workers, as well as pensioners, have received a certificate of ownership and about two thirds of these certificates have been registered by local authorities. The value of privatized assets accounts for 64% of the total assets earmarked for privatization. Up to now the distribution has the form of paper certificates and does not yet involve division of physical assets. The average value of an asset share in Moldova (after the 1996 revaluation of assets) is 5,300 lei, that by no means represents the real market value of assets, most of which are old, worn out and not of much use for production.

An important component of the asset privatization program is the transfer of responsibility for social assets and services to local authorities, which enables the large farms to concentrate on productive business-oriented activities. This process has not progressed quickly until now: only 19% of social assets have been transferred to local authorities as of April 1, 1998. However, when comparing all current data to those of last year, a slow but steady progress of the asset privatization process is clearly observed.

Farm Restructuring and Private Farm Development

There are around 1,000 large-scale farms in Moldova today, a number practically similar to that of collective and state farms prior to reform. Based on the number of members and the average land share in Moldova (1.5-2.0 ha), the land holdings of some new organizational forms, such as agricultural cooperatives and joint stock companies, can be estimated at 1,500-2,000 ha. Thus it seems that traditional forms reorganize into new ones without significant downsizing and fragmentation with a main difference that the new structures guarantee the right of their members to exit with land and assets.

Farmers associations and limited liability companies appear to be much smaller, with 100-200 members on average and apparently constitute a truly new intermediate form between the

traditional large-scale farms and small peasant farms. However, only 124 farmers associations, out of 244, are actually created by peasant farms and they combine about 13 thousand members, or 20% of the total number of registered private farms. The rest are, probably, traditional large-scale farm that did not go beyond "changing the sign on the door".

The privatized assets valued at over 3.5 billion lei have been transferred to the new organizational forms, representing over 1000 large scale structures and nearly 200,000 individual land holders, that have created independent farming units (not necessarily registered as private farms). The transfer of assets to large-scale organizations is almost completed: they have received on average 90% of assets represented by the entitlement shares of their members. The individual farmers, on the other hand, have received less than 70% of their asset entitlement from the parent farms.

Out of a total number of 198 thousand owners of land plots as of April 1, 1998, only 96 thousand have used them to create over 68 thousand private farms. Concomitantly, the number of individuals with no intention to register their farms continuously rises, which confirms the tendency of rural population to lease land while holding the ownership title. So, the rest 100 thousand people are involved in subsistence farming or have leased out their land plots to the leaders of larger farms, commercial firms, etc.

Land Holdings of Private Farms

	Jan. 97	April 1997	April 1998
Individuals who applied to receive land shares in physical form	168,178	204,771	277,970
Individuals allocated land in private ownership including	117,002	131,891	198,047
Individuals who did not register their land plots	42,982	61,747	102,095
Number of registered peasant farms	41,229	51,488	68,485

Source: Department of Statistical and Sociological Analysis

The Moldovan Government announced at a meeting for farm managers and mayors on March 14, 1998, that the Land Project is the National Program for privatization and reorganization of agricultural enterprises in the Republic of Moldova. The Ministry of Privatization and State Property Administration of the Republic of Moldova has been working with two contractors of the United States Agency for International Development, Booz-Allen & Hamilton and Center for Private Business Reform (CPBR) on completing this task.

The program is an extension of the pilot project that began in Nisporeni with "Maiak" farm enterprise in 1996 and continued in 1997 with 72 former state and collective farms being privatized and reorganized. By March 1998 over 70 thousand land titles have been issued and an impressive number of people received their land plots in kind. On the basis of experience acquired, about 100 specialists have been trained in Chişinău and in 10 territorial agencies. A manual "Methodology of the break-up of collective farms in Moldova" was prepared, adapted to Moldovan legislation and to local social and economic conditions, which includes recommendations for the transformation of collective farms and state farms into market-oriented farm units and associations.

The 1998-1999 National Program will comprise 550 agricultural enterprises interested in privatizing and reorganizing, resulting in the issuance of land title certificates and distribution of property to entitled individuals. By June 1998 68 large farms had been already broken up and dismantled, but titling has not been yet done. USAID Land Project is currently working with additional 100 farms. The physical allocation of land is scheduled for September 1998, and the provision of land titles is expected to occur in October 1998.

Financial Crisis in Agriculture

Since the start of reforms the agriculture has suffered the most from price liberalization. Being an inert branch that has strong links with the biological cycles of the nature, agriculture has lost financial means in the period 1991-1993 of high inflation. Later on the adjustment to new economic conditions has been impeded by the difference in prices for inputs and outputs. Unexpectedly enough, the sector considered the base of the economy has become unprofitable and unable to cover production costs. The attempts of the state to support the large scale unstructured enterprises by means of granting technical credits have not been effective.

During 6 years (1992-97) the agricultural enterprises have received about 360 million lei of state guaranteed credits from the Ministry of Finance, including technical credits for acquisition of petrol products, spare parts, mineral fertilizers, plant protection agents, and aimed at providing help to the agricultural producers and processors, given their scarce financial resources. However, over 50% of agricultural enterprises haven't paid back the credits in time due, and thus, a total amount of 141 million lei has not been returned. Moreover, an important share of credits granted (over 70 million lei) have been simply cancelled by the state, fact that transforms them into direct subsidies.

The main reasons explaining the lamentable financial situation of large-scale collective enterprises are the low productivity of labor, land and capital, as well as the weak reaction to changing market conditions.

As a result of their non-profitability, the agriculture enterprises do not pay taxes, thus accumulating huge debts and requiring state support that lies as a heavy burden on the state budget. The total tax collection rate in Moldova averaged at 80% in 1997: the tax collection from agri-processing industry exceeded the average (85%), while the agricultural sector registered the lowest tax collection rate in the economy – 48%³. Moreover, the share of agri-industrial sector in total budget arrears accounts for 60%, 48% of which belongs to agriculture. Meanwhile, the agricultural contributions to the budget revenue constitute only 14% of the total, which is half of sector's share in GDP.

However, there are significant differences within the agricultural sector in this respect. According to the results of a study on tax and subsidies⁴, peasant farms pay nearly 100% of their taxes, whereas large farms pay on average less than 35% of their tax liabilities. Moreover, the large agricultural enterprises make most of their tax payments in kind, partly voluntarily, and partly in the framework of government initiated campaigns (e.g. grain procurement). Meanwhile, peasant farmers pay the tax liabilities fully in cash.

The lamentable position of the agricultural enterprises, as well as the ineffectiveness of the current state subsidies is clearly observed when comparing two indicators: the negative profit reached by agricultural enterprises in 1996 – 240 million lei and the non-cash support of 430 million lei used as tax/debt reduction of economic agents to the state.

According to the consolidated balance sheet, the total obligations of the large farms at the end of 1997 were 2.2 billion lei. These are predominantly current obligations including accounts payable to: suppliers for inputs and services (800 million lei), salary arrears (190 million lei), budget and social fund (760 million lei, or over 34% of total obligations). Bank credits have a relatively small share of 10% of the total, including 108 million lei long-term credit and 116 million lei short-term credit.

A positive sign is that total current obligation of large scale farms slightly decreased in 1997 (coming down from 2.3 billion lei in 1996) due to a reduction in farms' obligations to the budget, social fund, as well as to commercial banks (Table 12, An1). This fact indicates that the state has tightened the tax collection system, while the responsibility of farms toward bank

³ Data of the Fiscal State Inspectorate of Moldova

⁴ The study on tax and subsidies system have been accomplished by ASA Institute for Sectoral Analysis (Germany) in collaboration with Agency for Restructuring Agriculture (ARA).

credits reimbursement has increased. However, the payment to employees and suppliers has worsened last year.

The total debt of agri-processing industry in amount of 0.5 billion lei appears much smaller as compared to the one of the primary agriculture.

As of January 1, 1998, the volume of farm sales, which is actually the source of earnings for repayment of debt, is very low in 1997 (as well as in 1996): only 2.5 billion lei as compared to total balance of 15 billion lei. Farms have nearly 1 billion lei in salable stocks of products and in account receivable versus current obligations of 1.8 billion lei, fact, which indicates a low level of working capital.

The Law on Budget for 1998, adopted on December 27, 1997, makes important stipulations regarding debt postponing of agricultural enterprises. The immediate impact of the above law stipulations has been negative on the state budget, as agricultural enterprises chose the 'wait and see' strategy and stopped paying even current taxes to the state and local budgets. According to the data of the State Inspectorate as of 1.06.98, the tax collection rate of enterprises pertaining to the agri-sector to the state and local budgets was about 10% and constituted only 3.8% of 1998 state revenues.

* * *

Real privatization and farm restructuring is the most recommended way to improve tax collection and, thus, raise government revenues. By increasing the share of peasant and real private farming, which tend to be both more productive and better tax-compliant, the government revenues would significantly grow. Besides, the functioning of the tax system is going to be improved as soon as the payments in kind are eliminated and the vicious circle of arrears and debt write-offs is avoided.

The farm restructuring process has to be continued according to the patterns developed in Moldova. The National Farm Restructuring Program envisages complete restructuring of at least 50% of large-scale agricultural enterprises by the end of 1999. While implementing the Program the methodology developed under the pilot projects has to be used without deviations, thus ensuring genuine reorganization based on market-oriented operation and incentive systems that encourage individual accountability. Settlement of outstanding debts must be concluded under the condition of general restructuring. Strict financial discipline must be enforced in all farming units that are currently unable to operate efficiently. The application of bankruptcy procedure, which is currently being implemented by the Ministry of Finance and ARA, will hopefully bring positive results in the nearest future.

At the present moment the farm restructuring process is seriously constrained and slowed down by the absence of a consistent legal framework (contradictions between the Law on Privatization and law on Bankruptcy), as well as lack of clear political decisions concerning expedited settlement of debt of those farms which are ready to be restructured. Thus, the further targets on farm restructuring are likely to be met *only if* a new legislative framework backed by strong political will toward the expedited settlements of farm debts is adopted.

3.4 Privatization and private sector development

According to the Constitution of the Republic of Moldova, the development of a viable private sector is a priority for the national economy. Since the beginning of the 90s, three privatization programs were adopted and implemented, the first one - for Patrimonial Bonds - in 1994, the second - mixed privatization for Bonds and cash - in 1995 and 1996, and, finally, privatization for cash exclusively in 1997. Nevertheless, the process of private sector

development in the Republic of Moldova confronted many formal and informal obstacles, no less than 50 per cent of it being embraced by the shadow economy.

Causes for delays in privatization have been multiple:

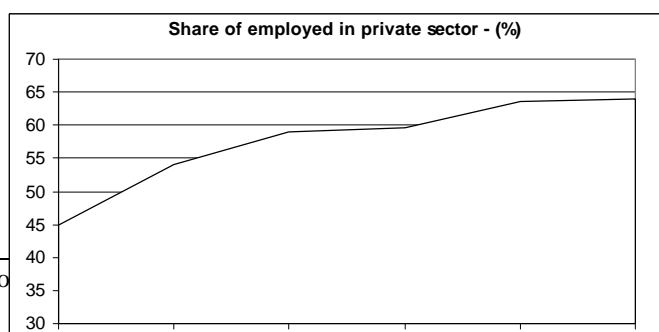
- inconsistent policies with regard to the sale of unfinished constructions and other underdeveloped projects (oftentimes significantly overpriced);
- lack of property rights protection due to a weakly developed legal system;
- lack of interest in a truly popular privatization on the part of those who benefited from illegal grabs of state property;
- inconsistencies in terms of payment with the nature of expenditures, which represent an investment for the buyers (50 per cent at the moment of signing of the contract and 50 per cent three months later, both – in cash);
- nonpayment of rent by the companies to the local budgets and, as a result, the refusal of local administrations to allow their sale;
- small enterprises interest for privatization the adjacent lends for investments, and lack of interest in purchasing it for medium and big enterprises.

The mass privatization process created a bisectoral economy, a new class of owners has been established, conditions were created conditions for the development of stock and capital markets, and corporate management practices were improved.

Current situation. During 1997 and the first half of 1998, the privatization occurred in unsatisfactory pace. From 2000 of rented premises only 283 were sold to small enterprises, which had a negative impact on investments. From 1,900 of adjacent plots only 26 in Chişinău and 17 in Bălţi were sold. From 724 joint stock companies for sale only 276 were sold at a nominal price of lei 18.6 million and a market price – lei 7.5 million. The privatization of enterprises attractive for foreign investors in which the state holds the control stock of shares is taking place slowly. A series of attempts by the Ministry of Privatization to sell the control stock of shares by means of international and local tenders were not successful, due to the excessively high prices established and accumulated debts. The decision making process was delayed in a couple of cases when there existed a demand from foreign agents (“Tutun”, “Ciment”). None of the strategic enterprises (from the energy sector, “Moldotelecom”, a couple of wine factories, former military complex etc.) were sold.

According to the Ministry of Privatization in 1996-1997, 90 state property auctions were organized, in which offered were a total of 636 objects. 120 of these were sold for a total price of lei 34.5m. The trade in shares of state enterprises remained after sales for Patrimonial Bons began on the local stock market. Offered for sale were the shares of all enterprises, which possessed unsolicited stocks, at the nominal value of lei 471.6m. At the fifteen bidding sessions held, stocks worth of lei 6.9m were sold. About 10,000 apartments have been privatized, revenues amounting to lei 5.5m. Sixteen auctions of unfinished industrial projects were organized, in which out of 56 offered for sale only 8 were sold for a total of lei 1.2m. The first stage of reorganization of the energy sector has been completed. The formulation of the procedure of privatization of these individual corporations has begun, subject to the approval by the Parliament. The Ministry of Privatization started the implementation of the program “Pământ” (‘Land’) for the reorganization and privatization in the agricultural sector. In 72 agricultural enterprises in some 15 counties these activities are in the final stage.

In the first quarter of 1998, state property worth of lei 31.53m was privatized, compared to lei 15.45m in the corresponding period of 1997. There were 39 state property auctions, at which out of 365 objects offered 38 were sold only. Despite this fact, it is expected that the total value of public property sold in 1998 will reach lei 200m.



Problems and consequences of privatization in Moldova. The first and most important consequence of privatization for Patrimonial Bons is: *the productivity of enterprises privatized for Patrimonial Bons did not grow*, the share of population employed in the private sector is 64 per cent, the share of private sector in GDP is about 60 per cent. Therefore, the productivity of the private sector is even smaller than that of the state sector. This is due to multiple reasons: a relatively easier concealment of incomes in private sector in comparison with the state sector, lack of an efficient corporate management system, and inefficiency of privatization for Patrimonial Bons.

Pluses and minuses of various forms of privatization					
	Better corporate governance	Speed and feasibility	Better access to capital, skills	More government revenue	Greater fairness
Sale to outside owners	+	-	+	+	-
Management-employee buyout	-	+	-	-	-
Equal-access voucher privatization	?	+	?	-	+
Spontaneous privatization	?	?	-	-	-

Source: From plan to market: World Development Report 1996

The privatization for Patrimonial Bons should have been done as soon as possible for the transition to the privatization for money. Delaying the privatization caused a number of problems:

- *lack of a real owner, dispersion of state property amongst a very large number of proprietors unable to ensure adequate level of investment for the re-modernization of privatized enterprises;*
- *low capacity of the state to exercise control over its property, inadequate involvement of government officials and even disinterest and lack of political will in privatization-related decision-making;*
- *in the course of privatization, a great deal of capital equipment was illegally removed from enterprises, which blocked their timely privatization;*
- *lack of a corporate management system, abuse of power, and lack of responsibility on the part of the managers;*
- *delays in the adoption of the State Program for supporting the small business for 1998 – 2000 and the Law of Entrepreneurial License impedes brakes the development of private sector;*
- *registration of various types of property (land, buildings, etc.) is administered by different Government agencies - a disharmonizing practice that does not appeal to potential investors;*
- *a weak system of state control authorities and inadequate legislative basis that contribute to sliding of private business into the informal sector, which, in turn, results in difficulties in obtaining reliable economic statistics and effecting a meaningful analysis of the economy.*

Objectives for expanding the private sector include: consolidation of legal and institutional framework for private property, extending the list of enterprises subject to privatization and diversifying the forms of their privatization, establishment of an efficient corporate management system, consolidation of share holdings, development of the real estate market, finalization of housing stock privatization, acceleration of reforms in the agrarian sector.

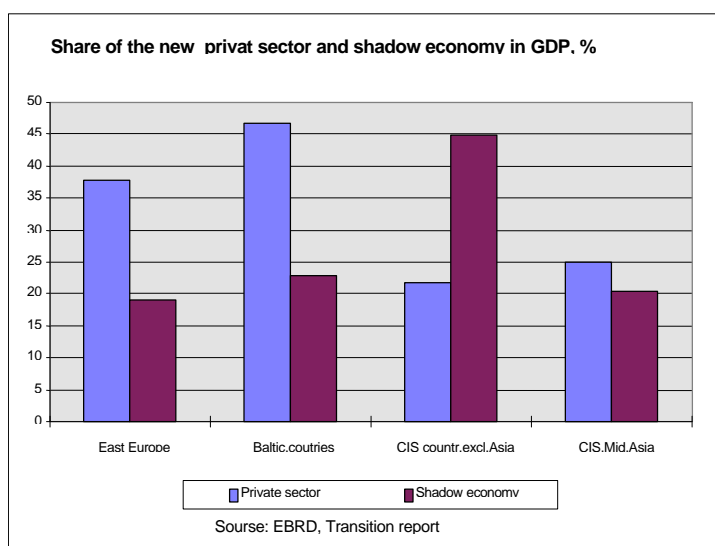
Actions aimed at private sector development include:

- Selling the supplementary rented entities of small scale (500 more enterprises), the adjacent lands (about 470 parcels);
- Improvement of the terms of payment for privatized premises – 25 per cent – to be paid immediately upon the signing of the contract and 75 per cent over three years;
- Taking effective measures toward making the privatized enterprises pay rent for the land to local administrations instead of paying taxes for land, as it is now;
- Converting the deposits in the savings banks in shares remained after privatization; launching privatization through repayment of the state debts with assets or shares of the enterprises subjected to privatization;
- Launch of privatization of energy and telecommunications sectors involving foreign investment in these sectors; privatization of tobacco factories, wineries located in the Russian Federation, as well as electronics manufacturing industry;
- Acceleration of privatization of agricultural enterprises, promotion of farmers' associations and allotment of land plots according to the National Program "Pământ";
- Ensuring the continuation of housing stock privatization and promotion of private housing owners' associations;
- Supporting greater involvement of Moldovan citizenry in the domestic stock market through measures such as Public Offers;
- Establishment of an integrated system of registration of various types of property;
- Effecting inventories of unfinished enterprises subject to privatization for their further sale for a symbolic price;
- Compilation of a unified information database of public property to ensure its privatization in conformity with the state program;
- Amending the existing legislation with the view to facilitate sale/purchase of state property;
- Allocation of at least half of the revenues from privatization of public property to restructuring and further modernization of privatized enterprises;
- Improving administration of state-owned property, including those with 100% state capital and those of mixed ownership managed by private partners; establishment of a State Property Fund endowed with legal personality.

Thus, by the year 2000, property reform should bring the share of private sector in Moldova's GDP up to 60% to 65%.

However, the economic situation of the private sector remains unclear. An economic data-base is absent. It is impossible to evaluate objectively the productivity of functioning of this sector.

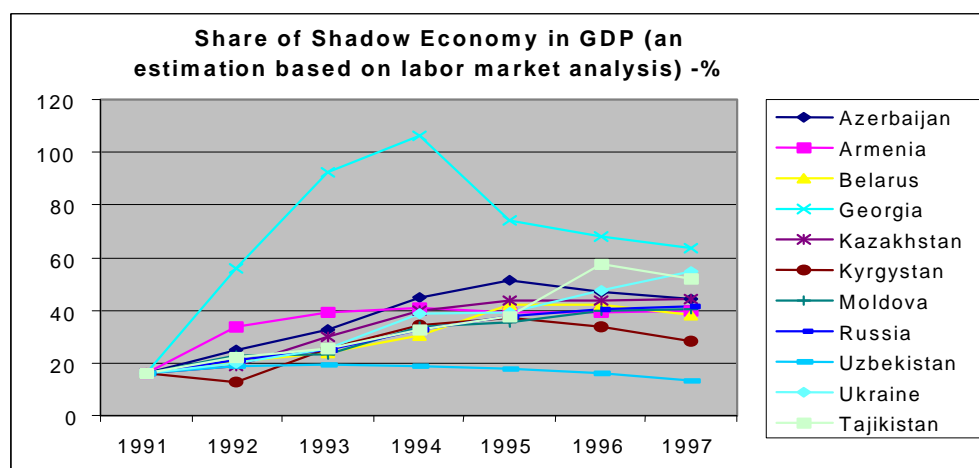
A common characteristic for the post-socialist countries is sliding of the private sector as well as the state one into the shadow economy. In the Transition Report -1997 of EBRD it is mentioned, that if in countries of Eastern Europe and Baltic states the private sector share prevails, in NIS the share of the underground sector predominates, which includes in big part a unreported production of the private sector.



3.5 Shadow economy

The shadow economy in transition countries, especially in NIS, differs to some extent from shadow economies in developed countries. This is manifested in the fact that the state sector is very active in realizing shadow economic transactions, often the state property is used for obtaining unofficial personal gains by the state employees. A clear divide between the official and nonofficial sectors is absent, the labor force of the underground sector includes high skilled professionals. The shadow economy in NIS countries grew up so substantially not only because of the economic decline, but also as a result of involving in the privatization process of new objects – land, assets of enterprises, etc.

It is possible that the shadow economy phenomenon has an anti-cyclic character and grows up, even faster in countries experiencing economic decline. Methods of estimation of the shadow economy's volume of output are bound to be not fully accurate and give a very approximate picture of the real situation. Moreover, the results will differ depending on the method used. Therefore, for making an international analysis of the degree of presence of this phenomenon, it is necessary to use the same methods of estimation and to take averages for every country. In this study a labor force market analysis on the information on NIS countries was used. The specific of the method lie in underestimation of shadow economy parameters. Thus, utilization of monetary methods would produce far graver results. Furthermore, the utilization of the same method for the Republic of Moldova on the basis of the scriptic number of employees instead of employed population leads to a 7-8 per cent increase in the results.



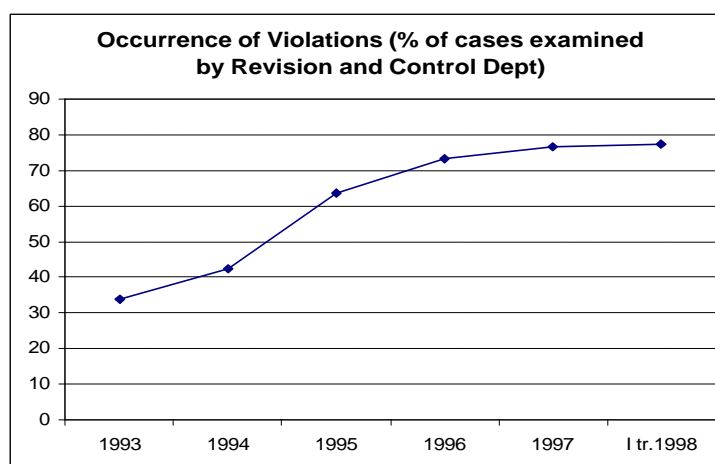
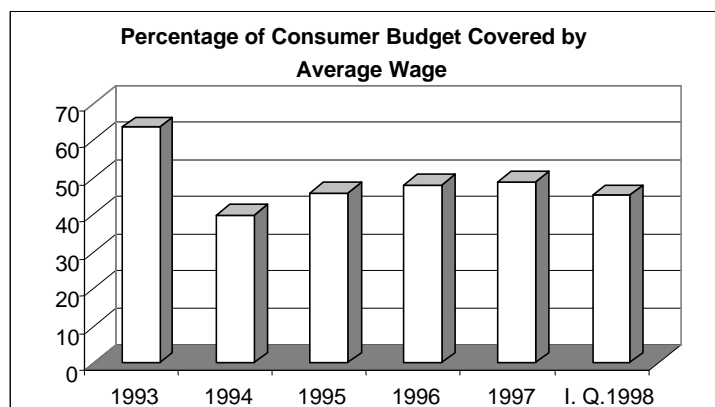
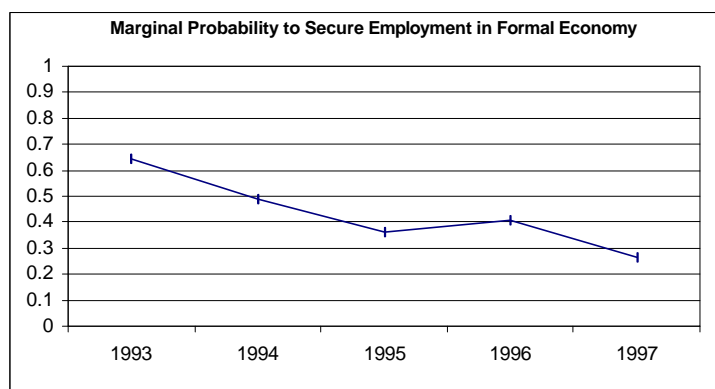
Starting with 1994-1995 the share of the shadow economy began to diminish in a number of countries. This can be explained not as much by some essential regulating measures made by the state, as due to the launch of the stabilization process in those countries resulting in diminished share of the shadow economy in the official one. A case in point is Georgia. During 1991 – 1994, the number of employed diminished from 2.5 to 1.75 million persons (by 30 per cent), growing up to 2.1 million persons in 1997.

For the Republic of Moldova the, 1997 economic relaunch (GDP growth by 1.3 per cent) was too small, therefore the rate of the shadow economy in comparison to the official one is in continuing growth. The discrepancy between unemployment and vacancies grows up and, as result, the marginal probability to find a job in the formal sector of the economy grows up.

The situation of the employed in the formal sector is discouraging too. The registered revenues of less than 3 per cent of population (5 per cent of urban population and 1.9 per cent of the rural one) cover the consumer basket. The share of the average wage in the consumer basket (40 per cent) remains still too small for a long run to allow the population to survive, staying only in the formal sector of the economy. This “pushes” a growing share of population to the shadow sector.

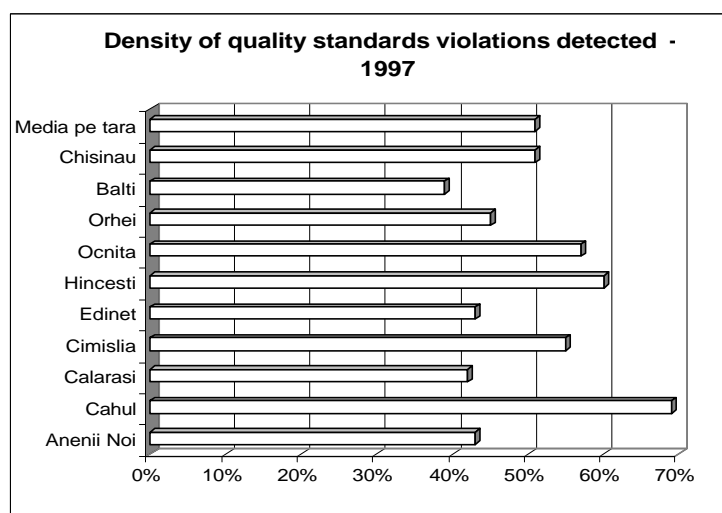
The spread of the phenomenon of shadow economy is accompanied by the growth in crime, fall of economic and financial discipline, quality of goods and services. Thus, during the first quarter of 1998, the number of crimes, including the economic ones, grew up by 5.3 per cent in comparison to the last year. According to some estimates, the daily income of the drug-business in Bălți amounts to about 2 million lei. Losses of power grew up from 10 per cent of the total consumption in 1990 to more than 30 per cent in 1997, constituting daily 300 thousand lei, according to some evaluations.

The growth of illegal export-import transactions' volume is worrisome. Thus, according to Romanian data (“Curierul Național”) the volume of Moldovan sugar exports to Romania exceeded by 1.8 times (450 Th. tons) the officially recorded volume of production of sugar on the territory of the Republic Moldova. Generally, a big part of this sugar is produced in the Ukraine, and is fraudulently certified as originated from Moldova, with the aim of gaining advantages from the trade agreement between Romania and Moldova. The comparison between Russian and



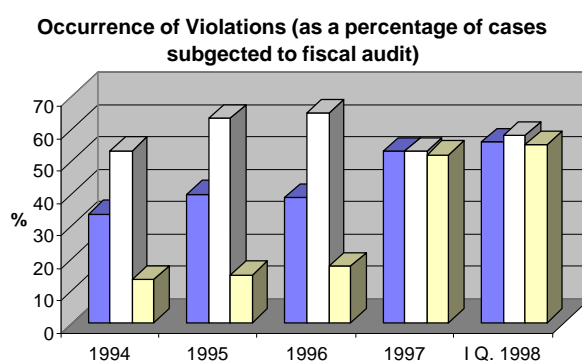
Moldovan official statistics sources indicates that the sparkling wine exports of Moldova exceed 1.6 times the Moldovan production; more than this, after passing the border prices grow up 2.4 times. In the Russian statistics the imports of Vermut – wine from Hungary and Bulgaria disappeared – since, as they pass the customs, they are being registered as Moldovan wines, thus giving the violators the advantages of the Moldo-Russian agreement. A practical absence of a border between the right side of Moldova and the territory of Transnistria and the existence of two different fiscal systems on this territory implies considerable losses to the state budget of Moldova. Thus, the absence of a value added tax on the territory of Transnistria implies paying the custom duties on the territory of Transnistria, coming to the right side of r. Nistru as local goods, avoiding paying the VAT (in average 20 per cent), aggravating the situation in the budget and creating an *unhealthy competition to the local goods*.

Production and marketing of fake or uncertified goods is a component of the shadow economy. It has a double negative impact: on health of population and worsening of Moldova's prestige in the external market. The *Department for Standards, Metrology and Supervision of Moldova*, having as its most important direction the protection of consumers rights through state control and supervision of normative documents, firstly, referring to the populations health and life security, the environment protection and growth of goods and services quality, made a number of controls in 1997. The results of the department's work indicated, that during 2,226 checks made 1,129 violations were detected (51 per cent - in 1997 and 47 per cent in 1996). The share of deviations from required standards amounted 61 per cent (in 1996 – 48 per cent). A regional goods and services quality differences is observed. On average, there are established violations (deviations of quality standards, faking, or absence of necessary documentation) for meat – foods in about 52 per cent, for canned vegetables and fruits – in 77 per cent of cases, alcoholic beverages – 39 per cent, electric appliances – 67 per cent, for the commodities for children, the deviation rate reached 74 per cent, services -63 per cent.



A worrying sign is the quality of imported goods. The Republic of Moldova, being a small open economy, promotes a policy of liberalization of external trade. In many cases, the imported goods create a serious competition for the local ones often easily substituting them, and discouraging the local production. Having competitive prices, these goods often are of bad quality and are harmful for population's health. Thus the density of negative results for imported goods is bigger than the average in the country and reached 79 per cent in 1997 against 86 per cent in 1996. In the case of detection of this cases of law violation, the aforementioned Department prohibits the trade of these goods. The mass information of the population regarding the quality of goods, including the imported ones could offer to consumer the possibility of choosing between price and quality, and, possibly, could contribute to the reviving of local production.

Placing emphasis on the quality of goods is an obligatory condition for a stable economic development and the

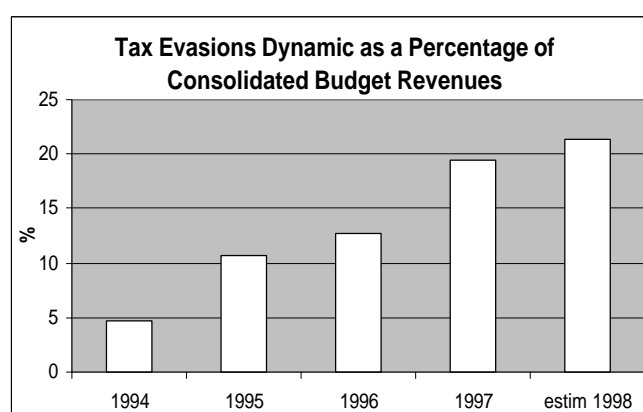


country's prestige. With the aim of consolidation of the country's relation with other countries and collaboration with different international organizations, according to the decision of the General ISO (International Standards Organization) Assembly, the Republic of Moldova represented by the Department for Standards, Metrology and Supervision became a correspondent member of ISO in 1997. Agreements of collaboration in the field of standardization with Lithuania, the Ukraine, Azerbaijan, Uzbekistan were signed. The preparation for the entrance of the Republic of Moldova into the WTO was completed. For the Republic of Moldova, it is important that these kinds of agreements be signed with the basic partners in export-import transactions.

Year 1997 and the first quarter of 1998 were marked by a decline in the economic and financial discipline. The data of the Department for Revision and Control show that the density of violations in the total number of control continues to grow, the prejudice per economic unity grew up from 3.3 thousand lei in 1997 till 6.9 thousand lei in the first quarter of 1998, almost doubled. According to our estimation, in 1998 it is expected the total prejudice to reach about lei 90 millions in 1998. According to the information of the *Main State Fiscal Inspection*, in 1997, 17,541 (I quarter 1998 – 4614) units from 219,180 (respectively, 234,025) were exposed to fiscal control, in 9,233 (I quarter 1998 – 2,601) cases violations were detected. Additional payments were calculated in the volume of lei 290.3 million (in I quarter 1998 – 44.8), including fines lei 163.7 (22.5) million. In the course of the analyzed period, a practical leveling in the density of violations among legal entities and individuals took place.

The evaluation of the proportions of tax evasion in the Republic of Moldova in 1997 – I quarter of 1998 was done on the basis of the information contained in “The Report regarding the results of control activity of the respecting the legislation and other payments” of the Main State Fiscal Inspection, depending on the share of checked taxpayers and the detected sum of evasions (see following tables). The calculations showed a slow down of the tax evasion process in the first quarter 1998. In the structure of tax evasion, LTDs, stock companies and cooperatives of all kinds predominate.

The compensation of losses detected by the inspectors of the Main State Fiscal Inspection occurs in very slow pace. Thus, while in 1996 there was collected 19.09 per cent of the established sum, in 1997 – only 13.7%, and in the first quarter 1998 - 15.6%.



Evaluation of tax evasion in the Republic of Moldova - 1997 (Th. lei)

	Total	Subjected to audits	Density of control	Violation detected	Density of violation	Suppliment. payments	Detected evasions	Average evasion	Benefit from evasion	Efficacy of evasion	Fines	Collected total	Collected %	Collected fines	Collected fines %	Total Evasions
Total legal entities and individuals	219190	17541	0.08	5233	0.53	290300.9	129531.3	7.22	103398.4864	445.05	163669.6	39909.7	13.75	23213.6	0.14	537408
Legal entities - total	173801	11524	0.07	6095	0.53	280576.1	121930.6	10.59	103386.8004	565.73	156695.5	38547.4	13.74	22418.4	0.14	502394
including:																
state enterprises	1407	773	0.65	659	0.72	32856.8	15885.1	20.39	-2365.74	-13.11	17170.7	8124.7	24.73	4378.2	0.25	28550
joint enterprises	38	10	0.26	9	0.90	486.5	248.8	24.88	126.04	102.67	217.7	33.8	7.20	26.3	0.12	945
renting enterprises	64	16	0.25	10	0.63	129.9	77.2	4.83	46.23	149.23	46.7	13.8	11.14	8.8	0.19	309
cooperatives of all kinds	3109	1012	0.33	839	0.83	49546.8	23541.7	23.36	8783.69	58.12	22004.1	5613.4	12.30	3604.9	0.17	72630
from them kolshozas	367	317	0.86	274	0.86	29226.6	15277.3	48.19	-9967.47	-39.48	13949.3	3955.9	13.57	2543.6	0.19	17687
LTDs	21869	3618	0.17	2323	0.64	66720.6	30721.3	8.49	19883.07	178.32	38999.3	6445.2	9.66	4049.5	0.11	158895
stock companies	4886	1816	0.37	1408	0.78	84221	33329.1	18.36	2066.37	6.68	50691.9	11640.7	13.82	6509.5	0.13	89759
enterprises with foreign invest.	1298	183	0.14	140	0.77	9794.5	5891.7	31.67	4450.81	322.31	3962.8	992.4	10.13	613.3	0.15	41364
social organizations	3397	313	0.09	146	0.47	2769.3	1719.9	5.49	1463.98	572.05	1049.4	202.8	7.32	95.2	0.09	18611
banks	29	11	0.38	9	0.82	5992.3	2547.9	240.72	374.96	16.60	3344.4	4754.8	79.35	2578.1	0.77	6991
insurance companies	103	13	0.13	6	0.46	161.4	62.8	4.83	42.43	208.28	98.6	31.6	19.58	24.6	0.25	498
associations, concerns	473	111	0.23	80	0.73	23076.8	3765.2	34.10	-1630.29	-30.10	19291.6	296.6	1.29	113.9	0.01	16130
other unions																
farmers	133606	2577	0.02	41	0.02	194.7	61.4	0.02	57.64	1534.99	133.3	37.9	19.47	16.2	0.11	3183
budget institutions	2316	827	0.36	366	0.47	1203.2	302.8	0.37	-126.84	-28.62	900.4	295.6	24.58	186.1	0.21	846
other legal entities	1214	245	0.20	129	0.53	7350.3	3875.7	15.82	2392.32	161.27	3474.6	64.1	0.87	14.8	0.00	19204
Individuals - total	45379	6017	0.13	3148	0.52	9724.8	9540.7	0.771265	3951.245253	259.6966	5084.1	1352.3	14.00661	785.2	0.158409	39014
individual enterprises	45194	6006	0.13	3128	0.52	9681.7	9520.6	0.77	3336.32	269.78	5061.1	1376.2	14.24	787.6	0.16	34833
collective societies	146	15	0.10	14	0.93	32.1	17.4	1.16	14.15	434.83	14.7	11.5	35.83	7.6	0.52	172
societ with unlim. responsib.	37	7	0.19	6	0.86	11	1.7	0.24	-0.39	-18.31	9.3	0	0.00	0	0.00	9

Estimation of tax evasion in the Republic of moldova - first quarter 1998 (Th. Lei)

	Total	Subjected to audits	Density of control	Violation detected	Density of violation	Suppliment. payments	Detected evasions	Average evasion	Benefit from evasion	Efficacy of evasion	Fines	Collected total	Collected %	Collected fines	Collected fines %	Total Evasions
Total legal entities and individuals	234025	4514	0.02	2601	0.56	44879.00	22385.50	4.85	21809.05	616.20	22493.60	6952.6	15.51	4523.00	20.11	365373.67
Legal entities - total	185770	2184	0.01	1267	0.68	43613.90	21803.70	9.98	21290.95	1038.09	21810.20	6708.1	15.38	4345.20	19.92	354048.07
including:																
state enterprises	1403	150	0.11	98	0.65	4209.70	2378.60	15.86	1928.53	107.12	1831.10	1321.5	31.39	1126.70	61.53	22247.84
joint enterprises	97	3	0.03	3	1.00	28.70	6.70	2.23	5.81	163.70	22.00	0	0.00	0.00	0.00	216.63
renting enterprises	63	4	0.06	1	0.10	123.90	123.60	30.95	115.93	368.43	0.10	0	0.00	0.00	0.00	1949.85
cooperatives of all kinds	3130	238	0.08	160	0.67	4158.40	1765.40	7.42	1449.20	114.59	2393.00	667.6	16.05	495.00	20.69	23217.24
from them kolshozas	313	63	0.20	50	0.79	2864.40	1128.40	17.91	551.85	23.93	1736.00	73.2	2.56	52.40	3.02	5606.18
LTDs	22496	871	0.04	546	0.63	10403.90	6109.60	5.87	4706.60	291.97	6294.30	1313	12.62	784.60	14.82	131910.98
stock companies	4904	406	0.08	287	0.71	23953.70	12047.40	29.67	10072.66	127.61	11806.30	3118.9	13.06	1771.60	15.01	145518.35
enterprises with foreign invest.	1372	32	0.02	22	0.69	556.70	266.10	8.38	255.12	491.20	268.60	167.5	30.09	106.80	36.94	11494.79
social organizations	3692	23	0.01	9	0.39	32.10	27.50	1.20	27.30	3403.65	4.60	11.9	37.07	6.90	150.00	4402.39
banks	37	2	0.05	1	0.50	62.40	0.50	0.25	3.87	-28.71	62.90	7.7	-12.34	7.70	-12.24	9.25
insurance companies	94	1	0.01	1	1.00	0.40	0.20	0.20	0.20	1150.00	0.20	2.9	725.00	2.70	1350.00	18.80
associations, concerns	476	26	0.05	19	0.76	64.40	17.10	0.88	14.25	125.25	37.30	38.9	71.51	19.20	51.47	326.95
other unions																
farmers	144460	234	0.00	27	0.12	2.80	1.90	0.01	1.90	10447.91	0.90	3.7	132.14	3.70	411.11	1172.97
budget institutions	2283	162	0.08	84	0.45	280.60	137.80	0.75	115.43	129.01	142.80	295.8	53.20	186.10	130.32	1728.56
other legal entities	1291	13	0.01	9	0.69	94.80	42.90	3.30	41.94	1089.79	51.90	1.3	1.37	3.90	7.51	4227.30
Individuals - total	48255	2430	0.05	1334	0.65	1265.10	591.80	0.24	618.00	203.31	683.30	254.5	20.12	177.80	26.02	11325.60
individual enterprises	47211	2419	0.05	1328	0.65	1250.10	572.40	0.24	608.35	198.41	677.70	252.8	20.22	176.20	26.00	11171.38
collective societies	150	9	0.06	6	0.67	10.80	7.30	0.81	6.65	266.64	3.60	1.5	13.89	1.50	42.66	121.67
societ with unlim. responsib.	31	2	0.06	2	1.00	4.20	2.10	1.05	1.83	168.75	2.10	0.2	4.76	0.10	4.76	32.55

Fight against tax evasion as a way to ameliorate the budget deficit problem.

At present, one of the main state problems is the budget deficit. The study of traditional macroeconomic theories regarding budget deficit allows us to make a conclusion. Budget deficit implies shrinking of savings and investments, diminishing of capital stocks, which, in its turn, slows down economic development. In the long run this implies a rapid growth of the external debt, and current account balance deficit. According to these theories the state debt presents an additional burden for next generations, but for the Republic of Moldova – even for the current generation.

According to the Ricardian macroeconomic theory (less traditional), the state budget deficit is just a substitution of current debts by future growing taxes. The adherents of this theory consider the negative effects of the budget deficit on the country's economic development would not be essential. With regard to the Republic of Moldova, it is clear that the socio-economic condition will not allow the population to make these savings. Therefore the conclusions of the Ricardian theory will not be valid in the case of Moldova.

It is clear that the amelioration of this situation becomes more difficult and it is necessary to elaborate concrete measures. Amongst the most traditional ways of amelioration in this situation at least five could be used:

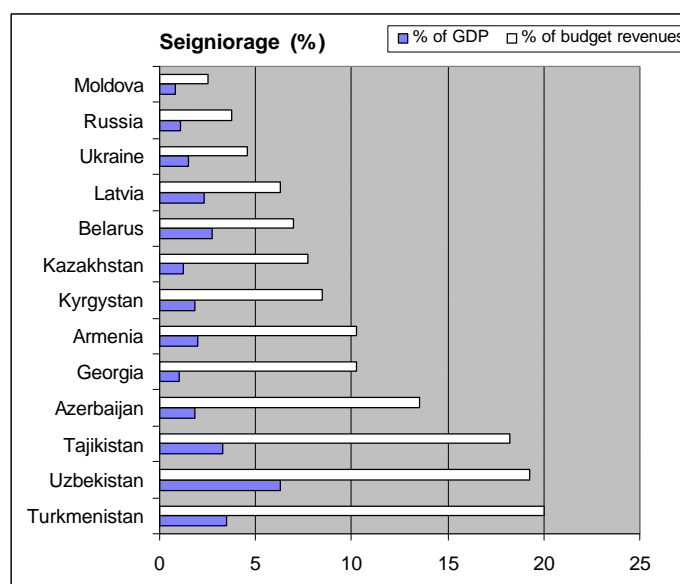
- financing the budget deficit out of supplementary credits;
- seignorage, or gains from money emission;
- tax growth;
- reduction of state expenditure;
- fight against tax evasion.

Unfortunately, the first way, that one of *financing the budget deficit out of supplementary credits* was overutilised during the last years, and as a result the external debt of the country grew up to 64 per cent of GDP in 1997. The continuation of this practice could be too dangerous for the economic stability of the country.

The seignorage or gaining revenues from the emission of additional sums of money is also problematic. The data of the National Bank of Moldova show that since the introduction the national currency, the money aggregate MO grew up more than 8 times achieving a sum of 972.06 million lei at the end of 1997. The “pressing” of this process could cause an inflation growth with all negative consciences.

Obtaining a growth in the budget revenues *raising taxes* will be doubtful too. First, our calculations show that the increase of the fiscal burden by one per cent will result in a 2-3 per cent growth of tax evasion. Secondly, the traditional macroeconomic models show that this will shrink the production and GDP. That is why this measure could be unacceptable for the condition of Moldova.

The reduction of the Government expenditure can be partially used in the short run to ameliorate the budget deficit problem, but it is a difficult way, from both social considerations and economic ones. The traditional macroeconomic models show that that the diminishing of Government expenditures will cause the fall of GDP, or this measure could solve the problem



for a short time, but could be discouraging the economic growth.

Another way of solving the problem is *the fight against tax evasion*. Being prevalent in the society, the phenomenon of tax evasion presents a considerable reserve, a potential source of additional incomes for the budget. For a country like the Republic of Moldova a partial *fighting against tax evasion could be the most efficient way of solving the budget deficit problem, but the diminishing of the tax evasion in bigger proportions could create possibilities to ease the tax burden and stimulate the production.*

Among the causes of tax evasion phenomenon, a heavy and nonuniform tax burden, weakness of control institutions, and the existence of an overdriven system of fiscal facilities could be mentioned.

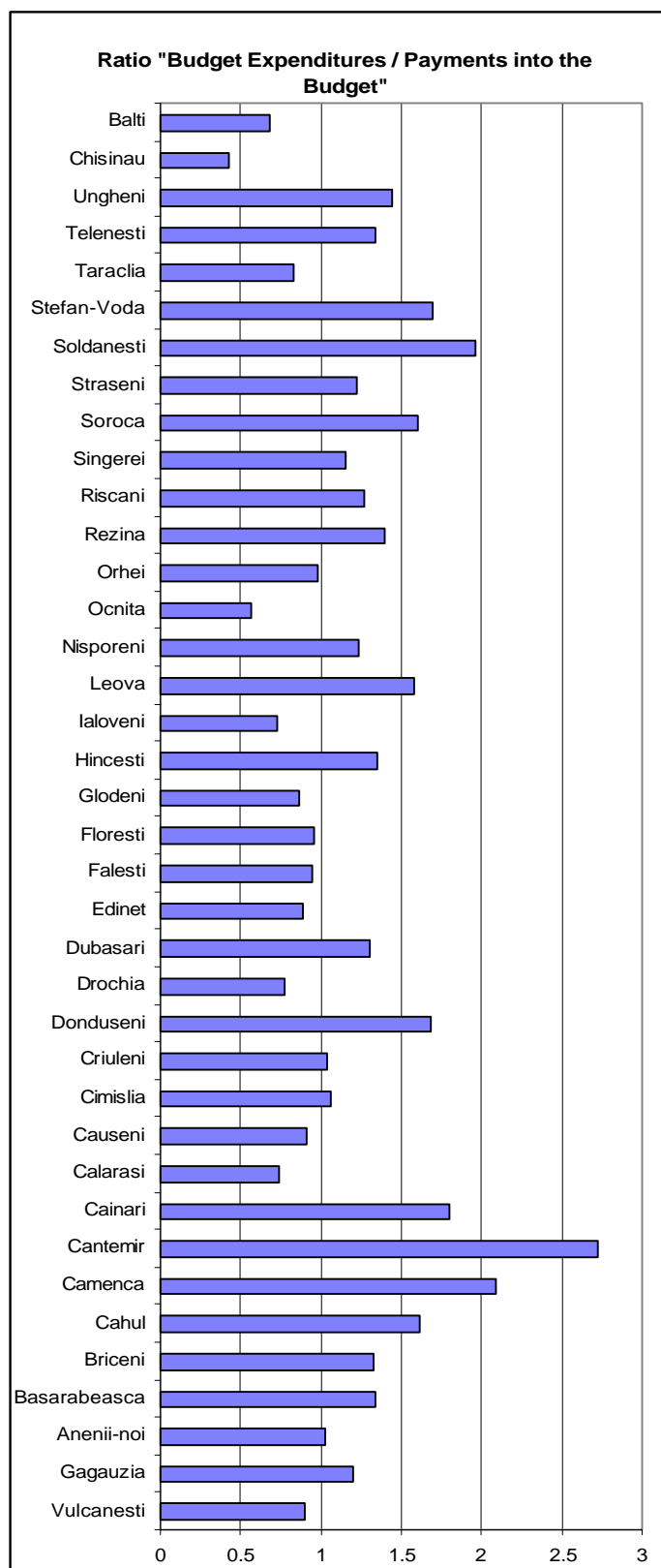
Even if the formal tax burden in the Republic of Moldova fluctuates during the last years in limits of 3—33 per cent, this figure is formed due to the fact that the tax burden for one part of economic agents exceeds 50 per cent, but the other part does not pay taxes.

Probably, one of the causes of tax evasion's phenomenon spread is lack of interest of the local authorities in fighting it. The ratio "budget expenditures / payments into the budget" varies substantially from one locality to another other (from 0.43 in Chi°inãu till 2.72 in Cantemir county). On one hand, the possibility to cover the local needs with finances from the state budget does not stimulate local administration to maximize tax collection. On the other hand, the realization by the local authorities of the fact that a big share of tax collection on the territory will be spent in other regions creates indifference to tax collection and facilitates other kind of agreements between local authorities and taxpayers.

Another cause of tax evasion spread is the weak activity of fiscal institutions. Thus, the share of economic agents subjected to fiscal

audits diminished from 32.3 per cent in 1994 to 8 per cent in 1997, and 1.9 per cent in the first quarter of 1998, which facilitates evasions.

In this study a basic *model of tax evasion* was examined. The following assumptions lie at the base of the model: the taxpayer is an amoral person and evades paying taxes when this is

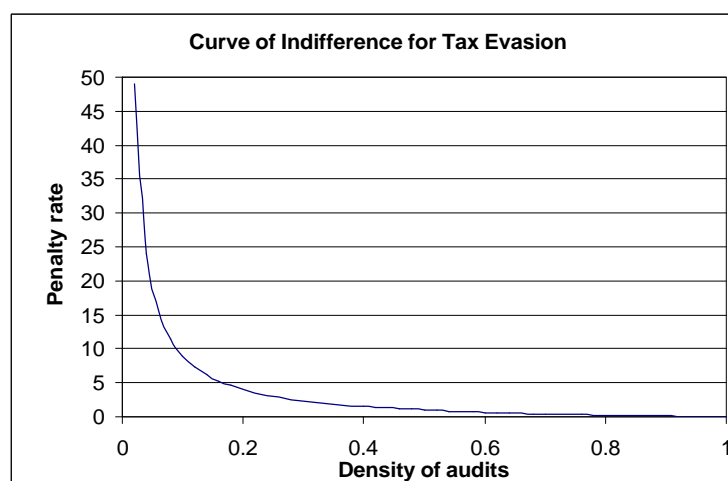
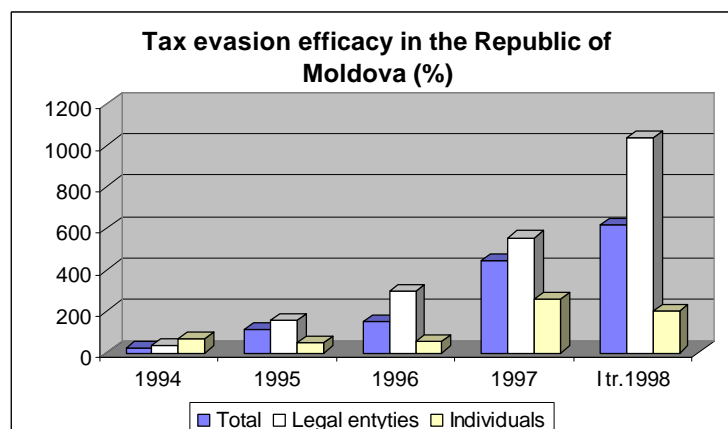


economically advantageous; the tax inspector is an absolutely honest person who objectively records all the violations of the fiscal legislation in his reports; the inflation rate is zero. The condition when tax evasion is considered to be economically advantageous means that the gain from tax evasion exceeds the expected losses in the case of detection by the fiscal auditors. In this case the gain from tax evasion is the tax evasion sum itself. The expected losses from tax evasion are the sum of tax evasion which will need to be reimbursed and penalty (fine) in the case of being caught corrected to the probability of being caught in tax evasion. The total net benefit from tax evasion was calculated being equal to the difference between the gains and expected losses.

The calculation made by the Main State Fiscal Inspection showed that for the majority of the taxpayers' categories the benefit from tax evasion is positive, which means that there exist favorable conditions for tax evasion and the phenomenon will grow. In 1997, only state enterprises, budget institutions and kolkhozes were exceptions. The net benefit for legal entities amounted lei 103.5 million in 1997 and lei 21.2 million in the first quarter 1998. The net benefit of individuals - lei 3.4 million in 1997, lei 0.6 million in the first quarter 1998, and the total for the Republic of Moldova estimated at lei 107 million in 1997 and lei 22 million in the first quarter 1998.

For the numerical evaluation of the degree of tax evasion advantage a notion of "tax evasion efficiency" was defined as a ratio of the net benefit to expected losses. The calculation showed that this indicator grew up extremely fast during the last years and reached in 1998 a level of 1000 per cent for legal entities.

To fight this phenomenon, it is necessary to create the conditions that would reduce the economic efficacy of tax evasion to zero and would make the taxpayers indifferent to tax evasions. These conditions could be created by manipulating with the penalty rate and the probability of being caught in tax evasions (density of controls). The calculations allowed to obtain the *curve of indifference to tax evasions*. It presents the multitude of combinations between the penalty rate and the density of fiscal controls, which discourages the tax evasion, for which the efficacy of tax evasion is equal to zero.



We can see that the sensibility of these indicators is very strong. The surface under the indifference curve presents the multitude of combinations of penalty rates and densities of controls for which the tax evasion is efficient (the efficacy is positive). For the reduction of the phenomenon of tax evasion, the choice of the kind of control regime is important. The calculation showed that the efficacy of tax evasion does not depend on their volume. In space the dependence between penalty rate, density of controls and the efficacy of tax evasions forms a hyperboloid. The multitude of combinations under the zero level describes control regimes of fiscal inspections which discourages the tax evasion.

The analysis of the real information regarding the penalty rates and densities of fiscal audits corresponded to the sector where the evasions are efficient. Thus, for the density of audits created in 1997 amounting 8 per cent the penalty rate needed to be not 100 – 130 per cent, as it really was, but 1,150 per cent (!). And conversely, if the penalty varied in limits of 100-130%, then the density of fiscal controls had to be 43-50 per cent of all taxpayers. Besides, given the fact that collection of penalties is going very hard, it is necessary to make other measures to fight tax evasion.

First suggestion in this direction is the need to develop an ample study of the phenomenon. This study should include economic, sociological, juridical and psychological aspects. The problem is that the social - economic conditions created in the ex -socialist zone facilitate the avoiding of paying taxes. There exist economic models in the world practice which prove the fact that as long as the person realize that the tax evasion is widespread and he lives in an dishonest ambience, he concludes that his tax evasion will not change a lot the general situation, and essentially – his own benefits. As a result, he will decide to hide a part of his incomes.

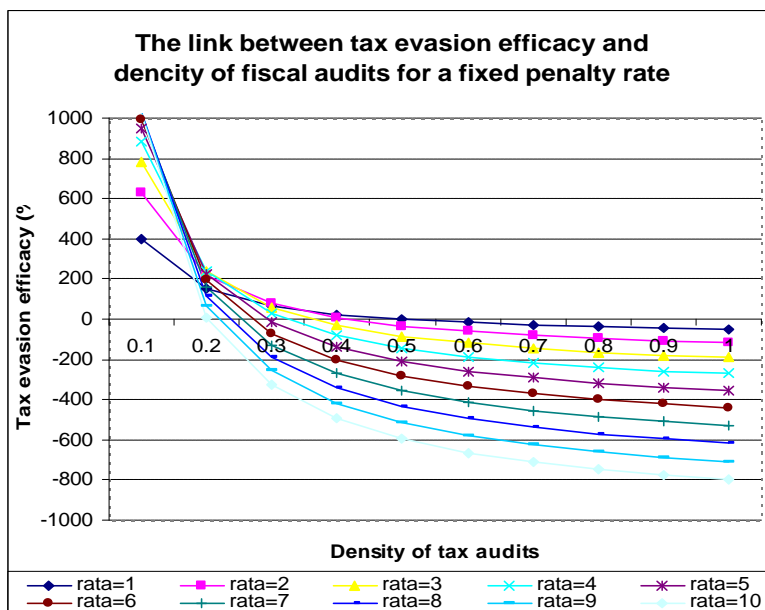
There are studies that prove the fact that the bigger is the income, the more he will be subject to tax evasion. The population having big incomes, who should, in principle, contribute the most of the budget revenue, will evade paying taxes in bigger proportions. *In countries with a dishonest ambience, the progressive tax system does not work efficiently. Formation of a state with a big share of medium size income population is the base of tax collection stability.*

Another aspect of tax evasion. *Studies of the psychological aspect of the tax evasion show* that independent of the real dimension of incomes, persons who complain about small incomes, about unfairness in evaluation of their work and aptitudes are more disposed to evade paying taxes, taking advantages from the state services to all population. That is why insufficient informing of the population regarding real incomes in society predispose to supplementary evasions. The information of the population regarding the buying capacity of the average wage, including various kinds of services and education in various countries could be beneficial.

As a solution for the creation of a more favorable ambience and amelioration of financial discipline, sociologists and psychologists propose the creation of various *educational programs of tax honesty*. According to the authors of these programs, education and moral appeal could have, probably, a better effect than high penalties.

Rise of the state authority in the public opinion can serve as a cheaper way of fighting tax evasion. Such educational programs could work more efficiently if being promoted by non Government organization, and financed by the state. They need to maximize the utilization of mass media and include the explanation of the following aspects:

- the tax system, in principle, is not bad and differs little from similar systems in the developed countries;
- the majority of taxpayers nevertheless pay their taxes;
- a convincing description of main directions of expenditures and explanation of their importance;



- description of possible consequences of tax evasion, including the personal risk and institutional consequences of an excessive punishment from the state;
- promoting a negative attitude to tax evasion, explanation of the fact that any tax evasion results simply in the tax burden's growth, and harms the rest of population.

Regretfully, especially in the countries having lower fiscal discipline, this educational work is not practiced at all.

Another aspect of tax evasion is that *the maturity of tax evasion reimbursement* is too long. Basically, the tax debts form a dead burden, which pushes more and more to the shadow economy not only the small businessmen, but also big enterprises, which resort to different manipulations with foreign accounts "run away" from this burden. Some studies of this phenomenon show that for easing this burden of taxes, which will never be paid anyway, a tax amnesty could be declared. *Negative and positive aspects of tax amnesty* could be distinguished.

The positive effects of the declaration of a tax amnesty include the following:

- *amnesty could offer a possibility to collect a part of tax debts, which in other case could not be collected;*
- the amnesty encourages honest declaration of incomes;
- amnesty makes the society more able to control its future, because the possibility of getting out from the shadow economy and entering the official one appears;
- amnesty makes possible to declare that a mistake was made, but now conditions for changing the behavior are created;
- amnesty can serve as transition to a new, softer tax regime, because when the Government fails systematically in promoting its tax policy, this could signify about a too heavy tax burden;

The negative effects are summarized in the fact that if this kind of amnesty is repeating, the population gets used to the fact that in any case they will be forgiven for breaking the law, this could undermine the authority of the Government and diminish the financial even more.

With regard to the Republic of Moldova, the utilization of different forms of tax amnesties becomes a too often used practice. In general, the population expects regular debt forgiveness, that is why it is necessary to examine carefully the possibility to continue this practice, or to declare clear that this amnesty is the last one and later the control work will be done with greater severity.

Fighting tax evasion needs to be done by all ways: economic, legal, administrative and educational.

The economic measures could include:

- increased fines and frequent inspections by fiscal institutions to such an extent that to make tax evasion unprofitable;
- wider and more active use of bankruptcy legislation;
- freezing enterprises' debts, deblocking of bank accounts and finding ways of cutting debts by taking into account the non-objective ways of their formation;
- diminishing the tax burden (the last one to be done only after accomplishing the others);

Legal measures would include:

- development of a legal system to promote economic measures;
- simplification of enterprise "shut-down" procedures for those that cannot prove their being in operation over an established period of time;
- implementation of the management law and means of its enforcing, providing management administrative and penal responsibility for not paying taxes and other payments due to the state;

Administrative measures would include:

- creation of a body endowed with functions and powers sufficient enough to fight tax evasion, including the right for investigation and application of administrative sanctions, to promote a single policy with regard to the investigation, discovering and penalizing people breaching the financial discipline;
- strict delimitation of functions of control institutions;
- building the prestige, quality and incentives of fiscal control institutions;
- ensuring transparency and free access of large parts of the population to the decisions made by state authorities, which might be an efficient measure of fighting corruption.

Educational measures:

- development of an awareness raising program explaining the implications of tax evasion on people's welfare, educating a negative attitude towards this phenomenon. This program is likely to be more efficient if conducted by non-governmental organizations and financed by the state;
- psychological education of economic agents with regard to the increase of severity on the part of fiscal control institutions via all available information channels (mass-media), explaining the positive effects of such measures, including eventual lightening of the tax burden.

Implementation of these measures could serve as first steps in fighting the parasitical phenomenon of tax evasion and could permit solving the problem of budget deficit, external debts, transition of the economy to a more civilized, stable, attractive for the international organizations and investors stage.

CHAPTER 4. SOCIAL DEVELOPMENT

Analysis of the current situation

Recent evolution of the social sphere (in 1997 and the 1st quarter of 1998) confirm the trend of a dramatic worsening of this sector. Anti-crisis measures of the Government and the correction of 1998 budget (July 1998) will certainly have a dramatic impact on population's living standards. The galloping growth of pensions and salaries' arrears, accompanied by the erosion of real incomes of the population and enhancement of latent unemployment, amplifies the poverty and lack of people's confidence in the days to come, entailing a considerable increase of the social costs' burden. Although maintenance of macroeconomic stability (the major objective of the Government for the period under review) had a positive impact on the monetary policies, the precarious state of the public funds had a negative effect on the programs of the social protection of the population. Facing severe fiscal constraints, the Government did not succeed to provide for a proper financial coverage of the social costs. As a result, the discrepancy between the financial possibilities of the state and its social commitments has considerably broadened. By mid 1998 the social funds were in a sharp crisis, which endangers the fate of the social sphere in the future. Besides, the universal nature of the social protection schemes and wide spread of social benefits have considerably devalued their real value. Due to this, the social program efficiency is miserable, and the vulnerability risk extremely threatening.

Being treated as a secondary derivation of the economy, the reform of the social sector has been unwillingly delayed. The structure of social benefits and eligibility conditions, in most cases, remain to be those inherited from the old economic system. In addition to that, the legal framework is antiquated, frustrating the activity of the social employees. The performed modifications during the recent 7 years are perfunctory and often are at variance with the market