European Commission

Ex-post Evaluation of the EU's Macro Financial Assistance to Moldova (2010- 2012)

European Commission, Directorate-General for Economic and Financial Affairs

Executive Summary

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ICF GHK
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This executive summary exists in English and French and can be downloaded from the website
http://ec.europa.eu/economy_finance/evaluation/index_en.htm

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Executive Summary

This report presents the results of the Ex-post Evaluation of the Macro-Financial Assistance (MFA) provided to Moldova over the period 2010 to 2012. The evaluation was commissioned by the Directorate-General for Economic and Financial Affairs (DG ECFIN). The work was undertaken by ICF GHK with the support of Cambridge Econometrics and with inputs from experts based in Moldova.

The background to the MFA operation

The effects of the global financial crisis were transmitted to Moldova in late 2008, as recession hit its major economic partners – Russia, Ukraine, Romania, and Western Europe, leading to an abrupt fall in remittances, foreign direct investments (FDI), and exports. Consequently, domestic demand and imports also collapsed, and real gross domestic product (GDP) contracted by 6 per cent in 2009.

In June 2009, the Moldovan government formally requested for assistance from the EU to help the country deal with the impact of the economic crisis. In October 2010, the European Parliament and the Council adopted a decision (No 938/2010/EU) to provide MFA to Moldova in the form of a grant of up to EUR 90 million. Further details including the number of tranches, approximate timing of disbursements and conditions related to implementation of structural reforms were agreed in the Memorandum of Understanding signed by the European Union and Moldova in December 2010.

The MFA grant to Moldova was released in three instalments:

- EUR 40 million was disbursed in December 2010;
- EUR 20 million was disbursed in September 2011; and
- EUR 30 million was initially planned for disbursement in December 2011, but due to delays in implementation of certain conditions, it was eventually disbursed in April 2012.

The total size of the MFA operation was substantial, accounting for around 1.8 per cent of the Moldovan GDP in 2011. The MFA operation was linked to the IMF programme approved in January 2010 with a three year horizon and total financial assistance in the form of concessional lending of up to SDR 369.6 million (about US$586 million). First disbursement from this programme of SDR 40 million took place in February 2010.

Evaluation objectives and methods

The overall objective of this evaluation is to provide an independent assessment of the MFA operation, focusing in particular on the following three areas of analysis:

- The macroeconomic impact of the MFA assistance operation on the Moldovan economy with and without IMF involvement;
- Sustainability of the country's external position as a result of the assistance;
- Value added of the EU intervention.

The evaluation is both summative and formative and it seeks to draw lessons which could be applied to the design and implementation of future MFA operations.

The evaluation has utilised several tools: (i) macroeconomic data collection and analysis; (ii) a review of relevant literature; (iii) semi-structured interviews with key informants during two missions in Moldova, missions to Brussels and Washington DC complemented by interviews carried over the phone; (iv) focus group discussion with non-governmental stakeholders in Chişinău, and (v) macroeconomic modelling. The findings presented in this report are based on the triangulation of the results emerging from these sources.

Macroeconomic and External Sustainability Impact

Moldovan economy rebounded from the 2009 crisis strongly and during 2010-2011, GDP growth averaged around 7 per cent per annum. The MFA is found to have positively contributed to the recovery. The key mechanism at play was that the assistance allowed for a more gradual fiscal adjustment path from 2009 onwards, than would otherwise have been possible. Model-based analysis suggests that the MFA contributed to higher economic growth, especially immediately after the crisis. The impact of assistance was less pronounced in 2012 as Moldova was less reliant on external assistance to sustain its budgetary operations. In 2012, Moldovan GDP was around 0.5 per cent higher and employment around 0.2 per cent higher than would be the case in a counterfactual situation without the assistance. The MFA also helped to increase the country's foreign exchange reserves. Sensitivity analysis suggests that this broad finding of a positive MFA contribution to economic growth and reserve accumulation is robust.

The MFA was closely linked to the IMF programme and the combined net macroeconomic impact of these two operations is found to have been substantially larger than the impact of the MFA alone. Specifically, the modelling results suggest that the combination of the IMF and EU MFA support might have raised Moldovan GDP by as much as 1.5 per cent and employment by 0.8 per cent as of 2012. The effect of the assistance was greatest in 2010, i.e. just after the crisis and in the first year of the IMF programme, when Moldova was in most need of budgetary support.

No clear evidence has been identified of a medium- to long-term impact of the MFA and IMF support on the current account. The MFA has contributed – to a limited extent – to the external sustainability of the country improving debt to GDP ratios and also limiting the public external debt issuance (that in the counterfactual scenario would likely be needed e.g. to finance investment expenditures foregone in the counterfactual scenario of no MFA). A similar logic applies to the case of a combined MFA and IMF support. Lack of IMF lending would force cuts in fiscal expenditures, including investment expenditures during 2010-2012. However, in this counterfactual scenario public expenditures would likely need to eventually increase at some point in the future, e.g. to compensate for necessary, but earlier foregone public investments. These additional expenditures would then need to be financed by borrowing and it is highly unlikely that Moldova would have been able to obtain alternative external (or domestic) financing on similarly concessional terms to what was provided by the IMF. Hence, the combined impact of the MFA assistance and the IMF programme on public external debt sustainability has also been positive.

Impact on structural reforms

The disbursement of the second and third MFA tranches was, inter alia, dependent on fulfilment of twelve conditions defined in the following areas:

- Public Finance Management (PFM) reforms focusing on budget preparation and execution, public debt management and public finances;
- Financial sector reform;
- Legislative and regulatory convergence with the EU in public procurement and central bank governance.

The conditionality attached to the MFA was selected in close consultations with Moldovan authorities and other development partners, in particular with the IMF. Coordination with other donor-supported policy agenda is assessed as adequate. There was no duplication of conditions and in some instances, MFA conditions complemented those attached to the IMF programme. This applied for instance to the promotion of closer co-operation between Moldovan institutions responsible for financial stability. Importantly, MFA conditions should be seen as just one element of on-going co-operation between the Moldovan government and the EU in promoting reform agenda in various fields.

There is evidence to demonstrate that the MFA had an operational and/or political reinforcing effect in all domains in which conditions were formulated. The degree of the reinforcing effect of the MFA varies across conditions. In some cases, MFA conditionality promoted actions that might not have been implemented otherwise or at least within a similar timeframe. This applies to the census of public sector employees, and parliamentary submission of laws related to financial regulation and supervision of the non-banking sector. An action plan related to public procurement is believed to have added weight to reform efforts along the lines prescribed in the plan. In other cases, MFA conditions were related to actions that would have been most likely undertaken by Moldovan authorities even in absence of the MFA, albeit potentially at a slower pace (e.g. reforms related to the planned introduction of the new Financial Management Information Systems (FMIS), working out rules for the functioning of the National Financial Stability Committee).

Several conditions aimed at stimulating processes, rather than achieving an outcome with an independent policy role. In particular, conditions were related to five substantial legislative processes (amending laws in important areas). All these conditions required approval of draft laws by the government and their submission to the parliament. Out of five submitted draft laws, only one was enacted by the parliament promptly while the other ones remained at various stages of the legislative process as of summer 2013.

The overall focus of conditions was appropriate as these mostly targeted areas which are relevant for macroeconomic and financial stability. Nevertheless due to the character of reforms, their potential gains are likely to materialise only in the medium- to long-term perspective.

Design and implementation issues

The long process of the operation's design and implementation have minimised any anti-crisis impact of the MFA. Indeed, in the view of the Moldovan stakeholders, the MFA is perceived as general budget support unrelated to crisis developments. While long MFA approval process has become a well-known feature for involved stakeholders, including the Moldovan government and the IMF, the uncertainty as regards the time actually needed for the operation to kick-start complicates planning of financing flows and limits the effectiveness of the MFA instrument.

The assistance was provided entirely in the form of a grant based on the arguments that Moldova is the poorest European country and its debt repayment capacity. This choice is assessed as appropriate and justified. A grant form was a very important feature of the operation, significantly increasing its attractiveness to the Moldovan authorities and likely increasing the leverage of the EU in terms of securing the government's commitment to deliver on agreed structural reform conditions. It also had some intangible but important outcomes, e.g. strengthening the EU's image among some stakeholders as a reliable partner providing generous support.

EU value added

The provision of the support as a grant rather than a loan was an important element distinguishing MFA from other support available to Moldova in the post-crisis environment. The scale of assistance was substantial relative to the size of the economy and this has had implications for the IMF programme, allowing the IMF to design a more gradual fiscal adjustment path for Moldova and hence supporting recovery. MFA grant is believed to have contributed to external debt sustainability and also – as noted above – strengthening the leverage of the EU structural reform conditions.

From the EU perspective, key benefits are related to the MFA's role in supporting economic and political stability in the direct EU neighbourhood, with related important, although impossible to quantify economic, social and political benefits.

Recommendations

The MFA instrument would be strengthened by better aligning its declared objectives with the design and implementation practice. Maintaining the focus on dealing with serious short-term balance-of-payments or budget difficulties would require shortening of the approval procedures. A stronger focus on supporting structural reform efforts in beneficiary countries might benefit from introducing more flexibility in the way the conditions are formulated. Specifically, it could be beneficial if conditionality could be adapted to evolving circumstances during the MFA implementation period (e.g. dropping already fulfilled conditions, adjusting conditions that become infeasible / controversial in view of changed macroeconomic and /or political realities). It is recognised that these recommendations would require high level political decisions.

The relatively short time-span of the MFA instrument implies that conditions will need to continue being specified in terms of expected short-term outputs. However, it is recommended that expected longer-term outcomes and impact of conditionality should also be explicitly articulated to strengthen domestic ownership, minimise the risk of implementation deficit (the difference between de jure and de facto reforms), and to provide the basis for future ex-post evaluations and follow-up through EU budget support.

Making a stronger effort to clearly spell the objectives of the MFA instrument and in particular of the structural reform conditions attached to it, could help spreading the information about the MFA among the general public. Given the inherent difficulty in achieving broad visibility of assistance with macroeconomic objectives, it is further suggested that information activities on EU support as a whole should be more closely coordinated and possibly channelled through a single source, e.g. EU Delegations in countries receiving assistance. The communication strategy could instead of publicising various instruments of EU support independently, present them as coherent elements of the broad EU assistance.