European Commission

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

European Commission, Directorate-General for Economic and Financial Affairs

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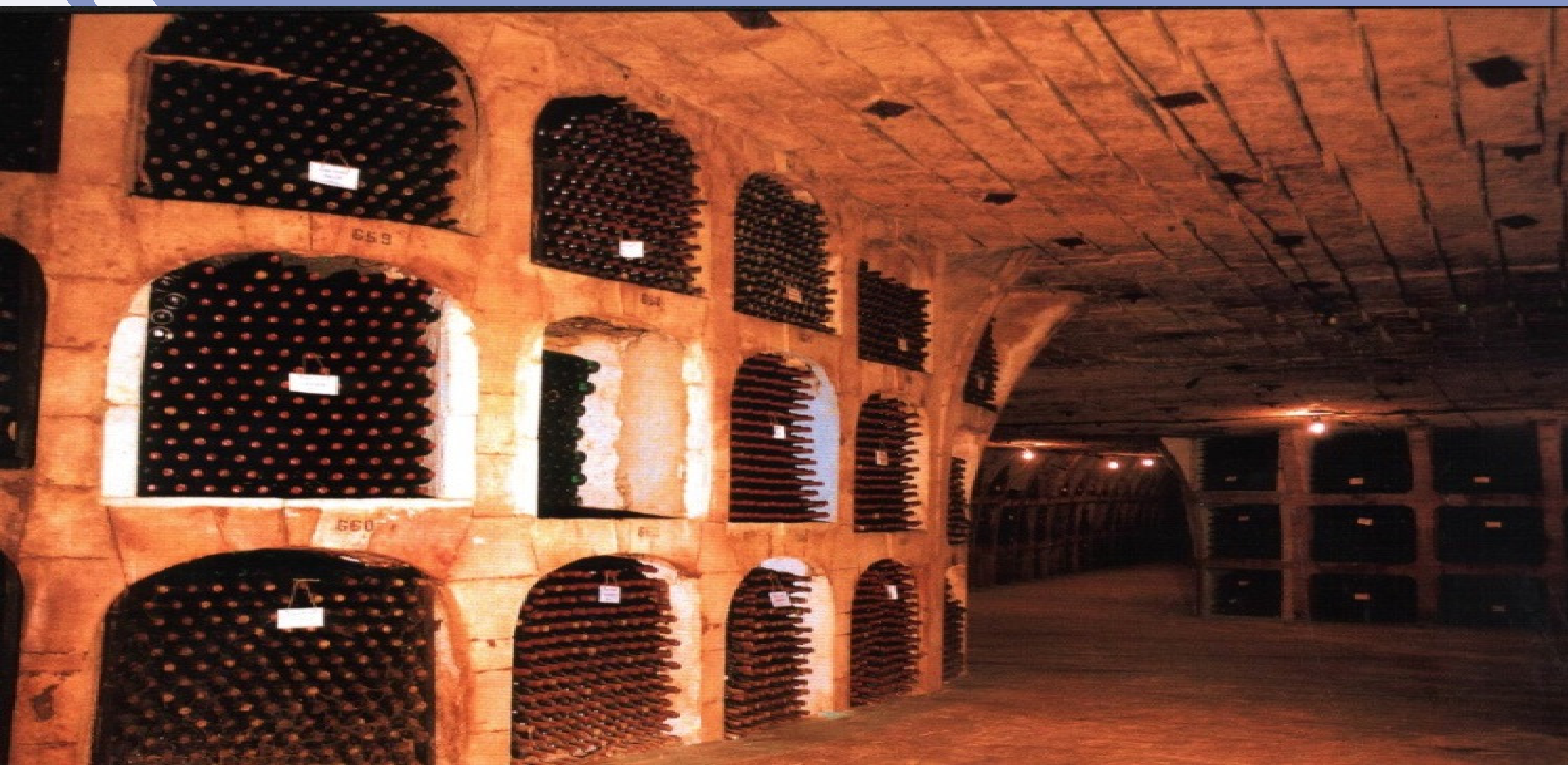

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This study exists in English only and can be downloaded from the website
http://ec.europa.eu/economy_finance/evaluation/index_en.htm

A great deal of additional information is available on the Internet. It can be accessed through the Europa server (ec.europa.eu)

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List of Acronyms and Abbreviations

ACP	African, Caribbean and Pacific (countries)
AEI	Alliance for European Integration
ANRE	Agenţia Naţională pentru Reglementare în Energetică (National Energy Regulatory Agency)
BoP	Balance of Payments
CEDB	Council of Europe Development Bank
CIS	Commonwealth of Independent States
CIT	Corporate Income Tax
CPI	Consumer Price Index
DeMPA	Debt Management Performance Assessment
DG DEVCO	Directorate-General for Development and Cooperation
DG ECFIN	Directorate-General for Economic and Financial Affairs
EBRD	European Bank for Reconstruction And Development
EEAS	European External Action Service
EC	European Commission
ECF	Extended Credit Facility
EFF	Extended Fund Facility
ENP	European Neighbourhood Policy
ENPI	European Neighbourhood Partnership Instrument
EU	European Union
EUR	Euro
EurAsEC	Eurasian Economic Community
FDI	Foreign Direct Investment
FMIS	Financial Management Information System
FSC	Financial Stability Committee
FSL	Fund for Securing Loans
GDP	Gross Domestic Product
GFCF	Gross Fixed Capital Formation
GoM	Government of Moldova
IDA	International Development Aid
IMF	International Monetary Fund
MDL	Moldovan Leu
MEFP	Memorandum of Economic and Financial Policies
MFA	Macro Financial Assistance

MoF	Ministry of Finance
MoU	Memorandum of Understanding
MTBF	Medium-Term Budget Framework Forecast
NBM	National Bank of Moldova
NCFM	National Commission for Financial Markets
NDA	Net Domestic Asset
NFSC	National Financial Stability Committee
NGO	Non-Governmental Organization
NPEEY	National Program for Economic Empowerment of Youth
OECD	Organisation for Economic Co-operation and Development
PEFA	Public Expenditure and Financial Accountability
PFM	Public Finance Management
PRGF	Poverty Reduction and Growth Facility
REER	Real Effective Exchange Rate
SDR	Special Drawing Rights
SIDA	Swedish International Development Cooperation Agency
TA	Technical Assistance
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Program
USAID	United States Agency for International Development
USD	United States Dollar
WB	World Bank

Abstract

On 20 October 2010, the European Parliament and the Council of the European Union adopted a decision providing macro-financial assistance (MFA) to the Republic of Moldova. The MFA was provided alongside a three-year International Monetary Fund (IMF) programme to support the country's recovery from the adverse impact of the 2009 global financial crisis. The assistance was provided in the form of a EUR 90 million grant and was disbursed in three tranches between December 2010 and April 2012. The disbursement of tranches was linked to the fulfilment of structural reforms conditions related to Public Finance Management and financial stability. This document presents the findings, conclusions and recommendations of the ex-post evaluation of the MFA operation in Moldova. The evaluation concludes that the MFA had a positive net impact on the Moldovan economy, enabling a more gradual fiscal consolidation than would otherwise have been possible in the post-crisis period and hence supporting economic growth over the period 2010 to 2012. Model-based analysis suggests that the MFA boosted Moldovan GDP by around 1 per cent in 2011 and 0.5 per cent in 2012 when compared to a counterfactual scenario without the MFA. The MFA also contributed to external financial sustainability, especially due to the provision of assistance in grant form. By linking disbursement of tranches to specific conditions that were agreed with the Moldovan authorities and coordinated with other donors/ development partners, the operation also helped promote some structural reforms in Moldova, although their full impact can only be visible in the longer term. Finally, the MFA, as a component of the broader 'package' of EU support to Moldova, played an important role in supporting economic and political stability in the direct EU neighbourhood.

Source: http://www.lib.utexas.edu/maps/moldova.html. Courtesy of the University of Texas Libraries, the University of Texas at Austin

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.

1. Introduction

This is the Final Report for the Ex-post evaluation of the EU's macro-financial assistance to the Republic of Moldova (2010 – 2012). The evaluation was launched by the Directorate-General for Economic and Financial Affairs (DG ECFIN) in February 2013 and has been undertaken by ICF GHK in association with Cambridge Econometrics and with inputs from two local economists.

1.1 The Scope and Objectives of the Evaluation

The evaluation covers the EU's macro-financial assistance (MFA) to the Republic of Moldova over the period 2010 to 2012 (Decision No 938/2010/EU). The MFA to Moldova, consisting of a grant of EUR 90 million, was released in three tranches:

- EUR 40 million was disbursed in December 2010,
- EUR 20 million was disbursed in September 2011;
- EUR 30 million was disbursed in April 2012, instead of originally envisaged end-2011 due to delayed fulfilment of relevant conditions.

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

- The *macroeconomic impact of the MFA assistance* operation on the Moldovan economy (e.g. economic growth, balance of payments, fiscal balances, exchange rate); with and without IMF involvement.
- *Sustainability of the country's external position* as a result of the assistance.
- *Value added of EU intervention* i.e. to what extent assistance added benefits to what would have resulted from other interventions.

1.2 Evaluation Approach and Methodology

The evaluation was based on a structured and systematic approach to collecting, analysing and presenting evidence. Table 1.1 summarises the approach and methods used to address the evaluation questions set out in the Terms of Reference.

Table 1.1 Summary of the Methodological Framework for the Evaluation

Core Issue	Evaluation Question	The Approach in this Study
Macroeconomic impact of the MFA operation	How would the economy of Moldova have evolved in the absence of MFA (and IMF) assistance?	Identification of all potential counterfactual scenarios Assessment of the likelihood of occurrence of each counterfactual scenario Modelling of the most likely/ plausible counterfactual scenarios

Core Issue	Evaluation Question	The Approach in this Study
	To what extent has the MFA assistance been effective in terms of the short-term macroeconomic stabilisation of Moldova?	Description of actual macroeconomic outcomes (as observed in macroeconomic data) Estimation of net impact = the difference between actual outcomes and counterfactual outcomes
Impact on external sustainability	To what extent has the MFA contributed to returning the external financial situation of Moldova to a sustainable path over the medium to longer-term?	Analysis of trends in key external indicators: before and after MFA Macroeconomic modelling of key external indicators: with and without MFA (and IMF programme)
Impact on structural reforms	To what extent has the MFA assistance been effective in terms of supporting structural reform in Moldova?	Assessment of relevance, fulfilment and durability, additionality and impact of MFA-supported reforms
	What have been the indirect and/ or unexpected effects of the MFA assistance?	Elaboration of the ex-ante intervention logics of all structural reform measures Ex-post verification of the intervention logics Comparison between the ex-ante intervention logic and ex-post outcomes to identify actual indirect and/ or unintended effects
Design and implementation	How has the way in which the MFA operation was designed and implemented conditioned its effectiveness and efficiency?	Examination of relevance and effectiveness of the package (financial support + reforms) and their relation with identified features of design and implementation
Added value	To what extent has EU added value been maximised?	Assessment of financial and non-financial added value of EU support e.g. in terms of market confidence, political stability, etc.

As illustrated in Table 1.1, a combination of quantitative and qualitative research methods was used to build a comprehensive evidence base for the evaluation and to provide the basis for triangulation of results. These methods are described below.

1.2.2 Desk Research

This entailed an in-depth review and analysis of the following documentation, literature and data:

- *European Commission files relating to the MFA operation* which comprised documents such as the initial request for assistance submitted by the government of Moldova (GoM) to the EU; the Commission's proposal for a Council Decision providing MFA to Moldova; Council Decision approving the operation; ex-ante evaluation statement prepared the Commission; the Memorandum of Understanding between the EU and GoM; MFA Grant Agreement; mission reports prepared by the Commission; compliance statement and documentation submitted by the GoM etc.;
- *Operational Assessment prepared by PwC* prior to the implementation of the MFA;
- *EU Policy documentation* such as European Neighbourhood Policy (ENP) country reports, EU-Moldova Action Plan and progress reports;
- *European Commission documents relating to Sector Policy Support Programmes* supporting reforms in the area of Public Finance Management (PFM), public procurement and overseeing architecture of financial markets;
- *Documentation published by the Moldovan authorities* such as economic strategies, reform programmes, action plans and progress reports;
- *IMF documents* namely, the Letters of Intent submitted by the GoM to the IMF and IMF Country Reports;
- *World Bank documents* such as Country Partnership Strategies, program documents relating to the Bank's Development Policy Operations in Moldova, documents relating to projects supporting relevant reforms;
- *Academic and grey literature* on political and economic developments in Moldova and its progress with the implementation of structural reforms (particularly PFM reforms);
- *Macroeconomic data and statistics* on Gross Domestic Product (GDP) and its components, Balance of Payments (BoP), public finances, exchange rates, inflation, unemployment etc.;
- *Other literature and data* such as reports and data published by the European Bank for Reconstruction and Development (EBRD) and by other relevant stakeholders such us international (i.e. OECD) and national think-tanks.

Annex 5 provides a full list of the documentation and literature reviewed by the study team.

1.2.3 Semi-structure interviews

A series of semi-structured interviews was carried out with key informants notably, European Commission officials, representatives of relevant Moldovan authorities and IMF, World Bank (WB), and EBRD officials. With exception to one interview with World Bank officials, all interviews were carried out face to face. The purpose of these interviews was to collect additional background and contextual information relating to the operation.

Table 1.2 provides an overview of the interviews carried out in the context of this evaluation. The list of interviewees is available in Annex 6.

Table 1.2 Overview of semi-structured interviews carried out as a part of the evaluation

Stakeholder Group	Key Informants	No. of Interviews
European Commission	Directorate-General for Economic and Financial Affairs (DG ECFIN) Directorate-General for Development and Cooperation (DG DEVCO)	4
European External Action Service (EEAS)	EU Delegation to Moldova	1
Moldovan Authorities	Ministry of Finance Ministry of Economy National Bank of Moldova (NBM) National Commission for Financial Markets (NCFM) Parliamentary Committee on Economy, Budget and Finance Public Procurement Agency State Chancellery	14
Bretton Woods Institutions	IMF World Bank	9
Other donors	EBRD	1
Total Number of Interviews		29

1.2.4 Focus Group Discussion

A focus group discussion was also organised in Chișinău to gauge wider stakeholder perceptions of Moldova's reform efforts and the specific role of the EU in promoting better economic governance in the country. The focus group comprised representatives of national business associations, research institutes, think-tanks and civil society institutions. Detailed list of focus group participants is available in Annex 6

1.2.5 Macroeconomic Modelling

A model based approach was used to determine the net economic impact of the MFA, i.e. the difference between actual macroeconomic outcomes (what actually happened) and potential 'counterfactual' scenarios (what could have happened in the absence of the MFA).

The macroeconomic model used for the present evaluation shares many of the features of the models used in previous MFA evaluations for the European Commission, drawing upon the principles of 'flow of funds' and financial-programming approaches used, for example, by the IMF.

The model links the following key economic and financial variables:

- GDP (and its components);
- Government finances (revenue, expenses, deficit financing/debt);
- Moldova's Balance of Payments (trade flows, transfers, changes in reserves etc).

The model also includes indicators of money supply (remittances inflow) and a simple treatment of employment (linked to economic activity) as auxiliary components. The detailed description of the model is presented in the Annex 4.

As mentioned, the model is based on a 'flow of funds' approach. In such a model, a flow of funds from one sector (expenditure) must either show up as a flow of funds to one or more other sectors (receipts) or alter the stock of a particular asset. For example, when domestic firms receive revenue from household domestic expenditure, funds flow from households to firms. An example of a change in a stock is government deficit-financing. In years when the government spends more than it receives, it must make up the gap by running a deficit; the government's stock of debt must increase. Thus, changes in trade patterns, transfers and finance alter an array of other economic variables, simply by accounting definition.

Accounting identities and ratios make up the majority of the model framework and, combined with assumptions about sources (and limits) of financing and a small number of behavioural equations, yield an internally-consistent picture of the counterfactual scenarios.

The model produces annual projections over recent history (up to 2012) and we have compiled the model's database, and calibrated it to Moldovan economics statistics and data published by the IMF (principally the International Finance Statistics publication).

1.2.6 Strengths and Limitations of the Methodology

Table 1.3 critically assesses the information sources used and the validity of the data collected as part of this evaluation. Although each method has its strengths and limitations, the various methods taken together helped build a rich evidence base for the evaluation and provided the basis for cross-validation of findings.

Table 1.3 Strengths and Limitations of the Research Methods

Research Method	Strengths	Limitations and caveats
Desk research	A rich source of facts; statistical data; and, recorded information on the MFA operation. Helped provide first answers to the evaluation questions.	Desk research only provided part of the evidence base for the evaluation; it was necessary to update, cross-check and complement the information collected from secondary sources through primary research. Certain issues are not explicitly discussed in documents. While desk research was useful in developing a preliminary outline of the potential counterfactual scenarios, these needed to be validated and elaborated through stakeholder interviews.
Stakeholder interviews	Provided additional context and insights. Helped fill the gaps in the evidence base. Stakeholder interviews were also useful for confirming the accuracy of the information collected from other sources and corroborating what had been established from other sources.	Interviews covered stakeholder groups which were closely involved in the implementation of the assistance. Still, some interviewees did not have broad overview of MFA process. Also, there were certain limitations to recall of events and discussions from two years prior to interviews. The evaluation team detected some bias in their responses to the evaluation questions - particularly those relating to the relevance and impact of the financial assistance and reforms promoted by the MFA (i.e. condition related to new financial supervision architecture of non-banking sector).
Macroeconomic modelling	Was used to quantify the net macroeconomic impact of the MFA. A key advantage of a quantitative model is that it is explicit in its framework, economic logic and assumptions, allowing for scrutiny and testing of the results it produces. A quantitative, model-based approach has clear economic logic and assumptions. Changes in exogenous assumptions generate	The specification of counterfactual was challenging and essentially based on subjective judgement and educated guesses as to what might have happened in the absence of the MFA. The time span of the available statistical data for Moldova is relatively short and in many instances official data published by the authorities (i.e. Ministry of Finance) does not cover the latest period. Therefore

Research Method	Strengths	Limitations and caveats
	concomitant changes in the endogenous variables in the model, yielding an internally-consistent simulation of states of the world with and without MFA. A model based approach thus, provided an explicit framework for scrutiny and testing of results. Given the small scale of the assistance, it is obvious that the macroeconomic impact of MFA would be rather marginal. However, modelling helps quantify the scale of the impact.	making estimates of certain parameters was characterised by higher uncertainty. Given the uncertainty in the economic climate when the MFA was provided, it is important to interpret the model results with care; the results rely on a number of assumptions and so the direction and orders of magnitude of the effects are to be interpreted with more certainty than the precise point estimates.
Focus Group	Focus group discussions provided a forum to collect the views and opinions of a wider group of stakeholders i.e. those 'outside' the government and not directly involved in the operation. The group dynamic was particularly useful in triggering an objective discussion on the reform process and its outcomes. Focus group discussions provided an indication of the visibility of the MFA among wider stakeholder groups and their perceptions of the role of MFA in promoting reforms. Focus group discussions were also useful in determining if the MFA had any confidence boosting effects and / or impact on EU-Moldova relations, public opinion of the EU.	The scope of the focus group discussions was limited by definition. The focus group focussed on issues such as visibility of EU support, its role in promoting reforms and it covered also the overall assessment of the reforms' pace in Moldova since the MFA implementation.

2. The MFA Operation in Moldova and its Context

This section describes the economic situation in Moldova in the period leading up to the crisis, the government's policy response and the key elements of the anti-crisis support provided by the IMF and the EU to support the country's stabilisation and recovery.

2.1 Pre-crisis Context in Moldova

Moldova experienced strong growth in the years preceding the crisis. Real GDP growth averaged 6.4 per cent during 2001 to 2008, and unemployment declined from 7.3 per cent to 4 per cent over this period – Table 3.1. This growth was underpinned by capital inflows in the form of remittances (representing up to a third of the GDP according to some estimates) and FDI (which peaked at 12.3 per cent of the GDP in 2007) as well as rising credit (almost 21 per cent growth in 2008). The economy exhibited signs of overheating and build-up of macroeconomic imbalances in the run up to the crisis. Buoyant domestic demand pushed the current account deficit to above 15 per cent of the GDP during 2007- 2008, fuelled inflation that has persistently stayed in double-digit territory. Ensuing substantial real effective exchange rate (REER) appreciation and lacklustre progress of structural reforms led to declining competitiveness of the economy.

Box 1 Moldova at a glance

Moldova is a small economy with a GDP of EUR 5.9 billion (2012) and a population of 3.6 million (2011).

Stock of emigrants: around 770 thousands (2010)

Stock of emigrants as percentage of population: 21.5 per cent (2010)

Top destination countries: the Russian Federation, Italy, Turkey, Romania, the United States, Israel, Ukraine, Spain, Germany, Kazakhstan, Greece[1]

With a per capita GDP of USD 2,037 in 2012 Moldova is the poorest country in Europe

Note: Macroeconomic, social and demographic indicators do not include Transnistrian Region

Sources: _IMF, World Bank Statistics._

2.2 Causes and Consequences of the Crisis

The global financial crisis led to a sharp weakening of Moldova's economy, exposing its vulnerability, and the fragility of its recent remittance-led growth path. The effects of the global financial crisis were transmitted to Moldova in late 2008, as recession hit its major trading partners – Russia, Ukraine, Romania, and Western Europe, leading to an abrupt fall in remittances, FDI, and exports. Consequently, domestic demand and imports also collapsed, and real GDP contracted by 6 per cent in 2009.

The following sub-sections explore the causes and consequences of the economic crisis in Moldova in further detail.

[1] Based on Labor Force Survey conducted by National Bureau of Statistics http://statbank.statistica.md/pxweb/Database/EN/03%20MUN/MUN07/MUN07.asp and http://siteresources.worldbank.org/INTPROSPECTS/Resources/334934-1199807908806/Moldova.pdf. Data should be treated as only indicative.

2.2.1 Pre-crisis Vulnerabilities

The Moldovan economy was severely affected by the crisis, reflecting a high degree of economic vulnerability:

- *Weak structural fiscal position:* while headline fiscal balances of the general government remained close to balance until 2007/2008, underlying trends suggest a deteriorating structural fiscal position since mid-2000s. A period of strong economic growth (with output above its potential level) coincided with rising size of current expenditures (see below) and lowering of taxes. At the same time external grants increased their role in fiscal accounts. As a result, estimated structural fiscal balance of the general government (excluding grants) deteriorated from 0.4 per cent of potential GDP in 2003 to 2.9 per cent deficit in 2006 and 5.1 per cent deficit in 2008[2].

- *Large and growing size of the government:* throughout the growth period (2000 to 2008), Moldova's general government spending increased considerably: from 29 per cent of GDP in 2001 to 37 per cent in 2005 and further to 42 per cent in 2008. The bulk of this increase was on the current spending side with capital expenditure rising from 5 per cent of GDP in 2002 to a peak of 7.8 per cent in 2006, before declining to 7 per cent in 2008[3]. In particular, public sector wages increased substantially whilst investment in productivity enhancing infrastructure was neglected[4].

- *Large dependence on remittances:* by 2006-2007, remittances accounted for over a third of Moldova's GDP by some estimates, making it one of the world's most remittance-dependent economies (ranking second in the 'league table', after Tajikistan)[5]. Remittances grew on average by 34 per cent annually in US dollar terms from 2001 to 2008[6]. This fuelled the disposable income of households, thus leading to an increased aggregate consumption demand. The share of private consumption in GDP increased from 56 per cent in 1995 to more than 90 per cent in 2006–08. Constrained by the limited capacity of domestic production, this demand was largely met by imports of goods and services

- *A high degree of exposure to the Russian economy:* Russia was the country's main source of remittances and FDI, and a key trading partner:

- 55 per cent of remitters live in Russia[7];

[2] For a detailed analysis see IMF Country Report No. 12/289. Potential GDP is defined as the level of output that an economy can produce without accelerating inflation. Although an economy can temporarily produce more than its potential level of output (in which case observed GDP will be above the potential GDP), that comes at the cost of rising inflation. Potential output depends inter alia on the capital stock, the potential labour force and labour efficiency (see http://stats.oecd.org/glossary/detail.asp?ID=2094).
[3] IMF Country Report No. 12/289.
[4] World Bank (2011) Moldova after the Global Crisis: Promoting Competitiveness and Shared Growth
[5] SEC(2009) 445 - Millennium Development Goals: Impact of the Financial Crisis on Developing countries. Although the magnitude or remittances for Moldovan economy is indisputable, precise estimation of remittances faces methodological challenges and should be considered with caution. Among other ones, the following issues make estimates of remittances difficult: data on money transfers from abroad made in favour of natural persons via Moldovan banks available to the National Bank of Moldova likely contain some money flows related to business transactions and transfers to non-residents; there is no complete data money brought to Moldova in cash or through other informal transfer channels; and there is no complete data on value of property moved across borders by migrants.
[6] World Bank data on Remittance Inflows: http://data.worldbank.org/data-catalog/migration-and-remittances
[7] USAID (2008) International Remittances and Eastern Europe. Another dataset, the joint World Bank – OECD Global Bilateral Migration Database based primarily on the foreign-born concept indicate that around 2000 around 43 per cent of all Moldovan migrants lived in Russia.

- Russia accounts for almost a quarter of Moldova's FDI stock – making it the origin country with the largest investment share[8];
- Russia accounts for roughly 20 per cent of Moldova's exports[9];
- *Narrow economic base:* agriculture has been one of the largest sectors and a major contributor to the Moldovan economy. Share of agriculture in total value added declined from 17 per cent to 11 percent during 2006-2008. In the same period employment in agriculture dropped from 34 per cent to 31 per cent of total employment[10]. This large share is backed by the export-oriented agro-processing industry, which produces most of the agro-food exports and adds approximately 7–8 per cent to the GDP[11]. Agro-food exports represent 45–50 per cent of the total exports. The narrow export base of the country, with a high share of agricultural products, makes Moldova more vulnerable to shocks both on the supply and demand side. Vulnerability reflected by high dependence on the agriculture *per se* is even further reinforced by the weather caprices having a pivotal impact on the total output of this sector.
- *A weak investment climate:* the quality of business environment was negatively affected by costly overregulation, poor property rights, expropriation of businesses, and the creation by licensing and regulation of monopolies for export and distribution of agro-based products for which farmers get depressed farm gate prices[12]. As one illustration, in 2007-2008, Moldova ranked 103rd out of 181 countries in the World Bank Doing Business ranking[13].

Box 2 2009 crisis vulnerabilities, policy responses and outcomes: lessons from literature

Financial crises of various characteristics have been a recurring phenomenon in economic history of both developed and developing countries. While crises differ from one to the other and country-specific aspects make it far from easy to draw strong conclusions from other experiences it is nevertheless useful to review key lessons from economic literature that could be relevant for the assessment of the situation of Moldova around 2009.

Remittances – mitigating crisis vulnerabilities

Very strong reliance on remittances is characteristic for Moldova and several other transition and developing countries. A significant drop in remittance inflows, observed in particular in the first two quarters of 2009 played an important role dampening economic activity in Moldova.

However, existing empirical literature largely agrees that remittances usually act as economic stabilisers for countries facing external shocks[14]. A recent study looking at African countries suggests that remittances as a share of GDP significantly reduce both

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[8] Giucci, R., and Radeke, J. (2012) FDI Attraction to Moldova: Facts, Potential and Recommendations, available at http://www.get-moldova.de/download/policypapers/2012/GET_Moldova_PP_02_2012_en.pdf. The share would likely be higher if Russian businesses registered in Cyprus are added to the figure.
[9] Based on NBS Data.
[10] Based on World Bank, World Development Indicators database, accessed 2 July 2013.
[11] Based on NBS Data.
[12] World Bank (2012) Program Document for a Proposed Credit in the Amount of SDR 19.8 Million (US$30 Million Equivalent) to the Republic of Moldova for a Competitiveness Development Policy Operation
[13] World Bank, Doing Business 2009, September 2008, http://www.doingbusiness.org/reports/global-reports/doing-business-2009/
[14] See UNDP, Towards Human Resilience: Sustaining MDG Progress in an Age of Economic Uncertainty, New York 2011 and references cited therein.

output and consumption volatilities with the effect on consumption volatility being less pronounced[15]. Similar results are obtained in another study using panel data for 95 countries over the period 1970-2005[16]. An analysis of migrant responses to the recent global economic crisis also confirms relative resilience of remittance flows (e.g. shorter period of remittance decline compared to other economic indicators)[17].

One additional argument supporting the view that remittances were most likely to act as a factor mitigating volatility of economic conditions at the household level draws from the survey based study in rural parts of Moldova (field work carried in autumn 2008, i.e. just before the crisis). Findings suggest that a relatively high percentage of received remittances were saved by households and that households treated remittances as an insurance against the potential risk of future financial problems[18].

The above does not suggest that a decline in remittance inflows did not contribute to Moldovan recession in 2009. It surely did, and quite significantly given the size of remittance inflows relative to Moldovan GDP. However, the experience of other countries may suggest that remittances could have also to a degree provided a cushion to Moldova at the time of the crisis. For example, while convincing evidence is lacking it is possible that saved remittances from earlier quarters might have helped some households limit the decline in consumption.

Large balance of payment deficits – exacerbating crisis vulnerabilities

Moldova was running high levels of current account deficit in the run up to the crisis. Substantial BoP deficits are typically found in the literature as substantially increasing countries' vulnerability to crises, including vulnerability to crisis contagion[19]. Balance of payment crises, i.e. rapid adjustments of unsustainable BoP positions are itself an important category of financial crises. Large BoP deficits are typically listed among indicators used to assess external risks and vulnerabilities[20]. BoP deficits are also a factor potentially limiting space for fiscal policy response to a crisis[21].

Channels of crisis transmission to developing countries

The unique feature of the crisis that affected a very large number of economies around the globe since 2008 was synchronicity of negative developments and a global character. It is the character of linkages between a given country and the rest of the world as well as characteristics of the domestic economy and its vulnerabilities that had a bearing on the timing and strength of crisis transmission, and ensuing consequences. The crisis transmission process was diverse in its working for various countries and groups of countries[22]. Declining foreign trade and commodity prices (including for agricultural commodities) as well as reduced access to credit as capital inflows to

[15] Jihoud, A., Remittances and Macroeconomic Volatility in African Countries, mimeo Toulouse School of Economics, February 2013; accessed at http://economix.fr/fr/recrutement/2013/jpo-2013/Jidoud.pdf.
[16] Craigwell, X. Jackman, M. Moore, W. (2010) "Economic volatility and remittances", International Journal of Development Issues, Vol. 9 Iss: 1, pp.25 – 42.
[17] Sirkeci, I. Cohen, J. Ratha, D. (2012). Migration and Remittances during the Global Financial Crisis and Beyond, World Bank.
[18] Walewski, M. Mincu, G. Sandu, M. and Hristev, E. The Effects of Migration and Remittances in Rural Moldova (2009). CASE Network Studies and Analyses No. 389/2009, CASE – Center for Social and Economic Research.
[19] Bekaert, G. Ehrmann, M. Fratzscher, M. and Mehl, A. Global Crises and Equity Market Contagion (May 31, 2012). Accessed at SSRN: http://ssrn.com/abstract=185688
[20] IMF, The IMF-FSB Early Warning Exercise. Design and Methodological Toolkit. International Monetary Fund, September 2010.
[21] UNDP, Towards Human Resilience: Sustaining MDG Progress in an Age of Economic Uncertainty, New York 2011.
[22] Alexander Chudik and Marcel Fratzscher. (2011). "Identifying the global transmission of the 2007-09 financial crisis in a GVAR Model," Working Paper Series 1285, European Central Bank.

emerging and transition economies declined abruptly in late 2008 and early 2009 were among important channels for crisis transmission23. As regards financial linkages factors that are believed to have mattered in Moldova included substantial currency depreciation and volatility of exchange rate and a drop in private debt and equity capital flows24. A decline in remittances also played a significant role (Moldova was among the countries that experienced the strongest fall in remittances relative to the country's GDP25).

2.2.2 Impact of the crisis on Moldova's economy

The global financial crisis unveiled the underlying fiscal imbalances and forced a rapid adjustment of the balance of payment imbalance.

- A freeze in global capital flows and severe recessions among Moldova's main trading partners (several EU economies, Russia, Ukraine) caused a rapid stop to capital inflows to Moldova and a substantial decline in exports (minus 20 per cent between 2008 and 2009) and remittances (down by 30 per cent in the same period);
- The sharp fall in capital inflows, remittances, and exports put pressure on the exchange rate since late 2008. The National Bank of Moldova (NBM) intervened in support of the lei, resulting in the loss in international reserves of about 60 per cent from the September 2008 peak to US $1.1 billion by the end of March 2009;
- Falling capital inflows and ensuing external financing gap also resulted in rapid adjustment of the current account with deficit narrowing from around 16 per cent in 2008 to around 8 per cent in 2009.
- The effects of the crisis and pre-election spending resulted in a large fiscal gap in 2009. The headline fiscal deficit increased from 1 per cent of GDP in 2008 to over 6 per cent in 2009, and the structural deficit (excluding grants) reached 7.5 per cent;
- The overall economic impact of the crisis on the economy was as follows:
- Real GDP contracted by 6 per cent in 2009 (i.e. significantly more than the median for the Commonwealth of Independent Countries (CIS) countries, but less than in Russia, Ukraine and Armenia);
- Employment declined by more than 5 per cent in 2009 and unemployment rate rose from 4 per cent in 2008 to 6.4 per cent in 2009 and 7.4 per cent in 2010;

[23] United Nations, (2011). The Report on the World Social Situation 2011: The Global Social Crisis, Department of economic and Social Affairs, New York 2011. Accessed at http://social.un.org/index/ReportontheWorldSocialSituation/2011.aspx
[24] Nissanke, M. The Global Financial Crisis and the Developing World: Transmission Channels and Fall-outs for Industrial Development, UNIDO Working Paper 06/2009, Vienna, 2010.
[25] Ocampo, J.A., Griffith-Jones, S, Noman, A. Ortiz, A. Vallejo, J. and Tyson, J. , The great recession and the developing world, mimeo 2010. Accessed at http://policydialogue.org/publications/working_papers/the_great_recession_and_the_developing_world/

Table 2.1 Evolution of Moldova's Key Macroeconomic Indicators, 2004 - 2014

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013 [proj]	2014 [proj]
Real Sector											
Real GDP Growth (%)	7.4	7.5	4.8	3.0	7.8	-6.0	7.1	6.8	-0.8	*4*	*4*
Nominal GDP (USD billion)	2.6	3.0	3.4	4.4	6.1	5.4	5.8	7.0	7.2	*7.8*	*8.4*
GDP per capita (USD)	724	834	954	1234	1699	1527	1635	1971	2037	*2218*	*2389*
CPI average (% change)	12.4	11.8	12.7	12.4	12.7	0.0	7.4	7.6	4.7	*5*	*5*
Unemployment rate (%)	8.1	7.3	7.4	5.1	4.0	6.4	7.4	6.7	5.5	*6.2*	*5.7*
Fiscal sector											
Government Revenues (% of GDP)	35.4	38.6	39.9	41.7	40.6	38.9	38.3	36.6	38.1	*37.6*	*37.6*
Total Government Expenditure (% of GDP)	34.6	37.0	39.8	42.0	41.6	45.2	40.8	39.1	39.4	*39.7*	*38.8*
Net Lending/Borrowing (% of GDP)	0.7	1.5	0.0	-0.2	-1.0	-6.4	-2.5	-2.4	-2.1	*-2.1*	*-1.3*
General Government Debt (% of GDP)	42.8	34.8	30.0	24.0	18.8	28.6	26.2	23.1	23.8	*22.4*	*20.8*
Monetary Sector											
Central Bank Base Rate (%)	14.5	12.5	14.5	16.0	14.0	5.0	7.0	9.5	6.5	-	-
Private Credit Growth (%)	21.2	30.7	38.4	60.1	16.5	-5.2	9.9	15.6	16	-	-
External Sector											
Current account balance (% of GDP)	-1.8	-7.6	-11.3	-15.[illegible]	-16.1	-8.2	-7.8	-11.2	-6.8	*-7.6*	*-8.7*
Exports of goods and services (% of GDP)	51.0	50.3	44.8	45.5	41.1	36.8	39.4	45.0	43.6	*46.6*	*48.3*

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013 [proj]	2014 [proj]
Import of goods and services (% of GDP)	80.9	90.9	91.9	98.2	94.3	73.4	78.7	86.0	84.2	*87.4*	*88.4*
FDI (Net Inward) (% of GDP)	5.6	6.4	7.6	12.3	11.7	2.7	3.4	3.8	2.4	*4.0*	*5.1*
External and Debt Vulnerability											
External Public Debt (long-term; % of	30.7	24.4	24.6	20.6	15.4	20.2	22.5	21.1	23.8	23.5	23.3
Public Debt Service Ratio	7.4	4.3	4.5	3.1	2.5	3.4	2.4	-	-	-	-
Gross External Debt (% of GDP)* GDP)	72.4	69.5	73.0	75.4	67.4	79.6	81.3	76.6	82.7	*72.9*	*72.5*
Gross Reserves (Including Gold) (USD millions)	470	597	775	1334	1672	1480	1718	1965	2515	*2414*	*2489*
Import cover (months)	2.1	2.2	2.2	2.8	5.0	3.9	3.4	3.6	3.7	*3.7*	*3.5*

Note: * At year-end

Sources: IMF World Economic Outlook; World Bank, National Bank of Moldova

2.3 Government's Policy Response

In November 2009, the newly elected government adopted an Economic Stabilisation and Recovery Plan as a policy response to the crises.

Box 3 Crisis Response: Economic Stabilisation and Recovery Plan for 2009-2011

The Programme provided a set of actions to support the reforms that were initiated previously, as well as new actions which were envisaged to start in the fourth quarter of 2009 and were meant to run up until the end of 2011. Both types of actions had either an immediate or a medium-term perspective.

The Plan was based on three priorities:

- Stabilisation and streamlining of public finances.

  The objectives included actions aiming at mobilisation of additional revenues (including foreign budget support) and cutting non-priority spending especially those related to the operational costs of public administration.

- Economic recovery.

  The objectives focused on reducing the administrative and fiscal burdens for businesses, facilitation of access to finance for business and stimulating public and private investments.

- Securing an efficient and fair social protection.

  The objectives included support for vulnerable groups to prevent social exclusion by more efficient channelling of social assistance pro-employment initiatives targeted returning migrants and other unemployed.

Costs of programmes were intended to be covered from national sources and international financial assistance. The specific objectives of the programme and examples of certain key actions envisaged within each of them are provided in Annex 2.

Source: http://www.onu.mfa.md/img/docs/economic-stabilization-recovery-plan.pdf

The plan also became a reference point for international assistance from Moldova's development partners.

Box 4 Policy responses to 2009 crisis and their effects – lessons from literature

There is hardly a simple story on optimal policy responses to a crisis or macroeconomic implications of alternative policy options. This is for a good reason: there is simply no policy prescription that would fit in all circumstances. To the contrary, optimal policy responses are likely to be country specific. Some broad lessons emerging from literature are fairly intuitive: depending on fiscal stance including public debt situation at the time of the crisis, there was different room for manoeuvre on the fiscal side[26]. What also matters in this respect is the possibility to finance countercyclical fiscal stance, i.e. higher deficits. Access to funding can be secured domestically provided there are sufficient domestic saving rates and the domestic debt markets are sufficiently developed. Alternatively, given that international markets were hardly an option for most countries in 2009-2010, funding could have come from international financial institutions and development partners,

[26] Griffith-Jones, S and Ocampo J.A, The Financial Crisis and its Impact On Developing Countries. UNDP Working Paper 2009. Accessed at http://mdgpolicynet.undg.org/ext/economic_crisis/UNDP_-_The_Financial_C.pdf

notably through IMF, World Bank and EU instruments. MFA itself was one such instrument, as was e.g. the so-called VFLEX instrument designed to help the most vulnerable African, Caribbean and Pacific (ACP) countries cope with the impact of the global financial crisis[27]. Monetary policy also had a role with typical objectives of avoiding pro cyclical tightening and facilitating access to finance.

Exchange rate arrangement was also relevant. While substantial currency depreciation provided support to some economies with flexible exchange rate regimes (e.g. Poland) other countries preferred to stick to their fixed exchange rate regimes. Latvia is one example in the latter group which chose to pursue internal devaluation as opposed to external devaluation in order to maintain the lat's peg to the euro: a policy response which involved heavy front-loading of fiscal austerity measures. While short-term economic and social costs were often very substantial in the latter case (Latvia provides a case in point) it still remains to be seen whether long-term implications of such strategies will be better or worse than of a more countercyclical policy stance. In fact, even the ex post assessment may be difficult given the different initial characteristics of countries at the time they were hit by the global crisis. In summary, there are no simple lessons or readily available benchmarks against which a policy response to the crisis in Moldova could be compared.

2.4 Moldova's Financing Needs and Sources

In the context of a deteriorating economic situation and worsening outlook, the Moldovan authorities approached several international donors during 2009 to cover the country's substantial external financing needs.

2.4.1 Overview of the IMF Package

In early 2009, Moldova was not only dealing with the economic impact of the global crisis, but internal political situation was very tense following the April 2009 parliamentary elections and ensuing political gridlock. This period coincided with the expiry (May 2009) of the IMF programme approved in 2006 (Poverty Reduction and Growth Facility (PRGF) with an amount of SDR 80 million or circa US$118 million).

Following the new parliamentary election in July 2009, a staff level agreement was reached with the newly formed coalition government on a new IMF programme.

Two three-year arrangements were approved in January 2010: the Extended Credit Facility and Extended Fund Facility (ECF/EFF), each providing an equal amount and with the combined financial assistance amounting to SDR 369.6 million (about US$586 million). The overall aim was to 'support the country's economic program aimed at restoring fiscal and external sustainability, preserving financial stability, reducing poverty, and raising growth'28. First disbursement in the amount of SDR 40 million took place already in February 2010.

Implementation of the programme was monitored through semi-annual reviews, prior actions, quantitative performance criteria, indicative targets, and structural benchmarks (reforms)[29].
Table 2.2 outlines the prior actions and necessary reforms that Moldovan government declared to undertake at the outset of the project. All prior actions were considered completed by the end of January 2010[30].

[27] See basic information see http://europa.eu/rapid/press-release_IP-10-1091_en.htm. For an initial assessment see e.g. Griffith-Jones, S, and te Velde, D. W., Protecting Developing Country Growth from Global Shocks, mimeo 2012. Accessed at http://www.stephanygj.net/papers.html
[28] IMF Press Release No.10/21, January 29, 2010 Accessed at http://www.imf.org/external/np/sec/pr/2010/pr1021.htm
[29] IMF, Country Report, 2010. Available at: http://www.imf.org/external/pubs/ft/scr/2010/cr1032.pdf

Table 2.2 Prior Actions and Structural Reforms linked to the IMF Package

Measure	Objective
Prior Actions	
Parliamentary passage of an amended 2009 budget with a deficit target in line with the MEFP	To bring budget allocations in line with available resources.
Parliamentary passage of a 2010 budget with a deficit target in line with the MEFP	To facilitate macroeconomic stability and mitigate rising fiscal sustainability risks.
Parliamentary passage of amendments to Budget System Wage Law 355 to bring wages in line with the wage bill allocation in the 2010 budget and with the MEFP	To ensure the credibility of the budget and rationalize spending on wages to increase resources available for investment and social protection.
The NBM's net international reserves, as defined in the TMU, will amount to US$1300 million by end-December	To provide for an adequate level of reserves and enhance market confidence by partly offsetting the loss of reserves in early 2009.
Parliamentary passage of legislation transferring to the energy regulator (ANRE) the authority to set tariffs for heat directly, rather than indirectly through the municipalities as at present	To depoliticize tariff setting and foster cost recovery in the district heating sector.
The new heating tariff, to be set by ANRE by January 14, 2010, will cover at least amortization and all variable costs and will be legally binding	To alleviate fiscal risks stemming from inadequate tariffs.
Structural Benchmarks	
Cabinet approval and submission to parliament of amendments to the Law on Financial Institutions to strengthen the tools available to resolve problem banks	To facilitate speedy resolution of problem banks.
The NBM will collect and share with Fund staff the results of the on-going diagnostic studies in all banks that use conservative methods of asset valuation previously agreed with Fund staff	To identify banking system vulnerabilities.
The Cabinet will adopt a plan for the speedy expansion of the new targeted social assistance system with a view to cover at least 2/3 of all eligible recipients by end-2010	To rectify a fragmented system and improve efficiency of welfare benefits during the recession.
Cabinet approval and submission to parliament of amendments to the Law about guaranteeing the deposits of physical persons in the banking system that provides depositors with early	To allow insured depositors early access to deposit funds and thus strengthen confidence in the banking

[30] Statement by the IMF Staff Representative on the Republic of Moldova, January 29, 2010 in: IMF Country Report No. 10/32 (February)

Measure	Objective
access to their deposit funds in the event of a bank failure	system.

Source: http://www.imf.org/external/pubs/ft/scr/2010/cr1032.pdf

Table 2.3 presents the list of quantitative performance criteria and indicative targets.

Table 2.3 Quantitative criteria and indicative targets linked to IMF package

Quantitative performance criteria (set for end of 1st and 3rd quarter 2010)
Ceiling on the overall cash deficit of the general government
Ceiling on net domestic assets of the NBM (stock)
Floor on net international reserves of the NBM
Ceiling on contracting or guaranteeing of non-concessional external debt of the general government
Indicative targets for the 1st Programme review were set for:
Ceiling on reserve money
Ceiling on change in domestic expenditure arrears of the general government
Ceiling on the general government wage bill
Floor on priority social spending of the general government

Source: *IMF Country Report, February 2010.*

2.5 Objectives of the MFA Operation

It was in the context of the above IMF programme, that the European Parliament and the Council approved the Commission's proposal for providing an MFA grant of EUR 90 million to Moldova in October 2010 (Decision No 938/2010/EU). Furthermore, there were strong political reasons for the EU's support. The 2009 economic crisis coincided with a political crisis in Moldova. Following the contested parliamentary elections in April 2009, the Republic of Moldova entered a period of political crisis and deadlock between the ruling Communist Party and a coalition of opposition parties. The elections were followed by street protests against alleged irregularities. By boycotting the presidential election, the opposition forced the dissolution of parliament and brought about early elections in July 2009. Following the elections, four political parties31 combined in the Alliance for European Integration (AEI), to form a coalition government. On September 25, 2009, the Parliament gave the vote of confidence to the new government led by Prime Minister Vlad Filat. A key objective of the new government was to lead the country towards European integration. The EU was therefore, keen to show reciprocity and support the newly elected pro-European government.

The explicit as well as implicit objectives of the operation were as follows:

- To support Moldova's economic stabilisation and to alleviate its balance of payments and budgetary needs (938/2010/EU);
- To strengthen the reform momentum in the Republic of Moldova in supporting the government's economic programme {COM(2010) 302 final};

[31] Liberal Democratic Party, Liberal Party, Democratic Party and Our Moldova Alliance

- To contribute to its efforts towards integration with the EU and the implementation of the EU-Moldova Action Plan and Eastern Partnership {COM(2010) 302 final};
- To help increase EU leverage on policy making {COM(2010) 302 final}.

2.6 Implementation of the Operation

The request for additional financial assistance from the EU was expressed in the letter by prime minister Zinaida Greceanîi dated 23 June, 2009. In October 2010, the European Parliament and the Council of the European Union adopted a decision to provide the MFA to Moldova in the form of a grant of up to EUR 90 million. The discussion of this delay can be found in section 5 of this report.

Specific conditions attached to the grant including the number of tranches and approximate timing of the disbursements were agreed in the Memorandum of Understanding signed by the European Union and the government of Moldova in December 2010.

MFA to Moldova was released in three instalments:

- First instalment in the amount of EUR 40 million was disbursed in December 2010;
- Second instalment in the amount of EUR 20 million was disbursed in September 2011; and
- Third instalment of EUR 30 million was initially planned for December 2011 but due to insufficient implementation of conditions, it was eventually disbursed in April 2012.

In contrast to the relatively long time span between a request for the MFA and signing of the Memorandum of Understanding, the implementation of the MFA operation proceeded largely in line with the initial planning that had foreseen disbursement of all the resources during a period of 12 month. Only the last tranche was delayed by more than 3 months due to problems in fulfilling certain conditions.

The MFA to Moldova represented almost a third (30 per cent) of Moldova's residual external financing needs (EUR 295 million) for the years 2010 and 2011 as estimated at the time of designing the MFA32. MFA was also sizeable in relation to the size of the economy, accounting for around 1.8 per cent of the Moldovan GDP in 2011. 0 illustrates the timing and the relative size of MFA disbursements and IMF programme disbursements.

Table 2.4 MFA and IMF tranche disbursements, 2010-2012 (EUR million & per cent of quarterly GDP)

	MFA (million EUR)	IMF (million EUR)	MFA (per cent of quarterly GDP)	IMF (per cent of quarterly GDP)
1Q10		66		8.4
2Q10				
3Q10		66		5.2

[32] Based on the financing needs assessment provided in ECFIN/D3/RA/c1Ares(2010) – Macro-financial Assistance to the Republic of Moldova, A Commission proposal for 2010-2012, Note for the Economic and Financial Committee.

	MFA (million EUR)	IMF (million EUR)	MFA (per cent of quarterly GDP)	IMF (per cent of quarterly GDP)
4Q10	40		2.9	
1Q11				
2Q11		54		4.6
3Q11	20	54	1.3	
4Q11				
1Q12		56		4.9
2Q12	30		2.2	
3Q12				
4Q12				4.2
Total	90	296		

Source: Calculations using NBS preliminary quarterly 2012 GDP figures and estimating quarterly 2011 figures based on final annual data and seasonal GDP patterns in 2012.

2.7 Conditionality Attached to the Operation

The release of tranches was subject to the IMF programme being on track and – in the case of second and third tranche – the satisfactory fulfilment of agreed structural reforms. Table 2.5 overleaf lists the conditions attached to the second (4 conditions) and the third tranche (8 conditions). MFA conditionality targeted 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.

[1] Based on the financing needs assessment provided in ECFIN/D3/RA/c1Ares(2010) – Macro-financial Assistance to the Republic of Moldova, A Commission proposal for 2010-2012, Note for the Economic and Financial Committee.

Table 2.5 Overview of MFA Conditionality

Area of reform	Tranche 2	Tranche 3
PFM- Budget preparation and execution	**Condition 2.1:** In the context of the implementation of the planned transition to a new Financial Management Information System (FMIS) by 1 January 2012, ▪ The Ministry of Finance will approve a new budget classification system compliant with GFS 2001/COFOG ▪ The Ministry of Finance will develop an appropriate methodology for budget preparation.	**Condition 3.1:** In the context of the implementation of the planned transition to a new Financial Management Information System (FMIS) by 1 January 2012: ▪ The Ministry of Finance will approve a new unified Chart of Accounts for the whole public sector, replacing the current system. ▪ The Ministry of Finance will prepare methodology for budget execution, covering also the full implementation of the commitment management system in the new FMIS. ▪ The government will prepare and submit to Parliament a new Law on Public Finances, replacing the current legislation on the budget system and budget process, with a view to its adoption in the course of 2011.
		Condition 3.2: The government will approve and publish the Medium-Term Budget Framework Forecast (MTBF) for the period 2012-2014
PFM – Public debt management	None	**Condition 3.3:** The Ministry of Finance will elaborate, approve, and publish a medium-term debt management strategy for the period 2012-2014 as the MTBF, covering also the principles of the settlement of the outstanding government bonds held by the National Bank of Moldova.

Area of reform	Tranche 2	Tranche 3
PFM - Public finances	**Condition 2.2:** The government will prepare the terms of reference and the methodological guidelines for a census of: ▪ the number of public sector employees (in central and local government, and extra-budgetary funds and institutions) ▪ the number of payroll positions in each subsector the paid wage bill. The census aimed at improving control of expenditure on public sector compensations will include the breakdown by categories of functional budget classification and occupation.	**Condition 3.4:** Based on the preparatory work conducted to this effect and included in the list of actions to be accomplished prior to the release of the second Grant instalment, the government will conduct a census of the number of public sector employees, of the number of payroll positions and of the paid wage bill.
Financial Stability/ Financial Sector Reform	**Condition 2.3:** The participants in the National Financial Stability Committee, with the support of institutions they represent, will agree and publish a Memorandum of Agreement governing its decision making processes, the delimitation of supervisory responsibilities and the preparation of contingency plans for systemic risks in the financial sector.	**Condition 3.5:** The government will prepare and submit to the Parliament changes in the legislation on financial regulation and supervision specifying the regulatory and supervisory responsibilities for leasing and micro-credit institutions in the context of the Memorandum of Agreement between the institutions represented in the National Financial Stability Committee
		Condition 3.6: The Ministry of Finance and the National Bank of Moldova will jointly elaborate a time bound action plan to ensure over the medium term sufficient capitalisation of the National Bank of Moldova

Area of reform	Tranche 2	Tranche 3
Legislative and regulatory convergence with the EU	**Public Procurement legislation and regulation** **<u>Condition 2.4:</u>** The Public Procurement Agency will prepare and submit to the government a time-bound action plan with specified targets to redefine the tasks and responsibilities of the Public Procurement Agency, and to bring the public procurement legislation, regulation and practices closer to good EU standards.	**Public Procurement legislation and regulation** **<u>Condition 3.7:</u>** The government will prepare and submit to Parliament changes in the Public Procurement Law removing domestic preference for procurement amounts under 2.5 million lei and suppressing the list of products to which domestic preference applies with the aim of making the procurement legislation and regulations compliant with EU Directive 2004/18/EC.
		Central Bank legislation **<u>Condition 3.8:</u>** The government in cooperation with the National Bank of Moldova will prepare and submit to Parliament adaptations to the Central Bank Law so as to provide for its compliance with the Treaty on the Functioning of the European Union, in particular in the field of central banks independence and prohibition on monetary financing.

Source: *Memorandum of Understanding between the European Union and the Republic of Moldova dated 16 December 2010*

2.8 Overview of other International Support

2.8.1 Other EU support

The MFA complemented European Neighbourhood Partnership Instrument (ENPI) sectoral budget support to Moldova – see Table 2.6. Budget support disbursements in 2009 and 2010 amounted to EUR 66.1 million and EUR 56.6 million respectively followed by EUR 132.4 over the period 2011 - 2013.

Table 2.6 Overview of ENPI Budget Support to Moldova

	2007 - 2010	2011-2013
Programmed Amounts	EUR 209.7 million	EUR 273.1 million
Priorities	▪ Support for democratic development and good governance ▪ Support for regulatory reform and administrative capacity building ▪ Support for poverty reduction and economic growth	▪ Support for good governance, rule of law and fundamental freedoms ▪ Support for social and human development ▪ Support for trade and sustainable development
Committed Amounts	EUR 225.3 million*	EUR 200.6 million**
Disbursements	EUR 154.4 million	132.4 million

**includes EUR 16.6 million from the Governance Facility; ** includes EUR 28 million from EaPIC allocation*

Source: *http://ec.europa.eu/world/enp/docs/2013_enp_pack/2013_statistical_annex_en.pdf*

2.8.2 Other International Support

Both bilateral and multilateral donors supported Moldova during the analysed period. Brief snapshots on the scale and characteristics of this assistance are provided below.

The World Bank

World Bank assistance to Moldova between the period of 2009 and 2012 was provided within the framework of Country Partnership Strategy prepared in the partnership with the government of Moldova and with consultations with business, civil societies and other donors.

Overall from July 2009 till June 2012, World Bank approved concessional lending of around EUR123 million with effective disbursement of EUR 84 million[33]. Although loans were a key component some part also came in the form of grants. In addition, a grant of EUR19.5 million was provided by Trust Funds administered by IBRD and IDA but supported by other development partners such as EU, SIDA, Japan or the Netherlands[34].

[33] Lending though the International Development Association (IDA), part of the World Bank that helps the world's poorest countries.
[34] World Bank, 2013. Concessional Finance and Global Partnership. http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/ORGANIZATION/CFPEXT/0,,contentMDK:23345020~menuPK:9030913~pagePK:64060249~piPK:64060294~theSitePK:299948,00.html

Three essential areas of focus consistent with country's National Development Strategy for 2008-2011 were: (i) improvement of economic competitiveness, (ii) minimizing social and environmental risks building human capital and promoting social inclusion, and (iii) improving public sector governance35. World Bank has also been instrumental in leveraging substantial co-financing for reforms.

The European Bank of Reconstruction and Development (EBRD)

Total assistance provided from EBRD over the period 2010-2012 reached approximately EUR254 million, predominantly in the form of loan36. Key target areas included modernisation of transport and municipal infrastructure, support to SMEs as well as the financial sector.

In 2012, EBRD provided a EUR38 million loan to six financial institutions, including two leasing companies and one micro-finance provider. As discussed in more details in Section 4 of this report MFA conditionality concerned in particular supervision of the two latter types of financial institutions.

The European Investment Bank (EIB)

The EIB finances projects in Moldova on the basis of a joint EU Council / Parliament mandate of EUR 3.7 billion for Eastern Europe, Southern Caucasus and Russia for the period 2007-2013. There is no ex-ante allocation of the overall amount by country. Over the period 2010-2012 EIB's financing agreements signed totalled around EUR232 million for Moldova with the largest share injected in road infrastructure and programme seeking to modernise the country's wine industry[37]. Over this period Moldova was the biggest beneficiary of the EIB financing among Eastern Partnership peers as measured by the proportion of provided loans to the national GDP[38].

Bilateral donors

Apart from the assistance provided by multilateral donors, Moldova also received substantial support from bilateral donors amounting to around EUR84 million in 2010 and EUR96 million in 2011[39]. Some examples include Sweden whose financial assistance between 2010 and 2012 totalled approximately EUR33 million[40], US which provided on average EUR16 million annually between 2010 and 2012[41] as well as Japan (US$8.1 million in 2011[42]), Poland (US$15 million in 2010[43]) Germany, Netherlands, Romania and the United Kingdom.

Non materialised financial assistance

In the period leading to July 2009 elections, there were also announcements of a possible loan from Russia and China, but neither of these materialised after the formerly ruling Communist party was ousted in the summer 2009 elections.

[35] World Bank, 2013. Moldova Partnership Country Programme Snapshot
[36] EBRD, 2013. Moldova at glance. Available at: http://www.ebrd.com/downloads/research/factsheets/moldova.pdf
[37] EIB, Finance contracts signed – Republic of Moldova. Available at: http://www.eib.org/projects/loans/regions/cei/md.htm?start=2010&end=2012&sector=
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[40] Swedish Ministry of Foreign Affairs, 2013. Available at: http://www.openaid.se/en/countries
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[42] Embassy of Japan in Moldova, 2013. Available at: http://www.ua.emb-japan.go.jp/eng/bi_md/
[43] Rocznik Instytutu Europy Srodkowej, 2012. Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2175263

3. Impact of the MFA Operation on Macroeconomic Stability and External Sustainability

The impact of the MFA operation on macroeconomic stability and external sustainability can be assessed at two levels:

- Gross impact as observed in actual macroeconomic outcomes;
- Net impact which is the difference between what actually happened and what might have happened in absence of the IMF/ MFA support; this involves the construction of counterfactual scenario(s).

This section first describes gross impacts to later outline the construction of counterfactual scenarios and estimates of net macroeconomic impacts.

3.1 Observed Outcomes

Output has recovered fast…

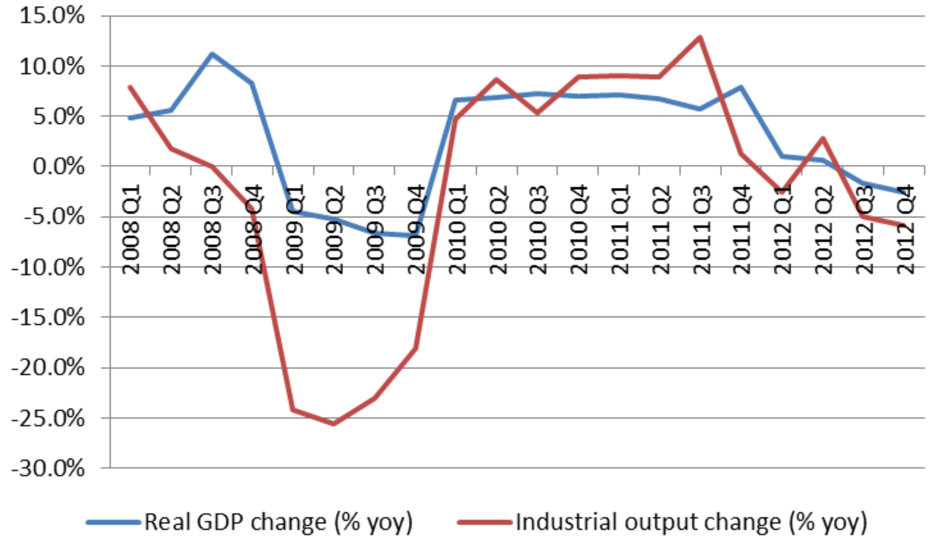
The Moldovan economy rebounded quickly from the crisis and returned to robust growth already from the first quarter of 2010, faster than expected (0). Recovery was initially driven by external trade as real exchange rate depreciation helped Moldova regain international competitiveness. Strong growth of exports continued during 2010-2011. Private consumption and gradually also investment recovered strongly and continued solid expansion driven by remittances returning to their rising trend (0) and credit growth. GDP growth averaged 7.1 per cent in 2010 and 6.8 per cent in 2011 before contracting by 0.8 per cent in 2012 (0). The 2012 recession (particularly in the second half of the year) was caused by a severe drought that led to a 23 per cent decline in agricultural value added and halving of the grain harvest as well as the euro-area slowdown.

… while employment has remained subdued.

At the same time, domestic labour market has seen a prolonged period of weakness with employment declining by 5 per cent in 2009 and another 4 per cent in 2010[44]. Modest employment gains in 2011 (below 3 per cent growth) were reversed in 2012. Interpretation of these trends requires caution given that most significant employment changes were recorded in the rural areas where productivity in the agricultural activities is very low, masking substantial overhang of labour force with limited chances of finding employment opportunities outside the agricultural sector. These labour market features are more long-term in nature and not directly linked to the 2009 crisis. At the same time, it is worth remembering that large part of Moldovan populations works abroad and remittance data as well as LFS-based data on the economically active population abroad suggest an overall better situation in foreign labour markets where Moldovans are active since the crisis.

[44] Based on labour force survey data. Accessed on 20 May 2013 at http://www.statistica.md/category.php?l=en&idc=107&.

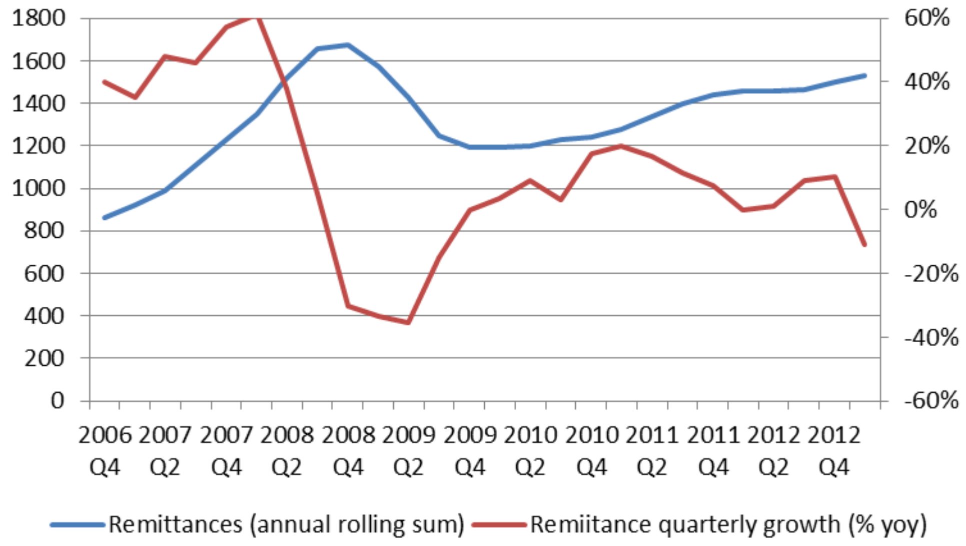
Figure 3.1 Evolution of Real GDP and Industrial output, 2008-2012



Note: 2011-2012 GDP data are provisional estimates. Quarterly industrial output dynamics calculations based on monthly data.

Source: National Bureau of Statistics

Figure 3.2 Proxy measure of remittances inflow, 2006-2013 (USD million and % change yoy)



Note: The values used to plot the figure are Money Transfers from Abroad Made in Favour of Natural Persons (Residents and Nonresidents) via Banks of the Republic of Moldova, net settlements. They can be considered a proxy measure for remittances, in particular as regards dynamics of flows.

Source: National Bank of Moldova.

The authorities have made substantial progress in restoring fiscal sustainability...

A combination of the severe 2009 recession and pre-election spending spree (especially public sector wage and pension hikes) opened a substantial fiscal gap. The 2009 general government deficit hit 6.3 per cent of GDP with limited options to finance it outside official foreign sources. A key objective of the authorities' IMF-supported programme therefore, was to restore fiscal sustainability by end-2012, operationalized as a return to the pre-2008 structural fiscal balance, i.e. the level that could be financed without recourse to exceptionally high official assistance. To this end, the Moldovan authorities embarked on an ambitious growth-enhancing fiscal consolidation strategy that comprised structural reforms focusing on rationalising current expenditure, while enhancing and better targeting social assistance to protect the most vulnerable groups and gradually raising public investment to support growth.

The fiscal adjustment during 2010–11 was successful in bringing the large post-crisis deficit to a much lower level (2.4 per cent of GDP in 2011). This was supported by strong economic rebound. In 2010, the adjustment mainly took the form of expenditure restraint: current expenditures declined by above 4 per cent of GDP between 2009 and 2010. In 2011, rationalisation of expenditures allowed a further current expenditure reduction to the tune of 2 per cent of GDP and locking-in some gains from the consolidation45. In particular, public sector wage bill was reduced by 2.2 per cent of GDP between 2009 and 2011.

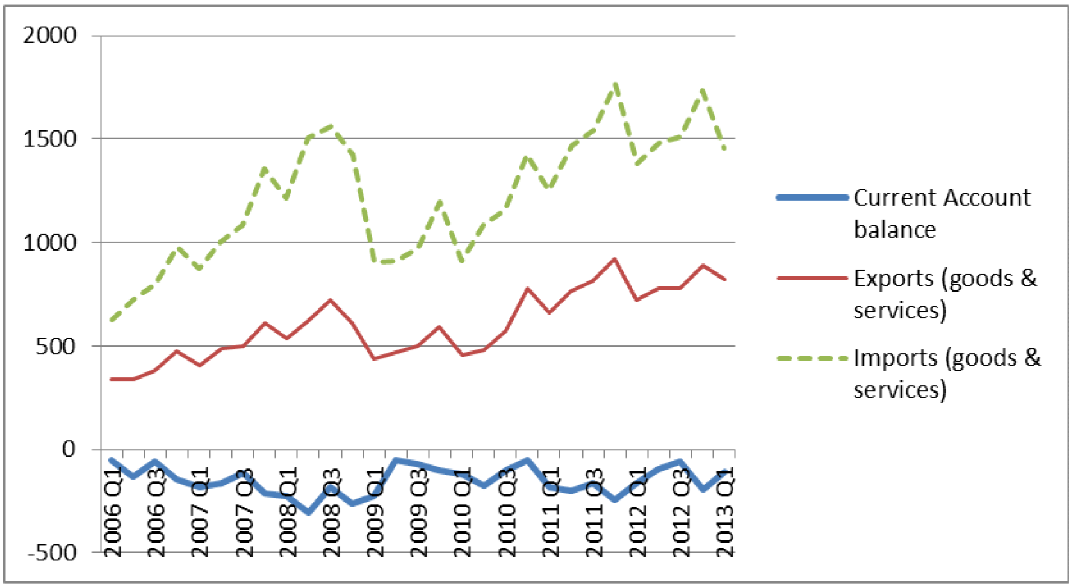
However, the budget has remained dependent on exceptional external assistance with grants contributing an estimated 2.1 and 2.7 and per cent of GDP to 2011 and 2012 general government revenues, respectively. In its 2012 budget, the authorities announced their plan to maintain the headline fiscal deficit close to 1 per cent of GDP over the medium term – a level that is consistent with regularly available financing. In 2012, Moldova recorded a headline fiscal deficit of 1.3 per cent.

… and external position of the economy has improved but some concerns remain…

The current account adjusted rapidly with a deficit of above 16 per cent of GDP in 2008 falling to below 10 per cent of GDP in 2009-2010. The deficit widened again in 2011 to above 11 per cent of GDP before contracting to an estimated level of round 7 per cent of GDP in 2012 (0)46. These recent trends are mainly driven by foreign trade balance where the rise of imports has slightly outpaced the rise in exports as well as rising remittances, in particular from the CIS countries47. The persistently large deficit also reflects the availability of substantial external private and official funds supporting investments well in excess of low domestic savings. The current account deficit is expected to remain above its long-term equilibrium in the next few years.

[45] For a detailed discussion see IMF Country Report No. 12/289.
[46] Based on IMF World Economic Outlook data released in April 2013. This assessment uses provisional estimates rather than official data on 2012 GDP and balance of payments.
[47] It is worth recalling once again that the remittance data are likely imprecise and should be interpreted cautiously. The assessment is based on the World Bank, Moldova Economic Update dated April 10, 2013.

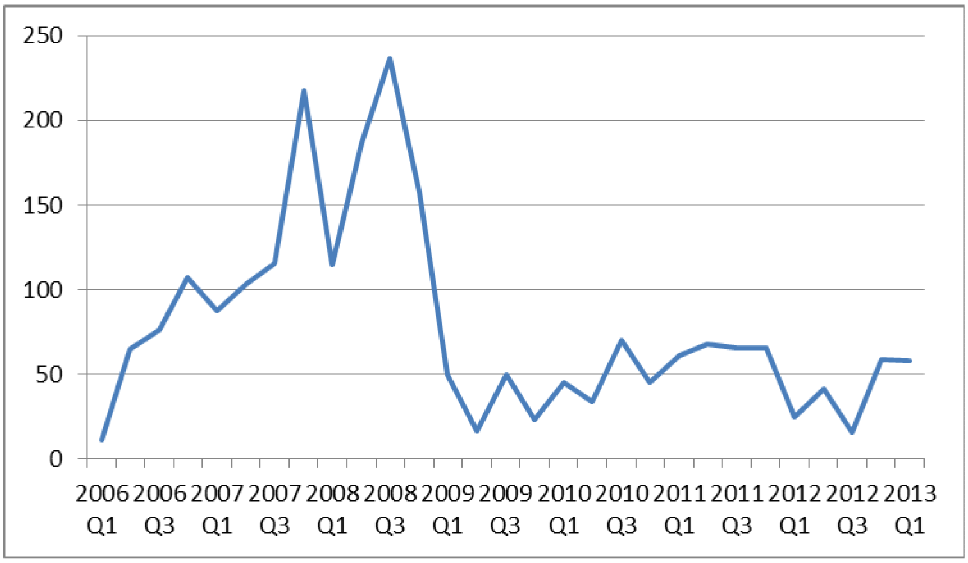
Figure 3.3 Moldova's foreign trade and current account, 2006-2013 (USD million)



Source: National Bank of Moldova, accessed: 5 July 2013.

FDI has remained much lower than in the pre-crisis period (0). Following relatively high FDI inflows in 2011, 2012 saw lower figures again. Remittances and compensation of employees have returned to the solid growth trend and are likely to remain an important driving force for the Moldovan economy in the years to come.

Figure 3.4 Moldova's inwards FDI, 2006-2013 (USD million)



Source: National Bank of Moldova, accessed: 5 July 2013.

… although public debt outlook remains positive.

Improved fiscal performance and strong growth during 2010-2011 led to a reduction in the public and publicly-guaranteed debt from 31 per cent of GDP in 2009 to 28 per cent in 2011. The debt to GDP ratio is projected to continue following a downward path (with the likely exception of 2012)48. Most of the public debt is external and was

[48] This analysis draws from the IMF-World Bank's Debt Sustainability Analysis – the most recent update can be found in the IMF Country Report No. 12/288. This assessment is in line e.g. with the more recent IMF

granted by multilateral creditors on concessional terms. Domestic public and publicly guaranteed debt only accounted for below 7 per cent of GDP at end-2011. These debt levels remain well below all standard thresholds that could suggest concerns with sustainability. At the same time Moldova's debt servicing capacity remains low.

In parallel, private external debt remained at about 44 per cent of GDP during 2009-2011, and is projected to increase over the medium-term, with a rising share of short-term debt49.

Box 5 Observed macroeconomic outcomes – a summary

Moldovan economy quickly returned to growth and already in end-2010 reached pre-crisis level of output.

The Government's policy response supported by the IMF and EU-MFA contributed to short-term macro-economic stabilisation.

The fiscal situation has improved especially through consolidation of current expenditures. External assistance was also instrumental and reliance on external assistance (including grants) remains a weak point.

Public debt remains at low and safe levels; private foreign indebtedness may be a potential source of vulnerability.

Remittances have returned to close to pre-crisis levels, but FDI have not. Foreign trade deficit remains large and the size of the balance of payments deficit may also be a potential source of vulnerability.

3.2 Identification and Assessment of Plausible Counterfactual Scenarios

This section details the process of identifying the most likely counterfactual scenarios providing the long list of potential counterfactuals considered initially and the rationale for their rejection or approval. For the retained plausible counterfactual scenarios for which macroeconomic modelling is possible, section 3.2.3 outlines the details of the modelling treatment.

3.2.1 Potential Counterfactual Scenarios – Initial List

Table 3.1 sets out a range of candidate counterfactual scenarios that were initially considered and analysed for plausibility in the inception stage. The next two subsections first explain which of these potential counterfactuals were considered implausible and why and then present the counterfactual scenarios that were retained for further analysis. The selection was based primarily on the following sources of information:

- Views of the Moldovan authorities;
- Views of the IMF experts;
- Analysis of historical macroeconomic data and other economic data on Moldova (e.g. on the domestic debt market, etc.);
- Literature review;
- Views of the evaluation team, including Moldovan economists; and
- Discussions with the Steering Group.

assessment from the Republic of Moldova. Poverty Reduction Strategy Paper – Joint Staff Advisory Note. IMF Country Report No. 13/270, August 2013.
[49] IMF Country Report No. 12/288, October 2012

Table 3.1 Scoping of Potential Counterfactual Scenarios

	Potential counterfactual	Description
Scenario 1: No MFA	Scenario 1A: No change in government's spending behaviour	Other international assistance remains unaffected: IMF/ WB/ ENPI budget support/ EIB/ EBRD/ Council of Europe Development Bank (CEDB) etc. No change in government expenditure The fiscal deficit is financed by domestic borrowing instead of MFA
	Scenario 1B: Reduction in public expenditure	Other international assistance remains unaffected: IMF/ WB/ ENPI budget support/ EIB/ EBRD/ CEDB etc. However, under this scenario, the government reduces its expenditure to maintain the fiscal deficit at observed levels
Scenario 2: No MFA and no IMF	Scenario 2A: Borrowing from international markets	International assistance from other sources remains unaffected: WB/ ENPI budget support/ bilateral support There is no EU or IMF support Moldovan government seeks to borrow corresponding sums (EUR 435 m IMF & EUR 90 m MFA) from international markets
	Scenario 2B: Borrowing from other sources	International assistance from other sources remains unaffected: WB/ ENPI budget support/ bilateral support There is no EU or IMF support Moldovan government seeks to borrow corresponding sums (EUR 435 m IMF & EUR 90 m MFA) from Russia or China
	Scenario 2C: Borrowing from domestic sources	International assistance from other sources remains unaffected: WB/ ENPI budget support/ bilateral support There is no EU or IMF support Moldovan government seeks to raise corresponding financing (EUR 435 m IMF & EUR 90 m MFA) by placing T-bills with domestic banks
	Scenario 2D: A combination of internal (fiscal consolidation) and external adjustment (depreciation)	International assistance from other sources remains unaffected: WB/ ENPI budget support/ bilateral support There is no EU or IMF support There is deeper and /or longer lasting lei depreciation. The fiscal adjustment is more substantial than in Scenario 1B and mainly takes place on the expenditure side.

Potential counterfactual	Description
Scenario 2E: Fiscal shock	International assistance from other sources remains unaffected: WB/ ENPI budget support/ bilateral support There is no EU or IMF support Moldova is unable to raise financing from other sources.
Scenario 2F: Sovereign default (Full blown crisis)	International assistance from other sources remains unaffected: WB/ ENPI budget support/ bilateral support There is no EU or IMF support Moldova is unable to raise financing from other sources and adjust its spending rapidly enough

3.2.2 Implausible Counterfactual Scenarios – a Discussion

Several of the above listed potential scenarios have been subsequently discarded because they have been deemed implausible. This describes the rationale for these decisions.

The key issue concerns views on availability of alternative sources to finance higher counterfactual fiscal deficit. The following observations are relevant:

- Foreign loans, e.g. from Russia or China were not among plausible alternatives given the political realities of the time, i.e. after the new pro-European coalition government was formed as a result of the July 2009 elections. Given that Moldova was not a member of the Eurasian Economic Community (EurAsEC) access to funding from the EurAsEC's Anti-crisis Fund is also not considered plausible.
- Moldova did not have access to international capital markets at the time, so this source of financing can be ruled out.
- The size of domestic debt market was relatively low and precise data are not readily available. In early 2008 the total outstanding stock of T-bills was estimated at around 3.6% of GDP[50]. T-bills were owned mainly by commercial banks with little secondary trading. Nominal yields oscillated in the range of 8-12 per cent in late 2010-early 2011. Hence, while some increase in domestic debt issuance could have taken place, interviews suggest that it is highly unlikely that this could have replaced the entire MFA grant (and even less likely to have replaced both IMF and EU resources).

At the same time relatively low public debt level of Moldova and its character (large component of concessional lending from multilateral creditors) makes the debt default option not plausible: it would not have been necessary and would not have been an attractive option for the Moldovan authorities.

The above considerations lead to rejection of scenarios 1B, 2A, 2B, 2C and 2F.

3.2.3 Most Likely Counterfactual Scenarios

Following on from the discussion above, macroeconomic modelling is carried for two main counterfactuals:

- 1A in the case of 'No MFA operation', and
- 2E in the case of 'No MFA operation and no IMF programme'.

In both cases, the model has been calibrated to replicate the actual observed outcome (the 'outturn' or 'baseline'). Changes to the input assumptions are then made to reflect the absence of the external support each year, relative to that initial baseline. Taking these together with assumptions as to the likely policy response in reaction to the lack of MFA (or MFA and IMF) funds, the model generates consequent changes in other macroeconomic variables and thus provides an internally consistent description of the counterfactuals, i.e. descriptions of possible alternative states of the world, had EU/IMF support not been provided to Moldova.

As regards the policy response, in line with the observations from the previous section, the assumption in both scenarios is that, in the absence of MFA and IMF funds, Moldova would not have been able to obtain financing from anywhere else. In

[50] World Bank (2008), Debt Management Performance Assessment Moldova April 2008. http://go.worldbank.org/KKUUP66NO0, Accessed on 24 May 2013.

the counterfactuals, the government response is thus a combination of deficit-reducing measures on both the expenditure side (lower spending) as well as the revenue side (higher tax rates).

0 summarises the EU and IMF support to Moldova. EU MFA in 2010 was disbursed at the very end of the fourth quarter of the year. Hence, and after consultation with key informants, in the counterfactuals it is assumed that the funds are absent in 2010 but that the effect of this on government spending is only seen in 2011. The implication is that the government did not incur any expenses in 2010 in anticipation of receiving MFA in that year; instead, the funds were received before being spent.

In the case of the IMF programme, part of the support was used to increase reserve holdings at the central bank. Another part of the funds was earmarked specifically for budgetary support. In the counterfactual it is this last component of the support that is no longer available to finance the fiscal deficit.

Table 3.2 Summary of EU and IMF Support to Moldova, 2010-2012

Year	EU MFA (EURm)	IMF Programme (SDR m) [of which budget support]	leu/EUR exchange rate	leu/SDR exchange rate	EU MFA (m lei)	IMF Programme (m lei) [of which budget support]
2010	40	120 [80]	16.4	18.9	656	2,263 [1,509]
2011	20	100 [15]	16.3	18.5	327	1,853 [278]
2012	30	100 [0]	15.6	18.5	467	1,855 [0]

Source(s): European Commission, IMF and National Bank of Moldova.

The difference between the actual outcomes and the first counterfactual (i.e. 'no MFA') gives an indication of the impact of EU MFA while the difference between the actual outcomes and the second counterfactual ('no MFA and no IMF support') gives an indication of the combined impact of the EU and IMF support.

The model used has been developed specifically for this evaluation, making, as far as possible, the best use of the available data. This approach also means that country-specific factors, such as Moldova's relatively large dependence on remittances, can be accounted for. The model has been constructed with the key evaluation questions in mind.

The model has been built in the tradition of 'flow-of-funds'-type economic models, in which outflows of funds from one institutional sector must be matched to inflows of funds to one or more others (including 'Rest of the World' as a sector). Such accounting consistency is a feature of a number of long-established modelling approaches, including the IMF's 'financial programming' approach. Similar models have been built and applied for more recent analyses, including previous MFA evaluations.

The advantage of a model-based approach is that it generates internally-consistent macroeconomic outcomes, accounting for wider effects and feedbacks.

The model generates annual projections to 2012 with the database constructed principally from national-level sources (but checked for consistency against international publications). Values for some variables in 2011 and 2012 have been estimated.

Further details on the specification of the model can be found in Annex 3.

3.2.3.1 The case of no MFA operation

This scenario excludes MFA from Moldova's sources of external financing while all other international assistance remains unaffected. In particular, IMF, World Bank and EU support under ENPI remains at actually observed levels.

The initial impacts, before any policy or behavioural response, are:

- An increase in the current account deficit from the lost transfers[51]; and
- A reduction in government revenue from the lost grants.

Given that the MFA was in the form of a grant and acted de facto as a general budget support operation the key issue in deciding on the most plausible counterfactual scenario in the absence of the MFA operation concerns the assumptions on the alternative fiscal path that would have been taken by the government.

Since the MFA disbursement began in December 2010, it is assumed that the alternative fiscal policy would have taken effect from 2011 onwards. The underlying assumption is that the government did not spend in 2010 in anticipation of receiving MFA.

Given the economic and political realities of 2010-2011, feasible options include:

1. Additional revenue mobilisation, to compensate for the lost funds;
2. Government expenditure reduction, accepting the lower availability of revenue; and
3. Domestic borrowing to replace the lost revenue with deficit financing.

From the stakeholder consultations, the most likely counterfactual scenario would be a combination of the first two options i.e. an increase in fiscal revenues through tax increases, and expenditure cuts. Some increase in the deficit is plausible, but available options for domestic financing were limited during 2010-2011 and it is highly unlikely that domestic sources of funding would have been sufficient to fully compensate for the lack of MFA resources. Hence, to improve clarity of the presentation a limited increase in the budget deficit is not incorporated in the most likely counterfactual.

The counterfactual assumptions are as follows:

- Expenditure reduction: no change in the deficit compared to the baseline outcome, with government expenditure on goods and services adjusting as required to maintain this constraint[52]; and
- Additional revenues: earlier re-introduction of the 12 per cent corporate income tax on reinvested profits in 2011 (rather than 2012 as was actually the case).

No other government response and no change in interest rates or exchange rates is assumed.

[51] In the first instance, before considering other effects from the lost funds, Moldova's holdings of foreign exchange reserves fall by an amount equal to the lost MFA.
[52] The initial spending reduction, before accounting for indirect effects, is equal to the lost revenue from no longer having access to MFA.

Second-round effects arise in this counterfactual through the corporate income tax curbing private consumption expenditure and lower government expenditure lowering the demand for domestic production. Lower production in turn lowers income paid back to households, with implications for expenditures (a multiplier effect). Moreover, lower economic activity in the economy lowers tax revenues and raises non-discretionary government expenditure such as social security payments. The imposition of a limit on the deficit then leads to further government spending cuts in order to preserve the budget constraint (owing to the decreases in tax revenue and the increases in non-discretionary payments). 0 sets out the full specification of input assumptions to the no MFA scenario.

The difference between the observed outcome and this counterfactual gives an indication as to the impact of EU MFA to Moldova in each year.

Table 3.3 Specification of the No MFA Counterfactual

	2010	2011	2012
Initial reduction in government spending (m lei)	0	656 + 327 = 983	467
Corporate Income Tax rate (per cent)	0	12	12
Lei/EUR exchange rate (annual average)	16.4	16.3	15.6
Memorandum: value of MFA assistance in million lei foregone in the counterfactual	*656*	*327*	*467*

Note(s): Reduction in spending and deficit constraint begins in 2011, to account for the disbursement of MFA late in 2010 (the assumption is that the 2010 MFA funds were spent in 2011, rather than in 2010, in anticipation of the disbursement).

CIT increase to 12% brought forward one year from 2012 to 2011.

3.2.3.2 The case of no MFA operation and no IMF programme

This counterfactual scenario considers the case where Moldova did not receive MFA (matching the treatment in the previous scenario) but also did not receive IMF financial support. All other international assistance remains unaffected; in particular, World Bank and EU support under ENPI remain at actually observed levels.

The second counterfactual, in addition to the lack of MFA grant disbursements, involves the absence of the IMF support, part of which was unusually provided specifically for budget support. Specifically the following amounts are not disbursed in this counterfactual:

- 120m SDR in 2010, of which 80m SDR was allocated specifically for budget support;
- 100m SDR in 2011 (15m SDR for budget support); and
- 100m SDR in 2012 (none for budget support).

The IMF support was provided as a loan and its absence in the counterfactual leads to an initial:

- Decrease in the capital account of the balance of payments from Moldova not receiving the inflow of additional funds; and
- Reduction in government deficit finance (equivalent to the budget support component of IMF loan tranches).

The most likely counterfactual developments and policy responses can be summarised as follows:

- Earlier re-introduction of the 12% CIT rate, i.e. in 2010, rather than 2012 (or 2011 in the No MFA counterfactual);
- No change in the fiscal deficit compared to the baseline outcome (with government expenditure on goods and services adjusting as required to maintain this constraint);
- Depreciation of the Moldovan lei by 12.5 per cent against the outturn value in 2010, followed by a gradual return to the actual level by 2012. Alternative exchange-rate trajectories were also tested, in the range of 5 to 20 per cent compared to the actual rate in 2010.

The consequent tax and government-spending impacts are similar in mechanism to the no-MFA counterfactual, although larger in size owing to the larger amounts of funds not disbursed in this counterfactual.

An additional factor that affects the counterfactual outcome is the depreciation of the currency. The rationale for this assumption stems from confidence building effects of the IMF agreement and exchange rate pressures that were clearly visible in Moldova as well as several other countries in the region during the period. Depreciation raises the domestic currency value of external debt (denominated in foreign currencies), raising debt-service requirements.

Exchange-rate depreciation also has impacts through trade, tending to lower imports demand and, possibly, raising exports. The latter effect depends in part on the extent to which imports are of intermediate products that feed into final production (generating inflation).

The final channel by which the Moldovan economy is affected by exchange-rate fluctuations is through remittances. The assumption in the counterfactual is that the situation in foreign labour markets is unchanged in terms of the foreign-currency value of money transferred back to Moldova. Hence, for a given value of remittances (denominated in foreign currency), the exchange-rate depreciation raises the domestic-currency value of income that flows to Moldovan households, potentially driving higher expenditure (potentially offsetting some of the negative impacts elsewhere).

0 sets out the full specification of input assumptions to this scenario. While the depreciation implies somewhat larger absences of funds in the counterfactual (in Moldovan lei), other elements of the balance of payments also change, once the flows have been converted to domestic currency.

Table 3.4 Specification of the No MFA and no IMF Counterfactual

	2010	**2011**	**2012**
Initial reduction in government spending (m lei)	1,697	738 + 347 + 295 = 1,380	467
Corporate Income Tax rate (%)	12	12	12
Leu/EUR exchange rate (annual average; assumed)	18.4	17.4	15.6

	2010	**2011**	**2012**
Leu/SDR exchange rate (annual average; assumed)	21.2	19.7	18.5
leu depreciation relative to outturn (%) [upper, lower bound]	-12.5 [-5.0, -20.0]	-6.2 [-2.5, -10.0]	0.0
Memorandum: value of MFA assistance in million lei foregone in the counterfactual	_738_	_347_	_467_
Value of IMF assistance in million lei [of which budget support] foregone in the counterfactual	_2,546 [1,697]_	_1,968 [295]_	_1,855 [0]_

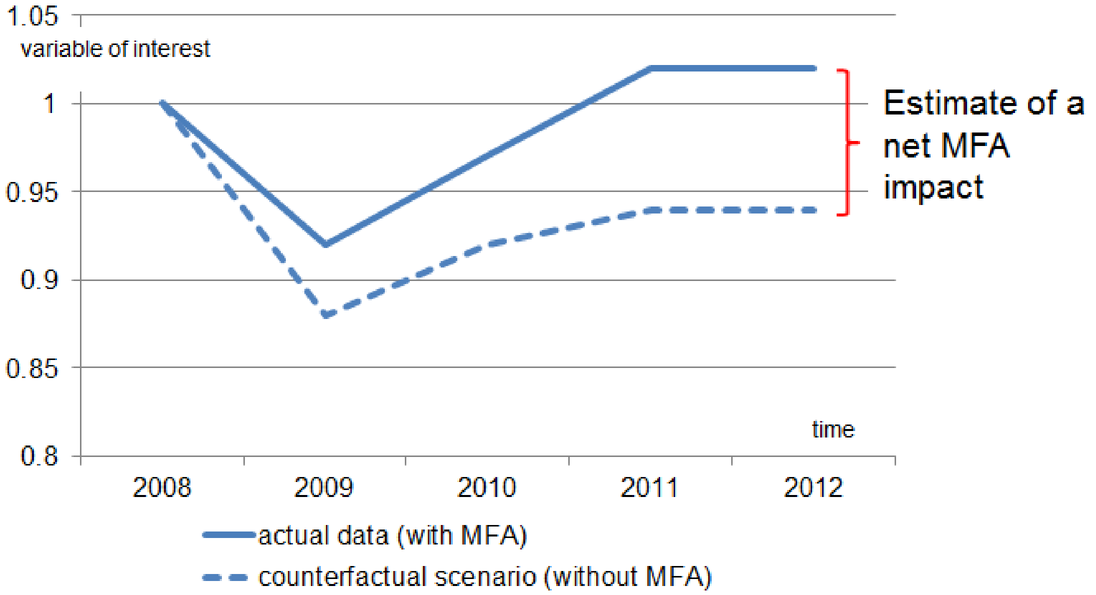
Note(s): Reduction in spending and deficit constraint from MFA begins in 2011, to account for the disbursement of MFA late in 2010 (the assumption is that the 2010 funds were spent in 2011, rather than in 2010, in anticipation of the disbursement)

CIT increase to 12% brought forward two years from 2012 to 2010.

3.3 Macroeconomic and External Sustainability Impact

The explicit construction of counterfactual scenarios in the previous section enables estimating an indicative size of net macroeconomic impact of the MFA (or a combination of the MFA and IMF assistance). It is calculated as the difference between an observed macroeconomic path of the Moldovan economy (what has actually happened) and the counterfactual path (what would have happened without MFA assistance or without both MFA and IMF assistance). 0 illustrates this graphically.

Figure 3.5 Estimating net MFA impact – an illustration of the approach



The three sections that follow present:

The Outturn: a summary of the key indicators from the observed outcome over 2010-12;

The case of no MFA operation: the results from the counterfactual without MFA and the estimated contribution of MFA to the final Outturn result; and

The case of no MFA operation and no IMF programme: the results from the counterfactual without MFA or IMF support and the estimated contribution of the two sources of support to the final Outturn result.

3.3.1 Outturn

This section draws from Section 3.1 and presents the key indicators for comparison, from the outturn (the baseline). 0 shows what actually occurred in Moldova over 2010-12.

The table shows solid real GDP growth in 2010 and 2011, of around 7 per cent each year in domestic currency, followed by a decline in 2012, of almost 1 per cent. As noted earlier in this section, key factors driving the upturn in 2010 and 2011 included strong growth in private consumption (as remittances grew once more) and exports (reflecting the global recovery). The implication is that external factors were important in Moldova's economic recovery.

Employment trends broadly followed GDP although the reduction in the unemployment rate in 2012 reflects a marked reduction in labour supply: the workforce in Moldova in 2012 was the smallest over the ten years for which data are available.

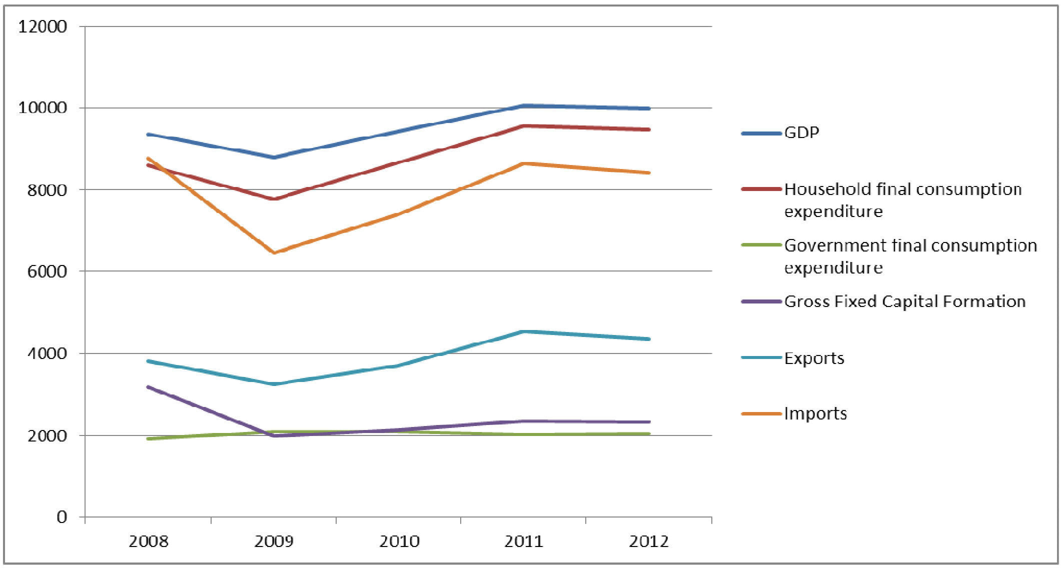
Despite a sharp increase in the current account deficit in 2011, overall, Moldova accumulated foreign exchange reserves over 2010-12, thanks in part to the IMF support provided in those years.

Table 3.5 Baseline Outcomes

	2010	2011	2012
Real GDP (1995m lei)	9,425	10,066	9,984
Real GDP growth (per cent)	7.1	6.8	-0.8
Real GDP (1995m EUR)	575	616	641
Inflation (per cent, period average)	10.1	7.9	7.3
Current account balance (EUR m) (negative is a deficit)	-420	-624	-447
Reserve assets (EUR m)	1,295	1,412	1,957
Employment ('000s)	1,143	1,174	1,147
Unemployment rate (per cent)	7.4	6.7	5.6

0 shows real GDP over 2008-2012, along with key components of final expenditure. The chart clearly shows the contributions of household consumption and exports to growth, as well as broadly flat government expenditure throughout the period (the EU and IMF support allowed the Moldovan government to maintain its expenditure during the crisis).

Figure 3.6 Real GDP and its components, 2008-2012 (million constant 1995 lei prices)



3.3.2 The case of no MFA operation

0 summarises the results from the first counterfactual: the projected outcomes for Moldova in the absence of MFA.

Because the MFA operation in Moldova consisted entirely of grant support, the EU aid did nothing to affect Moldova's overall domestic or foreign debt situation over the period[53]. The outcomes are thus restricted to:

The impacts on the real economy and labour markets (from the higher government spending facilitated by MFA); and

The implications of the MFA grant for the balance of payments (specifically the current account) and for Moldova's stock of foreign exchange reserves.

Table 3.6 No MFA Counterfactual Outcomes

	2010	2011	2012
Real GDP (1995m lei)	9,425	9,957	9,938
Real GDP growth (per cent)	7.1	5.6	-0.2
Real GDP (1995m EUR)	575	609	639
Inflation (per cent, period average)	10.1	7.9	7.3
Current account balance (EUR m) (negative is a deficit)	-460	-601	-457
Reserve assets (EUR m)	1,255	1,397	1,932
Employment ('000s)	1,143	1,167	1,144
Unemployment rate (per cent)	7.4	7.2	5.8

[53] Note that the timing, of the MFA receipts in 2010 and the corresponding expenses in 2011, does shift the deficit between those two years in the modelling, but the overall outcome at the end of 2012 is no change in the debt situation.

Table 3.7 below shows the estimated contribution of the EU MFA operation to the observed historical outcome. The table shows that MFA had no *macroeconomic* impact in 2010, because it is assumed that the government stockpiled the additional funds until 2011. In accounting terms, both the government deficit and the current account deficit are reduced by EUR 40 million, with a corresponding increase in Moldova's stocks of foreign exchange reserves.

The macroeconomic effects of MFA begin to feed through in 2011, when the government was able to spend the grant money. This amounts to stimulus spending without incurring further debt. The overall increase to GDP from the MFA-supported spending exceeds the value of the MFA. This arises from a multiplier effect:

- Higher government spending leads to higher production in the economy; which drives
- Higher incomes from employment; leading to
- Further expenditure in the economy and, in turn, further increases in employment income.

The MFA grant also allowed the government to increase its spending by more than the actual value of the grant, because the stimulus led to higher economic activity, leading to:

- A larger tax base, increasing government revenues; and
- Higher employment, reducing government expenditures on social security.

Under the assumption that the government would not have used the excess revenue to reduce its deficit, the additional funds were available for further spending.

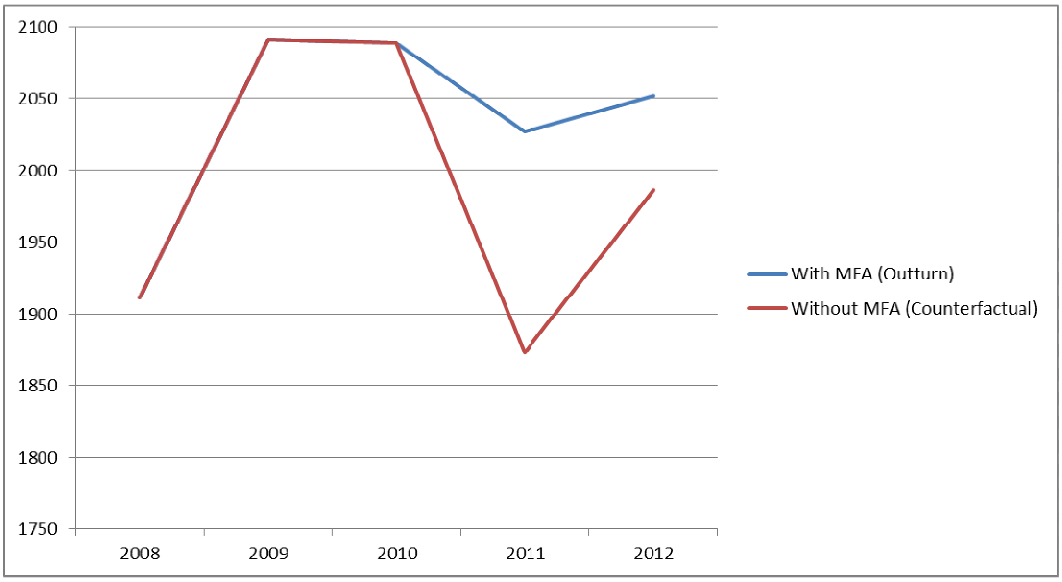
In 2011, MFA contributed to higher economic growth in Moldova: 6.8 per cent compared to 5.6 per cent had MFA not been provided, i.e. 1.2 percentage points of growth. The results indicate that the current account deficit increased in 2011 from the MFA operation. This is simply a feature of the timing of the operation, with the current account deficit falling in 2010 by the full EUR 40 million but the deficit then rising in 2011 because imports in that year increase from the combined spending effect of the 2010 and 2011 MFA. There are no timing issues in 2012 and the impacts reflect fully the MFA grant provided in that year.

Overall holdings of reserve assets were improved by the MFA. At the end of 2011, the MFA operation is estimated to have increased reserve assets by some EUR 15 million, rising to EUR 25 million by end-2012. The conclusion is that the MFA operation did increase Moldova's holdings of foreign exchange reserves, but not by as much as the size of the aid. This is because the stimulus drove higher import demand, which served to offset some of the initial reserve-asset accumulation.

The analysis indicates that the MFA operation led to GDP in 2012 that was 0.5 per cent than would otherwise have been the case. This increase is smaller than that brought about by MFA in 2011 and arises from the differing contributions of the MFA to government spending each year.

0 below shows the profile of real government consumption (a component of final expenditure) both with and without MFA. The chart shows that MFA filled a much larger spending gap in 2011 than it did in 2012. In 2012, the general improvement in the domestic and external financing situation meant that more of the Moldovan government's expenditure could be financed without MFA. More growth might have been possible in 2012 without the MFA, but the overall level of GDP would not have been as high.

Figure 3.7 Government Spending with and without MFA (lei in constant 1995 prices)



The analysis of this counterfactual indicates that the MFA operation in isolation had no discernible effects on inflation.

Table 3.7 Contribution of EU MFA to Observed Outcome (difference between actual and counterfactual outcomes)

	2010	2011	2012
Contribution to GDP growth (percentage points)	0.0	+1.2	-0.6
Contribution to GDP level (per cent)	0.0	+1.1	+0.5
Contribution to inflation (percentage points)	0.0	0.0	0.0
Contribution to current account balance (EUR m) (positive is a decrease in the deficit)	+40	-24	+9
Contribution to end-of-year level of reserve assets (EUR m) (positive is an increase in reserves)	+40	+15	+25

Note: The results should be treated as indicative only. Annex 4 provides alternative estimates obtained in the sensitivity analysis.

In summary, the analysis of this counterfactual suggests that the EU MFA operation contributed to:

- Higher GDP, by 1.1 per cent in 2011 and 0.5 per cent in 2012;
- Higher employment, by 0.5 per cent in 2011 and 0.2 per cent in 2012; and
- Larger stocks of foreign exchange reserves.

By assumptions on the counterfactual the MFA did not affect the government deficit (it is assumed that the support and boost to activity and tax revenues allowed government spending to be higher). Since GDP was higher as a result of the support, the result was a slight reduction in the debt- and deficit-to-GDP ratios for Moldova and thus a (mild) improvement in its fiscal sustainability, both domestic and external.

3.3.3 The case of no MFA operation and no IMF programme

The second counterfactual considers a situation in which Moldova does not receive any MFA or IMF support.

Under the assumption that the government could not have raised deficit financing from elsewhere, the counterfactual represents a state of the world in which Moldova has to tighten its budget when it does not receive IMF support. While the consequence is that Moldova does not have as much external debt as before (which would have to be serviced and paid down in the future), the country must endure the full macroeconomic impacts of the lower deficit financing and government spending.

0 earlier in this section outlines the inputs to this counterfactual, consisting of the absence of both MFA and IMF support (which was a combination of direct budgetary aid as well as reserves for the central bank). This counterfactual also includes depreciation in the Moldovan leu as a result of the lower market confidence without the IMF support. The corresponding results from the scenario are shown below, in 0.

Table 3.8 No MFA and No IMF Counterfactual Outcomes

	2010	2011	2012
Real GDP (1995m lei)	9,130	9,811	9.836
Real GDP growth (per cent)	3.7	7.5	0.3
Real GDP (1995m EUR)	495	565	632
Inflation (per cent, period average)	13.0	9.0	7.1
Current account balance (EUR m) (negative is a deficit)	-328	-505	-410
Reserve assets (EUR m)	1,254	1,379	1,840
Employment ('000s)	1,126	1,159	1,138
Unemployment rate (per cent)	8.9	7.9	6.3

A comparison of the outrun and the modelling results in this counterfactual suggests that the combined EU and IMF support in 2010 contributed to GDP growth. Without the combined support, GDP would have grown by 3.7 per cent, compared to an actual increase of 7.1 per cent. The support warded off a further year of sharper depreciation in 2011, hence the lower inflation in that year as well. Inflation is not much different in 2012 with or without the support but the support served to keep the overall price level somewhat lower by that year (because it avoided higher inflation in previous years).

The analysis of this counterfactual indicates that the combined support led to an increase in the current account deficit in 2010. This is because higher economic activity boosted imports. However, as in the first counterfactual, the effect of the support is still that overall reserves increased.

0 below shows that economic growth is projected to have been lower in 2011 and 2012 with the support than in the counterfactual scenario. This is because the impact of the support is to raise the level of GDP in 2010, and then the impact of the global

recovery that drove growth in 2011 is measured against this higher level. These factors, which are assumed to operate in the same way in the counterfactual as they did in reality, were reflected in:

- Higher household incomes (as remittances grew once more) and higher consumption expenditure; and
- Higher exports.

Even so, the net effect over the two years of the support is to raise the overall level of GDP above what it might otherwise have been (by around 2.6 per cent in 2011 and 1.5 per cent in 2012).

Table 3.9 Contribution of EU MFA and IMF Support to Observed Outcome

	2010	2011	2012
Contribution to GDP growth (percentage points)	+3.3	-0.7	-1.1
Contribution to GDP level (per cent)	+3.2	+2.6	+1.5
Contribution to inflation (percentage points)	-2.9	-1.1	+0.2
Contribution to current account balance (EUR m) (positive is a decrease in the deficit)	-92	-119	-37
Contribution to end-of-year level of reserve assets (EUR m) (positive is an increase in reserves)	+42	+33	+118

Note: The results should be treated as indicative only. Annex 4 provides alternative estimates obtained in the sensitivity analysis.

As with the government-expenditure profile in the no MFA scenario, the support was most important prior to 2012, to fill a financing gap (0), although the model results do suggest that a larger factor contributing to recovery in Moldova was in fact external in nature: the recovery in the global economy, driving higher export demand and increased flows of remittances.

Figure 3.8 Government Spending With and Without MFA and IMF Support (lei in constant 1995 prices)

The combined EU and IMF support provided, principally, higher growth in 2010 and greater price stability, prior to the wider economic recovery in the rest of the world.

3.4 Conclusion

The evidence suggests that the EU MFA operation had a positive contribution to macroeconomic recovery in Moldova following the 2009 crisis. The economy grew by 7.1 per cent in 2010 and 6.8 per cent in 2011. MFA had a positive net impact. The MFA support allowed for higher government spending in the post-crisis years, leading to GDP being around 1 per cent higher in 2011 and 0.5 per cent higher in 2012 when compared to a counterfactual without the MFA. The positive net impact of the MFA is estimated to be lower in 2012 than in 2011 because by 2012 the Moldovan government was less constrained in its deficit financing. Over 2010-12, the MFA also helped to maintain higher employment, by as much as 0.5 per cent in 2011 (when the impact was the strongest).

The MFA was closely connected to the IMF support programme and the combined macroeconomic impact of these two operations is found to have been substantially stronger than the impact of the MFA alone. Specifically, the modelling exercise suggests that the combination of the IMF and EU MFA support might have raised Moldovan GDP by as much as 1.5 per cent by 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. In that year the support contributed over 3 percentage points to growth, and raised employment by around 1.6 per cent (around 18,000 workers). In later years, while the MFA and IMF support continued to fill a funding gap, relatively more of the economic growth was driven by developments in the rest of the world. The global recovery drove Moldovan exports and remittances to Moldova supporting economic growth in the country.

The estimates of the MFA impact are robust and they remain in the similar order of magnitude under alternative assumptions on counterfactual paths and model parameters. Annex 4 provides details.

From the analysis, the implied fiscal multiplier on the combined support is around 0.3: a 1 per cent increase in government expenditure yields an overall increase in GDP of around 0.3 per cent. This is at the lower end of fiscal multipliers identified in the literature, although there is evidence to suggest that countries like Moldova could plausibly have lower multipliers[54], with high dependence on imports dampening the growth effect.

While the MFA and IMF support clearly had an impact on current account developments during the assistance period, no clear evidence has been identified of any medium- to long-term impact on current account. The MFA has contributed to external sustainability of the country by limiting the public external debt issuance (that would likely be needed e.g. to later finance investment expenditure foregone in the counterfactual scenario of no MFA). The support also raised economic growth leading to marginally lower debt- and deficit-to-GDP ratios (but this effect is small).

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. Then these additional expenditures would need to be financed by borrowing and it is highly unlikely that Moldova would be 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.

[54] See, for example, Ilzetzki, E., Mendoza, E.G., Vegh, C.A. (2009), 'How big are fiscal multipliers?', Centre for Economic Policy Research Policy Insight, 39, whose analysis suggests that emerging economies will tend to have lower multipliers, as do economies with high trade-openness.

4. Scope and Impact of the Structural Reforms

This section provides an assessment of the MFA impact on structural reforms. The analysis is primarily based on extensive desk research and interviews with stakeholders from the Moldovan authorities, EC and other development partners, and experts in relevant fields.

4.1 Intervention Logic and Assessment of Implementation of Reforms

The analysis of MFA conditions related to structural reforms focused on the following elements:

- the nature and scope of the conditionality attached to the MFA operation;
- the rationale for each condition;
- the implementation of the conditionality by the Moldovan authorities;
- evidence for reform impact, and
- evidence of MFA contribution to the reform progress.

MFA reforms focused predominantly on areas that are highly relevant for macroeconomic stability: public finance management (PFM) and financial sector stability. Specifically, PFM reform conditions were designed to address the weaknesses identified in the Operational Assessment conducted in 2010 (OA 2010)[55]. Financial sector reforms sought to adequately capitalise the Central Bank and ensure its independence, so that it had the capital and the capability to pursue its mission and stabilise the financial sector (which was at risk during the crisis) and to improve the governance and institutional framework of the financial sector. Additionally, three conditions sought to achieve convergence with EU regulations, in line with the parallel Association Agreement negotiations. There was a degree of continuity with conditions set up in the previous MFA operation for Moldova provided during 2007-2008. This applies in particular to conditions in the areas of PFM and public procurement[56].

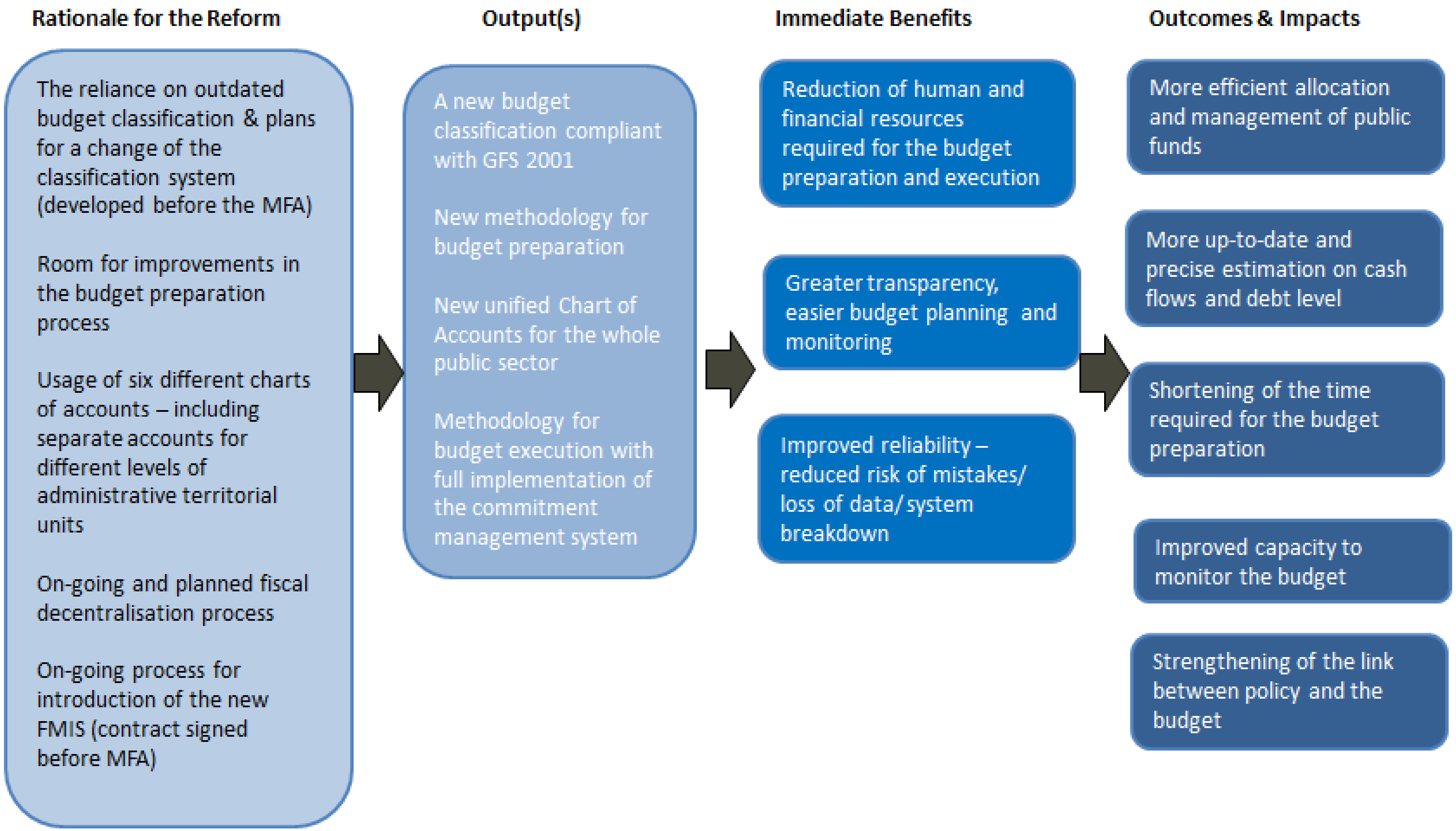
The selection of conditionality attached to the MFA was done in close consultations with other donors, especially the IMF and in dialogue with Moldovan authorities. Coordination with other donor-supported policy agenda is assessed as adequate and in particular WB and EU Delegation have been involved in discussions. There was no duplication of conditions and in some instances MFA conditions complemented conditions attached to the IMF programme. For instance, the first review of the IMF programme in mid-2010 set up a condition requiring key Moldovan institutions dealing with financial sector including the Ministry of Finance, and the National Bank of Moldova to sign a Memorandum of Understanding with rules of coordination and a clear division of responsibilities between them in times of financial distress. One of the MFA conditions defined in late -2010 made this requirement more precise given the establishment of a high-level Financial Stability Committee (FSC). Also, the IMF conditions in the fiscal area focused on raising tax collection, whereas MFA conditions addressed issues such as new budget classification system. Interviews with Moldovan authorities revealed that selected conditions were addressing important issues from their point of view with no condition which could be perceived as unnecessary. Importantly, MFA conditions should be seen as one element of on-going co-operation between Moldovan government and its development partners in promoting reform agenda in various fields.

55 PricewaterhouseCoopers (2010) Moldova: Operational Assessment, Final Report, August 2010.
56 Ecorys, CASE & Economisti Associati (2010), Ex post Evaluation of MFA operations in Moldova, Accessed at http://ec.europa.eu/economy_finance/evaluation/completed/.

Figures and tables below provide an assessment of the following aspects of structural reforms conditionality:

- intervention logic underpinning the selection of conditions as reconstructed by the evaluation team;
- expected outputs, i.e. actions or products expected as the fulfilment of conditions;
- implementation, i.e. actions related to fulfilling conditions;
- implementation deficit, i.e. whether there is any evidence on implementation problems, e.g. discrepancy between de jure and de facto situation;
- immediate outcomes, i.e. what benefits were expected quickly after fulfilment of conditions and whether there is any evidence of their materialisation;
- longer-term outcomes and impacts, i.e. what changes / benefits were expected in the longer-term and whether there is any evidence of their materialisation;
- domestic ownership of reforms and donor support, i.e. to what extent reforms were part of the domestic policy agenda and which other actors promoted reforms in a given area; and
- MFA value added, i.e. to what extent any effects can be attributed to the MFA.

Figure 4.1 Intervention logic of conditions on reforms in the area of budget preparation and execution (related to planned implementation of the new Financial Management Information System



Condition 2.1 (second tranche): In the context of the implementation of the planned transition to a new Financial Management Information System (FMIS) by January 2012:
Sub condition A: The Ministry of Finance will approve a new budget classification system compliant with GFS 2001/COFOG
Sub condition B: The Ministry of Finance will develop an appropriate methodology for budget preparation.

Implementation	A new budget classification compliant with GFS 2001 was approved by the government in March 2011. In addition a unified set of methodologies concerning the budget elaboration was developed with assistance of external contractor.
Evidence of Implementation deficit	None. However, the implementation of the FMIS system was delayed significantly. In June 2013, MoF anticipated that the system will be operational by the end of 2013 so that it can be available in the preparation of the budget for the year 2015[57]. Previous deadlines were revised several times already.
Relevance	Re A: The issue of budget classification non-complying with the 2001/COFOG standard was identified in the 2010 Operational Assessment (OA 2010)[58]. Re B: OA 2010 referred to specific issues concerning the methodology applied for budget preparation and the need of its improvement.
Importance	Re A: OA 2010 attached high priority to this issue as did the review carried by OECD economists[59] Re B: no clear evidence identified of the issue being of high priority, but it can be seen as an important element of broader reform of the budget process.
Domestic ownership & donor support	Seen as important by the government. Work on these issues started before the MFA was initiated through various TA programmes. Many reforms of Public Finance Management were already outlined in National Development Strategy approved by the Parliament on 21 December 2007. World Bank has been promoting PFM reforms including the establishment of the new FMIS and development of new budget classification through financial support and technical assistance[60].
Added Value of MFA	MFA conditions are believed to have mobilised government efforts in this area. These changes would have been implemented also without MFA conditionality (being a part of a broader process), but possibly somewhat later. The relevance of this added value is diminished by a delay in implementation of FMIS and hence the two reforms are yet to deliver concrete benefits (see below).
Evidence of benefits	No clear immediate benefits given the delay in new FMIS implementation, while the new budget classification system depends very much on the FMIS implementation.
Evidence of long-	New FMIS has not been implemented yet, hence no evidence so far on potential long-term impact.

[57] 24 April 2013. ICF GHK interview with the Ministry of Finance, April 2013.
[58] PwC, September 2010. Moldova Operational Assessment.
[59] Dirk-Jan Kraan, Valentina Kostyleva, Colin Forthun, Jutta Albrecht, and Ragnar Olofsson (2010), Budgeting in Moldova, OECD Journal on Budgeting Vol. 2010/3.
[60] PwC, September 2010. Moldova Operational Assessment and Moldova October 2011 update.

term Impacts

Condition 3.1 (third tranche): In the context of the implementation of the planned transition to a new Financial Management Information System (FMIS) by I January 2012;

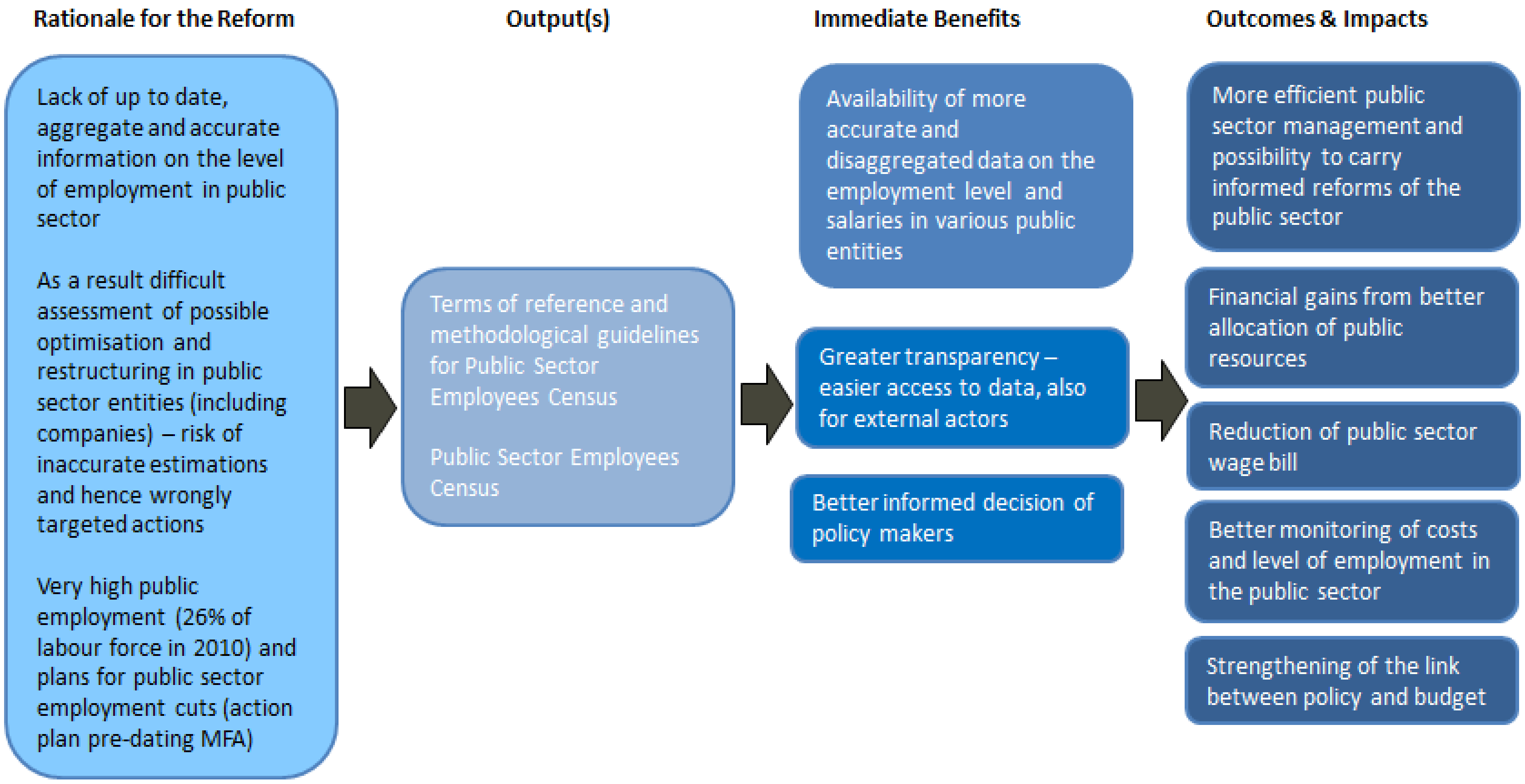
a) The Ministry of Finance will approve a new unified Chart of Accounts for the whole public sector, replacing the current system.
b) The Ministry of Finance will prepare methodology for budget execution, covering also the full implementation of the commitment management system in the new FMIS.
c) The government will prepare and submit to Parliament a new Law on Public Finances, replacing the current legislation on the budget system and budget process, with a view to its adoption in the course of 2011.

Implementation	a) Unified Chart of Accounts: the Ministry of Finance approved the "Methodological Norms on Accounting and Financial Reporting within the Budget System", containing a unified Chart of accounts within the budget system, drafted in compliance with the GFS 2001 standards. The norms were approved via Minister of Finance´s Order no.108 from 26 August 2011 and published on the official web site of the Ministry of Finance. b) Budget execution: The Ministry of Finance approved via Order no. 109 dated 26 August 2011 and published on its web site the "Methodological Norms Related to the Cash Execution of the Budget Sources Components of the National Public Budget via Treasury System of the Ministry of Finance". The norms regulate the cash execution of the national public budget through the treasury system of the Ministry of Finance through the implementation of the FMIS. The methodology for the budget execution covers the full implementation of the "commitment management system" in FMIS. c)The draft Law of Public Finances: was approved by the government through the Government Decision nr. 773 of 17 October 2011 and submitted to the Parliament for consideration and approval.
Evidence of Implementation deficit	None. However, the implementation of the FMIS system was delayed significantly. In April 2013, MoF anticipated that the system would be operational by the end of 2013 so that it can be available in the preparation of the budget for the year 2015[61]. Previous deadlines were revised several times already. As of May 2013 the Law of Public Finances passed the first reading in the Parliament – the delay in Parliamentary approval is related to delay in FMIS implementation.
Relevance	The issues were identified as problematic in the OA 2010[62].
Importance	No clear documentary evidence has been identified indicating these issues as being of high priority. However, they can be seen as an element of a broader reform of the budget process.
Domestic ownership & donor support	Seen as important by the government. Work on these issues was started before the MFA through various TA programmes and e.g. State Treasure developed the draft Unified Budget Classification and Chart of Accounts for the public sector. Many reforms of Public Finance Management were already outlined in National Development Strategy approved by the Parliament on 21 December 2007.

[61] 24 April 2013. Interview with MoF during the first mission in Chisinau conducted by ICF GHK.
[62] PwC, September 2010. Moldova Operational Assessment.

	Other donors were involved.
Added Value of MFA	MFA conditions are believed to have mobilised government efforts in this area. These changes would have been implemented also without MFA conditionality (being a part of a broader process), but possibly somewhat later. The relevance of this added value is diminished by a delay in implementation of FMIS and hence no benefits of the two reforms (see below).
Evidence of benefits	No clear immediate benefits given the delay in new FMIS implementation while the unified chart of accounts and methodological norms related to budget execution depend very much on the FIMS implementation and on entry into force of the new Law on Public Finances.
Evidence of long-term Impacts	New FMIS has not been implemented yet, and new Law on Public Finances has not been passed hence no evidence so far on potential long-term impact.

Figure 4.2 Intervention logic of conditions related to the census of public sector employees



Condition 2.2 (second tranche): The government will prepare the terms of reference and the methodological guidelines for a census of the number of public sector employees (in central and local government, and extra-budgetary funds and institutions) of the number of payroll positions in each subsector the paid wage bill. The census aimed at improving control of expenditure on public sector compensations will include the breakdown by categories of functional budget classification and occupation.

Implementation	Ministry of Finance hired an external consultant who prepared the methodological guidelines for a census.
Evidence of Implementation deficit	None
Relevance	The methodological guidelines were part of the process leading to the implementation of the census. The issue of excessive public sector employment and ensuing cost has been raised in several documents (e.g. IMF reports). The census was planned as an instrument allowing monitoring of the wage costs, determining the wage fund and the categories of salaries.
Importance	Moderate as assessed by numerous references to the issue of public sector size and the fact that implementation of the census did not change the assessment of Moldova in the PEFA between 2008 and 2011 in the dimension: PI-18. Effectiveness of payroll controls[63].
Domestic ownership & Donor support	Existing monitoring mechanisms for public sector employment and wage bill were inadequate, but resources devoted to their monitoring were limited (small unit at the Ministry of Finance). Interest in carrying the survey appears to be limited to a narrow group within the Ministry. UNDP provided financial resources to carry the census. IMF used declared interest in using the information from the census.
Added Value of MFA	MFA was the only external instrument directly promoting the implementation of the census and is believed to have contributed to its implementation.
Evidence of benefits	Allowed implementation of the census.
Evidence of long-term Impacts	Not applicable, as the fulfilment of this condition was only a preparatory step for the implementation of the census.

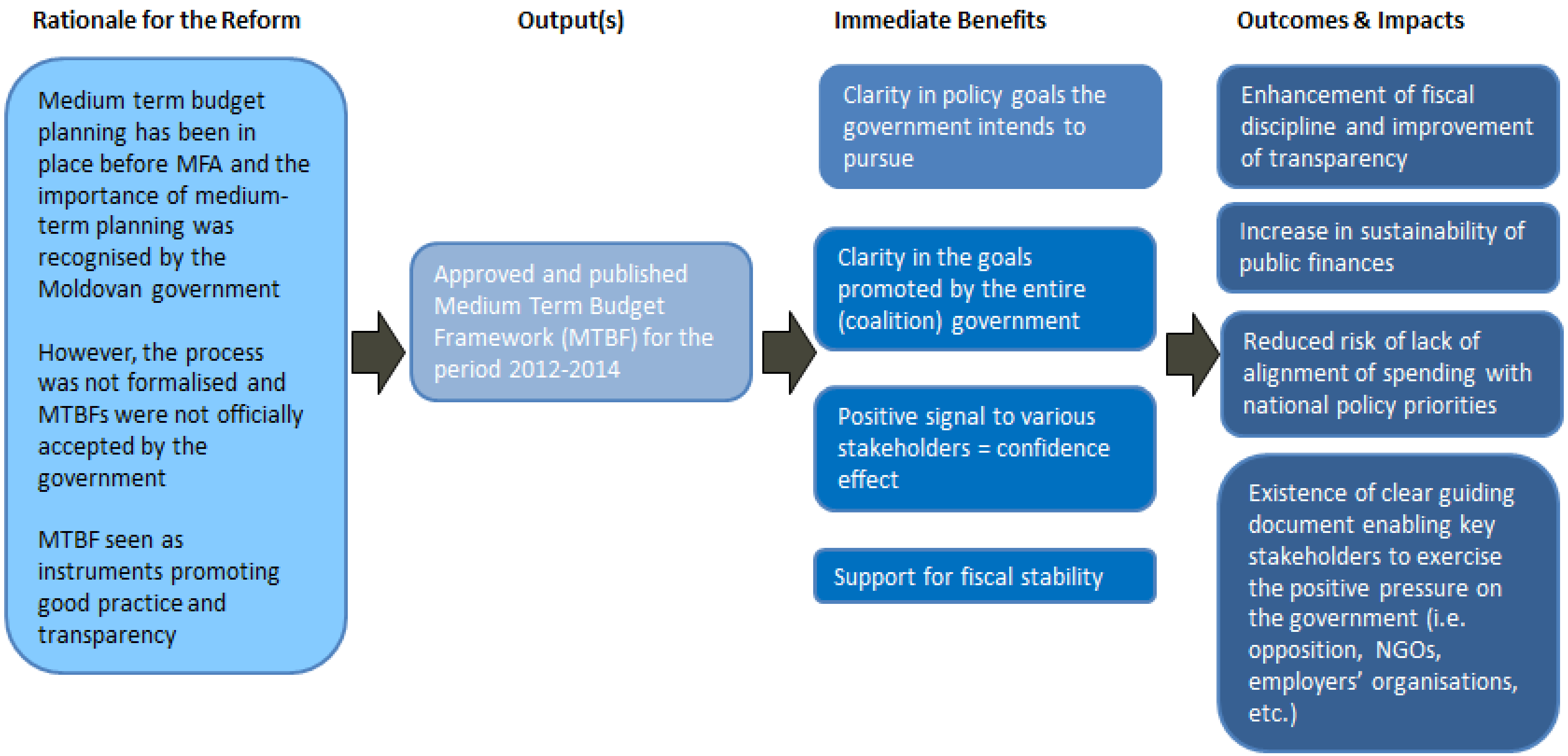
[63] PEFA (2011), Republic of Moldova Public Expenditure and Financial Accountability Assessment Public Financial Management Performance Report Moldova October 2011 update, Available at http://www.pefa.org/en/content/pefa-publically-available-assessments.

Condition 3.4 (third tranche): Based on preparatory work conducted to this effect and included in the list of actions, the government will conduct a census of a number of public sector employees, of the number of payroll positions and of the paid wage bill.

Implementation	The Census of the Public Sector Employees was conducted during September -November 2011 by the Institute for Advanced Economic Development, in collaboration with specialists from the Ministry of Finance, Ministry of Labor, Social Protection and Family and the State Chancellery[64].
Evidence of Implementation deficit	None
Relevance	The issue of high level of public sector employment and ensuing cost has been raised in several documents (e.g. IMF reports). The census was planned as an instrument allowing monitoring of the wage costs, determining the wage fund and the categories of salaries.
Importance	Moderate as assessed by numerous references to the issue of public sector size and the fact that implementation of the census did not change the assessment of Moldova in the PEFA between 2008 and 2011 in the dimension: PI-18. Effectiveness of payroll controls[65].
Domestic ownership & Donor support	Existing monitoring mechanisms for public sector employment and wage bill were inadequate, but resources devoted to their monitoring were limited (small unit at the Ministry of Finance). Interest in carrying the survey appears to be limited to a narrow group within the Ministry. UNDP provided financial resources to carry the census. IMF used declared interest in using the information from the census.
Added Value of MFA	MFA was the only external instrument directly promoting the implementation of the census and is believed to have contributed to its implementation.
Evidence of benefits	Limited evidence. One example of use is in the work on the educational sector reform[66]. For the Ministry of Finance the major tangible benefit appears to be in learning methodological lessons that could enable establishing a more efficient system for regular monitoring of government (and possibly public sector as a whole) employment.
Evidence of long-term Impacts	Lack of evidence of long-term impact.

[64] European Commission, February 2012. Report from the Economic Dialog and MFA mission to Moldova – February/ March 2012.
[65] PEFA (2011), Republic of Moldova Public Expenditure and Financial Accountability Assessment Public Financial Management Performance Report Moldova October 2011 update, Available at http://www.pefa.org/en/content/pefa-publically-available-assessments.
[66] Reported by the IMF Moldova team in an interview with the evaluation team.

Figure 4.3 Intervention logic of the condition related to the Medium-Term Budget Framework

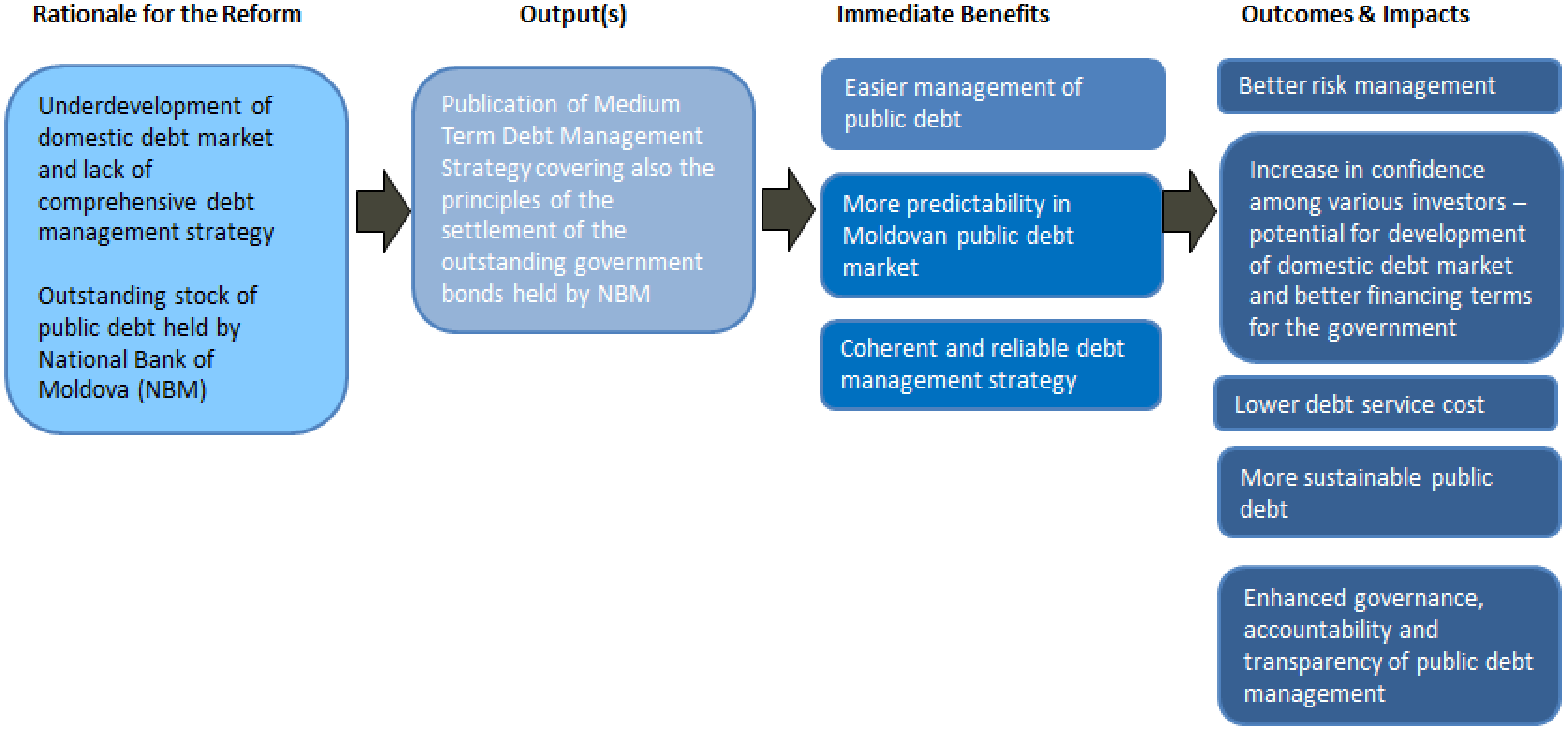


<u>Condition 3.2 (third tranche):</u> The government will approve and publish the Medium-Term Budget Framework Forecast (MTBF) for the period 2012-2014

Implementation	The MTBF for the period 2012-2014 was submitted to the government on 22 June 2011 and approved on 15 July 2011 by the Inter-ministerial Committee for Strategic Planning. The draft 2012-2014 MTBF was also published on the official web site of the Ministry of Finance. On 29 December 2011, the Prime Minister also approved the 2012-2014 MTBF via a resolution ("Dispozitie"), published on the official web site of the Ministry of Finance[67]. It was not approved at the government level.
Evidence of Implementation deficit	No approval at the government level. In practical terms, the 2012 Budget was drafted based on the 2012-2014 MTBF and a multi-year budget framework note containing the 2012-2014 MTBF parameters accompanied the draft 2012 Budget Law in the Parliament.
Relevance	Lack of identified documentary evidence on the importance of further formalisation of medium term budget planning. OA 2010 recommended introduction of medium term expenditure forecasts at the local government level. A review carried by OECD recommended major simplification of medium term expenditure forecasts signaling misconceptions of aims and uses of such forecasts[68]. In the post-crisis environment with volatile economic conditions the relevance of medium-term planning is naturally somewhat diminished (e.g. macro-economic assumptions may quickly become unrealistic.) However, this was not easy to predict during 2010 when the condition was agreed upon.
Importance	No evidence identified suggesting this was a priority issue.
Domestic ownership & Donor support	There appears to be a degree of domestic ownership as regards general importance of MTBF – PEFA 2011 assessed that 'There is good understanding of the importance of reliable medium term budget and fiscal planning'. However, the government has not been formally approving MTBFs for several years and formalisation of the process does not appear to be perceived as particularly important or feasible especially under the coalition government(s). EU has supported widening the use of Medium Term Expenditure Frameworks since 2002 first through the Food Security Programme, and then budget support programmes.
Added Value of MFA	No clear evidence of MFA value added.
Evidence of benefits	No clear evidence.
Evidence of long-term Impacts	No clear evidence.

[67] European Commission, February 2012. Report from the Economic Dialog and MFA mission to Moldova – February/ March 2012.
[68] Dirk-Jan Kraan, Valentina Kostyleva, Colin Forthun, Jutta Albrecht, and Ragnar Olofsson (2010), Budgeting in Moldova, OECD Journal on Budgeting Vol. 2010/3.

Figure 4.4 Intervention logic of condition related to the Medium-Term Debt Management Strategy

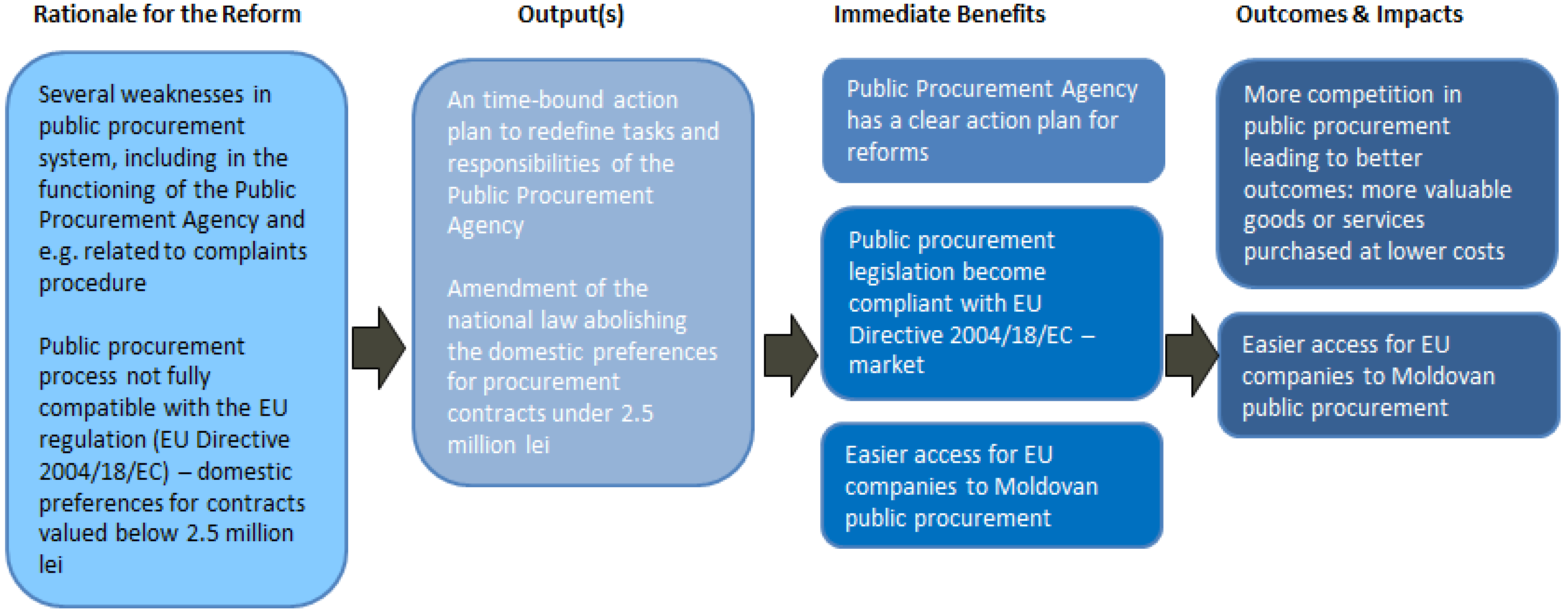


Condition 3.3 (third tranche): The Ministry of Finance will elaborate, approve, and publish a medium-term debt management strategy for the period 2012-2014 as the MTBF, covering also the principles of the settlement of the outstanding government bonds held by the National Bank of Moldova.

Implementation	The Ministry of Finance drafted the Medium-Term Debt Management Strategy (2012-2014) which was approved by the Inter-ministerial Committee for Strategic Planning on 15 July 2011 and by a Prime Minister resolution ("Dispozitie") on 29 December 2011[69] The document was published on the Ministry of Finance's website. The document inter alia outlined plans for gradual reduction of the government debt to the National Bank of Moldova on previously taken loans by MDL 650 million during 2012-2014 (approximately 25% of the total debt to NBM).
Evidence of Implementation deficit	None.
Relevance	The issues of lack of medium term management strategy and slow and ad hoc repayment process of public debt held by the central bank were identified in the 2010 OA.
Importance	Medium to low priority based on 2010 OA Assessment
Domestic ownership & Donor support	Domestic ownership of reform appears limited, possibly in part due to limited use of varied debt instruments (with overwhelming majority of debt being long-term concessional debt from multilateral creditors). World Bank (and IMF) was involved through the Debt Management Performance Assessment (DeMPA)[70].
Added Value of MFA	MFA conditions are believed to have mobilised government efforts in this area, although MTBF would have likely been developed also in absence of the MFA conditions as this was linked to on-going reform processes in the debt management area.
Evidence of benefits	No clear evidence. Potential benefits might materialise in the longer-term perspective.
Evidence of long-term Impacts	No clear evidence. Potential benefits might materialise in the longer-term perspective.

[69] European Commission, February 2012. Report from the Economic Dialog and MFA mission to Moldova – February/ March 2012.
[70] World Bank (2011), Public Debt Management Reform Plan. Moldova. http://www.mf.gov.md/common/publicdebt/reports/Moldova_Reform_Plan_2011.pdf

Figure 4.5 Intervention logic of conditions related to the reform of public procurement



Condition 2.4 (second tranche): The Public Procurement Agency will prepare and submit to the government a time-bound action plan with specified targets to redefine the tasks and responsibilities of the Public Procurement Agency, and to bring the public procurement legislation, regulation and practices closer to good EU standards.

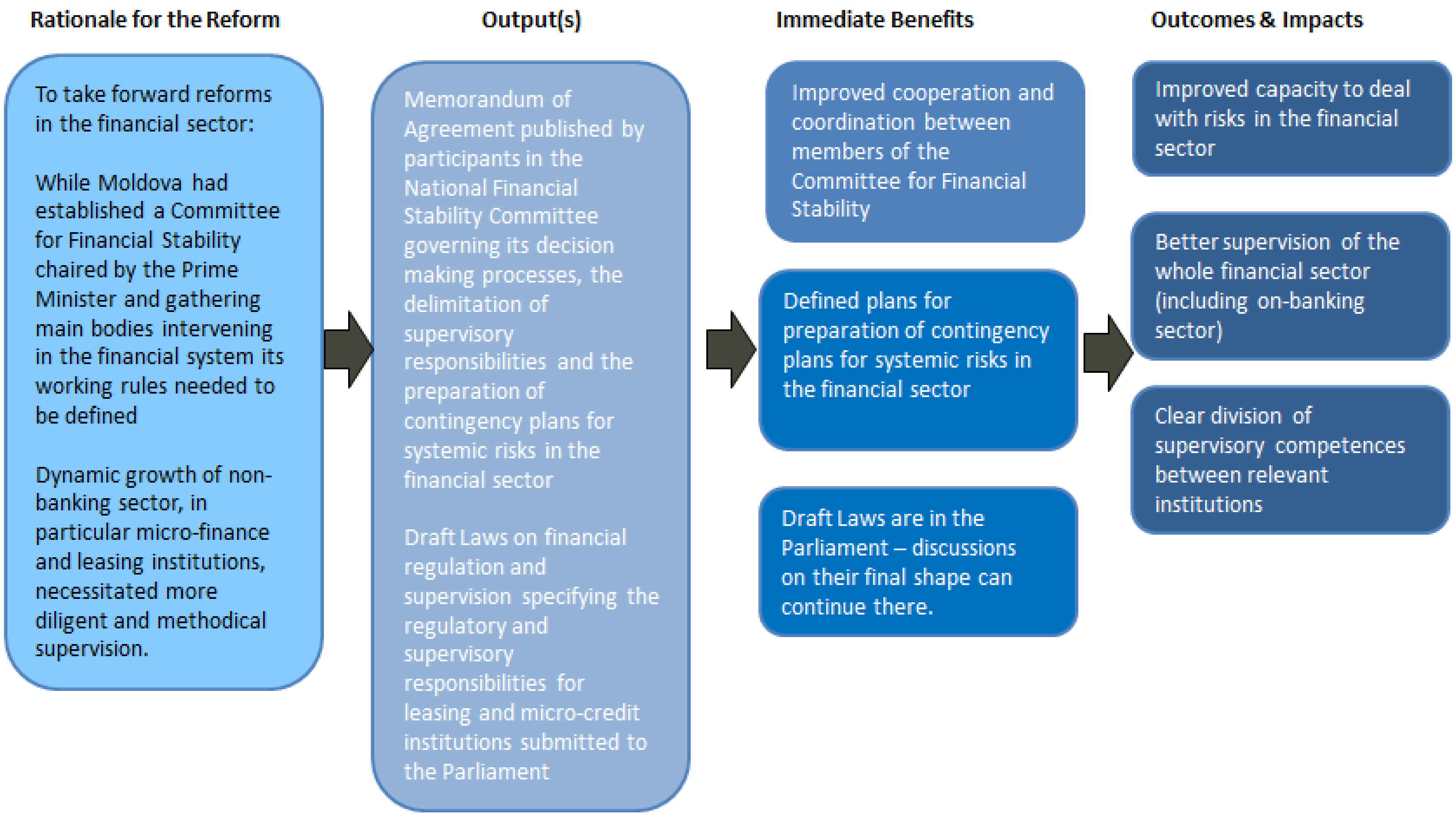
Implementation	The PPA has prepared an 'Action Plan of the Procurement Agency for 2011-2013' which was approved by the Minister of Finance on May 12, 2011[71]. Action Plan specified targets and redefined tasks and responsibilities of the Public Procurement Agency.
Evidence of Implementation deficit	None.
Relevance	2010 OA has identified several shortcomings in the area of public procurement.
Importance	Several aspects relating to the functioning of the Public Procurement Agency and the public procurement procedures were considered as high priority in the 2010 OA.
Domestic ownership & Donor support	Reforms of institutional framework for public procurement was initiated before the MFA (Public Procurement Agency was created in November 2009). Also, legal approximation with EU Directives was already under way by the time of MFA (the Law on Public Procurement from April 2007). EC has promoted changes in public procurement in Moldova, including approximation with EU Directives as evidenced e.g. by the EU-Moldova European Neighbourhood Action Plan adopted in 2005. Other donors were also involved (EBRD, World Bank, UNDP).
Added Value of MFA	MFA appears to have added political weight to the action plan making implementation of its elements easier by allowing the Public Procurement Agency to use the document in the dialog with government/Parliament.
Evidence of benefits	Some changes in the public procurement area foreseen in the action plan are believed to have contributed to better public procurement environment in Moldova.
Evidence of long-term Impacts	No clear evidence. Potential benefits might materialise in the longer-term perspective, although their attribution to MFA or other driving forces will remain very difficult.

[71] European Commission, July 2011. Report from the MFA mission to Moldova 22-24 June.

Condition 3.7 (third tranche): The government will prepare and submit to Parliament changes in the Public Procurement Law removing domestic preference for procurement amounts under 2.5 million lei (around EUR 160,000) and suppressing the list of products to which domestic preference applies with the aim of making the procurement legislation and regulations compliant with EU Directive 2004/18/EC	
Implementation	The government endorsed a law for the amendment of the Law on Public Procurement nr. 96-XVI of 13 April 2007 through its Decision nr. 771 of 14 October 2011. The amendments include the removal of domestic preferences for procurement amounts under 2.5 million lei and suppress the list of products to which domestic preference applies in order to make the procurement legislation and regulations compliant with the EU acquis[72].
Evidence of Implementation deficit	None. The Law was quickly passed by the Parliament (in December 2011).
Relevance	2010 OA has identified several shortcomings in the area of public procurement, including on issues of domestic preferences for small contracts.
Importance	The condition was assessed and considered as high priority in the 2010 OA.
Domestic ownership & Donor support	Reforms of institutional framework for public procurement was initiated before the MFA (Public Procurement Agency was created in November 2009). Also, legal approximation with EU Directives was already under way by the time of MFA (the Law on Public Procurement from April 2007). EU has promoted changes in public procurement in Moldova, including approximation with EU Directives as evidenced e.g. by the EU-Moldova European Neighbourhood Action Plan adopted in 2005.
Added Value of MFA	No clear evidence of MFA value added. Domestic preferences would have likely been removed anyway.
Evidence of benefits	No clear evidence. Could be seen as a step in approximation of Moldovan legislation with EU *acquis* which is important for negotiations on the Association Agreement.
Evidence of long-term Impacts	No clear evidence – potential to stimulate more competition for public contracts but relatively small size of Moldovan public procurement market may limit interest of foreign bidders.

[72] This was confirmed by the member of the EU High Level Policy Advice Team supporting the Moldovan Public Procurement Agency.

Figure 4.6 Intervention logic of conditions related to the reforms of financial sector regulation and supervision



Condition 2.3 (second tranche) The participants in the National Financial Stability Committee (NFSC), with the support of institutions they represent, will agree and publish a Memorandum of Agreement governing its decision making processes, the delimitation of supervisory responsibilities and the preparation of contingency plans for systemic risks in the financial sector.	
Implementation	The members of NFSC signed the memorandum of agreement on February 28, 2011.
Evidence of Implementation deficit	No evidence.
Relevance	EU Moldova European Neighbourhood Action Plan from 2005 identified the task of 'Enhancement of a prudential regulatory framework for financial markets and supervision equivalent to that existing in the EU.' IMF's 2008 update called for enhancement and institutionalisation of the cooperation between the National Bank of Moldova and the National Commission on Financial Markets and ensuring the effective operation of the newly established NCFM and expanding its remit to leasing.
Importance	No clear evidence identified allowing an assessment of relative importance.
Domestic ownership & Donor support	Several changes in related areas preceded the MFA – e.g. setting up the National Commission on Financial Markets. There was also on-going debate on the optimal division of supervisory responsibilities in non-banking sector. IMF and World Bank were involved e.g. through Financial System Stability Assessment. IMF provided assistance for the development of contingency plans (e.g. during the mission in April 2011)[73]. EU was involved given the place of related issues in the EU-Moldova ENP Action Plan.
Added Value of MFA	MFA might have contributed to signing of the Memorandum of Agreements. Given some disagreement between parties and limited experience in the work of the committee such as NCSF it is plausible that it could have taken longer to sign the Memorandum.
Evidence of benefits	NFSC has defined rules of operations.
Evidence of long-term Impacts	No clear evidence.

[73] European Commission, July 2011. Report from the MFA mission to Moldova 22-24 June.

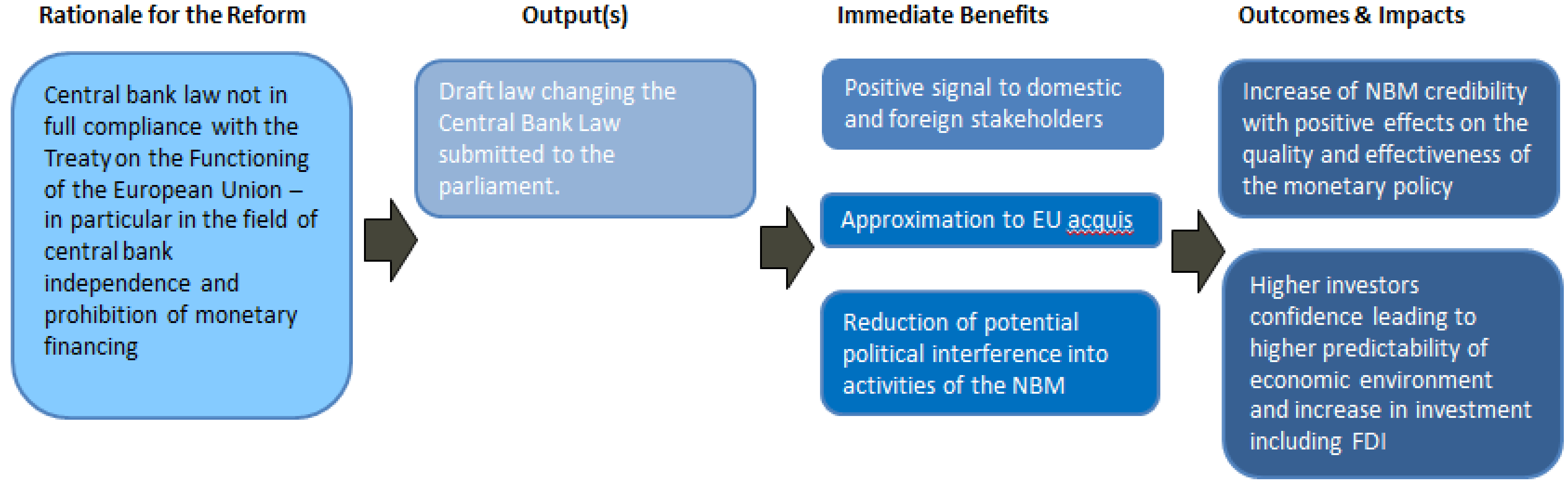
Condition 3.5 (third tranche) The government will prepare and submit to the Parliament changes in the legislation on financial regulation and supervision specifying the regulatory and supervisory responsibilities for leasing and micro-credit institutions in the context of the Memorandum of Agreement between the institutions represented in the National Financial Stability Committee (NFSC)

Implementation	During the meeting of 14 December 2011, the government of Moldova endorsed the draft Law for complementing and amending the Law nr. 192-XIV of 12.11.1998 'On the National Commission on Financial Market' and the Law nr. 59-XVI of 28.04.2005 'On Leasing' in order to incorporate the described modifications. The draft Law for complementing and amending the Law was approved through the Government Decision nr. 95 of 15 February 2012 and was submitted to the Parliament[74]. The delay in submitting the draft law was one the reasons for a delay of the third MFA tranche disbursement.
Evidence of Implementation deficit	None. Fulfilment of the condition was delayed due to lack of consensus between NBM and NCFM. Strongly divergent views on the delimitation of supervisory responsibilities persist until present. As of June 2013 the draft law was not yet reviewed by a relevant parliamentary committee.
Relevance	EU Moldova European Neighbourhood Action Plan from 2005 identified the task of 'Enhancement of a prudential regulatory framework for financial markets and supervision equivalent to that existing in the EU.' 2008 update of the IMF's Financial System Stability Assessment called for enhancement and institutionalisation of the cooperation between the National Bank of Moldova and the National Commission on Financial Markets and ensuring the effective operation of the newly established NCFM and expanding its remit to leasing.
Importance	No clear evidence identified allowing an assessment of relative importance. Growing size of non-banking financial sector suggesting increasing importance of covering it by effective supervision.
Domestic ownership & Donor support	The NFSC, with the support of the World Bank, drafted a new Law on the National Commission of Financial Market (NCFM), which expands NCFM's authority to include regulation, supervision of the professional participants of the whole nonbanking sector, including: insurance companies, savings and lending associations, private pension funds, securities market, credit history bureaus, microfinance organizations, mortgage credit providers, leasing companies and pawn shops. Technical assistance was provided while designing the draft laws (i.e. from IMF, WB and EC). Donors' views on the optimal division of supervisory powers in non-financial sector have apparently evolved. 2008 update of the Financial System Stability Assessment called for expanding the supervisory powers of NCFM to the leasing sector, while more recently, both IMF and the World Bank experts appear to support the idea of unified supervision (i.e. at the central bank)[75]. The National Bank and Moldova and the NFSC have continued dialogue with the World Bank and IMF on these issues
Added Value of	MFA might have played some role in motivating discussion in Moldova on the design of financial sector supervision.

[74] European Commission, February 2012. Report from the Economic Dialog and MFA mission to Moldova – February/ March 2012.
[75] IMF, Republic of Moldova: Financial System Stability Assessment - Update, IMF Country Report No. 08/274 and ICF GHK interviews with World Bank representatives.

MFA	MFA appears to have forced submission of the draft laws to the parliament despite lack of consensus view on the optimal shape of legislation.
Evidence of benefits	None – as of June 2013 draft law was not being actively developed in the Parliament.
Evidence of long-term Impacts	None – as of June 2013 draft law was not being actively developed in the Parliament. Uncertainty on long-term impacts given diverging views of stakeholders (including donors).

Figure 4.7 Intervention logic of a condition related to the central bank legislation

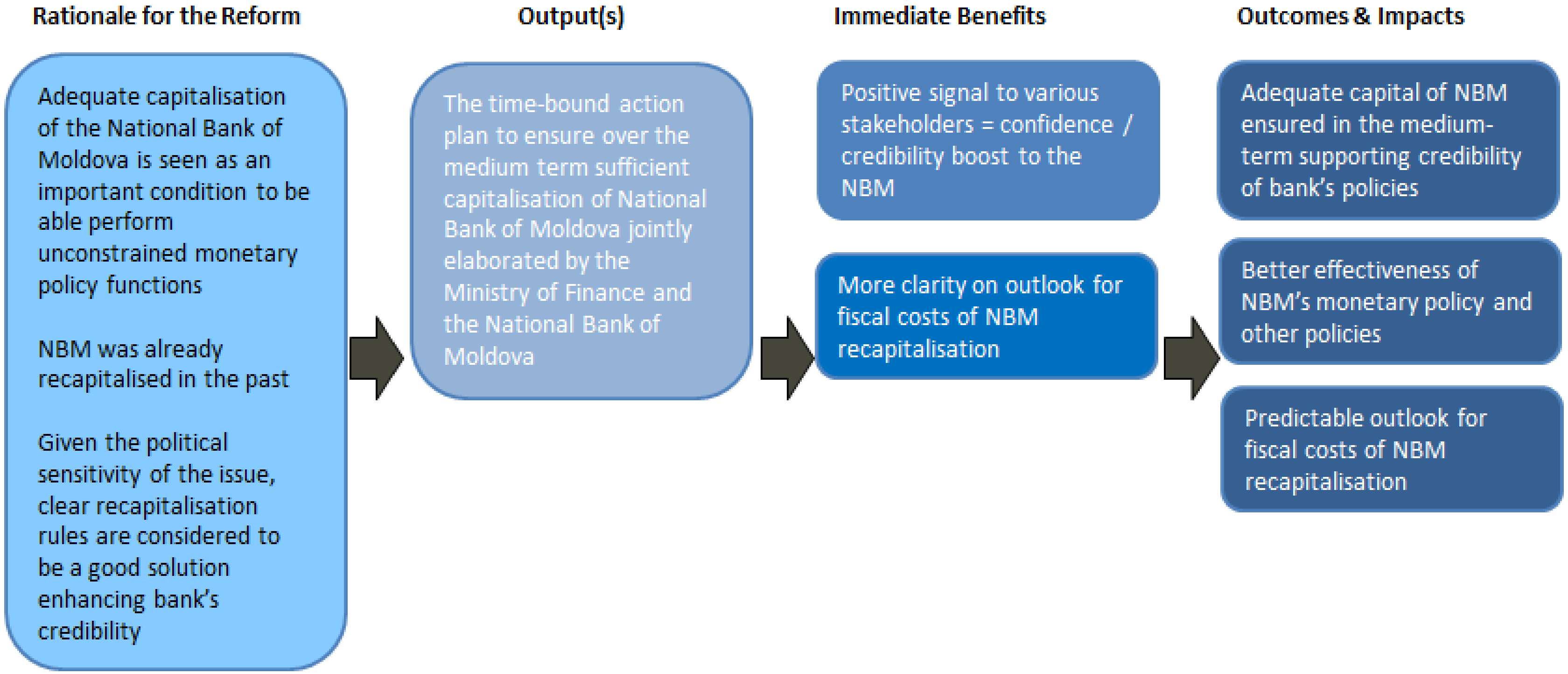


Condition 3.8 (third tranche): The government in cooperation with the National Bank of Moldova will prepare and submit to Parliament adaptations to the Central Bank Law so as to provide for its compliance with the Treaty on the Functioning of the European Union, in particular in the field of central banks independence and prohibition on monetary financing.

Implementation	On 14 December 2011, the government endorsed the legislation containing NBM's draft amendments to the Central Bank law, strengthening the central bank's independence and the prohibition of monetary financing[76]. It was submitted to the Parliament in March 2012.
Evidence of Implementation deficit	None. Fulfilment of the condition was delayed due to disagreements between the government and the NBM. As of June 2013 the law has passed the first reading in the parliament.
Relevance	Part of the broader effort of aligning Moldovan legislation with the EU.
Importance	No documentary evidence identified allowing for the assessment of the relevance of the condition.
Domestic ownership & Donor support	The issue was of interest to Moldovan authorities and there were some differences in views on the legislative solutions between the government and the NBM. The work on central bank law amendments was carried at the NBM before the MFA. NBM was assisted by the IMF during the work on the law adaptations.
Added Value of MFA	MFA appears to have played a role in submission of the draft law to the parliament.
Evidence of benefits	None – draft law is not yet approved by the Parliament.
Evidence of long-term Impacts	None – draft law is not yet approved by the Parliament.

[76] European Commission, February 2012. Report from the Economic Dialog and MFA mission to Moldova – February/ March 2012.

Figure 4.8 Intervention logic of a condition related to the capitalisation of the central bank



Condition 3.6 (third tranche): The Ministry of Finance and the National Bank of Moldova will jointly elaborate a time bound action plan to ensure over the medium term sufficient capitalisation of the National Bank of Moldova.

Implementation	On 11 October 2011, the National Bank of Moldova and the Ministry of Finance adopted a decision on establishing a working group responsible for developing an Action Plan to ensure sufficient capitalization of the National Bank of Moldova over the medium term On 2 December 2011, the working group agreed upon an Action Plan to ensure sufficient capitalization of the National Bank of Moldova[77].
Evidence of Implementation deficit	None. To ensure over the medium term sufficient capitalisation of the National Bank of Moldova, the draft amendments of the Law on the National Bank of Moldova were approved by the Parliament in the first reading on November 30, 2012. According to the proposed amendments, the National Bank of Moldova will transfer the profit available for distribution to the State budget providing that the capital of the National Bank of Moldova reaches the necessary level of capital adequacy established by the legislation (10% of total monetary liabilities). Working out the Action Plan was delayed.
Relevance	No documentary evidence identified allowing for the assessment of the relevance of the condition. The post-crisis environment suggests importance of ensuring sufficient capitalisation of the NBM.
Importance	No documentary evidence identified allowing for the assessment of the importance of the condition.
Domestic ownership & Donor support	Both Ministry of Finance and the NBM had views on the plan and looking for a compromise was arguably difficult. NBM was recapitalised already in the past, but no documentary evidence was identified providing information on Moldovan actors' interest in agreeing on the medium-term recapitalisation action plan.
Added Value of MFA	MFA appears to have played a role in working out the Action Plan.
Evidence of benefits	No evidence of benefits identified – these may be indirect and difficult to identify.
Evidence of long-term Impacts	No evidence of benefits identified – these may be indirect and difficult to identify and related to more efficient monetary policy of the NBM[78].

[77] European Commission, February 2012. Report from the Economic Dialog and MFA mission to Moldova – February/ March 2012.
[78] For discussion on potential mechanisms see e.g. Adler, Gustavo; Castro, Pedro; Tovar Mora, Camilo Ernesto (2012). Does Central Bank Capital Matter for Monetary Policy? IMF Working Paper No. 12/60 or Skander J. Van den Heuvel (2002). Does bank capital matter for monetary transmission?, Economic Policy Review, Federal Reserve Bank of New York, issue May, pages 259-265.

The above exposition is based on both an analysis of documents and interviews with stakeholders/ key informants. Differences in views among stakeholders, limitation to their memories in recalling details of events more than two years prior to interviews, lack of explicit discussion of certain issues in documents, often very difficult attribution of certain decisions to MFA conditions relative to other forces at play, and inherent uncertainty as regards observed and future impacts of certain policy measures all limit the precision of possible analysis and suggest certain caution in interpretation of the results.

4.1.2 Feasibility of Modelling Structural Reforms

The feasibility of using a model based approach to determine the impact of the structural reforms was assessed during the inception phase. Most of the conditional reforms associated with the MFAs are long-term in nature. They are designed to strengthen various aspects of government (notably debt management, budgetary control, tax-raising capacity, pension reform and procurement procedures), assure compliance with international practice and strengthen the institutions responsible for monetary policy and supervision of the financial sector. Although in some cases these reforms could begin to have budgetary or economic implications within the period of interest (2011/2012), at this early stage these impacts would be negligible and not worth attempting to quantify in detail. More generally, the reforms would give the government greater credibility with respect to their capacity to achieve targets for deficit and debt management, and would strengthen investor confidence in the general operating environment for the private sector. But this effect should be assessed as part of a view on the general confidence-building impact of the MFAs, rather than related to any specific reforms. Much of the effect would, presumably, only come in the longer term (outside the period of evaluation) as investors wait to see evidence that the reforms are actually implemented.
For these reasons, the present evaluation does not attempt to apply formal economic modelling to the assessment of the MFA contribution to the Moldovan structural reform agenda.

4.2 Conclusions

The analysis presented above allows for drawing the following conclusions concerning MFA impact in the structural reforms area.
The process of selecting conditionalities attached to the MFA operation was carried well, ensuring involvement of Moldovan authorities and close coordination with other donors, notably the IMF.

Several conditions aimed at stimulating processes, rather than achieving an outcome with 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 submission to the parliament. Already meeting such conditions proved difficult in two cases (changes in laws on financial regulation and supervision and the central bank law), leading to a delay in the disbursement of the last MFA tranche. Out of five submitted draft laws only one was enacted by the parliament promptly. As of June 2013, the remaining four laws remained at various stages of the legislative process in the parliament.

More generally, the prevailing focus of conditions on processes rather than outcomes and lack of explicit specification of concrete (and where possible, measurable) objectives behind given conditions limit the possibility to verify MFA outcomes in the area of structural reforms. Spelling such objectives would make it easier to asses MFA impact but also potentially to communicate to the wider public. This issue is taken up in the final recommendation section of this report.

Disentangling the net impact of the MFA in promoting reforms is in most cases very difficult due to linkages with own agenda of the Moldovan authorities and involvement of several other actors as well as different – and often longer-lasting – EU initiatives targeting the same areas. In several cases MFA conditions were related to actions that would have been likely undertaken by Moldovan authorities also 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). In the case of the condition requiring adoption of a time-bound action plan with specified targets to redefine the tasks and responsibilities of the Public Procurement Agency, and to bring the public procurement legislation, regulation and practices closer to good EU standards it is believed that the action plan has added weight to reform efforts that were being pursued.

In yet other instances, MFA appears to have promoted actions that might not have been implemented otherwise, at least within a similar timeframe. This applies to the census of public sector employees, parliamentary submission of laws related to financial regulation and supervision of the non-banking sector.

With regard to the overall focus of conditions, this study concludes that it was broadly adequate by mostly targeting areas relevant for macroeconomic and financial stability. In particular several conditions addressed reform areas relevant to (a) controlling the fiscal deficit (e.g. measures related to budget preparation and execution), (b) allocating resources effectively (e.g. conditions related to implementation of the survey of public sector employees), (c) spending resources according to budget and achieving value for money (e.g. conditions related to the medium-term budget framework). The potential gains from these reforms will generally materialise only in a medium- or long-term perspective, although a census of public sector employees is an example of the measure with potentially quick gains (however, these have materialised to a very limited extent only). Indeed, this study concludes that potential impact of fulfilment of MFA conditionality is yet to be seen as there is currently no evidence of effects.

Another important question on the level of ambition of reforms promoted by the MFA in view of the character of the support instrument, its duration and interactions with other EU support and other donors' support is tackled in the section six on design and implementation issues as it is linked to more fundamental question on the positioning of the MFA instrument and how it can reconcile the purpose of providing crisis support and promoting reforms/ institution building in beneficiary countries.

One condition that – with the benefit of hindsight and the passage of time – appears potentially misplaced concerns the requirement to submit to the parliament legislative proposals on the division of supervisory powers for micro-credit and leasing institutions. The rationale for the condition was, inter alia, to motivate Moldovan stakeholders to start a serious discussion on the design of financial sector supervision. However, the formulation of the condition unintentionally forced the government to submit to the parliament the draft law that – based on information available as of June 2013 – has little chance of being approved in this form given substantial divergence of views on optimal design of institutional framework of financial sector supervision. Given lack of internal consensus and World Bank and IMF support for unified model of supervision (centralised at the central bank) the MFA conditionality appears to have unintentionally supported one side of internal policy debate in Moldova (at least as far as some stakeholders' perceptions are concerned). This is because the only draft law that was earlier prepared and could be submitted to the Parliament had foreseen granting supervisory powers for micro-credit and leasing sectors to the National Commission on Financial Markets.

The above issue has not led to any unexpected effects, though, given that the legislative processed stalled on the draft law. No other unexpected effects of the MFA have been identified in the area of structural reforms.

5. Design and Implementation Issues

5.1 Preparation of the Operation

The MFA operation in Moldova was the first operation under the new Lisbon Treaty requiring approval from both the Council and the Parliament. As a result, there was an increase in the number of steps to follow and the paperwork involved.

The calendar of action (0) indicates that there were considerable delays at several points during the preparation and implementation of the operation. There was a time lag of over 12 months between receipt of request from Moldovan authorities and the submission of Commission proposal to the Parliament and the Council for approval. In mid-2009, this might have been related to on-going political uncertainty in Moldova when negotiations were under way on formation of the new coalition government. While the IMF programme was formally approved in January 2010, paving the way for the MFA. Further discussions continued and the agreement on the substance of the proposal for providing MFA to Moldova was reached in June 2010. However, the text had to be adapted at a later stage and the finalisation process took somewhat more time also because the adapted text had to be first signed by the President and then by the Parliament. As a consequence, six months elapsed, before the MoU and Grant Agreement were signed in December 2010. The first disbursement was made 18 months after the request was received and when the crisis was over. Such delays undermine the quick disbursing and anti-crisis nature of the instrument and ultimately, reduce its impact.

These delays cannot be directly linked to the involvement of the European Parliament in the decision making process. In the case of the previous MFA operation to Moldova (2007-2008) the period between the official request for support and the first disbursement lasted 16 months[79].

Table 5.1 Overview of the main activities surrounding the design and implementation of the MFA operation

Timing	Event
23 June 2009	Prime Minister Greceanîi submits a request for the MFA assistance.
05 August 2009	The European Commission acknowledges the request and expresses an intention to assist Moldova
September 2009	Meeting between ECFIN Commissioner and Prime Minister Filat
October 2009	DG ECFIN undertakes fact finding mission to Moldova
February 2010	DG ECFIN undertakes preparatory mission to Moldova
July 2010	The Commission submits a proposal for providing MFA to Moldova to the European Parliament and the Council
20 October 2010	The European Parliament and the Council adopt a decision to provide MFA to Moldova
16 December 2010	Signature of MoU
17 December 2010	Signature of Grant Agreement
December 2010	Disbursement of first tranche

[79] Ecorys, CASE & Economisti Associati (2010), Ex post Evaluation of MFA operations in Moldova, Accessed at http://ec.europa.eu/economy_finance/evaluation/completed/.

Timing	Event
September 2011	Disbursement of second tranche
April 2012	Disbursement of third and final tranche

5.2 Design of the Operation

The size of the financial assistance provided through the MFA instrument was based on a consideration of Moldova's residual financing needs, burden sharing principles of the EU (in line with Genval criteria) and the EU's budgetary constraints (several parallel MFA requests were being considered by the Commission).

The assistance was provided in grant form on the basis that Moldova was the poorest European country and considering its limited debt repayment capacity. This choice appears appropriate and justified. It is also clear that 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 commitments to deliver on agreed structural reform conditions. Given substantial delay in the start of the operation it is not surprising that the instrument was generally not considered by interviewed Moldovan authorities as a crisis-support instrument, but rather as general budget support. Importantly, this perceived general budget support form was considered a very attractive characteristic distinguishing MFA from sectoral budget support provided by the EU.

The factors affecting the choice of conditionality have already been discussed in section 4. The example of conditions related to legislation on supervisory powers in non-bank financial sectors discussed in section 4 illustrates a more general point, i.e. that the MFA is not well positioned to take on-board conditionalities related to medium term legislative reforms requiring extensive political debate, a long approval period or sufficient "bedding-in" time to translate into concrete achievements[80].

There remains a fundamental question on the de-facto positioning of the MFA instrument and how it can reconcile the purpose of providing crisis support and promoting reforms/ institution building in beneficiary countries. One particular area where several stakeholders interviewed in the evaluation process expressed their views was related to defining several of the conditions as submission of draft laws to the Parliament rather than enacting these laws. Several interviewees believed that a more ambitious formulation, i.e. requirement of enacting laws by the Parliament would be beneficial and feasible. This would require an involvement of the Parliament (relevant parliamentary committees) in the negotiation process. Such a strategy would, however, involve certain important risks e.g. related to political instability in a recipient country and a possibility that some conditions are not fulfilled or the risk that poorly conceived legislation is rushed through to satisfy donors. The latter could be particularly problematic in view of the very limited flexibility on the side of the European Commission to adjust originally agreed conditions in view of new developments. In this last respect there is a clear difference between the MFA and IMF programmes, where the latter routinely adjust conditions in subsequent reviews in view of new macroeconomic (and to a certain extent also political) developments. There are also aspects related to perceptions of such conditions as being 'intrusive' in a sense of requiring certain actions from a democratically elected and independent Parliament. Moreover, such conditions could in some negative scenarios have perverse effects by exerting pressure on governments to rush through ill-conceived laws (particularly in countries with weak opposition).

[80] Ecorys, CASE & Economisti Associati (2010), Ex post Evaluation of MFA operations in Moldova, Accessed at http://ec.europa.eu/economy_finance/evaluation/completed/.

This evaluation has not identified convincing evidence that formulation of conditions requiring parliamentary approval of certain laws would be beneficial in terms of strengthening MFA impact on reform processes in a country. Such an approach might be attempted in the future in some circumstance following an ex-ante assessment of possible gains and risks.

The MFA operation was linked to the IMF programme that started in January 2010 after the staff level agreement was reached in October 2009, soon after the new government came to power. As discussed in section 4, the coordination of conditionality selection between the MFA and the IMF programme was very good avoiding overlaps and ensuring complementarity.

5.3 Monitoring and Implementation

The monitoring of the operation was based on progress reports on reforms, compliance statements of Moldovan authorities, and field missions performed by European Commission experts. 0 lists macroeconomic and financial indicators that were used to monitor the developments in Moldova during the course of the operation.

On the side of the Moldovan authorities quarterly reporting scheme was coordinated by the Ministry of Finance. Institutions responsible for implementation of conditions specified in the MoU provided quarterly progress updates to the Ministry that was subsequently sending quarterly progress reports to the EU Delegation and DG ECFIN. The organisation of the monitoring was generally assessed positively by the interviewed Moldovan stakeholders. They also reported that the process of monitoring progress in fulfilment of MFA conditionality was substantially easier than in the case of EU sector budget support.

While the delay in the start of the operation was substantial (it was longer than expected by the IMF despite the Fund's experience with previous MFA operations) the timing of MFA disbursements fit very well with the country need for budget support (quite by chance). This was because of a combination of factors. First, Moldovan economy rebounded much stronger than earlier anticipated in 2010 leading to over-performance of fiscal deficit reduction targets for 2010 agreed with the IMF. However, with budget support component of IMF loans coming to an end in 1st quarter of 2011 and relatively ambitious fiscal targets for 2011 (related to a 'base effect' of very good budget performance in 2010) this opened a fiscal revenue gap in 2011 that was filled by MFA disbursements (the combined value of the first tranche disbursed on 28 December 2010 and the second tranche (September 2011) amounted to close to 1.3 per cent of 2011 GDP.) This 'perfect timing' was unintended but such situations are not unlikely given inherent uncertainty of economic projections and even more so at times of macroeconomic turbulences that motivate MFA operations.

Table 5.2 Key macroeconomic and financial indicators monitored through the assistance period

Information submitted by the Ministry of Finance	Information submitted by the NBM
▪ GDP or national income (quarterly) ▪ Main components of GDP (quarterly) ▪ Price indicators for GDP and consumer and producer prices (monthly) ▪ Employment and unemployment rates (quarterly) ▪ Level and composition of general and central government revenue and expenditure as well ▪ as government payment arrears (quarterly) ▪ Foreign trade (monthly) ▪ External public debt, including external arrears (monthly) ▪ External public debt service payments (monthly) ▪ Domestic public debt and debt service (monthly)	▪ Interest rates on benchmark government bonds at liquid maturities (monthly) ▪ Interbank interest rates at benchmark maturities (monthly) ▪ Banks' lending rates to households and non-banking sector at benchmark maturities ▪ (monthly) ▪ Balance-of-payments and main components (quarterly) ▪ International reserve position (monthly) ▪ Nominal exchange rates MDL/USD and MDL/EUR end of period and average (monthly) ▪ Capital ratio aggregates of the domestic banking sector regulated by the NBM (quarterly) ▪ Coverage ratio of the deposit guarantee fund (quarterly)

6. EU Added Value

This report has identified added value of the EU assistance provided in the form of the MFA operation in several areas that are described below.

Financial value added: The assistance was provided in the form of the grant and its size relative to the Moldovan GDP was significant (the whole size of the operation (EUR 90 million) corresponded to around 1.8 per cent of Moldovan GDP in 2011). Therefore, MFA directly supported the Moldovan budget without increasing Moldovan public debt. This element was highly appreciated by the Moldovan authorities. From another perspective, this could also be seen as making the whole package of combined IMF and EU MFA operation more concessional. Given that EU support in the form of MFA operation was the only available assistance of this magnitude in the form of a grant (rather than loans) it can be argued that MFA directly contributed to public and external debt sustainability of Moldova.

***Smoothing of the fiscal adjustment path*: ** Given the various external and internal developments before and during the 2009 crisis, at the end of 2009 Moldova faced a very difficult challenge of major fiscal adjustment. While substantial fiscal consolidation was necessary, the crisis environment was not conducive for a very rapid adjustment path. Designing the optimal path of the reduction of budget deficit became an important element of the IMF programme. In this regard, the prospects of the MFA grant provided much needed breathing space allowing more gradual fiscal adjustment path that would otherwise have not been possible. This was important in supporting the rebound of the Moldovan economy from the 2009 recession.

***Contribution to promotion of certain reforms*: ** As discussed in section 5 above the MFA played an independent role in promoting certain structural reforms agenda that may have potential to positively affect Moldova's economic development in the future.

Box 6 Educational Sector Reform

In 2011, the Moldovan government in cooperation with the World Bank government launched a comprehensive medium-term reform of the oversized education sector. The reform focuses on primary and secondary education, which account for about 60 per cent of total public spending in education. The reform aims at rationalising the sector by raising efficiency and improving quality through class size and school network optimization. Total net savings of 0.5 per cent of GDP a year is expected from the reform upon completion.

Source: IMF Moldova country report cr12/289.

There is also another dimension to reform-promoting role of the MFA. The smoother fiscal adjustment path enabled by the provision of MFA grant could be also seen as allowing for better preparation of certain reforms that simultaneously aimed at limiting fiscal costs in a given area and improving the quality of public services. The reform of the educational sector starting in 2013 and supported by the World Bank credit is one important example. The strategic vision of the reform was outlined in the government 2012 document National Development Strategy: Moldova 2020[81]. Reforms such as this are very sensitive politically, require careful preparations and have a potential to significantly impact long-term development prospects of the country while also reducing fiscal spending on education (from record high level of 9.5 per cent of GDP in

[81] Moldova 2020. National Development Strategy: 7 Solutions for Economic Growth and Poverty Reduction, approved by the Government of Moldova on July 12, 2012. Accessed at http://www.gov.md/public/files/Moldova_2020_ENG.pdf.

2009, almost twice the European average[82]). While this is an indirect and hypothetical impact it is plausible that without MFA the pressure to kick-start the reform (and especially its spending-reducing elements) would have resulted in attempts to its pre-mature implementation, without sufficient preparation.

Increasing economic stabilisation in the country in the direct EU neighbourhood: As discussed above MFA played a positive role contributing to restoring the macroeconomic stability in Moldova and also supported growth outlook for Moldova. The joint IMF-EU support might have prevented a disorderly macroeconomic adjustment. As such the assistance has also had positive (albeit very small given the size of the Moldovan economy) spillover effects on the EU economy. For instance, EU export growth to the Moldovan market (from EUR 1.24 billion in the crisis year 2009 to EUR 2.04 billion in 2012) could have been minimally weaker should economic recovery in Moldova have been more subdued in absence of the MFA[83]. There are several other dimensions of potential EU gains beyond prospects of market entry, e.g. related to migration trends (difficult to predict), costs of cross-border business, potential expansion of market for FDI, etc. all of which can benefit the EU economically if Moldova becomes more stable, more democratic and more affluent. The MFA contribution in these areas is clearly rather limited and impossible to quantify given their long-term character.

Improving political stability in the country in the direct EU neighbourhood: Beyond direct economic impact there is clearly a wider dimension to developments in Moldova as economic situation is related with political stability. The above arguments on MFA role in allowing smoother fiscal adjustment also have political implications. This has likely facilitated the work of the coalition government that was formed after turbulent political developments in 2009. Without MFA internal political struggle could have been yet fiercer potentially shortening the period of post-election political stability.

Improved EU-Moldova relations and strengthened EU leverage as an actor supporting transformational reforms in Moldova: The MFA assistance was provided on top of other substantial EU-funded programmes available to Moldova (mainly through ENPI). However, the macroeconomic focus of the MFA (generally not present to a similar extent in other EU instruments) meant that MFA can be seen as complementary to rather than duplicating other assistance programmes. MFA support was appreciated by the Moldovan authorities and can be plausibly believed to have strengthened EU-Moldova relations as well as the position of the EU as a promoter of socio-economic transition in Moldova.

Improved position of EU as partner of Moldova: MFA was provided after the elections that resulted in formation of the government supporting Moldova's integration with the EU rather than predominantly seeking closer relations with Russia. In this regard MFA could have to a certain degree contributed to ensuring that such geopolitical choices of Moldova are positively perceived by the population. This impact is limited by lack of general awareness of MFA support among the broader public.

In summary, this report assesses that the 2010-2012 MFA operation for Moldova was valuable to Moldovan general public, EU tax payers and other actors involved in

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[82] World Bank, World Develoment Indicators, Database accessed on 20 May 2013 at http://data.worldbank.org/indicator/SE.XPD.TOTL.GD.ZS. In 2011, the spending share in Moldova declined to 8.6% of GDP. For comparison, educations spending in countries such as Belarus, Poland, Slovak Republic or Germany were in the range 4-5.5% of GDP during this period.

[83] Trade data as reported in the informational material Moldova – EU Bilateral Trade and Trade with the World published at http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113419.pdf. Accessed on 20 May 2013.

promoting socio-economic development of the country. MFA meaningfully enriched other international support that Moldova was receiving after the 2009 crisis in ways that contributed to better macroeconomic outcomes, improved external sustainability, and more political and economic stability in the EU neighbourhood country trying to develop its geopolitical European orientation.

7. Conclusions and recommendations

This section sets out the main conclusions and recommendations emerging from the evaluation.

7.1 Conclusions

How would the economy of Moldova have evolved in the absence of MFA (and IMF) assistance?

In the absence of the MFA it is highly likely that a much faster fiscal consolidation would have been necessary leading to more subdued recovery from the 2009 recession. It is likely that both tax increases (possibly in the form of earlier reintroduction of the corporate income tax) as well as expenditure cuts would be necessary. In this scenario GDP would have grown much less in 2011 and by 2012 it would have been by around 0.5 per cent less than what was actually observed. This would have negative implications for the labour market with lower employment and somewhat higher unemployment rates.

Lack of both MFA operation and support from the IMF programme would have yet stronger negative implications in view of the large size of the IMF programme. Yet much deeper fiscal consolidation that would be necessitated in view of lack of alternative sources of deficit funding from early 2010 would have likely led to a much more subdued recovery in 2010 (instead of the robust growth observed in actual data). It was in this year that the support was most needed, owing to the financing gap that would have been left otherwise. In this counterfactual scenario economic growth would be weaker by around or even more than 3 percentage points in 2010.

To what extent has the MFA assistance been effective in terms of the short-term macroeconomic stabilisation of Moldova?

With the MFA disbursements staring from end-December 2010 when Moldovan economy was robustly expanding for the whole year there was hardly any direct impact of the MFA on short-term macroeconomic stabilisation after the 2009 crisis. However, MFA had an indirect effect on macroeconomic stabilisation already from 2010 as the IMF programme anticipated the MFA in designing macroeconomic (and especially fiscal) path for Moldova.

The economic outcomes in Moldova in 2010 turned out substantially better than expected by all stakeholders at the time of initial discussions on MFA and designing of the IMF programme. Strong growth continued in 2011 to slow down strongly in early 2012 and turn negative later in that year due to a combined impact of euro area recession and severe drought halving of the grain harvest. Performance of the domestic labour market has been less robust with employment still on the declining path in 2010 and weak rebound in 2011 being more than reversed in 2012. Moldovan workers have been more successful in keeping or finding jobs abroad as evidenced by a steady growth of remittances throughout 2010-2012. Forced current account adjustment in 2009 (from a deficit above 16 per cent of GDP in 2008 to below 10 per cent of GDP in 2009 persisted in 2010 and limited widening of the deficit in 2011 was reversed in 2012.

Quantitative estimates suggest MFA and IMF support was of most importance in the short-term, when the government financing gap was largest. Thereafter, Moldova benefited from general improvements in the world economy.

By 2012, without MFA, lost output would have amounted to some 0.5 per cent of Moldovan GDP. Without MFA or IMF support, the difference could have been as much as 1.5 per cent.

To what extent has the MFA contributed to returning the external financial situation of Moldova to a sustainable path over the medium to longer-term?

Strong recovery during 2010-2011 accompanied by fiscal consolidation has led to a reduction in the public and publicly-guaranteed (mostly external) debt from 31 per cent of GDP in 2009 to 28 per cent in 2011 with an outlook for further decline in the medium-term. Such low levels as well as deb structure (mostly concessional borrowing from multilateral creditors) do not suggest any higher risks to sustainability of public external debt situation. Private external debt has remained broadly stable at about 44 per cent of GDP during 2009-2011, and is projected to increase over the medium-term.

MFA has had a positive but small role in affecting the medium- and long-term external financial situation. These effects mainly stem from positive impact on economic growth during 2011-2012 that lowered debt to GDP indicators. Another relevant, yet somewhat less important channel is related to the fact that in a counterfactual situation without MFA additional fiscal austerity and cuts in public expenditure including investment expenditures might have required that some abandoned investment projects are eventually undertaken at some time after the period analysed in this evaluation (i.e. after 2012). The reason for this becoming a plausible scenario is that public investments in Moldova have been very low for the last several years while investment needs in several areas have remained substantial. These potential new spending would likely need to be – at least partly – financed by external borrowing hence adding to public external debt. MFA has not been found to have any meaningful impact on medium- and long-term outlook for private external debt.

The adjustment of the current account balance took place in early 2009, i.e. before the MFA operation. A current account deficit of above 16 per cent of GDP in 2008 contracted to below 10 per cent of GDP in 2009-2010. While MFA has had small impact on current account developments during 2010-2012, its contribution to medium- and long-term outlook has been negligible.

To what extent has the MFA assistance been effective in terms of supporting structural reform in Moldova?

MFA conditions regarding structural reforms have been well coordinated with the IMF, other donors and other EU support instruments. This have likely strengthened overall coherence of donor support to Moldovan reform efforts. At the same time it makes the task of disentangling the net impact of the MFA alone more difficult.

Moldovan authorities in several relevant ministries and institutions have been well aware of the MFA conditions and in this sense MFA the MFA has had a political reinforcing effect in all domains in which conditions have been formulated.

The impact varies between conditions. In some cases they have promoted actions that might not have been implemented otherwise, at least in a similar timeframe. This applies to the census of public sector employees, parliamentary submission of laws related to financial regulation and supervision of the non-banking sector. An action plan related to the public procurement it 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 likely undertaken by Moldovan authorities also 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).

One condition that – with the benefit of hindsight – appears potentially misplaced concerns the requirement to submit to the parliament legislative proposals on the division of supervisory powers for micro-credit and leasing institutions. Instead of genuinely promoting a dialogue between Moldovan stakeholders on the important issue, as it was hoped for at the time of designing conditionality, it has led to premature submission to the parliament of the draft law with hardly any chances of being eventually approved.

Several conditions aimed at stimulating processes, rather than achieving an outcome with 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 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 in the parliament as of June 2013.

The overall focus of conditions was adequate by mostly targeting areas relevant for macroeconomic and financial stability. The potential gains from these reforms can generally materialise only in a medium- or long-term perspective.

What have been the indirect and/ or unexpected effects of the MFA assistance?

The main identified indirect effect of the MFA was in its impact on the design of the IMF programme. Expectations of the MFA grant disbursements have allowed avoiding excessive pace of fiscal consolidation in the early stage of recovery from the 2009 recession.

More gradual fiscal consolidation path enabled by the MFA might have had another indirect impact allowing better preparations of some difficult reforms involving the element of saving of budgetary resources, such as the education sector reform. However, this finding remains somewhat hypothetical and cannot be categorically confirmed.

While interpretation of the condition to submit to the parliament legislative proposals on the division of supervisory powers for micro-credit and leasing institutions by some Moldovan stakeholders was unexpected and unintended it has not led to materialisation of any significant impacts given that the legislative process on the draft law stalled in the parliament.

The long process of designing the operation and disbursements of most funds only in 2011, i.e. long after the 2009 crisis was overcome was not intended. However, given the much stronger than originally anticipated recovery of the Moldovan economy in 2010 and associated fiscal developments the MFA disbursements unexpectedly proved very timely, coming exactly when budget support component of the IMF programme was coming to an end and when a sizeable fiscal financing gap opened.

How has the way in which the MFA operation was designed and implemented conditioned its effectiveness and efficiency?

The assistance was provided in the form of a grant on the basis that Moldova was the poorest European country and considering its limited debt repayment capacity. This choice appears 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 government's commitments to deliver on agreed structural reform conditions.

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

To what extent has EU added value been maximised?

The provision of the support in grant form was an important element distinguishing MFA from other support available to Moldova in the post-crisis environment. This has also had implications for the IMF programme enabling designing 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 strengthening the leverage of EU structural reform conditions.

From the EU perspective, key benefits are related to the MFA role in supporting economic and political stability in the direct EU neighbourhood, with related, although impossible to quantify economic, social and political benefits. The timing of the operation and coincidence with the period when pro-European governments were in office might have played a certain (albeit limited) role in supporting a pro-European geopolitical orientation of Moldova.

7.2 Recommendations

The long acceptance process of MFA operations has been a recurring weakness identified in several previous evaluations. This point remains valid. If the instrument is to retain any meaningful anti-crisis character and be able to address extraordinary balance of payment or fiscal difficulties, it would need to be designed in a much faster manner. This would require changes in the legal framework of the MFA with more powers granted to the European Commission.

Alternatively, the focus of the instrument could be explicitly shifted towards providing post-crisis recovery support and promoting structural reforms. In this scenario, it would be beneficial if the Commission received more leeway in adapting conditions during the operation should such a need arise. This would significantly increase the instrument's flexibility and could in some circumstances improve efficiency of its reform-promoting role.

While the two recommendations above address issues that might require decisions at the level of the Council and the Parliament there are also issues that could be addressed more easily. Spelling the objectives and expected outcomes of MFA and in particular of the structural reform conditions attached to the disbursements could make it easier to asses MFA impact, but also potentially to better communicate the operation to the wider public. For this to be possible, reforms on which disbursements of MFA tranches are conditioned would need to be linked to objectives that are expressed in a way that is understandable to the general public and that lends itself to some form of verification. This verification could also be qualitatively and carried over a longer term horizon. Formulating objectives in such a way may not always be easy, but the effort appears worthwhile trying. One benefit this could achieve is in avoidance of possible misinterpretation of underlying objectives of certain conditions, as was apparently the case (at least for some stakeholders) with the condition pertaining to supervision of micro-credit and leasing institutions.

It is also recommended to better communicate both targeted stakeholder groups and general public in Moldova about the MFA as an element of the broader EU assistance.

The character of the instrument (being linked to macroeconomic developments and addressing macroeconomic policies) makes it relatively difficult to communicate to the broader public. For instance it is clearly much more difficult than any assistance for building infrastructure, e.g. roads. At the same time MFA can be a potentially important element complementing other channels and instruments of EU support to third countries. This suggests that it would be beneficial if information activities on EU support as a whole are very well coordinated and possibly channelled through a single source, e.g. EU Delegation in a country receiving assistance. The communication strategy could avoid attempts to publicise various instruments of EU support independently, and instead present them as elements of the broad EU assistance.

Annex 1 Methodological Framework for the Evaluation

Evaluation Question	Quantitative Analysis	Qualitative Analysis	Sources of Information
1. How would the economy of Moldova have evolved in the absence of the MFA assistance?	▪ Analysis of macroeconomic trends - examination of key macroeconomic indicators such as GDP, public finances, balance of payments, monetary indicators, employment, inflation etc. before the introduction of MFA (and IMF) to determine their likely trajectory in absence of MFA/ IMF support ▪ Analysis of data on government spending, borrowing etc. to determine likely counterfactual scenarios e.g. the scope for Moldovan government to reduce its expenditure or increase revenue (and thus run a lower fiscal deficit) or borrow from the market to meet its financing needs ▪ Specification and modelling of counterfactual scenarios – see section 5 and annex 1	▪ Development of potential counterfactual scenarios and their likelihood of occurrence - stakeholders and local economist's assessment of what would have happened in absence of the MFA (and IMF) support. The options at the disposal of Moldovan authorities to fill the financing gap if MFA (and IMF) resources had not been provided?	Document and data review: - Macroeconomic data sourced from IMF, World Bank and national sources - MFA documentation - IMF/ WB documentation Semi-structured interviews: - EC officials: DG ECFIN - IMF/ WB officials - Key bilateral/ multilateral donors - Moldovan authorities - EU Delegation Inputs from the local economist
2. To what extent has the MFA assistance	▪ Analysis of actual macroeconomic imbalances	▪ Stakeholders and local economist's views on the	Document and data review: - Macroeconomic data

Evaluation Question	Quantitative Analysis	Qualitative Analysis	Sources of Information
been effective in terms of the short-term macroeconomic stabilisation of Moldova?	experienced by Moldova and their financing sources ▪ A description of what actually happened as a result of MFA and IMF support as observed in key macroeconomic data such as GDP, public debt, public spending, revenues, external balances, employment etc. ▪ Modelling of the net impact of MFA i.e. the difference between what actually happened and the counterfactual scenario(s)	specific contribution of MFA to short-term macroeconomic stabilisation of Moldova	sourced from IMF, World Bank and national sources - MFA documentation - IMF/ WB documentation - Academic and grey literature Semi-structured interviews: - EC officials: DG ECFIN - IMF/ WB officials - Key bilateral/ multilateral donors - Moldovan authorities - EU Delegation Inputs from local economist
3. To what extent has the MFA assistance been effective in terms of supporting structural reform in Moldova?	According to the ToR, MFA conditionality *'The MFA helped trigger reforms in the areas of budget preparation and execution, optimisation of public finances and public debt management, financial stability and financial sector reform, public procurement and central bank legislation'.* More detail is needed on the specific reforms promoted by MFA to check if these can also be modelled. This will be discussed with the Steering Group at the Kick-off Meeting.	To answer this question, the study team will examine the following issues: **Relevance of MFA conditionality** ▪ Whether the focus of MFA conditionality on PFM reforms was relevant and appropriate in Moldova's context and also bearing in mind the characteristics of the MFA instrument (such as its quick disbursing nature, scale of assistance)?	Documentary analysis: - Memorandum of Understanding (MoU), signed on 5 July 2010, detailing a set of economic policy conditions for the disbursement of MFA - Grant Agreement between the EU and Moldova - Republic of Moldova PEFA Assessment and PFM Performance Reports

Evaluation Question	Quantitative Analysis	Qualitative Analysis	Sources of Information
		▪ Whether there was a clear rationale for focussing MFA conditionality on budget preparation and execution, optimisation of public finances and public debt management, financial stability and financial sector reform, public procurement and central bank legislation? **Fulfilment and durability of reforms** ▪ To what extent were the MFA conditions fulfilled? i.e. what specific action was taken by the Moldovan authorities in response to the MFA conditions? ▪ What has been done since the end of the MFA operation - have the Moldovan authorities made further progress in any of these areas? Have any of the MFA promoted reforms been reversed? **Additionality (the specific role of MFA in promoting the reforms)** ▪ Did the MFA operation reinforce the Moldovan	- Operational Assessment of Moldova's PFM system - Report and supporting documentation submitted by the Moldovan authorities to the European Commission on the fulfilment of the structural reform criteria related to the first tranche - Commission's assessment of compliance with conditionality requirements - IMF Reviews - EC and donor group other PFM reports and performance indicators/metrics Semi-structured interviews: - EC officials: DG ECFIN, DG DEVCO - IMF/ WB officials - Other bilateral/ multilateral donors supporting PFM reforms in Moldova - Moldovan authorities

Evaluation Question	Quantitative Analysis	Qualitative Analysis	Sources of Information
		authorities' general commitment to reform in the areas of PFM, financial and central bank legislation? ▪ Whether MFA was the main driver behind the reforms? ▪ Whether the MFA supported and accelerated domestic reform efforts and the efforts of other donors for example, by providing a useful second voice and a clear timetable for implementation ▪ Is there any evidence to suggest that the MFA accelerated the timing and / or influenced the sequencing of reforms? ▪ How far can the MFA conditions be said to have influenced their fulfilment? Would these reforms have taken place anyway? And at the same speed? **Complementarity with conditions attached to EU budget support** ▪ The extent of cross-conditionality with budget	- EU Delegation Focus groups

Evaluation Question	Quantitative Analysis	Qualitative Analysis	Sources of Information
		support ▪ Whether the cross-conditionality between MFA and budget support gave the EU greater leverage in promoting reforms in specific areas **Impact** ▪ What difference did the MFA conditionality make? For example, the extent to which PFM reform contributed to a more rigorous and efficient medium-term planning process thereby, improving the quality of public finances; impact of financial sector reform in promoting financial stability etc.	
4. What have been the indirect and/ or unexpected effects of the MFA assistance?	▪ Trends analysis: analysis of key macroeconomic indicators to identify unusual patterns (indicating unexpected or indirect effects)	▪ Elaboration of ex ante intervention logic to identify potential indirect effects ▪ Ex post verification of intervention logic ▪ Identification of unusual patterns/ unintended outcomes	Document and data review: - Macroeconomic data sourced from IMF, World Bank and national sources - MFA documentation - IMF reviews and country reports - Academic and grey literature

Evaluation Question	Quantitative Analysis	Qualitative Analysis	Sources of Information
		▪ Anecdotal or concrete evidence provided by stakeholders on indirect/ unexpected effects of MFA assistance	Semi-structured interviews: - EC officials: DG ECFIN, DG DEVCO - IMF/ WB officials - Key bilateral/ multilateral donors - Moldovan authorities - EU Delegation Focus groups Inputs from local economist
5. To what extent has the MFA contributed to returning the external financial situation of Moldova to a sustainable path over the medium to longer-term?	▪ Analysis of trends in key external indicators: before and after MFA ▪ Evolution of external indicators with and without MFA - macroeconomic modelling (see section 5)	▪ Stakeholders and local economist' assessment of the country's current external financial situation ▪ Stakeholders and local economist' assessment of the contribution of MFA	Document and data review: - Macroeconomic data sourced from IMF, World Bank and national sources - MFA documentation - IMF reviews and country reports - Academic and grey literature Semi-structured interviews: - EC officials: DG ECFIN - IMF/ WB officials - Key bilateral/ multilateral donors - Moldovan authorities - EU Delegation Inputs from local economist
6. How has the way in which the MFA	▪ The extent to which the MFA addressed the financing gap	<u>Design considerations:</u> ▪ Size and form of assistance -	Document and data review: - Macroeconomic data

Evaluation Question	Quantitative Analysis	Qualitative Analysis	Sources of Information
operation was designed and implemented conditioned its effectiveness and efficiency?	facing Moldova	whether the scale and form (i.e. loans) of the MFA operation was appropriate in relation to Moldova's financing needs and in the context of EU-Moldova relationship ▪ Degree of consensus among key stakeholders/ informants regarding the relevance and importance of the MFA (in absolute and relative terms) ▪ Choice of conditionality – answered as part of Q.3 <u>Implementation issues:</u> ▪ Whether MFA disbursements were timely ▪ Whether there was effective dialogue between the European Commission and Moldovan authorities ▪ Whether there was effective monitoring of the MFA operation ▪ Look for good practice / lesson learned from the design and implementation of MFA operation in Moldova	sourced from IMF, World Bank and national sources - MFA documentation Semi-structured interviews: - EC officials: DG ECFIN, DG DEVCO - EEAS - IMF/ WB officials - Moldovan authorities - EU Delegation

Evaluation Question	Quantitative Analysis	Qualitative Analysis	Sources of Information
7. To what extent has EU added value been maximised?	▪ The role of MFA/ IMF support in averting a crisis in Moldova ▪ Supplementary analysis will be carried out, to identify, in broad terms, the economic added value of MFA/IMF support –the extent to which Moldova's economy would have been worse off in the absence of MFA/IMF leading to a reduced demand for the EU's exports to Moldova (See annex 1)	▪ Stakeholders' perceptions of confidence boosting effect of EU support e.g. stock market indicators, government borrowing rates, changes in FDI and exchange rates ▪ Qualitative assessment of links between wider fluctuations in confidence indicators and EU assistance ▪ Political and economic relations between the EU and Moldova subsequent to the MFA ▪ Stakeholders perceptions of impact of EU support on bilateral political and economic relations between Moldova and the EU ▪ Whether MFA/ IMF support by averting and economic crisis in Moldova, contributed to regional stability	Document and data review: - Macroeconomic data sourced from IMF, World Bank and national sources - MFA documentation - IMF reviews and country reports - Academic and grey literature Semi-structured interviews: - EC officials: DG ECFIN, DG DEVCO - EEAS - IMF/ WB officials - Key bilateral/ multilateral donors - Moldovan authorities - EU Delegation Focus groups Inputs from local economist

Annex 2 Overview of Moldova's Economic Stabilisation and Recovery Programme

Stabilisation and streamlining of public finance		
Objective 1: Identify potential sources for building up the public revenues and decreasing the budget deficit	Immediate actions (2009): ▪ Negotiate with the International Monetary Fund a new economic and financial policy program; ▪ Start-up negotiations with the European Commission, the World Bank and with other external development partners of the country to receive the budget support; ▪ Improve the customs and tax administration systems; ▪ Restart the privatization of state assets in liberalized areas based on open, publicized and transparent tendering; ▪ And others	Medium-term actions (2010-2011): ▪ Define "reinvested income" to improve the tool to enforce the tax facilities granted to legal entities when paying income taxes. ▪ Set clear-cut principles for the re-channelling of state budget revenues to the budgets of administrative-territorial units; ▪ Speed up the implementation of a new real estate taxing system.
Economic recovery		
Objective 1: Reduce the administrative and fiscal burden on doing business	Immediate actions (2009): ▪ Reforms aiming at ease of administrative burden i.e. implement a one-stop shop system at the State Registration Chamber with cross-access of the National Bureau of Statistics, the National Social Insurance House, the National Healthcare Insurance Company; ▪ Reduce the number of types of business subject to licensure; ▪ Improvement and simplification in issuance of various certificates; ▪ Ease of tax burden i.e. Cut down the dues for	Medium term actions (2010-2011): ▪ Ease of administrative burden including analysis of chargeable public services provided by public institutions and reforming them, simplifying the procedure of business close-up, simplifying the certification system for imported goods, liberalise and privatise the railroads ▪ And others

	customs clearance or repay the debts owed to VAT repayments ▪ And others	
Objective 2: Facilitate the access of businesses to financial means for launching, developing or recovering businesses	Immediate actions (2009): ▪ The National Bank of Moldova to conduct an assessment of the banking system to identify problematic banks that need support; ▪ Intensify the process of granting loans under Component II of the National Program for the Economic Empowerment of Youth (NPEEY); ▪ Intensify the efforts of implementing foreign assistance projects.	Medium term actions (2010-2011): ▪ The National Bank of Moldova will ensure an adequate level of national currency issuance and population-to-banking-unit rate; ▪ Cover in part the interest rate on loans granted to economic agents, subject to the priorities of the national economy; ▪ Provide for an increase in the annual allocations to the special Fund for Securing Loans (FSL) from MDL 1.5 million up to MDL 100 million and remove administrative hurdles in guaranteeing credits; ▪ And others
Objective 3: Stimulate public and private investments	Immediate actions (2009): ▪ Draw strategic investments to the country's economy by securing direct negotiations between the government and strategic foreign investors; ▪ Call on the meeting of the Advisory Board of donors in order to raise the financing of projects contributing to economic boost; ▪ Ensure the efficient operability of the Public-Private Partnership Unit.	Medium term actions (2010-2011): ▪ Action in the area of corruption tackling and justice i.e. Draft and endorse an effective program to prevent and control corruption within public bodies and court, random distribution of cases to courts of law, making the retribution of judges harsher when the law is violated; ▪ Actions aiming at improvement in investment climate i.e. review the normative and legal framework in view of

		removing the excessive administrative hurdles, review the work of companies – natural monopolists; development of the concept of industrial parks; ▪ Actions aiming at attracting new infrastructure investment i.e. remove existing barriers for project financing (procurement rules); ▪ As well as actions in the area of privatisation of public assets; ▪ And others
Ensuring an efficient and fair social protection		
Objective 1: Support vulnerable groups through more efficient channelling of social assistance and prevention of social exclusion.	Immediate actions (2009): ▪ Remove the possibility for multiple reappraisals of pensions and reappraisal of pensions based upon monthly payment increases; ▪ Carry out a strict control over how the setting of the commercial add-on is observed by the economic operators when selling goods of social importance; ▪ Provide for a minimum guaranteed monthly income for disadvantaged families; ▪ Increase the tax waive and tax-break for dependents; ▪ As well as multiple social and health care arrangements (i.e. increases in monthly allowance for certain groups, extended health diagnosis coverage of disease prone groups).	No mid-term actions.

Objective 2: Provide for employment for the unemployed and for returning migrants.	Immediate actions (2009): ▪ Scale up the means of informing the population about labor market demand and supply; ▪ Scale up re-training courses for the unemployed and for returning emigrants; ▪ Involving unemployed into short-term public works.	Medium-term actions (2010-2011) ▪ Expand the base of unemployment allowance beneficiaries to include agricultural workers and migrants; ▪ Change the way the unemployment payment is provided by motivating the unemployed to search for a job; ▪ Increase the number of people enrolled to professional training courses; ▪ And others

Annex 3 Detailed Description of the Approach to Macroeconomic Modelling

A3.1 Introduction

This annex sets out the key features of the model applied to inform the evaluation. The purpose of the model is to provide a framework with which to quantify the effects of EU and IMF support to Moldova across a variety of different (but interlinked) indicators. The analysis complements the other aspects of the evaluation.

- This annex is divided into the following sections:
- The motivation for a model-based approach;
- An overview of the model developed specifically for this evaluation, in terms of its key components and indicators;
- The approach taken in the counterfactual analysis (a 'baseline-scenario' approach);
- A description of the input data to the model and the nature of the model's parameterisation; and
- Further details on the specification of each component of the model.

A3.2 Motivation

An evaluation of the impact of EU and IMF support to Moldova, whether explicitly or implicitly, requires a comparison between two states of world:

1. The one in which Moldova received Macro-Financial Assistance (MFA) and IMF support: the 'outturn'. This actually occurred and this state is thus observable in the published statistics and by interviewed stakeholders.
2. A 'counterfactual' in which Moldova did not receive the above support. This state cannot be observed directly because it never actually took place.

The difference between the above two states of the world gives an indication of the (net) impact of international support in the crisis.

However, as already mentioned, because the second state, the counterfactual, is never actually observed directly, it must be *constructed*, for the purposes of comparison.

Certain elements of the counterfactual are straightforward to specify. It is obvious that if one were to consider a counterfactual without EU MFA then, in that state of the world, Moldova would not have been in receipt of the EUR 90m of assistance (provided in grant form). The difficulty is then in establishing supporting information, which can be divided into two types:

1. The likely policy response (and constraints) in the absence of that support.
2. Indirect effects and feedbacks.

In the case of the former, a key consideration is whether the Moldovan government would (or, indeed, could) have secured financing from elsewhere or if, instead, it would have needed to cut its spending. These elements of the counterfactual required consultation with stakeholders and local experts in order to identify plausible responses in the absence of MFA.

However, even then, the counterfactual is potentially incomplete because of the possibility of indirect effects or feedback: wider effects that extend beyond the initial counterfactual specification.

As an example, consider a counterfactual where Moldova did not receive MFA and to which the most likely policy response was a cut in government spending (thereby reducing the requirement for deficit financing). Lower government spending would lead to lower production requirements in the economy and, in turn, lower incomes paid to workers. Lower household income, in turn, tends to lead to lower household spending which leads to further reductions in domestic production. This is an example of a 'multiplier' effect where the initial reduction in government spending generates a fall in economic activity that exceeds the initial spending cut.

Another effect of the spending cut in this example may arise from lower production requirements leading to higher unemployment. Higher unemployment will require additional government transfers (social security), forcing higher government spending elsewhere in its budget. Consequently, government expenses in the counterfactual will not necessarily equal outturn expenditure minus the value of the spending cut.

On the government receipts side, lower economic activity leads to fewer taxable economic activities and transactions: tax revenues will not necessarily match those in the outturn case.

As a result of the above, it is possible that the deficit in this example counterfactual will not equal the initial cut in financial support. Should the counterfactual be specified such that the government could not have raised additional deficit financing from elsewhere, further spending cuts may be necessary to satisfy the constraints of the public budget.

This example serves to illustrate how complex a counterfactual may be, even given a constraint as (apparently) simple as a reduction in deficit financing possibly with a maximum government deficit.

In order to trace through the impacts in a counterfactual scenario, it is necessary to have in mind some kind of 'model' that embeds the relationships between different aspects of the economy. The purpose of the modelling exercise here is to establish an explicit, rather than implicit, representation of the key features of the Moldovan economy and to provide a consistent framework to analyse counterfactuals.

In the model developed for the evaluation, changes in exogenous input assumptions, such as the disbursement or otherwise of MFA and IMF funds, and the likely government response, generate concomitant changes in the endogenous variables in the system. It is thus possible to simulate alternative states of the world through changes in these assumptions and to analyse the wider effects in an internally-consistent manner[84].

The advantages of a formal model lie in its explicitly-specified framework, logic and assumptions, allowing for scrutiny and interrogation of its results. A key limitation is that what is incorporated into the model must be *possible* to model or, at the very least, possible to model in a satisfactory manner with respect to the questions of interest. More abstract (or less quantifiable) concepts are not readily interpretable or represented in such a framework. To some extent, the same holds with regard to the inherent uncertainty in crisis conditions. In modelling terms, some of this can be addressed with sensitivity analysis, to gauge the robustness of the outcomes to alternative assumptions and/or parameters (e.g. the nature of the import-demand response). In other cases, more qualitative analysis is required.

[84] It is not always so straightforward to identify inconsistencies in a model that has not been formalised in this way.

A3.3 Model Overview

As mentioned in the previous section, the aim of the model is capture, in a consistent manner, key elements and relationships in the Moldovan economy.

The main indicators of interest, which correspond broadly to the main components of the model (as set out in **Error! Reference source not found.**) are:

- The performance of the 'real' economy, as defined by production and transactions in goods and services (GDP, prices etc)
  - For example, changes in government spending on goods and services should have an effect on GDP and, as a consequence, affect household incomes and spending.
- Government finances (revenues, expenditures and, as a consequence, deficit financing and debt)
  - Drawing on the example from the previous bullet, changes in government spending should, other things being equal, alter the deficit-financing requirements of the Moldovan government (or meeting deficit constraints).
- The Balance of Payments (current and capital accounts, as well as changes in holdings of foreign exchange reserves
  - The absence of the MFA grant should be reflected in a corresponding deterioration in the current account (before accounting for wider effects).
- The labour market (employment/unemployment).

Table A3.1 Components of the Model

Component	Description	Dataset
Real Economy	Indicators of macroeconomic performance	National Accounts
Government Finances	Indicators of the Moldovan government's fiscal position e.g. surplus/deficit and debt	Government Finance Statistics
Balance of Payments	Indicators of Moldova's external sustainability e.g. foreign exchange reserves	Balance of Payments statistics
Labour Market	Indicator of socio-economic performance	Labour Market statistics

In previous evaluations that have applied models of this type, a further component, the monetary/financial system, was also included. The principal reason for its inclusion in past evaluations was to incorporate a (monetary) mechanism to explain inflation[85]. In this evaluation, owing to the open nature of the Moldovan economy, particularly its high dependence on imports, inflation is instead related to the exchange rate. While monetary statistics are accounted for in the model, the outcomes from this component do no feed directly into any other component of the model. Consequently, this model description does not dwell on the specification of the monetary system.

[85] Given the limited availability of data for the countries in receipt of MFA, such a treatment is more pragmatic than the preferred, albeit more data-intensive, alternative, which is to build up a measure of production costs (materials, labour, taxes etc) and to then apply a mark-up to yield the final price i.e. cost-plus pricing.

Crucially, the other indicators and components of the model are not independent. For example:

- Government tax receipts are linked to transactions and other activities in the real economy;
- Some government expenses are autonomous with, for example, higher unemployment leading to higher expenditure on social security; and
- Changes in exports and imports (as they appear in the national accounts) are reflected in the current account of the Balance of Payments, also leading to corresponding changes in foreign exchange reserves, to balance the account.

While the first two are policy-rated and thus country specific (tax rates and social security, respectively), the last is a requirement in order to preserve accounting consistency. While not a new idea, accounting consistency is one of the key features of the model developed for this evaluation.

The model draws on the 'flow of funds' tradition in economics, in the sense that it aims to capture the idea of transactions (flows) that take place between pairs of actors: one sector's outflow must show up as an inflow to another in current prices and the same currency86. Such a principle underpins the IMF's 'financial programming' approach87 as well as previous model-based analyses of MFA for the European Commission. It is by this framework that the model combines multiple datasets into a consistent whole (as in the above example of national-accounts trade affecting the balance of payments, including reserve assets).

Moreover, the model aims to incorporate, where the data permit, elements of the more recent 'Stock-Flow Consistent' modelling approach, whereby differences between a sector's total inflows and total outflows imply changes in that sector's balance sheet (a change in stocks). An example of this is provided by government finance statistics. If government expenses (e.g. on goods and services, or social security) exceed total receipts (e.g. from taxes), the gap (a deficit) between the two must be met by other sources of finance (such as bonds). This leads to an increase in government debt (the stock).

The system by which the components of the model are linked can be represented as a table or 'transactions matrix', loosely following the exposition in Godley and Lavoie (2007)88, which has parallels with the Social Accounting Matrices sometimes used to represent a country's national accounts. The transactions matrix so depicted in 0 lists the institutional sectors of the economy (households, firms, government etc.) in the columns and the types of flow (investment, exports, imports etc.) in the rows.

Set out in this form, the transactions matrix becomes useful to identify the source of outflows and the destination of inflows. The accounting requirement is that the rows should sum to zero, indicating that each outflow is recorded somewhere else as an inflow. Outflows appear in the matrix as negative values, indicating a use of (a decrease in) funds while inflows are positive, representing a receipt (an increase) of funds. The first row of the matrix shows how Private Consumption involves an outflow of funds from

[86] A key element of the model, in order to capture the effect of exchange-rate effects, is to ensure that input variables specified in foreign currency are converted using the correct exchange-rate assumptions in the counterfactuals. Moreover, in the case of stocks actually denominated in foreign currency (but modelled in Moldovan lei), it is important that changes in stocks represent both changes in the holdings of foreign currency and revaluation from changes in the exchange rate.

[87] See, for example, IMF (1987), 'Theoretical Aspects of the Design of Fund-Supported Adjustment Programs', _Occasional Paper_ **55**.

[88] Godley, W. A. H & Lavoie, M. (2007), _Monetary Economics: An Integrated Approach to Credit, Money, Income, Production and Wealth_, Palgrave MacMillan.

Households (-C) and to Firms, in return for goods and services (+C). A slightly more complex example can be seen in the case of Income/Output, where Household income is the sum of:

- Domestic sources of income: wages and distributed profits from firms; and
- Foreign sources of income: remittances.

In this example, disposable household income is the sum of the above, and net of taxes and transfers (e.g. social security).

The bottom three rows of the table (the 'Changes in …' items) represent the allocation of sectoral surpluses and deficits. Of these, the changes in debt (fiscal sustainability) and foreign exchange reserves (external sustainability) are tracked in the model but private wealth is not, owing to a lack of data.

Note that accounting consistency must hold regardless of the behavioural relationships embedded in the model. The implication is that of 'quadruple entry accounting' where a change in a particular element of the matrix should lead to changes in at least three other items: one in the same column (a shift in uses/receipts for that sector); and one in each of the two rows (the shift in uses/receipts of the transacting sectors).

A transactions matrix of this type provides a convenient framework in which to link disparate datasets together and identify accounting discrepancies. Once populated with data, in some cases it becomes possible to infer the value of some (unobserved) elements using the matrix. This becomes useful when filling out the database to 2012, as complete annual data are not always available.

The matrix also provides a way to set out the transmission channels between sectors of the model. Moreover, the matrix imposes constraints on the specification of the model because it implies that a choice must be made as to which variables are determined behaviourally and which must arise as a matter of accounting consistency.

- In summary, the model has the following features, which make it well-equipped for this evaluation:
- It combines the real and financial economies together such that developments in one have implications for the other i.e. feedback; this is a growing area of interest in economics and relatively few models do this;
- It combines a range of disparate datasets in as consistent a manner as possible, to ensure, for example, consistency between external financial assistance and government receipts of these finances;
- It is relatively light in terms of its data requirements, reflecting the limited availability of data for Moldova; and
- It generates a set of consistent indicators to assess economic-financial stability.

Table A3.2 An Example Transactions Matrix

	Households	Firms	Financial system	Government	Foreign (Rest of World)	Total
Private Consumption	-C	+C				0
Government Spending		+G		-G		0
Exports		+X			-X	0
Imports		-M			+M	0
Income/Output	+Y	$-Y_d$			$-Y_f$	0
Net Taxes/Subsidies /Transfers	$-T_h$	$-T_f$		+T		0
Grants/Loans (including MFA)				+MFA	-MFA	0
Changes in Debt			$+/- D_d$	+/- D	$+/- D_f$	0
Changes in Foreign Exchange Reserves			+/- R		+/- R	0
Changes in Wealth/Deposits	+/- W		+/- W			0
Total	0	0	0	0	0	

Note: h and f subscripts on Net Taxes/Subsidies/Transfers denote Households and Firms, respectively.

d and f subscripts on Income/Output and Changes in Debt denote Domestic and Foreign, respectively.

A3.4 Evaluation Approach

The model-based evaluation follows a baseline-scenario approach in which the counterfactuals (scenarios in which Moldova does not receive EU and/or IMF support) are compared against the baseline case (the outturn). The difference between the two yields the estimated impact of EU MFA and IMF financing in the crisis for the historical period covered by the model.

Where appropriate, sensitivity analysis is also conducted, to assess the robustness of the core findings.

The model also generates indicators that can be interpreted as gauges of fiscal and external sustainability such as deficit-to-GDP and debt-to-GDP ratios. While it is not possible for the model to simulate the transition into a crisis, it is able to track the evolution of such indicators under alternative input assumptions. One may not be able to say at what point higher debt would lead to a crisis situation89 but it is reasonable to

[89] This is because the tipping point is not fixed at some particular threshold but depends instead on a range of varying and interdependent factors such as investor confidence and the wider political situation.

think that higher debt-to-GDP ratios would tend to indicate greater vulnerability to a crisis than lower ratios.

The model-based evaluation thus generates metrics that enable one to comment qualitatively on the contribution of international aid to:

Support macroeconomic stability: economic growth and prices;

Promote fiscal sustainability: deficit and debt-to-GDP ratios; and

Provide external sustainability: slower depletion of foreign exchange reserves.

A3.5 Input Data and Model Parameterisation

This section covers the input data to the model and also discusses the parameterisation of the model. Combined with alternative input assumptions, the model then generates results for each of the counterfactuals.

A3.5.1 Input Data

The data for the model are relatively limited in both detail and timespan. Consequently, the model is annual in frequency, to make best use of the available data:

- National Accounts: National Bureau of Statistics of the Republic of Moldova[90];
- Government Finance Statistics: Ministry of Finance of the Republic of Moldova[91];
- Balance of Payments: National Bank of Moldova[92];
- Monetary Statistics: National Bank of Moldova[93];
- Labour Market: National Bureau of Statistics of the Republic of Moldova[94].

The above indicate a preference for national-level data, on the grounds that these data are consistent with international sources (such as the IMF and World Bank) and relatively more detailed (in general, international organisations only require or publish a subset of the available detail).

The model is 'aggregate' in the sense that it does not sub-divide the institutional sectors from 0 any further. There is, for example, no distinction between manufacturing and services within Firms. While there indeed some data broken down in such a way, there are insufficient data across all the required datasets for it to be feasible to represent this level of detail in the model.

For *ex post* counterfactual analysis, the model must run to 2012. The last year of complete historical data across all the variables is 2010, with series in later years filled with estimates where necessary. Data filling applies particularly to the Government Finance Statistics, as the other datasets are comparatively more timely:

- National Accounts: final expenditure and GVA available 2012; breakdown of income in 2012 constructed using 2011 shares[95];
- Balance of Payments: complete to 2012;
- Monetary Statistics: complete to 2012; and

[90] http://www.statistica.md/index.php?l=en
[91] http://www.mf.gov.md/en/
[92] http://www.bnm.md/en/home
[93] http://www.bnm.md/en/home
[94] http://www.statistica.md/index.php?l=en
[95] Some elements of the national accounts are available earlier than others. This is typically followed by a balancing exercise to reconcile the data to conform to official national accounting conventions. Given the baseline-scenario approach followed in this evaluation, the estimation method to complete the baseline to 2012 is unlikely to have much of a bearing on the final results, particularly as the key indicators are already known.

- Labour Market: complete to 2012.

In the case of the Government Finance Statistics, the change in debt is known, as are certain aggregates, but some of the underlying detail is not. In the first instance, these elements have been estimated using the ratios (implicit tax rates/expenditure ratios) from the last year of data and adjusted for cases where the tax rate was known to have changed (e.g. the increase in the Corporate Income Tax to 12% in 2012). Where items of the account are assumed exogenous, they are adjusted so as to ensure that the implied deficit matches the published data.

A3.5.2 Parameterisation: Closure Rules

In addition to the accounting framework outlined above, the model requires at least some elements of the system to be endogenously determined to generate behavioural effects, such as the response of private consumption to changes in income.

The strict accounting requirements of the transactions matrix each period (the requirement for all rows and columns to sum to zero once accounting for changes in stocks) means that a decision must be made as to which elements should/can be solved behaviourally and which ones must instead arise by accounting necessity[96]. Such a decision relates to the 'closure rules' of the model.

In some cases, the choice is obvious: for example, final demand should be set by the sectors that consume (demand) the output and Firms' production should follow to meet that demand. Household consumption should be set by an equation (as set out later on in this annex), and firms' production should match it. The same holds for the other components of final expenditure although, in the case of government, that expenditure is in turn governed by a binding constraint on the deficit. The implication of such a decision is that the real-economy part of the model is demand-driven.

In other cases the choice requires some judgement, possibly based on the relative flexibility/availability of the economic/financial assets (which variables/sectors typically use as 'buffers' to accommodate unexpected changes) and the sectors that purchase/supply them. One example of this is the change in foreign exchange reserves in the Balance of Payments which automatically adjusts in order to balance the accounts.

A3.5.3 Parameterisation: Behavioural Relationships

The accounting in the model consists of identity relationships that are clearly defined and fixed; only the decision regarding the closure rules is potentially ambiguous. The accounting rules thus relate the elements of the transaction matrix to each other and the key decision is which variables are set by accounting identity.

In contrast, behavioural relationships in the model determine how the elements of the transactions matrix are set. Ideally, these relationships would be derived from econometric analysis of the data, lending an empirical foundation to the model's behaviour. However, short time series[97] and the likely presence of outliers and structural

[96] For *n* elements in a particular row of the transactions matrix, the *n*th element is implied by the other *n-1* elements so as to ensure that the sum of inflows and outflows equals zero.
[97] Barely ten years for national accounts data and even fewer for suitably-detailed government finance statistics; the balance of payments statistics are reasonably complete from the mid-1990s onwards.

breaks prevent the rigorous use of these more formal methods[98]. A range of alternatives to econometric estimation are discussed in Swann (2006)[99].

Where behavioural relationships are required, their parameters have been set by assumption, where possible drawing on existing empirical literature. There are few empirical studies that relate specifically to Moldova and the parameters used, in some sense, reflect 'average' or 'representative' values.

Elsewhere, where there is evidence of stability through time, simple ratios are taken between variables.

A3.5.4 Parameterisation: Calibration to Outturn

No behavioural equation can perfectly replicate the historical data; there is always some discrepancy e.g. the errors from an econometric equation or other discrepancies from imposing simple ratios through time. Collectively, these 'residuals' explain the deviation of the raw baseline model results from those observed in the outturn data. By the accounting requirements of the model, these residuals then propagate through the system. While accounting consistent, the model cannot be guaranteed to replicate the outturn, once behavioural relationships have been incorporated.

In order to generate a baseline run that matches the outturn, the approach taken is to 'calibrate' the model by calculating the residuals from the baseline run and adding them back in during solution. In this way, the baseline run used for the analysis (the model results plus the residuals) replicate the outturn data. The residuals are similarly applied to the counterfactual runs in order to be able to compare the counterfactual outcomes consistently against the actually-observed state of the world.

A3.6 Specification of Model Components

This section details the structure of each of the five key components of the model.

A3.6.1 The Real Economy

The real economy represents the production of goods and services in an economy.

The national accounts is the principal statistical framework that tracks the evolution of the real economy. It is this framework that defines the concepts that lead to the calculation of a country's GDP, expressed equivalently by:

- The production approach: the sum of Gross Value Added of all relevant producers plus taxes less subsidies on products;
- The expenditure approach: the sum of final uses of goods and services, less imports; and
- The income approach: the sum of primary incomes distributed by producers in the economy.

The specification of the real economy in the model is demand driven. The underlying assumption is that supply adjusts to meet demand and that the most important accounting identity in the real economy block of the model is the one that describes GDP in final-expenditure terms:

[98] Calibration, which involves fitting parameters to the available data by hand, is also unlikely to be possible in many cases.
[99] Swann (2006) 'Putting Econometrics in its Place: A new direction in applied economics', Edward Elgar, Cheltenham

$$GDP = C + I + G + X - M$$

where:

C is private final consumption expenditure

I is Gross Capital Formation (investment expenditure, including inventories)

G is government expenditure

X is exports

M is imports

The main behavioural relationships that drive the model (particularly in terms of the multiplier response) centre on the response of:

- Private Final Consumption;
- Gross Fixed Capital Formation (the largest component of Gross Capital Formation);
- Government Expenditure;
- Exports; and
- Imports.

By identity, GDP can be equivalently broken down into sources of income, of which some accrues to households. This forms a loop from expenditure (demand) to production (supply) to income which then feeds back to drive expenditure. The nature of income generation in Moldova is such that it is important to account for income by source (particularly the domestic/foreign split). The final key element in the real economy is the price level. In both cases, more detail can be found further down.

In the modelling, the elasticities used are applied as deviations from the original baseline such that counterfactual real household disposable income that is 10% below the baseline value in a given year would lead to real household consumption that is also lower, by 10% multiplied by the corresponding elasticity. In this setting, the preference is for short-run, rather than long-run, elasticities.

A3.6.1.1 Private Final Consumption

Household Final Consumption Expenditure is the largest component of final expenditure in Moldova, accounting for more than 90%. While the transactions matrix is specified in current prices, the equation that determines household expenditure is expressed in real terms (volumes/constant prices) as a function of household disposable income and the price level.

The timespan of the compiled model database was too short for econometric analysis to be feasible. Instead, the parameters were set as follows, in line with short-run behavioural responses identified in the literature[100]:

[100] The elasticities in Davidson, J. E. H., Hendry, D. F., Srba, F & Yeo, S. (1978), 'Econometric Modelling of the Aggregate Time-Series Relationship Between Consumers' Expenditure and Income in the United Kingdom', for

- The income elasticity of demand was set to 0.30;
- The price elasticity of demand was set at 0.20.

For many countries, it is straightforward (and often reasonable) to use domestic economic activity (e.g. GDP) as a proxy for income. However, in Moldova, remittances from overseas are an important source of household income. The income variable is thus formed explicitly from a combination of domestic and foreign sources (see below). This is also important when considering counterfactuals with alternative exchange rates, as it alters the domestic value of remittances.

The price level is also determined endogenously (see below).

Real expenditure is converted back to current prices before insertion into the transactions matrix.

A3.6.1.2 Gross Capital Formation

The main components of Gross Capital Formation (investment) are:

- Gross Fixed Capital Formation (GFCF); and
- Changes in inventories (stock building).

Of the above, GFCF is by far the largest component of investment and is determined endogenously. Changes in inventories are held constant across the scenarios.

Economic theory highlights the importance of expectations in determining investment. Agents will tend to invest less in a more uncertain economic and political climate, such as that seen during the crisis, when MFA was provided. This is because greater uncertainty and/or pessimism reduces agents' expectations of the future return on their investment.

Expectations are not straightforward to represent in an economic model, with the concept of 'rational expectations' being a common approach, albeit one that has endured greater scrutiny in the wake of the crisis.

Over 2009-12, GFCF accounted for around 23% of GDP in Moldova each year. Given the stability of this relationship (and the absence of other effects such as varying interest rates across scenarios), this ratio is applied in the scenarios, in real terms.

A3.6.1.3 Government Expenditure

Government expenditure is a key element of the analysis. The nature of the government response is a critical detail in the counterfactuals without financial support. In all cases, government expenditure is set such that the implied deficit does not increase relative to the outturn actually observed. Put another way, all the counterfactuals impose the constraint that without EU or IMF support, Moldova would not have been able to raise deficit financing from alternative sources. The only options available are to cut spending (lower expenses) or raise taxes (to increase receipts).

Changes in government spending affect incomes and other real-economy expenditure (through the multiplier effect). This may also lead to further effects through higher unemployment requiring greater provision of social security (an increase in *mandatory* transfers; an example of an automatic stabiliser). If there is a deficit limit in the

example, are indicative of the type of parameter values identified. More recent studies suggest similar elasticities.

scenarios, there may be a requirement for further adjustments to discretionary spending, beyond those required to reduce the initial deficit.

A3.6.1.4 Exports

In a multi-country model, it would be reasonable to model demand for exports such that it depends on economic activity in the rest of the world, and the relative price of domestic and foreign production (allowing for exchange-rate effects), to capture competitiveness. This is not so straightforward in a single-country model, unless one is willing to specify alternative trajectories for world economic growth. It seems unlikely that Moldova is a large enough country for that to be the case in the counterfactuals identified in this study.

In the scenarios, the real-terms value of exports is held constant, under the assumption that global demand for Moldovan production does not change as a result of economic developments in Moldova. The implication on the supply side is that no economic developments in Moldova affect its ability to supply goods and services to meet foreign demand.

Thus, in the model, exports are assumed fixed across the scenarios in foreign-currency terms. The assumption is that Moldova exports are priced in foreign currency (e.g. dollars) and, with Moldovan exporters as price taker, the nominal value of the exports, in leu, must increase (while the volume remains unchanged).

A3.6.1.5 Imports

Imports represent the second-largest component of final expenditure in Moldova (behind private final consumption expenditure).

Import demand is a function of real domestic economic activity. As with investment, imports as a ratio to GDP was relatively stable over the period of analysis. As such, real import demand is set at 80% of real GDP (with the observed differences between the model results and the actual outcomes added back, in order to calibrate to the outturn).

A3.6.1.6 Household Income

As mentioned above, for many countries, it is reasonable to use domestic economic activity (e.g. GDP) as a proxy for income. This is not so reasonable for Moldova because of the importance of remittances from overseas and the fact that some counterfactuals incorporate alternative exchange-rate trajectories that alter the value of these remittances once converted into Moldovan leu.

Consequently, the model builds up household disposable income from the following components:

- Wage income (compensation of employees in the national accounts);
- Profit income (proxied by Net Operating Surplus in the national accounts; under the assumption that no profit is retained from year to year);
- Domestic transfers (social security);
- Foreign income and transfers (whose value in domestic currency changes under alternative exchange-rate assumptions); and
- Taxes (as a negative item).

This breakdown is important in order to capture the effect of exchange rates on remittances and to allow for the expenditure-curbing effects of higher profit-tax rates (Corporate Income Tax).

The final term, once converted to real terms, enters into the household consumption function.

A3.6.1.7 Price Level

The preferred approach to determining prices in the model would be to relate them, empirically, to changes in the underlying domestic and import costs. However, this is difficult given the available data and perhaps of somewhat limited value given that the model is not disaggregated in a way that identifies multiple industry sectors and cost structures.

Instead, the approach is to link the price level to the exchange rate, on the basis that Moldova has a high dependency on imports. The exchange-rate elasticity of domestic prices (the GDP deflator) has been set at 0.20.

This treatment contrasts to that followed in previous evaluations, where changes in the money supply affected the price level. The approach in this evaluation resembles more a cost-plus pricing approach than the monetary theory of inflation embodied in previous evaluations.

A3.6.2 Government Finances

The government sector is defined in terms of:

- Revenues (inflows);
- Expenses (outflows); and
- The surplus/deficit arising from differences between the above (leading to changes in the stock of debt).

The main sources of revenue are taxes and social-security contributions, which are linked to the relevant real-economy flows e.g. income tax is linked to earned income. The other key source of revenue to the government is foreign grants, of which MFA is one. In the counterfactuals, this component of the receipts is removed.

Expenses consist primarily of:

- Consumption expenditure on goods and services;
- Social security payments;
- Interest payments; and
- Subsidies.

As with revenues, some of these elements are linked to other variables in the model, in order to represent non-discretionary spending, such as social security. Spending on goods and services, on the other hand, is discretionary and set by assumption/rule. In all the counterfactuals, this expenditure adjusts in order to preserve the deficit at outturn levels (modelling a situation in which it was not possible for Moldova to incur further debt).

The difference between expenses and revenues gives the deficit/surplus, which drives the evolution of the stock of public debt through time.

A3.6.3 The Balance of Payments

The Balance of Payments accounts for transactions between residents and non-residents of a particular economy. It is composed of:

- The Current Account;
- The Capital Account; and
- The Financial Account.

The accounts balance through changes in Moldova's stock of foreign exchange reserves (depending on the representation of the Balance of Payments, these may be incorporated into the Financial Account).

In the model, the treatment of the Balance of Payments is entirely accounting/identity-based, serving as a means to track the external implications of developments in the Moldovan economy:

- Changes in exchange rates affect the value of flows once converted into Moldovan lei e.g. a depreciation of the leu will increase the value of remittances, once converted to domestic currency;
- Changes in exports and imports lead to corresponding changes to the goods and services component of the Current Account;
- The absence of MFA (which was provided entirely in grant form) in the counterfactuals is modelled as a deterioration of the transfers part of the current account, with a corresponding change to revenues in government finances;
- The absence of IMF support in the counterfactuals is modelled as a reduction in Moldovan drawings of Fund credit/loans; and
- Flows of foreign exchange reserves are calculated as the residual to maintain balance in the accounts, leading to changes in Moldova's stock of reserve assets.

The effect of alternative exchange-rate scenarios only directly alters the *value* of international transactions. The relative-price effects of alternative exchange rates affects trade demand in the real-economy block which are then reflected in the current account and reserve assets (by residual).

A3.6.4 Labour Market

The model generates employment as a socio-economic indicator. Output (real GDP) is the driver, with an elasticity of 0.50 on employment. A more detailed treatment cannot be easily incorporated into the model given the available data and risks introducing a potentially misleading level of complexity. Unemployment follows as the difference between employment and an exogenously-set workforce, which precludes the possibility of changes in labour participation across scenarios.

While quite simple, an additional reason to model the labour market is in order to represent the automatic-stabilising effect of social security. It is common for government deficits to increase in a recession, as higher unemployment drives higher non-discretionary public expenses. By including a labour-market treatment in the model, it is possible to capture this feature of public deficits in a downturn.

Annex 4 Simulation of counterfactual scenarios – sensitivity analysis

The main part of the report provides counterfactual scenarios' results from the macroeconomic modelling for one specific set of assumptions on model parameters. In view of inherent uncertainty of these assumptions sensitivity analysis was carried to check robustness of the results. The outcome of this analysis is reported below.

A4.1 No MFA scenario

The No MFA counterfactual analysed in section 3.3.2 suggests that the EU MFA operation enabled modest increases in government spending which supported somewhat stronger economic growth in 2011, contributing to an overall higher level of GDP in 2012. While the additional economic activity did lead to higher spending on imports, the effect of this did not outweigh the inflow of reserves from the MFA operation. Overall, the MFA operation increased Moldova's holdings of foreign exchange reserves.

The sensitivity analysis in this section seeks to establish the extent to which the above findings are robust to changes in the underlying model parameters, the key ones being:

- Those that relate to the GDP response (and contribute to the multiplier effect):
  - Household income elasticity on consumption
  - Investment share
  - Import propensity
- Given the GDP response, the import propensity, which additionally determines the extent to which higher import spending offsets the initial inflow of foreign exchange reserves.

Higher income and investment parameters will tend to generate larger GDP impacts than lower values and, for a given import propensity, also offset more of the inflow of foreign exchange reserves. Higher import propensities curb GDP and offset more of the inflow of reserve assets.

The response of employment to economic activity may also have some bearing on the results. If employment is relatively more responsive to economic activity, then GDP would tend to increase further because the government has lower requirements to pay out social security benefits, freeing up resources to spend in the economy.

In summary:

- Higher household income responses will lead to higher GDP impacts but lower reserves accumulation;
- Higher investment shares will also lead to higher GDP impacts but lower reserves accumulation;
- Higher import shares will lead to lower GDP and lower reserves accumulation; and
- Higher employment sensitivity to economic activity will lead to higher GDP but lower reserves accumulation.

0 shows the results from varying the above four parameters. The comparison of the 'Main' parameter (used in the analysis from the previous section) against alternative 'High' and 'Low' values suggests that the overall result of MFA contributing to both higher

GDP and higher reserves accumulation is robust. There is no indication that economic growth and/or the import response would ever lead to a net decrease in foreign exchange reserves from the MFA operation.

The sensitivity analysis suggests that the model outcomes are most sensitive, in GDP terms, to the imports parameter. Because household consumption and imports are the largest components of final expenditure relative to GDP, these parameters have the largest (but still fairly modest) effect on reserves.

Table A4.1 Sensitivity of No MFA Results under alternative assumptions

		Difference in Real GDP (per cent)			Difference in Reserves (EUR m)		
	Parameter	**2010**	**2011**	**2012**	**2010**	**2011**	**2012**
Household income							
Main	0.30	+0.0	+1.1	+0.5	+40	+15	+25
High	0.50	+0.0	+1.2	+0.5	+40	+9	+17
Low	0.10	+0.0	+1.0	+0.4	+40	+19	+31
Investment share							
Main	0.23	+0.0	+1.1	+0.5	+40	+15	+25
High	0.28	+0.0	+1.1	+0.5	+40	+13	+22
Low	0.18	+0.0	+1.0	+0.4	+40	+16	+28
Import share							
Main	0.80	+0.0	+1.1	+0.5	+40	+15	+25
High	1.00	+0.0	+0.9	+0.4	+40	+12	+20
Low	0.60	+0.0	+1.3	+0.6	+40	+19	+31
Output-Employment							
Main							
High	0.50	+0.0	+1.1	+0.5	+40	+15	+25
Low	0.75	+0.0	+1.1	+0.5	+40	+13	+23
	0.25	+0.0	+1.1	+0.4	+40	+16	+27

A4.2 No MFA and no IMF scenario

In addition to the main scenario considered in section 3.3.3, two alternative exchange-rate paths were considered, representing more- and less-severe depreciation trajectories, respectively. Their impacts are summarised in 0 and 0.

Table A4.2 Contribution of EU MFA and IMF Support to Observed Outcome – More Severe Depreciation

	2010	**2011**	**2012**
Contribution to GDP growth (percentage points)	+4.3	-0.9	-1.1
GDP relative to no MFA/IMF counterfactual (per cent)	+4.2	+3.3	+2.2
Contribution to inflation (percentage points)	-4.3	-2.2	+0.4
Change in current account (EUR m)	-134	-168	-66

	2010	2011	2012
(positive is a decrease in the deficit)			
End-of-year difference in reserve assets (EUR m)	-3	-59	-11

Table A4.3 Contribution of EU MFA and IMF Support to Observed Outcome – Less Severe Depreciation

	2010	2011	2012
Contribution to GDP growth (percentage points)	+2.3	-0.4	-1.0
GDP relative to no MFA/IMF counterfactual (per cent)	+2.2	+1.9	+0.9
Contribution to inflation (percentage points)	-1.4	+0.1	+0.1
Change in current account (EUR m) (positive is a decrease in the deficit)	-46	-69	-8
End-of-year difference in reserve assets (EUR m)	+90	+129	+251

In both variants, combined EU and IMF support would still have raised economic growth in 2010, by helping to sustain government spending. As in the main version of this counterfactual scenario, while growth is not higher in 2011 and 2012, this is simply a result of the same external factors driving higher output from a lower base.

The more severe the depreciation that was avoided, the more price stability conferred by the support.

In the variant with the most severe depreciation, the outcome for economic activity would have been so strong that the combined support might actually have led to lower reserves. This occurs because, in this variant, the economic activity that the Moldovan government would have been able to sustain would have led to stronger import demand, offsetting the initial inflow of reserves. Moldova would still have accumulated reserves each year (as observed in the baseline), but at a slower rate.

The results from this counterfactual suggest that the combined external assistance supported higher GDP growth in 2010 and promoted greater price stability. The growth in 2011 was driven more by external factors. Had the absence of support led to more severe depreciation, the estimate of the contribution of the support to economic growth would have been greater, but possibly at the expense of faster reserve accumulation.

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Annex 6 List of Interviewees

Stakeholder Group	Stakeholder Name	Role	Date of Interview
European Commission, DG ECFIN, Unit D2	Mr Andreas Papadopoulos	Deputy Head of Unit/Moldova supervisor	13 Mar 2013
European Commission, DG ECFIN, Unit D2	Mr Mihai Macovei	Former Desk Economist for Moldova	13 Mar 2013
European Commission, DG ECFIN, Unit D2	Mr Ronald Albers	Former Supervisor	13 Mar 2013
European Commission, DEVCO	Mr Pierre Lejeune	Programme Manager - External Relations	13 Mar 2013
EU Delegation in Moldova	Mr Oleg Hirbu	Project Manager MFA, Public finance and budget support programmes	24 April, 2013
IMF, Representation in Moldova	Mr Tokhir Mirzoev	Resident Representative in Moldova (since 2009)	24 April, 2013
IMF, Washington DC	Michael Gorbanyov	Senior Economist	16 May, 2013
IMF, Washington DC	Mr Nikolay Gueorguiev	Deputy Division Chief	16 May, 2013
IMF, Washington DC	Mr Tidiane Kinda	Economist	16 May, 2013
IMF, Washington DC	Ms Nadia Rendak	Senior Counsel	17 May, 2013
IMF, Washington DC	Mr Allessandro Gullo	Counsel	17 May, 2013
IMF, Washington DC	Ms Nikita Aggarwal	Counsel	17 May, 2013
Ministry of Economy in Moldova	Mr Iurii Turcunov	The Head of Division Macroeconomic analysis and forecast	25 April, 2013
Ministry of Economy in Moldova	Mrs Tatiana Besliu	Head of the Analysis, Monitoring and Evaluation of Public Policies Division	25 April, 2013
Ministry of Economy in Moldova	Mr Octavian Calmac	Deputy minister	26 June, 2013
Ministry of Finance in Moldova	Mrs Maria Cauras	Deputy Minister in Ministry of Finance since 2009	23 April, 2013
Ministry of Finance in Moldova	Mrs Vasile Bulicanu	Head of General Direction budgetary	23 April, 2013

Stakeholder Group	**Stakeholder Name**	**Role**	**Date of Interview**
		synthesis	
Ministry of Finance in Moldova	Mrs Elena Matveeva	Head of General Direction Public Debt	23 April, 2013
Ministry of Finance in Moldova	Mrs Emilia Prujanskaia	Deputy Head of General Direction Budgetary Synthesis	23 April, 2013
National Bank of Moldova	Mr Dorin Dragutanu	Governor	23 April, 2013
National Commission on Financial Market	Ms Veronica Cuha	Head of Foreign Relations and Development Directorate	25 April, 2013
National Commission on Financial Market	Ms Elena Pui	Director, General Executive Division	25 April, 2013
Parliamentary Committee on Economy, Budget and Finance	Mr Veaceslav Ionita	Chairman of the Parliamentary Committee on Economy, Budget and Law	25 June, 2013
Public Procurement Agency	Mr Stefan Creanga	Director	25 June, 2013
State Chancellery	Mr Ion Gumene	Head of Policy Coordination and Strategic Planning Division	24 April, 2013
State Chancellery	Mrs Lucretia Ciurea	Head of Foreign Aid Coordination Section	24 April, 2013
World Bank Office in Moldova	Mr Ghenadie Cotelnic	Financial and Private Sector Development Specialist	24 April, 2013
World Bank Office in Moldova	Mr Abdulaye Seck	Country Manager for Moldova	4 July, 2013 (telephone interview)
World Bank Office in Moldova	Mr Ruslan Piontkivski	Senior Economist and Country Economist for Moldova	4 July, 2013 (telephone interview)
World Bank Office in Moldova	Mr Marcel Chistruga	Economist	4 July, 2013 (telephone interview)

Stakeholder Group	Stakeholder Name	Role	Date of Interview
EBRD, Moldova	Ms Dorina Harcenko	EBRD UNCITRAL Initiative on Public Procurement	26 June, 2013
Participants of the Workshop in Chişinău (25 June, 2013)			
Business Consulting Institute	Mr Liviu Andriuta	Executive Director	25 June 2013
Institute for Economy, Finance and Statistics	Mr Alexandru Stratan	Director	
Association of Private ITC Companies of Moldova	Mrs Ana Suhovici	Associate Professor	
Institute for Public Policy	Mr Arcadie Barbarosie	Director	
Association for Efficient and Responsible Government (AGER)	Mrs Olesea Stamate	Chairman	
American Chamber of Commerce in Moldova	Mrs Mila Malairau	Executive Director	
American Chamber of Commerce in Moldova	Mr Serghei Toncu	Deputy Executive Director	
Institute of Marketing and Public Opinion Pools	Mr Doru Petruti	Director	
Market Economy Institute	Mr Roman Chrica	Director	
the Institute for Economy, Finance and Statistics	Mr Alehandru Fala	Researcher	
Expert-Group (Think-Tank)	Mr Valeriu Prohnitchi	Director	
IDIS Viitorul	Mrs Tatiana Lariushin	Senior Economic Researcher	