

Moldova's Transition to Destitution

BY PER RONNÅS AND NINA ORLOVA



Close to the heart of Europe, Moldova has suffered a severe peacetime decline in economic performance and living standards during the past decade. Exploring different mechanisms both on the macro- and micro-economic levels and in different sectors, Per Ronnås and Nina Orlova discuss the external debt, the foreign trade, the political and institutional development as well as the social effects of the crisis. The conclusion entails tentative lessons for future outside assistance.

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Sida Studies no. 1

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ISSN 1404-9562

ISBN 91-586-8901-X

The studies in the series are selected by an appointed committee within Sida.

Series Editor: Anne Sisask

Graphic Design: Johan Nilsson/Kombinera

Cover Photo: Thomas Raupach/Phoenix

Printed by Novum Grafiska AB, Gothenburg 2000

Art. nr. D 0708

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Sida**studies**

Foreword by Sida

Moldova is one of the countries given priority in Sida's cooperation with Eastern and Central Europe. Sida initiated its activities in Moldova in 1997. The number of activities and the different sectors involved have increased during the last few years.

Sida's cooperation with Moldova promotes institutional development and capacity building – especially in the social sectors, and for democratic development and economic reforms. The following are some examples:

- We are cooperating with the World Bank in the Social Investment Fund. A Sida grant has enabled thirteen schools to be refurbished and it is expected that a further fifteen social projects will receive grant funding.
- Capacity building is provided for the mayors and local decision-makers in two “judets” (regions). This has resulted in well-balanced local annual budgets.
- The Sida-supported debt management programme reduced Moldova's foreign debt in 1999 by USD 133 million, which is approximately 15% of the total state debt.
- Among the other projects we would like to mention the World Bank Land Cadastre Project that is receiving Sida funding for a period of five years. Furthermore a district heating strategy is currently being produced.

In order to achieve fully-fledged consolidated cooperation with Moldova, Sida is planning to open a country office with a Swedish representative in the capital city, Chisinau.

It is our wish that this study will contribute to increasing interest in and knowledge of Moldova in Sweden, within Swedish authorities and among Swedish partners.

Stockholm, October 2000



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Deputy Director General



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Executive Summary

Moldova probably holds the unenviable record of having suffered the most devastating peacetime decline in economic performance and living standards of any country in modern times. From a situation of relative prosperity, Gross Domestic Product in this country, close to the heart of Europe, has fallen by over 70 per cent within a decade – to a mere 330 USD per capita, placing Moldova almost on par with the poorest countries in Africa and Asia¹. For most Moldovans, life has become a daily struggle to satisfy the most basic needs against increasingly uneven odds.

The virtual collapse of Moldova's economy is all the more remarkable as the country has ranked among the best achievers with regard to macro-economic policies, institutional and economic reforms and democratisation among the successor states of the Soviet Union. As one of the more faithful disciples of the International Monetary Fund (IMF), Moldova's sound macro-economic policies earned the praise of the IMF and the World Bank (IBRD) during the early years of independence and turned the country into a regional showcase. Yet, in retrospect, the disastrous outcome of the transition is not inexplicable, nor, indeed, very surprising.

The collapse of the Soviet Union transformed virtually overnight Moldova from a small cogwheel in a giant economy, completely isolated from the outside world, into a small open economy and independent state. Lacking energy and other natural resources, Moldova became totally dependent on export for its economic survival and recovery. Its energy-guzzling and inefficient economic infrastructure was singularly ill suited as a basis for an export-based open market economy, and needed to be rebuilt. All the formal and informal institutions – part and parcel of a modern statehood and democracy – were instantly needed, yet entirely lacking. In the social field, the systems of health care, education and social protection needed to be redesigned. In essence, the country had to be built more or less from scratch. The *de facto* division of the country after the brief civil war in 1991 made this task even more difficult.

Half a century of isolation under Soviet rule implied that there were little in terms of contacts, experiences, visions or civil society to build on.

1. To be compared with the Gross Domestic Product in USD per capita of e.g. Angola 340, Bangladesh 350, Vietnam 330. *Source:* The World Bank's World Development Report 1999/2000. *Source GDP Moldova:* Moldovan Economic Trends, Jan. 2000.

Moldova was ill prepared to take on the gigantic task of transforming the country into a modern Western economy and society on its own.

The establishment of democratic institutions was smooth. However, as a consequence of political vacillation, the restraining impact of the continued presence of Russian forces on Moldovan soil and the feeble support from the West, the reorientation of the economy and the country as a whole was not pursued with sufficient force. Instead, trade with the familiar partners in the former Soviet republics, in particular Russia, was gradually re-established. The lack of re-orientation of exports and of the country at large was both cause and effect of a failure to reconstruct the economy and to build a modern, competitive economic base. The high cost of this failure to re-orient the economy was brought home with full force as the financial collapse in Russia in 1998 dealt a second devastating blow to the reeling economy and public sector.

Following independence, Moldova was clearly in desperate need of technical and financial help to manage the fundamental transformation of the society, to rebuild the economy and re-orient it towards Western markets, and to soften the blow inflicted by the economic and fiscal collapse on the key social sectors. Yet, instead of assistance, it received short-term loans at high commercial rates of interest from the international community. Bilateral grant-based assistance emerged only slowly on the scene and fell far short of the needs.

As Moldova failed to cut public expenditures at pace with the collapse of revenues and meet specified reform targets, relations with the IMF and the World Bank deteriorated. Lending was discontinued in 1997 – the same year as Moldova much belatedly received IDA-status (and thus would have qualified for subsidised loans from the International Development Association within the World Bank Group). A year later, in the wake of the financial crisis in Russia, a sharp devaluation more than doubled the dollar-denominated foreign debt. At the same time, the short-term loans obtained from the West during the early years of independence, used largely to keep the public sector afloat and to fund basic social services began to fall due.

The shrinking economic base and the sharp devaluation, together with the harsh terms of the loans gave the debt service burden a truly monstrous proportion at a time when Moldova could afford it the least. Servicing the debt, primarily to the West, while suffering from the debilitating impact of the Russian crisis, implied a deathblow to the already much weakened publicly funded social sectors. As the provision of health care more or less collapsed, education became increasingly a privilege rather than a right and as the last threads of the social security net broke, Moldo-

va's destiny as an impoverished country, close to the heart of Europe – yet seemingly forgotten – seemed sealed.

The failure of the West to come to Moldova's rescue is all the more disheartening as there is convincing evidence from individual projects in Moldova, as well as from the support to the Baltic countries, that well-conceived and timely assistance to countries undergoing such dramatic and fundamental societal transformation can play a highly conducive role in shaping the transformation in the desired direction.

The present study is an attempt to chart and analyse Moldova's road to destitution. This is followed by a discussion of some of the conclusions and lessons that may be learnt from the experience. The study is directed towards all those who have a professional or personal interest in trying to understand what so rapidly has happened, and is happening, in the so-called 'backyard' of Europe, in a country at peace.

Preface

The present study is based on an earlier study, 'Twice Hit – Badly Wounded: The Devastating Cost of an Inadequate Transformation in Moldova', Sida, 1999. This revised edition is considerably shortened. It includes an updating of statistics and on recent developments. There is a certain shift of focus from the consequences of the collapse to its causes, and from detailed suggestions for assistance to a discussion on tentative lessons for future outside assistance.

Introduction

CHAPTER 1

Expectations were very high when the dramatic events of 1991 released Moldova from the Soviet Union. For the first time in modern history, the peoples of Moldova were masters in their own house, free to stake out their own future. They set about to create a market economy and a parliamentary democracy, which promised not only economic prosperity and political freedom, but also rapprochement with the West. By and large they embarked on this road with enthusiasm tempered with some anxiety, as the destination was difficult to visualise and the road ahead uncertain. They were coached and guided by an increasing number of international experts, who appeared to have a road map and prescribed the course ahead, backed up by promises of funding and support.

Almost ten years down the road it is clear that the road map was at best inadequate and that the so-called transition in most respects has been a failure. The quality of life for the vast majority of Moldovans is today much worse than it was under the Soviet Union. For the majority of the population basic needs for (and rights to) food, shelter, heating, basic health care and education are beyond reach and life has become a daily struggle to make ends meet against increasingly uneven odds and with no improvement in sight.

The main immediate factors behind the virtual collapse of the Moldovan economy have been two severe external shocks; the first resulting from the collapse of the former Soviet Union and the second in the wake of the financial collapse in Russia in the autumn of 1998. As a small, highly integrated part of the Soviet economy, but with little contact with the rest of the world, the Moldovan economy was predestined to suffer a severe blow as the Soviet Union imploded. Yet, although it was arguably in a worse position than most other republics in the former Soviet Union, it was hardly alone in this predicament. The Baltic countries, too, were

in an economic position not greatly dissimilar to that of Moldova on the eve of the collapse of the Soviet Union. Yet, their successful economic development after an initial, inevitable decline contrasts sharply with the disastrous decline of Moldova. One main factor behind this difference in development would seem to be the fact that the Baltic countries, in contrast to Moldova, have successfully detached their economies from those of the rest of the former Soviet Union, and of Russia in particular.

The economic shock resulting from the collapse of the Soviet Union took two main forms. First, shortly after independence Moldova suffered deterioration in its terms of trade equivalent to approximately 16 per cent of its Gross Domestic Product (GDP). The main cause of this was Moldova's complete dependence on imports for its energy needs (World Bank, 1994:6). The cost of energy imports increased from 1.4 billion roubles in 1991 to 40 billion roubles in 1992, equivalent to 55 per cent of the cost of all imports. In addition, almost all raw materials and inputs, apart from agricultural inputs, must be imported in Moldova. (In one year, 1992, the cost of gasoline and natural gas increased forty-fold and the cost of coal rose one hundred-fold.) (World Bank, 1994:65). Apart from creating an acute balance of payments problem, the price shock also had a severe depressive and inflationary effect on the domestic economy. A parallel may be drawn with the oil crisis in 1973, when a 'mere' threefold increase in oil prices was enough to derail the economies of Western Europe and push them into a long period of stagflation.

However, it was the long-term effects of the price increases of energy that proved to be most devastating. Although Moldova has virtually no energy sources of its own, the entire society had been constructed during the Soviet era on the assumption of unlimited access to virtually free energy. (In 1990 the energy intensity of GDP was 1.4 kilograms oil equivalent (koe) per USD, which, although lower than that of Russia and Ukraine, was still far above the average of 0.6 koe per USD for the OECD countries.) (World Bank, 1994:65-66). The shift to world market prices rendered almost the entire production technology and the associated physical capital and infrastructure (in agriculture as well as in industry) economically unviable in one blow. It also made the highly inefficient central heating,

Table 1. Development of real GDP

	1991	1992	1993	1994	1995	1996	1997	1998	1999
% change	-17.5	-11.9	-24.1	-31.1	-3.5	-8.0	1.3	-8.6	-4.4
Index: 1900=100	82.5	72.7	55.2	38.1	36.7	33.8	34.2	31.3	29.9

Sources: *Economic Trends Moldova* (1997:7); *Economic Trends Moldova*, November (1998c:4); IMF (1999:8); IMF (2000).

with the use of uninsulated underground pipes in urban areas, an unaffordable luxury and the cost of private heating of dwellings in rural areas beyond the means of most of the population.

Secondly, as a small economy highly integrated into the Soviet system, Moldova suffered a paralysing disruption of trade links and distribution channels, and lost both its main source of inputs and its market for outputs as the centrally planned economy of the Soviet Union imploded and disintegrated. The effect of this disruption of trade links was particularly severe for Moldova due to its very high degree of integration in the Soviet economy and almost complete isolation from the rest of the world. The civil war and *de facto* separation of the Transnistrian region from the rest of the republic further aggravated the problem, as much of the manufacturing is or was located in the breakaway region.²

Furthermore, the combined effect of the dramatic change in relative prices, that is primarily the increase in energy prices, and the disruption of trade links and distribution channels had a devastating effect on industrial production. The utilisation of the productive capacity for most areas and products fell to a small fraction. In many firms production stopped altogether. In the few fields where there has been a slight improvement in the past few years (such as wine producing and some other agro-processing), this has largely been achieved through a replacement of the previous production facilities by new ones – usually through an infusion of foreign technology and capital. However, such sunshine stories remain few and far apart.

The impact of the externally induced shock was amplified and sustained by a collapse of domestic demand, resulting from the sharp fall in real incomes. Thus, Moldova was caught in a vicious circle of falling demand and lack of growth impulses; a deep depression, which provided the worst possible base for the reconstruction and re-orientation of the economy which, in turn, was and remains fundamental to sustainable economic recovery. As the country reeled from the effects of the economic shock, the immediate momentum for drastic change was lost.

Short-term crisis management rather than strategic and long-term reform policies has dominated the political and economic agenda ever since the initial collapse. The ambivalent attitude towards fundamental reform of the Sangheli Government (1994-97) contributed to the patchy and slow implementation of reforms, as did the country's relative isolation from the

2. With only about 17 per cent of the population of Moldova, Transnistria accounted for more than a third of the total industrial input before independence. Nearly all the cotton textiles, power transformers and electrical machines were produced there as well as 90 per cent of the electricity generation.

West. Externally, the country vacillated in its political orientation, while emphasis was given to the re-establishment of traditional trade links with the Commonwealth of Independent States, *cis*³, rather than a fundamental re-orientation of the trade pattern.

The dangers inherent in the geographical imbalances in the trade pattern and the export dependence on Russia were brought into the open by the financial crisis in Russia in the autumn of 1998. The direct impact of the Russian crisis on Moldova's economy was extensive. It resulted in a severe drop in exports, a negative effect on the budget and a sharp increase in the external debt burden as the leu was depreciated. The modest growth achieved in 1997 was reversed. GDP fell by 8.6 per cent in 1998 as a direct consequence of the crisis and by another 4.4 per cent in 1999.

Today Moldova is in severe crisis. The acute expressions of this crisis are rapidly diminishing foreign trade and a negative trade balance, a crippling debt-service burden and a public sector on the brink of financial collapse. However, beyond these acute problems is a more fundamental crisis of disastrous economic decline and dramatically deteriorating living standards to the point where large parts of the population live in abject poverty. There is a virtual collapse of social security and health care, a serious erosion of the educational system and increasing mental and physical fatigue and a feeling of despondency among the population at large.

3. *cis*: the successor states of the Soviet Union, with the exception of the Baltic Countries.

Transformation of the Economy

CHAPTER 2

2.1 Agriculture

Agriculture and related activities form the cornerstone of Moldova's economy and provide the main source of livelihood for well over half the population. While Moldova has always been an agricultural country, the importance of this sector has increased considerably in the 1990s as other sectors of the economy have contracted sharply. The agricultural sector is of key importance to the future development of the economy, not least because demand-led growth will depend on improved conditions and incomes in agriculture.

Just as the rest of the economy, the agricultural sector has suffered substantial decline since independence. By 1999 total production had fallen to about 60 per cent of the 1991 level at constant prices (IMF, 1999:8). Rural incomes have plummeted to dismally low levels and the rural – urban income gap has widened. By the second quarter of 1999, average disposable income in rural areas had fallen to less than 10 USD per month and a quarter of the rural population earned too little to satisfy their most basic physiological needs for food, clothing and shelter (Economic Trends Moldova, 1999b:26, 100).

The agricultural sector experienced a dramatic deterioration in its terms of trade shortly after independence, as prices for energy and energy-intensive inputs such as fertilisers increased many times more than the prices of agricultural produce. It has also suffered from a sharp contraction of both the external and the domestic market. The former, which had begun to pick up in the mid-1990s, suffered a new and devastating blow as the Russian market all but collapsed in the autumn of 1998.

The sharp deterioration in the terms of trade resulted in a deadly blow to the traditional mode of capital and energy-intensive large-scale social-

ist farming, and consequently to the large collective and state farms. A transformation of agricultural production towards small-scale labour-intensive farming became not only ideologically desirable, but also economically imperative in order to restore agriculture on a commercially viable footing. Major steps towards decollectivisation had begun as early as 1991, but this process ground to a halt a few years later as the Parliament and Government put in place after the 1994 elections had strong vested interests in retaining the status quo. Official support for the privatisation of agriculture by the Sangheli Government contrasted sharply to the numerous bureaucratic and administrative obstacles to this process.⁴ Several of these obstacles were clearly unconstitutional and some were removed by order of the Constitutional Court in January 1996.⁵ Yet, the political attitude towards decollectivisation remained hostile and individual farmers who attempted to break out of the kolhozes in order to set up their own farms encountered numerous and often insurmountable obstacles. The situation changed for the better after the installation of the Ciubuc Government in early 1997, but it was only after the Parliamentary elections in March 1998 that the political climate changed decisively in favour of privatisation of agriculture. Since then, decollectivisation and the establishment of small-scale private farms have proceeded at an impressive pace and are approaching completion.

Decollectivisation is carried out in two stages. The first involves the transformation of the kolhozes and sovchozes into various forms of joint stock companies or limited liability firms. In the course of this process, the individual members receive land shares and value shares in the newly formed company and the right to vote on the management of the farm/company as part owners. This process was more or less completed by 1998. However, this external reorganisation was only seldom accompanied by any internal restructuring of the farms. A World Bank survey in 1998 showed that over 70 per cent of the farms had retained the old central management structure (World Bank, 1998a:37-43).

The second, decisive stage is when individuals or groups of farmers demand to receive their land and asset shares and leave the enterprise-farm in order to set up their own farms.⁶ This phase did not commence in earnest until early 1998, but has since progressed at an impressive pace. Just one year later, by the summer of 1999, all but 64 of the 961 former

4. Thus, the minimum size for new private farms were set at 100 (sic!) hectares, exit from collective farms was possible only between November and March and potential private farmers had to produce an official certificate that they were duly qualified in order to register as head of farms.

5. Constitutional Court Ruling on the Law of Amendments to the Land Code of January 25, 1996.

6. For details on the mechanisms involved, see World Bank (1998a) or IMF (1999).

state and collective farms in Moldova were participating in the privatisation programme and half of them had already been transformed into privately owned farms (IMF, 1999:73). By mid-July some 500,000 land titles had already distributed to the new landowners, which must be considered a remarkable achievement by any standard.⁷

Yet, bureaucratic hurdles apart, the actual distribution of land and value shares is far from straightforward. The average land share is only 1.5 hectares, divided into four to six plots of orchards, vineyards, gardens and arable land. Distribution of the asset shares is even more difficult, as most of the physical assets are indivisible. Stories of individual farmers who have received a spare wheel for a tractor as their asset share abound, but more often than not farmers voluntarily form groups in order to overcome the problem of indivisibility of machinery and other physical assets. Another problem has been the severe indebtedness of most of the collective and state farms, which in many cases made the net value of the farm negative. However, a law on farm debt restructuring, passed by the Parliament in 1999, went a long way to remove indebtedness as an obstacle to privatisation.

Most collective farms have run constant losses in the last few years and have become deeply indebted. Fully 80 per cent of the large farm enterprises surveyed by the World Bank in 1997 operated at a loss in 1996 and 95 per cent reported arrears in wage payments (World Bank 1998a:54). By January 1999, their total debt amounted to two billion lei or 20 per cent of GDP. Tax arrears and arrears in payments to the social fund made up approximately 40 per cent of the debt. There were also large arrears in wage payments and defaults on credits from private institutions (IMF, 1999:76).

Deplorable and deteriorating living standards and little prospects of any improvement for members and workers on farm enterprises relentlessly and remorselessly pushed the privatisation process forward. Some 84 per cent of the member/employees on the farm enterprises surveyed by the World Bank had suffered a fall in living standards in the past few years and an equally high proportion did not believe that the coming year would bring any improvement (World Bank, 1998a:xix). Almost 40 per cent stated that they lived below subsistence level. Among those who desired to set up their own private farms, push factors provided a stronger incentive than pull factors. Thus, 59 per cent desired to set up an independent farm because the farm enterprise did not ensure a minimum standard of living, while only 32 per cent stated 'independence from boss-

7. A Sida supported cadastre project would seem to have played an important role in this success.

es', 20 per cent 'personal fulfilment' and 14 per cent 'increased prestige and respect' as main reasons. The main deterrents to breaking out of the farm enterprise among those who had no plans to do so were 'shortage of capital' (52 per cent), 'difficulties with purchase of farm inputs' (48 per cent) and 'unwillingness to assume the risk involved' (33 per cent).

2.1.1 Development of Agricultural Production

The rather disappointing development of agricultural production in the 1990s should be seen against the severe external shocks that have afflicted this sector and the fundamental transformation from large-scale collective farming to small-scale private farming.

Overall crop production fell by over a quarter between 1991 and 1998. A more detailed analysis of production trends in physical terms yields a somewhat mixed picture. Cereals and sugar beet production would appear to have fared best, as both output and yields for these crops have declined only slightly. However, within the umbrella category of cereals, there has been a shift from mechanised crops such as wheat and peas to maize, which not only tends to give higher yields but is also more amenable to unmechanised cultivation. By contrast, production of high value crops such as vegetables, tobacco and grapes has fallen quite sharply, primarily as a result of declining yields.

The declining production should be seen in the context of the very sharp reduction in the use of cash inputs in agriculture. Fertiliser use has fallen from 184 kilograms per hectare in 1985 to virtually zero in 1997 (Table 2). The use of pesticides has registered a similarly dramatic decline from very high levels to close to nothing. Seen in this context, and in the light of the sharp fall in mechanised farming and problems of marketing, the declining yields and production levels are hardly surprising. Indeed, it may come as a surprise that the falls have not been more drastic.

Table 2. Fertiliser use in agriculture

	1985	1990	1995	1996	1997
<i>Chemical fertilisers</i>					
Total use, 1000 tonnes	304.4	217.1	11.2	13.5	10.1
Kg/hectare	184	136	9	11	9
<i>Manure</i>					
Total use, 1000 tonnes	9.8	9.7	1.5	0.8	0.3
Kg/hectare	5.5	5.6	1.2	0.6	0.2

Source: Republica Moldova in Cifre (1998:205).

Remark: Figures for 1995, 1996 and 1997 exclude Transnistria.

It should be noted that one unintended benefit from the cessation of use of fertilisers and pesticides is that agriculture has become environmentally friendly. This is an important benefit that the country should be able to exploit commercially, not least for export purposes. A common conclusion drawn by outside 'experts' visiting Moldova is that the country, by virtue of its high labour/land ratio and low labour costs, has a strong comparative advantage in the production of biologically cultivated high value crops, (such as fruits and vegetables), in natural or processed form and that it might be worthwhile to try to develop this as an export niche.

Animal production has declined much more sharply than crop production. Meat and milk production had fallen by 1997 to little more than a third of their levels in 1990, while production of eggs had fallen by approximately fifty per cent (Economic Trends Moldova, 1998b:84; Republica Moldova in Cifre, 1998:205). The fall in production is in most instances the result of both declining productivity (yield per animal) and a fall in the animal stock. Thus, the cattle stock (excluding milk cows) had fallen to half its 1990 level by 1997 and the number of hogs had fallen to little more than 40 per cent. Poultry, too, has fallen to approximately half the 1990 level, while the decline in milk cows has been somewhat less drastic.

The decline up to 1997 was almost entirely confined to the large-scale farm enterprises, i.e. the former kolhozes and sovchozes. Private, small-scale production has actually increased, particularly of milk. The overall decline can largely be attributed to the near collapse of the external market and the very sharp contraction of the domestic market resulting from the dramatic fall in incomes and meat consumption. The virtual collapse of large-scale industrial meat production on the former kolhozes and sovchozes is in line with the situation elsewhere in the former socialist countries. As fodder and energy are charged at full cost, this type of production almost invariably becomes economically unviable.

2.1.2 The New Private Sector and the Road Ahead

Seen from the bird's eye perspective of planners and outside experts, the transition from large-scale collective farming to small-scale private farming invariably seems very messy. It inevitably results in severe mismatches of access to production factors such as land, labour and capital at the level of the newly established farms. It also results in mismatches between the needs of the new small units to have access to inputs, markets and other services and the ability of the existing structures, typically dominated by large state monopolies, to serve these needs. There are also the

practical problems of land demarcation and issuing of land titles, although progress in this field has been remarkable in Moldova. Yet, the experience from other countries in the region that have gone through this process shows that these dislocations and problems tend to be temporary and that, given a conducive economic and institutional environment, they are gradually solved. This is likely to be the case also in Moldova. A positive factor in Moldova is that the transformation as such would not appear to result in production losses, largely because of the deplorable state of the large-scale farms. On the negative side may be noted that the majority of the farming population appear to be pushed rather than pulled towards private farming.

While it is too early to make any detailed analysis of the emerging private agricultural sector, some tentative features may be gleaned from the World Bank survey in 1997.

The average size of the surveyed farms was found to be 3.8 hectares and the median size 2.4 hectares. Some 35 per cent of the farms had only 1-2 hectares, while about 45 per cent had between 2 and 5 hectares of land. The land of most of the farms was divided into three to six plots. The average number of persons working on a private farm was reported to be 2.7 and the average labour/land ratio was 1.2 workers per hectare. As might be expected, the labour/land ratio falls with the size of the farm. By comparison, it may be noted that the large-scale farm enterprises on average employed a mere 0.3 workers per hectare. Thus, the private farms do not only yield higher incomes per worker, but are also much more labour-intensive than the large farm enterprises. This is an important observation at a time when agriculture is called upon to serve as an employment buffer and absorb large amounts of labour made redundant in the non-agricultural sectors.

Most farms reported diversified crop-livestock operations. Over 95 per cent of the farmers produced crops and nearly 90 per cent produced livestock. Half of the farmers produced between six and ten different products and 85 per cent produced more than five products. Compared to the large farm enterprises, the small farms tend to produce less feed crops and industrial crops. The farms are also diversified in other respects. Only 53 per cent of working age members of the farm household worked full-time on the farm, while 17 per cent had non-farming jobs and 10 per cent worked on local farm enterprises. Yet, non-farm incomes accounted for a mere 20 per cent of the total household income.

Although the bulk of the production was consumed on the farm, some 80 per cent of the farmers sold at least some of their output. However, the amounts sold tended to be rather small; on average a mere quarter

of the total production. Only one-tenth of the farmers reported that they sold more than half of their production. Most of the sales took place at nearby markets or directly to consumers. Low prices were seen as a main obstacle to commercialisation of the produce, but some 29 per cent also found it difficult to find buyers and a quarter complained of difficulties with transportation. For key crops, such as vegetables and grapes, transport problems were much more common.

Approximately half of the farms stated that they had access to farm machinery, most commonly a tractor. In the overwhelming number of cases, the machinery was jointly owned with other farmers. More or less formal associations of farmers are common. Some 30 per cent of the farmers reported that they were members of associations. Most members of associations managed their farms through a combination of individual and collective arrangements. Thus, cultivation of land, purchase of inputs and marketing was more often than not undertaken on a joint or combined joint and individual basis. Even outside the framework of formal associations there is widespread collaboration between farmers. The vast majority of all farmers belong to machinery pools. A large proportion of the farmers also reported co-operation in production, processing, product sales and input purchasing.

Thus, by and large the picture of small-scale private farming that emerges is quite positive. Although most farms are small, few are minuscule. The capacity of this sector to productively absorb labour is vastly superior to that of the large farm enterprises. Despite being highly labour-intensive, it yields comparatively high incomes per worker. Most of the farmers produce a highly diversified portfolio of products. The strategy is clearly to produce primarily for own consumption and to sell the surplus, rather than producing primarily for the market. This risk-adverse strategy is easily explicable by the highly uncertain market conditions facing the farmers. Problems of mismatches of access to labour, capital and land at the farm level and of a lack of scale economies are to a large degree solved through collaboration with other farmers, either informally or within the frame of formal associations.

The ongoing process of privatisation is clearly contributing to solving the problems in agriculture rather than aggravating them, not only in the long term, but also in the short term. The Achilles' heel for the emerging private agricultural sector, just as for the agricultural sector in general, is that of access to markets. For the emerging private agricultural sector to flourish and develop from being subsistence-based to becoming commercially oriented, new markets will need to be found and penetrated, not only within Moldova, but primarily abroad. The near col-

lapse of the Russian market makes this problem particularly acute.

Moldova produces a large surplus of agricultural products, and a very large share of Moldova's agricultural production is destined for exports. Half of the previous large farm enterprises had direct export channels, primarily to Russia and other countries in the Commonwealth of Independent States, CIS. As the large farm enterprises are dissolved most of their direct export links are also likely to disappear. Entirely new export structures and channels, catering to the small private farms, need to be created. It is logical and desirable that this rebuilding of agricultural export channels should be combined with a geographical diversification of the exports and a reduction in the dependence on exports to the Russian market.

2.2 The Industrial Sector

The restructuring of the industrial sector is taking place in the context of a virtual collapse. The break-up of the Soviet Union had an immediate impact on industrial production, which fell by more than a third between 1990 and 1992 (Table 3). A further fall was registered in 1994 and after several years of fairly stable, but low, levels of production, there was yet another decline in 1998 of 11 per cent, largely as a consequence of the Russian crisis.

Much of the industrial decline in the early years of independence was no doubt inevitable. The Moldovan industry was very closely integrated in the Soviet economy. Apart from agro-processing, much of Moldova's industry consisted of highly specialised component manufacturing for industry elsewhere in the Soviet Union. The plants were invariably designed with the Soviet rather than the Moldovan market in view and many were entirely dependent on their supply of inputs from outside Moldova as well as markets for their outputs in the other republics. Thus, the collapse of the Soviet economy had an extremely disruptive effect, which was aggravated by the fact that, under central planning, vertical linkages via plan-

Table 3. Development of GDP and of industrial production. Index: 1990 = 100.

	1990	1992	1993	1994	1995	1996	1997	1998
GDP	100	72.7	55.2	38.1	36.7	33.8	34.2	31.3
Industrial output	100	64	64	47	45	42	42	37

Sources: *Annuaral Statistics 1996* (1997:288); *Republica Moldova in Cifre*. (1998:78); IMF (1999:88).

Remark: Excluding Transnistria.

ning authorities in Moscow were the norm and direct horizontal linkages between economic agents were poorly developed and generally discouraged. The civil war in Transnistria and the *de facto* separation of that part of the country, which had much of the industrial base, further added to the economic dislocation.

The industrial plants constructed during the Soviet era were not only designed with the entire Soviet market in view, but also on the assumption that energy and other raw materials carried little or no cost. The focus on the size of production rather than on the cost of production resulted in technologies that were highly energy-intensive and generally wasteful. Thus, even in cases where market channels to the former Soviet Union could be re-established, the enterprises were no longer viable because of dramatically increased costs of energy and other raw materials.

The decline has not affected all sectors evenly. Broadly speaking, food processing fared better than most other industries, at least until the Russian crisis in 1998. This is hardly surprising considering the abundance of locally available raw material and the good reputation of Moldovan food products throughout the former Soviet Union. Most other industries have fared very badly and production has typically fallen to a third or less of the level in 1992. Yet, for food processing too, the picture has been mixed. Only core areas like fruit and vegetable production and wine production show a relatively positive development. However, the seemingly positive development of the wine industry should be seen in the light of the fact that production was very depressed in the early 1990s as a consequence of Gorbachov's temperance campaign.

Table 4. Development of industrial production by sectors. Index: 1992 = 100.

	1993	1994	1995	1996	1997	1998
Food processing	106	80	84	76	74	68
– meat processing	60	37	35	34	27	n.d.
– fruit and vegetable	130	90	88	69	103	n.d.
– wine production	130	112	141	131	143	n.d.
Tobacco	102	95	71	79	75	n.d.
Textiles	81	47	24	24	20	15
Garments	81	46	40	39	36	39
Chemical industry	73	44	24	17	14	13
Engineering and metal processing	112	71	55	44	35	29
All sectors	100	73	70	65	65	58

Source: Republica Moldova in Cifre. (1998:178-181); IMF (1999:85).

Table 5. Utilisation of productive capacity in manufacturing 1994 and 1996.
Percentages.

Product	1994	1996
Agricultural machinery, excl. tractors	25.3	3.0
Televisions	45.5	6.4
Refrigerators	20.9	1.0
Cement	3.4	3.5
Non-metallic building materials	20.6	14.2
Knitwear	15.5	20.6
Salami and other processed meat	20.3	17.7
Canned fruit and vegetables	33.2	28.8
Wine	12.7	20.9
Cigarettes	83.3	91.7
Fodder	13.6	18.1

Source: *Anuarul Statistic 1996* (1997: 286-288).

The decline in production is also reflected in the very low degree of capacity utilisation in the existing plants (Table 5). For most products, it is well below a quarter. It is noteworthy that even for core industries, such as wine production and canning of fruit and vegetables, it is below 30 per cent. This reflects not only the decline of production in recent years, but also the fact that there was considerable over-capacity to start with. While the huge under-utilisation of productive capacity reflects a sharp decline in production and an immense destruction of physical capital, it should not be seen as an indicator of a potential to increase production. Most plants would need to completely revamp their technology in order to become economically viable again.

Rather more worrying than the decline of industry after independence is the very slow recovery. Given the need to rebuild industrial capacity virtually from scratch, a rapid recovery was clearly not to be expected. Yet, re-industrialisation in the form of new enterprise development, foreign direct investment and re-technologisation of existing plants has so far been painfully slow.

2.2.1 Privatisation

Large-scale privatisation began in 1993 with the distribution of patrimonial bonds (vouchers) to all citizens, supplemented by additional bonds based on their employment record. The bonds could be used for acquir-

ing shares. In addition, small units were sold through auctions or by tender for cash or patrimonial bonds. Between 1993 and 1998 some 1,364 small and medium-sized enterprises were auctioned in this manner (Economic Trends Moldova, 1999b:50). In retrospect, the large-scale privatisation by means of voucher distribution, though well intended, was not very successful. The ownership of the enterprises was dispersed among a huge number of patrimonial bond owners, who were neither capable of providing funds for the re-technologisation of the enterprises, nor to ensure effective ownership.

In recent years there has been a shift in focus towards privatisation for cash through tender. However, the results have so far been rather disappointing, despite the introduction in 1998 of more favourable conditions for potential buyers, including instalment plans for domestic buyers and so-called investment tenders (whereby the buyer can purchase the object at a reduced price in return for promises to invest in it). Total revenues have consistently been below target and have averaged 75 to 100 million lei per year. The privatisation of some major objects, such as Moldtelecom, has been achieved, but many enterprises in key sectors such as food processing and energy have proved hard to privatise. Huge arrears and obsolete equipment, together with a perceived lack of economic stability, have deterred potential investors. However, vested interests against the transparent privatisation of lucrative enterprises, for instance in the wine sector, have also slowed down privatisation and serve as a source of friction with the IMF and the World Bank.

Still, a main impediment to the privatisation of industrial enterprises has been the very poor economic, financial and managerial state of most of the units. Partly in order to address this problem, an Agency for Enterprise Restructuring and Assistance (ARIA) was established with support from the World Bank in 1996 to help sanitise enterprises financially, restructure them and strengthen their management structures in order to facilitate effective privatisation. Over the past few years ARIA has assisted in the restructuring of more than 70 enterprises. The restructuring is supported financially by the World Bank, TACIS⁸, USAID and the European Bank for Reconstruction and Development, EBRD. This approach has been successful and has gained in importance. Meanwhile, ARIA has developed into a large consultancy organisation with some 200 professionals.

8. The European Union's programme for technical support to the Commonwealth of Independent States.

Foreign direct investment (FDI) has begun to increase in recent years, although the volume is still comparatively modest. Thus, by October 1998 there were 1,532 enterprises with foreign capital in the republic, some 370 units more than a year earlier. The accumulated FDI amounted to 237 million USD. Most of the FDI (70 per cent) are joint ventures with a mixture of local and foreign capital. The largest investments have come from Russia, the United States, Germany and Ireland.

The FDI displays a very diverse character. Major investments in agro-processing and winemaking by reputable western firms are included as well as, mainly Russian, small-scale investments in retail outlets and restaurants. The latter sell primarily imported products and account for the very large share of foreign-owned enterprises in total imports.

Despite the rather modest levels of FDI to date, the impact on the economy is already noticeable. Thus, by October 1998 FDI employed some 18,000 people and accounted for about ten per cent of industrial production. FDI accounted for 28 per cent of total exports, mainly to the CIS countries, as well as for a large share of imports. Most of the FDI has gone into manufacturing (mainly agro-processing), the energy sectors and the wholesale and retail trade. Most of the investments are concentrated to Chisinau, which in 1998 accounted for approximately three quarters of the manufacturing output of the foreign-capital enterprises. Outside Chisinau, enterprises with foreign capital are mainly found in Causeni, Hincesti, Soroca and Balti.⁹

Detailed statistics on the development of small and medium-sized enterprises are unfortunately not available. In the beginning of 1998 there were 14,377 small-scale private enterprises, with a total labour force of 110,500 and a turnover of 7,568 million lei (*sic!*) in 1997.¹⁰ Of these 743 were partly or fully foreign-owned. Despite the relatively small number, this sector is clearly emerging as a force to be reckoned with in terms of employment. By comparison, the large and medium-scale industrial enterprises employed only 142,300 people in 1997.

The emerging small and medium scale enterprises face a rather hostile environment. Some of the main problems they confront are:

- bureaucratic and cumbersome registration procedures.
- frequent administrative controls and often predatory behaviour by local officials.
- involuntary payment to criminal groups, so-called *roofs*

9. Infotag, February 5, 1999.

10. Republica Moldova in *Cifre* (1998:139). The figure refers to juridical entities registered with the authorities.

(*acoperisuri*), which often act in conjunction with individual representatives of the authorities.

- shortage of starting capital and a poorly functioning banking sector.
- lack of market information and of management skills.
- high taxes and unfair competition from informal sector activities that do not pay taxes.

The conversion of previous large state enterprises into industrial campuses for small and medium-sized enterprises has proved to be a most successful way of promoting the development of new enterprises. The most spectacular case is probably the conversion of ALFA, a huge plant manufacturing TV sets and military radio equipment, into the home of some 70 new small enterprises. This plant, which covered an area of 29 hectares (*sic!*) and had some 5,000 employees, faced bankruptcy soon after independence as the market for its products completely disappeared. Rather than being written off as a complete loss, it was restructured with help from ARIA into an industrial park. Most of the owners of the new small enterprises residing there are previous employees of ALFA, who benefit from access to the existing physical infrastructure, from agglomeration advantages from being grouped together, as well as from access to consultancy services.

This case is not unique. ALFA has assisted with similar restructuring elsewhere and there are also examples where local authorities have attempted to solve the problems of mounting unemployment and huge defunct state enterprises in a similar manner. A case in point can be found in Causeni, where four joint ventures have been created producing a respectable output of 15 million lei, mainly for export, in 1998. In this case, the foreign partners contributed machinery and know-how, while the local partner provided the physical facilities.

The establishment of industrial parks for small-scale enterprises is a well-tested method of promoting enterprise development in many parts of the world. It would appear to have particular advantages in Moldova, where the need for an incubator environment and for agglomeration economies is especially large.

2.2.2 Rural Enterprises

Although detailed statistics are lacking, it is clear that development of small new enterprises has so far primarily been concentrated to the large cities. This is hardly surprising. Purchasing power in rural areas is very low and, more important, the *kolhozes* and *sovchozes* have traditionally catered to the needs of the rural population for non-farm goods and ser-

vices, as well as for non-farm employment opportunities. Under the system of large-scale farming there were, in Moldova as elsewhere, few local backward and forward linkages to agriculture, while those that existed were integrated within the collective farm complex.

The privatisation of agriculture creates entirely new and much improved conditions for the development of small-scale non-farm enterprises in rural areas and small towns. Small-scale private farmers need access to a whole range of upstream and downstream non-farm services in order to develop and prosper at the same time as they create new and much more conducive conditions for the development of such activities. Indeed, a mutually enforcing development of agriculture and local non-farm activities offers the best prospect for forceful and sustainable economic development in the countryside. Increased productivity and income in agriculture, resulting from successful privatisation, would create demand for non-farm services and products, resulting in increased non-farm employment and incomes. This in turn would permit a transfer of surplus labour from agriculture to local non-farm employment, as well as an increase in the demand for agricultural products, further raising labour productivity and incomes in agriculture. This suggests that, outside the large cities, it is important to take a holistic view and to see privatisation of agriculture and the development of non-farm small-scale enterprises in one context.

2.3 The Energy Sector: An Achilles' Heel

Energy is an Achilles' heel in Moldova's economy. The country entirely lacks domestic sources of energy, yet the whole economy was based on the assumption that energy was freely available at little or no cost. As discussed above, the introduction of world market prices for energy after independence undermined the viability of the entire economic infrastructure. Furthermore, Moldova lacked the means to pay for imports of energy that suddenly cost many times more than in the past.

Consumption of energy has fallen dramatically. By 1996 it stood at a mere third of the level in 1990 (Table 6). Since then it has fallen even further. At first sight this sharp reduction seems to suggest that Moldova has been highly successful in energy conservation. However, this is unfortunately hardly the case. The decline in energy consumption matches the decline in GDP. Thus, the very high energy consumption per unit of GDP produced before independence has hardly changed at all. Energy conservation requires large investments in new production technologies, insulated houses, more efficient heating systems, better transmission systems of elec-

Table 6. Energy balance 1999–1996. Thousand tonnes of standard fuel equivalent.

	1990	1994	1995	1996
Resources total	16,854	4,671	5,220	4,833
– domestic	151	68	111	113
– import	16,703	4,603	5,109	4,720
Use total	16,718	4,722	5,130	5,046
– domestic	14,269	4,636	5,085	5,045
– export	2,449	86	45	1

Source: *Anuarul Statistic 1996* (1997:302).

Remark: Figures for 1994 to 1996 exclude Transnistria.

tricity etc. Such investments have not been made for lack of resources. It is true that the nascent private agriculture and the new enterprises that are slowly emerging bring with them more energy efficient technology and that future economic growth will not be accompanied by any commensurate increases in energy consumption. However, large investments will also be required within the energy sector itself to reduce waste.

The entire energy sector has become an economic and financial morass. Inability or unwillingness among consumers to pay for energy, generally soft budget constraints, and lack of incentives, professional management and investments has made the energy sector a riddle of debts owed by consumers as well as by the energy companies to the, primarily Russian and Ukrainian, suppliers. The lack of transparency and a predominance of barter deals have also provided a breeding ground for unsavoury business practices and fraud.

The case of the electricity sector may be used to exemplify the situation. In 1998 Moldova consumed 4,366 million kWh of electricity, i.e. a third of the level in 1990 (Table 7). Of this, approximately 1,120 million kWh, i.e. 26 per cent, was lost through theft or technical losses (Infotag, January 29, 1999). The absolute amount of losses is in line with those of previous years, although it should be noted that, despite a decline in total electricity consumption of 65 per cent since 1990, transmission losses and theft have not declined at all and have increased in relative terms from less than ten per cent in 1990, to two and half times as much in 1998. In 1998 some 15,200 reports of theft were made, totalling 80 million lei, yet only six million was recovered.

However, even when the electricity reaches its intended consumers, payment is far from assured and arrears are chronic. The largest arrears are owed by the agro-industrial sector and by the public sector. Overdue

Table 7. Domestic electricity use 1990–1996. Million kWh.

	1970	1980	1990	1996	1998
Total consumption	3800,5	8,447.7	12,647.2	5,333.4	4,366
– industry	1,602.8	3,430.6	5,219.9	1,059.8	n.a.
– agriculture	933.0	2,004.7	3,372.6	1,363.4	n.a.
– transport	82.6	287.3	256.8	107.1	n.a.
– other branches/sectors	703.2	1,557.5	2,576.6	1,566.4	n.a.
– transmission losses & theft	478.9	1,167.6	1,221.3	1,236.7	1,120

Source: *Annual Statistic 1996*. (1997:302); Infotag, January 29, 1999.

Remark: Figures for 1994 to 1998 exclude Transnistria. Figures for 1998 are preliminary.

payments from the central and local budgets alone amounted to 68.3 million lei by the end of 1998. To add to the financial woes, when payment is eventually received it is more often than not in kind. Only 26 per cent of the payments received in 1998 were in the form of cash. The disastrous liquidity of the electricity companies resulting from the poor enforcement of payments is transferred to the producers of energy. Thus, by the end of 1998, the national energy sector owed 218 million lei to Ukraine and 203 million lei to the Moldavskaya plant in Transnistria. Periodic curtailment and stoppages in the supply of electricity are used by the Ukraine suppliers in particular, to enforce payment.

The situation in the other energy sectors, such as gas and thermal energy, is broadly similar to that in the electricity sector. The debt owed to Gazprom has become legendary.

The entire energy sector is presently being de-monopolised and privatised. These steps are no doubt necessary. In order to clear up the present morass of debt and inefficiencies, firm financial discipline and accountability must be enforced. However, while necessary to solve the problems in the energy sector, it will hardly be enough.

Firstly, in order to charge for consumption it is necessary to be able to measure it. In the household sector there are virtually no meters for gas and thermal energy consumption and the electric meters leave a lot to be desired. In the end it is the consumers who suffer, as the accumulated cost including theft and transmission losses is passed on to the final consumers and thus thrifty consumers share the cost of the waste of their neighbours. Yet, the installation of meters at the point of consumption is expensive.

Secondly, and more important, most households in Moldova can no longer afford to pay for their basic energy needs. The average cost of basic heating and electricity for a 30–50 square metre apartment is 25–30 USD

per month.¹¹ This amount should be compared with the average disposable income of 11.8 USD (127 lei) per person (15.3 USD in urban areas), and the 2.4 USD per month that the average urban dweller currently spends on rent and utilities.¹² In other words, the cost of basic heating and electricity alone would amount to almost the entire disposable income of an average household of three persons, which is clearly an impossible level. The situation in the rural areas is hardly better. Lack of forests (only 9 per cent of the land surface is forested) means that there is precious little fuel wood and most rural households depend entirely on commercial sources of energy.

The stark dilemma is that, due to climatic conditions, heating is a physiological necessity during a large part of the year, yet a very large proportion of the population lack the means to afford it. So far, the soft budget constraints and lax financial discipline among the energy enterprises have saved the country and the population from facing this dilemma, as payments have not been very strictly enforced. As financial discipline and hard budget constraints are enforced on the energy sector this will change. In order to protect the population against cold, the energy consumption of the vulnerable groups will have to be subsidised. The alternative would be nothing short of disastrous in human terms. Yet, at the present time neither the mechanisms, nor the budgetary scope for doing this exist.

11. Hot water supply is so rare as to hardly be of any consequence.

12. *Economic Trends Moldova*. (1999b:26-27).

External Imbalances

CHAPTER 3

3.1 Foreign Trade

On the eve of independence, Moldova was highly integrated in the Soviet economy. Some 95 per cent of its exports and 82 per cent of its imports were oriented towards the other Soviet republics, while trade outside the Soviet Union was minuscule. The disruption of the traditional trade links with the rest of the Soviet Union was a main factor behind the virtual collapse of the Moldovan economy in the wake of independence.

As a small open economy lacking in energy and other natural resources, Moldova is by necessity heavily dependent on trade. After independence Moldova faced the formidable, but crucial task of re-orienting and developing its trade relations in tune with the new geopolitical and economic realities. After almost a decade of independence it may be concluded that much too little has been done to meet this challenge. As a consequence, Moldova's external sector is in severe imbalance and the country's continued very heavy trade dependence on the CIS market in general and on Russia in particular, makes it extremely vulnerable to external shocks, as the recent financial crisis in Russia has shown.

During the years leading up to the financial crisis in Russia, Moldova's external trade developed three basic imbalances:

- A rapidly increasing overall trade deficit.
- A strong and accentuated geographical imbalance in the trade patterns.
- An increasing share of agricultural products in exports, from an already high level.

The trade deficit increased from 95 million USD in 1995 to 293 million USD in 1997, to 392 million USD in 1998 (Table 8). This increase took place

within the frame of a contracting economy and as a consequence the trade deficit as a proportion of GDP increased from 6.6 per cent in 1995 to an untenable 24 per cent in 1998 (Table 10). The very large trade deficit in 1998 was partly due to the near collapse of exports to Russia in the wake of the Russian financial crisis, but the trade deficit had reached alarming levels even before this crisis.

The deterioration of the trade balance was accompanied by increasing geographical imbalances in the trade pattern. The share of exports to the CIS countries actually increased from 63 per cent in 1995 to 70 per cent in 1997. It reached a peak of 76 per cent during the first half of 1998, before the onslaught of the Russian financial crisis (Table 9). This increase

Table 8. Geographical structure of foreign trade. Million USD.

	1995	1996	1997	1998	1999	Sept.– Dec. 97	Sept.– Dec. 98
EXPORT							
Total	745.5	801.6	879.6	632.1	471.4	348.1	168.0
CIS	466.9	546.1	612.5	429.1	256.2	213.6	76.1
– of which Russia	360.1	430.1	509.8	336.8	191.7	178.3	51.2
Non-CIS	278.6	255.5	267.1	203.0	215.2	134.5	91.9
– East Central Europe	158.7	132.4	95.7	80.5	82.8	n.a.	n.a.
– European Union	86.2	78.3	90.4	82.9	98.4	n.a.	n.a.
IMPORT							
Total	840.7	1,079.2	1,172.4	1023.7	567.9	427.5	259.6
CIS	568.9	664.1	612.4	440.2	221.0	210.7	120.8
– of which Russia	278.0	295.3	305.1	233.0	118.2	106.6	55.4
Non-CIS	271.8	415.1	560.0	583.5	346.9	216.8	138.8
– East Central Europe	120.4	179.5	240.9	214.8	142.7	n.a.	n.a.
– European Union	115.2	162.6	227.2	281.2	156.4	n.a.	n.a.
TRADE BALANCE							
Total	–95.2	–277.6	–292.8	–391.6	–96.5	–79.4	–91.6
CIS	–102.0	–118.0	0.5	–11.1	35.2	2.9	–44.7
– of which Russia	82.1	134.8	204.7	103.8	73.5	71.7	–4.2
Non-CIS	6.8	–159.6	–292.9	–380.5	–131.7	–82.3	–46.9
East Central Europe	38.4	–47.1	–145.2	–134.3	–59.9	n.a.	n.a.
European Union	–29.0	–84.3	–137.3	–198.3	–58.0	n.a.	n.a.

Sources: *Tendinte in economia Moldovei*. (1998:46); *Economic Trends Moldova* (2000:42).

was entirely due to increased exports to Russia and during the first half of 1998 alone, Russia accounted for 62 per cent of Moldova's exports, up from 48 per cent in 1997.

Meanwhile, exports outside Russia and CIS registered a dismal development. Exports to the European Union stagnated to a very low level of approximately 85 million USD per year, while exports to Eastern and Central Europe fell sharply. Taken together, exports outside the CIS fell from 279 million USD to 203 million USD, or by 27 per cent, between 1995 and 1998, while total exports outside Russia fell by 22 per cent (Table 8).

The increasing export dependence on Russia has been accompanied by a reduced diversification of the product mix. As the industrial sector all but collapsed, the share of agricultural products in total exports increased from 41 per cent in 1993 to 72 per cent in 1997 and 1998 (Economic Trends Moldova, 1999b). Wine and other alcoholic beverages produced from grapes accounted alone for 30 per cent of the exports in the latter year. The CIS markets, and Russia in particular, have been the recipients of the overwhelming part of the agricultural exports, reflecting a failure to penetrate the European markets.

By contrast, the geographical distribution of imports has been considerably diversified since independence. The share of imports from CIS countries fell from 68 per cent in 1995, to 52 per cent in 1997 and to 43

Table 9. Geographical distribution of trade. Percentages.

	1995	1996	1997	1998	1999	Sept. – Dec. 97	Sept. – Dec. 98
EXPORT							
CIS	62.6	68.1	69.6	67.9	54.3	61.4	45.3
– of which Russia	48.3	53.7	58.0	53.3	40.7	51.2	30.5
Non-CIS	37.4	31.9	30.4	32.1	45.7	38.6	54.7
– East Central Europe	21.3	16.5	10.9	12.7	17.6	n.a.	n.a.
– European Union	11.6	9.8	10.3	13.1	20.9	n.a.	n.a.
IMPORT							
CIS	67.7	61.5	52.2	43.0	38.9	49.3	46.5
– of which Russia	33.0	27.4	26.0	22.7	20.8	24.9	21.3
Non-CIS	32.3	38.5	47.8	57.0	61.1	50.7	53.5
East Central Europe	14.3	16.6	20.5	21.0	25.1	n.a.	n.a.
European Union	13.7	15.1	19.4	27.5	27.5	n.a.	n.a.

Source: Table 8.

per cent in 1998, while the share of imports from the countries of East Central Europe and the European Union, in particular, increased commensurately (Table 9). The declining share of imports from the CIS countries was largely attributable to the falling share of energy in total imports and, since 1998, to the impact of the financial crisis in Russia. The share of energy and other mineral products of total imports fell from 56 per cent in 1994 to 32 per cent in 1998, largely as a consequence of the rapid economic decline rather than the introduction of new energy-saving technologies. Machines, electronic devices and equipment, as well as consumer goods, account for the bulk of the increase in imports from the rest of Europe.

The consequence of these contrasting developments has been a highly unbalanced trade pattern. While exports to Russia exceeded imports by 67 per cent in 1997 and 45 per cent in 1998, imports from the non-CIS markets exceeded exports by nearly three times by the latter year (Table 8 and 10).

The increase in imports from the countries of the European Union and East Central Europe was not a problem in itself. It was largely due to increases in imports of machinery and equipment, which are sorely needed to modernise the domestic production technology, and as such

Table 10. Trade imbalances.

	1995	1996	1997	1998	1999	09-12 1997	09-12 1998
Trade balance as % of GDP	-6.6	-16.6	-15.6	-23.9	-8.3	-12.3	-16.8
Trade balance with Russia as % of GDP	5.6	8.1	10.9	7.0	6.3	11.1	-0.6
Trade balance with other countries as % of GDP	-12.2	-24.7	-26.5	-30.9	-14.6	-23.4	-16.2
Per capita export, USD	207	223	241	173	130	98	47
<i>Imports as % of exports</i>							
All countries	113	135	133	162	120	123	155
Russia	77	69	60	69	86	60	108
Other CIS	272	318	299	224	159	295	263
Non-CIS	98	162	210	287	161	161	151
East Central Europe	76	136	252	267	172	n.a.	n.a.
European Union	134	208	251	339	159	n.a.	n.a.

Sources: *Tendinte in economia Moldovei*. (1998:4, 46 and 49); *Economic Trends Moldova* (2000:42).

Remark: GDP figures for September-December 1997 and 1998 calculated as annual GDP/12 x 4. GDP figures recalculated to USD on the basis of average annual exchange rate. For 1998 the average annual exchange rate was 1 USD = 5.4 MDL, while the end-year rate was 1 USD = 8.32 MDL.

may be seen as an investment in the future. As Foreign Direct Investment remains at a low level,¹³ this modernisation has so far had to be paid for by domestic resources and loans.

However, a less positive development was the increase in imports of various agricultural products and other consumer goods. Imports of agricultural products from the non-cis countries ostensibly reached 116 million USD or 20 per cent of all imports from these countries in 1997 (*Nota informativa, 1998*). The combination of low or non-existent tariffs on the Moldovan side and, in many instances, export subsidies in the exporting countries, put Moldovan food producers at a distinct and unfair disadvantage on their home market. The lack of symmetry in agricultural trade, where the European Union in particular provide its producers with protection against imports as well as export subsidies, while on the Moldovan side the producers benefit from neither, is clearly detrimental not only to Moldova's external trade, but also to its economic development in general.

3.1.1 Failure to Re-orient Exports

It could be argued that at the heart of the problem of Moldova's foreign trade has been its failure to increase exports to non-cis countries. There are several reasons for this failure.

Moldova has no tradition of trade outside the former Soviet Union. After the virtual collapse in 1992/93, it followed the road of least resistance and tried to recapture old markets in Russia/cis where Moldovan products are well known and quality standards were less of a problem, rather than to trying to penetrate new markets.

- The failure to attract FDI has no doubt contributed to the difficulties of penetrating non-cis markets, and the lack of market information, contacts and marketing channels outside the cis remains a formidable problem.
- The successful macro-economic policies, until the onslaught of the Russian financial crisis, made the Moldovan leu one of the hardest and most stable currencies in the region. The backside of the coin is that as a consequence, there was a considerable appreciation of the leu vis-à-vis the USD and most European currencies in real terms, which eroded the competitiveness of Moldovan products on the world market.

13. Foreign Direct Investment averaged 56 million USD per year between 1995 and 1998 (IMF, 1999:80)

- The slow re-technologisation of the manufacturing sector made it difficult to achieve and uphold quality standards and to meet EU requirements with regard to product and package standardisation, hygiene standards etc.
- There have been no forceful Government policies to promote Moldovan exports to non-cis countries.

The trade with the cis countries has been and remains largely outside Government scrutiny and has largely been in the form of barter. Under-invoicing and over-invoicing provides considerable opportunities for illegal gains by both parties concerned in the trade and provides an additional, important, disincentive to divert trade from the traditional cis markets to new markets where these gains are less easily obtained.

Last, but not least, it takes two to dance the tango. The formidable protective barriers imposed unilaterally by the European Union against Moldova's main exports, i.e. agricultural products, have been and remain a main obstacle to exports.

The severe geographical imbalances in the trade pattern and the very strong dependence on the Russian market for exports have extremely negative consequences for Moldova. First and foremost of these is the vulnerability to external shocks, as amply proved by the recent financial crisis in Russia (discussed below). However, it has other negative features as well. The fact that much of the trade with the cis countries continues to be in the form of barter or in non-convertible currencies, while the trade with the non-cis countries is based on convertible currencies aggravates the imbalance. The lack of controls and the possibilities of illicit gains in the trade with the cis countries are obstacles to the establishment of the rule of law and a sound market economy and also have a negative effect on the Government's ability to collect revenue. Last, but not least, the export dependence on Russia also has political implications and is detrimental to the country's endeavours to strengthen its still rather frail independence.

3.1.2. The Impact of the Russian Crisis on Foreign Trade

The effect of the Russian crisis on Moldovan foreign trade was dramatic. Payments for goods already delivered were frozen, while new contracts came to a virtual standstill. During the last four months of 1998, total exports to Russia amounted to a mere 51.2 million USD, or 29 per cent of the level during the same period in 1997 (Table 8). As exports collapsed and the trade deficit increased uncontrollably, the leu came under strong pressure and the protection of the exchange rate became impossible. On

November 3, 1998 the National Bank abandoned its attempts to support the leu and as a result, the currency was effectively devalued by approximately 50 per cent. The impact of the near-collapse of exports to Russia was aggravated by a fall in exports to other markets as well. Thus, exports to non-CIS countries were 32 per cent down during the last four months of 1998 compared to the same period a year earlier.

The decline in external trade in the wake of the Russian crisis has so far proved to be a lasting phenomenon. Total exports continued to fall in 1999 to a mere 54 per cent of their level in 1997 or 471 million USD (Table 8). The dramatic fall in exports to Russia from 510 to 192 million USD between 1997 and 1999 accounted for more than three-quarters of the decline, while exports to the European Union increased marginally from a very low level.

The sharp depreciation of the domestic currency from its pre-crisis level of 4.7 lei to the USD, to 11 lei by the end of 1999 and the lack of means to sustain a continued large trade deficit resulted in an even sharper fall of imports than of exports. Thus, imports in 1999 were reduced to little more than half of their level in 1999 (Table 8). The improvement of the trade balance that resulted from the drastic curtailment of imports was no doubt necessary. Yet, it is doubtful that it is an indication of improved macro-economic performance or restructuring of the trade pattern and it is hardly sustainable.

The decline in both exports and imports has had a highly detrimental impact on the economy, reflected in a fall in GDP of a further 13 per cent between 1997 and 1998. It has also imposed severe additional hardship on the population. Energy imports fell by a third between 1998 and 1999, from an already very low level, as heating was reduced from an already precariously low level and the entire population outside Chisinau was literally thrown into darkness with electricity supplies reduced to a few hours per day. Imports of medicines, vital to a country with virtually no domestic pharmaceutical industry, were slashed in half to a derisory 3.3 USD per capita in 1999 (*Economic Trends Moldova*, 1999b:96).

The domestic economy, too, suffered from the contraction of trade. Exports of agricultural products during the third quarter of 1999 amounted to only 56 million USD or 39 per cent of the level during the same quarter in 1997 (*Economic Trends Moldova*, 1999b:95), thus severely increasing the demand constraint facing the country's main economic sector. While this may have assisted in speeding up the ongoing privatisation process by forcing collective farms dependent on the Russian markets into bankruptcy, it also gave the newly established private farms the worst possible start. Similarly, the lack of electricity has made the much needed devel-

opment of small and medium-scale enterprises outside Chisinau virtually impossible.

Lastly, the external trade crisis has brought into stark limelight the extreme importance of fostering exports to the non-cis countries, not least to the European Union.

3.2 Balance of Payments and the Foreign Debt

Until 1995, the deficit on the current account was to a large extent covered by IMF credits and arrears on energy payments. After 1995, IMF loans fell sharply, to virtually zero in 1997. In 1998 there were net repayments of IMF credits amounting to 63 million USD as no new credits were given while the repayment of earlier credits had commenced. Instead, general government loans (in 1997) and government issues of Eurobonds were increasingly being used to cover the current account deficit (Table 11). However, largely as a consequence of the turmoil on the global financial markets, the Moldovan Government found it increasingly difficult to finance the current account deficit through these sources, as the risk premium demanded by overseas takers of the loans became very high. As a result, the growing current account deficit in 1998 was increasingly funded through a decrease in the domestic foreign reserves, which in previous years had built up at an impressive rate. Hence, Moldova was facing increasing difficulties in financing the current account deficit even prior to the onslaught of the Russian crisis.

The sharp deterioration of the overall balance in 1998, from plus 67 million USD in 1997 to minus 311 million USD in 1998, was the result of a combination of several factors, some of which directly related to the impact of the Russian crisis. Thus, the rapid deterioration on the current account had started much earlier, but was accentuated by the Russian crisis. The capital account fell from a large surplus of 324 million USD in 1997 to a deficit of two million USD in 1998. This sharp deterioration was largely due to a decline in portfolio investments, i.e. mainly issues of bonds and securities overseas, from plus 237 million USD in 1997 to minus 55 million USD in 1998. The situation was further aggravated by net repayment of loans to the IMF amounting to 64 million USD in 1998. Thus, Moldova went from a situation of considerable accumulation of foreign reserves in 1997 to an external financing need amounting to 247 million USD in 1998. This was mainly done by drawing on the foreign reserves, which declined from 366 to 140 million USD, but also by defaulting/rescheduling of debt.

The sharp depreciation of the Russian rouble did not result in any immediate currency crisis in Moldova, as the currency reserves were large enough to withstand initial speculation and foreign investment in Moldovan treasury bills and other short term papers had been limited. However, in October 1998 the speculative pressure on the leu increased and after a futile attempt to defend the leu to the tune of approximately 100 million USD, the National Bank withdrew its support of the leu on November 4 to let the currency float freely. After a rapid fall, the leu stabilised at approximately 8.7 lei to the USD by the end of the year. The uncontrolled fall of the leu had the immediate effect of bringing the magni-

Table 11. Balance of payments 1995–1998. Million USD.

	1995	1996	1997	1998
Trade balance	-55	-252	-345	-398
Balance of services	-96	-64	-62	-73
Current transfers & net income	36	128	138	139
Current account	-115	-188	-268	-334
Direct investments	73	23	71	86
Portfolio investments (1)	0	54	237	-55
Medium and long term loans (net)	74	101	11	40
– Disbursements	132	133	101	83
– World Bank	50	0	38	32
– EBRD	5	34	23	15
– Amortisation	-58	-32	-90	-43
Other capital flows	-75	-9	5	-75
Capital account	71	170	324	-2
Errors and omissions	-10	17	11	24
Overall balance	-54	-1	67	-311
<i>Financing</i>				
IMF credits (net)	65	25	1	-64
Change in official reserves	-78	-57	-52	223
Debt arrears (2)	21	-35	33	50
Arrears on energy deliveries (2)	47	68	-48	103
Gross official reserves	257	314	366	140

(1) Includes 30 million USD private placement in 1996, 75 million USD Eurobond issue and 140 million USD securities to Gazprom in 1997.

(2) After debt rescheduling.

Sources: IMF (1999:98).

tude of the external debt burden out into the open, as it virtually doubled in GDP terms (Table 13).

However, it must be stressed that while the Russian crisis acted as a catalyst, triggering the present balance of payments and debt crisis, its root causes lie elsewhere. The external debt, which consists primarily of public and Government guaranteed debts, has been built up gradually since independence from 166.5 million USD in 1993 to 839 million USD in 1995, to 1,347 million USD by the end of 1998. In terms of GDP, it increased from 54 to 127 per cent in the same period. Yet, it was only recently that the full scale and implications of the debt became common knowledge.

Table 12. External debt (end-year). Million USD.

	1993	1994	1995	1996	1997	1998
Multilateral creditors	116	261	380	428	480	458
– IMF	88	165	228	243	234	171
– World bank	29	96	146	146	183	212
– EBRD	0	0	5	40	62	75
Bilateral creditors	139	248	261	279	257	257
– EU	32	65	59	76	67	71
– Japan	0	30	39	39	39	39
– USA	20	40	50	64	65	65
– Russia	82	93	90	79	64	62
Commercial creditors	0	0	27	108	312	299
Arrears in energy payments	n.d.	125	171	245	221	333
Total external debt	256	634	839	1,060	1,269	1,347

Source: IMF (1999: 34).

Table 13. External debt as per cent of GDP.

	1994	1995	1996	1997	Sept. .98	31.12.98
External debt, Million USD	634	839	1,060	1,269	1,300	1,347
GDP in Million USD	1,164	1,443	1,665	1,933	1,761	1,061
Real GDP growth	–30.9	–1.4	–7.8	1.6		–8.6
Debt as % of GDP	54	58	64	66	74	127

Sources: Table 12; *Economic Trends Moldova* (various issues).

3.3 The Main Causes Behind the Debt Problem

The main causes behind the debt problem contain the following elements:

- The loans taken were primarily used to pay for the cost of energy imports and to soften the blow of the economic collapse on the public sector. Little, if any, was used for productive investments and they were not accompanied by much needed reforms of the real economy.
- At the same time as the debt has increased in absolute terms, the economy has continued to decline and external trade has stagnated to a dismally low level. Thus, a shrinking economy has been forced to shoulder an increasingly heavy debt.
- The combination of the rapid and sustained appreciation of the leu in real terms, the deteriorating trade balance and the rapidly increasing debt burden was a certain recipe for disaster.¹⁴ It had been clear for quite some time that a comprehensive devaluation of the leu would sooner or later be inevitable. It had been equally clear that such a devaluation would abruptly and sharply increase the debt burden in domestic terms. The Russian crisis merely triggered off this devaluation.

Thus, with the economy already in tatters after two severe external shocks and little reconstruction in between, Moldova was faced not only with a daunting external debt, but also with a crippling debt service burden, as virtually the entire debt was short term and at high interest rates. Initial estimates suggested that the debt service burden for 1999 would be as high as 286 million USD (Ronnås and Orlova, 1999:37). Subsequent government estimates put it at 221 million USD for 1999. (<http://www.moldova.md/guvernul>). Even the latter figure implied that the Government had to spend almost 20 per cent of GDP and (as it turned out) 47 per cent of exports earnings in 1999 to service the debt. Little relief was brought by external assistance from the West. The IMF resumed lending in the spring of 1999, but a total disbursement of 50 million USD in 1999 was neutralised by repayments of almost the same amount. IMF lending was suspended anew in November the same year as the Sturza-led government lost a vote of confidence in Parliament over its austere economic policy, which had

14. Between January 1994 and mid-1998 the leu appreciated in real terms by more than 150 per cent vis-a-vis the USD. In the same period the trade deficit increased from 54 million USD in 1994 to 413 million USD in 1998.

been prescribed by the IMF as a condition for resuming lending, and by mid-2000 lending had not been resumed. More importantly, most other multilateral and bilateral financial assistance came to a halt with the renewed suspension of IMF lending.

While little relief was forthcoming from institutions and donors in the West, remarkable headway was made in reducing the energy debt. Technical assistance from Sweden, in the form of highly qualified financial expertise, was instrumental in helping Moldova renegotiate its debt to several of the main energy suppliers. This included a heavily discounted buy-back of 140 million USD bonds to Gazprom, rescheduling of the debt to Romania and a negotiated, but not concluded, rescheduling of most of the debt owed to Russia.

Servicing the external debt was given top priority by the Sturza government (March–November, 1999) as well as its successors, the government led by Dumitru Braghis. The heroic efforts paid off and the threat of wholesale default on the external debt, which appeared to be a distinct possibility in early 1999, was avoided, at least for the time being. However, honouring the staggering debt service on top of the external trade crisis has had a tremendous cost on several fronts.

3.4 The Costs of Debt Servicing

Moldova has been in a deep depression throughout the 1990s, resulting from a collapse of external and domestic demand. The Russian financial crisis in 1998 added to the burden by reducing external demand even further. Under different circumstances a forceful expansive economic policy would have been called for in order to stimulate growth and bring the economy out of the doldrums. Moldova, however, was forced to resort to an extremely contractionary policy in order to honour its huge debt-service. While it is difficult to estimate how much this cost Moldova in terms of foregone economic performance, it is clear that the decline in GDP of 4.4 per cent in 1999 and of an additional estimated 7 per cent in 2000 was due to no small extent to the servicing of the external debt. Short of a cancellation or drastic restructuring of the external debt, the only way Moldova will ever be able to relieve its heavy debt burden is through rapid and sustained economic growth. Yet, the heavy debt-servicing burden drains the economy and serves as an effective obstacle to economic recovery. Thus, Moldova is caught in a vicious Catch 22 situation, from which it cannot extricate itself on its own.

Another severe cost is that of human misery and the wastage of human

resources. As will be discussed below, debt servicing has become a severe problem in the Government budget, squeezing out all other expenditures. A sharp reduction in social sector expenditures, from an already low level, has been enforced in order to accommodate the large and increasing cost of debt servicing. The drastic reduction in expenditures on health care, education and basic social security that has taken place in the past few years under the euphemistic banner of 'reform and rationalisation' is taking a heavy toll in terms of increased morbidity and human misery as well as affecting future generations who are being deprived of education. Indeed, it is hard to conceive a more efficient means of turning transient poverty into chronic destitution.

Lastly, there is a political price as well. As the power to influence the destiny of Moldova is shifted from the population of Moldova to corridors and offices in Washington, democracy suffers. This should be a cause for particular concern in a young and fragile democracy like Moldova. The fact that Moldova has only recently emerged from half a decade of subservience to another foreign master, adds a tragic, ironical twist to this development. Yet, from the perspective of democracy and sovereignty, the parallels between the Soviet rule of Moldova and the comprehensive and detailed dictates laid down by the international financial institutions are too obvious to ignore, nor are they likely to be lost on the Moldovans themselves.

While it is not the purpose of this study to apportion blame, one cannot but note that the role of the international lending agencies has not been particularly helpful.

3.5 The Role of International Lending

The credits given have until recently been short term and at high commercial interest rates, even though Moldova by any standards should have been eligible for soft loans on IDA terms¹⁵. This situation is largely attributable to the refusal of the World Bank to scale down their GDP estimates for Moldova to a realistic level, despite ample evidence that their GDP estimates were absurdly high.¹⁶ Thus Moldova only attained status as de-

15. IDA, the International Development Association, is a member institution within the World Bank Group providing assistance and long term loans at heavily subsidised interest rates to poor developing countries.

16. In 1993 the World Bank's estimate of Moldova's per capita GDP was 1,060 USD, that is three times higher than the domestic estimate of 323 USD. Two years later, the gap in the estimates had been reduced to 920 versus 394 USD. There is today a near consensus that the domestic »

velopment country by the DAC-countries¹⁷ and recipient country by IDA, which opens the door for soft loans and development assistance in general, in 1997. Moldova is presently paying a heavy price for what could be argued was a prevalence of prestige over reason and fairness.

Lending was not accompanied for a long time by any meaningful technical assistance, with the exception of the strengthening of the national bank. Nor was lending for several years accompanied by much control or conditions with regard to its use. Excessive attention was paid to successful macro-economic stabilisation, mainly inflation control, while little attention was paid to the poor record of reform of the real economy. Most of the credits were extended to the Sangheli Government, which had little interest in genuine reform and which was rife with corruption. By contrast, the election of a more reform-minded Parliament and Government in 1997 coincided with a sharp curtailment in lending.

An illusion was created that there was no fundamental difference between external and internal borrowing. The crucial differences between an internal and external debt, particularly in a situation of an overvalued currency, was apparently not clear to the Moldovan Government(s) and it appears that little was done to advise them in this matter. As short term loans at high interest rates were presented as ‘money granted as a “reward” for achievements in the field of economic reform and stabilisation’, the question of the advisability for Moldova to accept the credits was never questioned.

Despite strong evidence that the leu was increasingly overvalued, it would appear that the IMF strongly supported the policy of maintaining the fixed exchange rate and a strong leu. As late as in mid-1998, the IMF concluded that there was no reason to believe that the leu was overvalued, based on the flimsy argument that wages in Moldova were very low.¹⁸ The detrimental impact of this policy on Moldova can hardly be overstated. As a small open economy in desperate need of export-led growth, an undervalued rather than overvalued currency was clearly called for. A gradual devaluation of the currency would also have brought the alarming increase in the external debt out into the open much earlier.

The above also highlights the problem of moral hazard, which arises as the large international lending organisations have extreme powers to reinforce repayment of loans given and as the risks and consequences as-

» estimates were fairly close to the truth. The GDP ceiling for qualifying for IDA loans is about 800 USD per capita.

17. DAC stands for Development Assistance Committee, which is comprised of a group of OECD countries providing development assistance.

18. IMF. 1998.

sociated with unsound loans or ill-advised policy prescriptions are not shared between the lender and the borrower, but are entirely borne by the borrower.

Political and Institutional Development

CHAPTER 4

4.1. Early Detachment

Although barely noticed in the West, Moldova, just as the Baltic countries, embarked on a process of detachment from the Soviet Union and independent nation-building well in advance of the achievement of formal independence. In June 1990, a newly elected legislature adopted a far-reaching declaration of sovereignty within a genuine federation. In the following months a number of new laws were introduced which further undermined Soviet authority in Moldova.¹⁹

In June 1991, Moldova instituted its own citizenship and in the same month the Moldovan National Bank was established. A month later, all Union enterprises in Moldova were subordinated to Moldovan control. The abortive coup in Moscow in August 1991 precipitated Moldova's decision to proclaim independence from the USSR. On August 27, the Moldovan Parliament proclaimed the independence of the Republic of Moldova and during the ensuing weeks Moldova left the all-Union structures and enacted a series of laws endowing the republic with the attributes of fully-fledged statehood (Socor, 1991). Yet, it was only after Moldova joined the CIS in December 1991, which paved the way for Russia's recognition of its independence, that the international community recognised Moldova's independence.²⁰

19. For example a law stipulating that Moldovan law had precedence over all-Union law and a law suspending military conscription. For more detailed accounts of the process towards independence and political development in the late 1980s and early 1990s, see Socor (1995a) (1995b) and Crowther (1997).

20. Only two countries, Romania and Lithuania, recognised Moldova as a sovereign state immediately following its own declaration of independence in August.

4.1.1 Brief Civil War

The surfacing of national and ethnic Moldovan aspirations and, along with it, a strong pro-Romanian movement after 1989 resulted in a counter-reaction from parts of the ethnic minorities. In face of the liberalisation and increasingly overt and assertive expressions of the Moldovan national identity, the hard-line Communist leaders in Tiraspol disassociated themselves from the leadership in Chisinau and declared the creation of the Transnistrian Moldovan Soviet Socialist Republic on the eastern bank of the river Dniestre (Nistru) as early as the middle of 1990, i.e. one year before Moldova attained full independence. At the same time, the Gagauz minority in the south of the country announced the formation of its own republic. Tension between Chisinau and the secessionists escalated throughout 1991, until a full-scale civil war erupted between Moldova and the renegade Transnistria republic in May 1992, as the Transnistrians, supported by the 14th Army led by General Lebed and Cossack and Russian volunteers brought in from Russia, attempted to forcefully consolidate control over the west-bank city of Bender. The short, but intensive war was brought to an end through a cease-fire agreement in July 1992.

A *modus vivendi* was soon reached between Chisinau and the Gagauz minority in the south and was subsequently codified, as Gagauzia was granted far-reaching autonomy within the framework of the Republic of Moldova. However, little progress has been made since the cease-fire agreement to normalise relations between Chisinau and Tiraspol. Indeed, seven years after the armed conflict, a solution to the problem is no closer in sight than it was at the time of the cease-fire. A complicating factor has been the continued presence of Russian troops in Transnistria and Russia's covert support to the separatists and lack of interest in any political settlement that would ensure Moldova's sovereignty over its entire territory, while granting extensive autonomy to Transnistria.

4.2 Harmonious Inter-Ethnic Relations

Despite the inauspicious start of Moldovan statehood, progress in the fields of democratisation, creating a national cohesiveness and institution-building in general has been impressive in the parts of the country that have remained under Chisinau's control. The strong ethnically based emotions, and not least rhetoric, abated soon after the war in Transnistria, as moderation gained the upper hand over extremism on all sides.

Moldova has a long tradition of harmonious inter-ethnic relations based on tolerance and respect. This is particularly strong in the towns and villages in the countryside, where Romanian-speaking Moldovans, Ukrainians, Bulgarians, Gagauzians, Poles and other ethnic groups have lived side by side in harmony for centuries and have often intermarried. There is also a strong sense of a specific Moldovan identity, particularly among the Romanian-speaking majority of the population which, contrary to common belief, is not a Soviet fabrication, but goes back to the 19th century if not before. This identity is not so much based on ethnicity as on its common past as a small and vulnerable multi-ethnic society, squeezed and often threatened by its much larger and ethnically more homogeneous neighbours.²¹

In the end, these positive and cohesive factors proved stronger than the disruptive separatist forces. The year of 1994 was a turning point. In a referendum in the spring of that year the overwhelming majority of the population expressed a desire that Moldova should remain an independent and sovereign state. Thus, the issue of either unification with Romania or closer political links with CIS/Russia was effectively put to rest. In the same year, the voters turned against the pro-Romanian Popular Front in favour of the centre-left Agrarian Democratic Party in the first post-independence parliamentary elections. The two main political figures, Mircea Snegur, the President of the Republic, and Petru Lucinschi, the newly elected Chairman of the Parliament, both became strong forces for moderation and consensus-building, despite belonging to different political camps. The generous policies for inter-ethnic relations and protection of minority interests which were put into practice in 1994 and subsequently codified in the new Constitution of the Republic, earned for good reasons a reputation as a model for the other CIS countries and for the region. At a more general level, steady progress was made in the field of democratisation and establishing respect for and protection of human rights and freedom and, in contrast to some of its neighbours, Moldova has managed to avoid any backsliding in these fields. These efforts have been explicitly recognised by the international community, as Moldova was the first of the CIS countries to be admitted into the European Council.

4.3 Towards Political Pluralism

A firm party structure is only slowly crystallising and the past few years

21. In this respect Moldova is not dissimilar to pre-war Bosnia-Herzegovina.

have seen a bewildering formation and dissolution of political constellations and alliances, often centred on individual persons. The Agrarian Democratic Party, which won a landslide victory in the parliamentary elections of 1994, portrayed itself as a democratic force ideologically close to the social democratic movement. However, most of the leading political figures in the party had a past in the upper echelons of the Soviet political structures and many found it difficult to fully embrace the sweeping political changes that had taken place. The attitude towards economic reforms and the establishment of the rule of law was often one of incomprehension and reluctant compliance, rather than wholehearted support. This was particular true of reforms in agriculture, as the interests of the kolхозes were firmly entrenched in parliament. As a platform for a wide range of diverse and competing political personalities, the party lacked cohesion.

In the presidential elections of 1997 the top three candidates – Mircea Snegur, Petru Lushinski and Andrei Sangheli – all came from the Agrarian party, although the first two had already begun to distance themselves from it. The presidential election, which was eventually won by Petru Lushinski, was perhaps most remarkable for the devastating defeat suffered by Andrei Sangheli, the Prime Minister, and, by implication, the lack of confidence it expressed in his government. As a consequence of the elections, the Sangheli government was forced to resign and a new government was formed, headed by Ion Ciubuc, the former head of the Court of Accounts. The presidential election was a death-blow to the Agrarian Party and left the parliament weakened.

In the run-up to the parliamentary elections in March 1998, there was massive defection from the Agrarian Party. The Russian dominated Edinstvo (Unity) party suffered a similar disintegration, as most of its representatives left for the Communist party and the centrist party 'Movement for a Democratic and Prosperous Moldova' (Stawila, 1998).

The parliamentary elections in March 1998 resulted in a radical change of the political landscape. The Agrarian party was effectively obliterated, as it did not even obtain the four per cent of the votes required to pass the threshold for entering parliament. The Communist party registered the greatest success and emerged (once again) as a main political force. However, with 30 per cent of the votes, it failed to obtain a commanding position in parliament and was confined to the role of main opposition party.

The Communist Party of Moldova is ideologically rather akin to that of Russia. It questions the wisdom of the abrupt transformation of the economic system and is very critical of its high social costs, and its political

platform contains an undertone of nostalgia for the past. As such it responds to sentiments that are increasingly widespread in society. Although its core constituency is found among the Slav minorities in the country, it is not primarily an ethnic party. In the 1998 election about 40 per cent of the votes came from those over the age of 60 and about half of the votes from the ethnic minorities.

Apart from the Communist party, only three other parties and party-constellations managed to pass the four per cent threshold and thus obtain seats in the new parliament. These were:

- The Democratic Convention of Moldova (*Conventia democratica a Moldovei CDM*) with 19.4 per cent of the votes. CDM is an election alliance of two parties on the right; the Party of Revival and Conciliation of Moldova (*Partidul renasterii si concilierii al Moldovei*) headed by the former President of the Republic Mircea Snegur, and the Christian Democratic Popular Front (*Frontul popular crestin-democrat*) headed by Iurie Rosca. These parties stand unequivocally for a economic and political reorientation towards the West and rapid privatisation, but the issue of unification with Romania no longer figures on the agenda and Mircea Snegur, in particular, went out of his way to placate the ethnic minorities.
- The Alliance for a Democratic and Prosperous Moldova (*Alianta pentru o Moldova democratica si prospera*), which contained many of the former members and supporters of the Agrarian party, received 18.2 per cent of the votes. At the head of this centrist alliance are Dimitri Diacov, the present President of the Parliament and Petru Lushinschi. This alliance characterises itself as non-socialist, but argues for gradual reforms and more concern for the social implications of the reforms.
- The Party of Democratic Forces (*Partidul fortelor democratice*), headed by Valeriu Matei, received 8.8 per cent of the votes. This is a party based on social liberal principles and is on most issues close to the Democratic Convention.

After the elections these three parties and alliances formed a majority coalition named Alliance for Democracy and Reform (*Alianta pentru democratie si reforme*). The task to form the new government fell once more to Ion Ciubuc. This choice was widely seen as the result of strong pressure by President Lushinschi and the failure of the coalition members to

unite behind a single candidate. Although many names in both the parliament and in the cabinet remained the same as before, the election nevertheless implied a major break with the past, as decidedly reform- and west-oriented forces came to the fore. As a consequence the political spectrum became highly heterogeneous.

The new government installed after the parliamentary elections in March 1998 lasted for less than a year. In February 1999 Prime Minister Ciubuc, apparently under pressure from the President, stepped down as, in his own words, his government had failed to live up to the challenges of the economic crisis. After protracted negotiations a new government led by Ion Sturza was sworn in.²²

The transfer of the executive power to the 37 year-old self-made businessman Ion Sturza – whose youth, dynamism, Western manners and vocabulary contrasted sharply with those of his predecessors and earned him immediate acclaim from the West – seemed to augur a new era for Moldova. However, his efforts to pursue radical reforms, combined with the programme of economic austerity laid down by the IMF, soon cost him the necessary political support at home. His rule was cut short after only eight months in office by a vote of no confidence in parliament. The ungrateful task of continuing the reform programme in the context of extreme economic austerity fell to Dumitru Braghis, whose profile as a pro-Western reform-minded young politician is blended with a background in Moldova's post-independence political establishment.

4.4 Political and Administrative Reform

Reforms of the formal structures of the executive powers have been patchy and are still far from complete. At the central level, the Ministry of Economy and Reform has assumed new and completely different roles from its predecessor, which was mainly concerned with economic planning. Similarly, the Ministry of Finance has emerged as a key ministry with vastly enhanced responsibilities from its relatively obscure position in the past. The same may also be said of the Ministry of Justice. Most other ministries have changed at rather a slow pace.

A number of control organs have been established to monitor the executive powers. Thus, the Court of Accounts plays an active and on the

22. The vote of the famous dissident Ilie Ilasco, who is imprisoned and kept in strict isolation by the Transnistrian 'authorities' in Tiraspol since 1992, but who is also a member of the Moldovan Parliament, was obtained in writing in a somewhat mysterious manner to ensure the 52 votes needed in Parliament to approve the proposed new government.

whole constructive role in monitoring the use of public finances. The past few years have shown that it does not shy away from exposing misuse of funds even at the highest levels, although the effect of these exposures has not always been what one might have expected and wished for. There is also a Department of Control and Auditing, which has branches in all the districts.

Transforming the elected local authorities from merely being the extended arm of central government to independent bodies with responsibility for, and the power to decide on, local matters, and which are answerable to the local electorate rather than to central government, has emerged as a main task in the overall process of democratisation of Moldovan society. A comprehensive reform of the system of local administration was approved by parliament in the spring of 1999 and was immediately put into effect. This reform consists of two parts: (i) a restructuring of the administrative territorial division, whereby some 44 districts and cities have been merged into eleven large units (nine counties, the city of Chisinau and the autonomous territory of Gagauzia)²³, and (ii) an entirely new relationship between the central and the local powers modelled on Western practices. The new system is based on a division into two levels, apart from the central one.

At the local level, the communes and towns are run by directly elected councils and mayors. The first election under the new system took place in the spring of 1999. These units are responsible for all affairs of local interest, such as physical planning, environmental protection, provision of local public services and public order, as well as for primary education and primary health care. They also have the right to levy fees and taxes, within the framework of the law, and are responsible for budget planning and management.

At the middle level, there is a directly elected council, which in turn elects a president, vice-president and an executive committee (permanent bureau) and recruits a non-political secretary. The county councils co-ordinate the activities of the communes, where applicable, and also provide them with technical and legal support and help them with economic planning and environmental protection. The counties are also responsible for secondary education, health care, socio-economic development planning and labour market activities, as well as other activities that cross the boundaries of the primary communes. They have the right to levy fees and taxes and the responsibility for the planning and management of their

23. The 900 primary communes are as yet unaffected by the reform, although it is foreseen that they, too, will be merged into larger units.

own budgetary resources. The state is represented at the county level by a prefect, appointed by the Government, but the law explicitly states that there shall not be a relationship of subordination between the county council and the prefect.

The new law on local finances, adopted in July 1999, implies far-reaching financial autonomy for both the communes and the counties. The counties as well as the communes are bestowed with full responsibility for their own budgetary planning and management and fiscal flows between the central and local levels are regulated and codified. It is hoped that the decentralisation of budgetary control and responsibility will serve to make the link between taxation and public services more transparent and straightforward and enhance local democracy.

Progress in other fields of institution-building and nation-building has been mixed, but on the whole positive. The successful establishment at an early stage of a strong central bank and a consensus on the need for macro-economic stability has been most important. After the havoc-wreaking experience of galloping inflation in 1992 and 1993, monetary independence was at last established through the launching of the Moldovan leu in October 1993. Since then, control of inflation has on the whole been very successful, despite the inflationary effects of the depreciation of the leu in the wake of the Russian financial crisis.

Progress in the field of legislation, the establishment of an independent and effective judiciary and the rule of law has proved more difficult although considerable advances have been made. After a chaotic situation in the first few years after independence, characterised by an uncoordinated flurry of legislative drafting, which virtually drowned the inexperienced parliament with often contradictory and poorly drafted proposals, the situation has now improved considerably. Mechanisms have been developed for legislative drafting and most of the basic legislation is now in place. However, the judiciary remains rather weak. Lack of funding, rather than good intentions, has slowed down the difficult task of upgrading the capacity and capability of the judiciary, not least in the district courts outside Chisinau.

The relationship between the legislative and executive powers on the one hand and the judicial powers on the other, has so far been relatively free from open tension. The constitutional court is active and in general respected. By and large, the judiciary is fairly independent, although it is not immune to outside pressure.

4.5 Present Issues and Problems

4.5.1 *Vast Diversity in the Political and Institutional Scene*

The political and institutional scene is characterised by extreme heterogeneity. In the Parliament die-hard communists rub shoulders with equally dogmatic neo-classical economists. Also within the Government, there are vast differences in the outlook and mode of operation between various ministries and ministers. Sophisticated state and para-statal institutions staffed by western-trained young professionals exist alongside institutions that have seemingly not changed at all since the Soviet times.

The heterogeneity can also be seen in other dimensions. While there are those for whom the rule of law epitomises the very essence of the new political system, there are others who fail to understand its intrinsic value and have few qualms about dispensing with it in the interest of political expediency. Recent attempts by the President to curtail the power of parliament, ostensibly as a means to facilitate tackling the acute economic problems, are an example of the latter.

There are also vast differences in management styles. Old habits of solving all problems at the very top and of making no distinction between petty and strategic issues still linger.²⁴ Yet, there are also examples of institutions where modern management practices prevail.

Corruption and 'group interests' at the highest level have in recent years increasingly been castigated as a main evil and reason for the lack of economic progress. There is clearly a great deal of truth in this. There are plenty of examples of both corruption and unsound links between politicians and more or less legitimate business interests at the highest levels. To give a few examples:

- In October, 1998, a Government decree was issued whereby all humanitarian medical aid coming into the country had to be placed in the custody of a specially created council and administered by a commercial pharmacy (Basafarm), whose the main shareholders are people with high positions in the Government.
- Individual enterprises have in the past been exempted on a completely discretionary basis from payment of taxes by individual politicians at the highest levels.
- Reluctance to impose effective controls on the flow of goods between Moldova and Transnistria, despite a law to this effect and the enormous amount of public revenues

24. The 'everything is of utmost importance and requires our immediate attention' syndrome.

lost because of this uncontrolled trade, has at least partly been due to personal interests among top politicians.

- Resistance within parliament to privatisation of state enterprises (the most spectacular recent case being the wine industry), is not only based on ideological or nationalistic motives, but is no doubt also due to personal business interests among some of its members.

There is still no clear-cut separation between business and politics and political positions are frequently used to further personal economic and business interests. The granting of immunity from prosecution to members of parliament is unfortunate, as it attracts candidates for whom such immunity offers distinct advantages.

Yet, it would be wrong to paint the picture entirely in black. Corruption is rather like the secret police. The fact that it exists is apt to make one believe that it is everywhere. There are many examples of people in politics and elsewhere, at all levels, who are primarily driven by ideals and whose integrity is impeccable. Unfortunately, they often go unnoticed.

There is a tendency among foreign experts to automatically assume ulterior motives whenever things are not done the way they expect them to be done, although more often than not it is merely a question of differences in culture and practices. These gross simplifications and suspicions are mutual. Among Moldovans there is an increasingly widespread belief that the IMF and the World Bank have a hidden agenda that features the colonial, economic and political subjugation of the country.²⁵ This atmosphere of mutual suspicion is very unfortunate. It is a strong argument for a stronger emphasis on bilateral assistance based on partnership and for a strong element of intensive contact, dialogue and exposure in this assistance.

It would also be wrong to conclude that high-level corruption has increased in recent years. Moldova inherited an unfortunate legacy of corruption from the Soviet period. The fact that corruption has become more visible to outsiders, now that mass media has gradually come to play a more active and assertive role in exposing it and it is more freely talked about, should be seen as a healthy sign and not as an indication that the phenomenon has worsened.

25. The very public interference of the IMF in the domestic political process, to the point where, during the weeks leading up to the formation of the Sturza government, it explicitly and publicly linked the composition of the government under formation with the prospects of continued lending and expressed its opinion on the merits of individual ministers, obviously fuelled this suspicion.

Closely linked to corruption as well as to the weak law enforcement has been the increasing influence of Mafia groups, primarily Russian. Although poorly documented, anecdotal evidence and hearsay, as well as the increasing number of heavily guarded luxury villas on the outskirts of Chisinau, suggest that the increasing grip of Mafia groups on the economy and society is indeed a severe problem.²⁶ It is not only a problem of justice that a small group enriches itself at the expense of the rest of the population in a conspicuous but illegitimate manner, but more importantly, a problem of economic development. The fact that entrepreneurship and enterprises depend on connections and protection and that legitimately earned income is siphoned off to Mafia groups acting as ‘roofs’ not only distorts the playing field for the various economic agents, but constitutes a severe obstacle to domestic entrepreneurship and enterprise development, as well as a possible deterrent to foreign investments. Yet, the severity of this phenomenon should not be overstated. Unlike the situation in Russia, these criminal organisations in Moldova appear to be made up of a multitude of largely uncoordinated and rather weak groups. Since Mafia groups would seem to be a predominantly Russian phenomenon, their base is likely to be confined to the larger cities and to be weak in the countryside where the overwhelming majority of the population is Moldovan. Their existence clearly depends on contacts at various levels within the public sector. It is commonly believed that the Mafia continues to prosper because of a lack of political will, rather than a lack of means, to combat it. It is unfortunate that the President has so far not expressed such a will in a firm and convincing manner.

4.5.2 Geopolitical Orientation

The financial crisis in Russia has brought the issue of Moldova’s economic and geopolitical orientation into the limelight. Until recently, this issue was more or less hidden under official declarations of the need to maintain neutrality, to serve as a bridge between the West and Russia, and to seek harmonious and closer contacts in both directions. The Russian crisis served as a useful reminder of Moldova’s vulnerability as a small nation, trade-dependent on Russia. However, other factors, too, have served to bring the issue of Moldova’s relationship with the rest of Europe to the fore. Firstly, since the parliamentary elections in the spring of 1998, ‘pro-Western’ or ‘pro-European’ forces have dominated both the parliament and the government.

26. Many of the houses are also owned by present or former members of parliament and senior government officials.

Secondly, the increasing integration of other countries in East Central Europe into the structures of the European Union is making it clear that Moldova risks ending up on the wrong side of the fence of the European 'fortress'. Thus, the free flow of goods and people would be impeded not only with the countries of the European Union, which is already the case, but also with its immediate western neighbours. The announcement made by countries such as Poland, the Czech Republic and Bulgaria, that they intend to introduce visa requirements for Moldovan citizens in order to comply with EU requirements, serves as a painful reminder that Moldova may soon end up alone in the cold outside Europe.

Yet, choosing between increased orientation towards the West or towards Russia is far from straightforward. Moldova retains a healthy respect for Russia and the unresolved conflict with Transnistria and the continued presence of a large contingent of Russian troops in Transnistria implies that Russia is eminently well placed to exert strong pressure on Moldova. The somewhat lukewarm interest in the West in Moldova's delicate position underscores Moldova's exposure to Russian pressure.

The unresolved Transnistrian conflict remains an open sore that is inflicting a very heavy economic and political cost on Moldova. The fact that the status quo has prevailed for a number of years does not imply that the situation is stable, nor that the threat that this conflict imposes on Moldova's economic and political stability – if not survival as an independent nation – has in any way diminished.

The economic cost of this conflict on Moldova is threefold.

- Firstly, there is the cost of dislocation, as much of the industrial and economic capacity of the country is in Transnistria. This cost was inflicted immediately after partition and is gradually diminishing, as the old economic structures become increasingly obsolete.
- Secondly, there is the cost of foregone Foreign Direct Investment, due to the image of political instability that the conflict gives Moldova abroad. This cost is difficult to estimate, but is likely to be smaller than commonly believed as other factors, too, have acted as a deterrent to Foreign Direct Investment.
- Thirdly, and most important, the open border with Transnistria and Transnistria's role as a small haven for smuggling and other illegal activities has imposed a very heavy cost on Moldova in the form of foregone public revenue and increased illegal and underground economic activities.

A law stipulating the establishment of border controls to control the flow of goods to and from Transnistria was passed in the autumn of 1998, but implementation was delayed until the spring of 1999. The initial failure of the Moldovan Government to act decisively on this issue has been interpreted as a sign of weakness and as proof that there are people in high positions who have an economic interest in maintaining the status quo. The issue as seen from Chisinau's perspective is rather more complex than one of simply mobilising the political will to establish border controls. Transnistria remains a potent instrument for Russia to exert political and economic pressure on Moldova and to undermine the viability of the country. Efforts on the Moldovan side to control the flow of goods between Transnistria and the rest of Moldova has met with strong disapproval by, *inter alia*, the Russian Duma.²⁷

Russia's threat to the integrity and independence of Moldova, both by refusing to withdraw its troops from Moldova, and by its support to Transnistria as an entity with equal status to that of the Republic of Moldova, effectively ties Moldova's hands in seeking a solution to the conflict.

The economic collapse, the increasing popularity of the Communist party fuelled by non-payment of wages and pensions, and the Russian pressure to create some kind of a federation in Tiraspol, that would have equal status, provide the ingredients of a nightmare scenario whereby Moldova's achievements in creating an independent state based on democratic principles and the rule of law, as well as its aspirations to become a full member of the European family of nations, would be completely undermined. Where its economic and political orientation is concerned, Moldova clearly faces a basic choice between the East and the West. However, in the absence of strong and constructive support from the West, this may well be a choice with only one option.

27. At a visit in 1998 to the Russian Duma, a delegation from the Moldovan parliament, headed by the president of the parliament, Dumitru Diacov, received a very frosty reception indeed. All but a few dozen of the members of the Duma left in protest when Mr. Diacov was invited to address the Duma and during the visit the Moldovan delegation was reportedly told in no uncertain terms that Russia had no intention of permitting Moldova to become further integrated in European economic and political structures and that it had no interest in any early solution to the Transnistrian conflict. A few days after the return of the delegation to Moldova, on February 24, the Duma adopted unanimously a resolution, which *inter alia* condemned the 'blockade of Transnistria by the Republic of Moldova' (that is the decision to control the flow of goods from Transnistria into Moldova) and emphasised the 'exceptional strategic importance of the Transnistrian region to Russia's security interests'.

The Public Sector in Crisis

CHAPTER 5

The public sector has suffered a decline parallel to that of GDP in the 1990s, albeit with an initial delay (Table 14). In 1996 public revenue amounted to about a quarter of the level in 1990, while the expenditure level was about a third of the level in 1990. Yet, in terms of GDP, public revenue was a respectable 27 per cent.

The adjustment of expenditures to the sharp fall in revenues since independence has been very painful indeed. Not only have capital investments been foregone, severe cuts have also been made across the board. Expenditures in key sectors such as education, health care and social services have been dramatically curtailed, although their share of total expenditures remained high until recently (Table 15).

The initial decline of the public sector bottomed out in 1994, and the following three years saw an increase in real terms, particularly of the pub-

Table 14. Development of public sector revenue and expenditure as % of GDP.

	1992	1993	1994	1995	1996	1997	1998	1999
Revenues	19.4	16.8	24.9	26.2	27.1	34.0	29.8	25.1
Expenditures	40.5	23.0	29.7	31.1	36.9	41.7	33.2	28.1
Surplus/deficit	-21.1	-7.5	-5.9	-5.9	-9.8	-7.7	-3.4	-3.0
<i>Development over time</i>								
<i>Index: 1990 = 100</i>								
GDP	72.7	55.2	38.1	36.7	33.8	34.2	31.3	29.9
Public revenue	40.1	26.3	26.9	27.3	26.0	33.0	25.8	20.2
Public expenditure	90.9	39.2	25.0	35.2	38.5	44.0	31.2	24.6
- excl. debt servicing					35.3	39.4	26.9	18.4

Sources: *Economic Trends Moldova*. (1998a. Pp. 51-52) (2000:20, 25).

Table 15. Public sector revenue and expenditures 1995–1999. Million Lei.

	1995	1996	1997	1998 plan	1998 actual	1999 plan	1999 actual
Revenues	1,916	2,074	2,942	2,950	2,722	2,900	3,066
– Profit tax	392	359	244	330	179	240	233
– Income tax	201	219	282	160	224	155	220
– VAT	568	614	949	900	1,124	920	938
– Excises	186	197	401	630	375	683	444
– Foreign trade taxes	51	95	127	120	109	265	214
– Others	518	590	939	810	711	637	1,017
Expenditures	2,345	2,827	3,609	3,300	3,027	3,100	3,435
Education, research	567	833	890	719	640	614	567
Health care	366	521	537	505	393	405	358
Social security	n.a.	167	456	551	361	502	463
Interest payment on debt	173	243	377	450	421	691	867
Capital investments	135	155	234	180	206	65	108
Surplus/deficit, cash	–437	–753	–667	–350	–305	–200	–369
Change in arrears	–145	–364	284		–430		n.d.
Deficit, total	–582	–1,117	–383	–300	–735	80	n.d.

Source: *Economic Trends Moldova* (1998a:89) (2000:25); IMF estimates.

Remark: Other revenues include grants of 111.5 million lei in 1999. Education includes research until 1996, inclusive. The total deficits include arrears. In addition, the social fund, which is not included in the figures above, had arrears amounting to 300 million lei in 1998.

lic expenditures. Public revenue increased, too, albeit at a much slower pace. However, the apparent improvement of the public sector budget was not based on any improvement of the real economy, nor on any fundamental reform of the fiscal system, which remained inadequate and inappropriate for the needs of a market economy. Furthermore, payments in kind and various netting operations, whereby debts are cleared against each other according to often complex and obscure formulae, remain widespread and still account for a considerable share of the public revenues.

The budget deficit increased from a comparatively low level in 1994 and 1995 to 9.8 per cent of GDP in 1996 and 7.7 per cent in 1997. The failure to keep the budget deficit under control in 1996 and 1997 incurred the displeasure of the IMF and as a consequence lending was suspended in early 1997. In the absence of new credits from the IMF and other interna-

tional and governmental creditors, the Moldovan Government increasingly resorted to funding the budget deficit by issuing treasury bills denominated in lei. The Government was also successful in raising funds outside the country in 1996 and 1997. In 1996 sales of bonds on the external market totalled some 39 million USD and in mid-1997 Moldova succeeded in raising a 75 million five-year Eurobond loan on the US and European markets. In addition, the public revenue benefited from the proceeds of the sale of MiG fighters to the tune of 40 million USD in 1997.

A combination of discreet incomes from sales of military equipment and improved tax collection resulted in a marked increase in public revenue in 1997. Successful external and internal financing, through the raising of a large Eurobond loan abroad and the issuing of treasury bills, permitted the Government to run a large non-inflationary budget deficit in 1997, despite the lack of fresh IMF and World Bank credits. Thus, public expenditures increased considerably in 1997, compared to 1996 (Table 15). The Government also managed to reduce the arrears in payments that had accumulated over the past few years.

The growth of the public sector in 1997 gave rise to over-optimism that was reflected in an unrealistic budget for 1998. The budget situation began to deteriorate in the beginning of 1998. As the possibilities of funding the budget deficit by external borrowing dried up, no windfall incomes from state sales of assets were obtained and tax revenues fell from the 1998 level, there was a sharp shortfall in total revenue to about 60 per cent of the planned level. At the same time, operational expenditures were being squeezed from the other side by a rapid increase in external debt servicing as earlier loans began to fall due, while few new ones were forthcoming. The response to this situation was a rapid increase in short-term domestic lending through the issuing of treasury bills, and a curtailment of operational expenditures, which mainly took the form of non-payment of wages and salaries to public sector employees. Thus, the Russian crisis hit a budget that was already reeling. The impact of the Russian financial crisis on the Moldovan public sector was threefold.

An involuntary reduction of the budget deficit as the market for treasury bills collapsed. Not only could the Government no longer expand this form of short-term borrowing, it also had to honour payment of T-bills that were falling due to the tune of 350 million lei (75 million USD) over a period of only four months (July – October), without being able to sell any new ones.²⁸ However, in contrast to Russia, the Moldovan government

28. Interview with Valeriu Muravschi, President of the Commission for budget and finance of the Parliament, October 26, 1998.

had the stamina and determination to weather the storm and did not default on its payments. The cost of the redemption of the T-bills was covered by loans from the National Bank and by diverting government revenue from scheduled expenditures on education, health care etc. and by further non-payment of wages and pensions.

Tax revenues fell further as the external sector and the economy as a whole contracted sharply.

The involuntary devaluation of the leu doubled, virtually overnight, the size of the external debt and the already high debt service burden, which assumed unmanageable proportions.

While the former of these three effects was of a short-term nature, the consequences of the latter two are proving to be lasting and continue to cripple the public sector.

The response to the crisis was threefold:

- Continued non-payment of wages and salaries, with the result that the accumulated arrears reached truly dangerous levels, both in terms of the months of non-payment and the amounts involved (Table 16).
- De facto default on part of the external debt, primarily that due for energy imports from Russia.
- Panic cuts in operational expenditures of all sorts and non-payment of incurred costs.

Table 16. Arrears in wage payments in the public sector as of February 18, 1999. Million Lei.

	Prior to 09/98	Sept. 1998	Oct. 1998	Nov. 1998	Dec. 1998	Jan. 1999	Total
State budget	0	7.0	25.6	29.5	30.2	30.2	122.5
– education	0	0	5.4	5.4	5.4	5.4	21.6
– health care	0	0	1.5	3.6	3.6	3.6	12.3
– other sectors	0	7.0	18.7	20.5	21.2	21.2	85.0
Local budgets	22.5	17.3	20.9	27.3	33.7	34.0	155.7
– education	8.5	7.5	11.0	12.3	17.0	17.1	73.4
– health care	5.4	5.6	5.4	8.9	9.6	9.4	44.3
– other sectors	8.6	4.2	4.5	6.1	7.1	7.5	38.0
Consolidated budget	22.5	24.3	46.5	56.8	63.9	64.2	278.2
– education	8.5	7.5	16.4	17.7	22.4	22.5	95.0
– health care	5.4	5.6	6.9	12.5	13.2	13.0	56.6
– other sectors	8.6	11.2	23.2	26.6	28.3	29.7	126.0

Source: Ministry of Finance, Verbal communication, March 1999.

One consequence of the sharp discrepancy between plan and reality was a collapse of the already shaky budget planning system. The planning horizon was reduced to a week or two, as any available resources had to be used to fill the most urgent gaps or to pay those who shouted loudest.

It was in this situation that the budget for 1999 was negotiated with the IMF in November 1998 and approved shortly afterwards. One basis for the budget appeared to have been a forecast from the Ministry of Finance that total revenues for 1999 would be 2.1 billion lei (at 1998 prices). Judging from past records and in view of the extremely depressed economic situation, this was hardly an overly negative forecast. Yet, following the negotiations with the IMF, by the time the budget was approved by Parliament, this figure had been revised upwards by 800 million lei to 2.9 billion lei. The budget was based on an IMF forecast of zero growth and modest inflation in 1999, which, under the circumstances, was clearly totally unrealistic. As it turned out, Gross Domestic Product fell by 4.4 per cent and inflation reached 44 per cent as the impact of the devaluation percolated through the economy. Thus, Moldova was once again stranded with an unrealistic budget which, as was the case in 1998, made the budgetary and financial planning of the public sector very difficult.

The budget law for 1999, resulting from the negotiations with the IMF, stated in its second article that servicing the external debt and payments of wages and pensions had top priority.²⁹ A closer look at the budget makes it clear that it was the debt to the western and international lenders that was meant by “the external debt”, while most of the debt to Russia for energy deliveries was presumed to have been rescheduled, (which at the time it had not yet been). It is also clear that the priority in respect of wage payments referred to current wages and not to wage arrears. Domestic arrears were assumed to be reduced by a mere 120 million, i.e. about 20 per cent, rather than to be honoured in full.

Thus, it was stipulated that the external debt to the West should be honoured in full, while much lower priority was attached to the accumulated debt to the public sector employees, pensioners and others. This was not only ethically questionable, but also economically and politically very shortsighted. While domestic employees and pensioners are too poorly organised to enforce their rights with the same vigour as western and international lenders, the accumulation of arrears in payments of wages and pensions over a long period of time is extremely detrimental to overall so-

29. *Legea bugetului pe anul 1999*, 1998.

cietal development. It undermines the country's ability to pursue reforms and effectively tackle its economic problems.

5.1 Effects of Honouring the Debt

As public sector employees are forced to demand payments from the public for the services they provide, it inevitably breeds corruption at all levels. This is socially unacceptable, as children are deprived of education, the sick of treatment etc. unless they pay up front for these services. It also throws a spanner into the works of the overall reform process, since corruption, which is recognised as a main impediment to reform and growth, becomes impossible to combat. It undermines the revenue side of the budget, as people who are not paid wages or pensions are unable to pay any taxes themselves or to pay the cost of public utilities such as heating and electricity. Furthermore, tax collection suffers, as those responsible for collecting taxes do not receive their wages for months on end themselves.

The arrears refer not only to wages and pensions, but also to economic agents. One case in point is the reimbursement of value added tax to exporters. Reimbursement was made after long delays, or not at all. Thus, an export tax of 20 per cent was in reality levied on those who exported legally. The economic implications of this, in a situation where the country desperately needs to promote its exports, are obvious.

Apart from pensioners and public sector employees, who did not receive their wages and pensions, the social sector suffered most from the budget crisis. As room had to be made in the budget for servicing the debt, social sector expenditures, which until then had made up the bulk of the expenditures, were cut. The share of education in total public expenditures³⁰ fell from 29.5 per cent in 1996 to 16.5 per cent in 1999, while health care expenditures fell from 18.4 to 10.4 per cent, as the share of interest payments on the debt increased from 8.6 to 25.2 per cent. The higher level of social security expenditures was primarily due to compensation paid to energy companies for sales of energy to the households at below cost.

Combined with the fall in overall public expenditures, by more than a third between 1996 and 1999, the fall in education and health care expenditures was very dramatic indeed. In the course of only three years,

30. Excluding the social fund.

Table 17. Distribution of total public sector expenditures by sectors, 1996–1999.
Percentages

	1996	1997	1998	1999 plan	1999 actual
Education	29.5	24.7	21.1	19.8	16.5
Health care	18.4	14.9	13.0	13.1	10.4
Social security	5.9	12.6	11.9	16.2	13.5
Interest on debts	8.6	10.4	13.9	22.3	25.2
All expenditures	100	100	100	100	100

Sources: Table 15.

real expenditures on education and health care fell by almost two-thirds, to little more than a third of the already low level of 1996. Since then these expenditures have suffered further cuts. In per capita terms, the public expenditures were a paltry 14 USD per capita on education and 9 USD on health care in 1999, that is a small fraction of their levels prior to independence.

The public health care system all but collapsed as hospitals and health clinics had to make ends meet as best they could with little or no help from the state. The result was a more or less formalised, but totally ad hoc, system of cash payments for all medical services. Individual doctors and hospitals set the fees at their own discretion. As a consequence, a large proportion of the population no longer have access to any health care and few can afford treatment for more serious illnesses.

In education, too, the situation is deteriorating rapidly, although it is not yet as bad as in health care. Informal fees, solicited by teachers from the parents have become standard practice, even in primary education. This threatens to deprive children, in particular many rural children, of access to even basic education. A similarly insidious practice is that of selling grades and examinations. The latter obviously erodes the value of the examinations and poses a long-term threat as access to professions requiring specialised academic knowledge, for example the medical profession, can be obtained by people who totally lack competence in the field concerned.

Concomitant with this dramatic crisis in the social sectors, a comprehensive social sector reform, proposed by the IMF and spearheaded by the World Bank, was launched (Government of Moldova, 1999). The need for reform of the health care and, in particular, social security systems had been obvious since the early days of independence. The systems devel-

Table 18. Development of public sector incomes and expenditures in real terms. Index: 1995=100.

	1996	1997	1998	1999
Revenues	100	128	100	78
Expenditures	100	115	82	64
– Education	100	96	58	36
– Health care	100	93	67	36
– Social security	100	246	165	147
– Interest on debt	100	140	132	189

Source: Table 15; *Economic Trends Moldova (2000:20)*.

Remark: Average annual rates of inflation were used to calculate development in real terms.

oped under socialism were, in Moldova as elsewhere, ill in tune with the needs under a market economy. The sharp economic decline of the early 1990s made the need for reform even more pressing. Yet, it was only in 1998, as the level of government expenditures became untenable and the need to make room in the budget for debt servicing became acute, that the issue was addressed. Under the circumstances, reforms became little more than an attempt to make the collapse look like an orderly retreat of the public sector from its obligation to provide the population with the most basic social services.

The Social Drama

CHAPTER 6

From a social perspective, post-independence development in Moldova qualifies for the epithet a ‘monumental disaster’. The transition to a market economy has become a transition to destitution. Since it became an independent state in 1991, Moldova has been suffering from a deepening social crisis. The main elements of this crisis are an enormous decline in income and growing income differentiation, decreasing expenditure and consumption, growing poverty and sharply deteriorating nutrition.

6.1 Mechanisms Behind the Falling Living Standards

The economic decline has been translated into falling standards of living through three main mechanisms:

- an erosion of liquid assets through inflation;
- a sharp fall in wages and other incomes from employment, together with a fall in employment opportunities;
- a near collapse of the public social security system.

6.1.1 Inflation

In the context of the economic crisis, described in the chapters above, dramatic changes have taken place in the living standards of the population. The income effect of reduced economic activity combined with high inflation has been devastating.

The hyperinflation of 1990-1993, when Moldova was still a part of the rouble zone, effectively wiped out all personal savings. By the end of 1993, prices had increased 1,255 times over the level at the end of 1990. As a consequence, life-long savings for a secure old age bought little more than

Table 19. Development of the real value of wages and pensions 1991–1997. 1991=100.

	1991	1992	1993	1994	1995	1996	1997	1998	1999
Real value wages	100	61.6	60.0	26.5	26.8	25.4	29.2	25.9	23.0
Real value pensions	100	41.2	28.8	14.4	12.9	12.7	11.6	n.a	

Sources: UNDP. (1997a:53); *Economic Trends Moldova*, 1998b and 2000.

Remark: Wages refer to January of the respective year.

a week's supply of bread. Old people, in particular, were hit hard by the inflation. Not only did it wipe out their savings, the value of their pensions, too, fell to ridiculously low levels. The problem with payments of pensions was not only a consequence of an erosion of the pension fund, but also that Moldova lost access to the centralised pension funds in Moscow when the Soviet Union broke up. Hence, pensions had to be paid out of the current expenditure budget of the new government in Chisinau. The average pension by end of 1998 was about 90 lei or slightly more than 10 USD, implying a fall to a mere fraction of the level in 1990 (*Economic Trends Moldova*, 1998c:49-51). It might be added that there were delays of several months in the payment of the pensions.

6.1.2 Sharp Fall in Wages and Other Incomes

The real value of wages and social benefits started to decline rapidly soon after independence, particularly as a result of the hyperinflation of the first half of the nineties. In the period 1992-1994 the real value of wages fell by 73.5 per cent to 26.5 per cent of their 1991 level, while the decline in pensions was even worse (Table 19). In 1994 pensions equalled only 14.4 per cent of their 1991 value. Since 1994 both wages and pensions have continued to decline, albeit at a slower pace. In 1999 the average wage was 28.5 USD or 23 per cent of its level in 1991 (*Economic Trends Moldova*, 2000:22, 25).³¹

However, there were large variations across sectors. By far the lowest wages were paid in agriculture, where the monthly wage was only slightly more than half of the national average. Wages in education and health care, too, were well below the national average, while average wages in manufacturing, construction and transport ranged between 350 and 400 lei. The average pension had fallen to little more than a tenth of its 1991 value.

The impact of the economic decline on the labour market (and thus on incomes) has also taken the form of a sharp decline in wage employ-

31. Average for first three quarters of 1999.

Table 20. Wage employment by sector of activity, 1990–1998, Thousand persons.

	1990	1991	1992	1993	1994	1995	1996	1997	1998
Total labour force	2,071	2,070	2,050	1,954	1,941	1,276	1,200.0	1,126.6	1,033.2
Agriculture and forestry	678	743	749	730	767	549.3	510.7	474.0	411.2
Manufacturing industry	456	424	415	245	232	176.9	156.7	141.5	125.1
Construction	172	153	146	105	91	48.6	34.7	34.7	29.8
Trade	145	136	132	116	107	81.8	54.1	48.8	40.6
Transport & communication	112	108	105	75	73	66.8	62.3	58.5	56.3
Health care	115	116	116	96	98	93.3	90.9	88.8	86.7
Education	232	224	223	166	168	150.8	149.4	145.3	142.5

Sources: *Anuarul Statistic 1994* (1995:90); *Anuarul Statistic 1996* (1997:127-128); *Statisticeskii Ejeodnik, SNG v 1996 godu* (1997:381); *Economic Trends Moldova* (1998b:24); (1999b:20).

Remark: Figures for 1990 – 1994 refer to the whole of Moldova, while those for 1995-1998 exclude Transnistria.

ment. Less and less people are entitled to wages. Official registered unemployment remains extremely low (3.7 per cent by mid-1999) because employment offices have little to offer job-seekers. They have almost no vacancies, extremely limited funds for active labour market policies, and only one-fifth of the registered unemployed are entitled to unemployment benefits. However, the number of people in wage employment has been falling steadily. Merely between 1995 and 1998 the total number of employed fell by 243,000 or 11.7 per cent.³²

The figures presented in Table 20 provide a broad picture of trends in wage employment. Agriculture has traditionally been the most important sector followed by manufacturing.

The decline in wage employment in agriculture in recent years can largely be ascribed to the impact of decollectivisation, and reflects a change in status from wagedworkers on collective farms to independent small-scale farmers. In the manufacturing sector, the decline reflects the overall decline of manufacturing.

The economic crisis has severely affected the capacity of the economy to generate wage employment. Among the first to be affected were rural youth entering the labour market who, for lack of wage opportunities, were often forced to join the ranks of the underemployed or self-employed in agriculture. The drastic reduction in the wage/state sector labour force as a result of the closures of industrial enterprises and the sep-

32. The available labour market data on Moldova are not always completely reliable and a regular labour force survey was started only in late 1998, but its results are not yet been fully processed due to lack of funding.

Table 21. Wage labour as per cent of total employment and per cent of wage labour force affected by involuntary leaves or restricted workweeks in 1996.

Industry	Labour Force	Wage Workers	% Wage Workers	A	B
Agriculture	771.0	515.5	66.9	0.1	5.7
Manufacturing	169.0	150.0	88.8	8.9	62.9
Construction	55.0	39.4	71.6	5.1	55.3
Trade & repair services	256.0	54.6	21.3	2.6	16.8
Transport	66.0	61.2	92.7	7.5	21.8
Education	155.0	147.0	94.8	1.4	6.5
Health care	94.0	90.9	96.7	0.3	3.4
All industries	1660.0	1187.5	71.5	2.3	16.3

A: % of wagedworkers affected by involuntary reduced working time in 1996.

B: % of wagedworkers affected by involuntary leave in 1996.

Source: *Anuarul Statistic 1996*. (1997:127-137).

Remark: The average period of involuntary leave was 77 days.

aration of Transnistria, where the biggest part of these enterprises were located, affected not least the rural labour force commuting to urban jobs. Consequently, many of the households which previously had a diversified income basket, where wage income often made up a dominant share, lost their main source of income and became increasingly more dependent on farm income. For lack of alternatives, agriculture was been forced to assume the role of an employment buffer.

There has also been a shift from industry to the, primarily urban, informal sector (Table 21). At the same time as the labour force involved in trade, commerce and repair activities increased considerably, to the point where it considerably exceeds the labour force in manufacturing, the share of wage labour in this sector has fallen to a mere 21 per cent. Although some may have gone from wage employment in industry to successful self-employment, it is more than likely that the majority, for lack of alternative income opportunities, have been forced into distress activities, such as petty trading.

Apart from flight into low-productive self-employment in agriculture, petty trading and services; unemployment and underemployment has taken three main forms:

- Open unemployment had reached 167,000 or 9.4 per cent of the wage labour force by May 1998 according to a pilot Labour Force Survey.

- An additional 120,900 were put on *involuntary leave without pay* in 1998.
- Some 39,900 suffered *involuntary reductions in working time and pay*.

Involuntary leave has been most frequent in manufacturing and construction, where in 1996 some 60 per cent of the wage labour force was affected. However, even for those who effectively retained their employment, wages have not always been forthcoming, since payment in kind (particularly in agriculture and manufacturing), and long delays in the payment of wages and pensions have become the norm, rather than exception. The cumulative effect of involuntary leave and arrears in wage payments may be gauged by the fact that during the first three-quarters of 1998, some 21 per cent of the permanent wage labour force were not included on any payroll.³³ According to BASA Press, by September 1998 the state had started repaying pensions and salaries arrears in the form of agricultural products, such as wheat, corn, sunflower and sugar. Yet, by end-1998, total wage arrears in the economy had reached 638.2 million lei, of which 247 million was owed by the Government to public sector employees. In addition, there were 297 million lei in pension arrears.³⁴

6.1.3 The Collapse of the Public Social Security System

The collapse of the public social security system has been the third mechanism, which has led to the fall in the living standards of the population. Prior to independence there was an overall social security fund comprising a pension fund, a social insurance fund and a reserve fund. These funds were used to finance a wide range of pensions and other social benefits. They were largely financed by compulsory contributions from both employers and employees. These funds have dissipated rapidly since independence. With the break-up of the Soviet Union most of the existing funds were lost to Moldova, as they had been centralised in Moscow. It has proven to be extremely difficult to build up new funds. With the economic collapse the need for benefits has increased vastly, while contributions have diminished. The process of privatisation and, in particular, the shift from wage to non-wage employment, has further eroded the social security system, as self-employed rarely make contributions, nor for that matter do many private enterprises. The state budget, which in the past assumed part of the cost of pensions and other benefits, has not been in

33. Economic Trends Moldova, 1998b, p. 21.

34. Basapress 20.09.98; Infotag 05.02.99.

a position to make up for the shortfalls in the social security funds. New legislation on social security with a sharper focus and more specific targeting, might have cushioned the collapse of the social security system if it had been introduced soon after independence. However, work on reforming the system only began in 1997.

6.2 Changes in Income during Transition

Three major changes in income have taken place since independence. First of all, total real income has plummeted mainly as the result of the rapidly declining real value of wages and social benefits, which have traditionally been the major income sources.

Secondly, there have been major shifts in the structure of income including a decrease in the importance of some of the major traditional income sources and a rapid increase in the importance of new sources. Thirdly, the differentiation of income has increased, widening the gap between different population groups.

The main sources of income in Moldova have traditionally been wages and social benefits, the latter consisting primarily of pensions. Their combined share of total income before 1991 used to float at about 90 per cent. An analysis of the structure of household income over a time span of thirteen years (1987-1997) shows a decreasing share of the wage component in total household income as a result of growing unemployment and underemployment since 1993 (Table 22). With the decline in their real value and growing arrears, the share of wages and benefits of total household incomes fell during the period 1992-1997. The most dramatic fall has been the decreasing importance of wages, which accounted for only 35 per cent of total income in 1997, compared to over 70 per cent before 1994. Since 1997 the share of wages in total disposable income would appear to have increased marginally, while the share of social transfers has fallen further. The fall in real wages has been further exacerbated by non-payment or

Table 22. Percentage share of the wage income and social transfers (pensions, indemnities and scholarships) in total household income (1987-1999).

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1997	1999
Wage income	72.9	73.1	74.0	73.0	75.0	71.6	74.5	40.6	37.7	34.2	35.1
Social transfers	18.1	17.0	15.4	15.2	15.2	18.1	16.3	14.0	13.1	12.4	8.5

Sources: Anuarul Statistic 1989 (1990:71-73); Anuarul Statistic 1990 (1991:62-65); Anuarul Statistic 1991 (1992:38-40); Statisticeskii Ežegodnik (1997:366); Economic Trends Moldova (1998b:37); (1999b:26).

Table 23. Monthly per capita income by rural/urban areas. April–June 1999. USD.

	Total	Urban	Rural
Total disposable income	11.86	15.28	9.83
– wage income	4.17	8.62	1.53
– non-wage income	5.02	1.58	7.06
– agriculture	4.67	0.83	6.95
– social benefits	1.01	1.75	0.57
– other transfers	1.52	3.09	0.58
– of which gifts	1.42	3.00	0.51

Source: *Economic Trends Moldova*. (1999b:26, 100).

Remark: Exchange rate: 1 USD = 10.71 lei. The figures include incomes in cash as well as in kind.

payment after great delays. By the beginning of 1999 total wage arrears amounted to 639 million lei, equivalent to 8.3 per cent of GDP for 1998. The agricultural sector, that is mainly the old kolchozes and sovchozes, accounted for a third of the arrears, while most of the rest, some 270 million, was owed by the public sector.³⁵

Recent income-expenditure surveys provide a grim picture of dimly low levels of income, large and increasing inequality in income distribution and a reduction in the importance of wages in the formation of incomes. In the second quarter of 1999 personal disposable income averaged less than 12 USD per person and month. At 15.28 versus 9.83 USD, average income was considerably lower in rural areas than in urban areas (Table 23). In urban areas wage incomes amounted to a paltry 8.6 USD per capita and month. In rural areas wage income had been reduced to complete insignificance, reflecting the shift from collective to private farming as well as non-payment of wages in the remaining collective sector. The figures for the rural areas also highlight the pervasive importance of agriculture. Social benefits were, on average, more than three times as large in urban areas as in rural areas, adding to the rural – urban income gap. The average value of gifts received was also much higher in the urban areas than in the rural areas, suggesting a net flow from rural to urban areas.

Together with the dramatic fall in personal incomes, there has been a rapid demonetisation of the income. An income-expenditure survey in 1998 showed that 42 per cent of the average income was obtained in kind.³⁶ A particular aspect of the demonetisation of incomes has been the increase

35. *Economic Trends Moldova* (1999, Chapter 5).

36. *Economic Trends Moldova* (1998c: Tables 4.3 and 4.6).

Table 24. Quintile distribution of household disposable income, April–December 1997.

Quintiles by disposable income	Share of income by quintiles, %	Monthly disposable income, USD
The first	4.3	6.2
The second	9.8	14.3
The third	14.8	21.5
The fourth	22.5	33.1
The fifth	48.6	71.0
Total	100	

Source: *Economic Trends Moldova. 1998c. Tables 4.3 and 4.6.*

in payments in kind over payments in cash. Wage payments are often not made in cash, but in kind, especially in the agricultural sector. In 1997 some 23 per cent of the cereals, 30 per cent of the vegetables and 52 per cent of the potatoes produced were ostensibly used for wage payments. In recent years the government has also resorted to paying pensions and wage arrears in agricultural products. Virtually all the income from agriculture is kind, primarily in the form of consumption of own produce.

6.2.1 Income Inequality

The decline in incomes has been accompanied by a dramatic widening of the income gap. The average disposable income per person, per month of the richest 20 per cent of the population was 6.8 times that of the poorest 20 per cent in 1998 (Table 24). Extrapolation of income distribution data from 1998 to the personal income data for 1999 suggests that the poorest quintile subsist on no more than four USD per month, while 80 per cent of the population have to make do with less than 15 USD per month, which clearly shows that poverty is no longer an isolated phenomenon, but encompasses the vast majority of the population. Even the richest quintile had an average per capita income of no more than 26 USD in 1999.

In 1997, the richest quintile accounted for almost half of all disposable income in the country while the poorest quintile had only 4.3 per cent (Table 24). The Gini coefficient³⁷ has increased sharply from 0.26 in 1990 to 0.44 in early 1999, which is high even by the standards of most developing countries.³⁸

Payment of social benefits would seem to exacerbate rather than re-

37. The Gini coefficient measures the degree of inequality (usually of income) on a scale from 0 to 1, where 0 represents perfect equality and 1 maximum inequality.

38. World Bank (1998b:68-71); UNDP 1999:40).

Table 25. Monthly per capita expenditures by rural/urban areas. April–June 1999. USD

	Total	Urban	Rural
Total consumption expenditure	12.19	15.86	10.02
Food	8.00	8.69	7.59
Alcoholic, tobacco and drugs	0.51	0.45	0.54
Clothing and shoes	0.73	1.13	0.49
Housing – rents and utilities	1.15	2.39	0.41
Health care	0.51	0.80	0.33
Transport & communication	0.57	1.02	0.30
Entertainment	0.11	0.27	0.01
House furnishing and equipment	0.25	0.33	0.21
Hotels, restaurants	0.05	0.13	0.005

Source: *Economic Trends Moldova* (1999b:27).

Remark: Figures include consumption of own produce.

duce the income disparities. As noted above, social benefits display a strong urban bias. Earlier studies have also shown them to be positively correlated with total income.³⁹

6.3 Expenditure, Consumption and Nutrition

As a direct result of the dramatic decline in real incomes, expenditure has suffered a similar erosion. An analysis of expenditure patterns confirms the picture of a population struggling with the problems of meeting their basic needs.

Food and non-alcoholic beverages account for two-thirds of total consumption, rising to an extreme 76 per cent in rural areas. Data from 1998 show that the poorest spend a much larger share of their income on food than those who are slightly better off. Among the poorest quintile, food accounted for a staggering 87 per cent of the expenditures in 1998 (Table 26). Yet, at a mere 30 lei,⁴⁰ this did not even suffice for a small loaf of bread per day. However, the extremely high share of food in total expenditure is not a characteristic of the poorest strata alone. More than 80 per cent of the population was found to spend at least 70 per cent of their income on food (Table 26).

39. *Economic Trends Moldova* (1998c: Tables 4.3 and 4.6).

40. 6.35 USD at the inflated exchange rate at the time.

Table 26. Consumption patterns by consumption quintiles.
April–June 1998. Percentages.

	Quintile I	Quintile II	Quintile III	Quintile IV	Quintile V
Food	86.6	83.7	79.0	72.6	54.5
Alcohol, tobacco, drugs	3.1	3.2	4.1	3.8	4.3
Clothes and shoes	1.9	3.2	4.1	5.9	11.6
Housing; rents, utilities	2.1	3.0	4.3	6.8	8.3
Health care	1.5	1.1	1.8	2.9	4.0
Transport, communication	2.1	1.7	2.8	3.6	10.1
Entertainment	0.1	0.2	0.4	0.5	1.2
House furnishing, equipment	1.9	2.5	2.0	1.8	2.1
Hotels, restaurants	0.2	0.1	0.1	1.7	0.5

Source: Economic Trends Moldova (1999b:37).

Yet, Moldova is not in the tropics and food alone is not enough to meet basic needs. The low expenditures on clothing and shoes – less than 1 USD per capita and month on average – reflect an inability to replenish stocks and to compensate for wear and tear. This is clearly a short-term solution at best, as in the long run clothes and shoes have to be replaced. The problem is acute, particularly for children in the rural areas, where dropout rates have increased sharply as children lack clothes and shoes to go to school.

Similarly, the very low expenditure on rents and utilities hardly reflects the real costs. The real cost of modest heating and electricity for a 2-3-room apartment of some 50 square metres in 1999 was in excess of 250 lei per month. Compare this with the per capita expenditures of 25 lei per month in urban areas on rent and utilities in the same year. The discrepancy is a result of the energy companies' poor rate of revenue collection and huge operating losses, which in turn are reflected in large and increasing debts to energy supplies in Russia.⁴¹

The expenditure figures by quintiles (Table 26) confirm the impression that the vast majority of the population in Moldova has fallen to a level of incomes and expenditures that is too low to be sustainable. As the overwhelming share of the income is spent on food, virtually all other expenditures are deferred into the future. This reflects a survival strategy, which is not only desperate, but also untenable. Sooner or later shoes and clothes wear out, deferred payments of utility bills have to be made or acute ill-

41. See Chapter 2.3.

Table 27. Average annual consumption of basic food products, 1985–1996
(kg per capita).

	1985	1990	1998	1998 as % 1990
Meat and meat products	54	58	23	40
Milk and dairy products	294	303	148	49
Eggs	209	203	114	56
Fish and fish products	13.4	12.0	2.2	18
Sugar	44.9	48.9	15.6	32
Vegetable oil	12.3	14.1	6.2	44
Potatoes	79	69	64	93
Vegetables	129	112	74	66
Fruit, including grapes	64	79	59	68
Bakery products (bread, cakes, flour, oatmeal, etc.)	173	171	129	75

Source: UNDP. (1998); (1999:101).

ness necessitates a visit to a doctor or a hospital. Yet, in the budget of the average Moldovan there is no allowance for such expenditures. Only the richest 20 per cent would seem to have a somewhat more balanced expenditure pattern (Table 26).

One of the main consequences of the fall in expenditure has been the deterioration in nutrition. In the period 1990–1996 the average consumption of basic food products declined by approximately a half, with the exception of potatoes (Table 27). Consumption of meat and meat products, fish and fish products, and sugar also dropped below 50 per cent of the level of six years before. The consumption of milk and dairy products, eggs, vegetables and vegetable oil suffered serious decline.

There is a strong overall decrease in the quality of nutrition of the population and the composition of the daily food intake has become less diversified. Most people are encountering difficulties in purchasing everyday basic products. The decline in living standards can be seen from the average daily nutritional value of food intake per person, which fell from 2970 kcal in 1990 to only 1976 kcal in 1998 (Moldova in Transition, 1998: 85). This is less than the minimum nutritional threshold of 2100 kcal per day calculated by the UN Food and Agriculture Organisation, FAO.

Malnutrition particularly affects the poorest strata of the population. Accompanying the decline in average food consumption, there has been an increasing gap in food consumption between the poor and those who are somewhat better off. Thus, the consumption of meat between the first

and tenth income decile differs by 6.6 times, of fish by 5.3 times and of milk and dairy products by 5.3 times (UNDP, 1999: 102). It is estimated that the poorest 20 per cent of the population receive a daily average of only 1,775 kcal or 84.5 per cent of the national average. Some 10 per cent of the population have a diet under the critical nutrition level of 1,500 calories, defined as extreme under-nourishment by the FAO and are actually suffering famine.

The worsening living standards are also reflected in demographic and health statistics. Falling birth rates and increasing death rates have resulted in a negative natural increase in the population. A rapid increase in emigration is adding to the population decline. Infant mortality is increasing steadily and life expectancy is falling. The incidence of anaemia among pregnant women has increased from 25 per cent in 1990 to 44 per cent in 1997. Anaemia increases the risk of complications at birth, for both the child and the mother, and also results in an inability to breast-feed. A study made by UNICEF in 1996 revealed that over 75 per cent of all children are born with a body weight of less than 2,500 grams, while 30 per cent are born prematurely.⁴² Some 28 per cent of the pre-school children were found to suffer from anaemia and 9.5 per cent were underweight.

6.3.1 Access to Medical Care and Education

With the privatisation of the pharmaceutical network, the access of the population to drugs has become a major problem. More often than not patients do not follow the medical prescriptions given in cases of ambulatory treatment, as the cost of the drugs is prohibitively high. Until recently, this led to an increase in visits to the hospitals, as they would sometimes provide the patients with drugs at a lower cost or free of charge. With the introduction of fees for hospital care, this avenue has now been closed. Thus, visits to hospitals have decreased even though the condition of health of the population has clearly deteriorated. As might be expected, the poor visit primary health care services less frequently than those who are better off.⁴³ For the majority of the population, medical care has become an unaffordable luxury.

As discussed above (Chapter 5) education, too, has suffered crippling cuts in resources, not least in the past few years. The precarious situation in the educational sector is particularly worrisome as it leaves the graduates from the educational system poorly equipped to face the demands of a rapidly changing society and labour market and implies that Moldova's

42. UNICEF (1996).

43. Tintiuk (1997:15).

human capital, its main asset, is rapidly being ruined. The falling demand for education is due to rising costs and the precarious material situation of the poor households. This situation affects the poor most.

The access of poor children to good education is being reduced by a combination of factors. These include deterioration of infrastructure, the outflow of qualified teachers, the cost of school supplies and even the lack of adequate clothing in winter. With the inability of the state to adequately fund education, private schools, teachers, and private institutions of higher education have moved in. But the quality of education offered by them varies, and they are unaffordable for the poor. In addition, the number of dropouts among schoolchildren has rapidly increased and is becoming endemic, as they drop out to join the labour force, primarily in subsistence agriculture and petty trading. According to the World Bank, over 15 per cent of the poor children do not go to school, the problem being worst for girls in rural areas. Among youth between the ages of 17 to 24, only 14 per cent of poor Moldovans were enrolled in higher schools, compared to 40 per cent of the youth from non-poor households.⁴⁴ This difference in educational access threatens to have serious consequences for the future, as the children from the poor households will have fewer opportunities to obtain an education and skills, and will thus remain poor.

According to the data of the Center for Social and Human Ecology of Moldova the negative tendency in the educational sector is reflected in a decrease in the number of pre-school institutions by almost 36 per cent (from 2,322 in 1990 to 1,480 in 1997). The number of children attending pre-school institutions decreased by 59 per cent in the same period. Since then attendance has plummeted with the introduction of user fees accompanied by a reduction in expenditures (IMF, 1999:102). The total number of educational institutions of all grades has decreased by 8 per cent, while school attendance decreased by 14 per cent compared to the level of 1990. Some 13,834 children (age 7-16 years old) did not attend school in 1996.

44. World Bank. 1997. P.viii.

Conclusions and Lessons

CHAPTER 7

7.1 The Economic Decline

The last few years of rapid decline has set Moldova back half a century or so in terms of economic performance. As industries have ground to a halt and with agriculture, the mainstay of the economy, in disarray, living standards have fallen to levels comparable to those experienced during and in the aftermath of World War Two. Economically, independence has so far been a disaster for Moldova. In the political field the record is better. The political and institutional transformation towards parliamentary democracy and respect for human rights and freedom has, against high odds, proceeded at a steady pace.

The failure to break out of the colonial trade patterns of the past is hardly the core problem, but a reflection of a more fundamental failure to reconstruct the economy in tune with the dramatic changes in conditions after independence. For Moldova, 'transition' from being a peripheral cogwheel in a huge centrally planned economy to becoming a small, open market economy has entailed an enormous amount of destruction, but precious little reconstruction.

The blame for the economic decline can hardly be put on grossly incompetent or predatory governance. All things considered, the record of the post-independence governments in Moldova is a great deal better than that of most other countries in the Commonwealth of Independent States, CIS. Although from a Moldovan viewpoint, the reform process may appear to have been painstakingly slow; this is clearly a question of perspective. Compared to the pace at which most governments in Western Europe and the European Union have been adapting themselves to the new political and economic realities of post-1989 Europe, the pace of change in Moldova appears almost breathtaking. Yet, a failure to adapt

to the fundamentally different economic situation after independence is clearly at the heart of the failure to achieve economic recovery after the initial, arguably inevitable, immediate post-independence decline.

In the absence of any substantial bilateral assistance, Moldova has had to rely primarily on international organisations and programmes, primarily the IMF and the World Bank, for assistance. It is probably fair to say that Moldova received an undeservedly raw deal. As a small and rather unknown fish in the sea of transition economies, Moldova clearly did not attract the attention and interest of the most prominent experts. The advice dispensed by the international agencies was, with few exceptions, little more than a standard fare of clichés, which is hard to contradict, but of little practical help, and scant attention was paid to the particularities of the situation in Moldova.

In retrospect, the complete failure to fully grasp the complexity and profound and acute nature of the problems confronting the new country suggests an astounding naiveté and a disinterest and/or inability to undertake anything more than superficial and perfunctory analyses of the situation. In many instances the Moldovans probably had a better understanding of the problems they faced than those who came to advise them. Yet, more often than not they failed to convey this to the foreign experts who arrived on brief visits armed with textbook knowledge and ready-made recipes.

In terms of financial assistance, too, Moldova was niggardly treated. The World Bank stuck to a much too high estimate of Moldova's GDP, based on extrapolations of estimates of the earlier GDP of the Soviet Union, and refused to accept fresh calculations made on the ground with foreign assistance and generally recognised by other international expertise, including the IMF, as reasonably accurate. As a consequence Moldova did not receive status as 'development country' under DAC, nor as 'recipient country' by IDA, and thus did not qualify for concessionary loans and general development assistance, until 1997. This high level squabble over GDP estimates has cost Moldova dearly. Not only was it denied concessionary credits at a time when it needed them most, but this dispute also delayed an awareness among potential bilateral donors of the precarious situation in the country.

The receipt of status as developing country by DAC in 1997 opened the door to more substantial bilateral assistance, primarily from the Netherlands, Germany, Sweden and the USA. However, there were no initial benefits in terms of access to cheap credit from the IMF and World Bank sources, as the IMF suspended all lending to Moldova as a sign of dissatisfaction with the pace of reform and with the growing budget deficit. Thus, as discussed above, Moldova was forced to resort to expensive commer-

cial credits on the world market to uphold basic public functions and services in the face of the near-collapse of the domestic revenue base and, increasingly, to service the expensive loans received earlier, mainly from the IMF and the World Bank. The uncompromising stand on debt servicing is having a devastating effect on Moldova and is also severely impairing the country's ability to recover in the long term. It would also seem to be counter-productive, as it is *the* most serious obstacle to economic restructuring and recovery and thereby undermines the ability of Moldova to honour its obligations in the coming years. Also from a moral perspective, it must be considered as highly questionable in view of the severe human misery it inflicts on a population that has already been hit very hard and since the blame for the heavy debt burden lies as much with the lenders as with the borrower.

7.2 Comparing with the Baltic Countries

Much like the Baltic countries, Moldova is a buffer state. It personifies *Zwischeneuropa*: located in the border area between East and West. Just like the Baltic countries it has a long and largely unfortunate history of being tossed back and forth between much larger Eastern and Western neighbours (although the parallel between the Nordic countries and Romania should perhaps not be drawn too far). Like the Baltic countries, it has politically, culturally and economically had a dual orientation; both to the East and to the West, the latter aspect being reinforced by its ethnic separateness from the Slav-dominated Russia/Soviet Union. Like the Baltic countries, the tide turned decisively with the collapse of the Soviet Union, as the economic and geopolitical situation made a re-orientation towards the West not only possible, but also imperative – if previous colonial subordination to Moscow was to be broken, instead of merely being replaced by a new neo-colonial dependence on the fate and whims of the previous master. Yet, whilst the Baltic countries have been exceedingly successful in turning the new geopolitical situation to their own economic and political benefit, Moldova has by and large failed to do so. A comparison of Moldova with the Baltic countries may therefore be useful, not so much for the similarities it presents as for the dissimilarities. Three dissimilarities would appear to have been of decisive importance.

Firstly, the Baltic countries were much better mentally prepared to exploit the political and economic opportunities and challenges presented by the collapse of the Soviet Union, as they were in the forefront in the drive for independence as the Soviet Union began to disintegrate. This

mental preparedness made them eminently well placed for a flying start and to embark on the monumental task of transforming their countries into full-fledged members of the European family of modern democracies and market economies once independence was achieved. This task was also clearly facilitated by their past experience as independent countries still in living memory.

Moldova's starting point was in this regard much less fortunate. Moldova had arguably been under a much tighter reign from Moscow than the Baltic countries; politically as well as economically. To a large extent Moscow's tight control of Moldova can probably be explained by Moldova's largely Romanian population and its past as a Romanian province. As a consequence, not only was the economy exceedingly closely integrated with the rest of the Soviet economy, the upper and middle levels of the administration were also largely manned by Russians and 'reliable' ethnic Moldovans, often from the areas east of the river Dniestre. Upward mobility in society of the predominantly Moldovan population was associated with a much stronger pressure for cultural and linguistic Russification than was the case in the Baltic countries. Equally important, the Moldovan population was kept in almost hermetic isolation from the outside world. Thus, when the grip of Moscow loosened, the focus among the Moldovans was initially on re-affirming their ethnicity rather than on independent statehood. When independence came as a consequence of the collapse of the Soviet Union in 1991, the preparedness to face the opportunities and challenges that this entailed was clearly less than in the Baltic countries. Yet, the objective economic cost to Moldova imposed by the collapse of the Soviet economy was probably greater than for any other of the former Soviet republics, as was the need to rapidly and fundamentally reconstruct the economy.

A second main difference between Moldova and the Baltic countries was the attention and assistance the latter countries received in the early years of independence from Western countries and international organisations. Largely due to their geographical location as a buffer between Scandinavia and Russia and to historical links, the Baltic countries received unprecedented attention, goodwill and support, particularly from the Nordic countries, already before independence. The massive financial and technical assistance they received during the first crucial and formative years of independence was no doubt crucial to their success, due as much to its timeliness as to its magnitude. Equally important has no doubt been the support provided to the Baltic countries in forging links with the rest of Europe and the welcome they have received as new members of the European family of nations. The Baltic countries have also been suc-

cesful in attracting Foreign Direct Investment on a large scale, which is crucial for reconstructing the economy.

By contrast, Moldova's achievement of independence was almost unnoticed by the outside world. Only Romania expressed enthusiasm, as it saw it as a first step towards Moldova's reintegration with Romania. However, Romania's initial warm support soon faded as it became clear that the Moldovans were not disposed to replace one master with another.

A third difference between Moldova and the Baltic countries is that for Moldova independence came at the cost of bloodshed and loss of control of part of its territory. Seven years after independence and the brief civil war, the renegade, self-proclaimed Transnistrian republic remains an open sore to Moldova. The conflict is of a political rather than ethnic nature and received initially active and subsequently tacit support of Russia. It has cost and continues to cost Moldova dearly in terms of foregone economic development and national consolidation.

The ensuing continued presence of Russian troops on Moldovan soil also imply that Moldova politically has to pursue a balancing act with regard to Russian interests. It cannot afford to follow the Baltic countries' example of uncompromisingly pursuing its own national interests and assuming a 'devil-may-care' attitude vis-à-vis its former master.

The dismal economic development in Moldova since independence has neither been an act of God, nor the result of particularly bad governance. Rather it is the inevitable consequence of the failure of Moldova to address the extremely difficult task of nation-building and economic and societal reconstruction in the wake of the economic collapse on a broad front with sufficient force, urgency and cohesiveness, and, one might add, of the failure of the outside world to extend a strong and desperately needed helping hand at the time when this was most needed. In contrast to the Baltic countries, external assistance, Foreign Direct Investment and domestic efforts proved inadequate to rebuild the economy, which was and remains, imperative both for a successful transition and as an escape from poverty.

7.3 Tentative Lessons

The attempt above to identify the key factors and sequences of events behind Moldova's transition to destitution suggests that these were fairly straightforward. Yet, the question remains how a small and newly independent country, only a few hours by air from the main capitals of Western Europe, could be allowed to suffer such a fate. The failure, not least

by Western Europe, to extend a timely helping hand to a fellow-European country in despair clearly gives cause for some serious soul-searching. Moldova's much referred to 'obscurity' – unlike the wars in Bosnia and Kosovo, the civil war in Moldova was too brief to effectively put the country on the map – is at best a partial explanation.

7.3.1 Understanding the Complexity

The most basic reason behind the ineptitude of the international community in coming to Moldova's rescue was probably a failure to comprehend (i) the complexity and severity of the challenges facing Moldova in the wake of independence, and (ii) the imperative need for economic reconstruction and growth in the wake of the economic collapse. As the need for a complete reconstruction and re-orientation of virtually all aspects of Moldovan society boiled down to an issue of economic transition, the focus became far too narrow and the sight was lost of the comprehensive nature of the transformation and of the fact that the political, institutional, social and economic change were intimately interlinked.

Furthermore, the prevailing perception of the nature of the economic transition, enforced not least by the World Bank, was and remains flawed. Some 60–70 per cent of Moldova's economic base became unviable with the transition to independence and an open market economy. Clearly, building up a new economic base and a forceful promotion of investment, export and growth should have been at the very top of the agenda, as the only road out of poverty and as a precondition for a successful transition to a market economy. Yet, by and large, this imperative need has been overshadowed by an excessive focus on macro-economic stabilisation – which is a necessary, but far from sufficient condition for growth – and on privatisation and restructuring of the remnants of the collapsed economy.⁴⁵

It is notable that the most successful programmes have related to the creation of a market economy in a narrow sense, such as privatisation of industry and agriculture, while much too little attention has been given, particularly in the early years, to the social, institutional and political aspects of the new nation. The macro-economic policies laid down by the IMF have suffered from an excessive focus on stability and a somewhat naïve belief in a textbook open market economy as a panacea for economic success, while scant regard has been given to the developmental aspects of macro-economic policy.

45. This is not to deny that there are individual projects aimed at fostering growth, i.e. micro-credit schemes and promotion of SME's.

Almost a decade down the road, buzzwords and mindless references to the inevitable pains of transition continue to take precedence over serious analysis. There is by and large still a failure to recognise that the problems that have plagued Moldova since independence are not simply transient problems of transition, but far more serious and long-term problems of destitution and development failure. The shortfall in serious analyses and the unwillingness to recognise realities when these have come to stand in glaring contrast to the envisaged path of transition, combined with rigidities in the framework of international assistance, have had and continue to have a detrimental impact on assistance to Moldova.

7.3.2 Timelines, Relevance, Appropriateness

A seemingly trivial conclusion and lesson from the Moldovan debacle is the importance of timeliness, relevance and appropriateness of international assistance, whether multilateral and bilateral.

Unlike development, which is always gradual and often slow, a collapse, as we have seen, can be quick and brutal. Less than three years after its declaration of independence Moldova's GDP had fallen by half. Not least thanks to timely assistance provided by Sida, a reasonably accurate estimate of Gross Development Product – at little more than 300 USD/capita – was obtained already in 1993/94. Yet, for reasons discussed above, another four years passed before this dramatic reality had any impact on development assistance. This delay was disastrous for Moldova. Had Moldova obtained the IDA status it obviously qualified for already in 1994, its situation today would no doubt have been very different. It would not be struggling under a crippling debt-service burden as the loans taken in the early years of independence would have been on generous IDA terms. Although the social sectors in any case would have needed to be both reformed and down-scaled, their virtual collapse could probably have been avoided. It is also likely that the eroding effect on the frail democracy of the dictates of the international lending organisations would have been less. The international community would also have noticed the plight of the country much earlier.

The issue of relevance pertains primarily to the excessively narrow focus of much of the assistance, particularly in the early years. The focus in the West was, and remains, very much on economic transition and the early successes in the field of macro-economic stability were by and large taken as a proof that the country was on the right track. A few years later failure to keep the key macro-economic indicators within the prescribed parameters was used as a motive to deny the country further financial assistance. Yet, the transformation of the Moldovan society was about far

more than economic transition, and macro-economic stability, important as it is, was far from the only prerequisite for success.

Self-determination, the reaffirmation of basic freedoms and human dignity, and joining the family of nations in Europe were probably at the fore of most Moldovans' minds as the country emerged from half a century of totalitarian imperial rule. Yet, more often than not these aspects were overshadowed by an all too exclusive focus on the technicalities of changing economic mechanisms, or they were simply not understood by the international development agencies which effectively set the development agenda.⁴⁶ As noted above, a failure to grasp the imperative need for economic reconstruction and growth has also undermined the relevance of the assistance. Relevance has suffered not only from a failure to understand the complexity and diversity of the issues involved and how closely they are interwoven, but also from a routine application of standard recipes and programmes with scant regard for local conditions and needs and, it would seem, from a lack of genuine dialogue with the recipients.

Appropriateness relates to the nature of the assistance. As the economy and the fiscal base virtually collapsed shortly after independence, Moldova clearly needed comprehensive technical *and* financial help to manage the difficult transformation of the entire society and to uphold basic social services. Short-term loans at high interest rates were, under the circumstances, a most inadequate and inappropriate form of 'assistance'. The standard package of the IMF intervention to achieve macro-economic stabilisation, followed by the World Bank loan-based support for structural adjustment, was designed with totally different situations in mind. It was clearly both inappropriate and inadequate to address the problems facing Moldova (or for that matter the many other similar cases at the time). Yet, it was basically all that was on offer.

7.3.3 Need for Pluralism

The Moldovan drama raises the question of the need for more pluralism in international development assistance. The advantages of aid co-ordination in terms of efficiency, impact, cost-effectiveness etc. are incontestable. However, this assumes that the assistance is based on correct analysis of the issues at stake and that the assistance is logical, relevant and

46. Although the Council of Europe and others have made important contributions in the areas relating to human rights and the rule of law, and NGOs and some bilateral donors have provided valuable assistance in alleviating the plight of the most vulnerable groups and in defence of human dignity, these crucial aspects of the transformation have nevertheless remained on the sidelines.

appropriate in relation to this analysis. In the case of Moldova, these conditions have clearly not been met. The danger is compounded when a single agency has the overall responsibility for both identifying the problems and prescribing the remedy.

A greater plurality of independent, serious analysis of the problems confronting Moldova in the wake of independence and a greater involvement of Moldovans in this analysis would no doubt have unearthed and cast more light on the complexity, profoundness and urgency of the transformations ahead, which in turn could have laid the basis of a more timely and adequate response from the international community.

Another, more positive lesson should also be drawn from the past few years of assistance to Moldova. As its entire society is being remoulded and cast in a new form, timely and well conceived assistance to its overall transformation can have crucial impact. Assistance from *inter alia* USAID, the World Bank and Sida has been crucial in the establishment of a private agricultural sector. Thus, a sound base has been laid for sustainable development of this key sector in the future. The current economic problems should not overshadow this feat. The placing of highly qualified expertise at the Moldovan government's disposal has given truly remarkable return in terms of reduced debt burden. At a different level, assistance to transforming orphanages and institutions for disabled children not only has the immediate impact of saving lives and vastly improving the quality of life for some of the most vulnerable groups of society, but can also have important demonstration effects. As society is being fundamentally and rapidly transformed, there is a vast scope for outside assistance in shaping this transformation.

7.3.4 Give Transition a Human Face

It could be argued that a sad legacy of the Soviet system is a disregard of the intrinsic value of all human beings and of their right to dignity. Where the individual existed for the collective and not vice versa, it arguably followed that the worth of an individual was commonly equated with his/her worth to the collective. Indifferent treatment in hospitals and inhuman conditions of the institutions where those with more or less serious disabilities were put away and stored are testimonies of the result of such a fundamental question of value.

Regaining human worth, rights and identity is therefore at the heart of the construction of a new civil society. This is amply understood by many, if not most people in the countries concerned and has been eloquently expressed by members of Charta 77, KOR (the Polish 'Worker's Defence Committee') and others who fought for civil society in East Cen-

tral Europe and in the former Soviet Union. It has perhaps been less well understood in the West.

From this follows that failure to uphold and protect the worth and dignity of the individual will fundamentally undermine not only the public support for, but the *raison d'être* and purpose of, the so-called 'transition process'. Moldova's record in this regard has been very disheartening indeed and it is probably fair to conclude that this remains the single most important threat to the entire transition process. The main reason behind this failure is the severe economic decline. However inadequate or inept reform of the social security system, ingrained attitudes of indifference, as well as a failure of most of the key international organisations to fully grasp the importance of this issue has compounded the problem.⁴⁷ It is of fundamental importance to understand that while poverty need not deprive those affected, and by implication society, of its dignity, destitution is almost invariably associated with a loss of human worth and dignity. In the past years Moldovans have fallen not only into poverty, but also into destitution at alarming pace and numbers. A large and increasing share of the population in Moldova no longer have the means to ensure their most basic needs in terms of food and protection against the cold. As discussed above, the results of recent living standard surveys reveal that the increasing numbers of people, particularly old people, who are driven to beg on the streets are just the tip of the iceberg. Nor has the situation with regard to social services and health care improved. While in the past the old and 'economically useless' had to suffer the indignity of indifferent and inadequate health care, today most people are deprived of access health care altogether, as it is now provided on a fee-basis only.

Severe budgetary constraints and the servicing of the external debt make it almost impossible for the Government to provide even the most basic forms of social security and health care, at the same time as the general impoverishment of the population makes the need for such services more necessary than ever. The task of creating an adequate and humane system of social protection and health care from the present state of collapse appears truly daunting. Not only is there an acute need of financial resources, there is also a lack of tradition. Yet, it is a task that deserves the highest priority. All things considered, this is also an area where bilateral assistance from countries in Europe is likely to be more appropriate than assistance from international organisations such as the World Bank, as it inevitably entails fundamental aspects of culture, ethics and moral values.

47. Support by Sida, Swedish NGOs and other NGOs to children and elderly at institutions in Moldova is a shining exception.

Generally speaking, poverty alleviation is primarily a question of enabling individual households to make optimal use of the productive assets they possess in the form of labour, skills, knowledge, land and/or capital. As such, it is intimately linked with promoting broad-based economic growth. It also contains an element of redistribution, which is linked to fiscal policies and to strengthening the fiscal base. Beyond this, however, there is a need to eradicate abject destitution. There is an acute need to provide a material safety net for those who need it most. In the present economic situation this requires external assistance.

The educational sector faces the immense challenge of transforming itself from being an instrument for forming obedient and subservient subjects of the state to an institution with the responsibility of equipping the new generations of Moldovans with democratic values, inquisitive and questioning minds and with the knowledge and skills required to bring Moldova forward in the next century. Yet, the educational sector is starved of resources and its teachers are increasingly demoralised by the hopeless material situation and by their own precarious economic situation. They also suffer from isolation from international practices and impulses. During recent winters many schools have remained totally or partly closed due to lack of energy. The introduction of user-fees implies that education on the whole will become a privilege for those who are slightly better off. It is hard to think of a more efficient way of transmitting poverty from one generation to another.

The impact of the present disastrous economic situation on the educational sector implies that the country is forfeiting its future. Yet, in the budgets for 1999 and 2000 the government has been forced to reduce the allocation to the educational sector considerably in order to make room for debt servicing. In order not to compromise the country's future further, external assistance to the educational sector is sorely needed. Such assistance can take a wide range of forms, but it is important that it targets rural as well as urban areas, that the primary levels of education are not forgotten and that equal access to education is ensured. Moldova has inherited pronounced rural-urban differences, particularly in the quality of primary education. Outside assistance should take care not to exacerbate these differences.

7.3.5 In Need of Europe

Moldova's excessive dependence on multilateral, rather than bilateral, assistance has been and remains unfortunate:

- As Moldova emerged as an independent state from half a century of isolation it needed direct links and contacts,

personal as well as institutional, at all levels with other countries, not least in Europe.

- To create a modern parliamentary democracy and a civil society, Moldova needed contacts with and to learn from democratic institutions and civil societies elsewhere.
- To put human rights, freedom and dignity in the fore of society, Moldova needed contacts with and assistance from countries where these ideals are held in high esteem.
- To successfully create an open market economy, Moldova needed free access to other markets, not least in the EU and help to penetrate these markets, not just help in establishing an open market economy of its own according to a text-book blueprint based on a make-believe world of open borders.
- In order to enter the family of European democracies and to genuinely feel part of this family – and few things matter more to the political future of Moldova than this – close links, not least personal, at all levels with other members of this family are needed. As far as possible, barriers to such contacts need to be removed.

Even by the standards of the Soviet Union, Moldova remained very isolated from the outside world until it achieved independence in 1992. Few Moldovans had had any exposure whatsoever to the rest of Europe. Moldova was also one of the least known of the former Soviet republics in the West. During the first years of independence the development of contacts with the rest of Europe remained hesitant and proceeded only slowly. One complicating factor has been and remains the conflict in Transnistria and the fact that Russia retains troops in Transnistria, i.e. on Moldovan soil, and it is crucial to achieve a final solution to the conflict. More than most of the other former Soviet republics, Moldova therefore has had to pursue a balancing act of broadening its network of contacts without incurring the displeasure of Russia. This has complicated relations not only with Romania, but has also resulted in a somewhat cautious approach in the development of contacts with other countries. The country's geopolitical and economic orientation has also been a divisive political issue within the country.

The impact of the Russian crisis on Moldova has clearly brought home the message of the dangers of excessive trade dependence on Russia in particular and on the CIS countries in general. This has already resulted in visibly increased efforts to develop contacts with the rest of Eu-

rope. In this regard, the crisis is serving the purpose of a useful catalyst. However, even before the crisis there was an increasing awareness of the potential negative impact on Moldova of the endeavours of its East Central European neighbours to become integrated in the European Union. As a result of this integration, Moldova risks becoming a small, trade-dependent economy on the wrong side of 'the European fence', which would drive it back into a position of being little more than an economic appendix to Russia. In the past few years, the political establishment in Moldova has endeavoured to foster its ties with its western neighbours and with Western Europe much more forcefully than in the past. This geographic re-orientation is welcome and deserves support. The fact that exports outside the CIS in 1999 amounted to a mere 59 USD per capita illustrates how much remains to be done in this field. A rapid and sustained increase in Moldova's trade outside the CIS is crucial to the country's re-technologisation and economic recovery and growth.

More generally, intensified contacts with the rest of Europe, at all levels, are important to secure Moldova's future as an open democratic society. Moldova needs and deserves the support of its friends in Europe in fostering closer economic, as well as political and cultural ties with the rest of Europe and with the countries of the European Union in particular. Such support is essential, not only due to the many and often formidable barriers that exist, not least when it comes to trade – but also to the potentially positive moral impact it would have within Moldova on the many Moldovans who despair about the country's future, yet do not wish to return to the past. There can be no doubt about the crucial importance that the open arms that much of Western Europe extended to the Baltic countries during the first crucial years of independence had on subsequent developments in this region. As a small, open democracy in the European borderlands, Moldova needs and deserves the same kind of outside support in order to secure its position as a fully-fledged member of the community of European democracies.

7.3.6 Foster Domestic Economic Growth

The Moldovan economy is currently in a state of virtual collapse. Most of the large former state industries have either closed down or are operating at very low levels of capacity. The small-scale enterprise sector is developing only slowly and is clearly facing great difficulties, foreign direct investments have so far been at a very low level (although there are signs that they are picking up), and agricultural production is down to levels not registered since World War Two. Although lack of demand, both overseas and at home, can be identified as a factor behind the low level

of economic development, there are severe structural and institutional problems as well, and there is no simple solution for re-building the economy. Yet, the task of creating conducive conditions for growth at home needs to be addressed in tandem with that of promoting exports and developing economic contacts with the outside world.

As noted above, the privatisation of state industry is progressing, albeit somewhat slowly. While it is clearly necessary to divest the state of these enterprises, this is hardly the key problem as far as promoting growth is concerned. With the exception of the enterprises bought by foreign capital and which will benefit from infusions of capital from abroad, few of these firms have the potential of making any major contribution to the economy in the future. More important is no doubt that the financial umbilical cord between the government coffers and these enterprises is effectively severed. However, this is gradually being achieved. The World Bank and IMF take a keen interest in the privatisation of the state industries and, barring any major change in government policy, this process is likely to continue.

The development of entrepreneurship and new small and medium-size enterprises has been somewhat lacklustre. As discussed above, there are a number of reasons for this. The depressed domestic market, lack of marketing information and channels and of capital, and less tangible factors such as an insufficient entrepreneurial tradition, all contribute to the unimpressive development. To this may be added high rates of taxation, a sometimes indifferent attitude by local authorities and extortion practices by local Mafia gangs. As the bulk of new employment and income opportunities in the future will have to be generated by new, primarily small, enterprises, the slow development of this sector is a very serious problem indeed. The informal sector is quite large. While part of this is primarily engaged in rent-seeking and other unproductive activities, a large part of it is clearly productive and contains the embryos of future enterprises. However, the high cost of growing and attaining a formal status in the form of exposure to fiscal authorities, and rent seeking by criminal organisations, often confine small enterprises to the informal sector.

The reasons for the slow development of Foreign Direct Investment, FDI are likely to be somewhat different. Apart from the fact that the country is poorly known and marketed, the unsolved Transnistria conflict, which apparently is often interpreted as a sign of political instability, and a lack of experience in catering to the needs and demands of foreign direct investors on the Moldovan side are likely to be some (but far from all) factors behind Moldova's poor performance in attracting FDI so far. However, it should be noted that FDI have recently increased and that

there are a number of quite large projects in the pipeline. The capital for re-technologisation, production and market know-how that comes with FDI is of crucial importance to the country's efforts to re-invigorate its economy and to expand its economic links outside the Commonwealth of Independent States, CIS. One cannot help getting the impression that the importance of FDI to Moldova has not been fully grasped in all circles in the country.

7.3.7 Start in the Agricultural Sector

As the majority of the population in Moldova depend in one way or another on agriculture for their living and as hundreds of thousands have received or are scheduled to receive land under the privatisation programme, the development of a viable, market-oriented agriculture sector based on small scale farming is of paramount importance for the country's future. After far too many years of hesitant reform, privatisation of agriculture is now in full swing. It is probably inevitable, as has been the case elsewhere, that privatisation in the short term will have certain adverse effects on production, as it takes time to sort out property rights, correct mismatches in access to land, labour and capital at the farm level, develop new backward and forward linkages etc.

The reform is taking place under the worst possible external conditions, due not least to the near collapse of the external market. In the past few years, yields of many crops have been well below the levels registered during World War Two. On the positive side it may be noted that the general crisis is pushing the reform forward, as the previous kolхозes are collapsing on their own. The task of developing a viable small-scale agriculture sector is very complex, yet hardly any single issue is more crucial to the country's economic future. To a large extent it is a question of developing efficient markets, where previously there were none. This includes markets for outputs, including agro-processing and exports, as well as for inputs, and markets for capital, labour and land. Left on their own, such markets are likely to gradually develop on their own. The main issues are therefore how to foster the development of markets by creating a conducive environment, as well as by direct intervention and action.

Efforts to embark on a path of sustainable growth probably have to start in agriculture. This requires turning the present low-productivity subsistence farming sector in the direction of more efficient market-oriented small-scale agriculture, which in turn requires the development of a whole range of support services, and distribution and marketing channels geared to the needs of small-scale farming. The difficulty is to set this process in motion. Once it has started, it has an in-built tendency to be-

come self-enforcing. As discussed above, increased productivity and incomes in agriculture would create demand for non-farm services and products, resulting in increased non-farm employment and incomes. This in turn would permit a transfer of surplus labour from agriculture to local non-farm employment, as well as an increase in the demand for agriculture products, further raising labour productivity and incomes in agriculture. This is a potentially very powerful process for development, and it would also have the advantage of being broad-based, encompassing the majority of the population. The preconditions in Moldova for this type of development would seem to be quite good. There is a vast under-utilisation of productive resources in the countryside, primarily in the form of labour and land. Hence, the potential for increasing production by increased use of the available resources is very large. The present depressed levels of economic activity and production are due to problems of restructuring, primitive markets and depressed demand.

7.3.8 Political and Institutional Development

Moldova has made remarkable progress in the fields of political and institutional reform and development since independence. Indeed, Moldova stands out as something of a model among the CIS countries in these regards. This does not imply that there are no shortcomings or problems left. However, the country has successfully made the hazardous transformation from totalitarian rule to parliamentary democracy.

Today, the main threat to democracy and the rule of law in Moldova is not shortcomings in the institutional reforms, but the disastrous economic situation. The seemingly endless economic decline can provide a fertile ground for extremist and non-democratic political forces, although in contrast to many other countries in the region, Moldova does not as yet have any significant political parties on the extreme left or right. However, the economic collapse threatens not only the achievements in the field of democratisation, but the independence of the country. The Transnistrian conflict and the continued presence of Russian troops in this region further underscore the latter aspect.

The acute economic problems undermine the achievements in the political and institutional fields in other ways. Most importantly, the large arrears in wage and pension payments are extremely damaging. This undermines confidence in the economic and political reforms, breeds corruption and constitutes a major impediment to reform of the public sector and to economic recovery in general.

Although much remains to be done in terms of streamlining the government structure and making it more efficient, a more fundamental

problem is the shortage of expertise and competence in key areas. This is particularly acutely felt in a situation where the country is facing unprecedented economic and social problems. Apart from resulting in sub-optimal decisions and actions, it also implies that the Moldovan political establishment is growing excessively dependent on the advice provided by international organisations, such as the IMF and the World Bank, whose own agendas do not always necessarily coincide with the interests of Moldova. It is probably also the case that the lack of expertise results in an unnecessarily weak capacity for negotiations, particularly vis-à-vis the IMF and the World Bank.

It should be recalled that nobody in the Moldovan political establishment has but a few years experience of running an independent state and that less than a handful of people in senior positions have more than very rudimentary knowledge in key areas such as fiscal policy, macro-economics or the functioning of a market economy in general. The situation is further aggravated by the fact that the advice received from overseas experts, from various organisations, in these fields has not always been of a very high quality. Thus, there is a considerable discrepancy between the complexity of the economic problems facing the country and the capacity of those involved to address these problems.

A partial remedy for this problem would be to provide Moldova with access to highly qualified experts who can serve as disinterested high-level economic adviser(s) to the Moldovan Government/Parliament/President. This can be done on an *ad hoc* basis and/or in the form of one or a few residential experts. The assistance already provided in the field of external debt management is a good example of how such assistance can yield very high returns and be very cost-effective. Similar assistance may be desirable in other specialised areas related to economic and fiscal policy and planning. Continued preparedness to render such assistance would therefore be welcome.

7.3.9 Balance of Payments and Budget Support

Despite valid arguments of a principle nature against balance-of-payments and budget support that derive from the fact that it tends to soften the budget constraint of the recipient government and country, there is a strong case for rendering such assistance to Moldova at the present time. The main arguments are the following:

The Russian financial crisis has resulted in an acute crisis in the external accounts of Moldova. The only sustainable solution to this crisis is a re-orientation of trade (particularly exports) to non-cis countries and a sharp increase in exports to non-cis markets, which in turn will require a

substantial increase in export-oriented FDI in Moldova. However, even if successful, this cure will not yield sufficient effects overnight. In the short term a case can be made for balance of payments support to provide a breathing space and to ensure that the flow of crucial imports can be maintained.

As a consequence of the disastrous economic development and the ensuing erosion of the fiscal base, the budget situation has become so precarious that the maintenance of the most basic public functions and provision of basic social services is at acute risk. The budget is at present being squeezed from two sides. The fiscal base has shrunk dramatically in the past few years from an already very low level. Revenue from privatisation of state property has somewhat cushioned the effect on public revenue, but this is neither a lasting nor an adequate solution. On the expenditure side, the heavy debt-servicing burden is crowding out all other expenditures. The public sector is therefore facing an acute financial crisis, which is so severe that it is threatening the economic, social and political stability and future of the country. The considerable arrears in the payments of pensions and of wages in the public sector is but one clear expression of this. A strong case can be made for direct support to the Government budget with a view to easing the extreme financial constraints in priority areas such as payments of outstanding pensions and wages, and provision of health care, education and other core social services.

It should be recalled that the circumstances behind the large external debt and the external crisis in general are mitigating, as they are due to a considerable extent to factors beyond Moldova's control.

The high debt-servicing burden is to a large extent due to the fact that Moldova has, since independence, been forced to borrow on unduly disadvantageous terms. Had Moldova from the very beginning received the soft credits it deserved by virtue of its economic situation, the external debt and the debt-servicing burden in particular would be much less of a problem today.

The skewed trade structure, which is at the bottom of Moldova's exposure to the Russian financial crisis, is not only due to a lack of effort to penetrate non-CIS markets, but also to the considerable trade barriers erected by the European Union, particularly against traditional Moldovan exports. The problem has also to do with political considerations, i.e. the need to pay attention to Russian sensitivities and interests as a price to be paid for the country's independence.

To uphold basic public and social services *and* pursue fundamental political and institutional reforms in the context of a 70 per cent decline of public revenues is virtually impossible. Yet, it is crucial to the country's

survival. Difficulties in balancing the budget can therefore hardly be solely ascribed to government incompetence and/or irresponsibility, as has perhaps been done in a too routine-like manner.

Unconditional balance-of-payment support would be likely to be less efficient than earmarked assistance as it might weaken Moldova's bargaining position vis-à-vis its external creditors and as there is a risk that it would be directly used for the servicing of the external debt. Support to Moldova's request to re-negotiate the debt and the ongoing assistance in the field of debt management are likely to be much more effective ways of addressing this problem. On the other hand, the extremely austere government budget implies that additional resources can have a major positive impact if their use is well targeted. Balance-of-payment and budget support should be explicitly tied to specified domestic public priority expenditures: viz. payment of wages and pensions arrears, health care and education.

7.4 The External Debt

Relief from the excruciating debt burden is an absolute prerequisite for economic growth, a successful transition and to reverse the human disaster that is unfolding. This can take place through comprehensive debt rescheduling to more favourable long-term loans at low rates of interest, which Moldova as a DAC country qualifies for and for which there are compelling reasons. It can also be achieved through outright debt cancellation. Debt servicing is having a strong contractive impact on the already severely depressed economy and is effectively blocking a much-needed economic recovery. Hence, a sharp reduction in the debt-servicing burden must be a key component in any meaningful programme of assistance to Moldova.

As discussed above, Moldova is under very strong pressure from the IMF and the World Bank in particular to honour its external obligations. However, economic recovery and growth are prerequisites for sustainable debt servicing. Yet, the debilitating impact of the heavy debt-servicing burden is an effective impediment to growth. The country therefore faces a three-pronged scenario:

- a default on its debt,
- a successful and comprehensive rescheduling, whereby some of the present short-term and high cost loans are replaced by soft credits under its DAC-status while others are bought back at a large discount, or

- protracted muddling through which debts are rolled over to avoid default, but there is no effective relief in the debt-servicing burden.

It should also be noted that there is clear trade-off between honouring the external debt and the internal debt (primarily in the form of wage arrears). The austerity budgets of 1999 and 2000, imposed by the IMF, have provided little room for clearing or even reducing the arrears in wages and pensions. The absolute priority attached to external debt servicing at the expense of honouring the domestic debt, has some very serious implications. Firstly, it implies that it is less important to honour overdue payments to its own citizens than external debts, presumably because individual workers are in a weaker position to enforce their rights than external creditors. This is nothing short of a slap in the face to a country that is endeavouring to establish the rule of law after decades of totalitarian and arbitrary rule of force.

Secondly, as discussed above, it would be a fallacy to believe that failure to honour wage and pension obligations does not carry any significant cost. The cost is very high indeed, not only to the individuals concerned, but also to society in general. The response by those affected is likely to be (and indeed has become) twofold: revolt and/or corruption. At the end of the day it is the common people who are forced to pay the arrears in wages as teachers begin to solicit illicit payments from parents, bureaucrats from those who need their services and doctors from patients. There is no doubt that the arrears in wages and pensions are, in themselves, a formidable obstacle to the reform process and to any efforts to combat corruption – which in turn is a major obstacle to economic growth.

There is also a clear trade off between servicing the external debt and meeting human needs and rights in terms of basic health care and education. As discussed above, there is a direct link between the sharp increase in the debt servicing cost and the dramatic fall in public expenditure on health care, education and other social services, from an already precariously low level. Under the present circumstances, the cost of debt servicing can be measured in terms of increased morbidity and mortality, foregone education and denial of basic human rights to food and shelter against the cold.

In the light of the above, it would appear that the best assistance that can be rendered would be to mobilise support for Moldova's efforts to renegotiate its external debt.

Valuable assistance is already being provided to enhance Moldova's competence in debt management and negotiation. This needs to be

backed up by political support for Moldova's case in international fora. The extreme debt-servicing burden effectively blocks any attempt to redress the disastrous economic and social situation and the importance of rapidly and dramatically reducing it can hardly be stressed enough.

7.5 To Build Upon

The review of the economic and social situation above makes for very dismal reading. It is therefore important to note that there are a number of entries on the positive side of the balance sheet as well.

- Moldova is a small country. The sums and efforts required to help the country weather the storm and to alleviate human suffering are by no means astronomical in an international perspective. They would amount to a mere fraction of the cost of the post-collapse assistance provided to the war-torn parts of the former Yugoslavia.
- Moldova has made remarkable progress in the fields of democratisation, the establishment of rule of law and respect for human rights. The political culture has improved and matured considerably, a fact underscored by the lack of any extreme fractions or tendencies. The country can also pride itself on its harmonious, although not friction-free inter-ethnic relations. These are no small achievements. Their importance can perhaps best be gauged if cast against the all too frequent example of extreme nationalism, open ethnic conflict and political strife elsewhere in the region.
- Peace and stability in Moldova and a peaceful resolution to the Transnistrian conflict have a strategic importance that goes beyond the small size of the country. The strong support of the United States, in particular, to Moldova is likely to be influenced by strategic as well as humanitarian considerations.
- The challenges and problems facing Moldova today are not all that dissimilar from those facing the Baltic countries on their eve of independence less than a decade ago. The truly remarkable transformation of the Baltic countries, to the point where today they are considered for membership of the EU, provides eloquent evidence of the catalytic impact that external assistance and support can have when provided on sufficient scale and in a timely and intelligent manner.

The potential for economic growth in Moldova would appear to be quite good. This statement may appear somewhat odd, considering the disastrous developments of the past few years, but in some ways the past collapse can provide the seeds for future growth. The country has a vast amount of grossly under-utilised production factors, primarily in the form of labour, skills and land. The previous economic and institutional structures, which tied up these resources in inefficient use, have collapsed. Hence, the difficult and painstaking process of dismantling old structures in order to provide room for new ones that are more efficient and market-oriented has by and large been completed. The field has been cleared for the rebuilding of new structures on the rubble of the old ones. The political and institutional framework for this type of reconstruction is already largely in place.

Finally, the sharp, yet by and large controlled depreciation of the domestic currency, the good record of rather low inflation and the low costs of production have the potential of providing a good basis for strong export-driven growth, which in turn would crucially depend on Foreign Direct Investment.

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Glossary

CIS	The Commonwealth of Independent States – the successor states of the Soviet Union, with the exception of the Baltic countries.
DAC	Development Assistance Committee. This Committee is comprised of a group of OECD countries providing development assistance.
EBRD	The European Bank for Reconstruction and Development.
FDI	Foreign Direct Investment.
GDP	Gross Domestic Product.
IDA	The International Development Association – a member institution within the World Bank Group providing assistance and long term loans at heavily subsidised interest rates to poor developing countries.
IBRD	The International Bank for Reconstruction and Development, the World Bank.
IMF	The International Monetary Fund.
Leu	The national currency of Moldova since 1993, singular.
Lei	– ” – , plural.

Average rate of exchange:

1994 1 USD = 4.07 lei

1995 1 USD = 4.49 lei

1996 1 USD = 4.60 lei

1997 1 USD = 4.62 lei

1998 1 USD = 5.38 lei

1999 1 USD = 10.51 lei

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