11. External impacts: the Russian financial crisis and the Moldovan economy

1. The August 1998 financial crisis in Russia affected many countries in transition to a market economy, even those where economic stabilization, liberalization and structural restructuring has been well advanced, such as the Baltic States, for instance. For several months Moldova resisted the financial turbulence of her neighbor, but then, unable to meet conditions put forward by international financial institutions and bilateral donors and thereby to receive the badly needed assistance, it had to yield to balance of payments current account pressures. The Moldovan lei has been effectively strongly devalued and the country found itself close to an international default. After seven years of structural transformation and attempts of sustained macroeconomic stabilization, Moldova's adjustment to the Russian financial crisis was closer to that of Ukraine rather then that of the Baltics, not to mention the Vyshegrad countries.

2. The causes for the Russian crises are subject to intensive investigation. Its immediate cause was the collapse of confidence of financial investors in Russia preceded by a fail of Russia's government to roll over its matured treasury bills and growing fear of default and devaluation. Among other causes were the structural weakness of Russia's banking sector, a fall in assets prices in stock exchange, decline in Russia's oil-export revenue, as well as the increasing risk-awareness of global financial investors following a rather spectacular collapse of some – until then very dynamic – Asian economies. However, at the roots of the crises there is a series of failed and aborted financial stabilization programs, and Russia's inability to scale back public finance requirements on the one hand, and lack and/or failure of many structural reforms, including privatization, restructuring of the state-owned enterprise sector, slow and corrupt development of the private sector, failed energy-saving programs, lack of reforms in agriculture, and last but far not least, huge money wages rises, higher than in other CIS countries, yet totally unjustified by productivity gains or improved liquidity of the enterprise sector but granted on political grounds.

3. With exports to Russia representing 60 per cent of Moldova's total exports, and imports from Russia representing 40 per cent of total Moldova's imports, the short-term results had to be the inversion of the Moldova's export surplus, especially that Moldova's imports from Russia consist mainly of gas, oil and other raw materials, i.e. their price elasticity is low, and Moldova's exports are mainly food and agricultural products, where price competition is sharp, and in the face of past appreciation of the Moldovan lei, profit margins of exporters are thin (if at all positive). Moreover, the low price elasticity of Moldova's imports from Russia imply additional inflationary push across the board. Ukraine, which is also an important trading partner for Moldova, undergoes possibly even a greater financial crises than that of Russia. Can Moldova cushion those external shocks and what it should do in order to achieve this?

4. First of all it must be noted that with some respects, macroeconomic stabilization in Moldova, after seven years of reforms, appears to be more solid than in Russia and Ukraine. Its public finance requirement is lower than in latter two countries as are the respective yields on treasury bills and the costs of financing the public debt. Also other 'hard' components of government spending represent a smaller proportion of the GDP.

True, budget deficit on commitments basis in Moldova got out of control, with pension and government sector wage arrears more than doubling the cash-based budget deficit, yet the new government already prior to the crisis was working hard on containing this problem in the 1999 budget.

5. More importantly, next to providing financial stability, a critical package of structural measures have been carefully prepared and agreed upon between the main coalition partners and with the international financial institutions. Once this package is introduced, Moldova may immediately receive a USD 28 million loan from the IMF and a USD 30 million loan from the World Bank. Although the money lent is relatively insignificant from the viewpoint of the donors, it will provide the necessary breathing space for the country and allow for the reform included into the package deliver their effects, even though with regard to some of them their respective maturity periods are rather long.

6. The necessary package of measures on stabilization of the financial situation in the Republic of Moldova was presented by Deputy Prime Minister Ion Sturza in the Parliament already on September 10, 1998. It includes among other things: (i) the introduction of a temporary import surcharge, of 5 percent; (ii) the introduction of reference prices for export and import transactions (for *ad valorem* tax-liability assessment); (iii) elimination of grace-periods for payment of excises on oil products (in order to eliminate tax and tariff avoidance); (iv) rescheduling of credits from commercial banks to the enterprise sector under government guarantees (in order to postpone commercial banks requests for repayments); (v) special measures against enterprises which do not reimburse credits received directly from the budget (such measures as arrest to accounts, confiscation of assets, etc.; 1 billion lei of such credits have been granted between 1992 and 1997); (vi) elimination of technical credits from the budget; (vii) cancellation of 22 million lei loan to agrarian producers; and, following a more elaborated schedule, a reduction by 20 percent of budget expenditures. Altogether 200 million lei is to be thus saved.

7. Financial stabilization will be reinforced by such additional measures as: (i) protection of foreign currency reserves through restrictions of currency transfers (introduction of a USD 5000 monthly limit to be taken away from the country; through request for authorization by the central bank of non-commercial transfers made by economic agents; and through restructuring of the foreign exchange operations and raising their required statutory funds; (ii) maintaining of the banking sector liquidity through obligation that T-Bills are serviced by the Ministry of Finance and handled through open market operations; and through recommendation to the commercial banks to reschedule their credits for economic units which are oriented towards the Russian, Belarus and Ukrainian markets; (iii) maintaining stability on the Treasury Bills market. At the same time, in order to provide some immediate assistance to the people, all current budget revenues are to be spent for payment of wages, pensions and for preparation for the winter period.

8. Of the most important structural changes next to more vigorous advancement of privatization and restructuring of the enterprise sector (most of the already privatized large enterprises including), and a less corrupt development of the private sector, including a genuine liberalization of its operations, the government prepared package includes (i) quick advancement of the pension reform; (ii) introduction of the administration-territorial reform; (iii) adjustments to the Land Code; and (iv) the energy sector restructuring. Of these I personally consider (iv) and (iii) of really critical importance, while both (i) and (ii) are still not well thought out and (i) at any rate will have a very long maturity period.

9. Regarding the Restructuring and Privatization of the Energy Sector, of course, any

tangible reduction of fuel and energy consumption per unit of output will be of paramount importance for a fall in import intensity of GDP and therefore for the improvement in the trade balance of Moldova. This implies among other things the introduction of planned rises in gas, electricity and heating tariffs to their respective costs of delivery without any further delay, but the respective social protection measures including. Important as it is, this is a medium-term measure, however. Acceleration of restructuring of the energy sector, and its demonopolization and privatization must go well beyond the already adopted new laws - on electricity, and on natural gas. Apart from this, a law on energy conservation, and a law that would enable privatization of individual power plants must also be quickly passed. Other measures put forward by the government, such as (i) take-over by the government of the debts of eight energy sector companies to be privatized; (ii) debt-settlement agreements with the energy sector enterprises; (iii) canceling of the netting-out operations with the energy sector; (iv) canceling of barter transactions in settling accounts for energy services; (v) attracting economic agents to enforce collection of payments due to the energy sector; (vi) re-examining the top management in the energy sector; and (vii) establishing the responsibility of the managers of budgetary units for over-consumption of energy resources, also need to be fast implemented.

10. Regarding the agricultural sector, it is worth while to note that nearly 55 per cent of total exports of Moldova is represented by processed food, drinks and tobacco, 8.5 per cent by live animals, animal products and non-processed meat, and 8.6 per cent by fresh vegetables and fruits (the 1997 export structure), i.e. exports of processed and non-processed agricultural products represent together 72 per cent of total exports (over 83 per cent of total exports to the CIS countries). Let alone on these grounds, acceleration of privatization of agricultural farms and food processing enterprises, limiting bureaucratic impediments to their restructuring and modernization by private sector, and facilitating their access to new technologies and markets would improve their export potential and secure improved standards of living in Moldova. Yet, although the aforementioned adjustments to the Land Code were already passed last September by the Parliament, agricultural and agro-processing restructuring has hardly started in Moldova as yet.

11. In conclusion it may be argued that after seven years of reforms Moldova succeeded in achieving some measure of macroeconomic stability and an impressive reduction in rates of inflation. Yet, unsupported by medium term measures that would make fiscal discipline sustainable nor by satisfactory advancement of structural changes, the Moldovan economy fell back on a development trajectory that may soon undermine past achievements. In terms of macroeconomic stabilization and restoration of short-term equilibrium of the current account of the balance of payments, a rather insignificant assistance of the IMF and the World Bank will be satisfactory, provided, however, that medium term measures that would secure fiscal equilibrium and structural reforms are also implemented. In fact, IMF and the World Bank assistance is conditional upon their implementation. However, even if their assistance were not conditional upon these reforms, they would still be a must in order successfully to complete Moldova's transformation to a market economy.