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Ex ante evaluation statement
Macro-financial assistance to the Republic of Moldova

Accompanying document to the

Proposal for a decision of the European Parliament and of the Council providing macro-financial assistance to the Republic of Moldova

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EX ANTE EVALUATION STATEMENT

MACRO-FINANCIAL ASSISTANCE TO THE REPUBLIC OF MOLDOVA

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PROBLEM ANALYSIS AND NEEDS ASSESSMENT

Background

The Republic of Moldova has gone through a difficult period of transition since the breakup of the former Soviet Union. It has been one of the countries in the European Union's eastern neighbourhood most heavily affected by the global crisis. Despite high average economic growth rates in the years leading up to the crisis, the country's income level as measured by purchasing power parity adjusted real GDP per capita is by far the lowest among the EU eastern neighbour countries. The policy response to the economic crisis was delayed first by the preparation for parliamentary elections in Spring 2009 and later by internal political tensions over the election results. The repeat elections that had to be organised in the Autumn of 2009 brought a coalition government into power on a reform agenda that seeks closer approximation to the EU and aims at turning around the previous growth model that was relied heavily on the inflow of remittances. These political developments have allowed a speeding up of the scaling up of bilateral relations with the EU, culminating in the opening of formal negotiations on a new Association Agreement on 12 January 2010.

In 2008, the Commission completed the implementation of the previous package of macro-financial assistance, totalling EUR 45 million, which was adopted by the Council on 16 April 2007. The second and third instalments of, respectively, EUR 10 and 15 million were released in June and December 2008. The programme was part of the financing package in support of the government's three-year arrangement with the IMF under the Poverty Reduction and Growth Facility (PRGF) dating back to May 2006. In addition, the World Bank (WB) has a consistent engagement strategy with the country.

Immediately after the new government headed by Prime Minister Filat was sworn in on 25 September 2009 the authorities of the Republic of Moldova approached international donors with a request to cover the financing needs of the country. On 29 September, during a visit to Commissioners Almunia and Ferrero-Waldner, the new Prime Minister confirmed the request for EU financial support submitted earlier in the year by the previous government. On 29 January 2010, the IMF Board approved a three-year assistance programme, covering the period 2010-2012. The IMF programme consists of a mixture of Extended Credit Facility (ECF) and Extended Fund Facility (EFF) Arrangements and was designed to be complemented by other international donors, in particular the WB and the EU. The IMF programme entails a frontloaded package of SDR 369.60 million in total over a three-year period (around USD 588 million). An initial purchase of SDR 60 million became available upon approval by the IMF Board. In addition, the authorities have been able to use the new allocation of SDRs from the IMF (around US$186 million, transferred in late 2009) to cover its immediate budget financing needs. Key prior actions implemented before the Board approval included corrective measures to the 2009 budget (scaling down of commitments to public wage increases made earlier in 2009, and measures to increase taxation and the price of heating to cost-recovery levels.

The Commission is submitting to the European Parliament and to the Council a proposal for macro-financial assistance (MFA) for the Republic of Moldova amounting to a maximum total amount in grants of EUR 90 million over a two year period. The European Union MFA is aimed at contributing to covering the country's external financing needs in 2010 and 2011 as identified by the Commission in cooperation with the IMF. Since the uncovered financing needs of the Republic of Moldova are concentrated in those two years, a two-year programme would be an appropriate contribution of the EU to close the financing gap. Should in 2012 a substantial financing gap still exist, further EU assistance might be considered under a new proposal. But on present information and given the large uncertainties surrounding the final year of the IMF programme, the current proposal appears appropriate.

The Union MFA will be part of the financing package put in place in support of the Republic of Moldova's efforts to confront substantial external financing needs and a sharp deterioration of public finances in the context of a v difficult economic situation. It will complement financing provided by the Bretton Woods Institutions (BWIs) – the IMF, in the context of the ECF/EFF programme and the WB, centred on a Development Policy Operation currently under preparation. The Union MFA is aimed at covering the residual financing needs that remain after the contributions of other multilateral creditors, and of other official bilateral donors, including other EU instruments, such as EIB loans and sectoral budget support programmes financed under the European Neighbourhood and Partnership Instrument.

The swift implementation of the measure is justified by the need to close the substantial external and budgetary funding gap of the Republic of Moldova in 2010 and 2011. EU macro-financial assistance to help stabilise the macro economy is needed rapidly in the expectation that the contributions from other (bilateral) donors are likely to take longer to come on stream[1]. A rapid response is in line with the objectives of the MFA instrument, which is by design a crisis-related support tool.

Recent economic developments and economic outlook

The Republic of Moldova has faced a very difficult year on both economic and political fronts. In Europe's poorest country, violent protests in the aftermath of disputed elections in April 2009 added to political grievances and led to new elections in the summer, with a victory for the opposition coalition. On the economic side, tumbling remittances are crippling the economy. The Republic of Moldova is one of the countries in the Eastern neighbourhood hit hardest by the global recession. GDP in 2009 shrank by 6.5%, which is in sharp contrast with the 7.2% GDP growth in 2008. External shocks due to the global crisis, such as falling remittances and FDI inflows are the main causes for the deep recession. The unemployment rate is rising rapidly and the government deficit has widened sharply to 6.9% of GDP in 2009. While the deep contraction in demand has also led to a considerable reduction in the current account deficit it still remains high. Monetary and fiscal instruments can help to cushion the shocks, but international assistance will be crucial to help stabilise the economy. For the medium term, the main reform agenda remains the diversification of economic activity and improvements to the business environment and public and private governance.

The Republic of Moldova is suffering from the economic recession in its main trading partners: Russia, Ukraine, Belarus and the EU. The global crisis started affecting the economy already in the last months of 2008. A deceleration of trade growth, declining access to trade finance, and lower remittances and FDI inflows were important transmission channels. In the course of 2009, the broad-based downturn continued. Exports declined substantially but imports declined even more sharply, along with domestic demand. In the third quarter of 2009, industrial production was about 25% lower to its level a year before.

1 In this regard, the outcome of the Consultative Group meeting which took place in Brussels on 24 March 2010 was encouraging.

With the trade balance improving due to imports contracting faster than exports, the current account deficit decreased markedly but remains large; it fell from around 17% of GDP in 2008 to some 9% of GDP in 2009. A fall in real incomes was partly cushioned by the rapid deceleration in prices. CPI inflation decreased very rapidly, from around 16% in the second quarter of 2008, to -2.3% in August 2009, before picking up again to 2.8% in January 2010. The adjustment of the external deficit due to the crisis also helped alleviate financing constraints somewhat. But external financing sources dried up even more sharply than the current account deficit, as remittance inflows are estimated to have decreased by 30% in 2009, and foreign direct investment by around 45%.

Whereas the external accounts have started to adjust as a result of the deep recession, the fiscal situation has deteriorated quickly since the middle of 2008, despite public expenditure cuts of 20% across the board decided in Spring 2009. The latest budgetary execution figures for 2009 reveal substantial revenue shortfalls (reflecting the strong reduction in imports as a key source of revenue), partly but not fully offset by lower-than-budgeted expenditures and rectifications implemented by the incoming government. All in all, the government deficit is expected to have deteriorated markedly in 2009, to 6.9% of GDP, against only 1% of GDP in 2008. The government has been financing part of the revenue shortfall by placing T-bills, largely with domestic banks. But this strategy is not sustainable as it is leading to a sharp increase in public debt (expected to rise to 31% of GDP towards the end of 2009, up from 21% in 2008), and also risks the heightening vulnerability of the financial sector to an adverse shift in sentiment.

The 2010 budget was approved by Parliament on 23 December 2009. It is in line with the targets of the IMF programme. It includes several adjustment measures aimed at reducing the deficit. On the revenue side, taxes were increased for gambling and diesel powered and luxury cars, the road tax was increased and excises were raised substantially for petrol, beer, other alcoholic beverages and cosmetics. Local taxes will also be higher, whereas the real estate tax will be levied on the market value of properties, not on the book value. On the expenditure side, several measures were implemented as well. Public employment will be reduced and early retirement options curtailed for civil servants, while public sector wages are set to increase less than had been foreseen by the previous government. In addition to the measures implemented in the budget, utility tariffs were raised to bring them to cost recovery levels. This entailed sharp increases in the cost of energy for households: 16.6% for gas, 29% for heating and 20% for electricity as of January 2010. Announced reforms on the structural side include a simplification of the procedures to register, start and liquidate a business and to obtain construction permits. The intended overhaul of the pension and social security schemes includes extension of the obligation to pay social security contributions to all employees. The statutory pension age (currently 62 for men and 57 for women) will not be raised, however.

All in all, the 2010 budget foresees a slight reduction of the government deficit to around 6% of GDP. The government debt level is expected to rise further to nearly 40% of GDP in 2011-2012. Domestic sources of budget financing are not sufficient to cover budgetary financing needs. Hence, there is a need for higher external financing.

***Table 1* : Republic of Moldova - Main economic indicators**

	2007	2008	2009	2010	2011	2012
	actual			projections		
Real sector						
Real GDP growth (domestic currency, % change)	3,0	7,2	-6,5	1.5	3,0	5,0
GDP nominal (US$, billion)	4.4	6,0	5.4	5.1	5.3	5.7
GDP per-capita (EUR)	902	1160	1091	979	n.a	n.a.
Inflation (average)	12,4	12,8	-0,2	6,2	5,0	5,0
Inflation (end-year)	13,3	7,2	0,5	6,5	5,0	5,0
Social indicators						
Unemployment (ILO definition, %)	5,1	4,0	5,5	n.a	n.a	n.a.
Fiscal sector						
Total revenues (% GDP)	41,7	40,6	39,3	38,8	n.a	n.a.
Total expenditures (% GDP)	42,0	41,6	46,2	45,8	n.a	n.a.
General government balance (% GDP)	-0,2	-1,0	-6,9	-6,5	-5,0	-3,0
Gross public debt (% GDP)	26,8	21,3	30,9	36,9	39.6	39.6
Monetary sector						
Domestic credit to the private sector (% GDP)	37,8	51,7	20,3	-4,9	n.a	n.a.
Broad money (M3, % change)	12,2	47,3	18,4	-6,0	n.a	n.a.
Degree of monetisation (M2/GDP, %)	34,5	34,7	26,5	26,5	n.a	n.a.
Dollarisation in bank deposits (%)	43,3	31,3	43,8	43,8	n.a	n.a.
External sector						
Current account balance (% GDP)	-15,3	-16,3	-9,0	-9,5	-11,2	-10,2
Trade balance (% GDP)	-52,1	-53,3	-52,8	-36,6	n.a	n.a.
FDI (net, % GDP)	11,0	11,2	11,8	6,4	n.a.	n.a.
Remittances (% GDP)	32,3	33,9	31,2	22,5	23,6	n.a.
External vulnerability						
External public and private debt (% GDP)	64.2	56,0	65.9	78.6	83.6	85.7
debt service (% of exports of goods and services)	13.7	16.6	19.2	20.8	16.9	18.3
International reserves (USD, million)	1334	1672	1456	1695	1876	2090
Financial sector						
Real effective exchange rate end-year (%, + is apprec.)	16,0	16,0	23,3	-19,7	n.a.	n.a.
Exchange rate (Moldovan leu per EUR, average)	16,5	16,5	15,2	15,5	n.a.	n.a.
Exchange rate (Moldovan leu per USD, average)	12,1	12,1	10,3	11,1	n.a	n.a.

Sources: Moldovan authorities, IMF, EBRD, WB, NBM, EC staff calculations.

As regards monetary and exchange rate policies, as a result of the double external shock on trade and remittances, pressures on the national currency built up. The National Bank of Moldova (NBM) could, however, partly counter these pressures by using some of the country's official reserves. Reserves were reduced by nearly 40% between September 2008 and April 2009. The bulk of this reduction took place in early 2009. Subsequently, the exchange rate of the Moldovan leu versus the USD (the traditional anchor currency) stabilised and reserve levels started increasing again. Between December 2009 and mid-February 2010, the exchange rate of the Moldovan leu weakened once more, by around 15% against the USD but stabilised thereafter. The central bank was also able to reduce official interest rates despite concerns about the exchange rate due to disinflation. Reserve requirements were eased substantially as well. Between September 2008 and September 2009, the NBM cut its main refinancing rate from 18.5% to 5.0%. Nevertheless, real interest rates remain high.

The outlook for the Republic of Moldova for the short to medium term is challenging. Its main trading partners – Russia, Ukraine, Belarus, but also the EU – have all been severely affected by the global crisis, and the recovery is expected to be gradual. Moreover, external financing conditions, notably the availability of credit resources for transition economies, and prospects for remittance flows have deteriorated sharply since the start of the crisis. Thus, after the sharp adjustment in 2009, the economy of the Republic of Moldova is expected to recover only slowly in the coming years. The budgetary situation in particular remains highly vulnerable. Macro-economic stabilisation is thus the central immediate concern, and financial assistance of the international community will be crucial in achieving this. That said, the ambitious domestic reform and adjustment agenda needs to be implemented to put the Republic of Moldova back on a sustainable convergence track.

The government programme of economic reform

In response to the challenges posed by the economic crisis, on 4 December 2010 the Moldovan authorities launched an Economic Stabilisation and Recovery Programme covering the period 2009-2011. The Economic Stabilisation and Recovery Programme aims at three priorities, namely: 1) stabilisation and streamlining of public finance; 2) economic recovery through structural reforms and 3) securing efficient and fair social protection.

As regards fiscal policy, the authorities are embarking on a path to restore fiscal sustainability by 2012. They target a structural budget deficit adjustment of about 6 percentage points of GDP, steadily reducing the headline deficit from 9 percent of GDP in 2009 to 7 percent in 2010, 5 percent in 2011, and 3 percent by 2012. This fiscal effort should bring the budget back to sustainability at a speed matching the economy's recovery. It will be achieved mainly through reform-based reduction of current expenditure to affordable levels, while public investment will be raised and the social safety net enhanced. In addition, there is the intention to raise revenue from consumption-based taxes, reinstate the corporate income tax in the medium term, and modernise tax administration to support the adjustment.

Structural reforms will aim to improve the business environment and support the fiscal effort**.** Over the whole programme period, a programme of deregulation and liberalisation will free business initiative, stimulate competition, and strongly support the economic recovery. In 2010, actions in the district heating sector will address the fiscal losses resulting from prices set below cost. Reforms in the social insurance system aim to keep it sustainable by phasing out early retirement and improving the mechanism for sick leave compensation. In 2011–12, continuing efforts to reform public administration and the education system should raise efficiency and yield further savings. The planned restructuring of the energy and telecoms sectors would draw private investment in, lower costs and raise the economy's long-term growth rate. Privatisation will accelerate as well once investor interest rekindles. Specific plans for reforms beyond 2010 will be fleshed out in the context of programme reviews and the 2010 Article IV consultation. The authorities are collaborating closely with international donors in the implementation of the structural agenda.

The fiscal adjustment and structural reform measures will be supplemented by developing targeted social assistance programmes to help vulnerable strata in society cope with the hardships stemming from the crisis. In this regard, the programme will help mobilise resources for successful implementation of the poverty reduction agenda.

As regards monetary and exchange rate policies, towards the end of 2009 the National Bank of Moldova announced a redefinition of its medium-term strategy for the period 2010-2012, which has price stability as its chief objective. For 2010, the central bank announced an inflation target of 5.0% with a deviation band of ±1 percentage point. As a first move under the new policy framework, the NBM raised the base rate to 6% in late January 2010, due to an increased perceived risk of overshooting the inflation target.

The national programme attaches an important role to international financial assistance to help the economy achieve macro-economic stabilisation and recovery and to underpin implementation of the reform agenda.

The Republic of Moldova's external financing needs

Table 2 summarises the estimates of the country's external financing needs over the period 2010-2012, the programme period foreseen by the IMF.

Total needs for the three years amount to a total of USD 8 billion, largely due to the need to finance current account deficits of around 10% of GDP. Reduced remittances and private capital flows (the combined amount of which is estimated to have decreased from around 41% of GDP in 2008 to around 27% of GDP in 2009) are expected to result in a persistent and substantial financing gap over the period 2010-2012, amounting to slightly over USD 1.4 billion.

Out of this amount, the Bretton Woods Institutions are expected to provide around USD 800 million. For the largest part, this will be in the form of the IMF's ECF/EFF programme, while the World Bank is putting in place an additional USD 230 million, mainly in the form of budget support. The residual financing gap – around USD 620 million or EUR 480 million over the 2010-12 period (based on the exchange rate assumptions underlying the financing table) – is expected to be partly covered by other multilateral creditors (the EIB, the EBRD and the Council of Europe Development Bank) and bilateral donors (Sweden, the Netherlands and the USA). Identified loans and transfers under this heading add up to more than EUR 210 million. In addition the EU has put in place sectoral budget support (BS) grants under the European Neighbourhood and Partnership Instrument (ENPI). The disbursements in 2010-2012 under budget support programmes already approved amount to nearly EUR 100 million. Taking into account programmes planned under the ENPI National Indicative Programme for the period 2011-2013 brings the total amount of ENPI budget support expected to be provided to the Republic of Moldova over 2010-2012 to nearly EUR 150 million. As ENPI budget allocations under future programmes are expected to be somewhat higher than those under the existing programmes, the ENPI BS disbursements should be increasing over time. This reflects a higher contribution of structural budget support to covering Moldova's financing needs.

Uncovered financing needs are currently estimated at close to EUR 120 million for the period 2010-12, including about EUR 90 million for 2010-2011. The proposed MFA would precisely match this uncovered part of the financing gap in 2010-2011. It would correspond to some 27% of the residual financing needs of this two-year period not covered by the Bretton Woods Institutions. Further EU MFA could be considered at a later stage, in case substantial uncovered financing needs remain beyond 2011.

Table 2: Republic of Moldova - External Financing Requirements and Sources, 2010-12

	2010	2011	2012	2010-12
		in million USD		
1 Total requirements	**2.537**	**2.665**	**2.844**	**8.047**
Current account deficit (excl. transfers)	2.172	2.331	2.450	6.952
of which: exports of goods	1.448	1.761	2.020	5.229
imports of goods	-3.358	-3.821	-4.175	-11.354
Debt amortization	365	334	395	1.094
of which: public and publicly guaranteed debt	51	48	50	149
private debt	314	286	345	945
2 Available financing	**2.208**	**2.363**	**2.664**	**7.235**
Capital and financial account	716	761	877	2.354
Capital transfers (net)	-11	-11	-12	-34
Foreign direct investment (net)	202	244	292	738
New private borrowing	440	460	534	1.433
Current transfers	955	999	1.112	3.065
Worker's remittances	700	759	855	2.314
Other private transfers	255	240	257	752
Compensation of employees	536	604	675	1.816
Other financial and income flows [1]	86	68	63	217
3 Gross international reserve accumulation (+: increase)	**240**	**180**	**200**	**620**
4 Financing gap	**569**	**482**	**380**	**1.432**
5 Exceptional IFI financing	**378**	**246**	**184**	**808**
IMF	265	186	124	575
World Bank	113	60	60	233
6 Residual financing gap (after IMF/WB financing)	**191**	**236**	**197**	**624**
		in million EUR		
Residual financing gap (after IMF/WB financing) [2]	**147**	**182**	**151**	**480**
Identified public borrowing, incl. EIB/EBRD/CEDB	38	38	30	106
Identified official transfers	15	46	46	107
EC structural budget support (ENPI-related)	44	55	49	148
7 Residual	***49***	***43***	***26***	***118***

Sources: IMF staff projections and Moldovan authorities

[1] Includes portfolio investment, net errors and ommissions, use of IMF credit (PRGF and EFF) and other income balance
[2] assuming exchange rate of euro vis-à-vis the US dollar of 1.30

OBJECTIVES AND RELATED INDICATORS OF THE MACRO-FINANCIAL ASSISTANCE

Objectives

The objectives of the proposed macro-financial assistance operation are to:

- Contribute to covering the external financing needs of the Republic of Moldova and to alleviating budgetary financing needs;
- Support the fiscal consolidation effort and external stabilisation in the context of an IMF programme;
- In this respect, help the Republic of Moldova to reduce the financial constraints on the implementation of its comprehensive economic reform programme;

- Facilitate and encourage efforts of the authorities of the Republic of Moldova to implement measures identified under the EU- the Republic of Moldova Action Plan and the Eastern Partnership;

- Reinforce the EU role in the economic policy dialogue with the authorities of the Republic of Moldova on the programme of reforms.

Detailed macro-economic and structural reform objectives will be further defined in the context of a Memorandum of Understanding, to be agreed with the authorities.

Indicators

To monitor the fulfilment of the objectives of the programme throughout the implementation period of the assistance, the Commission will use two types of indicators:

- Adherence to the IMF-supported programme;;

- Progress in the implementation of specific policy actions to be included as conditions for disbursement. Those actions will be specified in the aforementioned Memorandum of Understanding. They will be consistent with the priorities of the European Neighbourhood Policy and those of Eastern Partnership and the policy orientation of the IMF programme, with an emphasis on the improvement of public finance management.

ALTERNATIVE DELIVERY MECHANISMS AND RISK ASSESSMENT

Delivery mechanisms

Given the sharp deterioration of the Moldovan economy, the country's low income level and its eligibility for concessional lending, the foreseen macro-financial assistance will be provided in the form of grants. Macro-financial assistance is an untied and undedicated macro-economic support instrument, which helps the beneficiary country meet its external financing needs, and may contribute to alleviating budgetary financing needs. Moreover, as experienced with similar operations, including in the Republic of Moldova, the economic policy conditionality attached to this support strengthens the stabilisation and reform process.

Risk assessment

There are both fiduciary and policy risks related to this macro-financial assistance operation.

There is a risk that the macro-financial assistance, which is not dedicated to specific expenses (contrary to project financing, for example), could be used in a fraudulent way. In general terms, this risk is related to factors such as quality of financial circuits and management systems in the central bank and Ministry of Finance, administrative procedures, control and oversight functions, security of IT systems and adequate internal and external audit capabilities.

To mitigate the risks of fraudulent use, several measures will be taken. The Memorandum of Understanding and the Grant agreement will comprise a set of provisions on inspection, fraud prevention, audits, and recovery of funds in case of fraud or corruption. Also, the assistance will be paid to clearly identified accounts at the National Bank of Moldova. The NBM is one of the most professionally well-reputed state institutions in the Republic of Moldova.

Moreover, before the agreement on the Memorandum of Understanding is reached, the Commission services will assess the reliability of financial circuits and administrative procedures that are relevant to this type of assistance and will determine whether the framework for sound financial management of macro-financial assistance is sufficiently effective in the Republic of Moldova. In the light of this assessment, specific mechanisms applying to the management of the funds by the beneficiaries may be introduced in agreement with the national authorities. The Commission may also use other assistance instruments at its disposal to help the beneficiary authorities improve their public finance management systems if this area is not sufficiently covered by other donors. Against this background, special conditionalities on improving public finance management will potentially be required.

Finally, the assistance will be liable to verification, control and auditing procedures under the responsibility of the Commission, including the European Antifraud Office (OLAF), and the European Court of Auditors.

As regards policy risks, the main assumption is that the Government of the Republic of Moldova will remain committed to fiscal adjustment and compliance with its agreement with the IMF. This will be validated on the basis of IMF's regular monitoring of performance indicators and structural benchmarks. There is a risk that the Government of the Republic of Moldova will not comply with the IMF programme conditions, as the programme targets may turn out more difficult to reach than assumed and as political conditions in the country may change. However, the authorities have shown strong commitment to work with international institutions to implement the overdue reform agenda. Also, there have been internal discussions in the Republic of Moldova regarding independence of the National Bank.

Having made a serious assessment of the risks, the Commission services consider that there are sufficiently strong grounds to proceed with the MFA to the Republic of Moldova.

The Commission services will maintain close contacts with the authorities during the implementation of the macro-financial assistance in order to address quickly any concerns that may arise.

ADDED VALUE OF EU INVOLVEMENT

The European Union's financial support to economic recovery in the Republic of Moldova reflects the country's strategic importance to the EU as a partner country in the context of the European Neighbourhood Policy and of the recently established Eastern Partnership. The main financial support instrument to the Republic of Moldova is the European Neighbourhood Partnership Instrument that has three priority objectives: democratic development, administrative capacity building and infrastructure development. The macro-financial assistance instrument is directed at alleviating short- and medium-term external financial needs.

In addition to the financial impact of the macro-financial assistance, the proposed programme will strengthen the national government's reform commitment and its aspiration towards closer relations with the EU. This result will be achieved, inter alia, through appropriate conditionality for the disbursement of the assistance.

In a wider context, the action fits well into the EU’s general approach towards the Republic of Moldova, which is one of an accelerated and progressive engagement, as reflected in the opening of negotiations on an Association Agreement. This reflects the impetus the authorities have recently given to deepening the country's relations with the EU and is expected to lead to closer co-operation between the EU and the Republic of Moldova in many fields.

GENVAL CRITERIA ON MACRO-FINANCIAL ASSISTANCE

On 8 October 2002 the Council reconfirmed a set of principles for the use of the European Union's macro-financial assistance (Genval criteria). The five criteria are: (i) the exceptional character of the assistance, (ii) its complementarity to financing of the International Financial Institutions (IFIs), (iii) the existence of policy conditionality attached to the assistance, (iv) the existence of political pre-conditions and, finally (v) strong financial discipline that needs to accompany the MFA.

Exceptional Character and Limited Timeframe

The financing requirements of the Republic of Moldova in 2010-2011 result from the impact of the global economic crisis, and the substantial impact on the country's economy in view of its external and fiscal imbalances and its high dependence on foreign inflows and remittances.

The exceptional character of the foreseen MFA is reflected in the limited timeframe of the programme. The programme's planned duration is two years, one year shorter that the IMF programme which covers also 2012. In determining the actual amount of the tranches under the MFA programme, the Commission services intend to take into consideration the progress in the implementation of the IMF programme and of the World Bank development policy loans.

Political pre-conditions

MFA is reserved to the third countries that are geographically close to the EU territory, that respect democracy and human rights and with which the EU has important political, economic and commercial ties. The Republic of Moldova fulfils these criteria. First, it has direct borders with the EU. Second, its economic and political relations with the EU are evolving rapidly towards closer approximation: it is an active EU partner in the multilateral track of the recently established Eastern Partnership. Third, the Republic of Moldova has made progress regarding respect of democracy and human rights. The political situation in the country remains uncertain, in particular as regards the unresolved issue of presidential elections. However, the current government came to power on a pro-European agenda and has initiated many initiatives to bring the country closer to the EU, culminating in the opening of negotiations on an Association Agreement in January 2010.

Complementarity

The proposed macro-financial assistance will be complementary to the existing EU financing, to the IMF financing and to the financial support of other international donors.

The MFA programme is complementary to other EC financing, in particular to medium-term ENPI support. Thus, it can help increase the EU's leverage on policy making in the Republic of Moldova as well as help the country overcome the current deep economic crisis and to implement reforms as a basis for sustainable recovery.

The complementarity with the IMF programme is also assured. An MFA can only take place when a residual external financing gap is identified over and above the IMF resources and under the condition of a fair burden sharing. A residual external financing gap has been identified by the IMF; this assessment constitutes the basis for Commission's MFA programme proposal that would cover roughly one third of the external financing gap remaining after the intervention of the Bretton Woods Institutions.

Conditionality

The macro-financial assistance to the Republic of Moldova will be linked to the existing IMF Extended Credit Facility/Extended Fund Facility Arrangements. As usual with this type of assistance, disbursements under this macro-financial assistance will be subject to progress in the implementation of the IMF arrangement. It will also be conditional upon specific structural reform measures that will be further defined in the context of a Memorandum of Understanding to be agreed between the Commission and the authorities of the Republic of Moldova.

Given the nature of the planned operation, in defining the conditionality in the area of structural policies, particular attention will be paid to public finance management with a view to strengthening efficiency, transparency and accountability, and because of its importance for fiscal consolidation. As the Republic of Moldova is a partner country to the European Neighbourhood Policy and to the Eastern Partnership, the Commission may consider targeting specific sectoral policies of particular importance, identified as such in the EU- the Republic of Moldova Action Plan or the 2010 Progress Report, such as financial sector stability.

Financial discipline

The planned assistance would be provided in the form of a grant. The Commission services propose to limit the macro-financial assistance to the Republic of Moldova to EUR 90 million for the period 2010-2011. This corresponds currently to some 27% of the residual financing gap foreseen after IMF and World Bank support identified by the IMF for the years 2010 and 2011. Data on the balance-of-payments gap are by nature volatile. Additionally, additional bilateral financing may materialise in the course of the programme that cannot yet be included in current programme assumptions.

Concerning sound financial management, the Commission services are taking action in order to fulfil the requirements of the Financial Regulation. The Commission will update the Operational Assessment (OA) of the reliability of financial circuits and administrative controls at the Ministry of Finance and the National Bank of Moldova conducted in 2007, in the context of the previous programme of macro-financial assistance. Based on the OA report's findings, the Commission services will determine whether the framework for sound financial management is sufficiently effective in the Republic of Moldova. Also, the results of the OA will contribute to the definition of appropriate conditionality in the area of public finance management.

PLANNING OF FUTURE MONITORING AND EVALUATION

This assistance is of exceptional and macro-economic nature and its monitoring and evaluation will be undertaken in line with the standard Commission procedures.

Monitoring

Monitoring will involve the review of reports and data provided by the authorities and by the organisation of review missions to the Republic of Moldova by Commission staff. Although this assistance is centrally managed, where appropriate, the EU Delegation in Chisinau will also be called to provide reporting. The monitoring of the action by the Commission services will take place on the basis of macro-economic and structural policy indicators, which are to be agreed with the authorities of the Republic of Moldova in a Memorandum of Understanding. In this process, the Commission services will also monitor key areas of the public finance management system, as identified in the update of the Operational Assessment so as to have the relevant information on any changes in the control environment.

An annual report to the European Parliament and to the Council on the implementation of macro-financial assistance is foreseen in the proposed text for a Decision of the European Parliament and of the Council.

Evaluation

Two to three ex-post evaluations of macro-financial assistance operations are planned per year in the Multi-annual Evaluation Programme of the Economic and Financial Affairs Directorate-General. An ex-post evaluation of the proposed macro-financial assistance to the Republic of Moldova will be launched within a period of two years after the completion of the operation. A provision for the ex-post evaluation is included in the proposed legal basis for the programme, and in the Memorandum of Understanding. Budget appropriations from the macro-economic assistance budget line will be used for this evaluation.

ACHIEVING COST-EFFECTIVENESS

In implementing the programme, the Commission will be guided by the following principles:

- As soon as the European Parliament and the Council have adopted the proposal, the Commission will negotiate with the authorities of the Republic of Moldova a

Memorandum of Understanding laying out the conditions for the release of the EU assistance, as well as a grant agreement. Each instalment of the proposed assistance will be made available by the Commission to the Republic of Moldova on the basis of a satisfactory track record of the implementation of the IMF programme and the economic policy and financial conditions attached to the assistance.

- In negotiating specific policy conditions, the Commission will draw on all the expertise, including of the International Monetary Fund and the World Bank and of bilateral and multilateral aid agencies active in the Republic of Moldova. In addition, the Commission will aim at synergies with other EU policies and instruments (in particular ENPI as indicated above) that could be used to support the implementation by the beneficiary of the relevant measures (notably in the area of public finance management). Where appropriate, links to any related action under the European Neighbourhood Policy or Eastern Partnership and to findings of the Progress Reports on the Republic of Moldova would be established.