C E N T R U L
de Investigații Strategice
şi Reforme

C E N T E R
for Strategic Studies
and Reforms

UNDP / WB Project "Strategy for

MOLDOVA IN TRANSITION

economic survey

2

Chişinău – November 1998

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PREFACE

Seven difficult and contradictory years have passed since the Republic of Moldova affirmed itself as a new independent state of Europe, started on the path toward the democratization of society and economic reform, and tried to settle the problems facing it, based on its own resources and with the assistance of international, European and regional structures.

Today it is a certain reality that the Republic of Moldova has come close to the traditional democracies in terms of organization of the state, public pluralism and individual liberties. However, human beings cannot live of spiritual liberty alone.

The economic results of the reforms are, unfortunately, very modest. After the crisis of 1991/1992 (the collapse of the planned economy, hyperinflation, swift decline of output, loss by the population of bank savings), which was followed by the economic depression of 1993/1996, and by a weak growth impulse in 1997, the country, and unexpectedly for the majority of the population, has now been hit by the new crisis of 1998, which led to the devaluation of the national currency, threatening the country with the possibility of defaulting on its debts, and to a paralysis of the energy complex, of entrepreneurship and of the social sphere. The circle has closed up…

The November 1998 issue of 'Moldova in transition' contains articles which evaluate events and key processes of the 'first round' of economic reforms in Moldova. *Published by the Center for Strategic Studies and Reforms (in the context of the UNDP/WB project "Strategy for Development"), it reflects exclusively the view point of the authors of the articles, and in no case those of state structures or other organizations.*

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The next issue of "Moldova in Transition" (Feb. 1999) will deal with the lessons of 1998, possible scenarios of subsequent transformation of the national economy, and the mechanisms of their realization.

We invite you for collaboration.

1. Seven years – the first round of reforms

Now, at the end of 1998, there is a considerable diversity of opinions regarding the assessment of the seven years of reforms in Moldova – "irreversibility of market economy changes", "failure of monetarism", "virtual economy", "tactical zigzags in strategic direction", etc. In our opinion, a more balanced analysis of the situation is set forth in the analytical part of the Government Action Plan (approved by Parliament in May 1998), in the latest memoranda signed between the Republic of Moldova and international financial organizations – IMF, WB, EBRD, in the reports of the international rating agencies – Moody's Investors Service, Fitch IBCA Ltd. Finally, the first systematic investigation has appeared of the process of reforming the economy in the 1990s (I. Guțu, The Republic of Moldova: Transition Economy, Chişinău, Litera, 1998).

The main obvious lesson of this period of seven years is clearly that the transition to a market economy includes a combination of political, institutional, economic and social processes which, if they take place in an uncoordinated and inconsequential fashion, can considerably delay the reform process and have a negative impact upon the economy and the living conditions of the population.

The complicated interrelation of these processes has in the end affected the evolution of the indicators of socio-economic development of the country in the 90s. Being a small open country, the Republic of Moldova has been affected in this period by a strong external dependence (energy dependence, Transnistrian problem), as well as by the negative influence of internal economic and political factors.

These factors mentioned above have caused instability of political support for the reforms introduced by Parliament, lack of continuity in actions of six Governments, irrational waste of financial resources and slowing down in the activity of the executive and legislative powers during the frequent electoral periods (1990, 1992, 1994, 1995, 1996, 1998, 1999 and 2000 – all those being election years!). Three electoral campaigns have taken place every four years, all that in conditions of unconsolidated statehood and of an economy with many risk factors.

The main change in the economic policy of Moldova has taken place after 1993. This year marked the lin□□e between the state-dominated and market oriented

Of course, this period came after the important events of 1990-1992: liberalization of prices, commerce and enterprise operations, adoption of the firstet of laws oriented towards the market economy (laws regarding ownership, privatization, Land Code, etc.), entry into new markets. The first legal documents that formed the basis of the changes in the national economy were: the resolution of Parliament "Regarding the concept of transition to market economy" (1990) and the "Program of transition to market economy in Moldova" (1991).

Yet, the first real program of stabilization of the Moldovan economy was worked out by the Cabinet jointly with the IMF and the WB in 1993. It was targeted to five main objectives: (1) privatization and restructuring of state enterprises; (2) support for the private sector (notably to small and medium sized enterprises), investment promotion; (3) modernization of the financial system (banking, budget); (4) development of an affordable social safety system from active employment policies to anti-poverty measures; and (5) support of the policy reforms, demonstrated through the establishment to regulatory and legislative frameworks.

MAIN MACROECONOMIC INDICATORS *

	1994	1995	1996	1997	1998e
Real GDP growth rate	-30.9%	-1.4%	-7.8%	1.3%	-7.0%
Nominal GDP (excl. Transnistria), lei million	4737	6480	7658	8655	8645
Nominal GDP, USD million	1167	1443	1665	1876	1607
Export (FOB), USD million	618	739	822	851	723
Export, yr/yr	156.5%	119.6%	111.2%	103.5%	85.0%
Import (FOB), USD million	672	794	1056	1235	1150
Import, yr/yr	126.8%	118.2%	133.0%	117.0%	93.1%
Trade balance, USD million	-54.0	-55.0	-234.0	-384.0	-426.7
Current account, USD million	-97	-115	-209	-309	-367
as % of GDP	8.3%	8.0%	12.6%	16.5%	22.8%
Direct investment, USD million	18	73	53	79	90
as % of GDP	1.5%	5.1%	3.2%	4.2%	5.6%
Stock of foreign debt, USD million	627	806	1103	1234	1320
as % of GDP	53.7%	55.8%	66.3%	65.8%	82.1%
New borrowing**, USD million	239	189	180	160	50
Debt servicing**, USD million	18	67	53	161	180
NBM gross forex reserves, USD million	179.8	256.4	313.7	365.7	150.0
Budget deficit as % of GDP	5.8%	5.8%	9.8%	7.7%	2.0%
Annual inflation rate (end period)	104.6%	23.8%	15.1%	11.2%	13.3%
Average inflation rate	487.0%	30.0%	24.0%	12.0%	7.4%
End-year exchange rate, lei/1USD	4.27	4.50	4.65	4.66	8.36
Average exchange rate, lei/1USD	4.06	4.49	4.60	4.61	5.38
Nominal annual appreciation(+)/depreciation(-)	–170.7%	–10.6%	–2.4%	–0.3%	–16.6%
Real annual appreciation(+)/depreciation(-)	–514.8%	+16.2%	+21.0%	+11.7%	–10.4%

* - data for 1991-1993 n/a or not compatible

** - including loans from IMF, World Bank, EBRD, EU etc.+ Eurobond issues

It is already obvious that in all of these targets various degree progresses have been reached. To mention is, that 1993-1995 were the years of the “big bang” in the transition from one model of social, political and economic development to another. The new Constitution (July, 1994) included the stipulation that the guideline of the economy of the country “is a market economy, socially oriented, based on both private and public ownership, involved in free competition”. Together with joining the economic union of the CIS, the Republic of Moldova was the first of the post-soviet countries that has been accepted in the Council of Europe, and in November 1994 signed a Partnership and Cooperation Agreement with the European Union.

This was the period when the mass privatization program was implemented (1500 enterprises), the National Bank of Moldova initiated credit auctions, the new national currency was introduced and its stability maintained. The rate of inflation was reduced from 1184% in 1993 to 30% in 1995. The Council of State Creditors and ARIA agency restructured the first group of industrial enterprises. In June 1995 the Stock Exchange started its operations. Most industrial enterprises have been transformed into Joint Stock Companies.

Although the reform in the agrarian sector was suspended and the support of the private sector was insignificant, in this period, according to the annual estimates of the IMF, WB and EBRD, Moldova was ranked higher as compared to most CIS countries and to its neighbors – Romania, Ukraine and Bulgaria. The quotation of the respected magazine “The Economist” (March 1995) is very significant: “Moldova is a model of correct reform, and the fact that it is a small country, transforms it into a perfect laboratory for running reforms”.

Creating, in general, the legal and institutional basis of the market economy and carrying out a macroeconomic stabilization (reduced inflation, stable national currency, budget deficit under control), Moldova nevertheless failed to enter a period of economic growth. The break in the implementation of the reforms, decided by both Parliament and Government, had a negative impact –foreign loans were used for consumption, structural reforms were postponed, political issues prevailed upon economic ones.

The situation of the economy in 1996/97 could be described as a "stable depression" which, under the impact of external and internal pressures, led to the crisis.

Unfortunately, in the Autumn of 1998 Moldova fell under the "shade" of the financial collapse in Russia which, *inter alia*, generated pressures on the banking sector, blocked exports from Moldova to the East (with the consequent budget losses), and caused a rise in the prices of energy products imported from Russia. Taking into account all these factors, the preliminary estimation of GDP for 1998 is of minus 7% (against minus 4.7%in the first quarter).

It is already obvious that in the nearest period the economic and financial immunity of Moldova will be severely tested. For the first time since the introduction of Moldovan leu a real threat arose of the national currency falling and unleashing an inflationary process. The warnings came true regarding the lack of safety of macroeconomic (financial) stability, when it is not supported by reforms of the real sector of the economy and by consolidating the state budget.

In conditions of decline of the productive sector and weakening of the state structures (a significant indicator of this is the shadow economy accounting for 50-60% of GDP), the National Bank of Moldova has proved to be a strong center of the economic policy of the state. Now this image has been considerably compromised: during October 1998 the Moldovan leu devalued by about one-third against the US dollar, and during the last four days of the month the leu fell from 5.83 to 6.40 lei per US dollar. At the end of November the official rate of exchange has reached 9.00, whereas at the exchange offices it reaches even 10.00.

A general awareness has been growing in the country of the real threat to the positive results of the reforms - stable national currency, lucrative banking sector, active private sector and population with average incomes, and the gradual adaptation of the population to living in a market economy. Everybody - even the opposition - became aware of Moldova's dependence of the international financial organizations.

This fact has clearly been noticed in the activity of the Parliament and Government, who intensified the introduction of legal and organizational backing of reforms. It is enough to consider the set of laws discussed and adopted by the Parliament, as well as the actions of the Government in October-November 1998, to understand that the ruling block, the Alliance for Democracy and Reforms, not without difficulties and contradictions, made serious efforts to realize their action program.

It is important that, despite the famous algorithm "2+2+1" which broke up the top leadership of the state apparatus, in September-November the Government not only worked in a regime of crisis management, but also undertook long-run measures: the Government approved the "Strategic guidelines of the social economic development of the Republic of Moldova in 1998-2005" (resolution no. 1107, November 6, 1998), the middle-term program for agro-industrial sector development, etc. Along with this, the Government has laid down the path for the privatization of the energy sector, "MoldTelecom" and the tobacco complex. Due attention was focused on the declarations of the Government regarding the necessity for a *new economic policy*.

The need for a new economic policy for Moldova is determined by the main fact that a real threat has emerged for the economic security of the country. Most indicators, both economic (see table below) and social (table 6.1), are at a critical level.

Indicators of the state economic security, 1998

Initial data for calculation of indicators	
Foreign debt	USD 1.3 bn
GDP	MDL 9 bn
Foreign debt service	USD 60 m
Public debt service	USD 100 m
Total expenditures of state budget	USD 2 bn
Exports	USD 0.7 bn
Imports	USD 1.1 bn

Indicators	***Actual***	***Recommended***
1. Foreign debt/GDP	About 80%	65%
2. Foreign debt service/Export	8.6%	5%
3. Public debts service/Total expenditures of state budget	25%	5-7%
4. Three groups of imported goods / Total imports (mineral products, including energy resources, equipment, chemical products).	57.8%	30-35%
5. Three groups of exported goods / Total exports (food products, drinks, cigarettes)	54.8%	20-25%
6. Export to one country (Russia)/Total export	58.2%	25-30%
7. Import from one country (Russia)/Total import	28.5%	15-20%
8. Export/Import	64%	95-100%
9. Degree of customs control in the country	About 70%	100%
10. Share of shadow economy	50-60%	15-20%
11. Share of fiscal evasion / Budget incomes	25%	5-10%
12. Real fiscal burden	55%	25-30%
13. The degree of provisioning with energy resources as at the beginning of the cold season	10%	80-90%

** Source: Reports of the international financial organizations, average levels for developed countries, CISR expert estimations.*

The aggregate indicator of social-economic security, calculated by Prof. C. Zaman based on 10 indicators (demographic, social welfare, financial, external, institutional, etc.), has a value of 3.34, compared with the optimal figure of 10. This means that *in the Republic of Moldova a person has three times less social-economic security than is required for normal functioning of economic, social and political overall activities.* The greatest responsibility for this is borne by the state, since most indicators used in the calculation of this composite indicator relate to economic policies at the central level.

The reality is that at state level it is necessary to implement, within an economic policy, *measures to alleviate and avoid both internal and external threats to the economic security* of Moldova. The primary actions in this field that need to be implemented immediately would comprise *monitoring and forecasting* the basic factors threatening economic security and determining the thresholds for economic indicators beyond which it is necessary to introduce some extraordinary measures – legal, economic and organizational.

Comparisons with international indicators are extremely unfavorable for Moldova. Thus, according to the estimates of the WB, EBRD, the real GDP in 1997 accounted for 35% (1989=100%),against 37% in the Ukraine, 63% in Bulgaria, and 82% in Romania. GDP per capita (USD according to Purchasing Power Parity (PPP)) was respectively: 1,440 in Moldova, 2,230 in the Ukraine, 4, 280 in Bulgaria, and 4,580 in Romania. With a GDP per capita of 1440 USD according to PPP, the Republic of Moldova became one of the poorest countries of Europe. The UNDP ranked Moldova in 110th place among all the countries (191 in all), in its Human Development Index – the same level as in China, Egypt or Bolivia.

What happened? Why didn't Moldova become a model laboratory of reforms, as "The Economist" assumed in 1995? Nowadays, analyzing the events and the trends of the cycle "crisis of 1991/92 – crisis of 1998", the following results and lessons are evident from the first round of reforms:

- *Positive results - property reform has been implemented, a broad legal and institutional basis has been created for market economy,* the private sector produces not less than 60%, prices have been liberalized, as have internal and external trade and enterprise operations, the capital, labor and real estate markets have been established, and a viable banking system was consolidated. All these changes in market economy orientation can really be considered irreversible. However, on this way too many impediments and mistakes have been made.
- The economic reform has been carried out under strong influence of the "*political cycles*", and at the same time without a *national strategy for development*. Thus the continuity of those 6 governments' actions during 1991-98 was not assured.
- *Fragmentation of legislation in the economic domain*: the Parliament has not approved yet a Civil Code oriented towards the market economy, most of the laws that regulate the activity of the financial sector (banking sector, stock market, Fiscal Code) are based on the Anglo-Saxon model, whereas the legislation regarding enterprise bankruptcy, foreign investments, etc. is based on the European continental one. Law enforcement is very poor.
- *Lack of coordination* regarding the maintenance of *macroeconomic, financial stability and structural reforms* in the key sectors – energy, industry, agribusiness, social sphere. *Low social and economic efficiency of mass privatization* for patrimonial bonds, lack of real owners in most enterprises after their privatization, lack of conditions for attracting foreign investors. *Lack of a real support by the state to entrepreneurs.* The shadow economy provides at least 30% of jobs and approximately 40-45% of population incomes, which compensates for the state's economic inefficiency.
- *The problem of Transnistria has not been resolved on the basis of European standards for local self-administration;* the political status of Gagauzia was determined (territorial autonomy), yet, in terms of social-economic aspects, the region is hardly viable, the subsidies from the central state being crucial for its development.
- *Lack of constructive character of the social policy,* which for a long time was limited only to cutting budget expenditures; delaying of reforms of the basic branches of the social sphere, as well as of the implementation of the pension system.

For these reasons, opinion polls and of the results of the last parliament elections of 1998 show that at least 40% of the population perceives the economic reforms in a negative manner. The most criticized aspects are the inefficiency and equalizing nature of the social protection system. Striving not to hurt anybody, including the "new rich", the state in the end hurts the most needy.

Turning now to the causes of the current economic situation in Moldova, one can conclude, that they result from the attempt to manage the market economy "as in capitalism", and to have a social sphere and general employment rate "as in socialism" (with paucity of financial means), trying to imitate countries with socially oriented market economies. As for the financial resources and technical assistance which the country receives from abroad, they need to be used for promoting real reforms and not for imitating them.

Unrecovered economic system of the Republic of Moldova still has quite a few risk factors. And the current situation is such, that *regardless to which Cabinet is in power,* it needs to resolve the following set of *"burning" problems*:

- *budget rehabilitation* – reduction of budget costs (because of the commitment to support the agrarian sector, the social sphere, and public administration), tax system' improvement, and collection of budget revenues as well as contributions to the Social fund;
- *stimulation of the real economic sector, of entrepreneurship,* increasing exports and reducing the deficit in the balance of trade;
- realization of *structural reforms*, including the privatization of the energy sector, MoldTelecom, tobacco sector, and state companies for purchasing and marketing in the agricultural sector;
- continuation of the *agrarian reforms and privatization of land by simultaneous creation of new structures* for providing help with credit, technology, agro-chemicals and other necessary inputs to the private rural sector;
- *reform of the social sphere;*
- *fundamental reform of local administration,* with a view to use more efficiently the territorial resources – natural, demographic and productive.

Undelayed nature of these problems is obvious. Variants are possible only in methods of their approach. Parliament must at the same time ensure the legal provisioning of these measures (implementation of Civil Code, adjustment of laws regulating the financial sector, corporate management, social protection of the mostly vulnerable groups of the population).

Looking for ways to resolve the crisis, redress the economy and improve the living standards of the population *will require a more constructive participation of the state in the transition period.* Noteworthy is, that in the World Bank Yearly Report '98 particular attention is paid to the need of increasing the role of the state in conditions of crisis economy.

According to the results of the opinion polls (see Chapter 9), the expectations of the population vis-à-vis the role of the state are still exaggerated, for it is the state that was the initiator of the reforms and it must therefore take responsibility for their results.

The generalized dissatisfaction with the situation created in this country gives rise to demands *vis-à-vis* the political power, which should be truly able to guarantee a *balance of interests between state, economic agents and the population.* The solutions are clearly in the field of the institutional reforms, improved mechanisms for economic activity and social protection, and stressing the *national state ideology* - civic consensus, modernization of the economy and transformation of the Republic of Moldova into a civilized country, politically stable, neutral and open to international cooperation, which should be able to ensure economic progress and a decent standard of living for the population.