Center for Strategic Studies and Reforms

Moldova in transition

ECONOMIC SURVEY

No. 9, 2002

Chişinău, February 2002

C E N T R U L
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C E N T E R
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and Reforms

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PREFACE

In the Republic of Moldova Each year has its own particularities. In 2001, the country received a new President, Parliament and Government, based on the confidence that Moldova's population showed to the Moldovan Communists' Party during the February parliamentary elections.

For the first time in the transition period, the Government did not receive any credits from international financial organizations, did not get considerable foreign investments, while and privatization incomes decreased abruptly. But there were a series of populist measures undertaken, aiming at social support for the most indigent groups of the population, and at the same time statistics showed a "big leap" in growth of the real GDP, industrial production, agriculture and exports. National currency has been impressively stable during the whole year.

In August, as it should have been, a series of actions, including a military parade, took place in honor of the tenth anniversary of the country's declaration of independence. But, the Government, scientists or mass media did not organize any actions in December, when one should have recalled of the fact that it has been ten years since the first Moldovan President through the decree 256 "On liberalization of prices and tariffs and social protection of the population" of December 27, 1991, officially started market reforms.

This can be explained differently – including by apathy and disappointment of the population as regards reforms. Another reason – peculiarity of 2001 when, for the first time during the transition period in Moldova, radical revision of the previous course of "anti-national reforms" began (by legislative and administrative means) and attempts to strengthen state regulation and form a new economic policy that would conform more to state interests, domestic producers and the population were undertaken.

Starting from these circumstances, this Survey is dedicated to examination of different aspects of the phenomenon "Moldova in transition" in 2001. The opinions and conclusions presented hereinafter belong entirely to their authors. But these are taken into account by CISR, which is an independent think-tank whose main goal is to develop knowledge about transition processes in the country and create proposals for practical solutions to economic policy.

This Survey comprises studies carried out by CISR' and cooperating experts: Octavian Şcerbaţchi (1), Alexandru Munteanu, Veaceslav Negruţa and Alexander Muravschi (2), Jerzy Osiatynski, Poland (3, 4), Sofia Şuleanschi (5), Vladimir Crivciun (6), Baron Subaşi and Elena Vutcariova (7), Anatol Gudîm (8) and Vladimir Solonari (9).

The Survey, as well as other main outputs of the Center for Strategic Studies and Reforms, is accessible on CISR web site at ***http://www.cisr-md.org.***

We invite you to collaboration.

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1. MACROECONOMIC TRENDS OF 2001: OVERVIEW AND KEY ISSUES

Introduction

Evolutions in 2001 were characterized by the same fragile stability on macroeconomic level as in 2000 (stable exchange rate, dropping interest rates), but seriously jeopardized by lack of foreign financing (while the country continues to pay significant amounts for external debt service). Scarcity of budget financing impedes all attempts of country's communist leadership to improve the social indicators as per numerous promises done in the election campaign.

Following the approval of the new Government's economic program, International Monetary Fund (IMF) and the World Bank (WB) experts pointed out in April 2001 a number of provisions contradicting the agreements reached earlier with these international financial institutions (IFIs). Among them were state control over prices, state monopoly in alcohol and tobacco sectors, preferential crediting of agriculture, introduction of state orders in agriculture, and others. On top of that, in May 2001 IMF's resident representative in Moldova has released a worrying press statement saying that relations of Moldova with IMF were at a critical juncture.

In June 2001 Finance Minister M. Manoli addressed a confidential letter to Moldova's leadership focused on the difficulties in realization the State Budget for 2001 and consequences of cessation of relations with IFIs. He basically warned about an eventual total incapacity of the Republic of Moldova to make payments to external and internal creditors for a long period of time and imminence of a financial isolation with no way out. He wrote that state budget approved for 2001 was practically left without sources of financing amounting to about 660m lei. At the same time, he said, Ministry of Finance was facing a permanent pressure towards increase in state budget expenditures.

Nothing has changed in the months after. Resumption of external financing was conditioned then by implementation by the Government of a number of measures, among them being – Parliament's approval of pre-shipment inspection, of the new law on free economic zones, of the title V of Fiscal Code, as well as announcement of auctions for sale of two remaining wineries, elimination of export licenses, no increase in import tariffs, selection of a financial consultant for privatization of "Moldtelecom", and others. Although a number of the above measures have been implemented, neither IMF and World Bank, nor the EU and other donors expressed any visible satisfaction over government's policies. By the end of the year it became clear that there were no notably positive developments in relations with IFIs, except for just declarations.

The last drop was the signing of agreement between Moldovan government and Russian concern Gazprom. Reaction from IFIs to this was very adverse. Both IMF and World Bank had many objections towards the new gas supply agreement. In fact, an integral part of the agreement reached earlier with IMF was that the government would not take-on new state debt (since already the debt burden was very high and this was a drag on investment, growth, and poverty reduction). That is why, the Fund was concerned that government has assumed a state guarantee to repay gas debts to Russia's Gazprom and demanded revision of the gas agreement.

As it turned out, in spite of numerous optimistic statements of Moldova's communist leadership (that Moldova fulfilled all provisions of the memorandum with IMF etc.), financing from IMF and World Bank has not been resumed later in 2001. Some have argued that the government has implemented the measures agreed to with IFIs - that the government has "delivered" but that they failed to keep its promises. But this was not true.

The World Bank officials declared that lending would be resumed *de facto* only if there is a program reached with IMF. But to unlock the funding, IMF requires the following steps to be taken now: removal of the state debt guarantee that was signed with Gazprom in November, Parliamentary approval of market-oriented civil code, real progress with the World Bank on SAC-III negotiations, as well as fulfilling other provisions, among them being quantitative financial targets. An important IMF mission will visit Chisinau in late February. If all goes well, IMF Executive Board could meet to discuss Moldova's request for financial assistance in March/April.

At the same time, Moldova's problems might be discussed at the Paris Club meeting in the light of possible debt rescheduling, considering Moldova's difficult financial situation. But that will happen only if there are viable agreements reached with IFIs. Right now no one dares to make far reaching forecasts with regards to Moldova's economic development in general, and relations with IFIs in particular.

The country can not rely endlessly on the good will of external creditors without reforming its economy and getting out of the crisis. Without a firm implementation of reforms in real sector of the economy and reduction of critical public finances' disbalance, the stability of the monetary policy – of inflation rate and exchange rate of national currency – is on the way to failure.

MAIN MACROECONOMIC INDICATORS *

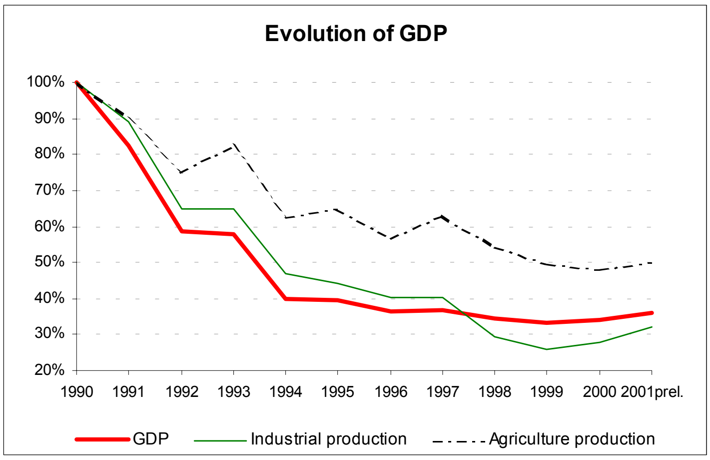
	1994	1995	1996	1997	1998	1999	2000	2001
Real GDP growth rate	**-30.9%**	**-1.4%**	**-7.8%**	**1.6%**	**-6.5%**	**-3.4%**	**2.1%**	**6.1%**
Nominal GDP (excl. Transnistria), lei million	**4737**	**6480**	**7658**	**8917**	**9122**	**12322**	**16020**	**19019**
Nominal GDP, USD million	1164	1443	1665	1933	1689	1171	1288	1478
GDP per capita, USD	322	400	463	529	463	321	354	406
Export (fob), USD million **	**618**	**739**	**823**	**890**	**644**	**469**	**477**	**580**
Export, yr/yr	156.5%	119.6%	111.4%	108.1%	72.3%	72.9%	101.6%	121.7%
Import (fob), USD million **	**672**	**794**	**1075**	**1238**	**1032**	**597**	**783**	**890**
Import, yr/yr	126.8%	118.2%	135.4%	115.1%	83.4%	57.9%	131.2%	113.6%
Trade balance, USD million	**-54.0**	**-55**	**-252**	**-348**	**-388.1**	**-128.0**	**-306.6**	**-310.0**
Current account, USD million **	-92	-115	-188	-275	-322	-34	-128	-143
as % of GDP	-7.9%	-8.0%	-11.3%	-14.2%	-19.1%	-2.9%	-9.9%	-9.7%
Foreign direct investments (yearly flows), USD million **	**18**	**73**	**23**	**71**	**86**	**34**	**128**	**120**
Total external debt (incl. private and energy), USD million	**636**	**840**	**1031**	**1293**	**1447**	**1487**	**1562**	**1548**
as % of GDP	54.6%	58.2%	62.0%	66.9%	85.7%	127.0%	121.2%	104.7%
State public external debt, USD million	**506**	**659**	**766**	**1019**	**1010**	**946**	**1014**	**1007**
as % of GDP	43.5%	45.7%	46.0%	52.7%	59.8%	80.8%	78.7%	68.1%
New borrowing, USD million ***	239	167	142	158	46	199	86	31
Debt service (principal+interest), USD million ***	33	90	84	156	150	225	110	109
NBM gross foreign exchange reserves, USD million	**180**	**258**	**316**	**368**	**141**	**182**	**222**	**227**
NBM gross reserves in months of imports of GFS	2.88	3.05	3.03	3.10	1.38	2.89	2.69	2.45
Internal debt, million lei	**270**	**477**	**737**	**984**	**1572**	**1910**	**2022**	**2400**
Consolidated state budget balance (incl. SF)	-500	-438	-582	-692	-300	-380	-258	109
Consolidated state budget balance (incl. SF) as % of GDP	-10.6%	-6.8%	-7.6%	-7.8%	-3.3%	-3.1%	-1.6%	0.6%
Cash in circulation M0, million lei	345	639	731	972	855	1122	1469	1834
Broad money M3, million lei	**753**	**1244**	**1434**	**1922**	**1756**	**2504**	**3511**	**4787**
Dollarization of deposits	19.0%	22.6%	20.2%	19.3%	44.2%	50.2%	48.8%	44.8%
Monetization of the economy	15.9%	19.2%	18.7%	21.6%	19.2%	20.3%	21.9%	25.2%
Average yearly interest rate on TBs	-	40.1%	37.5%	24.7%	29.2%	26.3%	22.4%	14.5%
NBM's base rate, short and medium term	**150%**	**21.0%**	**19.5%**	**16.0%**	**32.7%**	**17.0%**	**15.0%**	**13.5%**
Average rate on loans in lei granted by commercial banks	160%	41.9%	35.3%	29.9%	28.2%	35.5%	32.4%	28.5%
Average rate on lei time deposits with commercial banks	90%	32.5%	22.0%	20.4%	21.0%	27.8%	23.9%	20.7%
Annual inflation rate (end period)	**104.6%**	**23.8%**	**15.1%**	**11.2%**	**18.3%**	**43.7%**	**18.4%**	**6.3%**
Average annual inflation rate	487.0%	30.0%	24.0%	12.0%	8.0%	39.0%	31.0%	9.8%
End-year exchange rate, lei/1USD	**4.27**	**4.50**	**4.65**	**4.66**	**8.32**	**11.59**	**12.38**	**13.09**
Average exchange rate, lei/1USD	4.07	4.5	4.6	4.6	5.4	10.5	12.4	12.9
Nominal end-year appreciation(+)/depreciation(-), MDL/USD	–17.3%	–5.4%	–3.4%	–0.2%	–78.6%	–39.3%	–6.8%	–5.7%
Nominal end-year appreciation(+)/depreciation(-), USD/MDL	–14.8%	–5.1%	–3.2%	–0.2%	–44.0%	–28.2%	–6.4%	–5.4%
Real end-year appreciation(+)/depreciation(-)	+74.4%	+17.5%	+11.4%	+10.9%	–33.8%	+3.2%	+10.8%	+0.6%

** excluding Transnistria*
*** estimated for 2001*
**** refers only to state's public foreign debt*

Economic Growth

According to the preliminary data released by Statistics Department, Moldova's nominal GDP in current prices reached 19,019 million lei in 2001, thus showing a 6.1% real growth comparing to 2000 (official forecast was 5%). But it should be noted here, that numerous experts have been questioning this figure lately. Nevertheless, it is commonly recognized, that after the huge economic decline in previous years such a growth was expected sooner or later. Also, it is clear that last year's performance was in fact generated by the efforts of previous 2 governments, and especially of I. Sturza's cabinet, since there is a lag between implemented policies and impact on real GDP growth.

Nominal GDP in US dollar terms reached $1.48bn (that is $406 per capita). Statistics Department has also revised the 2000 data – nominal GDP was reevaluated at 16,020 million lei, indicating now a 2.1% real growth, instead of 1.9%. Cumulative figures show that in 2001 GDP reached 36.1% of the 1990 level, as shown on the chart.



Speaking about the sectoral breakdown, official statistics reported that in 2001 gross value added in industry increased by 16.5% comparing to 2000, in agriculture it increased by 4.4%, and in services – by 2.4%. Consequently, gross value added increased by 5.4%, while net taxes on production and imports increased by 10.8%.

Industrial enterprises of all types of ownership manufactured goods worth 10.35 bn lei (14.2% more than in the previous year), but, similarly with 2000, a big share of production capacities are still closed or work short hours, because of financial problems. The highest growth rates were recorded in textiles, machine construction, furniture, wine-making industry, bakery, soft drinks and diary industries.

Agriculture output amounted to 9.14 bn lei, i.e. 4% more than in 2000. This growth was mainly generated by the increase in crops (+7.6%), while animal husbandry experienced a decline (-3.4%).

In 2001 world's prime rating agencies have been showing increasing concerns about Moldova's perspectives. In early July 2001 Moody's has degraded the rating of external obligations of Republic of Moldova to Caa1 and that of bank deposits to Caa2. Over the last several years, the rating dropped considerably - from Ba2 in 1997 to B3 in 2000.

Fitch IBCA has downgraded Modova's sovereign rating twice in 2001. In early June Fitch has lowered Moldova's long-term foreign-currency rating from B- to CCC+, and the short-term local-currency borrowings - from B to C. Fitch downgraded the outlook of the long-term rating from "stabile" to "negative", and it noted that the Government's inability to attract means from other sources may influence negatively the Budget revenues and lead to a $70m gap in the 2001 payment balance, and in 2002 - up to $100 million. The gaps were to be covered from the country's scarce hard-currency reserves. The agency pointed out the slackness of structural reforms, a gigantic external debt, insignificant progress in privatization, instability of main export markets, and a need for restructuring liabilities to creditors. At end-June Fitch reviewed its rating again and further downgraded Moldova long-term foreign currency rating from CCC+ to CC. The agency again assigned a negative outlook to the rating, saying that its further downward slide is not out of the question. Fitch stated that the premise lying behind its decision to downgrade Moldova was high likelihood of government's failure to redeem outstanding Eurobond issue on time.

According to the IMF's Resident Representative in Moldova, Hassan Al-Atrash, the lesson learned in Moldova is that sustained growth requires:

- Reforming the energy sector: it is the least transparent sector, responsible for geometric increase in the debt burden, and a major source of corruption: "a state-within-a-state".
- Reforming the public administration: salaries in the public sector are too low (resulting in corruption and collusion between some government officials and mafia interests) and it is hard to attract—and keep—capable people. This needs to be done within the framework of an overall consolidation of the public sector.
- Ownership of reforms and a political consensus on policies needed to jump start the economy and reduce poverty. IMF-supported reforms have worked where there was local ownership and a consensus on the appropriateness of these policies and have not worked when these were lacking.

IMF thinks that notwithstanding the commendable job done in maintaining financial stability, there continue to be contradictory signals on structural reforms: some talk about privatization while others threaten re-nationalization, agricultural policy is particularly difficult to interpret. These mixed signals bode ill for investment – domestic and foreign. And in the absence of investment, sustained growth will be difficult to achieve. Same conclusions were also expressed by the World Bank experts.

Finally, the main objective set in the Memorandum for 2001-2003 between Moldova's government and IMF, as well as in the Memorandum on SAC with WB, was furthering of the policies ensuring high and sustainable economic growth, which is an important precondition for poverty reduction.

Speaking about concrete prospects for 2002, here is macroeconomic framework set by the Monetary Policy for 2002 approved by the National Bank of Moldova:

a) the annual inflation rate of 10%;

b) the real GDP growth by 6% for 2002;

c) the deficit of the national public budget of 1.4% of GDP;

d) the average estimated exchange rate for 2002 at the level of 13.5 lei/1US$;

e) the consolidation of state international reserves up to a level sufficient to cover around 3 months of imports.

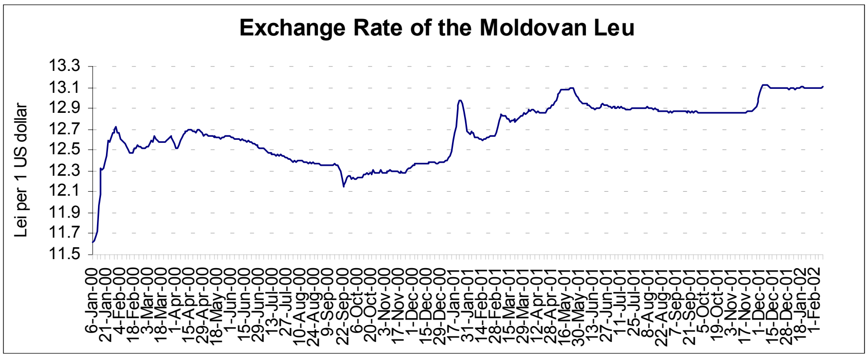
These targets also include the government's Forecast for the Social and Economic Development of the Republic of Moldova for 2002-2004, as well as the economic and financial agreements concluded between the Republic of Moldova and the international financial institutions.

Exchange Rate, Foreign Exchange Reserves

During 2001, as in 2000, exchange rate of the Moldovan leu against the US dollar was stable. In the first 5 months of 2001 leu was on a slightly depreciating path, but in the second half of the year it kept steady at around 12.9 lei/1US$, except the first week of December when an adjustment took place, and the leu depreciated almost instantly from 12.9 to 13.1 lei/1US$, which has become since then a new point of stability.

In 2001 the nominal depreciation, expressed in domestic currency terms, constituted 5.7%, leu sliding from 12.38 lei/1US$ to 13.09 lei/1US$ by end-2001 (in 2000 the leu has depreciated against the US dollar by 6.8%). Yearly average exchange rate for 2001 was 12.87 lei/1US$ (in 2000 it was 12.43 lei/1US$).

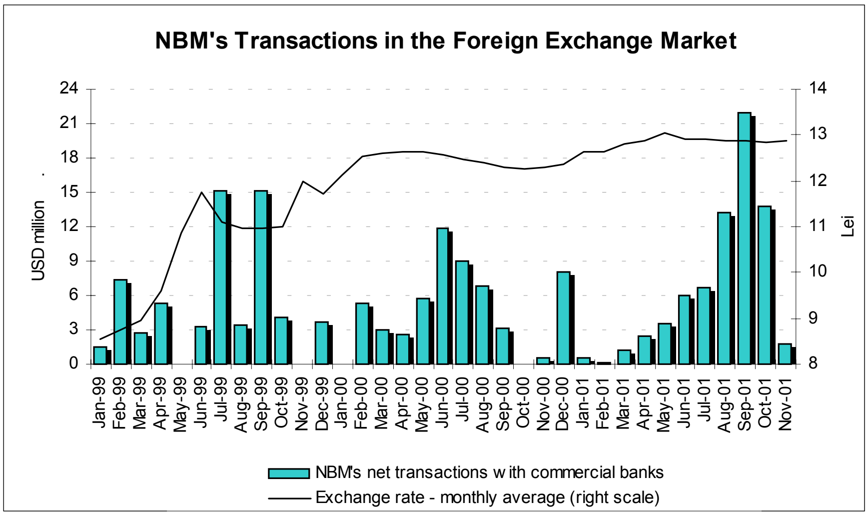
The foreign exchange policy of the National Bank of Moldova for 2002 provides for further freely floating regime of the national currency and setting of the official exchange rate on the basis of prevalent exchange rates on the foreign exchange market. Average estimated exchange rate for 2002, set in the NBM's Monetary Policy for 2002 is at the level of 13.5 lei/1US$.



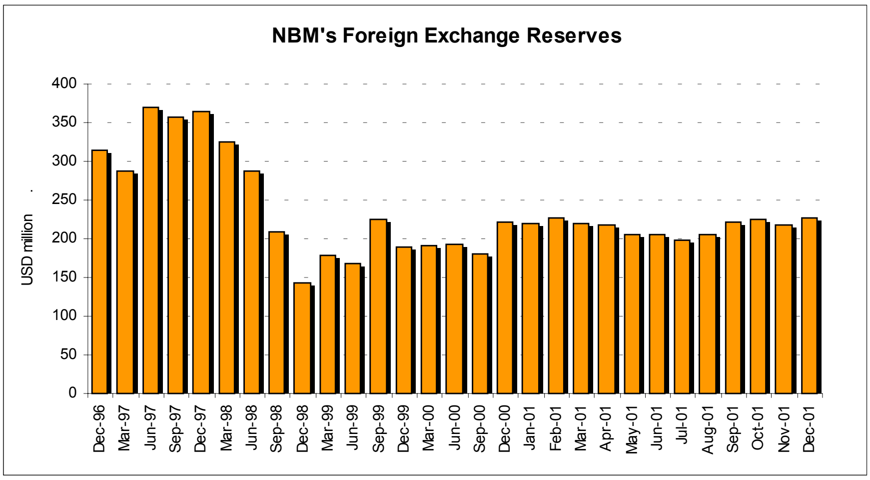
Stability of the national currency against the US dollar was caused by significant surplus of hard currency in the local market, which offset turbulences in the foreign exchange market, and at the same time allowed the National Bank to intervene as buyer of foreign currency, thus maintaining state's international reserves at the level of 2.5 months of import coverage.

Presence of such a high volume of foreign exchange in the market was caused, among other factors, mainly by significant incomes of residents of Moldova working abroad (exceeding 150 million dollars per annum), from which only a part is transferred to Moldova through the banking system, the rest is just brought in cash.

As it was already mentioned, under these circumstances NBM continued to buy important amounts of hard currency from commercial banks. This was more than welcome, considering the difficult situation characterized by absence of foreign financing. While in 2000 NBM bought from commercial banks US$60m, in 2001 this figure exceeded $75m, which did help a lot in offsetting the burden of the foreign debt service.



Owing to the successful strategy implemented on the foreign exchange market in 2001 (as well as in 1999-2000), the National Bank continued to consolidate its foreign exchange reserves. Thus, as a result of continuous purchases of foreign exchange in the local market (largest amounts were bought in August-October) and good reserves management, NBM's gross foreign exchange reserves did not diminish and constituted $227m at end-2001, covering about 2.5 months of imports of goods and services (at end-2000 reserves were $222m, covering 2.7 months of imports).



NBM's Monetary Policy for 2002 aims to achieve a further consolidation of reserves at the level of three months of imports. National Bank is reserving the right to perform foreign exchange interventions but in cases of stringent necessity to smooth excessive fluctuations of the real exchange rate and to influence the exchange rate with the view to creating favorable conditions for economic growth.

However, in the absence of financing from IFIs, foreign exchange reserves may drastically diminish, if the government attempts to use these funds for the repayment of foreign debt. Such an attempt was already taken in July 2001, when the Parliament passed an amendment to the 2001 Budget Law, according to which NBM had to extend a loan to the MoF up to 30 million dollars, used for foreign debt repayments.

Needless to say, how adverse such a policy is – no matter how justified the motivation would be, the implementation of such practice is far below any criticism, and it is a clear sign of infantile and irresponsible action. A preferred option, however, would be concluding successful negotiations with IFIs, ultimately allowing for both resumption of concessional lending, and a Paris Club rescheduling of Moldova's debt.

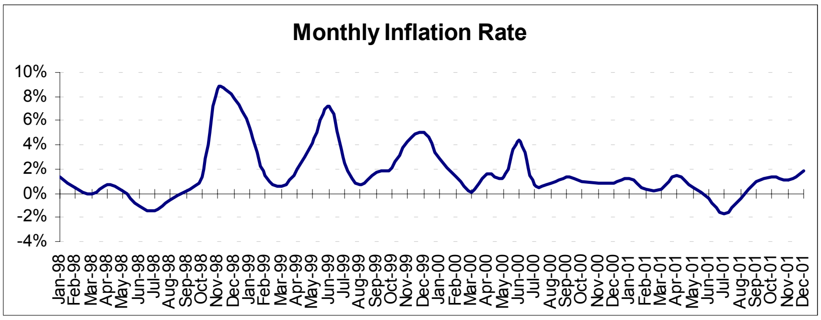
Inflation

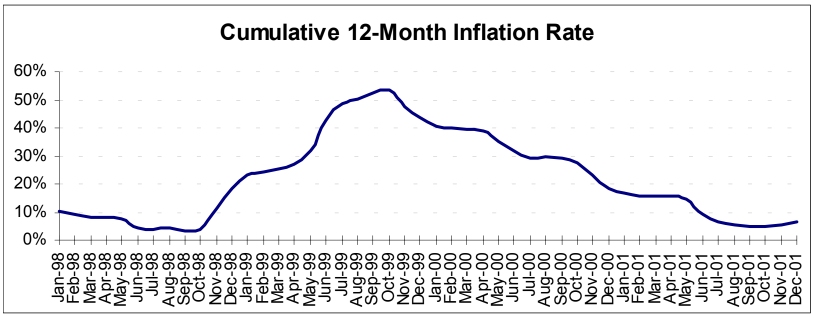
Inflation rate remained stable in 2001 and it even achieved the lowest level in the last decade – cumulative end-year rate of inflation constituted only 6.3% (in 2000 it was 18.4%). NBM's forecast for end-2001 was 10%. Average yearly inflation rate for 2001 was 9.8% (in 2000 – 31%).

Official statistics also reported that prices for foodstuffs increased by 6.1%, non-food prices grew by 7.9%, tariffs for services granted to the population have increased by 4.5%.

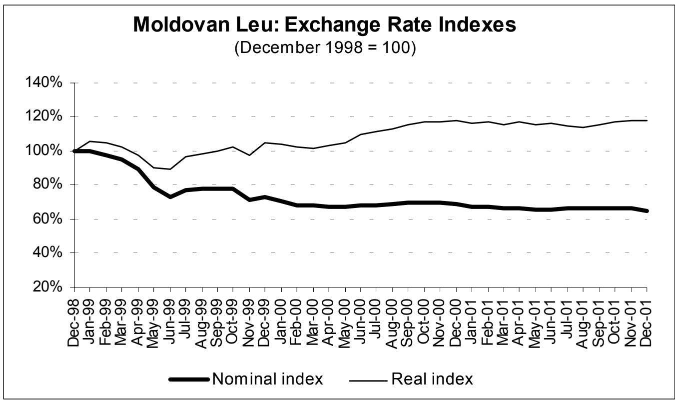
Highest inflation in 2001 was observed in December (1.9%), and lowest - in July (deflation of -1.7%). In 2001 similarly with the year 1998 there was a deflation for 3 months in a row: June, July and August.

NBM's Monetary Policy for 2002 forecasts again a 10% end-year inflation rate.





Evolution of the exchange rate of the Moldovan leu against the US dollar in real terms has also been stable throughout 2001. Slight nominal depreciation of leu was offset by the low level of inflation. Leu's real exchange rate index hovered in the first 6 months of 2001 at around 99%, if we take December 2000 as basis, following a bigger depreciation in real terms in the months with deflation, while higher inflation in November-December has led to a slight appreciation in real terms, and as it can be seen in the table below.



Exchange rate indexes (2001)

	Nominal	Real
Dec-00	100.0	100.0
Jan-01	97.8	99.0
Feb-01	98.0	99.4
Mar-01	96.6	98.4
Apr-01	96.1	99.3
May-01	94.8	98.5
Jun-01	95.8	98.9
Jul-01	95.9	97.4
Aug-01	96.0	97.0
Sep-01	96.2	98.1
Oct-01	96.2	99.4
Nov-01	96.1	100.3
Dec-01	94.5	100.5

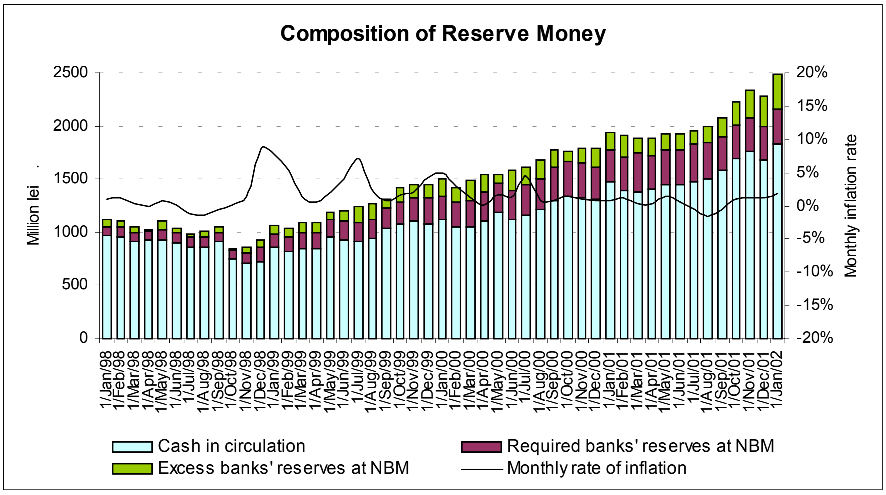
Monetary Aggregates

Evolution of monetary aggregates has shown a good performance in 2001. Table below reflects the yearly evolution of the main monetary indicators:

Evolution of monetary aggregates

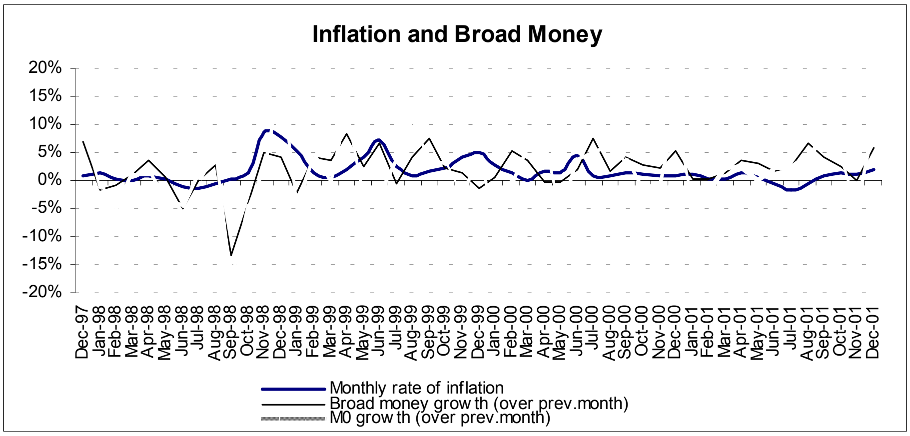
End-year:	Inflation	M_0 growth	RM growth	M_3 growth	Monetization
1994	104.6%	189.4%	128.2%	115.6%	15.9%
1995	23.8%	84.9%	42.3%	65.2%	19.2%
1996	15.1%	14.4%	9.7%	15.3%	18.7%
1997	11.1%	33.0%	31.5%	34.1%	21.6%
1998	18.2%	-12.0%	-5.6%	-8.7%	19.2%
1999	43.8%	31.2%	41.4%	42.6%	20.3%
2000	18.4%	31.0%	29.8%	40.2%	22.0%
2001	6.4%	24.8%	27.9%	36.3%	25.2%

Volume of lei in circulation M_0 grew by 24.8% reaching at end-2001 1.83bn lei. Reserves of commercial banks with the NBM rose by 38% (half of them are excess reserves, while at end-2000 in excess were one third only). Consequently, reserve money increased by 27.9%, reaching at end-2001 2.49 bn lei.

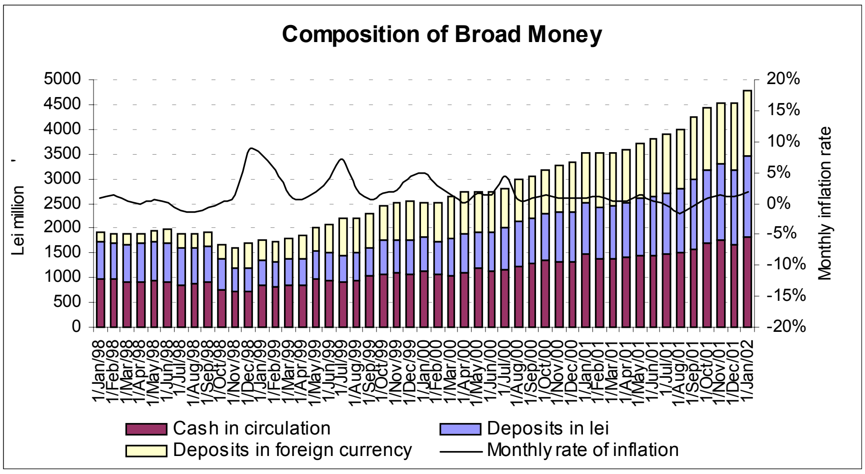


The reason of noteworthy increase in cash in circulation was the considerable supply of foreign exchange on the domestic market, generated by repatriation of export proceeds and, as already mentioned, significant workers' remittances from abroad.

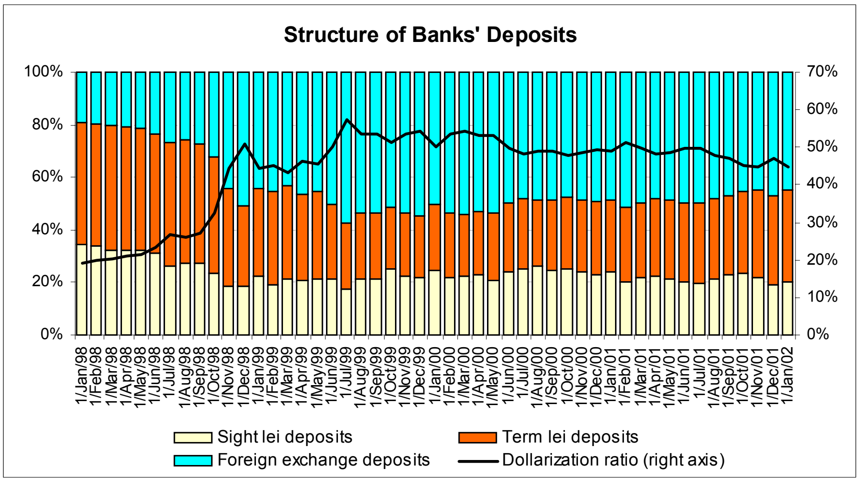
Following the provisions of its Monetary Policy for 2001, NBM implemented a gradual reduction of reserve requirement from 13% to 10% (October 2001). As a result, more than 70 million lei were freed up for lending into the real sector of the economy. In 2002 NBM is committed to further reduce the reserve requirement to 7%.



Broad money M_3 increased by 36.3%, reaching 4.79bn lei (NBM's Monetary Policy for 2001 assumed a broad money increase by 22.6%, denoting a larger money demand conditioned by the real growth in GDP and reduction of inflation expectations). Money multiplier for M_3 grew from 1.80 to 1.92. Due to the increase in money supply, the level of monetization of the economy further increased to 25.2%. As we can see, the percentages here are similar to the ones in 2000.



Growth of broad money by one third was on the account of large increase in the volume of deposits with the banking system (they increased by 45%, reaching at end-2001 2.95 bn lei), showing confidence of population and economic agents both in leu and in banking system. Share of foreign exchange deposits even diminished, hence dollarization ratio of deposits with commercial banks fell from 48.8% at the end of 2000 to 44.8% at end-2001.

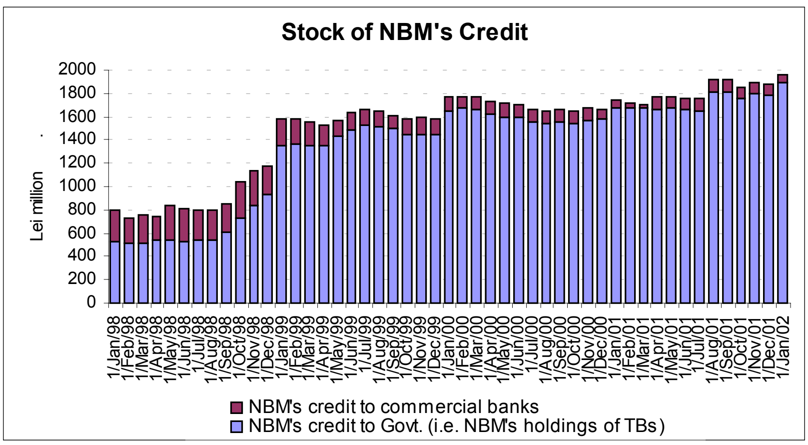


NBM's Monetary Policy for 2002 includes the following monetary assumptions: broad money increase by 27%, velocity 3.68, reserve money increase by 13%, money multiplier 2.16, credits to economy increase by 33%, level of monetization of the economy 27.2% (following the larger demand for money determined by a real economic growth of 6%). It is also foreseen a further reduction in dollarization level to 37%, based on stabilization of public confidence in the national currency and the attenuation of inflationary expectations.

NBM's Credit

Government's debt to NBM, expressed in the stock of NBM's Treasury papers, has increased during 2001 by 13%, reaching at end-2001 almost 1.9 bn lei. According to NBM's Monetary Policy for 2001, the National Bank was not supposed to provide credits to the Government to finance the state budget deficit, but, in order to avoid a default in meeting external obligations of the country, the Parliament passed at the beginning of July an amendment to the 2001 Budget Law, according to which NBM could extend a loan to the MoF up to 30 million dollars, used for foreign debt repayments.

According to NBM's Monetary Policy for 2002, similarly with previous years, the National Bank should not provide credits to the Government to finance the state budgetary deficit. Moreover, NBM should re-conclude credits previously granted under the pledge of state securities within the limits stipulated in the Law on the Budget for 2002 at a market interest rate and the maturity in 2003. Finally, NBM should accept the further re-issuance by MoF of old state securities (for the loans granted in previous years) in the amount of 400 million lei for a maximum term of 180 days.



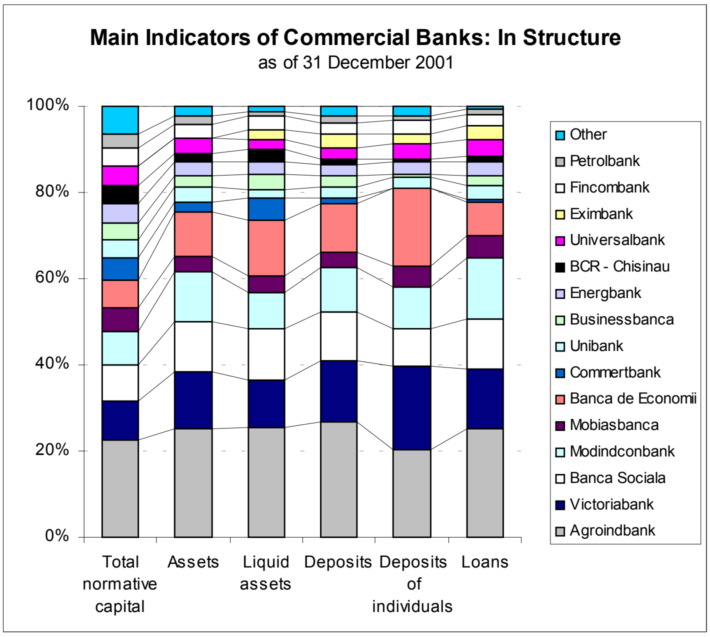
Stock of NBM's credit to commercial banks (excl. REPOs) hovered in 2001 slightly above 100 m lei. In the absence of refinancing auctions the main instrument of granting loans to commercial banks are open market operations performed by NBM (mostly sale REPOs and direct sales), which almost doubled in 2001 comparing to 2000. NBM applies the 2-month TB purchasing REPO rate as its basic rate, which serves as reference point while setting the interest rates for the other monetary instruments (overnight credits, Lombard facility and deposits with NBM). Basic (short and medium term) rate has diminished from 27% in December 2000 to 13% at end-2001. NBM also sets the interest rate on long-term credits, which in 2001 diminished from 15% to 13.5%.

In 2002 National Bank of Moldova will continue to apply the following indirect monetary instruments with the view to managing rates and liquidities of the banking system: open market operations, including TBs selling/buying, REPOs and reverse REPOs with TBs, Lombard facility, deposit acceptance and provision of overnight credits. Also, for 2002 NBM aims at conducting an interest rate policy, targeted at maintaining the real interest rates at a low positive level, thus stimulating real sector's demand for credits and, respectively, contributing to the economic growth. However, as in previous years, it appears that banks have sufficient credit resources and they are not so interested in getting new loans from NBM, especially noting that the reserve requirement is being gradually lowered.

Commercial Banks

Presently there are 19 commercial banks in Moldova, 5 originated from reorganization of the former state banks, and 14 are new banks. Banking sector is concentrated with five biggest banks (Moldova-Agroindbank, Victoriabank, Banca Sociala, Moldinconbank and Banca de Economii) these accounting for 69% of total assets in the system (end-December 2001).

From 1 January 2001 minimal capital requirement for commercial banks was set at: 32 million lei for a basic license (A type), 64m lei for a B type license (allowing operations with foreign exchange), 96m lei - for a C type license (allowing more operations with securities and other). This has spurred the consolidation of the banking sector, most of the banks increased their capital through share issues and only few merged. Moldovan banking system's aggregate assets reached at end-2001 5.99 billion lei (increased by one third compared to end-2000). Banks' aggregate normative capital equaled to 1.66 billion lei (increased by 18.7%), liquid assets - 2.07 billion (increased by 25.2%).

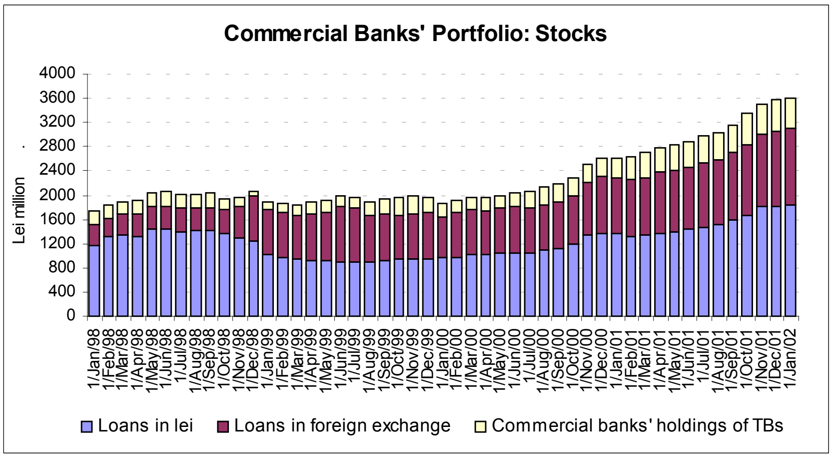


Data available for the first 9 months of 2001 shows that banks' credit portfolio was somewhat improving – ratio of bad loans in total credit portfolio has reduced by 12.5

percentage points as compared to end-2000, ratio of standard and supervised loans in total increased from 79.4% at the beginning of the reported period to 87.5% at the end of the 3d quarter of 2001.

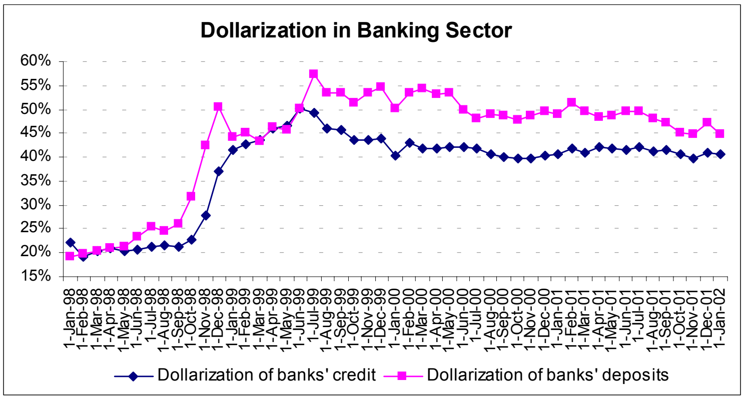
NBM's Monetary Policy for 2002 stipulates that NBM should further conduct a policy of banking system's consolidation, through continuous maintenance of set requirements and improvement of standards on absolute capital evaluation and coverage of related risks for each separate bank. With the view to averting the shortage of capital sufficiency, the National Bank shall support processes of banking association and merging.

Commercial banks' lending activity was gradually evolving: while in 2000 stock of banks' credits into the economy grew by 40%, in 2001 banks' credits grew further from 2.29 bn lei to 3.10 bn, i.e. by another 35%. Among the factors which contributed to the increase in banks' lending were: reduction of reserve requirement, reduction of inflationary expectations, growth in the economy, and last but not least important - reduction of interest rates on all monetary instruments.

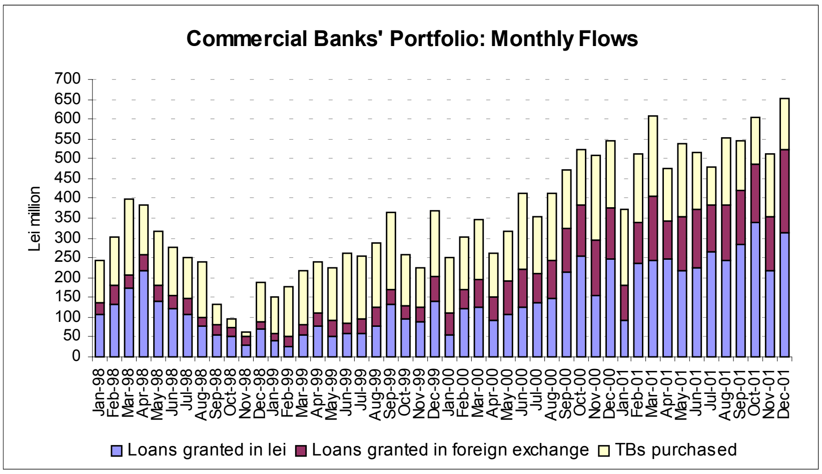


Stock of Treasury securities in banks' portfolios continued to increase, by end-2001 it stood at half a billion lei (it was 321 million at the beginning of the year).

Credit dollarization ratio hovered at 41-42% throughout the year, and at end-2001 it constituted 40.7% (while dollarization ratio of deposits with commercial banks fell from 48.8% at the end of 2000 to 44.8% at end-2001).



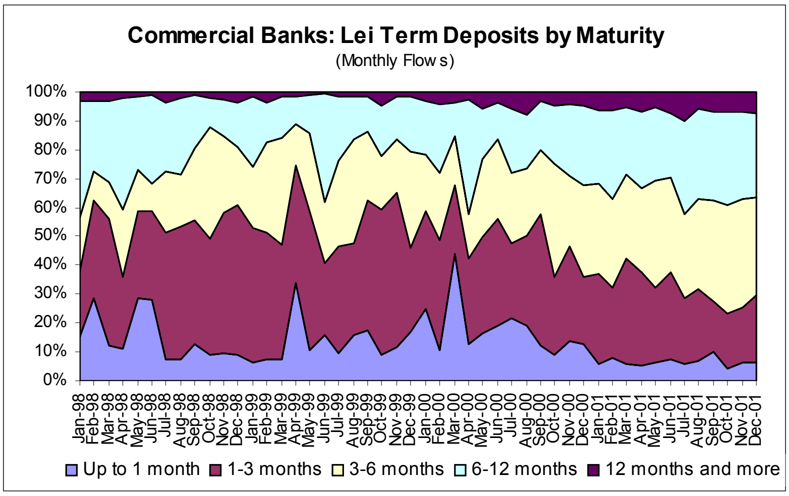
A more dynamic picture is offered by the monthly flows data for commercial banks' credits. As we can see, banks' loans granted to economic agents were on a rise: while in December 2000 loans in lei amounted to about 250 million lei, in December 2001 this figure constituted 313 million lei. In total, there were 2.9 bn lei of loans in lei granted by banks in 2001 (1.8 bn lei in 2000). Similarly, loans granted in foreign exchange rose from 1.1 bn lei total in 2000 to 1.6 bn lei in 2001.



Looking at the maturity structure of deposits with banks and banks' loan portfolios, one could see that in 2001, as well as in the previous years, the deposits are mostly short term (93% are up to 1 year), that consequently determines a reduced maturity of the loans granted by banks (81% are up to 1 year). Obviously banks cannot make long-term lending having a short-term deposit base of their clients.

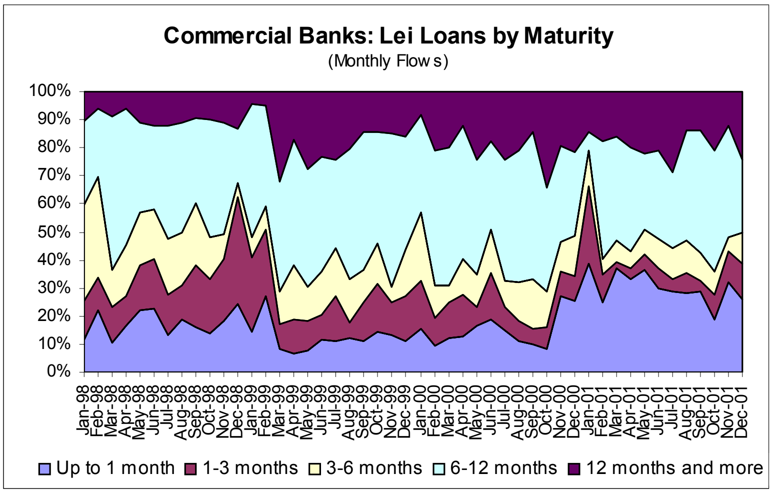
But, speaking about the deposits with banks, it should be mentioned a positive aspect here, namely that deposits' maturities shifted towards a longer term. The share of up to 1 month deposits has reduced 3-fold comparing to 2000, while share of deposits with over 6-month maturities has increased, as it can be clearly seen from the table below.

Unfortunately, the same cannot be said about banks' loans maturity structure. Share of loans granted for up to 1 month was in 2001 twice bigger, while loans with longer maturities have shrunk. This is a very worrying sign, proving that commercial banks have adopted a very cautious crediting policy.



Structure of term lei deposits by maturity (average)

Term:	1999	2000	2001
<1 m.	14.9%	18.3%	6.5%
1-3 m.	40.2%	31.4%	24.9%
3-6 m.	25.5%	24.8%	33.0%
6-12 m.	17.5%	20.9%	28.7%
>12 m.	1.8%	4.5%	6.9%



Structure of lei loans by maturity (average)

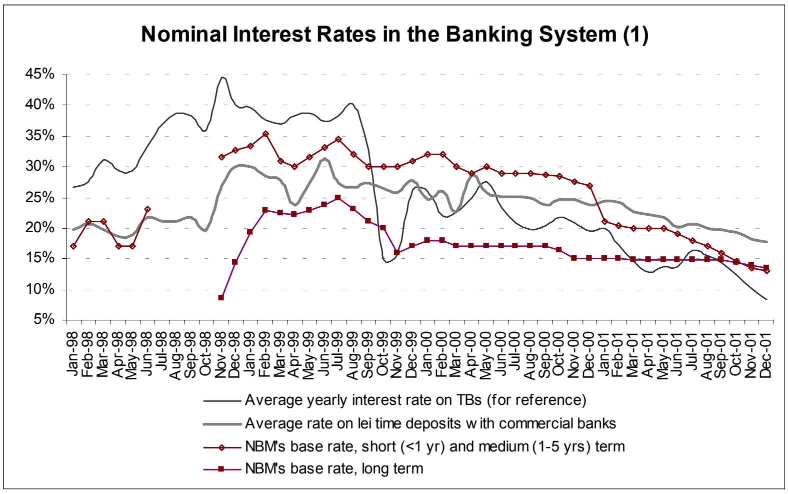
Term:	1999	2000	2001
<1 m.	11.6%	15.3%	29.2%
1-3 m.	13.6%	9.5%	7.7%
3-6 m.	13.4%	13.1%	9.0%
6-12 m.	43.5%	40.8%	35.0%
>12 m.	17.9%	21.3%	19.1%

Interest Rates

As it was already noted many times in our previous reports, there is a problem of availability and cost of credit in Moldova, partly resulting from limited competition in the commercial banking sector, which continues to keep the real cost of credit at a high level. High borrowing requirements of the government combined with low supply of domestic savings led in the recent years to the high interest equilibrating the financial market.

High systemic risk, driven by the weakness of court and legal environment, reduced the incentives for search for profitable lending opportunities. Let alone strong political interference, which probably is the worse factor from the above.

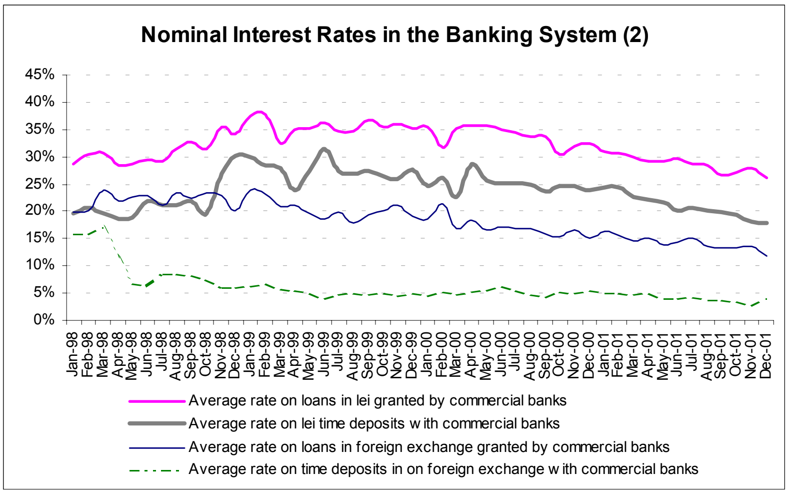
Throughout 2001 NBM successfully implemented the strategy of reducing interest rates in the banking system. It has repeatedly lowered its basic rate, and at the same time it recommended commercial banks to reduce their rates as well. As indicated earlier, NBM's basic (short and medium term) interested rate has diminished 2-fold: from 27% in December 2000 to 13% at end-2001, while NBM's rate on long-term credits from 15% to 13.5%.



The good thing was that in 2001 the average interest rate on government securities remained significantly lower than the average rate on banks' term deposits, hence imposing commercial banks to find more profitable activities than just investing in virtually risk free Treasury securities. Same tendency was seen in most of the year 2000.

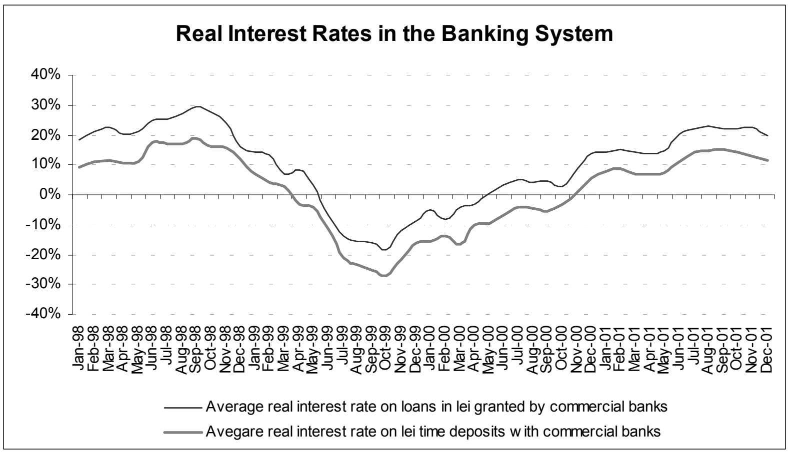
While back in 1999 and in 2000 interest rates on deposits with commercial banks did not vary much (same applies to rates for banks' loans), in 2001 a clear downward trend was observed throughout the year.

Average nominal interest rate (in yearly terms) for time deposits in lei went down from 23.9% in December 2000 to 17.8% in December 2001, while average nominal interest rate on loans in lei granted by commercial banks diminished from 32.4% to 26.2% for the same period of time.



On the other hand, average nominal interest rate on loans granted in foreign exchange also had a downward trend – it fell from 15.1% in December 2000 to 11.9% in December 2001, while the rate for time deposits in foreign exchange went down from 5.4% to 3.9% accordingly.

Real interest rates were continuously increasing throughout 2000, and they have become positive in the second half of the year. This tendency continued in 2001 as well – for the whole 2001 interest rates both on deposits and on loans were positive in real terms, reflecting the very low rate of inflation observed. In December 2001 average real interest rate on loans in lei granted by commercial banks was 19.8% (up from 13.8% in December 2000), while real interest rate on time deposits in lei stood at 11.4% (up from 5.3%).



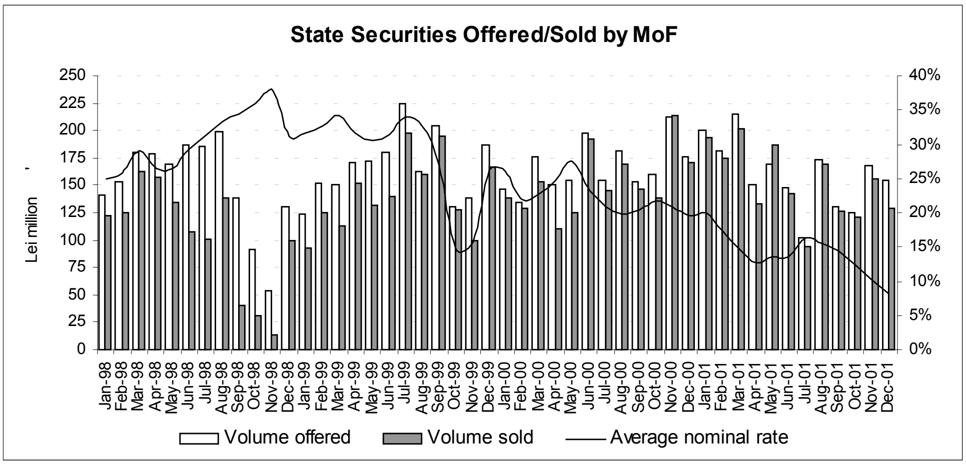
Positive real interest rates on deposits are a sign of stability in the banking system, banks willing to commit themselves to paying higher than inflation interest rates on clients' deposits. However, the margin between banks' lending rate and deposit rate did not change, and it is still large, meaning that commercial banks are still too cautious, thus keeping the lending rates high and costly for their clients.

On the other hand, evidence show that banks have sufficient credit resources and they are not so interested in getting new loans from NBM. There is an excess of liquidity in commercial banking system. One of the main causes of insufficient crediting of production sector remains lack of efficient investment projects and small number of solvent economic entities, that could efficiently use the credits and reimburse them in due time.

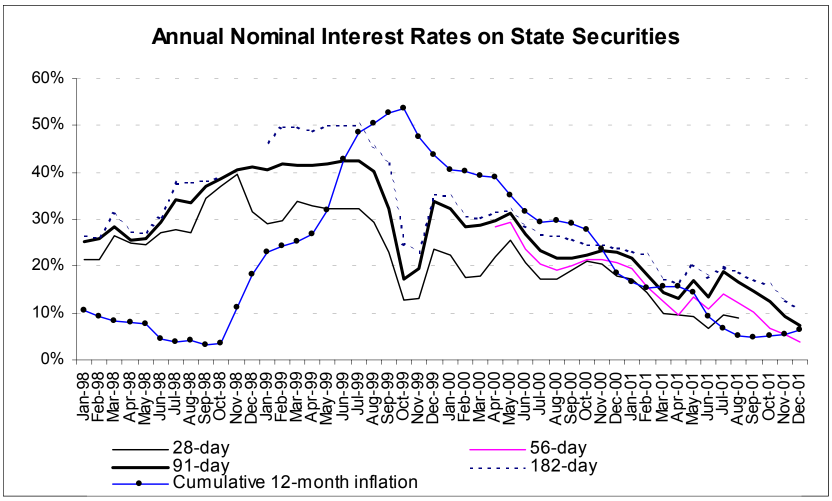
NBM's Monetary Policy for 2002 foresees further gradual reduction of interest rates on the credit market, following the increase of money supply and the reduction of inflationary expectations determined by the consistent achievement of medium-term inflation target. The interest rates policy of the National Bank of Moldova shall have as target the maintenance of real interest rates at a low positive level that would ensure a relevant decrease of nominal rates in economy and the reduction in price of credit recourses for the real sector.

Treasury Securities Market

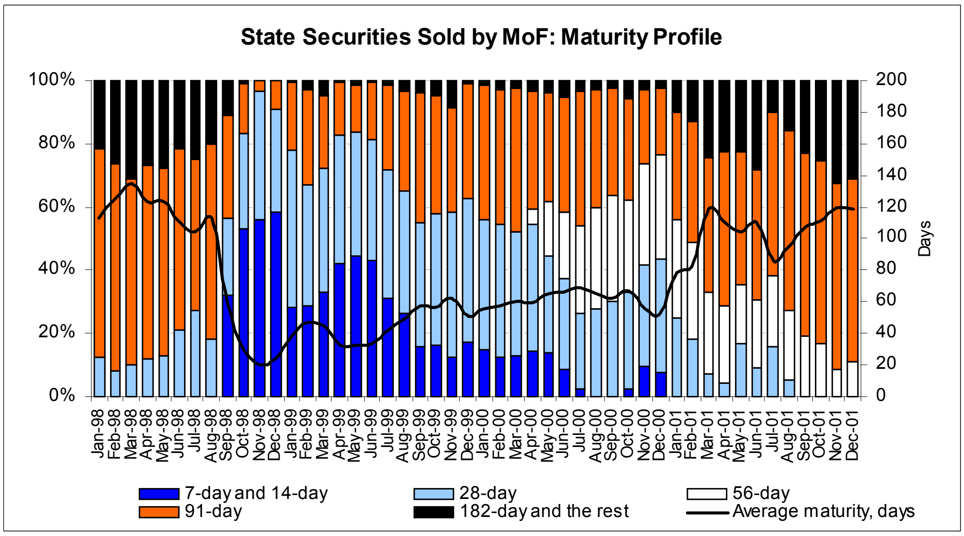
Situation in the state securities market remained stable. Like in previous 2 years, Ministry of Finance did not have difficulties in issuing new treasury securities and redeeming those in circulation. In 2001 at the primary auctions at NBM treasury securities were offered in a total volume of 1.9 bn lei, volume of TBs sold was 1.8 bn lei, i.e. on average 150 million lei sold per month (in 2000 volume of TBs offered was 2 bn lei, TBs sold were also 1.8 bn lei). In 2001 Ministry of Finance redeemed securities totaling 1.65 bn lei (net volume was about 150 million lei, these funds fuelling the state budget), while in 2000 volume of redeemed securities amounted to 1.69 bn lei (net amount being about 112 million lei).



The positive tendency of continuous reduction in interest rates for TBs in 2000 continued in 2001 as well. While in 2000 for the whole year weighted average interest rate for TBs (all maturities) constituted 22.3%, in 2001 it constituted only 14.3%. In December 2000 average interest rate on TBs was 19.6%, and in December 2001 it went down to 8.2%. Considering Government's desperate need in additional financial resources for the state budget, this evolution was obviously very favorable. High demand for TBs allowed the Ministry of Finance to cut the interest rates, thus reducing the burden of expenditures for servicing the issued securities.



Looking into the maturity profile of state securities sold, there is a positive tendency of significant growth in average maturity of TBs issued. During 2000 average maturity basically hovered at 55-65 days, but throughout 2001 it was on a rise, approaching to 120 days by end of the year.

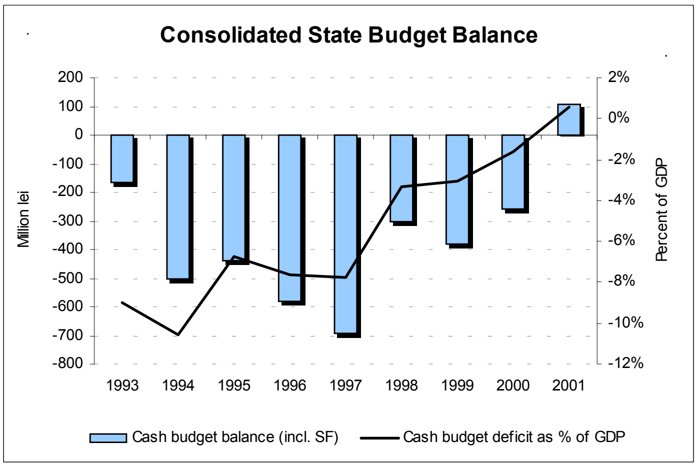


While throughout 2000 volumes of sold TBs with 182-day and longer maturities were on average 5 m lei per month, in 2001 they constituted around 30m lei and higher. At the same time, no 7-day and 14-day securities were sold at all (while in 2000 on average 12m lei per month were put up for sale). Moreover, starting from September 2001 no more 28 days T-bills were sold - they were effectively replaced by 56-day bills.

State Budget

A highly erratic fiscal performance has contributed significantly to Moldova's economic problems in recent years. Sizeable fiscal deficits were generated by inadequate tax collection and excessive public spending. As a result, public debt has grown significantly.

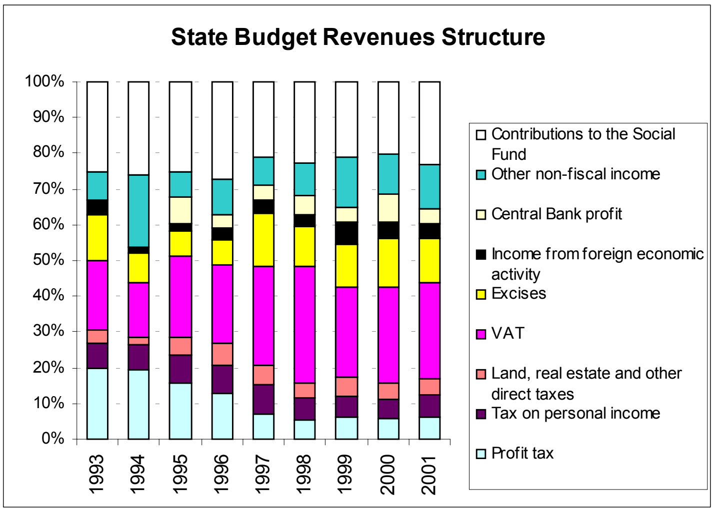
Preliminary figures for 2001 consolidated budget (including social fund) are: revenues 5.5bn lei, expenditures 5.4bn lei, with a resulting cash balance of 100 m lei, or 0.6% of GDP (it was -1.6% in 2000). As in previous years budget revenues were adversely affected by a number of factors, including tax evasion, low tax base, and revenue stream highly dependent on the economic cycle. Expenditures, on the other hand, have tended to increase from year to year.



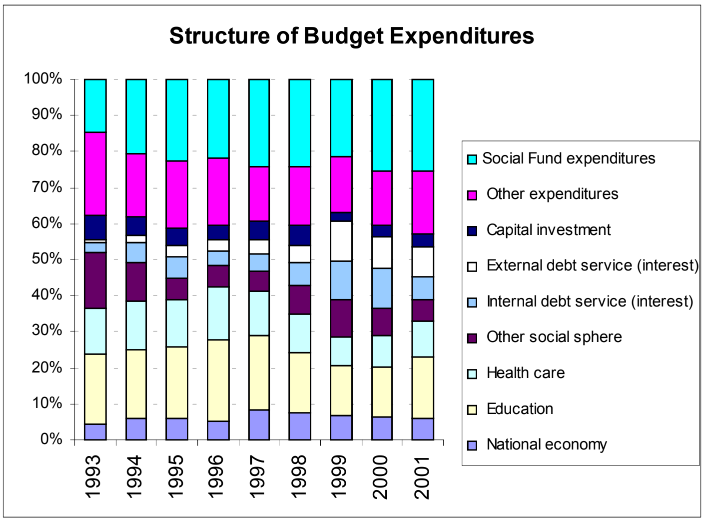
Consolidated State Budget (million lei)

	1993	1994	1995	1996	1997	1998	1999	2000	2001e
Revenues (incl. Social Fund)	488	1847	2555	2836	3671	3505	3745	4912	5520
Contributions to the Social Fund	124	474	640	761	729	783	783	994	1287
Expenditures (incl. Social Fund)	652	2347	2993	3418	4363	3805	4124	5169	5411
Social Fund Expenditures	93	452	648	766	1057	912	889	1328	1386
Budget balance (incl. Social Fund), cash	-164	-500	-438	-582	-692	-300	-380	-257	109
Budget balance, cash, as % of GDP	-9.0%	-10.6%	-6.8%	-7.6%	-7.8%	-3.3%	-3.1%	-1.6%	0.6%

Budget revenues' structure for 2001 is presented on the chart – there are no big changes observed since 2000. Figures show an improved tax collection - there was a 29% increase direct taxes collected (19% in 2000), and a 9% increase in indirect taxes (44% in 2000). Non-tax revenues diminished by about 5% (but they increased by 35% in 2000). Finally, contributions to the Social Fund increased by 29%, which is almost the same as in 2000



Budget expenditures' structure is presented on the other chart which shows that there are also no significant changes. Figures show that in 2001 national economy expenditure item decreased by 3% (in 2000 there was a 15% growth), social sphere item increased by 14% (17% in 2000), for instance expenditures for education grew by 28% (25% in 2000), and for health care – by 17% (38% in 2000). While interest payments for external debt service were the same as in 2000, interest payments for internal debt service decreased considerably (by 40%), as a result of considerable drop in interest rates. Finally, Social Fund expenditures stood at the same level as in 2000 (in 2000 they grew by 50%).



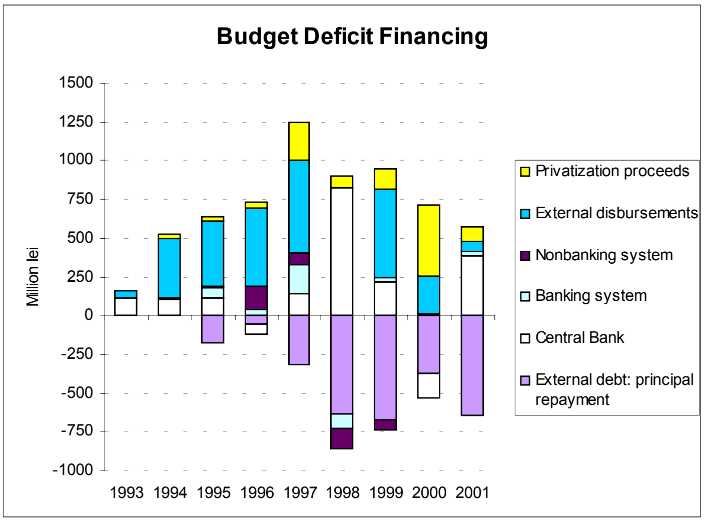
In 2000 foreign disbursements stood at about 240m lei, and principal repayments were 370m lei. Consequently, the net amount of minus 50m lei (80m lei were rescheduled) was covered by privatization receipts amounting to a substantial figure of almost half a billion lei. Moreover, these proceeds also allowed to substantially diminish government's debt to NBM (in fact, what happened was that government's foreign exchange deposit with NBM has notably increased).

However, a totally different picture was seen in 2001: in absence of financing from international financial institutions, government had to make huge principal repayments for its foreign debt (amounting to 650m lei).

Since privatization process has almost stopped, in 2001 the government easily resorted to financing from NBM (390m lei), which is of course the worse choice ever.

As it was already mentioned, in July 2001, the Parliament, in order to avoid country's default on external obligations, passed an amendment to the 2001 Budget Law, according to which NBM was forced to extend a loan to the MoF up to 30 million dollars.

If such a practice continues in 2002 as well (unfortunately it looks like this may well happen, considering the circumstances) then NBM's foreign exchange reserves would be rapidly disaggregated.

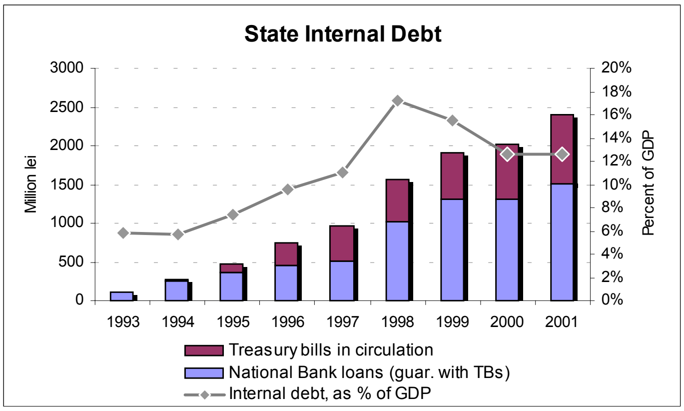


Budget Deficit Financing (lei million)

	1993	1994	1995	1996	1997	1998	1999	2000	2001e
Financing of deficit	163	500	437	583	691	300	378	258	-106
Central Bank	110	107	112	-62	142	823	217	-160	390
Banking system	0	9	69	42	189	-92	26	15	25
Nonbanking system	0	0	9	151	76	-127	-62	-3	-1
External sources, net	53	384	248	451	284	-304	58	-51	-582
Privatization proceeds	0	24	24	38	242	77	139	457	88

Internal Debt

In 2001 stock of state's internal debt grew by 18.7% (in 2000 – by 5.9%) from 2022 million lei to 2400 million lei, both on the account of the increased issuance of TBs on primary market, as well as increased NBM lending (while in 2000 government's debt to NBM remained unchanged). Share of internal debt/GDP remained unchanged at 12.6%.



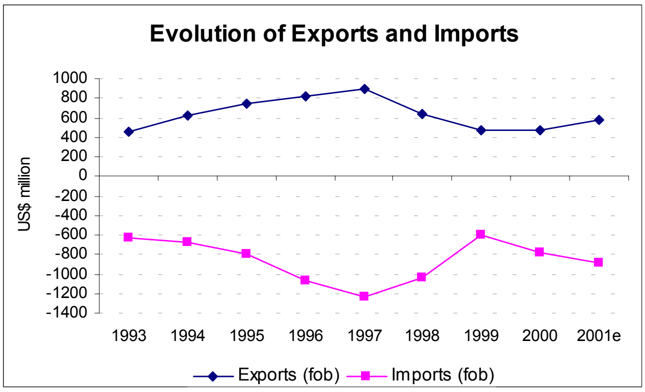
Foreign Trade

All the following figures are our Balance of Payments estimations for 2001 based on actual data for the first 9 months of the year, as well as on some end-year data released by the government.

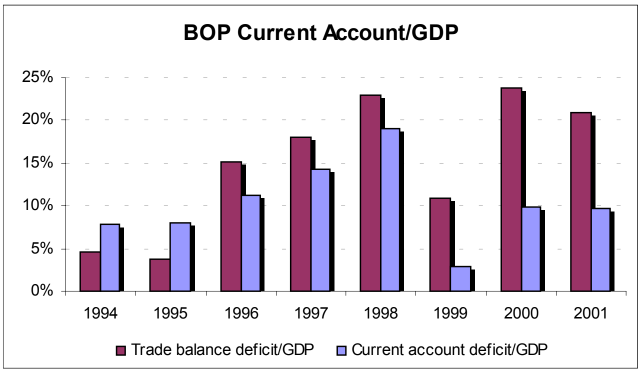
Unfortunately, it appears that similarly with 2000 there is no tendency of a reduction in country's trade deficit - although exports grew by 21.7% reaching about $580m, imports have also increased (by 13.6%, reaching about $890m). Ratio of trade deficit to GDP equaled 21%.

In 2001 Moldova's foreign trade turnover has increased to $1.47bn, by about 14% (in 2000 – by 31%), but it was still below the levels registered in 1995-1998, i.e. before the Russian financial crisis. Coverage of imports by exports was 67% (in 2000 – 65%).

Balance of services remained traditionally negative.



Such a huge trade deficit could not be offset by current transfers (including grants, technical assistance and humanitarian aid), or by positive net income (including almost $170m remittances of Moldovan residents working abroad, that is 35% more than in 2000). Therefore, current account deficit has deteriorated further, reaching in 2001 about $140m (9.7% of GDP).

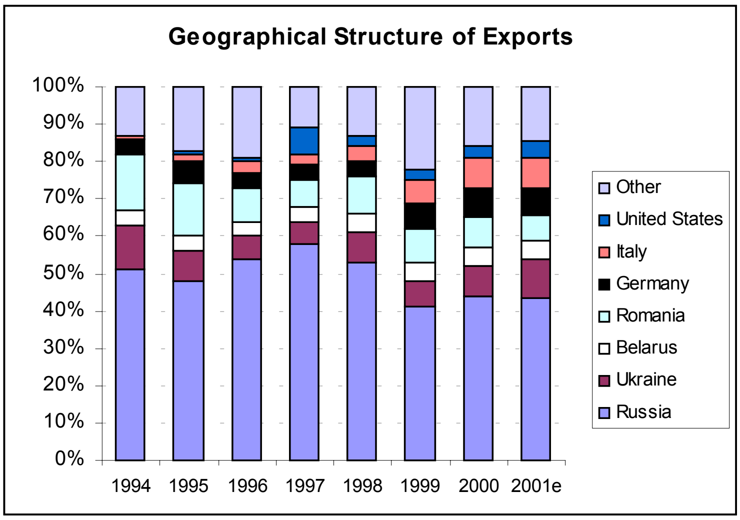


Balance of Payments: Current Account (USD million)

	1994	1995	1996	1997	1998	1999	2000	2001e
Current account balance	-92	-115	-188	-275	-322	-34	-128	-143
Current account balance as % of GDP	-7.9%	-8.0%	-11.3%	-14.2%	-19.1%	-2.9%	-9.9%	-9.7%
Trade balance	-54	-55	-252	-348	-388	-128	-307	-310
Export (fob)	618	739	823	890	644	469	477	580
Import (fob)	672	794	1075	1238	1032	597	783	890
Services balance	-46	-96	-64	-52	-73	-22	-43	-58
Income	-16	-29	55	47	41	34	72	95
including remittances from Moldovans working abroad	-	-	70	93	100	90	126	170
Current transfers (net)	24	65	73	77	98	82	150	130

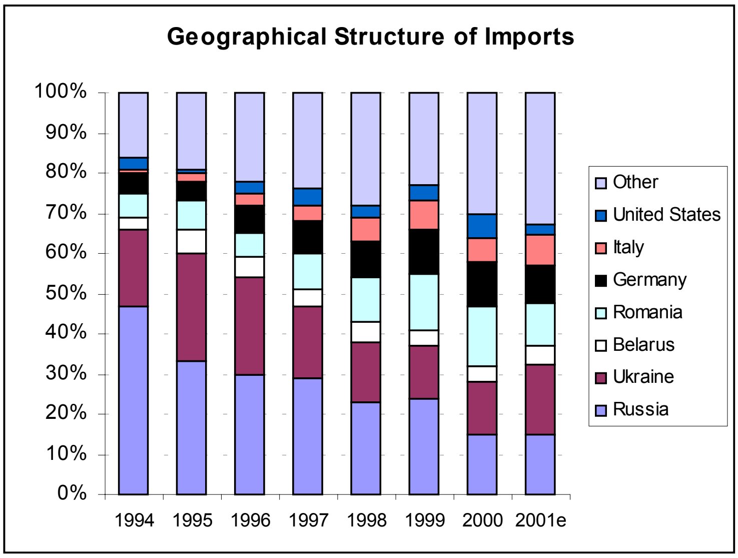
Moldova's primary exports were: foodstuffs, beverages, and tobacco (altogether making up 45% of total), textiles (20%), plants and vegetables (13%), equipment (6%). Biggest export growth rates had sparkling wines (by 2.1 times), cognacs (by 43%), and wine material (by 43%).

On the other hand, Moldova's primary imports were mineral products (making up 27% of total), equipment (14%), textiles (11%), chemicals (9%), foodstuffs and beverages (9%). Biggest share (98%) of mineral products imports belongs to energy resources, which diminished by 8% in 2001. Imports of electricity were 36% bigger than in 2000, and totaled $19m.



Unfortunately, following the Russian crisis, Moldova failed to diversify its external trade markets, and after the restoration of communist governance ties with Russia have been effectively consolidated. Traditional ex-Soviets markets remained Moldova's main trade areas, especially for agricultural products, which is a major item for Moldova's export.

Statistics show that exports to CIS constituted 61% of the total (in 2000 – 59%, and in 1999 – 55%, while in the years before this ratio stood at 70%). At the same time, exports to the EU as a percentage of total basically remained unchanged (21%), while this ratio for Central and East Europe diminished from 13% to 11%. In absolute numbers biggest increases registered exports to Ukraine and USA (both grew by 1.6 times), following exports to Belarus (by 36%), to Italy (by 25%) and to Russia (22%).



Imports from CIS constituted 37% of the total (in 2000 – 33%), imports from the EU as a percentage of total basically remained unchanged (28%), while this ratio for Central and East Europe diminished from 25% to 22%. In absolute numbers biggest increases registered imports from Ukraine (by 47%), from Italy (by 39%), from Belarus and France (both grew by 22%), and from Russia (16%).

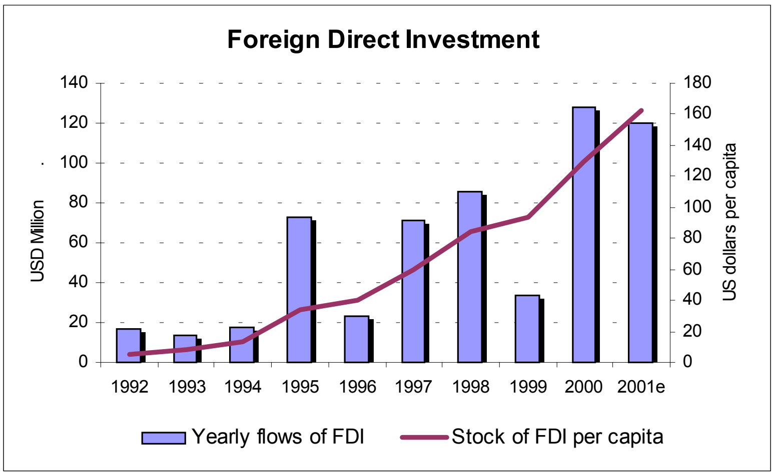
Foreign Investments

At end-2001 more than 2360 companies founded with foreign capital participation were registered in Moldova, out of which 790 enterprises had 100% foreign capital. Sectoral breakdown shows that most joint ventures and foreign companies were in retail and wholesale trade (64% of the total), and 13% - in processing industry.

According to the information from Statistics Department, in the first 9 months of 2001 stock of total equity investments constituted $617m, out of which about 60% came from investors from 83 countries. Still, only 7% of companies have equity capital of more than 500 thousand US dollars, while 69% of companies have an equity not exceeding 0.2-10 thousand dollars.

Most foreign investments came from: Russia - 40%, Spain - 11%, USA - 9%, while Germany and France have each less than 5%. Equity investments from abroad amounted to $17m, out of them largest came from The Netherlands ($6.5m), France ($1.8m), Italy ($1.8m), and Germany ($1.5m) – these partners have invested in transportation sector, communications and processing industry.

Out of all foreign investments in 2001, most were directed to the following sectors: electricity, gas, water – 49%, processing – 19%, transport and communications – 10%, wholesale and retail trade – 8%.



Balance of Payments: Foreign Direct Investments

	1994	1995	1996	1997	1998	1999	2000	2001e
Direct Investment, stock, USD mil.	49	122	145	216	302	336	464	584
FDI stock, as % of GDP	4.2%	8.5%	8.7%	11.2%	17.9%	28.7%	36%	40%
FDI stock, per capita, USD	14	34	40	60	84	94	130	163
Direct Investment, flows, USD mil.	18	73	23	71	86	34	128	120
FDI flows, as % of GDP	1.5%	5.1%	1.4%	3.7%	5.1%	2.9%	9.9%	8.1%
Portfolio investment, net, USD mil.	0	0	54	237	-55	-140	92	7

BOP estimations for 2001 show a similar flow of foreign direct investment into the Moldovan economy as in 2000 – about $120m, i.e. 8% of GDP (in 2000 the ratio was 10%). However, this figure should be treated with caution, because it includes the $50m Moldovagaz deal in the first quarter of the year. Thus, actual FDIs in 2001 were probably amounting to some $70m only, or even less.

Stock of FDI approached to $600m in total (1992-2001), i.e. only 40% of GDP in 2001. However, this is a very low indicator compared with other countries of Central and Eastern Europe. Stock of FDI per capita was only $163 in Moldova last year.

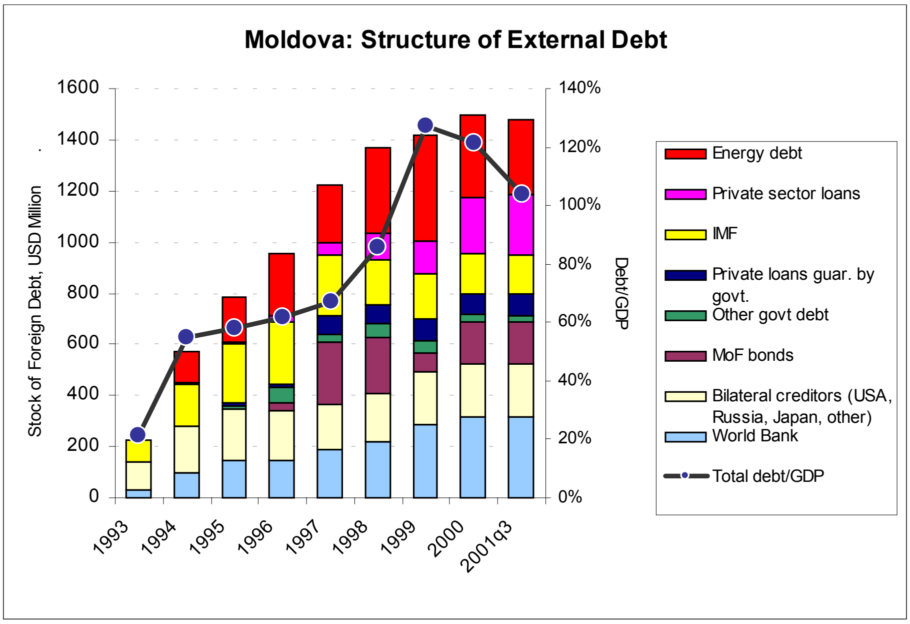
External Debt

According to NBM's data, stock of Moldova's total external debt (excl. Transnistria) at end-2001 has reached $1548m (105% of GDP). Situation is basically the same as it was at end-2000 ($1561m), but due to the increase in GDP the debt/GDP ratio is lower. This debt figures include: medium and long term loans received by the Government (from IBRD, IDA, EBRD, IFAD, EU, USA, Russia, Japan and others), IMF loans granted to NBM, MoF's long-term securities issues, loans received by commercial banks and private sector (including government guaranteed), as well as debt for energy resources (which constituted $309m).

Debt structure figures (from BOP statistics) are available, however, only as of 1 October 2001: stock of direct government debt was $771m, while private sector loans guaranteed by the Government stood at $82. NBM's debt to IMF was $154m. Therefore, public state debt amounted to $1007m, i.e. 68% of GDP (this obviously excludes energy debt).

Moldova's External Debt (USD million)

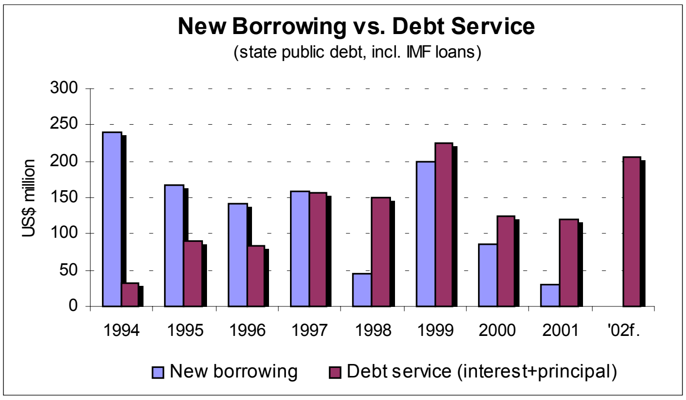
	1993	1994	1995	1996	1997	1998	1999	2000	2001q3
Total	255.7	635.7	839.7	1031.4	1293.4	1447.0	1486.9	1561.6	1532.4
Total (excl. private non-guar. and energy)	255.7	505.9	659.2	765.7	1018.8	1010.4	946.4	1014.4	1006.9
Direct govt. debt	168.4	343.0	416.9	505.9	713.5	756.8	684.4	778.7	771.3
Multilateral creditors (World Bank, EBRD, EU)	59.3	158.4	203.5	221.1	257.5	294.1	358.1	376.5	373.8
Bilateral creditors (USA, Russia, Japan, other)	109.1	184.6	198.5	194.2	178.6	187.9	203.2	209.9	207.4
MoF bonds				30.0	245.0	222.9	75.0	165.0	165.0
Other creditors			15.0	60.6	32.4	51.9	48.1	27.3	25.1
Private loans guaranteed by govt.			11.8	12.1	71.2	77.3	86.6	81.6	82.1
Multilateral creditors (EBRD)			8.4	0.0	44.7	52.8	65.6	63.0	64.4
Other creditors			3.4	12.1	26.5	24.5	21.0	18.6	17.8
Other private loans (non-guart by govt)			9.5	20.9	53.6	103.7	127.9	222.4	239.1
Banking sector		0.2	3.0	5.5	11.0	28.6	8.7	5.4	4.6
Other sectors		0.1	6.5	15.4	42.6	75.1	119.1	217.0	234.5
IMF	87.3	162.9	230.4	247.8	234.1	176.4	175.4	154.1	153.5
Energy debt		125.0	171.0	244.8	221.1	332.8	412.7	324.9	286.3



As for most FSU countries, multilateral creditors represent the only feasible source of financing for Moldova. Unfortunately, as a result of the inappropriate economic policy implemented by the communist regime, Moldova received no new disbursements from IFIs.

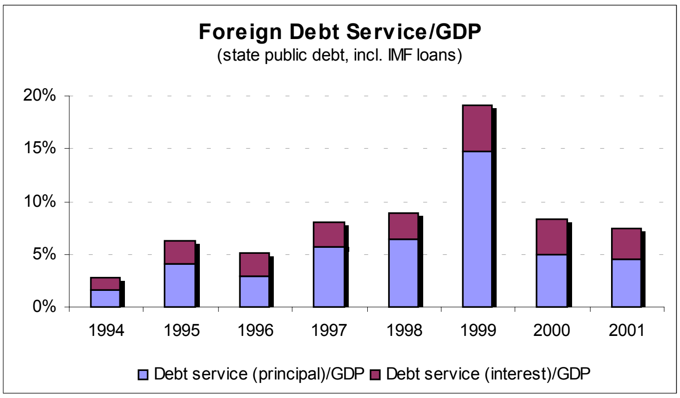
Since November 1999 Moldova had lived without foreign loans. Then, following long negotiations, in February 2001 IMF disbursed the second $12m tranche under PRGF (a three-year $142m loan for Moldova in the framework of the Poverty Reduction and Growth Facility) and after that the communists came to power and the financing was stopped again. Same with regards to World Bank – in February 2001 $19m were disbursed within SAC-II arrangement, and since then the government did not receive any more loans World Bank for state budget support. SAC-III negotiations are still under way, without any clear indication that money would be disbursed any time soon.

In 2001 state public debt service – both interest and principal – amounted to about $110m (basically the same as in 2000, and much less than in 1999), out of which about $85m were paid by the Government as debt service and $24m were paid by the NBM.



Speaking about ratios: in 2001 state public debt service to GDP stood at 7.4%; debt service payments to exports of goods and services constituted 14.7%; interest payments to exports of goods and services were 5.7%.

As it was already mentioned, in absence of financing from IFIs, the National Bank had to take over a part of government's liabilities towards foreign creditors, as voted by the Parliament. But NBM's foreign exchange reserves did not shrink thanks to purchases of foreign currency in the local market. Gladly, there was an excess of foreign exchange, that could be acquired without disturbing the exchange rate.



In 2002 Moldova's debt service payments will exceed $200m. The most difficult situation will be in June when the government will have to redeem the second Eurobond issued in 1997 amounting to $75m. Ministry of Finance officials estimated that Moldova may be running out of resources for the debt service already by April 2002.

At any rate, Moldova's perspectives are blurred in the absence of an IMF supported program and an agreement with the World Bank. At the same time, there will be no Paris Club rescheduling if no successful negotiations with IFIs are concluded, no matter how many optimistic statements are released by the government. Moreover, recently there was a statement of the IMF's Resident Representative in Moldova, saying that it is not true that ultimately the IMF will provide financial support to Moldova – irrespective of policies – just out of fear that the country would otherwise default on its external debt. This is not the case. Clearly, both IMF and World Bank stand ready to assist Moldova, but only if an agreement is reached on the right policies.

2. COMMENTARY ON THE ECONOMIC POLICY IN 2001 AND ITS RESULTS

GDP growth, real sector development and investment climate
(Alexandru Munteanu)

2001 preliminary data prepared by the Department of Statistics and Sociology are rather mixed in my opinion. On the one hand, 2001 registered a record growth of 6.1% as the most significant economic achievement of Moldovan recent history since its declaration of independence. On the other hand, as prof. Gavriil Popov, a prominent Russian economist, just remarked on the Russian economy, which grew by the same "mere 6%": "The growth of 6% should be felt by every citizen. This does not happen, does it?…"

Let's look at breakdown of *GDP* by different components to get an insight in what is going on. On the *revenue side*, the biggest contributor is the industry, which grew 16.5% in 2001 versus 10.8% in 2000. Construction registered a very impressive 25.5% growth in 2001 versus 30.3% decline in 2000. One could argue that the industrial growth would be less important in view of the fact that the industrial production plummeted down in the previous years, so the starting point was at a very low. Still, nobody would perhaps argue with the fact that construction activity usually signals a reviving economy. The slowing down in a rate of growth (i.e. a negative second derivative) of net taxes on products and import (10.8% growth in 2001 versus 17.2% growth in 2000), which resulted in an overall mere 1.3% contribution to GDP's growth in 2001 versus 1.9% in 2000, may signal an arising problem with tax collection.

On the *expenditure side*, a slightly narrowing gap (in relative terms) between exports and imports could be obviously commended. It's moreover surprising that the exchange rate was quite stable during this time. Probably this is due to the fact that the Moldovan trade balance is more sensitive to the external conjuncture, which predominantly means the import treatment of Moldovan products vis-à-vis their substitutes, than to the exchange rate differential.

A concern is the growth of consumption although at a declining rate (9% growth in 2001 versus 17.1% in 2000), but still surpassing the overall rate of growth of economy. The biggest red signal in my opinion is coming from a negative rate of growth of *investment*, which could be the main reason why 6.1% overall growth is neither seen nor felt by population. The economic growth was consumed (i.e. eaten up, wasted)! This can be sustainable in a short run only.

Since domestic investment has been declining for several years, let's look now at the foreign investment, which remains the only other source of investment.

As of October 2001, there were 2362 enterprises with foreign investment registered in Republic of Moldova: 1573 – joint ventures and 789 wholly owned by foreigners. In 2001, the rate of foreign investment remained quite low, e.g. official statistics show that about $17 million were invested in Moldovan companies by foreign investors in January – September, which would be about $4 per capita. This is a very low rate by Eastern European standards.

The companies with foreign investment have registered an overall growth in revenues of 29.6% in 2001 versus 2000; the private companies grew by 20.2% and public –by 6.5%. These figures, which confirm a well-known trend, would say a lot to the Moldovan authorities hopefully. If the economic growth is still the first priority, the attraction of foreign investment should become a first priority in the program for achievement of economic growth. The Moldovan authorities have done some efforts in this direction, by trying to attract capitals from outside, going mainly East in contrast with all their predecessors[1]. Still, the organizational efforts to lure foreign investors remained very weak. The merge of the State Agency for Foreign Investment Attraction with the Export Promotion Agency passed unobserved by all investors. The rare articles in Financial Times or Economist would send rather negative signals while Reuters would without fail remind all readers that “Moldova is the poorest country in Europe sandwiched between Ukraine and Romania”.

The foreign companies operating in Moldova, especially if backed by large international corporations like Union Fenosa (Spain), Voxtel/ France Telecom, Itera and Lukoil (Russia) could grow and invest in further development. Unfortunately no more big players came in 2001.

In terms of investment climate, the overall decline in investment tells it all. While initial skepticism of foreign investors after the victory of the Communist Party is somehow disappearing, the hesitance remains in view of a small market and rather risky investment environment, which is certainly influenced by an unpredictable legal framework, sophisticated rules of the game and corruption.

The period has been marked by unprecedented and biased attacks against Union Fenosa. Ultimately the Spanish company could ward off these attacks only after the President’s personal intervention. So, it has to be political will when most of other prerequisites for foreign investments are missing.

Farmaco story is a counter-example. This case has been extensively debated in mass media and it is not over yet, but certainly an unfair game is played against the foreign investor here. The most striking lesson learnt for me is the biasness and lack of professionalism shown by Moldovan courts.

Countries are competing for investors’ money. Moldova is too small, poor and undercapitalized to overlook this truth…

[1] Russian statistics reported that of $120 million invested by Russian Federation into CIS countries in the first half of 2001, $93.2 million were invested in Republic of Moldova. I could not find a reflection in Moldovan statistics of these figures under foreign direct investment, so most of the reported investments would be classified under debt and/or debt swaps presumably.

The results of actual governance will become tangible only in the second half of 2002

(Veaceslav Negruța)

One may affirm that in what regards economic and financial policy, the year 2001 has been, generally, a passive one. During the year 2001, *the Government did not have an economic or financial policy that would have been at least clearly formulated.* Albeit there exists an Activity Program and, already, a Development Strategy until the year 2005, many things (messages) are confusing, contradictory and often lack economic reason. On the other hand, the Memorandum of Economic and Financial Policies with the IMF (which offers at least some structure and systematization) was not accomplished, although the Government intended to sign (or maybe only to finance) it in the course of the entire year 2001.

It sounds as a paradox, but certain provisions of the Main Memorandum contradict the Activity Program. Moreover, some decisions, resolutions or laws do not fit into the Memorandum provisions and do not fulfill the requirements contained in President's message towards the Government. A natural question arises: why wasting so much time and energy to sign this Memorandum? Or was it that the stake was on receiving the money, and letting things go as they go afterwards? Moldova had such an experience before and that resulted in an enormous external debt.

The Republic of Moldova missed, in fact, the moment when a great part of the energy, telecommunications, tobacco, wine-making sectors could be privatized not for the sake of money only, but for creating competitive, income-generating sectors. From this viewpoint, the year 2001 confirms once again the lack of a clear policy, stuck in stagnation, accompanied by confusing messages launched by country's leadership, having a single goal: to obtain external financing.

Often in the course of the year 2001, certain trickeries have been used to deceit the public, including external partners. As a result of some declarations, certain conflicts ensued in the relations with the International Monetary Fund, the World Bank, the European Bank for Reconstruction and Development, governments of other states, economic agents and their representation offices. Wishing to maintain a good image, government authorities put their partners in unpleasant situations. The year 2001 is characterized by the fact that declarations almost never complied with real facts.

Even in the field of *statistical data*, which, as it is known, are based on certain calculation methodologies, one may surely affirm that such data have been distorted, without realizing the effects of such distortions.

The Department of Statistics does not any more fulfill the function of quantitative and qualitative evaluation and monitoring of economic, social and other phenomena, but is rather an efficient instrument used for arguing the wishes and dreams of the officials.

It may be affirmed with certainty that the 2001 inflation level was artificially reduced, under the statistical aspect. Otherwise, it is impossible to affirm that exports had a greater rate of growth than imports. Nobody doubts the fact that exports grew at a faster pace than imports, but this would have been practically impossible if a real appreciation of the national currency occurred. If taking into account the 6.3% inflation level, one does obtain a real appreciation. The conclusion is that the inflation level was greater (and should have been shown as such by statistics). Consequently, a real depreciation of national currency would have been obtained (statistically also).

This conclusion is also supported by the growth rate of the broad money, which increased by 36% in the course of the year. This indicator is comparable to that of the year 1999, but then the inflation reached 43%.

An additional argument is that, according to the official statistical data, the salaries and pensions had a substantial increase (by 29% and 60%, respectively). Obviously, this should have contributed to a greater inflation. Instead, the level of inflation was artificially reduced.

Conclusion #1. The level of inflation was artificially (statistically) reduced, which, in Moldova's situation (a substantial current account deficit) may not be univocally treated as an achievement; it is rather an adverse step.

Another important indicator that characterizes the yearly evolution of economy is the gross domestic product. Its computation and growth rate in real terms imply a special political interest not only in the Republic of Moldova. Very often, politicians and state officials use this term without even realizing what they are talking about, how is it calculated and what should be the conclusions and further actions. It may be affirmed with certainty that real GDP growth did occur, but the growth constitutes something around 3-3.5% and not 6.1% as statistic reports claim. Even World Bank and International Monetary Fund officials declared that a technical mission shall be invited to check the correctness of computations and authenticity of submitted numbers regarding the real GDP growth.

It is certain (confirmed by statistical data) that the 2001 GDP was formed up to 104% of the final consumption, a record level not only for the region to which Moldova belongs, but for Moldova itself. At the same time, the gross formation of capital experienced a 4% decrease in the GDP structure compared to the previous year (which may also be explained by the withdrawal of some businesses and investment from the national economy). The net exports, another component of the GDP structure, registered a substantial 24% drop.

The impression is created that in order to bring the GDP value in current prices as near as possible to the 19,300 million Lei value forecasted at the beginning of 2001, it has been resorted to the augmentation (crayoning, as some people say) of the real GDP growth rate up to 6.1%. Thus, in 2001 the GDP volume in current prices (according to statistical data) constituted 19,019 million Lei.

Together with the "crayoning" of this number, the maintaining of certain officials, whose position became shaky, was achieved and/or a message was successfully sent to the public: we are on the leading position in CIS in what regards economic growth.

No specialist can explain how the 4% growth in the agricultural sector was possible during the entire year 2001, while the 9-month statistical data clearly showed that a real decrease occurred in this sector. It is impossible to believe that a miracle happened in the 4th quarter.

Conclusion #2. The 2001 GDP growth rate is positive, but is, at the same time, artificially inflated by official statistics. Official statistics also becomes a dangerous instrument for modeling public perception.

The stabilization tendencies and the small growth that appeared in the last two or three years were largely undermined in 2001. The vulnerability of a stable economic growth was conditioned by certain economically poor-argued decisions. Thus, the calculated salary growth rate (imposed through administrative measures) exceeds many times the growth rate of economic activity, budgetary revenues and investment. This fact will inevitably baffle the 2002 economic activity and, importantly, will create all the premises for new financial blockages both for economic agents, as well as for public institutions, which later will result in new social tensions and rising unemployment.

Conclusion #3. Modest positive results (not those shown in statistical data) are due to economic and financial policies of 1998-2000, which have been at least consistently and adequately applied. The results of the actual governance will become tangible only in the second half of the year 2002. There is an economic rule saying that the results of any complex measures of economic and financial policy shall be perceived with a delay in time.

The negotiations regarding external debt restructuring and rescheduling practically failed. External creditors did not engage in any discussions, since the unblocking of relations with international financial bodies did not succeed. Moreover, these relations were further deteriorated together with the signing of the agreement of gas delivery and of other decisions that do not fit into the list of priorities of economic development. This fact renders the execution of the 2002 Budget Law unreal and the announcement of Moldova’s insolvency imminent. External economic policy practically left Moldova outside many economic processes, as well as interesting projects, including the Stability Pact in South-Eastern Europe.

Conclusion #4. The inability (or unwillingness?) to negotiate with creditors/donors makes the potential declaration of default imminent.

Ideologization of the economy, contradictory decisions
(Alexander Muravschi)

The Government tried to pursue a „soviet-market” policy and is satisfied with the final statistical results of the year.

First of all, one should start from that economy is inertial. Therefore, if in 2000 and 2001 there was registered a GDP growth in Moldova, then current Government has no moral right to consider it to be the merit of its own. It is important for every government to use, “saddle” the wave of positive tendencies and try to get rid of the negative past.

That is why official declarations about quick positive results of the Government’s activity (“for the first time in nine years”, etc.) should be treated critically. It is *insistent ideologization of the economy* that really takes place for the first time during ten years. And this is understandable: the Government fulfills the will of the party that has come to power. This party gave promises and is now trying to adjust strategy and methods of the reforms.

There are many inconsistencies in these actions. Let us consider, for instance, the idea of transferring enterprises privatized earlier, which have debts or do not fulfill investment commitments, into the state property. As a matter of fact the case in point is a concealed nationalization. The Government makes such a decision in spite of understanding that it will get a yoke over its neck, that it has no resources for rehabilitation of these enterprises. While repeated privatization, given such treatment of investors, is practically impossible. But from the ruling party's point of view all this is not necessary at all as the state should be the main boss. Ideology is again above sober consideration.

Moreover, if we analyze thoroughly papers of the ruling party and statements of its parliamentary fraction, as well as multiple amendments introduced into the legislation after the spring of 2001, is becomes clear that private property is recognized only in the economy's backyards – in form of small enterprises and companies.

Here is another example: idée fixe to strengthen the "vertical of power" of the ruling party (which has already a president, majority in the Parliament and Government) by means of pre-term local elections, returning to the old, soviet administrative-territorial system of the country. Is the Government really unable to understand that reorganization of local state bodies in the year of 2002 (when a peak of external debt payment and growth of internal one is expected) will affect negatively central and local budgets and will paralyze interaction of these bodies with economic units and the population? The more so as arguments advocating this innovation are absolutely groundless: "state machinery expenditures will diminish" (when there will be 32 regions instead of 12), "it is too far for people to go to regional centers" (why not transfer these functions to bodies of a lower level– notary, tax and other services?).

It is constantly being said that wage, pension and other debts were liquidated. This is partially true. State of affairs concerning social funds this year is better than ever. But what is the cost of this? Here, we should distinguish two things – social fund and state budget. As regards social fund, inpayments are really increasing; the fund activates independently and has practically fulfilled its part of the maximum programme. It has two sources – social insurance and additional earnings of the state budget. It is significant that, if everything concerning the first source is all right, then matters with the second one stand not so good. State budget underfinanced social fund by approximately 160 million lei. This caused compensation problems. And the magic wand were those 10 million USD of the Dutch grant that the Government received by the end of December.

But as for wage arrears to state employees, they were 13 million lei more on January 1, 2002, than at the beginning of the previous year. The debts were not only paid off, but their amount has increased! This is why teachers in some regions say they have not been getting wages for eight months in response to optimistic declarations of the Government that it has eliminated such a shameful phenomenon. This problem, of course, could not be solved in such a period, but it does not excuse disinformation.

The truth is that 2001 budget execution as regards incomes is 87%. Budget earnings in 2001 turned to be even lower than they were in 2000. While in all previous years there was a dynamics of growth.

All care of the Government during the end of the year consisted of one question: will we get the bank transfer or not? At the same time the Government insisted on the version: "They do not give, but we are alive!"

In the meantime, this is not so true. Let us calculate: 15 million USD were received in December (including 5 million USD – from the World Bank). These were money that the Government counted on and which would have get here anyway by virtue of previous agreements. Their transfer was guaranteed whatever could happen in Moldova. It looks like the country did not get anything more. But the Government headed by Tarlev did! For the first time – there has never been such thing before when a government of Moldova received such credits – 30 million USD from the National Bank of Moldova. Thus, internal debt was increased and monetary reserves were reduced, which is risky per se. So, one can see that the Government received the total of 45 million USD in a year – and paid off the same sum to foreign creditors. This is the smallest amount of payment during all years of our independence.

As for macroeconomic indicators of 2001, one will be able to judge their trustworthiness and influence upon the economy and social processes only in 2002. While experts predict almost unanimously a lot of problems for the Government this year. There will be no transfers from abroad in the first quarter. The relations between the Government and IMF and World Bank are rather difficult. It seems the Government of the ruling party will have to maneuver between populist promises and the wish to get credits for the whole year. It is confused decisions of our Parliament, which has been putting spokes in the wheels of planned transfers and credits until now that can hamper. Two hands – the Parliament and the Government – act in an uncoordinated and fussy way. One hand is not often aware of what the other is doing.

Negotiations with the Paris Club on restructuring of the debt have not been started yet. But it is already clear that they will not be easy, even started by the spring, which is also fishily. What else will go wrong during the year of Black Horse? First of all, lack of large foreign investment projects. There is almost no chance that anybody will appear on the scene with millions of dollars. State will not succeed in selling “Moldtelecom” for the longed-for 100 million USD and wineries for “good money”.

State debts will rise, including those to the Russian Federation thanks to the disadvantageous gas agreement. It will be due to disentangle from many speculative decisions made last year, such as, for instance, intention to return some privatized enterprises to the state or turn the Chamber of Accounts and prosecutor’s office into one of the main controlling and retributive bodies in the field of economy.

The Government will continue experiencing lack of specialists because it purposely refused services of dissenters. According to all showings, this Government will have no luck in realization of an economic programme uniting all sound forces of the society.

Let us however hope that Moldova will succeed in avoiding the Argentinean scenario – the default.

3. NEW ECONOMIC POLICY FRAMEWORK FOR MOLDOVA

1. Meeting the Challenges of Transition

Successful restructuring and development of any economy in transition requires radical improvement of its competitive position at the enterprise, the industry, the regional, and the national economy levels in such a way as to bridge the technology, the productivity, and the cost gaps between these in the economy in question and those of its competitors. Sustainable, balanced, long-term growth will not be possible unless Moldova's economic structures are dynamic and innovative, flexible in their product design and market expansion, and subordinated to tight budgetary discipline. Only then the long-run growth will enable improvement in the standards of living and the desired rates of capital accumulation, which are in turn a pre-condition for future development and modernization.

Macroeconomic stabilization is a basic prerequisite and a foundation for a successful economic transformation and modernization. However, sustained macroeconomic stabilization and economic transformation will not be accomplished unless they are accompanied by microeconomic adaptation, i.e. unless the supply response at the enterprise and the industry levels is forthcoming. Hence the central role of economic policy in a market environment is to establish the best possible conditions for a supply response that would enable the economy in transition to fully enjoy the opportunities provided by macroeconomic reforms and to successfully compete at the domestic and external markets.

Competitive position of Moldova's economy must be improved independently of whether and how soon Moldova applies for membership in the European Community. For even at present Moldova's industrial and agricultural products compete with those of the EC members at the domestic market, in the markets of other EC non-member countries, and inside the European Community. Therefore, in order to expand, the improvement of competitive position of Moldova's economy must enjoy the highest priority.

The essence of economic policy in a market economy does not consist in the absence of a positive role of the government. While discarding its former functions of a command economy nature, the government must assume a new role in the 'recasting' of its enterprise sector. This new role consists not only in

(i) establishing the market friendly economic infrastructure.

Moreover, in the period of transition the role of the state consists also in:

(ii) assistance to the former state-owned enterprises in their privatization and their restructuring, their bankruptcy including;

(iii) superimposing of hard budget constraint and market pattern of behavior on the state-owned firms that as yet have not been privatized, or where their privatization has not generated strategic investors;

(iv) assistance to the new private business and to the development of the small and medium-size enterprise sector;

(v) development of 'horizontal' economic policy measures that go across the industrial sector as a whole (such as investment promotion or improvement of the labor market);

(vi) development and monitoring of some narrowly defined, special 'target' Government programmes.

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It is by no means the ambition of this note to provide any specific recommendations on economic policies and-or policy instruments that should or should not be applied in Moldova. Rather, *what follows below represents a 'menu of options'* selected on the basis of the authors expertise and experience in Poland and in some other countries in transition.. *Which of the options to chose is, of course, the task of policy makers who must take into account next to the specific measures of the economic policy tool-box also their political priorities and limitations.* Moreover, the development of 'horizontal' economic policy programmes (v), and of 'target' programmes (vi), which both need to be specifically ;tailored' to the needs of Moldova, goes beyond the scope of the present note. Therefore they will be only briefly dealt with in Section 4 below.

Following the collapse of the Soviet Union and loss of the Soviet market in 1991, Moldova experienced prolonged economic recession. Its true causes related, however, first and foremost to the subsequent price shock that made most of the Moldova's industry non-viable due to its inherent high energy intensity. Hence, with benefit of hindsight, one may argue that the best strategy for industrial recovery at that stage was divesting and re-composition of industry towards new industries that would be rather labor and technology intensive than energy intensive, and rather development of new industries (service sector including) than forced rehabilitation of the old ones. After ten years of transition the situation improved only little. Although some recovery has been observed in the past two-three years, the economy of Moldova continues to face serious challenges:

- after years of contraction, fixed capital investment and modernization must be speeded up;
- with a view of catching up and then integrating with the advanced market economies, changes in industrial composition must involve increased shares of manufacturing industries and exports;
- conditions will have to be set up for harmonization of the technology, the safety and the ecology-friendly standards with the European practice;
- inadequacies of the legal system must be corrected, enforcement of contracts, and of commercial law and civil code in general, must be improved; the new Civil Code, Collateral Law, Bankruptcy Law, and other economic legislation must be made compatible with Western standards and correspondingly reviewed; the legal infrastructure related to law enforcement - its institutions, manpower and patterns of behavior - must be improved, the arbitration court system strengthened, and public institutions that would help to enforce the law established;
- in the area of private sector development, new public and private institutions that would represent interests of the new private businesses must be founded and the interactions between them, the trade unions and the government structures in economic policy formulation and implementation must be established.

Meeting these challenges requires well defined economic policy targets that would deal with both: (i) economic policies in support of rehabilitation and restructuring of the former state-owned enterprise sector, and (ii) with economic policies in support of private entrepreneurship, including the small and medium enterprise sector.

2. Economic Policies in Support of Rehabilitation and Restructuring of the State-owned Enterprise Sector

Privatization

Mass privatization in Moldova did not result in any significant improvement of the enterprise sector. *Also privatization of strategic enterprises* has proved very difficult. They should be privatized following individualized procedures and business plans. Not much progress has been achieved in that area, however. Thus, the fundamental purpose of privatization of state assets, i.e., the essential improvement of corporate governance and a genuine restructuring of the former state-owned enterprises, has not as yet been achieved. Nevertheless, privatization is likely to turn out the single most important avenue for enterprise restructuring, and especially for preventing political patronage and clientelism to suppress market pattern of behavior of enterprise managers and their supervisory boards. Moreover, even in the newly privatized or commercialized enterprises there tends to develop a close interrelationship between enterprise management and their supervisory boards on the one hand, and the Government on the other hand. The thus 'politicized' directors and board members became already a powerful lobby in Moldova, among other things as the newly elected parliamentarians, successfully fighting for direct subsidies, tax exemptions, government investment programmes, inter-enterprise debt clearing operations, state financing of additional working capital and other forms of subsidized crediting. Thus, privatization, all its present shortcomings notwithstanding, must be continued with full Government commitment and all political support it can muster.

At the same time one can observe in Moldova the establishment of political structures, in Parliament and elsewhere, which represent shadow economy, if not outright illegal economic activity. As in the case of 'politicized' managers of the former state-owned firms, also in that case clear separation between economic management and politics must be of a top policy priority for the Government.

Post-privatization restructuring

A satisfactory improvement of corporate governance has not yet been achieved in Moldova not only because of the intrinsic characteristics of her privatization processes. Also the legal system has not adequately supported the operation of the enterprise sector, and consequently property rights have not been clearly assigned and an effective system of enforcement of contractual obligations - including a credible threat of bankruptcy - are missing. Consequently, in order to accomplish the fundamental purpose of privatization, most of the already privatized or incorporated enterprises are in need for 'post-privatization restructuring'.

First, establishment of strategic investors requires greater capital concentration. Hence the *Government should assist the development of securities market.* Moreover, taking into account that the listing standards required by any State Commission on Securities must be high, a more powerful instrument for the improvement of corporate governance (and more risky at the same time) will be *the processing through the Stock Exchange of unlisted shares.*

Secondly, the large size of firms and the assets attached to them, make these firms non-viable even if their core business is sound and their business plans promising. Under the New Economic Policy *enterprises must be allowed to freely divest unused assets (at public auctions or otherwise).* Moreover, *firms must be allowed to amputate various public services they still provide,* like housing their employees and catering for them, maintaining medical centers, holiday resorts and spas, vocational schools, etc. Legal provisions that permit such amputations must be made clear in order to prevent political pressure on enterprise managers to refrain from such decisions. The respective services must be either commercialized and auctioned away, or - insofar as they are public - delivered by specialized agencies and local authorities, which in turn must be provided with legal foundations and finance that will make that possible.

Thirdly, a *legal base necessary to split horizontal or vertical monopoly structures into separate firms must be established.* As a rule co-operation between their separate subsidiaries on commercial basis and a measure of competition between them soon proves to be less costly than their centralized administration. Moreover, downsizing and restructuring of many large state-owned enterprises is indispensable for their economic survival, or at least for the survival of some of their separated parts, albeit this is difficult in the absence of strategic investors. *At the same time the Government must see to it that the struggle against monopoly structures does not become a vehicle for a reintroduction of broad price controls or other trade and production restrictive measures.*

Fourthly, notwithstanding a not entirely satisfactory experience of the Moldova's specialized Agency for Enterprise Restructuring and Assistance (ARIA), whose task is to assist economic restructuring of the already privatized enterprises that are in financial distress**,** *commercial banks* which are themselves interested in streamlining and improving the financial position of their bed debtors should be *encouraged to lead a parallel programme.* However, as the success of the project requires that the agency (agencies) and banks involved are themselves financially sound and, moreover, that their management is able to resist political and other pressure for the inclusion of distressed firms into the programme with no respect for their medium-term chances of survival, the Government (in case of commercial banks - together with the National Bank of Moldova) should attempt to *eliminate the presently existing, interlocked non-market relationship between the Government the enterprise sector, and the former state banks, that make them sensitive to Government pressures as well as to their major shareholders* that at the same time are heavy but bad borrowers from these banks. Moreover, the NBM's supervision of commercial banks covered by the programme (that involves reduction of enterprise indebtedness towards the state as well) should be strengthened.

Finally, another instrument of enterprise restructuring that may well be used under the New Economic Policy framework are *management contracts,* devised as part of a broader programme of 'Privatization Through Restructuring'. At the beginning the programme may be restricted to firms that are (i) treasury owned joint-stock companies, or (ii) state owned companies supervised by their founding organs, or (iii) treasury owned state-owned enterprises employing over, say, 1,500, but of cleared property rights and whose equity does not exceed some predefined value. *The enterprise restructuring agreement concluded between the managerial group and the State Property Fund next to implementation of the restructuring plan should request the sale of at least 51 % of the company's shares.*

Inter-enterprise indebtedness and bad credits

Large and rising inter-enterprise arrears represent a bottleneck of development of the enterprise sector in many countries of transition. Therefore the pressure to introduce some wholesale inter-enterprise credit clearing operation is not a surprise. However, as evidenced by already large experience (e.g. of Kazakhstan and Ukraine), arrears netting operations are extremely costly for the taxpayers and lead merely to accelerated inflation. Hence debt reductions must be approached with great caution and on *case-by-case basis.*

Firstly, bad debts of enterprises may be dealt with under the *ARIA's programme*. They may be dealt with from *within the commercial banks, through their special 'workout departments'* that would increase the banks involvement with their previous borrowers in order to enforce enterprise restructuring. The workout departments should be established as separate units within the troubled banks and run by banks' board members. These departments would be responsible for the recovery of assets classified as 'lost' or 'doubtful', and sub-classified by the workout unit between viable and non-viable. If viable, the enterprise would be able to receive further loans from the bank in a framework of conciliation arrangements that may include write-offs, rescheduling and debt-for-equity swaps. The bank would be the leader in these arrangements and other creditors are supposed to follow suit. Thus the bank rather than the government will become a major player in enterprise bad debt restructuring.

Secondly, reduction of the inter-enterprise and other arrears may be assisted by *development of a market in liabilities.* Usually debt trading is done by specialized agencies which invest in liabilities. In Moldova legal foundations for such trading by banks will only have to be developed (the present Civil Code regulations are not satisfactory). Commercial banks would organize invited tender sales of debts. Debts of an enterprise (say, of a power plant towards a gas supplier) will be bought at discount by its debtor (say a machine building factory) that next will settle its own accounts with the power plant by means of its acquired liabilities. Debts will also be bought in order to swap them for shares of the debtor company, or to acquire at discount its assets when they are pledged against the debt. Moreover, some well secured debts will be also sold in order to avoid their expensive and lengthy execution. Thus, by means of this instrument *also capacity of commercial banks to monitor the performance and improve financial discipline of the enterprise sector will be improved. Yet, unless there is a genuine threat of bankruptcy of the debtor company,* confirmed by the actual experience of some of the debtors and by improved legal environment related to bankruptcy procedures, no instrument will be able to help reduce inter-enterprise indebtedness.

Bankruptcy and liquidations

The Law on Bankruptcy for long has been unsatisfactory and there were many problems with its implementation. A new bankruptcy legislation was enacted last November. It is unclear, however, whether it would sufficiently enforce that *actions taken by a company facing insolvency or bankruptcy to the disadvantage of the creditor, or meeting the claims of some creditors at the expense of others, as well as a purposeful or negligent actions of the debtor that led to insolvency or bankruptcy, are all penalized, and whether conditions under which bankruptcy will have to be declared indeed comprise: (i) failure to pay debts, (ii) inability to meet claims of creditors, and (iii) capacity to go bankrupt.*

It is also unclear whether under the new Bankruptcy Law also the dates of bankruptcy proceedings are made reasonably short. The time for the court to decide whether to declare bankruptcy should be reasonably short (say, one month from the date of presenting the motion in court, or from the date of recognizing that the motion meets formal requirements defined in the bankruptcy law). The motion should comprise: (i) the list of creditors that tells the nature and the value of their respective claims, (ii) the list of securities made by creditors, and (iii) the date of last payment of credit(s) proceeding the bankruptcy motion. The latter would enable to decide whether the term in which the insolvent company should present a bankruptcy motion was met, and to establish civil and penal responsibility of board members in case it failed to do so. Failing to meet these terms would evoke administrative, civil and penal responsibility.

Moreover, it would be important that if the company board failed to apply for declaring bankruptcy, this should be made publicly known in a special, court-run registry of economic agents that discontinued to meet their financial obligations, including the names of managing directors and other persons who legally represent this company. A legal consequence of entering such a registry should be the loss of right to run a business on own account, or to legally represent other company. At the same time, in the bankruptcy procedures the order of claimant priority should favor secured creditors and unsecured banks, and the position of court-appointed trustees should be strengthened.

All in all, in order to improve the security of doing business in Moldova, the new bankruptcy regulations should:

- Expedite and simplify the bankruptcy process.
- Establish permanent mechanisms to ensure order of claimants' precedence and protection of creditors' interests.
- Encourage active participation of non-bank creditors.
- Establish penalties for borrowers found guilty of fraudulent dissipation of assets resulting in bankruptcy to avoid repayment of debt.
- Clarify the role of court-appointed trustees in the bankruptcy process.

It is unclear, however, if these requirements are indeed met by the Bankruptcy Law of last November.

Management of state-owned enterprises

Many managers of state-owned enterprises (and of the already privatized firms) lack basic business skills. They often remain engineering and production driven and see restructuring of their firms as contingent on: (i) investment into new equipment, (ii) the introduction of soft long-term crediting, tax reductions and similar forms of subsidies, and (iii) the re-negotiation of preferential trade agreements with the FSU countries. Substantial managerial energy continues to be spent in pressuring Government to secure the above rather than on market research and product development. As it was already noted, the Government must undertake special effort to eliminate the presently existing, interlocked, non-market relationship between the Government, the enterprise sector, and the former state banks. Furthermore, the management and organizational structures of the state-owned companies must be improved and the corporate system of management (including establishment of a two-tier management structure) introduced. A complex programme for undergraduate and postgraduate business education in the area of business management, financial and accounting techniques, marketing and promotion, business planning, business strategy, international financial techniques, etc. is only partially prepared and implemented. The management contracts, within the framework of ‘Privatization Through Restructuring’ (see 2.8) would also contribute to the improvement of management standards.

Moreover, as evidenced by the experience of other economies in transition, inflow of foreign direct investments and development of joint-ventures significantly contribute to the improvement of corporate governance not only within the companies directly affected but in the whole sectors involved. They lead domestic firms to significantly modernize their managerial structures and practices as well as their productive capacities, which soon become even superior to those of the respective foreign direct investors, and to more aggressive marketing practices. Consequently there follows large improvement in the competitive position of domestic companies which in defense of their respective markets often out-compete their foreign or joint-venture challengers. Measures that the Government may undertake to accelerate the inflow of foreign direct investment and the development of joint-venture companies are briefly discussed below.

3. Economic Policies in Support of Private Entrepreneurship (Including the Small and Medium Enterprise Sector)

General conditions for private sector development

Most of policy makers, preoccupied as they are with what used to be or still is the state sector of the economy, do not get far beyond lip service in their appreciation of the role of private sector and of its development in a market economy. In practice private sector continues to meet political opposition; moreover, part of political elite and the media continue to be ill-disposed to private business. From informal contacts with people who have recently operated their own business or continue to do so in Moldova it follows that actual or potential entrepreneurs got used to difficulties in starting up a private business and obtaining all necessary permissions and licenses. Widespread corruption is commonly admitted (especially with respect to bank credits; tax compliance, licensing, and multiple inspections). Although the exorbitant number of fields of activity that require licensing of one sort or another was recently reduced, there is still a lot of room for progress. Moreover, registration procedures must be simplified and done by chambers of commerce and industry rather than by public authorities. Both these measures hopefully would at the same time limit the scope of corruption.

Providing the business infrastructure

In providing the necessary business infrastructure, three areas of Government activity may be distinguished: (i) technical infrastructure, (ii) legal infrastructure, and (iii) institutional infrastructure. With respect to (i) an important hindrance to both local and foreign business in Moldova is an inadequate telecommunications system, especially outside Chisinau. Also modernization of the Moldova’s road system, postal services, and electronic means of communication must receive more Government attention.

Regarding legal infrastructure, the Government seems aware of the fact that the Moldova’s legal system is inadequate. Some laws are missing or only under preparation, others badly need revision, still others are inconsistent with the new economic environment and need revoking. The Government and Parliament should accelerate the process of enacting the necessary legislation.

Closely related to this is the absence of law enforcement - its institutions, manpower and patterns of behavior. The Government must put more effort to improve law enforcement in Moldova, to strengthen the arbitration court system and public institutions. The media could help to improve law enforcement throughout the country by constant monitoring of law enforcement process, by making any abuse of law publicly known and by pressing on the Government and Parliament to take appropriate measures in such cases.

Another bottleneck of economic modernization and restructuring, partly of legal and partly of institutional nature, refers to the accounting, book-keeping and auditing standards presently used in Moldova. USAID technical assistance is provided to achieve this. It is important that in the final result of this work these standards are made the same for the enterprise sector as a whole (except for simplified forms of accounting for small and micro firms), and full compatibility between the new Accounting Law on the one hand and the Tax Law and other legislation on the other hand is secured.

Financial constraints for private sector and small and medium size enterprise development

Financial constraints for small and medium size enterprises are at present a very important bottleneck of private sector development in Moldova. A separate review of those constraints is presently under preparation, especially in such areas as legal regulations, taxation policy, access to information, access to finance and commercial banks' interface with small and medium enterprises (SMEs). For obvious reasons in what follows only tentative observations will be offered.

First of all SMEs face extremely limited access of to capital because banks consider lending to small business more risky than to big enterprises. The largest source of founding for SMEs today is internal savings and other informal borrowing instruments. Hence a more developed bank-SMEs relationship is of critical importance. As the sector's needs exceed the inherent limits of informal borrowing, one can expect SMEs to turn to banking sector institutions as the primary source of finance for business expansion, or they will stagnate together with the rest of the economy.

Although short-term credit is available, it is extremely expensive and of difficult access without excessive collateral security. Most Moldovan start-ups in the private sector begin operations with no bank financing; moreover, there is relatively minimal reliance on bank loans also as a source for further investment outlays or turnover capital of the SMEs. Loan guarantees and similar credit facilities which are aimed primarily at small business and commonly used in market economies hardly operate in Moldova. However, until present the Government provided hardly any money, nor established a clear regulatory framework that would allow, or encourage, the development of such financial instruments. Other banking services that typically facilitate commercial activity in market economies are also absent. The excessively liberal bank licensing policy of the early years of transition, and the banks subsequent imprudent lending, have left many of these banks and the sector as a whole in a precarious financial position. The New Economic Policy framework should include allocating financial resources to facilitate access of small and medium private firms to credit and, at the same time, to develop appropriate financial instruments.

The expansion of credit activity to the private sector until recently has been severely constrained also by absence of an effective Collateral Law that would provide a systemic basis for collateralizing loans and registering liens or charges on a borrower's property. It is unclear, however, whether the new collateral law (i) creates a central registry to determine collateral status of a pledged asset (for otherwise it would be extremely difficult to determine if prior claims have been registered or if a lender's rights have been threatened, should a borrower sell collateral or use it to secure other loans); (ii) clarifies real estate property title records; (iii) enables creditors to place a floating lien that covers an entire company's operations; (iv) reassesses the order of claimant priority more in favor of secured creditors and unsecured banks; (iv) sufficiently expedites and simplifies the lien execution process.

Commercial information is limited and attitudes towards utilizing and exchanging information are considerably more stringent in Moldova then in Western Europe. A barrier to the establishment and operation of reputable credit rating agencies is in the Banking Law's regulations related to secrecy which do not allow banks to pass information to private agencies. This forces agencies to rely on information supplied largely by companies themselves, which is often incomplete and which cannot always be fully documented. The Banking Law should be revised in order to encourage the creation of credit rating and risk assessment agencies, and the development of a wider and more credible information base to be shared between financial and other institutions.

An additional information barrier is the limited and inadequately enforced system of business registration. A more complete and effective system that would include tighter monitoring and enforcement of financial information required from private business entities must be developed. Moreover, the Moldovan courts should make their verdicts on the wide range of economic and financially-related cases over which they preside more accessible to the public. The Government should facilitate publication of these verdicts.

The Banking Law should be amended in accordance with the evolving financial sector in order to allow the development of the second-tier or semi-banking financial institutions and instruments, such as leasing and loan guarantee funds, for which SMEs are an important market. The amendments should include: (i) providing the framework for creation of new financial institutions, including second-tier or ‘semi-banking’ financial institutions, co-operative savings institutions among them; (ii) eliminating conflicts between different pieces of legislation by means of more precise definitions and distinction between banking and non-banking activities, as well as a more clear recognition of bank guarantees as a banking activity; (iii) more clear defining of the acceptable vehicles of credit and financial intermediation activity; (iv) amending, revising and modernizing the Banking Law, Tax Law and other legislation to allow for consolidation of the banking sector by providing a precise and consistent definition of bank holding entities, the conditions under which they may be established, and their operating guidelines; (v) creating a separate legal category for and a clear definition of non-profit institutions.

Finally, with respect to direct credit mechanisms to assist SMEs it must be noticed that despite donor resources allocated to Moldova over the last few years, support from the national government and from international donors for loan guarantee funds and other appropriate financial mechanisms for small business has been limited. The full range of such institutions and financial instruments has not been fully examined. Current programs in operation are not standardized, often founded with limited capital and do not always aim at long-term financial self-sufficiency. The Government together with non-government agencies and donor representation should develop and implement an overall strategy to more effectively utilize loan guarantee funds and other financial instruments aimed at SMEs in Moldova.

Summing up, the primary measures that the Government should undertake in the area of financial sector reform should be geared towards: (i) increasing the SME access to capital; (ii) reduction of the risks to banks of lending to SMEs, and (iii) lowering the costs to SMEs and financial institutions in doing business together.

4. Economic Policies in Support of the Enterprise Sector as a Whole (‘Horizontal Programmes’), and Government Top Priority (‘Target’) Programmes

Investment promotion is the usual ‘horizontal’ programme in support of economic restructuring. It must be noted, however, that:

(i) Investment promotion must not be founded on branch development criteria, i.e. the Government must not decide who is the winner in the competitive market behavior lest the Government itself becomes an entrepreneur.

(ii) Various forms of investment support instruments may be used, such as 'accelerated amortization'[2], or partial tax deductibility of investment outlays.

(iii) Although the sectoral and branch differentiation in the rates of investment support instruments may not be used, differentiation is allowable to reflect regional policy priorities. For instance, in the regions of heavy structural unemployment the allowable rates of accelerated amortization or tax deductibility of investment outlays may be higher than elsewhere. In that case, however, it is of critical importance to define regions of preferential treatment very clearly and narrowly.

None of these instruments seems to be presently used in Moldova.

Another instrument of 'horizontal' development programme is Government *support of corporate research, development and innovation outlay.* Examination of its present use in Moldova requires a separate study.

Support of foreign direct investment in Moldova requires first of all improvement of general investment conditions there, and especially:

(i) the expansion of benefits under the Foreign Investment Law by granting access to international arbitration to all foreign investors;

(ii) accelerating efforts to join international agencies and accede to international conventions that are important for foreign investors, such as International Center for Settlement of International Disputes;

(iii) settling of state and municipal claims on land on which enterprises have been located and vesting with them the ownership of this land thus enabling them to sell land associated with them;

(iv) giving private investors that participate in joint-ventures the right of first refusal over purchasing the entire venture and/or the state-owned (stock-owned) partner, in case this partner is privatized.

Moreover, the Government should revise its legislation concerning the inward investment by establishing clear, stable and transparent rules for strategic investors, domestic or foreign, avoiding discrimination between them. In the long-run, inward foreign investment in the acquired company should concentrate on projects that favor modernization of its productive capacity, development of new capacities and improvement of its competitive position. Creating new competitive jobs is also an important consideration, especially in the short run, as is the development of new financial services, but the threat of short-terminism is only too real.

Export Promotion is often seen by exporters to be tantamount to domestic currency devaluation. Yet, in the specific conditions of the Moldova's economy it may be no solution to the problem of balance of payments. Considering that the Moldova's demand for imported fuels and other raw materials is extremely inelastic and, on the other hand, that the world's demand for Moldova's produce is highly elastic, devaluation of the Lei may actually deteriorate the Moldova's balance of payments. Therefore other instruments of cost reduction and improvement of competitive position of Moldova's exporters should be used. Some of those instruments go far beyond government support of research and development outlays, and

[2] Increasing amortisation charges through valorisation of capital assets for past inflation would be a welcomed measure only provided at the same time three conditions were met. Firstly, that increased enterprise profit margins were spent on increased capital formation rather than on increased salaries of managers or wages. Secondly, that the value of capital asset in question was calculated as a discounted value of future profits which it generates, and not as its historical cost that most often would be irrelevant. And thirdly, that the reduced tax revenue is linked to reduced budget expenditure which, given inelasticity of many budget allocations in Moldova, may well mean reduced budget subsidies for the economy.

traditional export promotion measures. Technical assistance in this field may be easily provided.

Competitive market protection is another 'horizontal' programme that may be relevant for Moldova's economy. The actual legislation in the field of antimonopoly policy is apparently not meaningful. The legal restriction of one firm (or a union of firms) controlling no more than 35**%** [?] of national or regional market respectively is not observed. Many newly privatized joint-stock companies are in fact the previous state-owned monopolists that continue to control vast shares of the market (because of lack of foreign competitors and lack of sufficiently strong new private companies). The actual legislation related to competition (far not comprehensive) is also weak in terms of its institutional part and its functions; consequently the powers and administrative capacity of the Anti-Monopoly Department of the Ministry of Economy are very limited.

Other 'horizontal' programmes that affect the industry as a whole usually include (i) Human resource development, (ii) Incentives for ecologically sound development, and similar.

With respect to '*targeted' Government priority programmes*, their number should be strictly limited in order to make them both credible and viable. One of such programme in Moldova should be the Energy-Saving Programme; another one – the Poverty Reduction Program (to be elaborated on the basis of the Interim Poverty Reduction Strategy Paper already prepared by the Government of Moldova with cooperation and the international financial institutions). Both, 'horizontal' and 'targeted' programmes must be clearly define: (i) which Government agency is responsible for the implementation of the programme in question; (ii) what are the budgeted resources allocated for the programme and what is the time-pattern of their disbursement; (iii) what are the non-budget resources; (iv) what are the criteria of assessing the success of programme's implementation, (v) who does the assessment in terms of programme's success criteria; and (vi) who checks the lawful and purposeful spending of the budgetary and other resources.

4. NOTES ON A NEW STRUCTURE OF THE MINISTRY OF ECONOMY

The *starting point* for any new functional structure of the Ministry of Economy of Moldova (MEC) should be *functional structure of the government as a whole*, and especially that of the ministries and government agencies that operate in the realm of economy and social welfare. Apart from some 'line' ministries that willy-nilly are likely to continue, government management of the economy should be concentrated in *two 'functional' ministries: Ministry of Economy, and Ministry of Finance.* In the new system, the basic functions of the Ministry of Finance although different compared to those in a centrally planned economy, are easier to understand than the respective new functions of the MEC. With regard to the latter, it is important that it must no longer manage everyday business of the enterprise sector, but set the rules of economic conduct and 'police' their implementation. The possible contents of economic policies in a quasi-market environment of Moldova's economy is spelled out in my note 'New Economic Policy Framework for Moldova'. 2 Therefore the present note presents a 'menu of options' regarding a functional structure of the Ministry of Economy vis a vis other ministries that regulate economic patterns of behavior and economic policies in Moldova. Of course both these notes are complementary with each other.

At the end of the present note some attention will also be given to the Ministry of Finance since its position and functions are often misunderstood and-or misrepresented in the present political debates in Moldova.

The reference point of this note will be, next to the present structure and functions of MEC, also a recent note of Mr. Victor Doras, Senior Advisor to the President of the Republic of Moldova and Chief of the Political Planning Department in President's Chancellery, 'On improvement of management of economic planning and of the Moldova's economy'(in Russian).

In some countries in transition the new Ministry of Economy is founded on the structure of the Ministry of Industry (or Ministry of Industry and Commerce that also includes the former Ministry of Foreign Economic Relations), rather than on the structure of the former Gosplan, lest the new Ministry of Economy falls back into the routine of direct management of enterprises. At the same time the analytical capacities of the former Gosplan are used by turning it into an analytical department of the Government and included either in the Prime Minister's Chancellery, or in the MEC. In Moldova, however, the risk of falling back into the routine of direct management of enterprises and interference into their daily business is possibly even greater in case of Moldova's present line ministries than in the case of MEC. Therefore, I tend to believe, *MEC should continue to exist, despite its former GOSPLAN foundations, albeit its structure and operations - as well as those of other ministries and Government departments - should be much revised.*

In public debates in Moldova much attention is given to the positioning of a macro-economic analytical department in the Government. Some want to see it in the MEC where it is positioned at present, others want it in MOF (where it hardly exists), i.e. in the Ministry which constructs annual budgets and medium term financial plans on the basis of forecasted macro-economic indicators, and should they prove ex post significantly different from what had been forecasted, it is this Ministry that is constitutionally hold responsible for budget under-

This note was prepared in light of the discussion (Dec. 2001) on improvement of management of the national economy of Moldova implementation or financial plans failure. This debate is largely irrelevant. It follows from the fact that there is still a shortage in Moldova of good macro-economic analysts (although the situation has much improved in the past 2-3 years and will continue to improve, among other things, due to assistance of USAID and other international donors. Indeed, there *should be at least two analytical macro-economic departments in the Government, one in MEC and the other in MOF* (the third one is already in the National Bank of Moldova). Moreover, they may well disagree with each other in their forecasts. This is by all means normal since one of them by definition centers on physical input-output analysis, and the other one on the respective financial interrelations, However, a friendly dialog between them will only add to better devising economic policies.

The present functional structure of MEC, and also the project put forward by Mr. Doras, preserve the old branch structure of the Gosplan and duplicate functions performed by other ministries. This relates especially to the Department of Development of the Real Sector of the Economy and to the Department of Strategic Planning and Development. In the former, next to divisions that are an important component of economic-policy making in a market environment, such as the Division of Development of the Enterprise Sector, or the Division of Development of the Business Infrastructure, there are divisions the functions of which overlap with those of the respective line ministries. For instance, if the task of Government of Moldova is not to manage enterprises in industry, agriculture, transport, or any other sector, but to elaborate policy framework in each of those sectors, as long as elaborating of such policies is the task of respective line ministries there is no room for these functions to be duplicated by the MEC. Or else, once elaborating of the respective policies is decided to rest with MEC, there is no room for the respective line ministries. However, if –as at present, and to an extent also in Mr. Doras's project, the MEC's function is to elaborates the respective policies, and the function of the respective line ministries is to implement them through managing individual enterprises or their holdings, and then to report back to MEC, then the system is also clear and rather well known - we are back in the old GOSPLAN framework.

Much the same refers to the Department of Strategic Planning and Development. The task of elaborating financial policies falls into constitutional competencies of the central bank, and those of the Ministry of Finance. Developing of social policies and of the social sphere belongs in turn to competencies of the Ministry of Labor and Social Welfare. Development of special economic zones is part and parcel of economic policy mandate of the Department of Development of the Real Sector of Economy. There are also other duplications of functions and internal inconsistencies in the present structure of MEC. Therefore it may be advisable to set out - as a point of reference for further work - a *project of functional structure of MEC that would follow some general principles of functional division of competencies between MEC and some line ministries, the essence of these principles being that the task of the Government is to elaborate the respective policies (regulatory functions) and to enforce their implementation, and not current management of the enterprise sector..*.Prior to outlining the proposed MEC structure, however, it should be noted that what follows below is closely related to the specific contents of the 'menu of options' of economic policies put forward in my note on 'New Economic Policy Framework for Moldova', and that both these notes are complementary with each other.

The proposed structure of MEC would consist of five departments.

The first Department would deal with *'horizontal' economic policies*, and with industrial policy in particular, and would include the following divisions:

- Division of Economic Strategy
- Division of Industrial Policies

- Division of Development of Small and Medium Enterprises, and of Handicraft
- Division of Regional and Rural Development

It should be noted that placing the Division of Regional and Rural Development in MEC implies some overlapping with functions of the Ministry of Agriculture, as it indeed does in several other countries in transition. Taking into account the importance of agricultural sector in Moldova and its specific problems that would continue to dominate policy making of this ministry, this duplication may be unavoidable.

The second department would deal with *economic restructuring and infrastructural development* and would consist of the following divisions:

- Division for Restructuring of Industry
- Division for Development of Infrastructure (of the energy sector in particular)
- Division for Development of Commerce and Services (if this is at all necessary)
- Division for Development of Science and Research

Entrusting MEC with functions of the first and second department is tantamount with elimination of the Ministry of Industry lest there is duplication of functions and of government bureaucracy. Moreover, for same reasons, entrusting MEC with functions related to development of Infrastructure is tantamount to eliminating the Ministry for Energy and other Government departments and agencies that presently operate in the domain of Government infrastructural policies. Division for Development of Infrastructure should also be responsible for Government investment projects.

The third Department would deal with *fair trade and commercial practices* and would consist of the following 'policing' divisions:

- Division for Control of Government Orders Practices
- Division of Protection of Competition and of Counter-monopoly Practices
- Division for Administration of Trade in Special Goods and Services

Entrusting MEC with functions of the third department is tantamount with elimination of other Government administration structures that presently operate in the domain of policing competitive behavior and counter monopoly practices. Although there is such a unit at present in the MEC, it is inadequately staffed and with far too limited competencies. Foreign expertise and legislation could be usefully applied in Moldova. This, in turn, would reduce temptation to use administrative measures to control prices, terms of trade, etc. It should also be noted that competencies of the Division for Administration of Trade in Special Goods and Services should include management of Government reserves.

The fourth Department would deal with *foreign economic relations* and it would comprise of the following divisions:

- Division for Economic Relations with CIS and the Baltic Republics
- Division for Economic Relations with Other Countries
- Division for European Integration and Relations with WTO and other International Organizations (except for those with IMF and the World Bank which should be vested with the Ministry of Finance)

Entrusting MEC with functions of the third department is tantamount with elimination of other Government administration structures that presently operate in the domain of Moldova's economic relations with abroad. At the same time specific requirements and relations between IMF and World Bank on the one hand and the Ministry of Finance on the other (and National Bank of Moldova) require that Ministry of Finance represented Government of Moldova in this domain.

The fifth Department would be *the Government Center for Strategic Studies* that would include the following divisions:

- Division for Analysis of Economic Development
- Division for Analysis of Social Development
- Division for Regional and Spatial Development
- Division for International Integration

As I already noted above, this Department could be positioned, either in the Prime Minister's Chancellery, or in MEC.

Competencies of individual divisions within each of the above mentioned departments should be elaborated accordingly.

Turning now to the Ministry of Finance.(MOF) let me first note that constitutional responsibility of any Ministry of Finance is to construct annual budgets, collect government revenues and exercise budget allocations in step with revenue collection. When medium term financial planning takes place, it is also done by ministries of finance. They do not determine taxes. These in most countries, Moldova including, cannot be imposed otherwise than by law, and laws are made in due course by Parliaments.

In preparing annual budget, MOF needs first to look into what is called Public Spending Requirement' (PSR). It represents spending commitments that follow from the present legislation (e.g., legal commitment to pay social insurance bill, wages of government employees) or from servicing government domestic and foreign debt. In many countries in transition - especially where on the one hand the public sector has not been reformed, social welfare programs are ill-addressed but the number of unemployed sharply increases, where there is plenty of waste of public monies, yet there is large public debt to service, and, on the other hand, where the economy is in prolonged recession, PSR is often close to the forecasted budget revenues, sometimes even more. This is the environment in which Ministers of Finance report to their Governments the volume of expected budget revenues and of the PSR. The difference represent what the Government may spend in order to meet its priorities. If the difference is negative, the Minister of Finance asks his Government whether the Parliamentary majority would rat her increase taxes or change laws that give rise to Government financial commitments. No Prime Minister, or President likes such questions. But even when the difference between projected budget revenues and PSR is positive, as a rule this is much less compared to what the Government (or President) would want to spend, and hard choices need to be made. But neither determining of Government priorities, nor the above mentioned choices are those of the Minister of Finance. They are of the Government (or of the President).

There is a tendency, in Moldova and elsewhere, in the face of permanent financial constraints, to partition the Ministry of Finance and weaken its position against those of other ministries. However, weak MOF means weak macro-economic framework and poor prospects of sustainable economic development. Therefore collection of all budget revenues should rests in the hands of MOF, as should the preparation of annual budgets and of medium term financial plans, and of monitoring of their respective implementation. The Moldova's MOF needs rather reinforcing and consolidating than weakening and partitioning, and the only delegation of competencies could relate to both administrative powers and the respective finance to local governments. This subject, however, requires a separate paper.

5. SMALL ENTERPRISES MUST BE CONSIDERED AS MAIN DRIVER FOR INNOVATION

Let us begin with a quote from the European Chapter for Small Enterprises (Lisbon, 2001): "Small enterprises are the backbone of the European economy. They are a key source of jobs and a breeding ground for business ideas. Europe's efforts to usher in the new economy will succeed only if small business is brought to the top of the agenda.

Small enterprises are the most sensitive of all to changes in the business environment. They are the first to suffer if weighed down with excessive bureaucracy. And they are the first to flourish from initiatives to cut red tape and reward success.

At Lisbon we set the goal for the European Union to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth, more and better jobs and greater social cohesion. Small enterprises must be considered as a main driver for innovation, employment as well as social and local integration in Europe."

Let us turn now to Moldova's reality. It is very contradictory. On the one hand, private sector covers the most part of Moldovan transition economy (about 60% of GDP and 68% of the employed). Property reform and privatization engendered thousands of new SMEs in urban and rural areas, which will assist the state in solving the problem of employment, production of goods and services, increasing incomes of the population.

At the same time *the relations of the state and SMEs is far from being unclouded*. According to EBRD estimates (Transition Report, 1999) indices of quality of governance and environment for entrepreneurship in Moldova are the worst among countries in transition. Opinion polls of entrepreneurs indicate the same[3].

Promotion of independent entrepreneurial activity started in Moldova at the beginning of the 90s, when respective legal basis has formed. Law on Propriety of January 22, 1991, stipulated for right of private property for any object of property (with few exceptions) and for possibility to procure and use means of production and undertake entrepreneurial activity. Law on entrepreneurship and enterprises of January 3, 1992, established juridical and organizational forms of entrepreneurial activity. Legal basis is continuously developing.

Economic reforms of the 90s also have lead to considerable changes in mentality of the population as regards private property, competition and entrepreneurship. Creation of a large number of small enterprises is characteristic to development of the Moldovan entrepreneurship at the present time. Prevalence of small enterprises demonstrates itself as a tendency of development of the country's economy during the last years.

During the last ten years, labor relationships in Moldova have changed dramatically. Thousands of people who used to work for state enterprises lost their jobs and changed their occupations, a private sector appeared, people started moving from urban to rural areas, labor migration abroad started to grow.

A new phenomenon settled in – *entrepreneurial self-employment*. Very quickly, in the course of 5 to 7 years a new social layer of people sprang up in Moldova, comprising those

[3] Impediments to Development of Small Rural Business. CISR, Carana Corp., 1999; Entrepreneurship in Moldova. CISR, New-Biznet, 2000; Barometrul de opinie publică. Institutul de politici publice, 2001

who created their own work environment and new work places. Representative examples are: small production and service businesses, self-employment in the social sphere (medicine, education), security services, etc.; however, the most massively developed domain is private trade.

Results from opinion polls and surveys of household budgets have shown that over 40%, as a whole in the country, and over 60%, for rural areas separately, of people's incomes come from self-employment, secondary employment, etc. In many cases these are unofficial, shadow-economy incomes. In 2001 wages received from employers, or indemnities received from the government (pensions, student stipends, etc.) constituted as a whole for Moldova about 40% of the population's income. The other part was made up of income from people's own businesses, occupation or profession. Self-employment and entrepreneurship are the main reason for low indicators in registered unemployment. Small business is a sector of survival that draws into the reformation process stirring people and people who lost their jobs. In the reality, it is almost the only sector of recovery of those seriously "ill", transforming social groups. So-called "shuttles", small proprietors, family business, small and medium entrepreneurs depend less and less on the state and, expanding the sphere of their activity, can abate acuteness of the unemployment.

Table 5.1.

Employment in the Moldovan economy, thou persons

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Economically active population	2091	2071	2070	2052	1700	1699	1696	1686	1671	1809	1682	1655
Employed population	2091	2071	2070	2050	1688	1681	1673	1660	1646	1642	1495	1515
Paid employed population	1928	1923	1792	1770	1454	1437	1425	1284	1237	1125	932	810
Unpaid employed population	163	148	278	280	234	244	248	376	409	517	563	705
Population employed in:												
Public sector	1461	1300	1192	1124	776	680	567	473	446	424	382	348
Private sector	630	769	874	920	906	995	997	1054	1064	1086	999	1059
Public and private	-	-	-	-	-	-	102	123	121	114	93	78

Source: DSS, 2001

As one can see from the Table 5.1, fundamental turning point in employment of the population in favor of the private sector occurred at the same time as mass privatization of state property began – in 1993. After seven years correlation of the employed in private and state sectors was 75: 25 already. If we turn to the employment structure (See: *Table 5.2*), we can note the state "is present" mainly in production infrastructure – electricity, gas and water supply, transport. It still provides for the most part of employment in social sphere: education and health care. Share of employed in economic agents with foreign participation remains low (10.9%).

Table 5.2.

Employment structure by ownership and economic sectors, 2000

(% of "total" by type of activity)

Activity	Public	Private	Mixed with foreign participation
Total	***48.9***	***40.2***	***10.9***
Agriculture	7.2	90.0	2.8
Industry	9.4	49.6	41.1
Electrical energy, gas and water supply	57.4	11.9	30.7
Construction	9.2	46.1	44.7
Total manufacturing branch	***10.7***	***71.1***	***18.2***
Trade, wholesale and retail	3.9	84.4	11.7

Transportation, warehousing and communications	64.9	14.9	20.2
Financial intermediation	8.9	75.0	16.1
Public administration, obligatory social insurance	99.9	-	0.1
Education	98.3	1.6	0.1
Health protection	98.7	1.3	-
Others public utilities, social and personal services	83.5	15.9	0.6
Total nonmanufacturing branch	***82.2***	***13.3***	***4.5***

Source: DSS, 2001

According to the data of the Department of Statistics and Sociology about 94% of all enterprises and 30% of all employed account for the small business sector now, while trade turnover of small and micro enterprises makes up 45% of the country's total. The most considerable part of the trade turnover (80%) accounted for private enterprises. It should be mentioned that 90% (5314) of profitable enterprises in the country are small business enterprises.

License-based entrepreneurial activity continues to develop. At the beginning of 2002 there were registered more than 46 thou of valid licenses, which shows 30% growth as compared to the same period of the previous year. More than 22 million MDL were collected owing to licenses, which contributed to the growth of budget and Social Fund inpayments.

At the present time amendments introduced into the Law on Entrepreneur's License somehow caused tensioning of the situation, depriving the most part of entrepreneurs of the possibility to function. It is this problem that multiple complaints regard on hot lines recently opened by Bizpro-Moldova.

In the second half of the 90s a series of measures aimed at amelioration of this situation has been undertaken, but unfortunately no considerable changes followed. Moreover, small entrepreneurs due to the lack of information do not always enjoy those facilities that they can claim. For instance, enterprise with an annual average number of employed from 1 to 19 and annual net sales volume of own production and/ or rendered services up to 3 million MDL are exempted from discharge of tax for 3 years. Exemption is granted if at least 80% of the sum of exemption is used for development of own production, services or creation of new workplaces.

Number of entrepreneurs that enjoyed this facility during 2002 just slightly exceeds 60, while this right belongs to several thousands of micro enterprises.

Period of time over which the exemption is granted is 3 years and does not depend on the fact whether income was taxable or there were losses during the period ulterior to the first fiscal period when the exemption was obtained.

In fact, entrepreneurs continue facing different difficulties in creation of small enterprises as well as in expansion of their activities. These problems have mainly structural, technical, management and financial character. The majority of registered enterprises can not undertake their activities due to the insufficient starting capital or even go bankrupt due to high taxes. In 1995, Fund for Support of Entrepreneurship and Small Business Development stopped its financing. Law on Budget for 2002 did not stipulate for any funds to support this sector.

It is expected that recent amendments (November 2001) into the Law on Support and Protection of Small Business, which provide for allotment of financial resources up to 0.5% of budget incomes of the Fund for Support of Entrepreneurship and Small Business Development, will ensure financing of national programmes, of projects and measures for development of small business will contribute to some extent to the solution of these problems. It remains to hope that this will succeed and stimulate creation of new enterprises, will contribute to the private sector development as lack of funds hampers functioning of many small enterprises, hinders implementation of new perspective ideas and impairs activities of existing enterprises.

Difficulties concerned with access to financing sources force the majority of small business economic units to undertake their activity in sectors with low consumption of capital, mainly in services.

Usually, small enterprises activate in trade, but not in production concerned with implementation of progressive technologies. Yet, transition process towards market economy inevitably passes on to the new stage, where capital-intensive enterprises producing expensive goods are a main factor of the capacity to compete and of the new workplaces creation.

Access to micro credits is of a particular importance for creation of new workplaces and fight against poverty with the help of small enterprises. But it is evident that granting of these credits by commercial banks presupposes large expenditures, this is why it is necessary to create respective state or private structures for solution of the given problem.

At present, in order to achieve an accelerated development of small business, creation of a favorable environment for the entrepreneurship it is necessary:

- to simplify tax procedures, to create infrastructure for supporting of small business;
- to renew the activity of the Fund for Support of Entrepreneurship and Small Business Development;
- to create a body within the local framework that would elaborate and implement regulation policy concerning small business at the regional level.

Starting from the fact that small businesses forms a sufficiently important sector of the national economy, an inevitable necessity emerges – to ensure them particular conditions for encouragement and support of their future development that, in its turn, will assist essentially to the social evolution, providing for a large number of workplaces and generating the “middle class”.

Formation of some business incubators for development of small business is meant to compensate and unite existing possibilities with the aim to achieve a higher level of local development. Business incubators as a local partnership structure can offer small enterprises a full range of services on beneficial terms focused on implementation of innovative processes into industry and services sphere designed for production of material goods.

Imperfection of the legal framework, unprotected property and personality of entrepreneurs, as well as corruption, informal relations of SMEs with officials seriously darken the everyday activity of the entrepreneurship. It is high time to undertake legal, economic and administrative measures, which would stimulate the entrepreneurship, diminish the shadow economy segment and eliminate barriers, which impede the day-by-day activities of the businessmen.

Taking into account the long-term interests of the country and its population, the SMEs sector is in need of a National Development Plan, in which entrepreneurship would be treated with due respect. It should envision a constructive policy for entrepreneurship as one of the key components of the state strategy for social-economic development. Only in these conditions, the SMEs sector will need more protection on behalf of the state and will become a competitive part of the national economy. Through transfer of the unclaimed human potential of thousands people into the assets of entrepreneurship, one can create new possibilities for going out of the crisis and formation of a fundamentally new structure of the economy: “large + medium and small”.

6. ANOTHER ATTEMPT TO RECOVER THE GOOD NAME OF FREE ECONOMIC ZONES

Free economic zones (FEZ) being evaluated so contradictorily in Moldova are a rather common phenomenon in the world. FEZ, as an institution of attracting investments, gave a good account of themselves in countries with distinctly different political structures and level of economic development, in conditions of market and state economy, in developed and developing countries. Total number of FEZ is continuously changing, but there is a clear tendency of increase and it now exceeds 1 thou. According to estimates of international experts, more than one fourth of world's commodity turnover accounted for such zones in 2000.

First FEZ (Chisinau, Tvarditsa) appeared in the Republic of Moldova in 1995 when structural reforms have started. But their image was compromised by excess of trade operations, retail trade first of all. Thus, FEZ "Expo-Business-Chisinau" in public opinion just turned into a large importer of consumer commodities. Management of the zone explained this bias into trade by the necessity to accumulate starting capital for reconstruction of its infrastructure. Activity of free zones at the initial stage (1995-1999) did not replenish state budget and did not contribute to attraction of investments and creation of new workplaces.

State was forced to take measures, rather disputable, aimed at correction of FEZ activity. There were amendments introduced into legislation on FEZ. And, on this basis, there were new free zones (industrial parks) created in Taraclia, Vulcanesti and Otaci oriented at production of goods for export.

Starting from 1992, a turn from trade to industrial production for export began to show and the latter now becomes legislatively the main direction of activity. Due to this investments into industrial projects increased, including production of wine and divins (cognac), construction materials (brick, paint), electronic equipment. New facilities for production of absorbents, glaze, polyethylene tubes and polyethylene are being formed.

Total number of residents of Moldova's FEZ exceeded 100 in 2001, while employment accounted for 4.3 thousand people. After a series of new production projects was implemented, the number of those employed will considerably increase during 2002.

Drastic changes of the fate of Moldovan FEZ took place after adoption of a new redaction of the Law on Free Economic Zones (Nov. 2001). This normative act removed defects of the previous legislation, improved controllability of processes of FEZ creation and development by the state. Industrial production for export was defined as the main type of activity in these zones, while retail and wholesale trade, banking and insurance activities, as well as production and sale of tobacco and tobacco goods are no longer allowed.

At the present time, residents are adapting to the new conditions of work, when supervision over intersection of free zones' borders is increased. At that, state guarantees to the residents, including protection of investments, are being kept. At the same time a series of stipulations of the legislation requires creation of a real mechanism for their implementation. This refers, in particular, customs and tax control.

Does Moldova need free zones? State (Parliament, Government) answers in the affirmative to this question. In conditions, when national economy is in depression, FEZs are considered to be the hotbeds of business activity on the country's territory with attraction of foreign partners.

Due to this, creation of FEZ seems to be an indispensable measure as state is not able to provide for, at least, a selective development of individual territories and acceptable conditions for investors to undertake their activity on the whole territory of Moldova.

The state hopes that activity of FEZ will have a positive influence on the country's balance of trade and increase its attraction for foreign partners.

Experience shows that FEZ development is not such an easy task as it seems prime facie. Whether it will be economic and social effectiveness or damage depends mainly on correct approach to their creation, including determination of their number and placement.

Creation of a free economic zone is expedient only if there are grounds to think that it will activate effectively. This can be achieved through creation of a FEZ with participation of functioning enterprises, machine-building and instrument-making ones particularly, and new enterprises, which would provide for a complex processing of agricultural raw materials.

The very fact of the creation of a free zone is not a difficult action for the state. It is much more important to provide for its successful development, which will demand a fast realization of requirements of the Law on Free Economic Zones by the state in conditions of a particular territory, implementation of a complex of measures with participation of FEZ administration, its residents and public authorities, both central and local.

Residents of zones should enjoy assistance in realization of their projects. At that, they should be provided with both state protection and guarantees and constructive supervision over their activities. Government, in this case, expects that free zones will be able to influence tangibly the country's economy, including regions where these zones are situated, during the first 2-3 years already.

One of the most widespread accusations addressed to FEZ is tax evasion, contraband and money laundering. It should be mentioned, though, that multiple verifications did not discover any gross violations committed by residents. It is a paradox that rate of violations in free zones is lower than throughout the country. This can be explained by the fact that a resident can be expelled from the FEZ for non-payment of taxes or contraband without any compensation, while most of residents prefer not to risk their investments.

Stability of legislation on free zones is one of conditions of their successful functioning. That is why changes of the current legislation on FEZ can be adopted only in case experts will definitely ascertain these changes can help overcome existing problems and, in the long run, do not contradict interests of the state and residents. An important role in realization of this task belongs to the Ministry of Economy and Department of Privatization and State Property Administration.

Recent events – in legislation and practice – inspire that Government and society, after a prolonged period of hesitation and indecision, proceeded to implementation of a constructive policy for free economic zones.

7. IS THERE A REDUNDANCY OF LABOR RESOURCES IN MOLDOVA?

Since the mid-90s Moldova became the country that provided European labor market with its citizens – from Portugal to Russia. According to the data of the Balance of Payment, remittances from Moldovans working abroad increased from 70 million USD in 1996 up to 170 million USD in 2001, which is almost equal to 30% of export incomes.

Evaluation of the extent of this new phenomenon - mass labor migration abroad – is quite contradictory: from 150-190 thou people (Labor Force Survey, DSS) to the "panic" 600 thou and even 1 million people are reported by other state bodies (Information and Security Service, Ministry of Internal Affairs). Estimates of the latter (more than 600 thou) are undoubtedly top-heavy, if to take into account that the whole population of Moldova, including Transnistria, makes up 4.3 million people, Right Bank region included – 3.6 million.

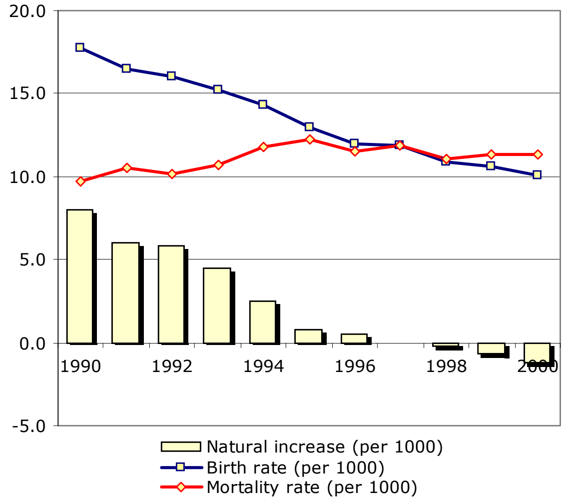
Is there redundancy of labor force in Moldova? Our opinion is that the answer can be affirmative. First, the country is notable for its high population density (about 130 persons per square km). Second, in conditions of an economic depression, reduction of employment, deindustrialization and shutting of many labor-intensive productions (instrument-making, radio electronics, light furniture industries, etc.) there is a large concealed unemployment, underemployment, flow of labor resources from cities into rural areas, general lowering of population's incomes.

Evaluating the situation as a whole, one should take into consideration that impact of transition to the market economy in Moldova showed in a very many-sided way in employment sphere:

- *rise of the labor market* as such, strengthening of the labor mobility of the population, rise of the "shadow" labor market (*along with the open labor market*), expansion of the *self-employment sphere*;
- *changing of the employment structure* in favor of the private sector of the national economy; given the state to private shift, unemployment has turned to be a buffer zone between these two sectors for many people;
- despite a considerable downswing, in 1991 – 1995 particularly (GDP dropped by 53% during these five years), *open unemployment* keeps *a rather low level* in the Moldovan economy, not exceeding during the 90's 1.4 – 2.1% as regards registered unemployment, and according to estimates under the ILO methodology – no more than 8.5 – 12.0%;
- existence of a large *concealed unemployment*: unpaid administrative leave, partially paid administrative leave, short-time working, maternity leave;
- *expansion of the economically inactive contingent of persons*, including those who despaired of finding a job and ceased looking for one, and women engaged in housekeeping as well;
- *rise of the gender asymmetry of the labor market:* male labor force is more mobile. Women strive to keep the previous working status, failing which they become predisposed to lingering unemployment or shift into the economically inactive population;
- fast growth of *the mass labor migration abroad*, mainly, of middle-aged persons, i.e. of the most active working age.

Figure 7.1.

Demographic trends, 1990-2000



There is another circumstance that should be taken into account. In spite of the fact that after 1997in Moldova process of depopulation, reduction of the population has started (see: Fig. 7.1.), the ratio of the number of people in the labor force related to the total populations is relatively stable in time. (See: table 7.1.)

Table 7.1.

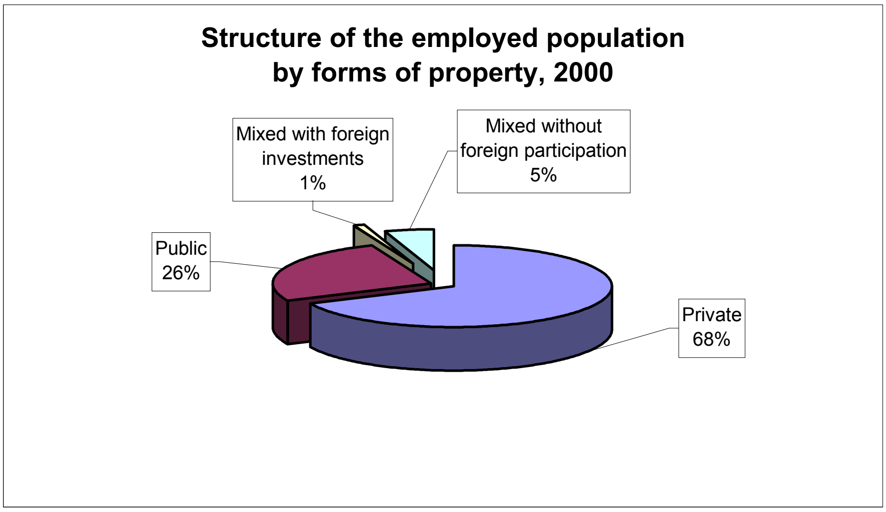
Labor force indicators

Indicator	Unit	1995	1996	1997	1998	1999	2000
Total population	Thou pers	3604	3599	3654	3652	3646	3639
Nr. of people in Labor force (LF)	Thou pers	1696	1686	1671	1809	1682	1655
LF as % of total population	%	47.1	46.8	45.7	49.5	46.1	45.5
Nr. people out of Labor Force (inactive)	Thou pers	1908	1913	1983	1843	1964	…
People not in the LF as % of total population	%	52.9	53.2	54.3	50.5	53.9	54.5
Employed	Thou pers	1673	1660	1646	1642	1495	1515
Employment rate	% of LF	98.6	98.5	98.5	90.8	88.9	91.5
Employment growth rate compared to the previous year	%		99.2	99.2	99.8	91.0	101.3
Unemployed under ILO	Thou pers	-	-	-	167	187	140
Registered unemployed	Thou pers	23	26	25	34	35	34

As the Republic of Moldova was converting to market economy, fundamental changes in labor force distribution took place. Formal impediments for the labor force mobility were eliminated.

As private sector appeared, reorganization of state enterprises in urban localities began and large collective enterprises in the countryside were being liquidated, a redistribution of work places among sectors has started. By the end of the 90’s, private sector has already accumulated major part of employment (See: *Fig. 7.2.*). Share of production sector, of industry in particular, dropped. Number of work places in services sphere, trade and finances increased. The larger employment in Moldova’s agriculture reflects both key status of this branch in the national economy and its importance for the population’s survival in conditions of transition crisis. Labor relations in agriculture are in many cases left out of the legal field.

Figure 7.2.



As in other transition economies, employment in Moldova fell sharply in the 90s, with a cumulative decline of some 11% by 200. Concurrently, a "burden" upon the employed emerged: if in 1990 475 employed fell per 1 thou inhabitants of the country, in 2000 – only 437.

For a developing economy reduction of the specific weight of the employed in the total number of the population is a rather normal phenomenon as incomes growth of citizens can be provided for as the number of employed reduces. From the point of view of crisis state of the economy and social sphere of Moldova, such processes should be considered as negative and undesired as population employment rate is decreasing on the background of the drop of GDP and households incomes.

Structural changes of employment are determined by *labor force mobility*. It is mobility that has sharply intensified in the transition period. For enterprises with more then 20 employers labor force mobility index was as follows: 1994 – 12.4%; 1995 – 13.2%; 1996 – 15.4%; 1997 –16.2%; 1998 – 16.1%; 1999 – 21.8 % and 2000 – 24.2%. Thus, labor force mobility index has doubled in the 2nd half of the 90's.

Table 7.3.

Labor force mobility by sectors

Activity	Mobility index				
	1996	**1997**	**1998**	**1999**	**2000**
Agriculture	10.4	11.8	11.1	22.7	26.1
Industry	19.6	21.8	22.8	25.2	29.3
Electrical energy. gas and water supply	24.1	23.8	22.3	19.9	29.8
Construction	32.2	33.4	31.5	28.3	31.8
Trade. wholesale and retail	25.6	25.8	29.3	30.9	34.9
Hotels and restaurants	27.4	28.0	31.8	33.2	34.8
Transportation. warehousing and communication	19.2	20.0	21.6	21.2	22.8
Financial intermediation	18.9	27.8	20.0	24.2	20.0
Public administration	14.7	14.6	13.6	19.0	16.4
Education	12.8	13.0	11.9	16.2	15.5
Health care	13.6	12.8	12.7	17.2	21.9

Labor force mobility between sectors of Moldovan economy grows rapidly and at the same time reflects able population adaptability to existing changes. To the utmost, labor force mobility shows in the reformed branches (industry, construction, trade, financial sector). The case of agriculture is a very good example of that labor force mobility sharply increased only after the National Land Program completion, collective farm regionalization and land privatization. Labor force is less mobile in public administration and education, health care sectors as structural reforms have just initiated there.

The transition process has profoundly affected the lives of almost everyone in Moldova. For some people, it has given them the opportunity to acquire new skills and training, to engage in entrepreneurial activity in the new, expanding private sector, to live and work in other countries. For others, the transition has caused considerable hardship, with widespread layoffs in state-owned enterprises, informal activities, rising unemployment and poverty, and shrinking social safety net.

There are three types of the *unemployment* that show in Moldova's transitional economy: *cyclic, structural and frictional*. The first of them was generated by economic depression and one should consider state actions at macroeconomic level, especially by means of monetary-loan and financial-budget policy, as the main direction of its overcoming.

Structural unemployment emerged as a result of quick spontaneous changes in the national economy structure, development recession of some sectors (those that use more qualified labor force, usually) and slow development of new sectors in exchange for the old ones. There is also a lack of correspondence of education, qualification, experience, etc. of workers to the new, changing labor market conditions.

Frictional unemployment has derived from mobility of the labor force seeking work with better wages and working conditions.

As in other countries in transition, in Moldova the number of officially registered unemployed is comparatively small: about 10 thou in 1993 and 34 thou in 2000 (0. 7% and 1. 9% of the total economically active population).

Beginning from 1998, DSS examines the unemployment rate according to International Labor Office methodology. For 2000, number of unemployed was established to be 140 thou persons or 8. 5% of the economically active population.

Along with official estimates of the unemployment rate for the Republic of Moldova, there are other, more extended estimates of the scale of unemployment. This is the contingent of the population that "saves itself" through self-employment, has occasional earnings or is formally on the list of workers, but does not receive wage or wage is time-lagged by 2 -3 months, is "on the leave on the administration's initiative", etc. Also, for Moldova, where a half of the population lives in the countryside, phenomenon of hidden agricultural unemployment is topical no less. Plus – mass flow-out of the "moldogastarbeiters", labor migrants searching for jobs abroad.

Taking into account all these circumstances, it is evident that unemployment in Moldova is not so much 2% or 8. 5% officially (and 14 – 20% according to unofficial estimates), as a difficult, many-sided problem that paralyzes not only the economy, but minds of a single persons, families, whole settlements and regions.

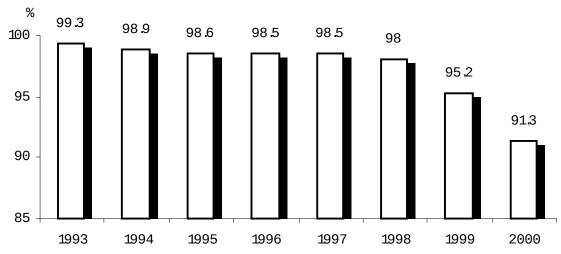
On the basis of a target opinion poll (CISR, Sept. 2001) there were discovered the following characteristics of unemployment in the country:

- *Open unemployment rate*, according to the poll's results, is estimated to be 6. 2% (DSS estimates for 2000 – 8. 5%). Along with this, however, almost one third of the employed is in the state of *hidden unemployment* (half-time working week, leaves on the administration's initiative, etc.). Only 20. 3% of the unemployed quit their jobs and 79. 7% were dismissed due to staff reduction or liquidation of the enterprise. Workers quit their jobs mainly due to low wages (56. 2%), chronic wage arrears or refusal of employer to pay them (18. 7%);
- *Duration of the unemployment.* Unfortunately, chronic long-term unemployment dominates – 73. 3% of the respondents. 11. 7% are unemployed during the period from 6 to 12 months. And 15. 0% of the respondents are unemployed less than 6 months;
- *Mobility of the unemployed* is high: 30. 5% of the unemployed worked at the last place of work no more than one year, and some more (6. 8%) – two years;
- *Professions of the unemployed.* The largest part of the unemployed works in the industry, constructions and agriculture (63. 8%). On the second place – 15. 5% of the employed who work in the sphere of culture, education and health-care. Management workers of both state structures and enterprises suffer from certain problems on the labor market that is predetermined both by restructuring of enterprises and permanent reorganization of the state administration – central and local. Search for a job presents the worst difficulty for people with short work tenure and those having professions that are not required in conditions of the market economy;
- *Regional aspect.* Distribution of the unemployed by type of settlement (urban - rural) shows that open unemployment prevails in cities and the hidden one – in the countryside. In spite of that more than 40% of the unemployed live in municipalities of Chisinau and Balti, there are more opportunities for searching for jobs in rural localities. 34. 4% of the unemployed fall on the share of the countryside, along with that a half of the population lives there. Population of small towns (10 – 50 thou people) is in the worst situation, which, unlike rural inhabitants, has neither job, nor land plot as a mean of subsistence;
- *Social parameters of the unemployment.* Demographic aspects of the unemployment (gender, age) in Moldova are in many respects alike to other countries in transition: *women* are subject to the unemployment risk to the utmost (57. 0%) as well as *young and pre-retirement people*. One should pay attention, though, to the circumstance that *a population group of 25 – 34 years of age is in a quite dramatic situation*: share of the unemployed in this group is the largest – 29. 1% that by 10 points is higher than its share in the age structure of the population (19. 7%). Meanwhile, it is this period of life when professional and social formation of a person takes place: completion of education, acquirement of professional skills, and formation of a family.

One of the most stable tendencies of the first decade of transition period in the Republic of Moldova is *reduction of the share of those employed in the totality of economically active population of the country* (See: Fig. 7.3).

Figure 7.3.

Share of those employed in economically active population

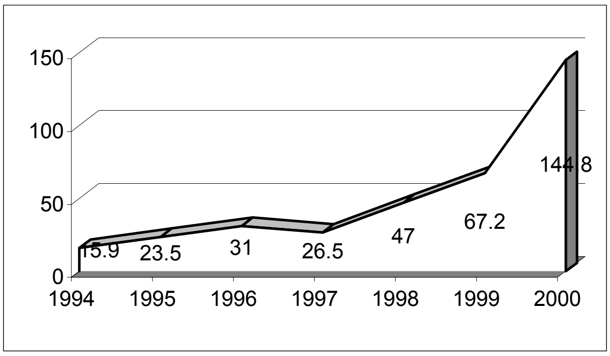


Permanent depression in the main sectors of the national economy (industry, agriculture), lack of investments for development and multiple impediments for SME, including business in rural area, have lead to that demand for labor force was considerably lower than its supply.

A significant excess of labor force has formed in the country. B. Subasi (Center of market problems) evaluated the extent of economically unjustified employment, which represents a ratio between the number of real employed persons, GDP dynamics and labor productivity in a certain period. As a result of calculations, presence of economically unjustified employment was revealed or, in other words, of the correlation between actual and economically justified demand for labor force.

Figure 7.4.

Dynamics of labor force redundancy



From Figure 7.4. can be seen that labor force excess has been constantly increasing (by 3 times during the period 1994 – 2000). Concurrently, there was a decrease of the share of those employed in structure of economically active population by 8%.

Thus, downtrend of labor force potential utilization is present in Moldova. This trend develops in two ways: increase of labor force excess occupied in public production with ineffective work and decrease of employed population share in economically active population structure.

The state, unfortunately, still has no clear policy concerning employment, which would allow solving the problem of labor force excess. That is why the population independently settles this issue: self-employment, labor migration abroad, labor market flow-out – forced or voluntary transfer into the category of those economically inactive. And, only as a last resort, - transfer into the category of the unemployed.

A new phenomenon for Moldova, which revealed itself strikingly from the middle 90's, is *a mass withdrawal of the population from labor market.*

What are the causes of the withdrawal? The first group of causes includes reduction of real wages and extremely low dole. As a result, a contingent of “hopeless” persons of able age who give up employment and active search voluntarily is being formed. The second group of causes is generated by some elements of state social policy – encouragement of pre-term retirement (in agriculture, for instance), increasing of the education period of the youth, prolongation of maternity leaves, etc. Consequences of these measures are considered to be more socially acceptable than growth of unemployment. In addition, they outwardly look in most cases as a result of a free choice.

A fact is suspicious, though. According to several polls (CISR, 1999 – 2001), almost every second person left out of Moldova’s labor market was at its working age; every third of them manifested a desire to work.

The state and researchers pay usually the main attention to the employed and unemployed. As regards those who do not participate in economic life, it is presumed that their “status of those inactive” is stable and they do not represent either any interest from the point of view of employment, nor any threat from the point of view of unemployment.

We are of opinion that such viewpoint is erroneous. In practice, economically inactive persons include a part of the practically unemployed – those who despaired of finding a job or do not believe that it is possible to find any acceptable job (according to wage and working conditions).

A rather low level of unemployment in Moldova (2000 – 2.0% officially and 8.5% by ILO) is explained in many respects by the fact that many workers upon being confronted with difficulties while looking for a job withdrawn from the composition of labor force. Unemployment rate indicator does not reflect this hidden unemployment and therefore gives *an inaccurate signal to the policy-makers*.

In the meantime, it is enough to compare two groups of Moldova’s population (right bank region, 2000) – active population (1654.7 thou people or 45.4%) and inactive population (1992.3 thou people or 54.6%) – to understand how serious and socially dangerous for the state is voluntary-forced unemployment of the population.

The highest share of inactive population is in urban localities (54.8%) where this contingent within the group of those aged 20 – 24 outnumbers even those economically active. As regards those aged 25 – 39, every fourth (!) of them belongs to the economically inactive population.

Of course, in view of the “voluntary” withdrawal of the population from labor market policy-makers get the impression that the problem of unemployment is not so acute. However, one should take into account that it is not only youth and persons with a low educational level that collect in the composition of economically inactive population, but share of middle-aged persons with higher and secondary professional education is also growing.

Thus, economically inactive population is heterogeneous according to both socio-demographic composition and causes of unemployment. According to the poll (CISR, Sept. 2001), about 40% of this contingent is ready to return to Moldova’s labor market, although they are not interested in any available job, but namely a job meeting their aspirations. These persons did not quit fighting for work, and being not able to find acceptable work on the internal labor market of Moldova they find an outlet for their capabilities in other countries, resupplying flows of labor migrants.

Labor force demand and supply on Moldova's labor market is to a large extent under the influence of a large outflow of people for work abroad. Assessment of this phenomenon is different.

Here is the official information from DSS: *Labor Force Survey for 2001 Q4 is evidence of that about 183 thou family members were temporarily absent.*

Table 7.4.

Persons who went abroad for work or in search for work (2001 Q4)

	Total	*Urban*	*Rural*	*Male*	*Female*
Total	183051	68065	114985	129729	53322
15-19	19992	4958	15034	12564	7428
20-24	45456	13698	31759	31248	14208
25-29	25514	9901	15613	19721	5793
30-34	20822	8395	12427	15904	4919
35-39	22969	9350	13619	16362	6607
40-44	26962	12447	14515	19062	7900
45-49	15225	6408	8817	9998	5226
50-54	5055	2424	2631	4060	995
55-59	753	352	401	508	246
60 and over	302	131	170	302	-

Source: DSS

As the table 7.4 shows men form 70.9% and women – 29.1% of those who went abroad for work or in search for work. Urban – rural ratio of migrants is equal to 37: 63. In 80% of cases, their working age is up to 40. In rural areas, people partly support themselves thanks to their land, while in the municipality of Chisinau – thanks to local possibilities of finding a job, but in many small towns the majority of working-aged men are involved in labor migration.

Working abroad has both negative and positive aspects. Among the first are outflow of the most active population, health, family and other problems. Among the latter: increasing incomes, mastering new professions, expansion of the mental outlook, etc.

Moldova, of course, is not the first country that has now and will have for a long time repercussions of the mass labor migration of this transition period. Many of the less developed European countries faced this problem quite recently – in the 60's – 70's (Turkey, Yugoslavia, and Portugal).

It is known from experience of these countries how important the attitude of authorities towards external migration is. Some countries facilitate the emigration of the home labor force or on the contrary, take prohibitive measures, while other countries facilitate free circulation of the labor force based on inter-state agreements or lead a policy on attracting of immigrants – the case with the majority of European countries, Canada and the USA now.

Taking into account the extent of external migration and importance of this problem for the country, *it is extremely necessary to raise the controllability level of emigrational processes.* A positive example of effective state policy on labor force export can be Turkey – in the 50's – 70's into Germany, now – into Russia and other CIS countries.

One cannot consider to be normal the situation when more than 90% of the Moldovan immigrants get employed abroad independently. This is done not avoiding the state services, but due to insufficient preparation of their personnel for such work, bureaucracy and corruption. Private agencies do not provide migrants any particular guarantees, but at least they work quickly.

As for the attitude of the authorities of the Republic of Moldova on migration, an uncertain position is observed. Nevertheless, the Republic of Moldova has an institutional-legal framework, which regulates the migration it does not correspond to the current requirements. The Government undertook some measures on regulating the labor migration in 2000, creating a new Department on labor issues. But, all these measures seem to be uncertain, compared to the extension of the migration process, which occurs in the country. Officially the Republic of Moldova signed bilateral agreements on labor activities and social protection with Russia, Belarus, Israel and Check Republic. There are negotiations held with Portugal, Greece and Italy, and in the perspective with other countries.

The Republic of Moldova is striving after the closing in with the European Union. Partnership and Cooperation Agreement (PCA) between Moldova and EU has been being realized since 1994. The most important component of this act is adjustment of the legal basis of Moldova to the European standards, including those in labor sphere.

Majority of migrants heads for the EU countries. Thereupon, EU – Moldova Cooperative Council considered this problem (Brussels, May 2001). Vice Prime-Minister A. Cucu admitted: “A large number of nationals of Moldova are working illegally abroad. Trafficking in women causes great concern. Analyzing the existing statistics indicates a growing tendency… At least half of the emigrants are in the EU member countries. This is fact which indicates the need to introduce a new approach to this problem. The PCA between Moldova and the EU includes some specific provisions of this topic. We would like to propose to initiate consultations in order to identify ways in which to solve this problem by legal means, at a bilateral level and at the level of the EU as a whole. This would allow for at least a partial improvement of existing situation. In order to find a more durable solution to the existing problems, Moldova needs relevant agreements and technical assistance as well”.

It is impossible to imagine Moldova joining the European economic system without the integration into its labor market. But this integration should be realized in a civilized way, taking into account interests both of the state and the population. This also refers to the CIS region, where attempts are being made to put in order labor migration on basis of legal norms (contracts, quotation of work places, etc.).

8. HOW FAR IS MOLDOVA FROM BRUSSELS?

How far is the Republic of Moldova from Brussels, administrative “epicenter” of the European Union? From the geographical point of view – it is more than 1, 5 thou km that is quite far. From the political point of view, for the former soviet countries, it is not too close either.

But everything depends on the speed this distance will be overpassed. It is known from the history that Belgium, Belgian firms, for instance, in the second half of the 19^{th} century passed this distance very quickly and took root in Basarabia in 2 – 3 years through creation of the first joint – stock company with foreign capital in the region – “Zarojan Sugar Plant” (more than 200 workers) and installation of the first tram in Chisinau (depot, car fleet, railways). As we can see, young Belgium that legalized its independence in 1830 was acting at that time quite aggressive even in the farthest corners of Europe.

The first steps of the young Republic of Moldova towards Brussels, the European Union, at the beginning were also impressive:

- 1991 – as early as the first year of its independence, the Republic of Moldova established contacts with EU and received a 1.1 million USD of technical support;
- 1992 – Moldova became member of the European Bank for Reconstruction and Development;
- 1993 – OSCE mission started functioning in Moldova;
- 1994 – European Union and Moldova signed Partnership and Cooperation Agreement (PCA);
- 1995 – Republic of Moldova, the first among CIS countries, was accepted into the Council of Europe;
- 1996 – between the Republic of Moldova and EU Temporary Trade Agreement was signed;
- 1998 – Partnership and Cooperation Agreement between EU and Moldova (after coordination with all member-countries of the European Union) came into force.

Then, a lull set in on the Moldovan side. In the mean time, Moldova still remains within the field of vision of the European politics. The last significant event took place in June 2001 when Moldova became a member of the Pact for Stability in the South-East Europe. That was the consequence of the support of the EU, other countries of the Carpathian-Balkans region and of the presence within the Republic of Moldova of a rather dangerous nod of tension – Transnistria.

The main platform, on which basis Moldova should show its activity and readiness for the European integration is the Partnership and Cooperation Agreement between Moldova and EU; step-by-step execution of its procedures must bring legal basis, economy and social order of Moldova to the European standards.

Only through execution of this agreement’s requirements Moldova can become an associate member of the European Union. Virtually, all East-European countries, “vertically” from Estonia to Bulgaria, in 2 – 3 years passed this stage and, having become associate members of the European Union, are advancing to the full EU membership. The “first wave” among them included Poland, Slovenia, Czech Republic and Hungary.

What about Moldova? Unfortunately, advancement is going slowly, with difficulties and caution. What are the causes? There are mainly two limiting circumstances that are being mentioned: a) complexity of the preparation stage (drawing together legal bases, structural reforms in the economy, etc.) and b) CIS membership and dependence on Russia, the main economic partner (traditional market of Moldovan goods and energy source).

It seems, though, that the main obstacle for the Republic of Moldova on its way to the European integration has been created by Moldova itself – through vagueness of the long-term course of the political and socio-economic orientation. During the decade after Moldova had obtained independence, the country changed three presidents, four parliaments and nine governments. So, what is the result? “Multi-vectored orientation”, “Moldova will be everywhere, where it’s profitable to be”, etc.

Essentially, the Republic of Moldova has no National Strategy for European Integration yet – a frame document adopted by the Parliament and providing for succession of alternating governments as regards coordination of actions in the field of the European integration.

All other countries – EU candidates realize such strategies. Let us turn, for instance, to the Poland’s National Strategy for Integration: “Membership of the European Union is the strategic aim of Poland. Integration with the Union will help to accelerate economic growth, modernize the economy and the legal system, and eliminate the technological gap between our country and other European countries. National interest explains the Polish determination to become a member of the Union. The balance of costs and benefits of membership shows that the positive effects are much more substantial than the negative. This has been shown also by the experience of the states which joined the Union in previous enlargements. This was notably the case for those countries whose level of economic development was below that of the European Union average. In these cases membership of the Union led to an acceleration of economic growth and welfare. Poland intends to follow this same path.” (National Strategy for Integration, Warsaw, January 1997, p. 5).

As we can see, it was said definitely enough: the EU membership as a goal. In official documents of the Republic of Moldova, especially lately, such distinctness is missing, be it the Activity Programme of the Government (April 2001) or Strategy of socio-economic development of the Republic of Moldova for mid-term period (Ministry of Economy, September 2001). In 2000, really, the Ministry of Foreign Affairs prepared “Strategy of the Republic of Moldova for integration into the European Union”; but it remained an internal departmental document.

What is this? Is it an insufficient understanding of economic, political and humanitarian advantages of the closer relations with the EU? Or is it the fear to become an appendage of Europe, a source of cheap manpower and raw materials, a country of the “peripheral economy”, while loosing profits of the traditional cooperation with Russia, CIS as well?

These fears are unjustified. Firstly, Russia itself is making more active its participation in the European integration (by the way, the EU share in its foreign trade in 2000 is about 40% that is twice as much as that of Moldova). Secondly, previous decade of collaboration with EU has already shown its advantages for Moldova.

The collaboration between Moldova and EU shows in the following fields:

- *Financial aid* – mainly for maintaining of the balance of payment. Moldova received 45 million Euro in 1994 – 1995, 15 million in 1996 expects another 15 million up to the end of 2001;
- *Trade* – the biggest progress took place in 1995 – 1999 when Moldovan export to the EU countries has doubled (from 12% to 21% in the structure of the Moldovan export) while the share of export into CIS countries decreased from 63% to 54%. Moreover, 18 – 20% of the Moldovan export fall on the countries of the Central and Eastern Europe every year. Later, though, share of Moldovan export to the EU countries did

not increase (21.6% in 2000 and 21.2% in 2001). Main partners of Moldova in the EU are Germany, Italy and France. The most favorable EU terms for Moldova are those concerning export of textile and ready-made clothes. In 2001, Moldova had a negative balance of trade with the EU and countries of the Central and Eastern Europe;

- *Investments* into the Moldovan economy with foreign participation constituted 369.7 million USD (2001), including from the EU countries – 39.5%. Areas of investments are: telecommunications (France Telecom), textile (Steilmann, Italian and Belgium firms), tanning industry (Esastampa, Italy), cement (Lafarge, France), sugar beet (Südsucker, Germany), oil products (Mabanaft, Germany), electricity (Union Fenosa, Spain), equipment for services (Spamol, Aquasant - Belgium), etc.;
- *Food security program* – support constituted 5.5 million Euro in 2001;
- *Humanitarian assistance* is represented by 4.8 million Euro (medicines, food) aimed at the most indigent population strata;
- *Technical assistance* is being offered within the framework of TACIS programs (there was spent more than 66.0 million Euro after 1991) as well as on the basis of bilateral cooperation with governments of the Netherlands, Sweden, France, Germany, United Kingdom, Denmark and others. The areas of cooperation are: infrastructure, agriculture, entrepreneurship, development of human potential, local self-administration, cross-border cooperation.

For the truth's sake, we have to mention that not all of the credits were used efficiently (reconstruction of highways, construction of the oil terminal "Giurgiulesti" and a glass-works in Chisinau). Realization of the TACIS projects and their coordination with the state structures' activity were not fulfilled properly either.

But the largest part of time and resources losses results from sluggishness of the Moldovan party. There are tens of examples. Here is just one of them, maybe the most striking one: Civil Code. The Parliament of the Republic of Moldova passed the decision to elaborate a new Civil Code on November 3, 1994, having fixed 3-months period for this task. Practically, the work started only in August 1999 with attraction of foreigner consultants and TACIS resources. The Parliament, at last, examined the Civil Code draft in the first reading in October 2000. Then, revision of the draft and its harmonization with requirements of the European Union followed. Seven (!) years and a lot of resources were spent. Meanwhile, Moldova lives up to its forty-year-old Civil Code…

EU – Moldova Cooperation Council (Brussels, May 2001) admitted to be necessary in the future "to concentrate the joint work on bringing closer the legislation and law enforcement, customs and cross-border cooperation, fight against crime, and follow up to the feasibility study on the EU– Moldova free trade area".

Thus, there is still a lot to do in order to prepare the country for the status of associate EU member. But implementation of the PCA is in the first place for the creation of a democracy and a market economy that are comparable to the ones in the EU. This is not only harmonization of our legal system with the European one. Everybody knows that having good laws is one thing, but implementing them is another. Provision of capability of the state bodies that guarantee democracy, economical upturn and growth of the quality of life, development of human potential are no less important. But above all, in order to shorten the way from Moldova to Brussels, it takes political will and consequence of actions.

9. POLITICAL ENVIRONMENT: THE YEAR OF A GREAT TURN AROUND

It looks like 2001 was a turn around year for Moldova. When this text is being written (mid-February 2002) it becomes increasingly clear that it marked a watershed in Moldovan history as an independent state. If until 2001 the country was moving, albeit slowly and inconsistently, along the road of transition, than after the landslide victory of the Party of Communists of Vladimir Voronin (President of RM since April 2001) in February that year parliamentary elections a vector has radically changed. Today Moldova is closer to Belarus of Alexander Lukashenko than to Romania of Ion Iliescu, to say nothing about more successful reformers like Poland or Hungary or the Baltic countries.

However, in the aftermath of Communists victory expectations were not at all alarming. Quite to the contrary, the prevailing moods were that Communist leaders would modify their stance, that their Government would distance itself from the more radical elements in the Party, that they would recognize where their "true" interests lied and ultimately decide that no political success and no re-election were possible without close cooperation with the international creditors, which implied subjecting themselves to the discipline of the market forces and following the advice of *the IMF and World Bank*. There was a quasi-consensus among the Chişinău-accredited diplomats and even businessmen in Moldova to the effect that no other course was possible for any Moldovan government and that at the end of the day the Communist leaders, as rational human beings (and there was no doubt that they were), would heed the voice of the reason.

Some of the first steps taken by the new Moldovan authorities (though in no way all of them) seemed to confirm this view. So, President Voronin designated Vasile Tarlev, 37 manager of the state candy factory and non-Party member, as a Prime-minister (later voted in by the Communist Parliamentary majority) and included in his cabinet some experienced administrators from previous cabinets, like Finance Minister Mihai Manoli, Economy Minister Andrei Cucu, Industry Minister Ion Leşan, as well as a known partisan of a "balanced" (i.e. not excessively pro-Russian) foreign policy Nicolae Cernomaz, a hangover from previous supposed "reform" era. The country joined in June 2001 WTO and Pact for Stability for South-East Europe, agreements negotiated under Communists' predecessors and imposing on Moldova obligations running counter to the grist of the Communist Party ideology. Shortly after exceeding to power the new leadership started sending signals about its willingness to reconsider or at least to conveniently "forget" some of the most controversial theses of its program – both a party one and that of the Government. It also hinted that it was ready to implement all requirements of the IMF and World Bank in order to receive new credits from those institutions and their support for the restructuring of the country's debts with the Paris club creditors – both an absolute must for a heavily indebted Moldovan economy. New President also indicated his willingness to backslide on some more controversial pre-election slogans, like Moldova joining Russia-Belarus union and making the second official language of the country.[1]

Voronin also managed to impress international public opinion by his unexpectedly firm stance on Transnistrian issue, and in particular on the customs control problem. When on September 1 Moldovan government introduced new customs stamps simultaneously denying

[1] See reports on the first meeting of Vladimir Voronin with Carlos Elbirt, resident representative of the WB in Moldova after the elections, INFOTAG Press Agency, March 13, 2001, available at: http://news.ournet.md/news?ID=544; and on his talk on Russian RTR TV channel, "Podrobnosti" program, INFOTAG Press Agency, April 17, 2001, available at: http://news.ournet.md/news?ID=11532.

them to Transnistrians (up until then Transnistrians were using Moldovan customs stamps issued to them in early 1996), USA, European Parliament and Germany lent their support.[1a] Vladimir Socor, the only American analyst, systematically following Moldovan political developments, whose commentaries are widely red by the State Department officials dealing with Moldova, wrote a rather sympathetic piece in support of Moldovan policies, including refusal of President Voronin to meet his Transnistrian counterpart Igor Smirnov.[1] In Moldova those journalists which normally would not be mentioned expressing pro-Communist views e made clear their support for this act of Voronin.[2] The same mood of approval of Moldovan authorities policies was evident during the hearings in the US Congress Commission on Security and Cooperation in Europe “Moldova: Are the Russian Troops Really Leaving?” In particular, Deputy Assistant Secretary of State, European and Eurasian Affairs Steven Pfifer admitted that the US Government greeted Communist victory with some trepidation, “given our hope for Moldova’s development as a democratic, market economy. But the new authorities in Chişinău have affirmed their adherence to OSCE principles of democracy and human rights, and their performance to date has reflected this pledge”.[3]

In early August 2001 IMF announced reaching an agreement with Moldovan Government on future finance policies,[4] and it was for some time widely believed that before the end of 2001 Moldova will get new credits form that institution and the World Bank, as well as their support for restructuring of its debts, especially when President Voronin in his speech before the Moldovan Government and Communist Parliamentary Group assembled in his office on October 23, 2001 ascertained that deploying relations with the IMF and World Bank, as well to begin negotiations concerning restructuring of the Moldovan debts was number one priority for the Govenmemnt.[5] In early November 2001 Peter Stek, Executive director of the IMF for Moldova, announced in Chişinău that most probably before the end of the year financing of the country by the two financial institutions concerned would be resumed.[6]

However, these hopes were dashed in a short while. On November 29, 2001 Moldovan Prime-Minister Vasile Tarlev and his Russian counter-part Mikhail Kasianov signed an agreement on the delivery of Russian gas to Moldova, which besides guaranteeing uninterrupted delivery effectively transformed the debt of Moldovan consumers into Moldovan National debt, the government assuming its responsibility for its payment. This deal ran counter to the Memorandum with the IMF, which provided for strict limits for further borrowing on the part of the Moldovan Government. As a result, the IMF postponed its

[1a] See report of the meeting of American Ambassador Pamela Hyde Smith with President Voronin, BASA-PRESS Press Agency, November 28, 2001, available at: http://news.ournet.md/news?ID=16698; declaration of the Co-chair-person of the Inter-parliamnetary Committee on cooperation European Parliament – RM Elisabeth Scrroedter, FLUX Press Agency, September 19, 2001, available at: http://news.ournet.md/news?ID=13812; Voronin himself publicly referred to the alleged agreement of Germany to participated in the installation of the mixed customs offices (BASA-PRESS Press Agency, February 1, 2002, available at: http://news.ournet.md/news?ID=17605.

[1] “Although a communist, Voronin is a sincere Moldovan patriot …”. “To Voronin's credit, he has publicly distanced himself from the 1997 "Moscow memorandum," a document that ensures stalemate and ample opportunities for Russian manipulation of the Transdniester problem.” Cf. also “The US and EU were initially suspicious of the return of Communists in part of the former Soviet Union. But diplomats in Chişinău have since been impressed by the government's pragmatism and that of Vasile Tarlev, prime minister, a non-party technocrat and former factory manager. Since the elections, Moldova has joined the World Trade Organisation”. The Financial Times, October 12, 2001.

[2] See Vlad Bercu’s commentary, available at: http://news.ournet.md/comment?ID=13760.

[3] Paper distributed at the hearings. *The Jamestown Foundation MONITOR – A Daily briefing on the former Soviet states*, 7 September 2001 - Volume VII, Issue 163.

[4] BASA-PRESS Press Agency, August 8, 2001, available: http://news.ournet.md/news?ID=13189.

[5] Moldavskie vedomosti, October 27, 2001. (This paper is available at: http://www.vedomosti.md).

[6] Nomember, 3, 2001.

disbursement, conditioning it by Moldova renegotiating this deal with Moscow.[7] World Bank followed suit. As of now, there are no signs of Moldovan authorities ready and trying to renegotiate the agreement in question. Rather, they prefer to blame the IMF and World Bank for putting forward "political conditions" after Moldova has implemented "all it obligations".[8] Meanwhile, new matters of discontent appeared on the part of international creditors, among them systematic harassment of foreign investors,[9] attempts at restore collective farms in agriculture, and others. When on the 9th of February dismissals of Ministers of Economy Andrei Cucu and of his deputy Marian Lupu were announced, and shortly afterwards Minister of Finance resigned after having made a strong statement on the inconsistencies and lack of fiscal responsibility on the part of the Government, those fact were widely interpreted as a clear sign of Communist authorities new-found resolve to get rid of the last hang-overs (so called "technocrats") and to establish "a purely ideological party" rule.[10]

The same evolution is discernible in what the respect of the principles of the rule of law *and democracy* are concerned. Despite all assurances to the contrary, it soon turned out that Moldova's Communists were ready to violate those principles at their convenience. So, when the European Court of Human Rights on December 13, 2001 adjudged in favor of the Metropolis of Basarabia in its case against the Republic of Moldova, hereby implicitly indicating that Moldovan Government ought to finally register this *religious community*, Communist leaders made it clear that they will not obey the decision of this European body.[11]

Even earlier observers ascertained serious deterioration in the situation in *mass media*, as well as in that of concerning access to information. So, according to the opinion poll taken in October 2001 among 253 Moldovan journalists by the independent Center for the Promotion of the Freedom of Expression and Accesses to the Information, 81.3 per cent of respondents considered that in RM existed "camouflaged censorship", 13.5 per cent believed that it was rather "an overt censorship" and only 5.2 per cent were of the view that there was no censorship at all. Among the bodies that promoted censorship, the first place was accorded to the Presidential office (53.0 per cent), followed by Parliament (45.5), Government (41.5), political parties (41.5), etc.[12] Especially worrisome is the situation in the state electronic media, i.e. National Television and Radio, which were effectively transformed into the docile tool of Communist propaganda. Though all previous governments in the country tried to manipulate those media, frequently changed their leadership and influenced agenda, never before has the opposition been barred from presenting its views and never before news coverage was so one-sided and uninformative.[13] On December 3, 2001 a Russian-language newspaper "Kommersant Moldovy" was closed by a court fiat under the accusation of supporting separatist regime in

[7] See declaration of Hassan al-Atrash, IMF representative, FLUX Press Agency, February 5, 2001, available at: http://news.ournet.md/news?ID=17652.
[8] Victor Stepanic, leader of the Communist Parliamentary group, in an interview to BASA-PRESS Press Agency, published in *Kishinevskii obozrevatel'*, February 14, 2001.
[9] The most important of them are Romanian-Ameriacan consortium "Farmaco" (see INFOTAG, January 24, 2002, available at: http://news.ournet.md/news?ID=17470) and Spanish company "Union Fenosa", from 200o owner of the electricity networks in the central and southern parts of Moldova (see report from the press-conference of Ignacio Ibarra, company's manager, as reported in *Moldavskie vedomosti*, February 13,2002).
[10] See Vladimir Socor, Moldova's Communists purging reform-era officials, in The Jamestown Foundation MONITOR, February 7, 20002 – Vol. VIII, Issue 2002. Nicolae Cernomaz, Foreign Minister, and Ion Leşan, Industry Minister, were dismissed even earlier, in July 2001.
[11] Useful though partisan commentary of Petru Bogatu is available at: http://news.ournet.md/comment?ID=17064.
[12] Dialog, November 23, 2001.
[13] See Declaration "For the Democratization and Demonopolization Of the State Television" signed by a number of journalists, writers, academics and other intellectuals in Luceafărul, February 14, 2002, the text is also available at: http://news.ournet.md/declaratie/. Complaints started to appear much earlier.

Transnistria.[14] This fact was widely interpreted as a sign of an imminent assault on the freedom of expression, even by journalists who otherwise would be utterly hostile to the said regime and to anyone seen as "close" to it.[15]

But the biggest challenge to the principles of European democracy came when the Communist authorities decided to abolish the system of *local self-government* established by the 1998 laws in close consultation with the relevant bodies of the Council of Europe and to revert to the Soviet-epoch system of "raions" whereby the chiefs of the local administration were nothing but the arm of the central government. The respective laws were voted by the Communist Parliamentary majority in a rude violation of their own promise of consulting the Congress of Local and Regional Authorities of Europe (CLRAE, a body under the CE) before taking a final decision on any draft.[16] Though CLRAE has yet to study the law as approved by the Communist government, there are no doubt that those texts blatantly violate European Charter of Local Self-Government, to which Moldova is a party since 1997. Despite all protestations of the CLRAE, local elections to the newly (re-)established local bodies are called for April 7, thus effectively shortening a mandate of the elected representatives and mayors in the local communities, once more in clear violation of the Charter. Because of this provocative behavior, the country faces a prospect of being excluded from the CLRAE and of other sanctions from the Council of Europe.

After the Parliament made this decision and election campaign started Constitutional Court of the Republic of Moldova found the decision unconstitutional (February 19, 2002).

Of potentially even more disastrous consequences was a decision of the Communist authorities to interfere with *linguistic regime* in the country. During their electoral campaign they had in their platform a promise to make Russian a second state language, but shortly afterwards Vladimir Voronin began to climb down on this issue.[17] However, in the Communist Party there has always existed considerable pressure to go forward with this idea without any delay, and the President apparently finally decided not to resist. At the end of the year 2001 this view prevailed in the parliamentary group, which presented a draft amendment in this sense to the Constitutional Court, thus starting a procedure to change the Constitution.[18] Approximately at the same time the Ministry of Education took a decision to make Russian language an obligatory object in all Moldovan (Romanian) language schools starting from the second form (until that time it was studied in virtually all Moldovan language schools from the 5th form on).[19] It should be noted that there was no obvious urgency for those decisions to be taken. The knowledge of the Russian language is fairly widespread among ethnic Moldovans and since early 90s, when the country went through a period of inter-ethnic tension and even bloodshed, inter-ethnic relations evidently improved and if there were the ideas to change the linguistic regime, which comprised recognizing constitutionally only one language, that of Moldovan (Romanian), as a state one, with a very wide linguistic tolerance in practice, than those ideas

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14 BASA-PRESS Press Agency, December 3, 2001, http://news.ournet.md/news?ID=16761.

15 See commentaries of Val Butnaru in *Jurnal de Chişinău*, December 7, 2001 and of Liliana Vitu, available at: http://news.ournet.md/comment?ID=16857.

16 See reports from the press conferences of the CLRAE Vice-Chairman in Chişinău, Flux Press Agency, October 31, 2001, available at: http://news.ournet.md/news?ID=14475 and BASA-PRESS Press Agency, January 31, 2002, available at: http://news.ournet.md/news?ID=17570.

17 See, e.g., report about his press-conference, MOLDPRES Press Agency, March 30, 2001, available at: http://news.ournet.md/news?ID=621.

18 INFOTAG Press Agency, December 28, 2001, available at: http://news.ournet.md/news?ID=17148.

19 FLUX Press Agency, January 2, 2002, available at: http://news.ournet.md/news?ID=17189.

were quite marginal.[20] The fact of the matter was, however, that what was just a marginal current in the country at large was a dominant one in the Communist Party.

By taking those two decisions Communist authorities provoked dormant phobias of the more nationalistic intellectuals of the imminent "russification" and the loss of a national and ethnic identity of the Moldovan population. Those fears were seen as especially plausible at the background of a growing unilateral dependence of Russia and worsening relations with the immediate members of Moldova like Romania and Ukraine (see below). Opposition pro-Romanian Christian Democratic Popular Party (CDPP, former Popular Front, seen by many as extremist and intolerant nationalistic) ceased this occasion to raise its profile. On January 14 they organized a first meeting of protest against russification in the center of Chişinău, which was followed by other actions of the same sort, thereby becoming a continuing campaign lasting now for more than a month. Initially, the Communist authorities attempted to stop the campaign by intimidating the leaders, and on January 22 Minister of Justice suspended the activity of the CDPP on the grounds of it violating the Law on meetings and demonstrations (accusation, which was formerly correct).[21] This decision was probably exactly what Mr. Iurie Rosca, leader of the said Party, wanted the most. He immediately became a kind of national hero in the neighboring Romania, and Romanian Prime-minister Mr. Adrian Nastase sent him a latter as "a Romanian to Romanian" congratulating him on his struggle "for the nation (neam)".[22] There were also strong reactions of the European politicians. Solidarity with CDPP expressed Hans-Gert Poettering, Chairman of the European People's Party in the European Parliament, Peter Schieder, Chairman of the Parliamentary Assembly of the Council of Europe and Walter Schwimmer, CE General Secretary, sent quite a strong letter to the Moldovan authorities asking for "explications" in regard of the decision to suspend CDPP.[23] Moldovan authorities finally succumbed and on February 8, 2002 Minister of Justice cancelled his order on the suspension of the CDPP. He motivated his decision by the necessity to allow this party to take part in the local elections due on April 7 and his willingness to take into account the views of the CE General Secretary Walter Schwimmer. [24]

This concession of the Communist authorities has probably only encouraged their opponents, the more so that the Communists' behavior was seen as quite inconsistent. After having cancelled its decision on suspension of the CDPP, the Government was still sending signals that it would not concede on the languages issues and on February 13 it even added oil to fire by taking a decision on another change in curriculum, this time on the subject matter of history, substituting the course on the "history of Romanians" to that of the "history of Moldova". The "history of Romanians" was introduced as a subject matter in all schools in the country in the early 90s. It treats Moldova as a part of "the Romanian space' and implicitly fosters pan-Romanian feelings, while "the history of Moldova", which was taught during Soviet times, treats RM as a separate and "self-sufficient" entity, closer politically and culturally to Russia than to Romania. It implicitly fosters pro-Russian feelings and identity.[25]

[20] I analyzed this situation at some length in "Regulation of Ethnic Relations in Post-Soviet Countries: the Cases of Latvia and Moldova Compared", in *Constitutional, Legal and Political Regulation and Management of Ethnic Relations*. International Conference, (Ljubljana, 8-10 December 2000).
[21] BASA-PRESS, FLUX Press Agencies, available at: http://news.ournet.md/news?ID=17426.
[22] Ţara, January 25, 2002, available at: http://tara.press.md/.
[23] See FLUX Press Agency, February 4, 2002, available at: http://news.ournet.md/news?ID=17618. Texts of the letters of Poettering and Schwimmer see in Ţara, February 7, 2002. Earlier there were reports in the Moldovan press on the letter sent by the European Union to the Moldovan authorities to the same effect. (The reference to the official in the Foreign Ministry , but no name of the signatory was disclosed. See Ţara, February 1, 2002).
[24] See BASA-PRESS Press Agency, February 8, 2002, available at: http://news.ournet.md/news?ID=17715.
[25] I dealt with this issue at some length in **"**Narrative, Identity, State: History Teaching in Moldova", in *East European Politics and Societies* (forthcoming in vol. 16 #2 2002), 39 pp.

This decision provoked even stronger reaction, and the scale of anti-Governmental demonstrations increased from ca. five thousand participants (mostly students from Moldovan-language colleges and universities) to ca. 20 thousand. Some nationalist-prone papers, not sympathetic to CDPP, began to talk in terms of “popular revolt” and “revolution”.[26] When these lines are being written, it seems that not only the scale of demonstrations widens, but also that they are becoming increasingly violence-prone, though no serious incident was reported until now. The most massive manifestation of protests (about 50 thou of participants) with participation of local inhabitants and people from other Moldova’s regions took place in Chisinau on February 24, 2002, on the eve of the anniversary since communists party has come to power. There is no clarity as to how the authorities will react if this dynamic will prove to be sustainable.

Simultaneously with these developments another point of tension appeared in the country, *political crisis in the autonomous region of Gagauzia*. Gagauzians, a small Turkish-speaking people of Christian Orthodox religion, mostly populates this region. A territorial autonomy was granted to the region in 1994 by the then governing Agrarian Democratic Party, and this generous act received a wide international acclaim. Since then the region stayed quite, never causing any serious problems to Chişinău. However, in 1999 a new governor (“bashkan”), Dmitrii Croitor, was elected, whom the Communist party has seen as too “right-wing” (meaning too pro-Western and pro-reform). After 2001 Communist party victory in the parliamentary elections relations between Chisinau and Comrat (administrative center of the region) gradually deteriorated, Croitor and especially Mihail Kendighelean, chairman of the Popular Assembly, accusing Communist authorities of refusing to honor their pre-election promises of upgrading the status of the autonomy. In response, supporters of the Communist Party (who are many in Gagauzia, this region normally displaying high degree of loyalty to the CP) decided to go into the offensive. On January 31 the deputies of the Popular Assembly, sympathetic to Chisinau, voted popularly elected governor out of his office by a simple majority of votes (there were not enough votes to make for two thirds majority provided for such occasion by the organic law on the special status of the region) and called for referendum to endorse this move.[27] They used as a pretext a report of the Auditing Office implicating Croitor in allegedly doubtful financial affairs. Soon afterwards Turkish ministry of Foreign Affairs expressed its uneasiness over these developments.[28] CLRAE of the Council of Europe also intervened in the analogous sense.[29] Croitor and his supporters tried to represent the whole affair as an attempt of the Communists to “destroy the autonomy”, an accusation for which there might have been some grounds.[30] As of now, it seems that this tactic of Croitor and his team proved to be successful: population of the autonomy finally boycotted so-called referendum in spite of protests of the official Chisinau.

During 2001 *relations between Chisinau and Tiraspol*, “capital” of separatist region of Transnistria, deteriorated considerably. This deterioration was caused by the desire of Mr. Voronin, Moldovan President, “to solve” Transnistian issue in a very short period of time. His vision was that it was the breakdown of the Soviet Union and of Communism that engendered

[26] Luceafărul, February 16, 2002; Jurnal de Chişinău, February 15, 2002. This last newspaper is available at: http://jurnal.press.md/.
[27] BASA-PRESS Press Agency, February 12, 2002, available at: http://news.ournet.md/news?ID=17744 . In response, supporters of the Communist Party (who are many in Gagauzia, this region normally displaying high degree of loyalty to the CP) deciding to go into the offensive. The best analysis of these events see in Vladimir Socor, Moldova’s Communists purging reform-era officials.
[28] BASA-PRESS Press Agency, Februry 8, 2002, available at: http://news.ournet.md/news?ID=17704.
[29] FLUX Press Agency, FebruARY 11, 2002, available at: http://news.ournet.md/news?ID=17724.
[30] See BASA-PRESS Press Agency, February 12, 2002.

all kinds of problems in Moldova, including territorial separatism. His election was in his political imagination a vindication of this historical injustice. If before the elections Transnistrian regime had its *reason d'être* in the existence in Moldova of a "democratic" (this word has in the Communists lexicon a negative meaning) and nationalist government, then since his election there was absolutely no justification for its continuation.[32] This reasoning, however, had no echo among Transnistrian leadership, who grew accustomed since early 90s to its "independence" and lack of accountability to Chişinău. Moreover, it turned out that these sentiments were to a large extent shared by the population of the region. Clash of those two perspectives produced an acute political crisis.

Initially, both side displayed some goodwill and even made important mutual concessions, like Tiraspol freeing Ilie Ilaşcu, long held in prison and condemned to death Nationalist militant, twice elected *in absentia* deputy in Moldovan Parliament on the lists of right-wing parties and in 2001 Parliamentary elections in Romania – Romanian Senator on the list of *Romania Mare* extremist political party,[33] and Voronin agreeing to abolish all customs offices along delimitation line with the region as well as to officially validate in Chişinău all documents issued in Tiraspol.[34] The last concession was, of course, a very significant one, hereby Chişinău effectively giving up a very important leverage on Tiraspol. However, when immediately afterwards Smirnov introduced Transnistrian "IDs", a long-prepared but earlier postponed, because deemed (rightly) to be highly provocative, decision, [35] Voronin reversed his position. He publicly protested and made it clear that validation decision will not be implemented in respect of Transnistrian IDs.[36]

Speedy deteriorating relations between Chişinău and Tiraspol (almost invariably provoked by the intransigent and insolent behavior of Transnistrians) came to a complete breakdown on August 8, when after a disastrous meeting in Tiraspol both leaders publicly accused one another at the press conference. In particular, Voronin said that in his opinion Smirnov exhausted himself and could not contribute anymore to the successful resolution of the conflict. He also made it clear that he did not expect any progress until after the December "presidential elections" (of course, considered illegal by both the official Chişinău and international observers).[37] Since this point on Voronin's tactics became overtly confrontational. His attention switched to the problems on Moldovan- Ukrainian border on the left bank of the Nistru-river, i.e. on the territory controlled by Transnistrians. Obviously, he was deceived by the assurances of support "to make an order on the border" he received during his visit in Kiev on May 18 and CIS Summit on June 1.[38] He took it as a sign that Ukraine was ready to institute mixed Moldo-Ukrainian customs offices at the eastern border of RM to put pressure on

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[32] See, e.g., his speech at the Independence Day (23rd of August), 2001, national holiday in Moldova (INFOTAG press agency, August 28, 2001. Available at: http://news.ournet.md//cgi-bin/ournet/mnews/page.cgi?ID=13481&From_Cat=1&d=1.

[33] BASA-PRESS, April 7, 2001, available at: http://news.ournet.md//cgi-bin/ournet/mnews/page.cgi?ID=11462&From_Cat=1&d=1. The Other three members of the "group" are still held in Transnistrian prison.

[34] BASA-PRESS, April 17, 2001, available at: http://news.ournet.md//cgi-bin/ournet/mnews/page.cgi?ID=11420&From_Cat=1&d=1.

[35] INFOTAG Press Agency, May 24, 2001, available at: http://news.ournet.md//cgi-bin/ournet/mnews/page.cgi?ID=11389&From_Cat=1&d=1.

[36] BASA-PRESS, June 12, 2001, available at: http://news.ournet.md//cgi-bin/ournet/mnews/page.cgi?ID=12184&From_Cat=1&d=1; INFOTAG Press Agency, June 20, 2001, available at: http://news.ournet.md//cgi-bin/ournet/mnews/page.cgi?ID=12329&From_Cat=1&d=1.

[37] MOLDPRES Press Agency, August 8,2001, available at: http://news.ournet.md//cgi-bin/ournet/mnews/page.cgi?ID=13194&From_Cat=1&d=1.

[38] See declaration of his aide Victor Doras, BASA-PRESS Press Agency, June 5, 2001, available at: http://news.ournet.md//cgi-bin/ournet/mnews/page.cgi?ID=12079&From_Cat=1&d=1.

Tiraspol and to effectively isolate Transnistria. This tactic, however, proved to be disastrous and led to considerable humiliation of Moldova and its Communist leadership.

On September 1 new customs stamps were introduced in Moldova in conformity with Moldova's obligations under the WTO membership agreement. These stamps were denied to Transnistrians, who used Moldovan customs documents since mid-90s. The same day Moldovan customs officials were supposed to establish mixed Moldo-Romanian customs offices along the eastern border of the country. However, when they came to the designated places, the Ukrainian counter-parts turned them off. Ensued additional negotiations both with Ukrainian President Leonid Kuchma and Prime Minister Anatolii Kinakh did not yield any results. Ukraine not only denied access of Moldovan officials to its customs premises, citing international norms, but also allowed Transnistrian trade via its border and territory, thus bringing to naught all efforts of Moldovan authorities to put pressure on Transnistrians.[39] Disgruntled and humiliated Voronin publicly accused Ukraine of non-fulfillment of gentleman agreement and hinted that Ukrainian authorities were themselves implicated in contraband activity together with Transnistrian leaders. He went as far as threatening Ukraine to bar its access to WTO by using Moldova's veto and publicly declared that Moldovan Communists will support Mr. Petro Simonenko, leader of the Ukrainian Communist Party in his bid at the next Presidential elections in Ukraine.[41]

On his own part Ukraine emphatically denied all allegations about its improper motives. On February 4, 2001 it released a memorandum, which was sent by it to the Council of Europe, European Union, OSCE and a range of other international borders in response to Moldovan note from January 18 on the situation on Moldo-Ukrainian border. After refuting all accusations in complicity in contraband it stressed that Ukrainian State assured effective control over all the perimeter of Moldo-Ukranian border. It also laid bare that from the Ukrainian point of view Moldovan actions were aimed not at "improvement of customs procedures but at applying hard administrative and economic pressure that in the final resort would bring complete blockade of [region's] export capacities", thus leading to the "one of the greatest humanitarian catastrophes in Europe".[42] By using this kind of alarmist language Ukraine came very close to appropriating Transnistrian vision over the situation.

[39] Credible account and commentary is to be found in *Moldavskie vedomosti*, November 6, 2001. This paper is available at: www.vedomosti.md.
[41] *Moldavskie vedomosti*, November 28, 2001
[42] Rendered by Olvia-press Press Agency, February 4, 2002. Available at: http://www.olvia.idknet.com/ol08-02-02.htm

Not less disastrous was the attempt of Voronin to influence the outcome of elections of Transnistria and thus assure debunk of Smirnov. This move of his was also provoked by Smirnov, who on September 8 announced his refusal to take part in any further negotiations with Voronin until Moldova stops what he called "economic blockade", meaning, of course, withdrawal of valid Moldovan customs documents from Transnistrians.[43] In response Voronin said that there is no sense on further negotiating with Smirnov and made it clear that he hoped Smirnov will be ousted as a result of Presidential elections on December 8.[44] Moldovan President made explicitly clear his support to the rival candidates in those elections, simultaneously, however, claiming they were "illegal".[45] Starting from September Moldovan TV began a crusade against Transnistrian regime, accusing him of all possible vices.[46] Voronin managed to obtain support from Russian President Vladimir Putin who assured positive to Moldova and very negative for Smirnov coverage of Transnistrian "elections" as well as the situation in Transnistria generally in the Russian Government-controlled media.[47]

However, all those efforts turned out to be counter-productive. The more Moldovan authorities were confronting Smirnov and his team head on, the more the latter managed to appear to the Transnistrians in the guise of their "defenders" against the alleged "predators" from Chişinău, no matter that this time those "predators" were not alleged "democrats" but fleshed Communists. Die-hard Nationalists from Russian State Duma also turned to their support, thus strengthening Smirnov's and his acolytes' credibility in the eyes of local public.[48] As a result, popular support for Smirnov grew day by day, and he managed to get in the "elections" (still unrecognized but attended by deputies from Russia and Ukraine as well as unrecognized "statelets" of Nagorno Karabakh and Southern Osetia)[49], according to "official" data, - 81.85 per cent of the popular vote with 62.89 per cent turn out. As one observer from Tiraspol, not particularly sympathetic to Smirnov, privately suggested to the author, Voronin's inapt anti-Smirnov propaganda was so instrumental in driving voters to support their time-worn leader, whose popularity was actually dwindling before the elections started, that some people were wondering whether there was not a conspiracy between the two. While correctness of this suggestion is completely out of question, it demonstrates the extent of the misjudgment on the part of Moldovan leadership.

Smirnov's re-election did not change Voronin's position who, despite clearly expressed wish of Russia, Ukraine and OSCE continues to refuse any meetings and negotiations with Smirnov.[50] He also tried his relations with Putin and especially Vyacheslav Trubnikov, vice-Foreign Minister of Russia responsible for relations with CIS countries and head of RF state

[43] MOLDPRESS Press Agency, September 8, 2001.
[44] INFOTAG Press Agency, October 2, 2001 on Voronin's talk on Moldovan TV on the day before.
[45] INFOTAG Press Agency, October 22, 2001. Reliable analisys see in Moldavskie vedomosti, November 6, 2001.
[46] As one observer from Chisnau privately remarked, the language used was quite remarkable of the early 90s confrontation.
[47] See Moldavskie vedomosti's report on Voronin's visit to Moscow and his talks with Putin on Transnistrian issue (Moldavskie vedomosti, November 20, 2001). On November 23 Russian State Television RTR broadcasted a very critical program on Transnistria, which was blanket out in the region and broadcasted several days later with rejoinder. See FLUX Press Agency, November, 26, 2001, available at: http://news.ournet.md//cgi-bin/ournet/mnews/page.cgi?ID=16646&From_Cat=1&d=1.
[48] See declarations of deputies of the Russian State Duma Georgii Tikhonov and Viktor Alksnis on September 3, 2001 in Tiraspol (FLUX Press Agency, September 4, 2001, available at: http://news.ournet.md//cgi-bin/ournet/mnews/page.cgi?ID=13574&d=1.
[49] BASA-PRESS Press Agency, December 10, 2001, available at: http://news.ournet.md//cgi-bin/ournet/mnews/page.cgi?ID=16862&From_Cat=1&d=1.
[50] See, e.g., Voronin's press conference in Moscow on the eve of the elections: INFOTAG Press Agency, December 6, 2001. On OSCE mission's position see BASA-PRESS Press Agency, January 30, 2001, available at: http://news.ournet.md/cgi-bin/ournet/mnews/page.cgi?ID=17553. On position of Russia and Ukraine concerning negations see Moldavskie vedomosti, 2001, November, 20, 2001.

commission for the settlement of Transnistrian conflict.[51] Probably due (at least partially) to his efforts Gazprom's stance at Transnistrian debt amounting to $ 600 million hardened and on February 4, 2002, gas delivery was interrupted to the Rabnitsa metallurgical factory, which supplies up to 30-40 per cent of the overall revenue to Transnistrian coffers.[52] Earlier Moldovan side complained about economic damage inflicted on it because of Transnistrian authorities measures to block Moldovan trade along the railways crossing Transnistrian territory.[53]

Because of President Voronin's idée fix of "solving Transnistrian" conflict in the short run seriously deteriorated Moldova's relations with its immediate eastern neighbor, Ukraine, as was shown above. Also in the early fall RM relations with Romania went through a period of very serious crisis. This crisis was provoked by a speech of Moldovan Minister Ion Morei at the sitting of the European Court of Human Rights in Strasbourg on October 2, 2001 in the case of Metropolis of Basarabia v. Republic of Moldova, referred to above. In his speech Moldovan Minister of Justice accused the said Metropolis of being in effect an arm of Romanian government and serving the aims of "Romanian expansionism". In a quick response Romanian Government sent to Chisinau a strongly-worded note of protest and Romanian Prime-Minister "postponed" (in fact, cancelled) his visit to Chişinău.[54] Later on all attempts (not very resolute on Moldovan part) to smooth away unwanted consequences of this incident failed.[55] Special Coordinator of the Pact for Stability in South East Europe Bodo Hombach during his visit to Chisinau on December 7, 2001 made it clear that European institutions were following with uneasiness developments between the two countries and counseled restraint.[55] A new angry exchange ensued after Communist decisions on upgrading the status of the Russian language and attempt by the same Minister of Justice Ion Morei to suspend CDPP referred to above.[56]

At the background of the deteriorating relations with Ukraine and Romania relations with Russia improved. On November 19, 2001 Presidents Vladimir Voronin and Vladimir Putin signed so called "basic treaty" laying down fundamental principles of relations between the two countries. Previous treaty, signed in September 1990 between Presidents Snegur and Boris Yeltsin was ratified by Moldovan Parliament, but Russian legislature refused to do it, so that it never entered into force. The new treaty turned out to be controversial. Particularly disputed were provisions referring to the role of Russian Federation as a "guarantor" of Transnistrian would-be settlement (this wording is contained in Preamble) and of the obligation of Moldova to provide for the role of Russian language in the public sphere(the treaty stops short of mentioning its official status). It is sometimes asserted, probably with some justification, that officially recognizing in the inter-state document of the highest level Russia's role as a guarantor in Transnistrian dispute amounts to transforming Moldova into that country's protectorate.[57] At the end of the 2001 Moldovan Parliament ratified this treaty, while Russian

[51] On Trubnikov see Vladimir Socor, Exit Primakov, Enter Trubnikov, in *Jamestown Monitor*, October 4, 2001.
[52] INFOTAG, Press Agency, February 4, 2001, available at: http://news.ournet.md//cgi-bin/ournet/mnews/page.cgi?ID=17615&From_Cat=2&d=1
[53] See report on the Voronin's speech at the Warsaw anti-terrorist conference, INFOTAG Press Agency, November 7, 2001, available at: http://news.ournet.md/news?ID=14596
[54] BASA-PRESS Press Agency, October 3, 2001, available at: http://news.ournet.md/news?ID=14040.
[55] See commentary of Nicu Popescu at: http://news.ournet.md/comment?ID=14193.
[55] Moldavskie vedomosti, December 8, 2001.
[56] Text of the declarations of Romanian President Ion Iliescu and Prime-Minister Adrian Năstase see in Țara, January 24, 2002.
[57] See, e.g., Flux Press Agency, December 27, 2001, available at: http://news.ournet.md/news?ID=17127.

State Duma is expected to do it in a short while.[58] Whether the criticism of Moldo-Russian treaty is correct or not, there is no doubt that under the current circumstances Moldova is becoming increasingly unilaterally dependent on Russia, having no support neither in Kiev or Bucharest, nor in the European capitals.

Less than a year has lapsed since the Communists' accession to power. During this period the new Moldovan authorities managed to bring relations with the country's neighbors Romania and Ukraine to all-time low, to squander a reserve of goodwill towards Moldova on the part of the international financial institutions, to engender anxiety in the Council of Europe and European Parliament as to where the country was really heading, and to exacerbate financial difficulties of Moldova. When this text is being written, the country is going through a major political crisis, or better to say, a series of crises, and there is absolutely no certainty as to when and how they can be resolved, if at all.

Still, it is quite probable that the Communists have, as of now, despite the affirmations in the radical nationalist circles to the contrary, considerable support among the population, especially in the countryside, so that they will keep the situation under control as before. It could also be that the wave of protests will somehow begin to die out in the not so distant future. It could than mean that the Communists' rule will be consolidated for a while. In this case the country will be heading towards an authoritarian neo-Communist regime of a Lukashenko type. It is highly unlikely that in this case the authorities will allow free elections to take place without a very serious international pressure, the likelihood of which is exceedingly difficult to presage. If, however, economic difficulties will be increasing profoundly this year and national protests will be supplemented by social ones, then one can expect much more dramatic course of events and the downfall of the Communists in the short period of time. It would hardly mean, however, the end of the country's difficulties.

[58] President Putin was reported to have promised it to Moldovan President during their telephone conversation on February 15, 2002. See MOLDPRES Press Agency, February 15, 2002, available at: http://news.ournet.md/news?ID=17127.

ANNEX

Moldova In Comparison With Other Transition Economies

A dozen years have passed since the beginning of the market oriented reforms in the transition countries of Central and South-Eastern Europe and the Baltic States (CSB) and the Commonwealth of Independent States (CIS). In spite of differences in development level and economic structure of these countries, logic of reforms (according to IMF and WB methodology) was similar: macrostabilization, liberalization and privatization - structural reforms - economic growth and social relief.

Only some of the transition countries followed the path to the very end, until the renewal of economic growth. Such winners are Slovenia, Poland, Hungary, and Czech Republic. Growth in a series of countries was interrupted in the mid-90s by serious macroeconomic crises brought by insufficient structural reforms. On the whole, in the CSB officially measured gross domestic product bounced back from a transition recession, recovered to its 1990 level by 1998, and exceeded that level by 6% in 2000. However, in the CIS countries GDP in 2000 stood at only 63% of its 1990 level.

In the majority of countries social costs of the transition have been dramatic: reduction of budget resources for education and health services, a sharp rise in the discrepancy between incomes, spread of poverty, growth of corruption and organized crime. In such a situation the transition has brought a great deal of disappointment to the population, and this has contributed but to the narrowing of the social base for reforms.

The Republic of Moldova started actively the transition and by the mid-90s it was being called a “laboratory of sound reforms” (The Economist, March 1995). But the following political instability, Russian financial crisis (1998) and braking of structural reforms plunged the economy into a stagnant depression.

By the end of the 90s, Moldovan economy reached the “bottom” and began recovering slowly. Two years in a row – 2000 and 2001 – Moldovan statistics registered growth of GDP – 2.1% and 6.1% correspondingly. A main body of economic units and a part of the population, which managed to adapt to market conditions has formed in the country. Self-employment of the population, including abroad, is actively developed.

Further development of the situation will depend on the political will of the Government to move forward along the way of the market reforms, openness and liberalization of the economy, balanced actions in social sphere given their understanding and support by the population.

Tables and graphs listed below allow comparing trends and results of economic reformation of Moldova and other countries in transition. The source of information: World Bank Report “Transition – The First Ten Years. Analysis and Lessons for Eastern Europe and the Former Soviet Union”, 2001. One can draw the following conclusions on Moldova according to this information:

- ***the most considerable GDP downfall*** among all transition economies, excluding Georgia (only 35% in 2000 compared to the 1990 level) – *Table 1;*

- ***pace of economic reforms*** was being kept up successfully until 1995, fell down abruptly in the posterior period – *Figure 1;*

- ***private sector share*** in GDP makes up about 45%, which is considerably less than in other countries of Eastern Europe and even Russian Federation – *Figure 2;*

- significant ***insecurity of property*** and contract rights, unfavorable business environment cause anxiety – *Figure 3;*

- ***quality of judiciary system*** in Moldova is at about the same level as in other CIS countries, but is inferior to the majority of Central and Eastern European countries – *Figure 4;*

- ***banking sector*** remains noticeably small in international perspective, even more so once bank credit to the public sector, often reflecting subsidization of unprofitable activities, is removed and attention is confined to the private sector. Moldova has a low share of credit to the private sector, about 15% of GDP – *Figure 5*;

- indicator of ***the difference between the average interest rate*** on banking loans to the private sector and ***the resident deposit rate*** in Moldova are also unfavorable – *Figure 6;*

- ***stock market capitalization*** and capacity of securities to provide finance to the real economy are close to nil, as well as in the Ukraine and the Transcaucasus – *Figure 7;*

- ***public expenditures on education and health care*** are 4-6% of GDP, which corresponds to the average level for OECD countries. But absolute amount of financing of these goals is evidently insufficient. What is more, falling of these budgets and protection of employment in these sectors is yearly registered – *Figures 8* and *9;*

- ***political system in Moldova***, capacity of the government to adopt and sustain economic reforms can be defined as “concentrated political regime” – *Figure 10.* At the time when countries with “competitive democracies” have had an average of six government turnovers, in Moldova there were nine of them since the start of the transition. And the last of them – as regards correction reforms – seems to be the most radical.

The Government approved *Strategy of Socio-Economic Development of the Republic of Moldova for a mid-term period (till 2005)* in December 2001. The Strategy stipulated for “creation of conditions for sustainable economic growth and provision for a yearly GDP growth of 6-7%”. If to start from the current state of affairs in the country, as especially regards business environment, it becomes clear that there is a many-sided and consistent activity ahead.

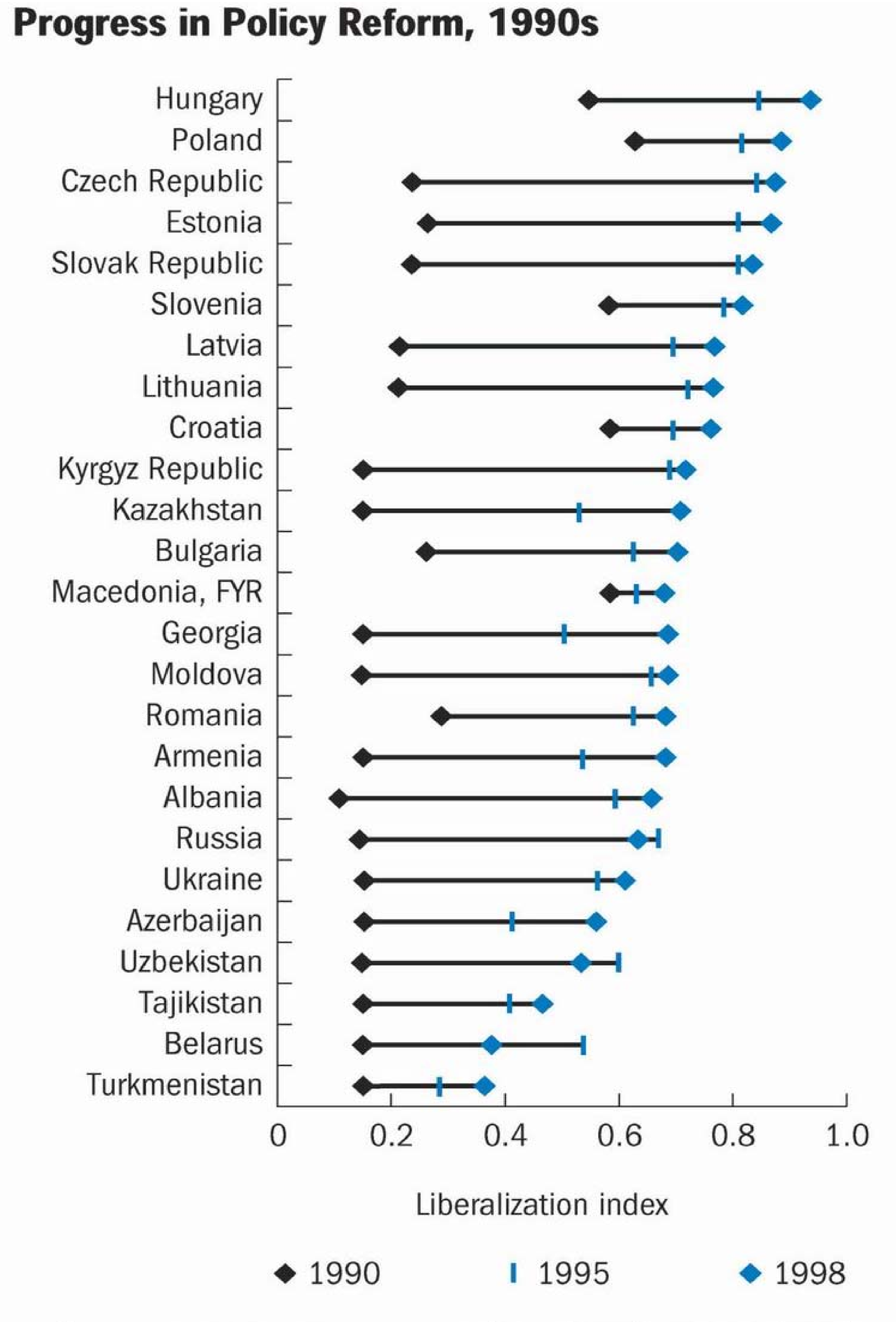
Table 1

The Transition Recession

Countries	Consecutive years of output decline	Cumulative output decline (percent)	Real GDP, 2000 (1990 = 100)
CSB[a]	*3.8*	*22.6*	*106.5*
Albania	3	33	110
Bulgaria	4	16	81
Croatia	4	36	87
Czech Republic	3	12	99
Estonia	5	35	85
Hungary	4	15	109
Latvia	6	51	61
Lithuania	5	44	67
Poland	2	6	112
Romania	3	21	144
Slovak Republic	4	23	82
Slovenia	3	14	105
CIS[a]	*6.5*	*50.5*	*62.7*
Armenia	4	63	67
Azerbaijan	6	60	55
Belarus	6	35	88
Georgia	5	78	29
Kazakhstan	6	41	90
Kyrgyz Republic	6	50	66
Moldova	7	63	35
Russian Federation	7	40	64
Tajikistan	7	50	48
Turkmenistan	8	48	76
Ukraine	10	59	43
Uzbekistan	6	18	95

Source: World Bank country office data

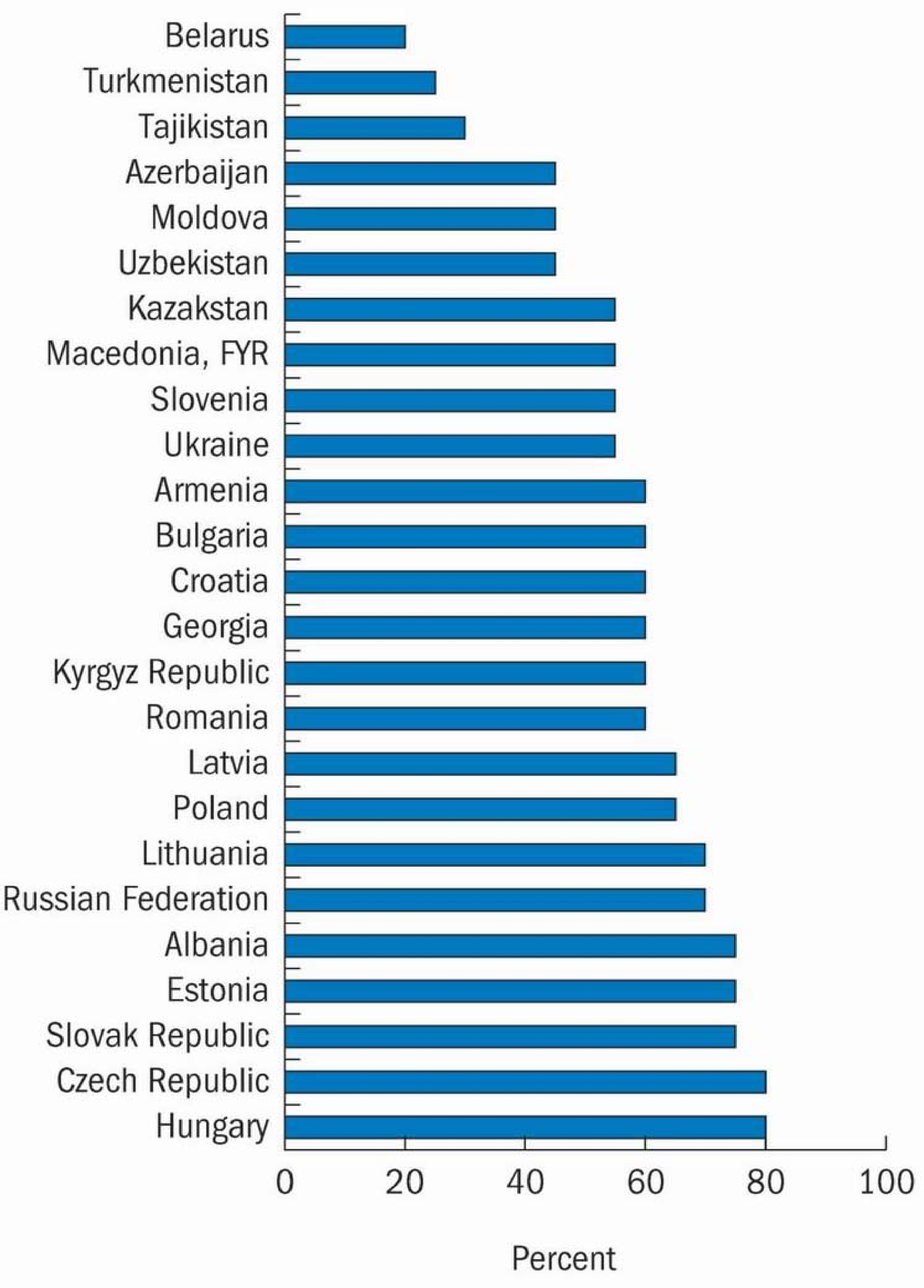
Figure 1



Source: de Melo, Denizer, and Gelb (1996); EBRD (2000).

Figure 2

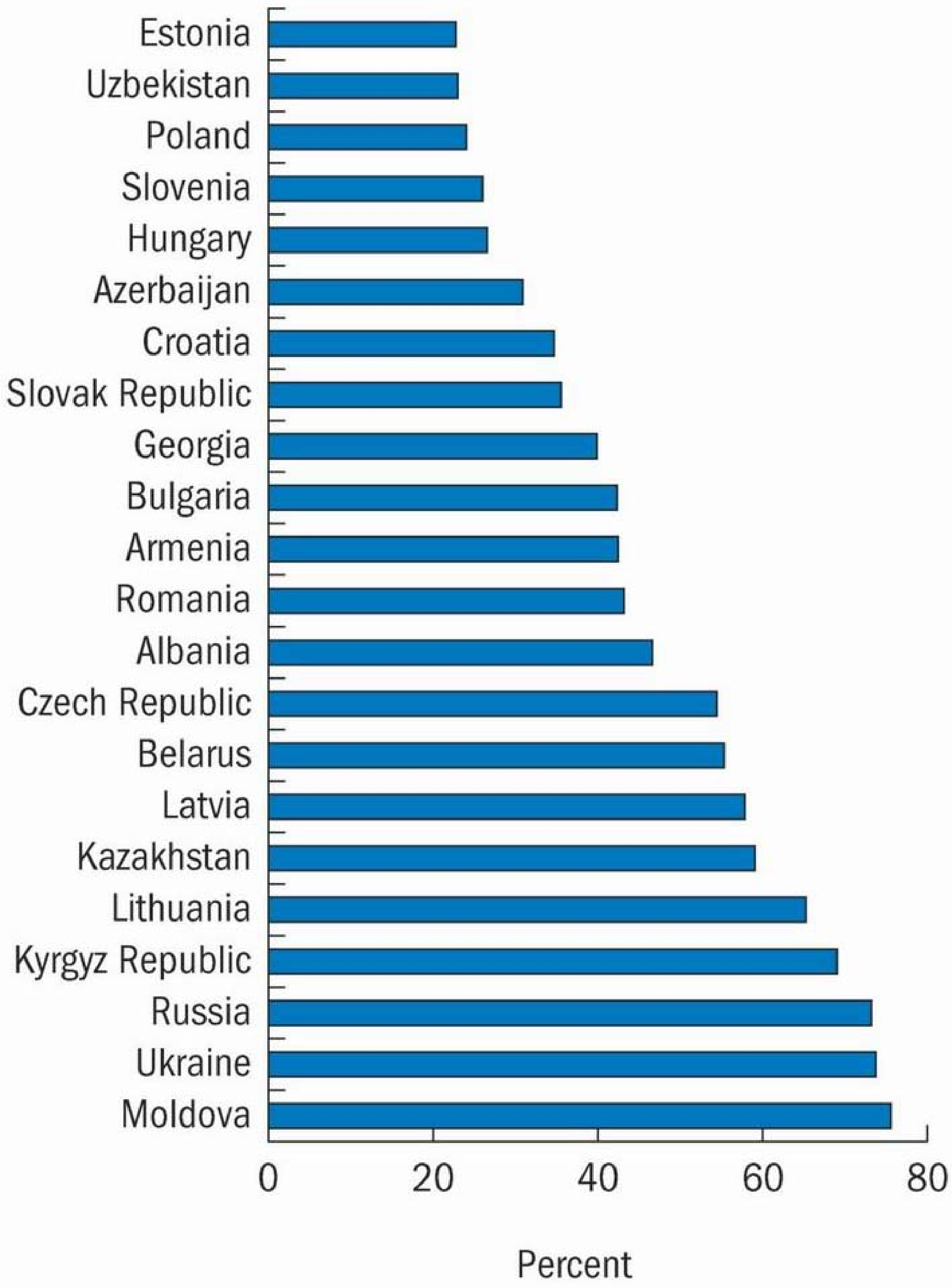
Private Sector Share in GDP, 1999



Source: EBRD (1999).

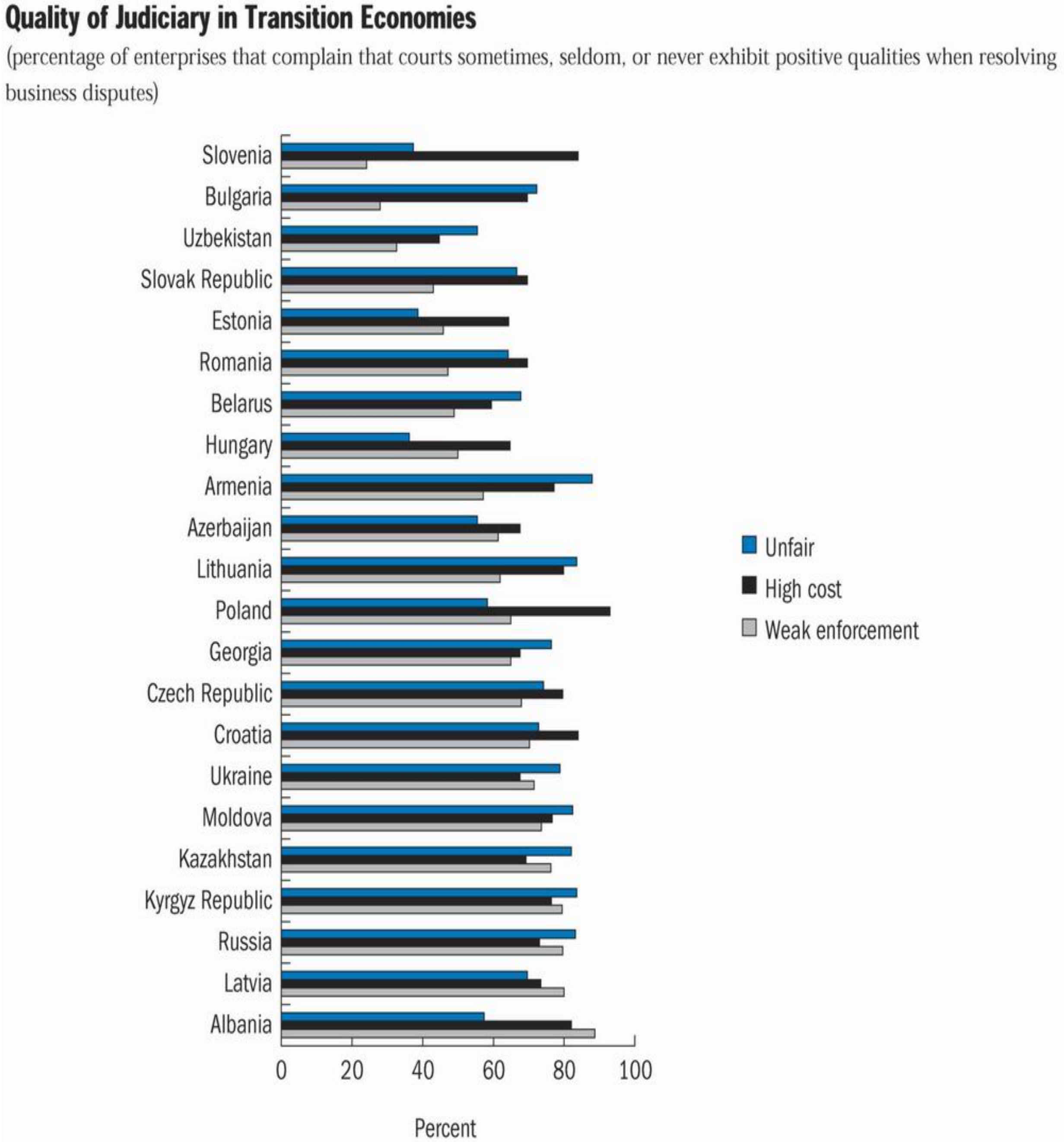
Figure 3

Insecurity of Property Rights in Transition Economies, 1999



Source: EBRD (2000).

Figure 4

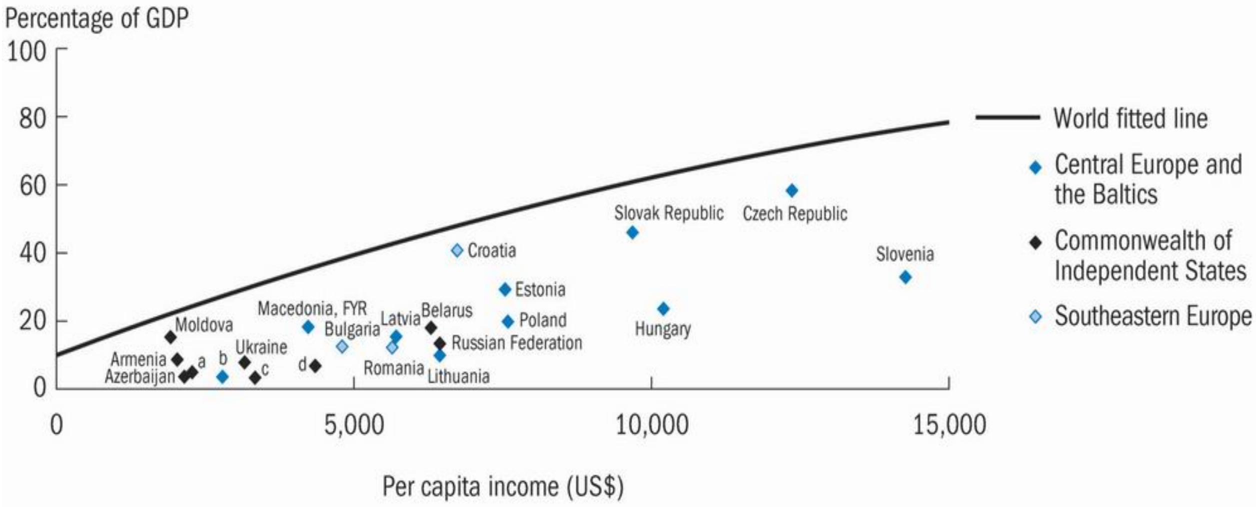


Note: This figure shows partial results from the following question on the Business Environment and Enterprise Performance Survey: "Now thinking about our country's legal system, how often do you associate the following descriptions with the court system in resolving business disputes?" The descriptions were: fair and impartial; honest/uncorrupted; quick; affordable; consistent/reliable; able to enforce its decisions. The possible responses were "always, usually, frequently, sometimes, seldom, or never." The "unfair" bar comprises the descriptions of fair and impartial, honest/uncorrupted, or quick. The "high cost" bar comprises the descriptions of quick or affordable. The "week enforcement" bar comprises the descriptions consistent/reliable and able to enforce decisions.

Source: World Bank data

Figure 5

Domestic Credit by Deposit Money Banks to the Private Sector, 1998

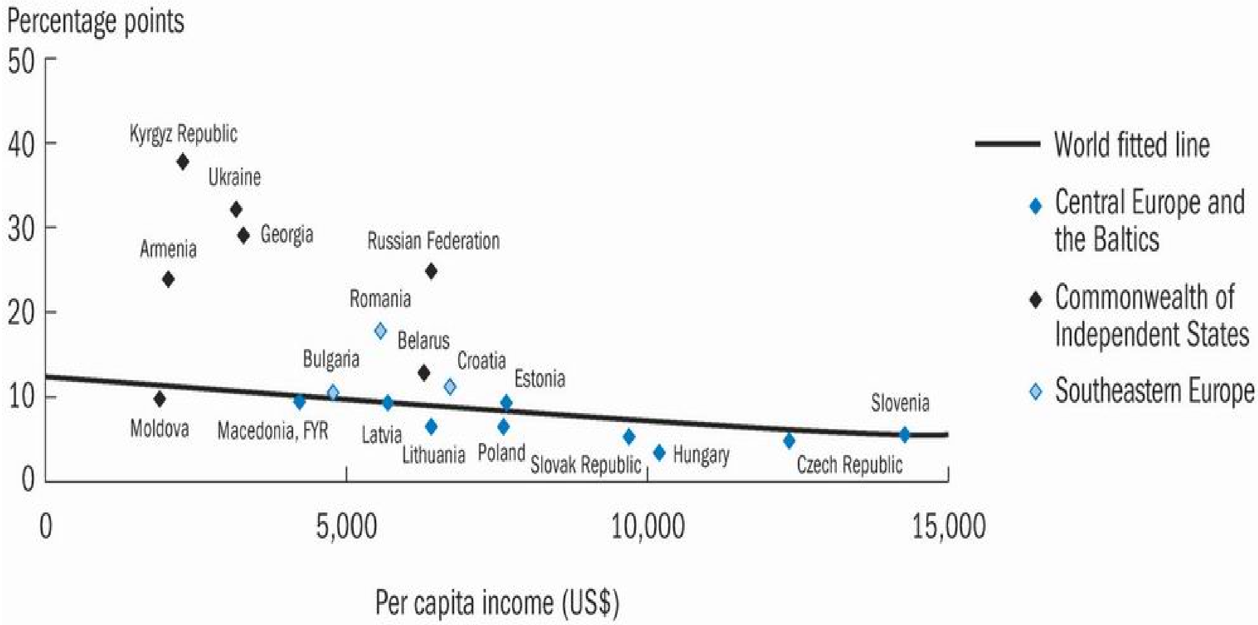


a. Kyrgyz Republic
b. Albania
c. Georgia
d. Kazakhstan

Note: The world fitted line represents the average of all countries in the world in that per capita income range.
Source: Eichengreen and Ruehl (2000).

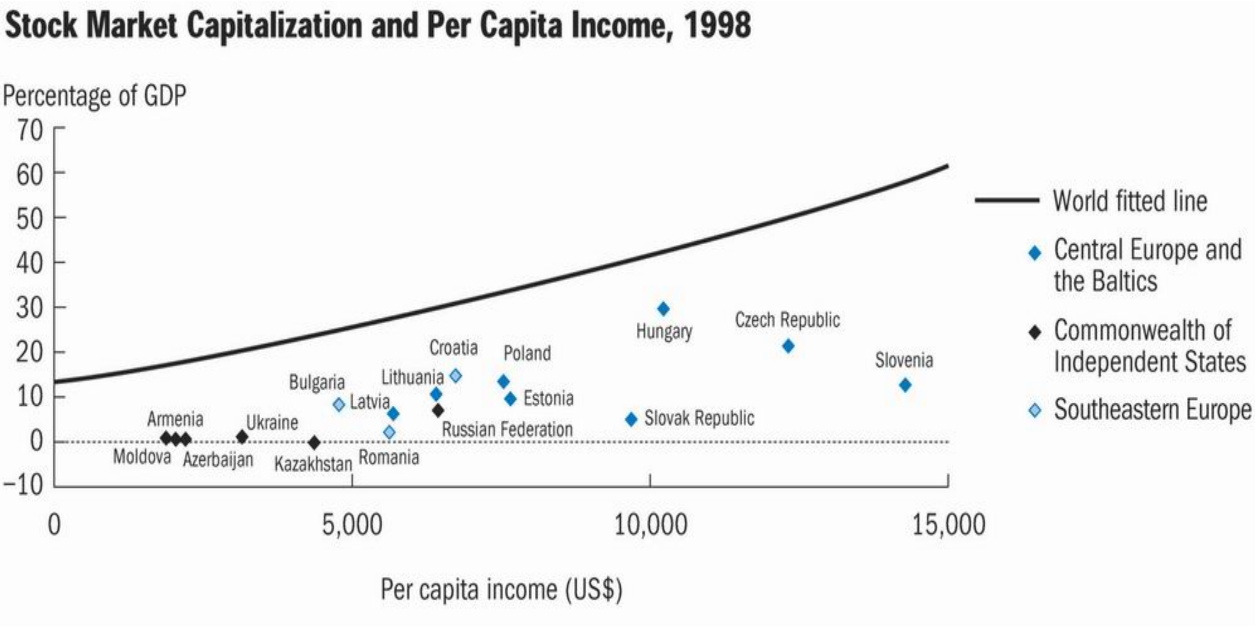
Figure 6

Interest Rate Spreads, 1998



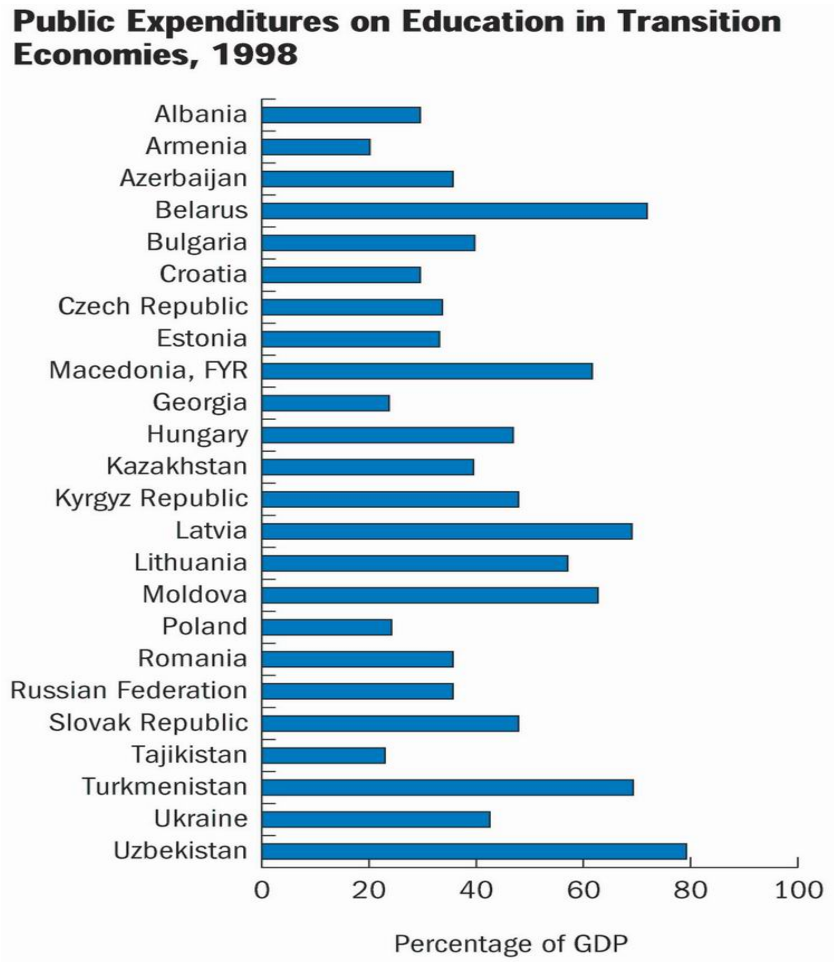
Note: The world fitted line represents the average of all countries in the world in that per capita income range.
Source: Eichengreen and Ruehl (2000).

Figure 7



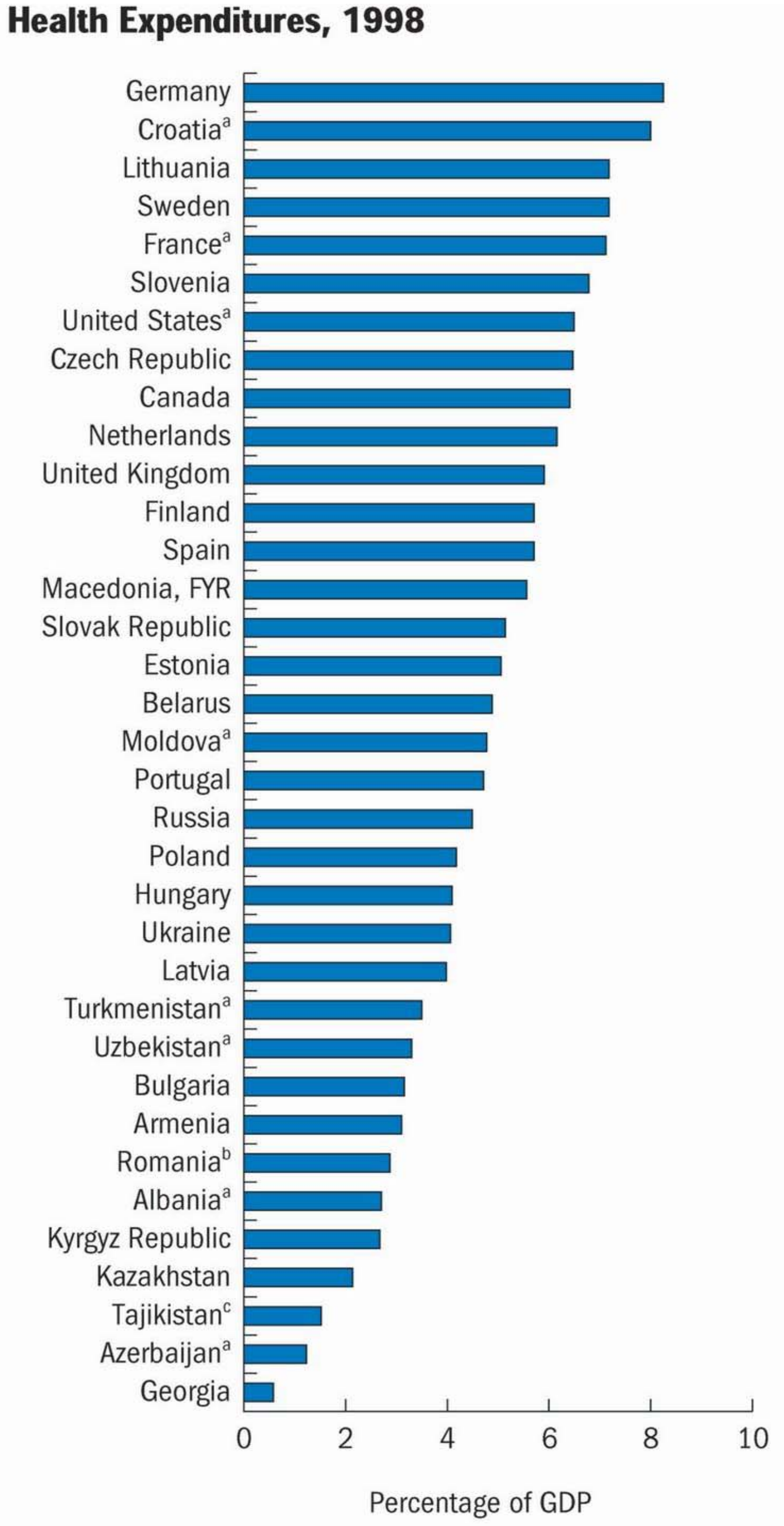
Note: The world fitted line represents the average of all countries in the world in that per capita income range.
Source: Eichengreen and Ruehl (2000).

Figure 8



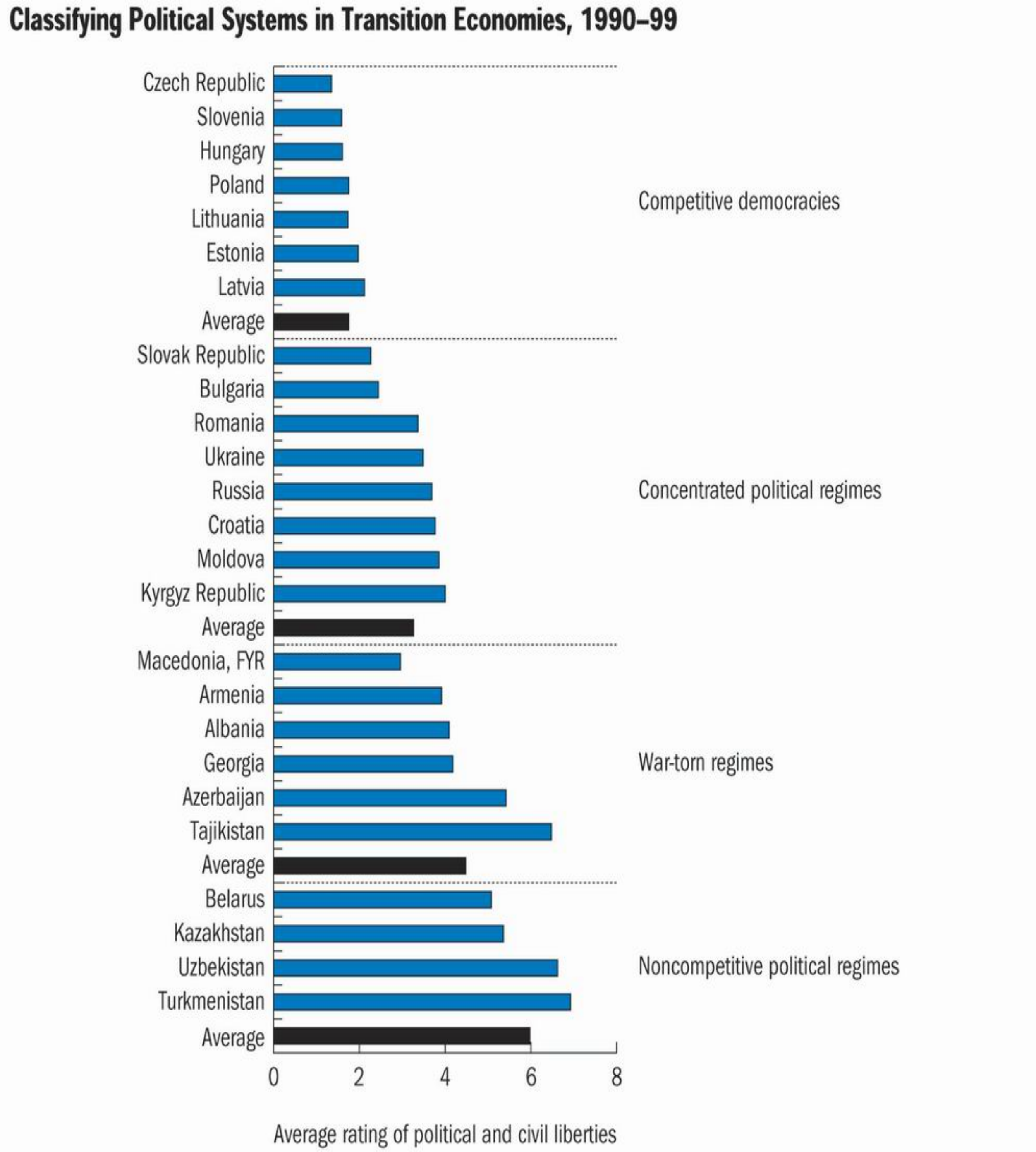
Source: World Bank data

Figure 9



a. Data are for 1997.
b. Data are for 1996.
c. Data are for 1999.
Source: The World Bank's World Development Indicators database.

Figure 10



Note: Ratings are based on the average scores for political rights and civil liberties ranging from 1 (free) to 7 (not free) by Freedom House from 1990 to 1999. The thresholds for determining the country groups are: competitive democracies: political rights ≤ 2.0 and civil liberties ≤ 2.5; concentrated political regimes: political rights or civil liberties > 2.5; noncompetitive political regimes: political rights or civil liberties > 5.0.

Source: Freedom House (various years).