DOCUMENT OF THE EUROPEAN BANK

FOR RECONSTRUCTION AND DEVELOPMENT

STRATEGY FOR MOLDOVA

As approved by the Board of Directors on 1 July 2003

TABLE OF CONTENTS

I. EXECUTIVE SUMMARY

Moldova is committed to the principles of multi-party democracy and pluralism in accordance with Article 1 of the Agreement Establishing the Bank, even though application of those principles during the previous Strategy period has not always been consistent.

For the past two years, Moldova has experienced a period of relative political stability, especially when judged against the unsettled period immediately preceding it. Frustration with a pattern of political ineffectiveness, economic paralysis and corruption, helped secure a decisive victory for the Moldovan Communist Party in the Parliamentary elections of February 2001, which then led to political consolidation and improved policy coordination. At the same time, however, the reform process has slowed.

The Moldovan economy has performed well over the last two years, with the most important economic development being Moldova's return to growth, helped by progress on macroeconomic stabilisation. Inflation has been substantially reduced as a result of cautious monetary management. However, Moldova remains one of the poorest countries in the region with the lowest recovery level of any transition country. Social indicators lag behind the regional average. The Government plans to address these issues through a Poverty Reduction Strategy (PRSP) expected to be finalised in the second half of 2003.

Long-term economic stability and growth remain threatened by the high level of external debt. The country plans to approach the Paris Club in 2003 for relief on its bilateral debt. A precondition will be an active IMF programme and the Fund is not currently disbursing under its Poverty Reduction and Growth Facility (PRGF). The IMF is concerned about the business climate, in particular the level of government intervention and the fiscal outlook over the medium term. Other issues, including those related to trade, are in the process of being resolved. The World Bank has disbursed the first tranche under the third Structural Adjustment Credit (SAC III), but disbursement of the remaining two tranches will depend on the government maintaining a satisfactory macroeconomic framework, as evidenced by continued access to IMF funds, and continued progress towards the fulfilment of the specific tranche conditions.

Further growth will also depend on the implementation of structural reforms and improvements in the investment climate. The track record in this respect over the past two years has been mixed. Important privatisations in key areas such as telecom and the wineries are taking longer than expected, holding back enterprise restructuring. Progress in reforming the energy sector, while significant, has not been sufficient to stop the accumulation of large external payment arrears (mostly for Russian gas). In the financial sector, the lending volume has grown substantially, but insufficient access to capital, particularly long-term finance, is still seen as a major impediment to business development by many entrepreneurs and by SMEs.

The difficult business climate has had a dampening effect on both foreign and domestic investment. According to the Business Environment and Enterprise Performance Survey (BEEPS) of the EBRD and the World Bank, and other surveys, Moldova's record on improving the business climate has been mixed. Although the country's poverty and difficult market access are adding to the challenge of attracting more investment, the Government has reversed the outcome of several earlier privatisations, important foreign investors have left the country as a result, while others have faced substantial levels of intervention from the authorities. Corruption remains a serious problem. On the other hand, good regulation has helped the banking sector to develop into one of the strongest among the CIS-7 countries.

Accordingly, the following transition challenges emerge for the Strategy period:

(i) Ensuring debt sustainability.

(ii) Improving the investment climate.

(iii) Accelerating the programme of privatisation, particularly in the telecommunications, energy, and wine enterprise sectors through attracting suitable strategic investors, thus reinvigorating the stalled process of enterprise restructuring.

(iv) Pursuing energy sector reform, including privatisation of the remaining state-owned power distribution companies.

(v) Deepening financial intermediation and improving access to long-term finance for the real economy.

(vi) A resolution of the secession issue with Transnistria will also require addressing the related problems of the territory's large external debt and very weak track record on reform.

The Bank's activities will focus primarily on supporting private sector development in Moldova, including in the infrastructure sectors, coupled to intensified policy dialogue with the authorities on improving the investment climate. The Bank's support for infrastructure development, however, will be subject to satisfactory resolution of the problems faced by its existing projects in the respective sectors. In view of Moldova's precarious debt position, the Bank does not anticipate pursuing any new sovereign-guaranteed operations unless these are accompanied by sufficient grant co-financing and have a regional dimension.

The Bank's activities will have the following operational objectives:

- **Financial Sector –** The Bank will focus on (i) the provision of financial support to the best local banks in the form of debt and equity financing, and (ii) expanding the Trade Facilitation Programme (TFP), with a view to further strengthening financial intermediation. New financial products, such as leasing and mortgage financing, will be supported if the regulatory and market conditions are conducive to their development.

- **Enterprise Sector** – The Bank will seek opportunities to support private enterprises, and particularly SMEs, including agribusiness, through (i) direct funding including equity, the latter mainly under the Direct Investment Facility (DIF), (ii) SME and micro-enterprise credit lines through local banks, (iii) risk sharing facilities with local banks, (iv) establishing a Warehouse Receipts Programme, and (v) expansion of the TurnAround Management (TAM) programme and establishment of a Business Advisory Service (BAS). The Bank will also continue to support projects linked to FDI and privatisation.

- **Public Utilities** – There are substantial needs in the development of the energy sector. The Bank's further involvement in this sector will be subject to satisfactory resolution of current outstanding issues affecting the past privatisations of certain energy distribution companies to Union Fenosa. New private projects will be subject to a suitable regulatory and operational environment. In the telecommunications sector, the Bank is prepared to consider support for a post-privatisation investment programme for Moldtelecom, subject to a transparent privatisation process.

- **Portfolio monitoring and implementation support:** given the problems affecting state sector projects in the Bank's portfolio, significant operational staff resources will have to be allocated to this purpose.

- **Policy dialogue:** in the context of finalising and implementing Moldova's Poverty Reduction Strategy (PRSP), the Bank will collaborate with other agencies in increasing its policy dialogue with the authorities on the investment climate.

All EBRD operations in Moldova will be subject to the Bank's Environmental Procedures. The Bank will continue to co-operate with other IFIs and bilateral donors through co-financing, complementary projects, and co-ordination of policy dialogue. The Bank will seek to mobilise donor grant financing, which is very low, for technical co-operation in support of the preparation and implementation of its projects, legal transition work, and its policy dialogue on investment climate. Given Moldova's debt and poverty problems, the Bank would welcome a greater involvement of the donor community in Moldova, and is prepared to collaborate on specific initiatives in this respect. This Strategy does not apply to the secessionist region of Transnistria, which is not under the control of the Moldovan Government.

LIST OF ABBREVIATIONS

ANRE	National Agency for Regulations in the Energy Sector
ANRTI	National Agency for Regulations in the Telecommunications and Information Technologies
BEEPS	Business Environment and Enterprise Performance Survey
CCI	Chamber of Commerce and Industry
CIS	Commonwealth of Independent States
DIF	Direct Investment Facility
EU	European Union
EUR	Euro
FDI	Foreign Direct Investment
FSU	Former Soviet Union
GCC	Glass Container Company
GDP	Gross Domestic Product
GtZ	German Technical Co-operation Agency
GUUAM	Georgia, Ukraine, Uzbekistan, Azerbaijan and Moldova
IDA	International Development Agency
IFC	International Finance Corporation
IFI	International Financial Institution
IMF	International Monetary Fund
IOM	International Organisation for Migration
CCI	Chamber of Commerce and Industry
MDL	Moldovan Leu
MEC	Micro Enterprise Credit
NBM	National Bank of Moldova
NEAP	National Environmental Action Plan
NLG	Netherlands Guilder
OSCE	Organisation for Security and Co-operation in Europe
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
PSI	Pre-Shipment Inspection
SAC	Structural Adjustments Credit
SME	Small and Medium Enterprise
TACIS	Technical Assistance for CIS countries
TAM	Turn-around Management
TC	Technical Co-operation
TFP	Trade Facilitation Programme
UNDP	United Nations Development Programme
USD	US Dollar
USAID	US Agency for International Development
UNECE	United Nations Economic Commission for Europe
WB	World Bank
WTO	World Trade Organisation
WNISEF	Western NIS Enterprise Fund

II. COUNTRY STRATEGY

1. The Bank's Portfolio

1.1. Overview of Bank Activities to Date

As of 30 April 2003, the Bank had signed 27 investment projects in the agribusiness, energy, municipal utilities and banking sectors, for a total commitment of EUR 169.6 million. Of these, 7 projects were in the public sector, totalling EUR 80.2 million (47 per cent of total commitments), and 20 in the private sector, totalling EUR 89.4 million (53 per cent). Cumulative disbursements were EUR 145.1 million. The total amount of TC funds provided to date is EUR 9.6 million, but only about EUR 600,000 are still active undisbursed commitments. The current net portfolio amounts to EUR 105.9 million. The Bank has helped mobilise EUR 124.6 million of co-investment from sponsors and other co-financiers for a mobilisation ratio of .73:1.

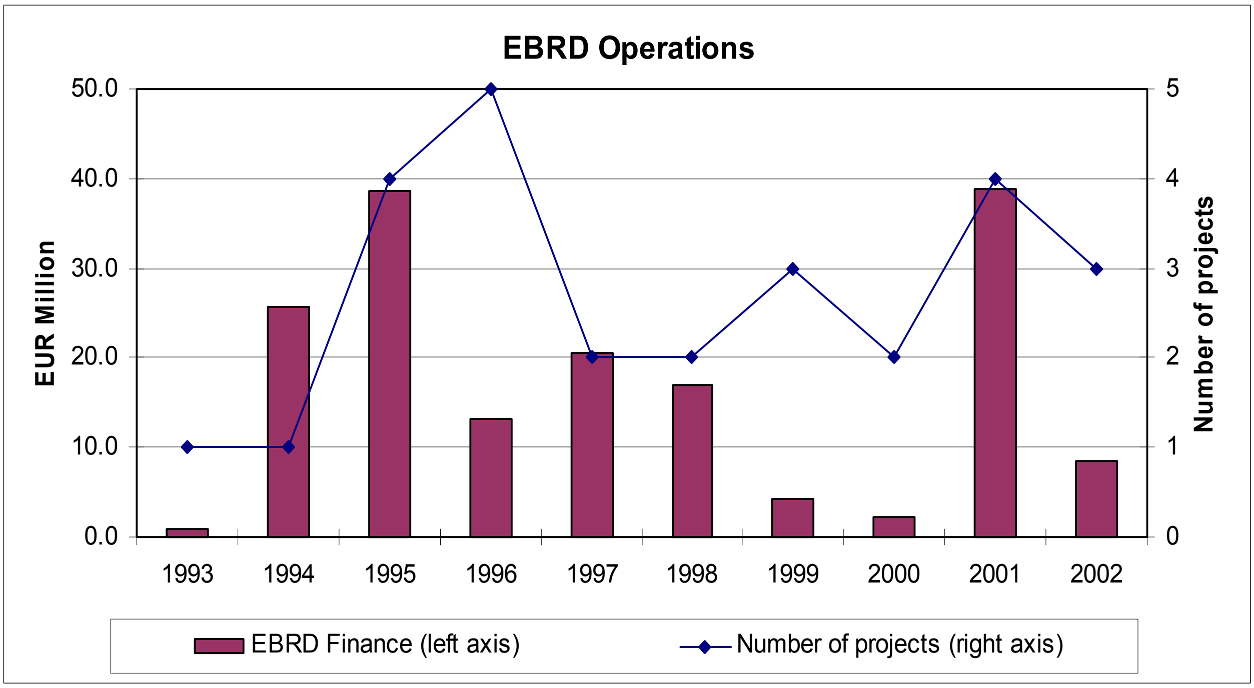
Table 1: Commitments and Net Portfolio as of 30 April 2003
(EUR million)

Sector	COMMITMENTS[1]					NET PORTFOLIO[1]		
	No. of Projects	Total Project Cost	EBRD Funding	% of EBRD Total	Disbursed	No. of Projects	Portfolio	% of Portfolio
Financial Institutions	**17**	**69.8**	**50.9**	**30%**	**42.5**	**12**	**18.7**	**18%**
Infrastructure	**8**	**167.1**	**86.1**	**51%**	**70.3**	**7**	**74.3**	**70%**
Energy	*3*	*69.5*	*36.4*	*21%*	*22.9*	*3*	*33.4*	*32%*
Water and Sewage	*1*	*36.5*	*20.4*	*12%*	*18.0*	*1*	*18.1*	*17%*
Transport	*3*	*59.6*	*28.4*	*17%*	*28.5*	*3*	*22.8*	*22%*
Telecommunications	*1*	*1.5*	*0.9*	*1%*	*0.9*	*0*	*0.0*	*0%*
Enterprise	**2**	**57.3**	**32.6**	**19%**	**32.3**	**2**	**12.9**	**12%**
Agribusiness	*2*	*57.3*	*32.6*	*19%*	*32.3*	*2*	*12.9*	*12%*
Country Total	**27**	**294.2**	**169.6**	**100%**	**145.1**	**21**	**105.9**	**100%**

[1]: Detailed project listings are provided in Annex 5.

Net portfolio distribution by sector was as follows: financial institutions 18 per cent, infrastructure 70 per cent, and enterprise support 12 per cent. Of the 21 total existing projects, 3 are equity participations, 9 are funded through debt instruments, 5 are financed through both debt and equity, and 4 are guarantees. Equity investments represent 10 per cent of the Bank's net portfolio.

The chart which follows shows the number of projects signed in each year and corresponding commitments. With the exception of a peak year in 2001 (when commitments included the power distribution project and the restructuring of the Glass Container Company financing), new commitments over recent years have varied between EUR 2 million and EUR 8 million per year, corresponding to between two and three projects per year. This reflects smaller financial sector transactions and no new sovereign project.



During the last Strategy period, new EBRD commitments have concentrated on the financial sector. Four operations were signed for a total amount of EUR 12 million, including two new SME credit lines with leading local banks, an equity participation in the Micro Finance Company, and a new TFP.

1.2. Transition Impact of the Bank's Activity

The most visible and important impact of the Bank's operations has been achieved in the financial and energy sectors, including during the last Strategy period, which identified agribusiness, infrastructure and the financial sector (including SMEs) as the key priorities for the Bank. The EBRD's extensive financial involvement in the banking sector through equity investments, the setting up of the micro lending programme, and SME credit lines and the Trade Facilitation Programme to various banks, contributed significantly to the strengthening and improvement of that sector. Despite the problems encountered, the power distribution project has had a significant transition impact in supporting reform in the sector. However, the transition impact of some other infrastructure projects has been more limited, given issues such as weak institutional and regulatory performance, and fiscal constraints.

1.2.1. Financial Sector

- The Bank invested in two of the leading banks in Moldova (Moldova Agroindbank and Victoriabank), thereby contributing to improved corporate governance and to the introduction of modern banking practices and controls.
- The Bank has provided significant support for the development of the private sector, particularly SMEs and micro-enterprises, through medium-term credit lines to local banks.
- The Bank has encouraged the development of micro-lending and the financing of micro-enterprises by implementing a micro-lending programme with four banks and by contributing to the establishment and operation of the Micro Enterprise Company, which focuses exclusively on supporting the needs of this segment of the market.
- The Bank has contributed to the enhancement of international trade by including four local banks under its Trade Facilitation Programme, thereby supporting their clients' export/import

transactions and assisting in the development of correspondent relationships between local banks and foreign banks.

- A comprehensive TC programme was put in place to improve lending procedure of local banks.

1.2.2. Enterprise Sector

- Credit lines provided via local banks have proven to be an efficient mechanism to reach SMEs and micro-enterprises, and thus support private sector development. However, the Direct Investment Facility (DIF) has not yet been able to invest in Moldova.
- Technical assistance has been provided to the management of twelve local enterprises through the TAM programme.
- The Bank was only partly successful in helping the Government increase Moldovan wine export potential and improve financial performance in the wine industry through the Wine Export Promotion Project. The wineries were severely affected by the 1998 Russian crisis, the lack of good sponsors, insufficient investment, weak marketing and the overall business climate.

1.2.3. Infrastructure

- Important transition impact was achieved through the successful implementation of the Chisinau International Airport Modernisation project. The project enhanced competition in the air travel market by bringing regional and international private airlines into the market, and provided a demonstration example of a successfully restructured public company.
- The electricity distribution project involving Union Fenosa, the largest foreign investor in the country, covering three power distribution networks, has had significant transition impact through the improvement of power supply and payment collections. This has been achieved despite difficulties faced by the company, due to obstructive challenges to its privatisation process and to regulatory issues.
- The Bank has only been partially successful in helping the Government to restructure public sector utilities such as the Chisinau District Heating Company Termocom and the Chisinau Water Company Apa-Canal, due to institutional weaknesses, management inefficiencies, regulatory issues and state budgetary constraints. The Giurgiulesti Oil Terminal Project financing had to be curtailed due to the authorities' inability to meet project obligations, and the project is currently being restructured.

1.3. Financial Profile of Existing Portfolio

The current EBRD portfolio reflects the difficulties encountered in infrastructure projects. Financial sector projects continue to be the most successful sector for the Bank in Moldova.

Four of the six projects financed by the Bank and supported by state guarantees continue to experience difficulties. Issues which have been faced include delayed repayments, delays on state counterpart contributions, tariff/collection issues, and delays in the asset sales to suitable strategic investors. In addition, the private sector Power Distribution Project continues to experience problems reflecting unresolved challenges to the privatisation process and tariff/collection issues.

1.4. Lessons Learnt

During the past Strategy period, two Moldovan projects were the subject of ex-post evaluations: the Chisinau Airport Priority Modernisation Programme and the Chisinau Energy Efficiency Project. Based on the results of the evaluation, supplemented by Bank experience on other projects in Moldova, the following lessons emerge:

- **Institutional Change**. Substantive institutional changes constituting important transition impact normally require longer-term gestation periods to achieve full fruition, close monitoring of expected institutional changes, and regular policy dialogue. The Bank's monitoring obligation does not stop once the physical or the institutional infrastructure (e.g. passing of a new law or set up of a new authority) has been implemented. It extends to ensuring that these work as anticipated and, should this not be the case, it is important to determine what steps can be taken to strengthen those aspects.
- **Structuring tariff reform.** Tariff reform must be based on full cost recovery. The risks related to approval of tariff increases are high in a volatile political environment. The subsidies to compensate increasing utility tariffs must be directed separately to the poorest part of the population and should be the Government's responsibility and not the regulator's. The Bank should also ensure that the regulator's independence is enshrined in law and covenanted in loan/ guarantee agreements.
- **Co-ordination with other IFIs** is essential, both in terms of conditionality in their respective programmes, and through cofinancing, particularly in areas such as tariff reform and issues which affect the business climate. As an example in point, co-ordination with other IFIs has proven essential in the Bank's efforts aimed at seeing a satisfactory resolution of the issues faced in the Power Distribution Project.
- **The participation of experienced strategic industry investors is essential,** particularly in the case of early transition countries, to provide necessary know-how, including foreign markets expertise. For instance, the absence of strategic industry investors weakened the Bank's efforts (supported with technical co-operation funds) to foster the restructuring of the wineries in the Wine Export Promotion Project and help them establish a strong presence in Western markets. The involvement of the Spanish company Union Fenosa in the privatisation of the power distribution companies has proven essential in improving the quality of service and performance of those companies.

In difficult transition environments, special efforts are needed on project due diligence to correctly identify and mitigate downside risks, and avoid over-optimistic assumptions.

1.5. Private/Public Sector Ratio

At the end of April 2003, 53 per cent of cumulative EBRD commitments were in the private sector. The Bank's activities over the next Strategy period will focus mainly on supporting private sector activity.

Industry	Private		State		Total	
	No of Projects	EUR million	No of Projects	EUR million	No of Projects	EUR million
Financial institutions	**17**	**50.9**	**0**	**0**	**17**	**50.9**
Infrastructure	**3**	**38.5**	**5**	**47.6**	**8**	**86.1**
Energy	*2*	*28.3*	*1*	*8.0*	*3*	*36.4*
Water and Sewage	*0*	*0*	*1*	*20.4*	*1*	*20.4*
Transport	*1*	*10.2*	*2*	*18.3*	*3*	*28.4*
Telecommunications	*0*	*0.0*	*1*	*0.9*	*1*	*0.9*
Enterprise support	**0**	**0**	**2**	**32.6**	**2**	**32.6**
Agribusiness	*0*	*0*	*2*	*32.6*	*2*	*32.6*
Total	**20**	**89.4**	**7**	**80.2**	**27**	**169.6**

2. Operational Environment

2.1 The General Reform Environment

2.1.1 Political developments

Moldova has enjoyed a period of relative political stability during the previous Strategy period. In the February 2001 general election, the Communist Party of Moldova (CPM) won just over 50 per cent of the vote and controls 71 out of 101 seats in Parliament. The two main opposition parties are the centrist Social Democratic Alliance (formerly the Braghis Alliance), which received 13.4 per cent of the vote in 2001, and the right-wing Popular Christian Democratic Party (PPCD), which received 8.3 per cent of the vote in 2001.

The Communist Party's decisive victory in the last general election allowed them to occupy the office of President and Prime Minister and maintain majority control of Parliament. This has led to a process of political consolidation and has improved policy co-ordination. However, where democratic traditions and institutions are relatively recent and still maturing, as in Moldova, dominance by a single party in all central decision-making bodies can lead to a weakening of checks and balances among the branches of power. Further, the territorial-administrative reforms which came into force in March 2003 have extended the central government's authority in the regions and localities, prompting criticism from many local groups, the Council of Europe and the IMF. Fortunately, a still active political opposition, open media and vibrant civil society are able to limit the potential for abuse of power, and the authorities have proven receptive to constructive recommendations from the Council of Europe and OSCE. The result is stable public support for the current authorities. According to an April 2003 survey by the independent Institute for Public Policy, 66 per cent of the population trusts the President and 53 per cent believe the current Government is better at managing the country than its predecessor. (A more detailed description of political developments is provided in Annex 1)

2.1.2 Legal

Over the past decade, Moldova has worked towards improving the legal foundations necessary for the development of a market economy. It has carried out extensive reforms of its commercial and financial legal framework and has taken key steps to implement legislation needed in the reform process such as laws on commercial companies and banking regulations. These improvements are reflected in the way the legal system is perceived by the business community. In the 2002 Business Environment and Enterprise Performance Survey (BEEPS), the surveyed enterprises reported improvements in the legal system along all its dimensions (enforcement, fairness, honesty, affordability, and speed) compared to 1999.

However, an analysis of key commercial laws that directly contribute to creating a favourable investment climate in Moldova, such as secured transactions and bankruptcy laws, shows that even relatively good laws suffer from being poorly implemented. Commercial laws continue to suffer as a result of not being sufficiently accessible or because of inadequate administrative and judicial support. This implementation gap both undermines the utility of specific laws and diminishes the confidence which foreign investors and traders have in the legal system as a whole, and in particular in its ability to uphold contractual rights. Indeed, the seemingly systemic nature of the gap and the persistently low effectiveness of Moldovan commercial laws are symptomatic of the larger problem that lies at the centre of the legal system, namely that the rule of law is not yet fully entrenched in Moldova. (Further details on the legal environment are provided in Annex 2).

2.1.3 Social

Despite good economic growth over the last three years, Moldova remains one of the poorest countries in the region. Its 2002 GDP was still only 39.5 per cent of the pre-transition level (i.e. 1990 GDP)– the lowest recovery level anywhere in the region. GDP per capita is a low USD 448 dollars or about USD 1,400 if output is corrected for purchasing power parity. This puts Moldova in the same income bracket as many low-income developing countries. According to a 2002 household survey just over 40 per cent of Moldovans live in absolute poverty, defined as a monthly income of less than MDL 271 (about USD 20), and over a quarter of the population lives below the food poverty line of MDL 212 per month (about USD 15).

There are large regional disparities, both in terms of poverty and economic performance. The gross regional product per capita of Chisinau is more than twice the national average, whereas some of the poorer and less industrialised districts produce less than two thirds the national average. The incidence of poverty in small towns is four times higher that in the bigger cities, and the share of poor people is 60 per cent higher in rural areas than in urban areas.[1]

The unemployment rate is relatively low at less than 10 per cent,[2] but the statistic masks a considerable level of hidden unemployment. The average wage, although growing, is only about USD 51 per month. Many Moldovans have reacted to the economic pressures by seeking employment as “Gastarbeiters” abroad. Exact statistics are lacking, but various sources suggest that up to 800,000 Moldovans have left the country, sending significant remittances back to Moldova.

Like the other poor countries in the region, Moldova is developing a comprehensive poverty reduction strategy with the help of the World Bank, the IMF and the donor community. Moldova’s Poverty Reduction Strategy Paper (PRSP) should be finalised by the end of the year. The long-term objectives of the PRSP include European integration.

2.1.4 Environment

The National Environmental Action Plan (NEAP) prioritises water quality issues, especially water supply and wastewater treatment in urban areas.

Environmental quality improvements have been observed in Moldova in areas such as NOx levels reductions, reduced pesticide use, and improved water quality. The Government aims to harmonise its environmental legislation with EU environmental directives. Insufficient institutional capacity

---

[1] The statistic refers to extreme poverty, defined as food consumption of less than 2,282 Kcal/day.

[2] Using the definitions of the International Bureau of Labour.

and financial resources remain obstacles for improvement of environmental quality in the country. (Further details are provided in Annex 3).

2.2 Progress in Transition and the Economy's Response

2.2.1. Macroeconomic Conditions for Bank Operations

Since the last Country Strategy, Moldova's overall macroeconomic performance has improved. The country has enjoyed three years of continuous economic expansion, with growth of 2.1 per cent in 2000, 6.1 per cent in 2001 and 7.2 per cent in 2002. Growth in the first quarter of 2003 was 5.4 per cent. Underlying the good recent performance was strong industrial and export growth, but agriculture remains the mainstay of the economy, accounting for about a quarter of total output. Wine production alone accounts for 5 per cent of GDP. The economic recovery is expected to continue and growth of 5-6 per cent is forecast for the year 2003 as a whole. However, longer-term prospects depend on the implementation of structural reforms, accelerated enterprise restructuring and privatisation in such key areas as energy distribution, telecoms and winery, and improvements in the investment climate.

The independent National Bank of Moldova (NMB) has pursued a careful monetary policy course. Inflation fell from 18.4 per cent in 2000 to 6.3 per cent in 2001 and 4.4 per cent in 2002. The exchange rate of the Leu against the US dollar stabilised in early 2000 and has remained relatively constant since then at 13.9 MDL/USD at the end of 2002. The NBM's forecast for the average exchange rate in 2003 is 14.4 MDL/USD.

The current account deficit has steadied at around 6-7 per cent of GDP over the last few years, as the country continues to benefit from a high inflow of remittances transferred from Moldovan citizens working abroad. Although Moldova was one of the first CIS countries to join the World Trade Organisation, it has developed only limited trade links outside its traditional markets. Moldovan exporters still primarily rely on the CIS market and mostly sell agricultural products. The closest trade links are with Russia, which takes up about 37 per cent of exports and provides some 15 per cent of the imports. The second most important trading partner is the European Union, followed by neighbouring Ukraine and Romania.

Fiscal policy has remained relatively tight and government arrears were reduced substantially. Despite mounting debt service obligations, the government managed to maintain a budget deficit of about 1 per cent of GDP in 2002. The 2003 budget targets a slight rise in the deficit to 1.4 per cent. While this is based on optimistic growth assumptions of 6 per cent, the authorities maintain that there is scope to cut expenditures should revenues disappoint. Nevertheless, there has been concern about the affordability of some of the government's spending plans, particularly the proposed salary and pension increases and the extra cost of territorial reform.

Moldova's main macroeconomic challenge remains debt sustainability. At the end of 2002, Moldova's external debt burden stood at USD 1.58 billion, of which USD 962 million was public or publicly guaranteed. While most of the public debt is to multilateral institutions, the main concern is about commercial and bilateral debt and the energy arrears, where debt service obligations are more immediate. On commercial debt, the pressure has eased with the rescheduling of Moldova's only Eurobond in August 2002, which also led to a restoration of Fitch and Moody's ratings, to pre-Eurobond default levels. With that, the focus shifted to Moldova's bilateral obligations to the Paris Club, on which the government intends to initiate negotiations as soon as possible. However, a key condition for approaching the Paris Club is an active IMF programme, and the Fund is currently not disbursing under its Poverty Reduction and Growth Facility (PRGF). Depending on progress in the discussions between the authorities and the Fund, an agreement may still be reached this year, allowing Moldova to proceed to the Paris Club. On the energy arrears, the negotiations with Russia (the main creditor) are on-going, and one of the options being considered is a debt-for-equity swap involving Moldovagaz, the natural gas distribution company, and other, unspecified energy assets. However, even if Moldova succeeds in overcoming its current difficult position, its debt situation will remain precarious for the foreseeable future.

2.2.2. Access to Capital and Investment Requirements

Moldova has substantial investment and rehabilitation needs both in the public and in the private sector. However, access to capital has been limited.

The ability of the sovereign to assume further liabilities is severely restricted. The debt service obligations of the government amounted to over 50 per cent of its revenues in 2001 and 2002 and this number could rise to almost 70 per cent in 2003. Even if Moldova succeeds in restructuring its debt as envisaged, the government will only be able to incur further indebtedness on concessional terms, which primarily means from the IMF under the PRGF or on IDA terms from the World Bank. Both organisations are prepared to lend further in principle and have ongoing programmes, but disbursements will be conditional on reform progress.

The volume of foreign investment in Moldova decreased to USD 64 million in 2002, compared to USD 156 million in 2001 and USD 129 million in 2000. Lack of strategic natural resources, the small size of the domestic market and a poor investment climate are creating obstacles to both domestic and foreign investment. The inflow of FDI has also been affected by the lower rate of privatisation.

Helped by falling interest rates and high liquidity, local commercial banks have increased considerably their lending activities. The expansion of lending started in 2000 and the loan portfolio has since grown by 39 per cent in 2001 and 34 per cent in 2002. At the end of 2002, the outstanding volume of credit issued by commercial banks stood at MDL 4.3 billion (USD 310 million), equivalent to 17% of GDP. The quality of the loan portfolio continued to improve over the last years. The loan loss provision of the total portfolio of the banking sector decreased from 7.9% at the end of 2001 to 6.2% at the end of 2002. Nevertheless, private companies, in particular small and medium-sized enterprises, continue to complain of limited access to financing, particularly with longer tenors.

2.2.3. Progress in Transition

As outlined below, Moldova has made only slow progress in structural reforms over the last Strategy period.

Liberalisation and Stabilisation

Moldova has made great progress in reining in inflation and stabilising the exchange rate, but, as discussed elsewhere, its level of external debt poses a major risk to long-term sustainability. The government has run a tight fiscal regime and the budget deficit is relatively low. However, given the low revenue base and recent expenditure increases, the fiscal position remains delicate. Moldova continues to rely on budgetary and balance of payment support from the World Bank and the IMF and medium-term sustainability remains a key challenge.

A notable transition success has been achieved in the area of trade liberalisation with Moldova becoming a member of the WTO in 2001. However, accession to the WTO has not yet led to the desired boost and diversification in exports and the structure of international trade remains largely unchanged. Moldova continues to depend on the CIS market which absorbs over 60 per cent of exports, and it primarily sells agricultural products, which also account for about 60 per cent of exports. Exports are also still hampered by trade restrictions imposed either by importing countries (for example in the case of meat and dairy exports to Romania, and agricultural products to the EU), or by Moldova itself , although the latter are being lifted under pressure from the IMF.

On the import side, the implementation of pre-shipment inspections (PSI), which is a requirement under the IMF programme, has moved forward with the adoption of a new PSI law in June 2003. Transparency in import and exports is also hindered by the situation in Transnistria. The territory has emerged as a centre for smuggling and illegal trading activity outside the control of the Moldavian authorities.

The stop-go nature of both the World Bank and IMF programmes is an indication of the fragility of Moldova's economic stabilisation and reform policies. The IMF resumed its disbursements under the Poverty Reduction and Growth Facility (PRGF) in July 2002, which in turn enabled the World Bank to disburse funds from the third Structural Adjustment Credit (SAC III). However, the Government only managed to get this one round of disbursements, and the subsequent tranches scheduled for December 2002 were postponed. The IMF was concerned about the poor business environment, in particular the level of government intervention, the fiscal outlook over the medium term (particularly in light of recent expenditure increases on wages and to finance territorial reform) and trade issues such as the PSI law. On a number of these issues there has been progress over spring and summer 2003. The World Bank has similar concerns and further SAC disbursements will depend on a satisfactory macroeconomic outlook and continued progress on the reforms outlined in the government's 2002 Letter of Development Policy.

Private sector development

Privatisation in Moldova started in 1993 with a Mass Privatisation Programme, which consisted of free distribution of public property through patrimonial bonds. At the end of 1996, after two waves of privatisation, around 225 joint stock companies were partially privatised. The implementation of the third privatisation programme covering the period 1997-98 was prolonged twice and now extends to 2005. By early 2003, some 470 enterprises and 160 unfinished structures remain to be privatised. The list includes strategically important enterprises in the telecoms, power and agribusiness (wineries) sectors, but mostly consists of loss-making enterprises, which have proven difficult to sell.

No significant privatisation results have been achieved during 2001-2002, and it seems unlikely that asset sales will pick up in 2003. Key reasons for this disappointing result are the dearth of interested investors in the current global economic climate, but also the manifest shortcomings in the Moldovan investment climate. A number of highly visible attempts by the government to reverse the outcome of earlier privatisations, completed before the Communist Party of Moldova gained the majority in 2001, in particular have discouraged foreign investors (see below). As a consequence, several important sales planned for 2002 either failed or had to be postponed. The most prominent privatisation failure was the attempted sale of the fixed-line monopoly, Moldtelecom, to a Russian company. At the recommendation of its advisors, the government postponed the sale of the two remaining state owned power utilities. The strategically important winery sales were also postponed. The consolidated budget for 2003 originally anticipated privatisation revenues of some MDL 795 million (approximately EUR 56 million), which included revenues from the sale of Moldtelecom and remaining power distribution networks. However this volume is unlikely to be achieved under the current circumstances, and budget figures will likely have to be adjusted downwards.

Without the inflow of external capital and know-how the process of enterprise reform has slowed, which will make it increasingly difficult for Moldovan enterprises to compete on the international market.

Investment climate

Although there has been progress in some areas, the difficult Moldovan investment climate continues to have a dampening effect on both foreign and domestic investment. According to the 2002 BEEPS, the Moldovan investment climate has improved along several dimensions, including legal reform, the average share of annual revenues firms pay in bribes ("bribe tax"), the use of illicit payments to influence government decisions ("state capture") and the number of firms paying kickbacks. However, progress has tended to be slow and there have also been setbacks, for example on the frequency of bribe payments and the quality of regulation. A similar picture emerges from two World Bank surveys on the cost of doing business in Moldova, carried out in 2001 and 2002. They suggest that Moldova has succeeded in reducing administrative barriers in such areas as business registration, import-export barriers, licensing and tax administration. Despite these improvements, Moldovan businesses still operate under less favourable conditions than their peers in neighbouring countries, which points to the need for increased efforts by the authorities, and enhanced dialogue with EBRD on investment climate.

Perhaps the most visible sign of the difficult business environment is the level of government interference. The Government has taken an increasingly interventionist approach and two important foreign investors (Europharm, a Romanian-American JV, and Unistar Ventures GmbH, the Dresdner Bank subsidiary) decided to leave the country partly for this reason. Others which remain, such as the electricity distributor Union Fenosa, have come under pressure from the authorities. A positive and irrevocable decision of the authorities on the legality of privatisation of three power distribution networks in 2000 is vital for the continuation of reforms in the energy sector and to attract foreign investors in general. The above situation is exacerbated by the lack of independence of the electricity regulator and the worsening payment record of government entities[3].

Corruption also remains a serious problem, partly due to the state's continued heavy involvement in the economy. Another key aspect of this problem is the smuggling of goods and arms through Transnistria, which is a haven for criminal activity. The BEEPS shows that bribery payments are decreasing as a percentage of annual revenues, but that private firms continue to bear a heavy burden from the persistence of widespread administrative corruption. According to the Transparency International Corruption Perceptions Index for 2002, Moldova ranks 93rd out of 102 countries surveyed, with an overall score of 2.1 (10 being the least corrupt). This represents a worsening in perceptions of corruption from 2001, when Moldova ranked 63rd out of 91 countries surveyed, with a score of 3.1.

Financial Sector

The National Bank of Moldova (NBM) is continuing to ensure the sustainability of the sector in a very difficult economic and socio-political environment. Generally, appropriate regulatory rules in line with international standards have been established and are continuously being improved, including for capital adequacy, liquidity, and exposure limits to single borrowers and related parties. The Moldovan banking sector is considered to be one of the strongest among the CIS-7 countries.

The number of Moldovan banks has been reduced to 16 (of which 14 are controlled domestically), and further consolidation is expected. The five largest banks account for over 70 per cent of assets and their market share is growing. Commercial bank deposits have tripled over the last three years. Although the banking system has been opened to foreign competition, the foreign presence in the Moldovan banking system is still low compared to other countries in the region with only two

---

[3] Tariff increases which were supposed to occur in March 2003 are still under discussion.

subsidiaries of foreign banks active in the country, Banca Comerciala Romana (a full subsidiary of the Romanian bank) and Unibank (fully owned by Petrocommerce, Russia). The National Bank of Moldova intends to keep minimum capital requirements at the MDL-equivalent of EUR 5 million, which means that a small adjustment can be expected shortly to correct for exchange rate movements.

Helped by falling interest rates and high liquidity, banks have substantially increased their lending volume over the last two years (by 86 per cent), but, with a loan to GDP ratio of 17 per cent, the level of financial intermediation is still low. The quality of the loan portfolio has improved, with the share of overdue loans decreasing during 2002 from 18% to 10.2% of the total banking system's capitalisation, and loan loss provisions from 7.9% to 6.2% of the total loan portfolio. Lending is restricted to short tenors and without an appropriate legal basis specialised products such as mortgages and leases remain undeveloped.

Infrastructure

Moldova has established independent regulatory agencies for energy and telecom, but the reform momentum has been recently maintained only in the latter sector, and even there not without setbacks. The telecom regulator, ANRTI, has embarked on a comprehensive tariff re-balancing exercise in preparation for full sector liberalisation in 2004 (currently the long-distance business cross-subsidises local calls). However, the fixed-line operator Moldtelecom is expected to remain the dominant player in the liberalised market over the medium-term. Moldtelecom was also recently awarded the third GSM licence of the country, joining Moldcell and Voxtel, which have about 200,000 customers each. Unfortunately, the licence was awarded without a tender and at the lowest permissible amount. Another set-back has been the failed privatisation of Moldtelecom in 2002.

The energy regulator, ANRE, covers the oil, gas and power sector as well as heat generation. End-user heat tariffs are set by the municipalities – as in the case of water and waste water – although ANRE has some say over the tariff methodology. Unfortunately, the creation of an (at least notionally) independent regulator has not prevented government interference particularly in the power sector, and the reform effort has stalled. The privatisation of three of the five electricity distribution companies in 2000 helped to increase service quality – power is now available 24 hours a day – and eliminate fuel payment arrears in that part of the system, but as reported elsewhere the private operator, Union Fenosa, is facing an extremely difficult investment climate. Given the difficult sector environment, both locally and internationally, the privatisation of the remaining two distribution companies had to be postponed. Major problems also remain in the heat sector, where the Chisinau district heating company Termocom is now the main source of fuel payment arrears. Total Moldovan energy arrears currently stand at around USD 290 million (excluding Transnistria, which has accumulated USD 1 billion of arrears of its own).

2.2.4 Transition Challenges

The following six areas emerge as the key transition challenges for Moldova over the next Strategy period:

- ***Ensuring debt sustainability***

  To ensure macroeconomic stability the government needs to continue its tight monetary policy, exercise fiscal prudence, maintain access to finance from the World Bank and the IMF and reschedule external debt where necessary. An agreement with the Paris Club is an essential step in this respect, but a solution also has to be found on the energy debt to Russia.

- ***Improving the investment climate***

  Improvements are needed along all its dimensions, including government interference, weaknesses in the legal and regulatory framework, administrative barriers and corruption.

- ***Accelerating the programme of privatisation and enterprise reform***

  A push is needed in the privatisation programme, subject to interest among suitable strategic investors, to attract new capital and know-how and advance the stalled process of enterprise restructuring. Further and successful privatisation of the telecommunication and energy sectors as well as wine and tobacco enterprises, together with the implementation of a sound regulatory regime, represents one of the major challenges for the country over the next two years.

- ***Advancing energy sector reform***

  Power sector reform, including the privatisation of the remaining state owned distribution companies, is key to reduce losses, adjust tariffs toward cost recovery level and increase payment discipline. Reform is also needed to increase system reliability and, perhaps more importantly, raise cash for system maintenance, to reduce the quasi fiscal deficit, and clear external arrears.

- ***Deepening financial intermediation***

  Further support to develop the financial sector is needed to improve access to finance for the real economy, in particular for long-term finance and for start ups and SMEs. Legislative changes are also needed to support the introduction of new products such as mortgages and leasing.

- ***Building on recent progress on Transnistria***

  Negotiating and implementing a peaceful resolution of the Transnistria secession issue will require political will on both sides, as well as constructive support from the main participants in the OSCE-led process. The agreement to pursue a constitutional solution, based on the creation of a federal structure and granting of substantial autonomy to Transnistria, is a welcome development. In addition to the considerable diplomatic and security challenges that this issue raises, there is a need to address specific economic and political transition challenges in Transnistria, including the region's high external debt, very weak track record on reform, and the suspension of democratic norms and practices.

Addressing the transition challenges outlined above will not only require the full commitment of the Moldovan authorities, but close coordination among donor agencies and international financial institutions (IFIs).

3. Strategic Orientations

Given its mandate and experience to date, the Bank will, over the next Strategy period, focus primarily on supporting the development of the private sector, including public utilities. The Bank's support for infrastructure development will be subject to the suitable resolution of issues faced by its existing projects in the respective sectors. Given Moldova's precarious debt position, the Bank does not anticipate pursuing any new sovereign-guaranteed operations unless these are accompanied by sufficient grant co-financing and have a regional dimension.

Opportunities for new investment projects and the quality of the portfolio will largely depend on the investment climate created in the country. The Bank will collaborate with other IFIs on an intensive policy dialogue with the authorities to improve the business environment.

The recently OSCE-brokered federalisation plan, endorsed by both the Moldovan Parliament and the Transnistrian Supreme Soviet, is a welcome development. Should Transnistria's successful reintegration be completed in the coming Strategy period, and the political and economic transition process in the region proceed, the Bank will consider, as appropriate, extending its operations to this region.

The Bank activities will aim to address the following main operational objectives:

- **Financial Sector –** The Bank will focus on (i) the provision of financial support to the best local banks in the form of debt and equity financing, and (ii) expanding the Trade Facilitation Programme (TFP), with a view to further strengthening financial intermediation. New financial products, such as leasing and mortgage financing, will be supported if the regulatory and market conditions are conducive to their development.

- **Enterprise Sector** – The Bank will seek opportunities to support private enterprises, and particularly SMEs, including agribusiness, through (i) direct funding including equity, the latter mainly under the Direct Investment Facility (DIF), (ii) SME and micro-enterprise credit lines through local banks, (iii) risk sharing facilities with local banks, (iv) establishing a Warehouse Receipts Programme, and (v) expansion of the TurnAround Management (TAM) programme and establishment of a Business Advisory Service (BAS). The Bank will also seek to support projects which assist FDI and privatisation.

- **Public Utilities** – There are substantial needs in the development of the energy sector. The Bank's further involvement in this sector will be subject to satisfactory resolution of current outstanding issues affecting the past privatisations of certain energy distribution companies to Union Fenosa. New private projects will be subject to a suitable regulatory and operational environment in the energy sector. In the telecommunications sector, the Bank is prepared to consider support for a post-privatisation investment programme for Moldtelecom, subject to a transparent privatisation process.
- **Portfolio monitoring and implementation support:** given the extensive problems affecting state sector projects in the Bank's portfolio, significant operational staff resources will have to be allocated to this purpose.
- **Policy dialogue:** in the context of finalising and implementing Moldova's Poverty Reduction Strategy (PRSP), the Bank will collaborate with other agencies in increasing its policy dialogue with the authorities on the investment climate.

The Bank will continue to ensure that all EBRD operations in Moldova are subject to the Bank's Environmental Procedures and incorporate, where appropriate, Environmental Action Plans. The Bank will continue to co-operate with other IFIs and bilateral donors through co-financing, complementary projects and the close co-ordination of policy dialogue. In line with the International Community Initiative for the CIS-7 countries, the Bank is seeking to mobilise increased donor grant financing, which is very low, for technical co-operation in support of the preparation and implementation of its projects, legal transition work, and its policy dialogue on the investment climate.

3.1. Financial Sector

Despite difficult circumstances, banking sector reform has made significant progress. The banking sector has shown positive sustainable growth. During 2002 the assets of the banking sector increased by almost 33 per cent in MDL terms, net loans increased by 35.1 per cent and total deposits grew by 48.9 per cent. The product range offered by leading banks has been diversified as they started issuing and servicing debit cards, and offering quick money transfer options, on-line banking and leasing services. The leading banks financed by the EBRD have become efficient financial intermediaries in supporting private sector development. The implementation of all EBRD projects in the sector remains good under current circumstances.

The future transition objectives of the Bank will continue to be primarily related to the further development of the private banking sector and the efficient and adequate financing of private enterprises through local banks, particularly SMEs and micro-enterprises. Priority will also be given to expanding the coverage of the financial sector to other instruments such as leasing and mortgages.

The Bank's operational objectives in the financial sector would include:

- Maintaining and enlarging effective financial intermediation to reach SMEs and micro-enterprises. This would include close monitoring of the existing credit lines and implementation of new transactions with existing and possibly new client banks in Moldova.
- Enlargement of longer-term lending possibilities to the best clients of the partner banks via the risk sharing facility for low-income countries currently under preparation, to promote sound and viable medium-sized projects in the private sector and to enhance the services provided by the local banks in this segment of the market.
- In terms of equity participation in local banks, the Bank will continue to monitor investments in Victoriabank, Moldova-Agroindbank and the Micro-Enterprise Company. The Bank will also consider increasing equity in the existing banks and taking new equity in other performing Moldovan banks on a selective basis.
- The Bank will continue to implement the Trade Facilitation Programme by promoting more active utilisation of the Programme by banks already in the Programme (Victoriabank, Moldova-Agroindbank, Moldindconbank and Mobiasbanca), as well as through the introduction of new instruments (e.g. revolving credits) and the inclusion of new participants.
- The Bank will endeavour to identify new projects in insurance, mortgage, leasing and other financial products, including technical assistance both to set up proper legal and regulatory frameworks and to structure investment projects, subject to the availability of strong and committed sponsors and an appropriate investment climate.
- The Bank would stand ready to consider participating in the privatisation of the Savings Bank.
- The Bank will continue its on-going dialogue with the National Bank of Moldova and other local financial institutions, aiming for further improvements in the legal and regulatory frameworks and elimination of obstacles to the development of the sector.

3.2. Enterprise sector

To sustain economic growth Moldova needs to further develop its enterprise sector by accelerating the restructuring of existing firms, promoting business start-ups and supporting SMEs. An unstable business environment, harassment by regulatory bodies, corruption, lack of efficient and accessible fiscal incentives, recent re-privatisation cases, and lack of medium and long-term funds available from the banking sector are hampering growth in the private sector, including SMEs. Many Moldovan enterprises also face difficulties in restoring commercial relations with the traditional CIS markets, and do not yet possess the required skills and competitive advantage to compete in Western markets.

The Bank will aim to support the development of a strong private sector, competitive domestically and internationally, with a particular focus on SMEs and micro-enterprises. Specific attention will be given to corporate governance and transparency. Through its policy dialogue with the authorities, the Bank will continue to promote improvements in the business climate, including reduced government interference. The Bank will also aim to cooperate with strategic partners who can improve backward and forward linkages, provide professional know-how, skills, and the FDI needed, and contribute to the sustainability of the projects and enterprises after its exit.

More specifically, the Bank will endeavour to:

- Provide funding for privatisation and post-privatisation projects, subject to commitment by the authorities to satisfactory and transparent privatisation processes. This would include privatisation of infrastructure enterprises, and other means of private sector participation (e.g. through concessions). The Bank's contribution could include, subject to adequate commitment by the authorities, technical assistance in support of the privatisation process.
- Work with local financial intermediaries to provide funding for SMEs and micro-enterprises through credit lines, as well as to promote trade through the Trade Facilitation Programme.
- Support local financial intermediaries and their medium and larger sized private clients by direct co-financing of their best clients to overcome the banks' longer-term funding constraints and single borrower exposure limits.
- Consider equity investments in local enterprises primarily through the Direct Investment Facility (DIF) or other mechanisms that may be established for this purpose in Moldova.
- Expand the Turnaround Management (TAM) Programme and establish a Business Advisory Service (BAS).

Agriculture and agribusiness play an important role in Moldova's economy, generating 21 percent (in 2002) of the country's GDP, employing almost 40 percent of the population and accounting for close to 60 percent of exports.

Moldova has implemented several fundamental reforms in agribusiness, such as privatisation of the majority of processing enterprises, land and farm restructuring. The privatisation process that started in 1993 has led to privatisation of more than 95% of all enterprises in the agro-processing sector. Despite these, agriculture and agro-processing are still underperforming in terms of productivity and marketability. The slow implementation of reforms and the overall unfavourable investment climate have both contributed to lack of interest from foreign investors and, as a result, there is a low level in the restructuring and modernisation of existing processing facilities that continues to result in low sector performance.

Given the importance of the agribusiness sector for the economy, including in terms of export, the Bank's operational priorities will include:

- Exploring opportunities to directly finance agribusiness companies, including working with potential foreign strategic partners to mitigate high risks in the sector, ensure transfer of know-how and maximise demonstration effect. These direct investments are likely to focus on export-oriented projects in sectors such as beer, wine, including vineyards, and the fruit and vegetable processing sectors.
- Considering the possibility of establishing a Warehouse Receipts Programme, as a means of financing the working capital needs of the agribusiness sector and improving transparency of commodity product transactions.

3.3. Infrastructure

3.3.1. Power & Energy Sector

Moldova's energy sector has been restructured significantly in the past few years, which has resulted in the unbundling of Moldenergo, the former power sector monopoly, and the creation of ANRE, the energy regulatory agency.

In 2000 Moldova embarked on a privatisation programme, beginning with its electricity distribution companies. Three out of five power distribution companies were privatised by Union Fenosa, a Spanish utility. The Bank supported this privatisation by providing both equity and debt financing (the latter with co-financing from the IFC) aimed at meeting investment obligations directed to decrease losses, improve the quality of services, and enhance the financial performance of the privatised companies. Since the privatisation, there have been significant improvements in the sector, including the return to a stable and secure power supply, improved billing and collection, cessation of barter transactions, and improved corporate governance of the distribution companies. However, the Spanish investor has faced a series of obstacles, including challenges to the legality of the privatisation contract, and external influence on ANRE's activities impeding timely and proper tariff adjustments. Although the issue of the legality of the privatisation appears to be currently in the process of resolution, both issues require final resolution and have had a significant adverse effect on the performance of the privatised companies and the investment climate in the country.

This has also led to the failure of attempts to privatise the two remaining state-owned distribution companies and electricity generation assets to qualified strategic investors. The Government has recently renewed its efforts in this area, in co-operation with the donor community. In light of the financial position of Moldova, the continuation of privatisation in the energy sector is of paramount importance to allow the state to divest ownership and operation in substantial parts of the sector and economise on scarce central management resources. Whereas earlier the success of this process depended mainly on the sector's reorganisation, which has been fairly well implemented, it must now be recognised that investors will require evidence of government policies supporting the further development of the sector. The final and irrevocable resolution of the problems faced by Union Fenosa in regard to the legality of the privatisation contract and tariff adjustments, accompanied by adequate support from the Government and the regulator, are needed to provide the right signals to encourage further investments in Moldova.

Although Moldova has made important progress in restructuring the energy sector, restructuring in itself without true willingness to implement tariff reforms will not result in a sustainable sector. Further progress in reform, attracting investment and finalising privatisation of the remaining state-owned assets will only be possible with strict objective observance of the agreements which the authorities have entered into and the regulatory guidance that has been promulgated. Only then will it be clear to the investment community that political will exists to support foreign investment. Moldova's participation in and domestic implementation of international efforts, such as the South East Europe Regional Energy Market, can provide further comfort to the international investment community, that Moldova intends to follow through in its policies and commitments.

During the Strategy period, the Bank will continue to monitor implementation of the Union Fenosa power distribution project. The Bank will work closely with the World Bank, USAID and other donors to ensure that the issue linked to the challenges to the legality of the privatisation of the three power distribution networks is resolved in a final and irrevocable manner. Provided that the latter issue faced is resolved quickly and in a satisfactory manner, that the privatised power distribution companies achieve satisfactory economic stability through appropriate tariff increases in line with the tariff methodology, and that sector reforms continue, the Bank will:

- Consider financing, alongside suitable strategic investors, the post-privatisation investment programmes of the North and North West Power Distribution Networks, as well as of the two combined heat and power stations in Chisinau, subject to a transparent privatisation process;
- Consider the financing of potential independent power generation projects if these prove bankable and competitive with energy imports;
- Consider a power transmission project to improve interconnections between Moldova and its neighbouring countries, provided that the project has a strong commercial rationale, improves

the efficiency of the sector, and is associated with appropriate steps by the authorities to reduce transmission losses within the country, and is co-financed by grants from other donors;

- Possibly support for the restructuring and privatisation of the Chisinau District Heating Company (Termocom); and
- Support feasible and clearly defined private sector energy efficiency projects on a stand-alone basis or as part of EBRD financing to local enterprises.

3.3.2. Telecommunications Sector

The telecommunications sector has undergone some positive changes over recent years. It is currently regulated by the National Regulatory Agency for Telecommunications and Information Technologies (ANRTI), set up in 2000. While the degree of its independence is unclear, the authorities assert a desire to clarify and consolidate in ANRTI regulatory competencies applicable in the sector to ensure legal/regulatory stability and the credibility of the regulatory function.

The state-owned Moldtelecom is the only provider of fixed line telephony and possesses exclusivity over long distance and international fixed line telephony, which expires on 1 January 2004, in line with the requirements on market liberalisation of the WTO "Reference Paper" on telecommunications. A cost-based tariff re-balancing plan is currently being implemented aiming to introduce cost-based tariffs for local and international calls by 1 January 2004. This is expected to prepare Moldtelecom for market liberalisation.

The third international tender for the privatisation of Moldtelecom organised in 2002 failed due to lack of interest and the low price offered by the single Russian investor qualified for the tender. However, Moldtelecom's privatisation is still included in the Government's privatisation programme and will be implemented when the situation is deemed to be appropriate.

Mobile services are currently provided through two companies Voxtel, and Moldcell, which have approximately 200,000 customers each. In February 2003 ANRTI approved a decision to issue the third mobile telephony licence to Moldtelecom. The price to be paid for this licence was decided by the Government and is much lower than that paid by the two existing operators.

Given the situation in the sector, the Bank will aim at supporting privatisation, the attraction of suitable strategic investors, strengthened independent regulation, and improved competition in the sector. During the next Strategy period, the Bank will pursue the following operational priorities:

- Consider financing, alongside a suitable strategic investor, the post privatisation investment programme of Moldtelecom, subject to a satisfactory and transparent privatisation process.
- Consider financing private telecom operators, including mobile telephony, should such assistance contribute to the strengthening of competition in the sector.

3.3.3. Transport Sector

The transport sector remains one of the least developed sectors mainly due to lack of sufficient funding for maintenance and investments. The efficient operation of the transport sector is important to support Moldova's economic recovery and growth. The country's geographical position, including its future closeness to the European Union, can have a significant impact on the country's development but requires, on a priority basis, the rehabilitation of major international routes.

The road sub-sector carries over 80 per cent of all domestic traffic. The road network is extensive in relation to the country's size. However, during the last ten years, due to lack of resources, the state has not been able to invest into road rehabilitation and adequate maintenance, and, as a result, the road network has significantly deteriorated. This is continuing and, if no remedial actions are taken soon, the cost of rehabilitation will increase significantly.

The Giurgiulesti Oil Terminal Project has experienced significant implementation delays, mostly due to the Government's failure to fulfil its financial and regulatory obligations. The restructuring of the project was initiated in 2002 through a mediation process. The parties agreed to sell the project, and the Government, at its own initiative, undertook to find a suitable investor. However, after more than a year the Government has still not concluded the transaction, and the Bank has requested the authorities to proceed with a public tender to find a suitable strategic investor.

Due to the importance of the transport sector in the economy and in view of the country's limited capacity for sovereign-guaranteed borrowings, the Bank's operational priorities in this sector will be as follows:

- Finding a satisfactory solution to the problems surrounding the Giurgiulesti Oil Terminal. This would be a necessary pre-condition to the financing by EBRD of other projects in the sector.
- Consider financing of a road rehabilitation project, subject to the ability to attract adequate grant co-financing (in order to achieve sufficient concessionality) and agreement with the IMF, and if sufficient transition impact can be demonstrated. The aim of the project would be to achieve the maximum transition impact by alleviating critical bottlenecks and repairing heavily used sections of roads, which have deteriorated to a critical extent.
- Support feasible and clearly defined private projects in the sector.

3.3.4. Municipal (Water) Infrastructure

Despite the reorganisation of municipal utility companies into joint-stock companies several years ago, no significant changes in the legal, regulatory and financial situation have so far taken place. The key challenges for this sector remain budget constraints leading to inability to honour financial commitments to the utility companies and vulnerable segments of the population, low tariffs not covering costs, high costs and inefficient management in some companies, low collections, high levels of bad debt, and lack of efficient and workable legal and regulatory mechanisms which may be used against non-payers. Privatisation or management contracts for the utility companies might be an option for their successful turn around; however these first require strong commitment and a favourable environment to be created by the central and local authorities of Moldova.

EBRD investments into municipal utilities are aimed at improving the financial performance of the respective companies by reducing losses, decreasing operating expenses, improving billing and collection systems and promoting the proper regulatory environment that would ensure adequate tariffs, covering the service providers' costs and investments needs.

The Bank will focus resources on the successful implementation of its current municipal water project in Chisinau. Follow-on projects in Chisinau, or perhaps elsewhere, will also be heavily predicated on improved macroeconomic conditions that ensure that the affordability to the population is adequate to support the cost of additional investment programmes. Measures to directly assist financially the poorer segments of the population will need to be implemented, coupled with appropriate tariff setting mechanisms.

3.4. Policy dialogue with the authorities on investment climate

Since 1999 Moldova remains one of a few countries where the investment climate has not improved and in fact has deteriorated. During the last two years the Government has taken an interventionist approach towards private businesses and particularly in regard to foreign investors, who had acquired companies through privatisation in the past. This drives off potential foreign investor interest in the country. The poor results of privatisation activity in 2001-2002 are one of the clearest resulting signs.

An example outlined in this document relates to the obstacles faced by Union Fenosa, the Spanish operator of the three private power distribution utilities, which has been affected by strong state interference, and the risk that the original privatisation deal could be declared illegal remains. A positive and irrevocable decision of the authorities on the legality of privatisation of the three power distribution networks is vital for the continuation of reforms in the energy sector and to attract foreign investors to the country.

In view of the critical importance of improving the business climate in Moldova, which currently negatively affects the country's development, the Bank will continue and expand its dialogue with the national authorities, in co-ordination with the other IFIs, on actions needed to improve the current situation, including in the context of the development of the PRSP.

3.5. Portfolio management

The Bank will continue to allocate significant operational staff resources to project monitoring, given the various problems experienced by the state sector and infrastructure projects in the portfolio. The Resident Office will continue to play an essential role in the management of the Bank's portfolio in Moldova.

4. Other IFIs and Bilateral Donors

The Bank will continue its close co-operation with other IFIs and donors present in Moldova. It will enhance its policy dialogue with the Moldovan authorities addressing issues related to general investment climate in the country, structural reforms, privatisation and post-privatisation support. Co-ordination with the IMF, IBRD, IFC, and USAID on investment climate issues, particularly in the energy sector, will be maintained. The Bank will also actively support the preparation and implementation of the PRSP, mainly from the standpoint of the private sector's role and its development, where the Bank has a comparative advantage.

In the context of the International Community Initiative for the CIS-7 countries, the Bank will seek to mobilise increased donor grant financing for technical co-operation in support of the preparation and implementation of its projects, legal transition work, and its policy dialogue on investment climate. Given Moldova's debt and poverty problems, the Bank would welcome a greater involvement of the donor community in the country, and is prepared to collaborate on specific initiatives in this respect.

ANNEX 1: POLITICAL ASSESSMENT

Compliance with Article 1

Moldova is committed to the principles of multi-party democracy and pluralism in accordance with Article 1 of the Agreement Establishing the Bank, though application of those principles during the previous Strategy period has not always been consistent.

Political Accountability

Moldova is a multi-party parliamentary democracy in which the unicameral Parliament is elected through proportional representation and the President is elected by the Parliament. The President appoints the Prime Minister who forms the Cabinet. The appointments of the Prime Minister and the Cabinet are subject to approval by the Parliament. In principle, the constitution, amended in 2000, provides for divisions of power and an independent judiciary. Under the current administration, both precepts have been called into question.

The Communist Party's decisive victory in the last general election allowed them to occupy the office of President and Prime Minister and maintain majority control of the Parliament. Although the process of political consolidation has led to improved policy co-ordination, dominance by a single party in all central decision-making bodies also reduces the effectiveness of checks and balances among the branches of power. Indications of the potential for abuse of power by the controlling majority were evident in the attempt in early 2002 to introduce mandatory Russian language instruction in all Moldovan schools, which led to wide-scale protests. The authorities' first response to public resistance was to suspend the activities of the opposition Christian Democratic Popular Party, which organised some of the demonstrations. Due in part to timely intervention by the Council of Europe, the policy was reversed and tensions subsided, but the Government sacrificed some of its hard earned trust among the electorate by pursuing policies at variance with the sentiments of the country's Moldovan/Romanian majority.

Elections in Moldova generally have been judged free and fair by international monitors, and this is an important step toward democratic consolidation. The OSCE final report on the February 2001 general election stated that the parliamentary elections "were conducted in accordance with the OSCE commitments for democratic elections enshrined in the 1990 Copenhagen Document and in the framework of the obligations of Moldova as a member State of the Council of Europe."

Two elections have been held since the February 2001 general election. In the regional election for Bashkan (Governor) of Gagauzia in October 2002, the OSCE did not organise an observation mission but the OSCE's Moldova Mission based in Chisinau did carry out a political assessment of the election process and the Council of Europe's Congress of Local and Regional Authorities of Europe (CLRAE) organised a small observation team. Both organisations noted a number of "procedural irregularities and shortcomings" in their election assessments.

The conduct of the local elections held in May 2003 was monitored by the OSCE Office of Democratic Institutions and Human Rights (ODIHR), jointly with the Council of Europe's Congress of Local and Regional Authorities of Europe (CLRAE). The preliminary conclusion was that "the conduct of the 25 May local elections in Moldova is a source of concern." Observers noted several positive elements of the election, mainly in the area of the legal framework and election administration, but focused on several "serious problems" during the election campaign that cast doubt on the "integrity of the elections and may have damaged public confidence in the electoral process". Among these, the international observer mission noted the arrest and intimidation of opposition candidates, incomplete separation of party and government, and the alleged misuse of public resources by the ruling party for campaign purposes, and a clear bias in favour of the authorities on state television.

The local elections were the first to be held following the controversial local Government reforms which entered into force in March 2003. Under these reforms, the ten constituent regions (judets) of Moldova were replaced by thirty two districts (raions). This reversed the reforms of 1999 which had garnered praise from the Council of Europe, and returned Moldova to the territorial-administrative division in place during the Soviet era. The return to a system of tighter control by the centre over local and regional affairs came in for heavy criticism by Moldovan civil society groups and mayors, the Council of Europe's CLRAE, and the International Monetary Fund, which cautioned that the projected cost of the reform would almost certainly rise with implementation, placing additional strain on the country's budget.

The Constitutional Court struck down several aspects of the first version of the territorial-administrative reform – including the call for early local elections and the switch to indirect election of local mayors by district councils – which reinforced faith in the process of judicial review. Also, the Government of Moldova has addressed many of the concerns raised by Council of Europe experts in amending the reform legislation, and in April 2003 they declared that, while certain questions remain outstanding, "this reform now broadly satisfies the Council of Europe."

Civil and Human Rights

The Government of Moldova generally adheres to its Council of Europe and OSCE commitments to uphold democratic standards of governance and to guarantee protection of human and civil rights. The Constitution provides for freedom of speech and press, freedom of assembly, association, and religion and these freedoms are generally respected in practice

There have been questions raised by Moldovan media NGOs, including the Moldovan Union of Journalists, regarding media freedom. They argue that the state press has become an instrument to promote the interests of the ruling Communist Party of Moldova. Opposition groups complain of government pressure on independent media imposed via financial and legal means. The Council of Europe has been actively involved in ensuring that media freedom continues in Moldova, and in that connection provided expert advice on the revision of the broadcasting law and the alteration of the status of the national public broadcasting company *Teleradio-Moldova*. The final version of the law, which was passed in March 2003, was called "an undeniable improvement" over past versions by the Council of Europe.

Another issue of concern is trafficking in persons. The law prohibits trafficking in persons, but the practice of trafficking in women and girls remains a very serious problem. Although the law imposes severe penalties for trafficking in persons, critics maintain that Government does not do enough to prosecute alleged traffickers. The US State Department has classified Moldova a Tier 2 country with regard to trafficking in persons – Tier 2 countries are those that do not meet minimum standards for eliminating trafficking in persons in accordance with the US Trafficking Victims Protection Act, but where the authorities are making significant efforts to bring themselves into compliance with the Act. The International Organisation for Migration (IOM) reported that Moldova was the main origin in Europe for the trafficking of women and children for prostitution in the Balkans, Western Europe, and the Middle East. The Government of Moldova has taken some action to amend the Criminal Code, criminalising trafficking in persons, and some special training courses for law enforcement officials have been introduced; however, borders require further strengthening and protection for victims is inadequate.

External Relations

The current leadership in Moldova has pursued co-operative relations with all its main international partners, including the CIS, the EU, Russia, Ukraine, Romania and the United States. Moldova is a member of the WTO and the Stability Pact for Southeastern Europe. The European Union's Wider Europe initiative has opened the door to increased co-operation, which the current Government has taken positive steps to reciprocate. A parliamentary committee and a separate Government Committee on European Integration have been recently established. Tensions with the Government of Ukraine over management of the common border and customs administration has been eased thanks to a customs protocol signed in May 2003. A protocol was also signed to co-operate in combating illegal trafficking in arms, munitions, explosives and psychotropic substances.

There has been recent progress in the pursuit of a peaceful settlement of the dispute over Transnistria. The OSCE-brokered federalisation plan has been endorsed by both the Moldovan Parliament and the Transnistria Supreme Soviet, and an official protocol laying out the timetable for a referendum (February 2004) and subsequent elections (February 2005) was signed in early April. Keeping to this schedule will not be easy, as public support for federalisation is still relatively weak in both Transnistria and the rest of Moldova, and the two sides have yet to agree on the key issue of Transnistria's autonomy in a federal state – Tiraspol wants an equal division of rights and responsibilities with the rest of Moldova, while Chisinau insists on an asymmetrical division with certain rights held exclusively by the centre (defence, border controls, customs, currency). Opposition groups in Moldova, who continue to insist on the preservation of a unitary state that includes Transnistria, have threatened to organise mass resistance to the plan. Co-ordination among the Russian Federation, the United States and Ukraine, through the OSCE mechanism, has been instrumental in getting to this point and will remain the key to achieving success.

ANNEX 2: LEGAL TRANSITION

COMPARATIVE ASSESSMENT OF MOLDOVA'S COMMERCIAL LAW

I. Assessment Over Time

According to the results of the Legal Indicator Surveys[4] conducted by the EBRD from 1997 to 2002, the extensiveness and effectiveness of Moldova's commercial laws as perceived by Moldavian legal practitioners seemed to be improving during the period 2000-2002. However, the effective implementation and enforcement of laws is still a major problem in Moldova, which has caused the perceived effectiveness of the commercial laws in Moldova to lag behind their extensiveness in practice. Therefore, a legal reform priority for the Government is to improve the effectiveness of the laws that the country has enacted.

II. Comparison with Other Transition Countries

According to the 2002 EBRD Legal Indicator Survey results, the commercial laws of Moldova as perceived by local lawyers and other legal practitioner were rated roughly on par with Romania or Kazakhstan. While this may suggest that the internal legal perception overall compares relatively well with that of other transition countries, Moldova's legal system in general does not yet fully approximate best international standards and still lacks adequate institutional support to implement laws as mentioned above.

LEGAL SECTOR ASSESSMENT

Bankruptcy

The Law of the Republic of Moldova No. 632 - XV on Insolvency dated 14 November 2001 as amended in 2002 (the "Law") regulates the process of restructuring insolvent enterprises in order to improve their financial state, as well as insolvency proceedings aimed at satisfaction of creditors' claims and liquidation of the insolvent enterprise.

Restructuring is an out-of-court process carried out under the supervision of the Council of Creditors, while insolvency proceedings are carried out under the supervision of the court. The Law sets forth the rights and obligations of the participants of the restructuring process and insolvency proceedings, establishes consecutive steps thereof, and determines the manner and order of satisfaction of creditors' claims, as well as particularities of insolvency proceedings applicable to specific industries, such as financial institutions and insurance companies.

---

4 The EBRD conducts a Legal Indicator Survey each year to measure the progress in legal reform in Central and Eastern Europe, the Baltic States and the Commonwealth of Independent States, as viewed by local lawyers and academics. The results of such survey are based on responses to the questionnaire sent out to lawyers practising in any given country. The survey represented their perception of the country's legal system and, in particular, the degree to which key commercial and financial laws have reached internationally acceptable standards (extensiveness) and to which extend these laws are implemented and enforced (effectiveness). The survey is based purely on local lawyers' perception of their own country legislation and does not represent EBRD's own view on these legal systems. In addition, it must be noted that each respondent is asked to answer the questionnaire for his/her country only, and not on a comparative basis.

According to the Law decisions of the Creditors' Committee are subject to approval by simple majority vote of its members representing at least 50 per cent of the total amount of the approved claims. The Law requires that the insolvency administrator be duly licensed for this type of activity.

Overall, the Law is perceived by practitioners as workable. However, in practice difficulties occur in the realisation of assets due to their low liquidity.

In recent years, bankruptcy proceedings have been used relatively frequently for purposes of liquidating insolvent companies existing since Soviet times.

Capital Markets

The principal regulator for the Moldovan securities market is the National Commission for Securities of Moldova (the “MNCS”), which was founded in accordance with the Law on National Commission for Securities of 1999 as amended in 2002 (the "NCS Law"). The other major piece of legislation concerning the Moldovan securities market is the Law on Securities Market, which came into force also in 1999. Along with the NCS Law, the Law on Securities Market was also amended in 2002. The provisions amended concern professional activities in the market, registration of reports to be filed with the MNCS and disclosure requirements by market participants.

The Moldova Stock Exchange was established in December 1994. However, trading activity remains relatively low and the market under-developed. The Moldovan over-the-counter market was abolished in October 2000, in accordance with a decision of the MNCS.

The insurance industry is at an early stage of development. According to an amendment to the Law on Insurance in 1999, 100 per cent foreign-owned companies are now allowed to sell insurance in Moldova; prior to the amendment, only companies with no more than 49 per cent foreign ownership were permitted to do so. A Law on Public Pensions was adopted in 1998, which was designed to improve the financial stability of the existing pay-as-you-go system by increasing the retirement age, eliminating privileges, and increasing individual contributions in line with benefit entitlements.

Concessions

Moldova has a separate Law on Concessions of 1995 as amended in 1999 and 2002 ("the Law"). In addition to the Law, Moldova has a number of sector laws regulating industry specific arrangements, including for instance the Law on Natural Resources and the Water Code. Furthermore, concession tender rules and procedures are governed by separate governmental Regulations.

Under the Law, any company or individual, domestic or foreign, save for a state or municipal entity, may be a concessionaire. The Law does not provide for a list of sectors that may be developed on a concession basis. Instead, it states that concession arrangements are permitted in any sector and activity to the extent this does not contradict the laws of Moldova. The assets subject to concession, along with its proposed mandatory terms, are first to be approved by the Government and then affirmed by the Parliament, after which the proposed concession is published for potential bids. Concessions are granted on the basis of tenders or direct negotiations where there is only one bid.

According to the Law, the concession agreement can not exceed 50 years. The Law provides for the right of concession granting authorities to unilaterally change the terms of a concession agreement on certain grounds listed in the Law. The concessionaire’s right for compensation is provided for by means of court procedures. The grounds for termination, however, seem vague. Also, fairly vague grounds exist for unilateral termination by concession granting authorities, such as for example the "violation by a concessionaire of the agreement terms".

Any transfer by a concessionaire of concession assets/rights is prohibited by the Law. This statutory restriction inevitably limits financing options. According to the Law, disputes may be resolved either by court proceedings or by arbitration (including international).

Corporate Governance

The Law on Joint Stock Companies (the "JSC Law") was adopted in 1997 and has been amended several times since then, most recently in 2002. There is no separate Corporate Governance Code existing in Moldova at the moment.

According to the JSC Law, a joint stock company ("JSC") is required to hold a general meeting of shareholders every year. Terms for notification and publishing information concerning the general meeting are specified by the charter of the JSC but cannot be less than 25 days following the date of completion of fiscal year or more than 30 days prior to the meeting date. Shareholders holding at least 5 per cent of voting shares of the company are entitled to request the board of the company to include in the meeting agenda up to two issues and to nominate candidates to the board of directors and to the auditing committee. The board of the company, however, has the right to refuse such request on grounds specified in the JSC Law. Members of the board of directors of a JSC shall be elected by general meeting of shareholders for a term of one year and are eligible for re-election without limitation. The number of board members in a JSC shall be determined by the company's charter and shall not be less than three. A simply majority of votes present at the meeting is required for a general meeting of shareholders to adopt a resolution concerning ordinary issues as defined by the JSC Law. For issues (for example, major corporate transactions) listed by the JSC Law or the company charter as within the exceptional authorities of the general meeting of shareholders, at least two-thirds of votes present at the meeting are required to adopt a resolution. Shareholders can vote in person or by proxy. The JSC Law has provisions specifically dealing with corporate transactions involving a conflict of interests situation. As regards take-over situations, a person who has acquired controlling stock is required to offer to all shareholders to buy their shares at average market price.

One of the common violations of shareholder rights in Moldova is abuse of office by officers in JSCs. Other violations commonly seen in the country include failure to notify shareholders about holding general meetings of shareholders, failure to hold tenders in cases of purchase of controlling interest, insider purchase/sale of shares without complying with the procedures prescribed by the law and insufficient disclosure to shareholders of information on the operations and activities of the company.

Secured Transactions

Security over movable assets is governed by the Law on Pledge of 30 July 2001, which entered into force on 1 November 2001. It was partly prepared with the assistance of the EBRD, GtZ and others, and was aimed at dealing with a number of concerns and deficiencies identified through the use of the 1996 Law. Yet, the major deficiency of the system was the absence of an adequate registration system. The registry that has been in operation since 1996 was operated by the Chamber of Notaries, and was paper-based. Entries made in regional offices were transmitted by phone to the central registry. Notaries were unclear as to the extent of their role in registration and the procedures themselves are confused with potentially dangerous consequences for the parties. The EBRD worked in 1998-2000 with the Ministry of Justice on the creation of a centralised, computerised registration system. However, the lack of commitment from the government, as well as disputes over the registry's operation and lack of agreement with the Chamber of Notaries made further progress impossible.

On 27 June 2002, the government approved an Order on The Register of Pledged Movable Assets and Regulations on the Register (published on 1 July 2002) providing more detailed rules on the functioning of a new register and the registration procedure. The registry is now operated by the Ministry of Justice and entries are made to a notary office. There are a number of problems in the way the register seems to operate: first, it is kept in both manual and electronic manners and in case of discrepancy of data, the manual data are meant to prevail. This defeats significantly the advantage of a computerised system and may mean the reintroduction of the uncertainty and distrust experienced under the former system. Also, the Order is unclear as to who will have access to information, in particular whether the register is open to public inspection – the Order seems to imply that only interested parties could have access to it, and prohibits "illegal dissemination" of information: this would go against the primary objective of a registry, which is to provide publicity to third parties. It is still too early, yet, to draw definite conclusions on the new system: it was put in place at the end of 2002. It seems to be functioning, with the number of notaries connected to the system constantly growing. Banks overall seem pleased with it.

An additional concern with the existing system involves the enforcement procedures. While the 1996 Pledge Law provided that a pledge creditor had the right to foreclose and sell pledged property without recourse to a court in the event of the debtor's default, in practice, the creditor faced major uncertainty as to the validity of such process, as well as obstruction by the debtor which resulted in lengthy litigation. It is unclear whether the new provisions have remedied these difficulties.

Telecommunications

The telecommunications sector in Moldova is currently governed by the Telecommunications Law of 1995, as amended through to 2001, and is regulated by the National Regulatory Agency for Telecommunications and Information Technologies (ANRTI). The ANRTI was established by decision of the Government of Moldova in 2000 and performs operational (day-to-day) regulation of the sector. The strategic policy maker for the sector is the Ministry of Transports and Communication.

The state-owned Moldtelecom is the primary provider of public local telephony and Internet services and possesses exclusivity over long distance and international fixed line telephony. There is some competition in data provision, paging, VSAT (satellite) and Internet service provision. Mobile services are provided through Voxtel, (a joint venture of Moldovan, French and Romanian companies) and Moldcell.

As part of Moldova's accession to the World Trade Organisation (WTO) the Government of Moldova has committed to liberalise the telecommunications market by 2004 in line with the requirements of the WTO "Reference Paper" on telecommunications. Rules and procedures regarding interconnection have been adopted and the government aim at strengthening ANRTI's independence. While the degree of independence enjoyed by ANRTI is unclear, the authorities assert a desire to clarify and consolidate in ANRTI regulatory competencies applicable in the sector to ensure legal/regulatory certainty and the credibility of the regulatory function.

A new tariff control regulation was adopted in 2001 and the Government of Moldova aims at completing the first phase of a cost-based tariff re-balancing plan by 2004. This plan seeks to make international calls competitive and introduce cost-based local and long distance tariffs for both residential and business users. It is also expected that the tariff re-balancing plan will increase the value of Moldtelecom and attract new operators into the country.

While the Government of Moldova appears committed to the privatisation of Moldtelecom, the preparations therefor have proceeded with some difficulty to date. The Government of Moldova recognises that efforts to reform and privatise Moldtelecom to date have damaged Moldova's reputation in the international investment community somewhat and may have decreased the attractiveness of investment in Moldtelecom on the international market. However, it should be noted that establishment of ANRTI is a significant step and their role in restructuring this sector will greatly assist the process. In addition, an advisor has been selected to assist the Government of Moldova in the privatisation process through an open, competitive and transparent international tender (together with the transfer of management control) on the basis of objective selection and evaluation criteria.

The key to progress in sector development is liberalisation and privatisation. To facilitate and support the liberalised environment envisaged for Moldova the authorities must continue to adopt and implement modern rules and procedures for the sector. Whilst the Government of Moldova appears to have made significant strides towards reform of the sector to date, much will now depend upon the practical implementation of those reforms. The independence, powers and resources of the ANRTI will be critical in this regard and the Government of Moldova must ensure appropriate support for ANRTI in its implementation of sector reform initiatives.

LEGAL REFORM PROJECTS

Legal Reform Project to Improve Leasing Transactions Related Legislation in Moldova

The Bank has approved a project to assist the Government of Moldova in creating comprehensive and modern leasing legislation. The main project work is to help Moldova evaluate the existing Moldovan legislation concerning operational and financial leasing transactions and to assist the Government to develop legislative proposals to reform the existing legal framework with the aim to bring the relevant legal framework into line with international sound practice in the leasing law area.

ANNEX 3: ENVIRONMENTAL ISSUES

Moldova's Ministry of Environment (MoE) was established in 1998. Environmental protection units have been set up at local level, by the MoE. Following the country's first National Environmental Action Plan (NEAP) in 1996, the Strategic Orientations of the Social and Economic Development were adopted by the Government in 1998. The authorities have prioritised water quality issues, especially water supply and wastewater treatment in urban areas. Furthermore, the Government specifically prepared a water supply and wastewater treatment programme for localities in 2002 to improve water quality and efficiency of water use.

Environmental quality improvements have been observed in Moldova. According to UNECE's environmental review, NOx levels have been reduced due to the increased use of gas. There is reduced pesticide use due to the cut down of agricultural subsidies and improved water quality, particularly in major rivers, through wastewater treatment investments. The Government aims to harmonise its environmental legislation with EU environmental directives. Insufficient institutional capacity and financial resources remain key obstacles to improvement of environmental.

The Bank's environmental approach in Moldova will focus on demonstrating the benefits of good environmental practice and the introduction of cleaner and more efficient technologies in the context of Bank-financed projects. In the financial sector, EBRD has conducted environmental due diligence training for four local banks. The training ensures that the Bank's financial intermediaries (FIs) are capable of implementing environmental due diligence procedures which are incorporated into the FIs' credit/investment appraisal process. The EBRD's Chisinau water service rehabilitation project is aimed at improving the water supply and waste-water treatment in the capital city.

The World Bank is implementing the Global Environmental Facility (GEF)-funded biodiversity strategy development project as well as preparing a wetland & biodiversity conservation project that will address existing national environmental priorities including improvement of water quality and habitat management on the Nistru River. With World Bank support, Moldova has prepared documentation for a biodiversity action plan (2001-2010).

ANNEX 4: selected economic indicators

Moldova updated Apr03

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
											Projection
Output and expenditure					*(Percentage change in real terms)*						
GDP	-1.2	-30.9	-1.4	-5.9	1.6	-6.5	-3.4	2.1	6.1	7.2	6.0
Industrial gross output	0.3	-27.8	-3.9	-6.5	0.0	-15.0	-11.6	7.7	13.7	10.8	na
Agricultural gross output	9.9	-24.6	1.9	-11.6	11.4	-11.0	-8.0	-3.3	6.4	3.0	na
Employment					*(Percentage change)*						
Labour force (annual average)	-1.0	0.0	-24.2	-6.5	-6.5	-5.4	-17.5	-15.1	na	na	na
Employment (annual average)	-17.7	-0.4	-24.7	-6.7	-6.5	-6.4	-18.2	-15.6	-5.8	2.3	na
Unemployment (end-year) 1/	na	na	na	na	na	9.2	11.1	8.5	7.3	7.4	na
Prices and wages					*(Percentage change)*						
Consumer prices (annual average)	1184.0	487.0	30.2	23.5	11.8	7.7	39.3	31.1	9.6	5.2	8.1
Consumer prices (end-year)	2777.0	104.6	23.8	15.1	11.2	18.3	43.7	18.4	6.3	4.4	8.0
Producer prices (annual average)	na	205.1	52.9	31.2	14.9	9.7	44.0	28.5	5.7	na	na
Producer prices (end-year)	6947.0	214.5	46.6	20.4	13.6	13.6	58.6	24.2	5.9	na	na
Gross average monthly earnings in economy (annual average)	783.4	247.4	32.1	31.2	16.3	14.6	21.6	33.9	27.3	na	na
Government sector 2/					*(In per cent of GDP)*						
General government balance	-7.5	-19.2	-13.1	-10.6	-10.3	-4.5	-4.9	-3.6	0.5	0.0	-0.8
General government expenditure	28.0	49.5	39.6	45.8	51.8	41.7	34.6	32.8	28.3	30.3	na
General government debt	na	34.3	37.2	39.7	48.1	82.8	77.9	73.1	60.7	58.2	na
Monetary sector					*(Percentage change)*						
Broad money (M3, end-year)	371.2	87.6	65.1	12.8	37.0	-8.7	42.6	40.1	36.4	36.0	na
Domestic credit (end-year)	331.3	101.5	64.7	18.8	26.8	29.2	18.1	14.4	29.6	26.0	na
					(In per cent of GDP)						
Broad money (M3, end-year)	22.0	15.9	19.2	18.0	21.6	19.2	20.3	21.9	25.1	29.5	na
Interest and exchange rates					*(In per cent per annum, end-year)*						
Refinancing rate	na	na	21.0	19.5	16.0	32.7	31.0	27.0	13.0	11.3	na
Interbank interest rate (up to 30 days maturity)	na	na	na	na	28.1	30.9	32.6	20.8	11.0	4.9	na
Deposit rate (one year)	na	na	32.5	25.4	23.5	21.7	27.5	24.9	20.9	14.4	na
Lending rate (one year)	na	na	41.9	36.7	33.3	30.8	35.5	33.8	28.7	23.5	na
					(Lei per US dollar)						
Exchange rate (end-year)	3.6	4.3	4.5	4.7	4.7	8.3	11.6	12.4	13.1	13.9	na
Exchange rate (annual average)	1.5	4.1	4.5	4.6	4.6	5.4	10.5	12.4	12.9	13.6	na
External sector					*(In millions of US dollars)*						
Current account	-182	-98	-85	-192	-275	-335	-68	-97	-95	-103	-105
Trade balance	-180	-54	-70	-260	-348	-388	-137	-294	-311	-378	-390
Merchandise exports	451	618	739	823	890	644	474	477	567	660	710
Merchandise imports	631	672	809	1,083	1,238	1,032	611	771	878	1,038	1,100
Foreign direct investment, net	14	12	66	23	78	76	38	129	156	110	97
Gross reserves (yearend), exc gold	76	180	256	314	362	137	180	223	229	269	na
External debt stock	255	634	844	1,062	1,287	1,452	1,492	1,544	1,516	1,641	na
					(In months of imports of goods and services)						
Gross reserves (end-year), exc. gold	1.5	2.9	3.0	3.0	3.1	1.3	2.7	2.7	2.5	2.5	na
					(In per cent of exports of goods and services)						
Debt service (scheduled)	na	2.3	8.2	5.7	17.7	33.6	44.2	25.4	23.9	29.9	na
Memorandum items					*(Denominations as indicated)*						
Population (end-year, millions)	4.3	4.4	4.3	4.3	4.3	4.3	4.3	4.3	4.3	4.3	na
GDP (in millions of leis)	1,821	4,737	6,480	7,798	8,917	9,122	12,322	16,020	19,052	22,040	25,200
GDP per capita (in US dollars)	348	323	392	462	528	465	321	354	408	448	484
Share of industry in GDP (in per cent)	38.9	31.4	25.0	23.1	20.2	16.7	17.0	16.3	18.7	18.6	na
Share of agriculture in GDP (in per cent)	31.2	27.3	29.3	27.5	26.0	25.8	24.9	25.4	22.4	21.0	na
Current account/GDP (in per cent)	-14.5	-8.4	-6.8	-11.3	-14.3	-19.7	-5.9	-7.5	-6.4	-6.3	na
External Debt - Reserves, in US$ m	179	440	412	503	925	1,315	1,312	1321.0	1287.0	1372.0	na
External Debt/GDP (in per cent)	20.4	53.1	39.7	42.5	66.7	85.5	127.4	119.8	102.4	101.1	na
External Debt/Exports of goods and services (in per cent)	56.8	95.2	77.2	87.0	121.7	182.5	244.6	240.6	206.2	188.7	na

Note: data for 1999-2002 represent official estimates of outturns as reflected in publications from the national authorities, the International Monetary Fund, the World Bank, the OECD. Data for 2003 reflect EBRD evaluations, partly based on information from these sources. All figures are for Moldova, excluding Transnistria.

1) Unemployment rate according to the International Bureau of Labour
2) General government includes the state, municipalities and extra-budgetary funds

ANNEX 5: SIGNED BANK OPERATIONS AND PORTFOLIO

(at 30 April 2003, EUR million)

by Sector

Sector Name	**COMMITMENTS**				**NET PORTFOLIO**		
	No. Of projects	Total Project Cost	EBRD Funding	% of total EBRD	Disbursed	Portfolio	% of Portfolio
Financial Institutions	**17**	**69.8**	**50.9**	**30%**	**42.5**	**18.7**	**18%**
Infrastructure	**8**	**167.1**	**86.1**	**51%**	**70.3**	**74.3**	**70%**
Energy	*3*	*69.5*	*36.4*	*21%*	*22.9*	*33.4*	*32%*
Water and Sewage	*1*	*36.5*	*20.4*	*12%*	*18.0*	*18.1*	*17%*
Transport	*3*	*59.6*	*28.4*	*17%*	*28.5*	*22.8*	*22%*
Telecommunications	*1*	*1.5*	*0.9*	*1%*	*0.9*	*0.0*	*0%*
Enterprise support	**2**	**57.3**	**32.6**	**19%**	**32.3**	**12.9**	**12%**
Agribusiness	*2*	*57.3*	*32.6*	*19%*	*32.3*	*12.9*	*12%*
Country Total	**27**	**294.2**	**169.6**	**100%**	**145.1**	**105.9**	**100%**

by Portfolio Class and Investment Type

	COMMITMENTS				**NET PORTFOLIO**		
	No. Of projects	Total Project Cost	EBRD Funding	% of total EBRD	Disbursed	Portfolio	% of Portfolio
Private	20	154.7	89.4	53%	67.6	57.2	54%
Public	7	139.5	80.2	47%	77.5	48.7	46%
Country Total	**27**	**294.2**	**169.6**	**100%**	**145.1**	**105.9**	**100%**
Sovereign	7	156.5	97.8	58%	95.3	44.9	42%
Non-Sovereign	20	137.7	71.8	42%	49.7	61.0	58%
Country Total	**27**	**294.2**	**169.6**	**100%**	**145.1**	**105.9**	**100%**
Debt	15	216.4	131.1	77%	114.9	80.2	76%
Equity	3	9.0	6.3	4%	6.3	6.3	6%
Guarantee	4	7.2	7.2	4%	0.0	3.8	4%
Debt and Equity	5	61.6	25.0	15%	23.8	15.7	15%
Country Total	**27**	**294.2**	**169.6**	**100%**	**145.1**	**105.9**	**100%**

ANNNEX 5: SIGNED BANK OPERATIONS AND PORTFOLIO (CONTINUED)

(at 30 April 2003, EUR million)

Operation Name	COMMITMENTS						
	Total Project Cost	Debt	Equity	Guarantee	EBRD Funding	Public/ Private	Year of signing
Financial Institutions							
Victoria Bank Credit Line	3.8	3.6	0.2		3.8	Private	1995
Moldova-Agroindbank Credit Line	16.5	16.5			16.5	Private	1995
Micro-Lending Project - Banca Mobias	0.6	0.6			0.6	Private	1996
Micro-Lending Project - Victoria Bank	0.6	0.6			0.6	Private	1996
Micro Lending Project - Universal Bank	0.6	0.6			0.6	Private	1996
Micro-Lending Project - Moldova Agroindbank	1.1	1.1			1.1	Private	1996
Victoria Bank Capital Increase	1.7		0.2		0.2	Private	1997
Moldova-Agroindbank Senior Convertible Loan	9.0	7.2	1.8		9.0	Private	1998
Victoria Bank Capital Increase II	1.4		0.2		0.2	Private	1999
TFP: Victoria Bank	2.2			2.2	2.2	Private	1999
TFP: Moldova-Agroindbank	1.8			1.8	1.8	Private	1999
TFP - Moldindconbank	1.3			1.3	1.3	Private	2000
MEC Moldova S.A.	0.9	0.8	0.1		0.9	Private	2000
Victoriabank Credit Line (II)	7.2	3.6			3.6	Private	2001
Moldova-Agroindbank Credit Line (II)	5.4	5.4			5.4	Private	2002
MEC Moldova - Bank	13.9		1.2		1.2	Private	2002
TFP: Mobiasbanca	1.8			1.8	1.8	Private	2002
Infrastructure							
Energy							
Chisinau Energy Efficiency Project, Termocom	18.7	8.0			8.0	Public	1995
Moldova Power Distribution Equity Investment	5.9		5.9		5.9	Private	2001
Post-Privatisation Power Distribution Loan	44.9	22.4			22.4	Private	2001
Water and Sewage							
Chisinau Water Services Rehabilitation, Apa Canal	36.5	20.4			20.4	Public	1997
Transport							
Roads Rehabilitation Project	14.8	10.3			10.3	Public	1995
Port of Giurgiulesti Oil Terminal Project	34.1	8.9	1.3		10.2	Private	1996
Chisinau International Airport Modernisation	10.8	7.9			7.9	Public	1998
Telecommunications							
Eurovision - NRT Moldova	1.5	0.9			0.9	Public	1993
Enterprise support							
Agribusiness							
Wine Export Promotion Project	50.3	25.6			25.6	Public	1994
GCC Cumulative Preference Share Issue	7.0	7.0			7.0	Public	2001
Country Total	**294.2**	**151.5**	**10.9**	**7.2**	**169.6**		
Total projects					**27**		

ANNEX 6: PROGRAMMES OF OTHER IFIS AND MAIN BILATERAL ASSISTANCE

IMF

The IMF's Executive Board approved a three-year Poverty Reduction and Growth Facility (PRGF) for Moldova in the amount equivalent to around USD 142 million on 21 December 2000. Three tranches, totalling nearly USD 37.5 million, have already been disbursed (in December 2000, February 2001 and August 2002). However, further disbursements are currently on hold.

The IMF's latest mission to Moldova in June 2003 acknowledged recent progress but concluded that the Government of Moldova has to fulfil a number of conditions for the IMF financing to be resumed. In addition to governmental intervention and business environment issues, the Fund has raised concerns about the medium-term financial outlook, as well as trade issues such as export restrictions on some categories of goods and details of the PSI law. On a number of these issues, there has been recent progress. The other pre-condition for the IMF programme includes activation of the WB SAC-III programme, as the funds to be received from the WB are included in the budget agreed with the IMF.

The Government has stated that it is doing everything possible to meet the conditions in time for a Board submission and subsequent disbursement in September 2003. The successful negotiation with the IMF is a prerequisite for the country to be able to approach the Paris Club.

World Bank Group

Since Moldova joined the World Bank in 1992 and the International Development Association (IDA) in 1994, the World Bank has provided consistent support for the country's economic reform programme. IBRD/IDA commitments have totalled approximately USD 505 million for 24 projects. Initial lending focused on adjustment support, building a private sector in both agriculture and manufacturing, and improving the economic and financial management of the energy sector. In April 2000, Moldova became an IDA-only country. The IBRD/IDA disbursements so far have amounted to USD 351 million.

The central objective of the WB in Moldova is to contribute to poverty alleviation and sustainable economic growth. Based on international experience and the prevailing situation in Moldova, the WB considers that poverty reduction in Moldova should be based on three basic pillars: (i) maintenance of macroeconomic stability and generation of sustainable economic growth that generates productive employment and higher incomes; (ii) insurance of an affordable social protection system targeted to the really needed and creation of self-targeted assistance programmes to assist the very poor; and (iii) improvement of access to social services by the poor. This is to be achieved through the elaboration of a Poverty Reduction Strategy Paper (PRSP) and implementation of various investment projects. An Interim PRSP (I-PRSP) was approved by the WB in December 2000, and a full PRSP is expected to be finalised by end 2003. The PRSP process will be co-ordinated with the preparation of a new Country Assistance Strategy covering the next two to three years. At the moment, a draft PRSP prepared by the Government is being reviewed by the World Bank and the final document is expected to be presented in the second half of 2003.

The most recent additions to the WB portfolio in Moldova include the following projects:

- Health Investment Fund Project (USD 21 million)
- Third Structural Adjustment Credit SAC III (USD 30 million/IDA credit) aims to support the government's reform programme necessary to create conditions for sustainable growth and

improvement of living standards. So far, only one tranche of USD 10 million was disbursed in July 2002. The second tranche was to be disbursed in December 2002 but was suspended due to non fulfilment of some conditions

- Rural Investment and Services Project (USD 25 million) aiming to increase rural incomes and living standards by promoting rural entrepreneurship, agricultural production, and trade in rural areas.

Projects under preparation include Energy Project II, a Public Sector Reform Credit I, a Pilot Water Supply and Sanitation Project in medium-sized towns and cities, and rural areas, a Trade and Transport Facilitation Project in Southeast Europe (customs administration and border control agencies), and a TB/AIDS project.

European Union and TACIS

The EU Branch Office was opened in Chisinau in November 1999. It operates in close co-operation with the TACIS Co-ordinating Unit. The EU Office mandate includes promoting the European Union by maintaining extensive relations with governmental institutions and by increasing awareness of the EU, its institutions and its programmes in Moldova, and supporting the preparation and implementation of the TACIS programme including project identification.

In 2002, the European Commission approved a grant of EUR 15 million for Moldova aimed at supporting the country's balance of payment. The grant is to be disbursed in three instalments of EUR 5 million each. Currently, the grant is on hold and is dependent on successful negotiations with the IMF and resumption of its programme in Moldova.

The main current technical assistance projects under implementation by TACIS include support for institutional, legal and administrative reform (EUR 6.3 million); human resources development (EUR 5.7 million); and support to enterprises (EUR 4.3 million), aimed at assisting export promotion and SME development.

Additionally, there are currently a number of projects under preparation for a total amount of approximately EUR 10 million on reconstruction of Giurgiulesti customs (EUR 2.3 million); strengthening border management (EUR 3.9 million) and reconstruction of the Radauti-Lipcani bridge (EUR 3 million).

USAID

The Agency for International Development (USAID) to date has provided over USD 290 million in technical assistance. The following are major objectives of USAID activities in Moldova: fiscal and financial reform to support market-led growth; private enterprise growth to create jobs and generate income; more effective, responsive and accountable democratic institutions; and social safety net programmes to reach vulnerable groups.

At present, USAID is actively involved in a fiscal reform project (USD 9 million) by assisting the Moldovan Ministry of Finance in six areas of fiscal reform: tax policy and public administration, budget, revenue forecasting, fiscal analysis, and intergovernmental finance.

Through such projects as the Power Sector Privatisation and Energy Sector Regulatory Development project, USAID is assisting the authorities with the sale of power distribution and generation plants and provides assistance for the energy sector regulator. In the telecommunications sector, the Agency plans to increase the coverage, scope and quality of services provided, as well as to assist the government in the privatisation of Moldtelecom. Additionally, it is advising the National Agency for Telecommunications Regulation on tariffs, licensing and frequency management. In agriculture, USAID is aiming for instance at improving the policy, legal and regulatory environment, developing and assisting individual farmer associations and co-operatives, completing residual land titling, expanding credit programmes in co-operation with participating Moldovan banks, and promoting training in farm management, business planning and co-operative development.

Support is also provided by USAID in accounting reform, including to the NBM; SME development by contributing to facilitation of access of SMEs to market business skills and information, as well as for institutional support to the Parliament and local government reform. The Agency also supports the development of the health sector by creating broad-based, community-orientated, primary health care services that can serve as models for national replication.

Germany

Germany has made available to date to Moldova around EUR 140 million. Two years ago, Germany and Moldova ratified a treaty on financial co-operation, which is still under implementation for a total amount of DM 20 million, of which DM 10 million were allocated for rural restructuring and DM 10 million for micro-lending activities of Micro Enterprise Credit. There are plans to re-programme some of the funds allocated to the rural sector into a programme on infrastructure and poverty reduction, to be decided shortly.

Sweden

Since 1998, the Swedish government has granted in total SEK 170 million (EUR 19 million), mainly focused on the social sector, economic transformation, environment and democratic development.

In the social sector the main ongoing projects are aimed at: establishing an effective social protection policy; improving the situation of newborn and handicapped children, children and teenagers as well as the elderly and the handicapped; supporting activities aimed at controlling TB and HIV/AIDS; and contributing to the Moldova Social Investment Fund.

The SEK 70 million set aside for economic transformation is focused on: post-privatisation growth of the agricultural sector (contribution to World Bank project); assistance in external debt negotiations; strengthening of the vocational education system; support to the SME sector; labour market efficiency and establishment of a land registry. Environmental issues are addressed via a training programme for Moldovan teachers and through studies of the quality of electricity and heat supply. Democratic development assistance is provided for projects concerning human rights training for the police, gender issues, trafficking (through the IOM programme), support to local administration and improvement of road maintenance management.

A new programme for bilateral assistance to Moldova for the period 2004-2006 will shortly be adopted by the Swedish Government.

Netherlands

Between 1997 and 2002, a total of EUR 12 million of grants were given to joint Moldovan-Dutch projects in the fields of agriculture, energy, environment and industry. This programme (PSO) is coordinated by Senter, an agency of the Ministry of Economy. In addition, the Netherlands co-finances UNDP projects for improvements to the Moldovan judicial system.

United Kingdom

Through the Department for International Development (DFID), assistance of approximately GBP 2 million a year is focusing on three core sectors: sustainable rural livelihoods, social protection and strengthening of civil society. Assistance is also provided through a two-year project on trade policy with emphasis on WTO post-accession issues.

One of the major projects focusing on rural livelihoods includes components on the establishment of Savings and Credit Associations and support to the State Supervisory Body. DFID has also worked with Banca Sociala to improve the quality of services and strengthen the bank's management.

New projects started in 2002 are mainly in the following fields: rural livelihoods (GBP 2.6 million) aiming to facilitate the establishment of effective business to support the livelihoods of rural citizens and communities; civil protection/civil society (GBP 0.7 million); and support to the PRSP (GBP 0.2 million) aiming to develop institutional capacities in the Ministry of Finance for medium-term expenditure planning.

Denmark

In 1998, a Memorandum of Understanding, constituting a formal framework for Danish grant assistance, was signed with the Moldovan authorities and covered water supply improvements, ecological projects and NGO support. Danish grants were used to finance consulting services as part of the EBRD's Chisinau municipality water project.

At the end of 2000, the Danish government signed an agreement with the Government of Moldova for long-term assistance, which included three more water supply projects in the rural areas of Borceag, Chircaesti and Edinet. In March 2003, a new energy saving project in Edinet was approved. Total Danish assistance to date amounts to USD 4.2 million. Denmark is also providing grants to support NGOs.

Japan

Japan commenced bilateral assistance to Moldova in 1991, by providing technical assistance for market economy transition and humanitarian assistance. A total of approximately USD 4.5 million in humanitarian assistance was extended between 1991 and 1998, and further humanitarian assistance worth JPY 200 million was to be provided from 1999 to 2004. Since 1997, priority areas for assistance are (1) market economy transition, (2) basic human needs such as health and medical care, and (3) agriculture (including infrastructure). In 2002, Japan donated medical equipment, and appointed a Japanese economic advisor to the Moldovan President. Emergency grant aid was extended in 1994 and 1997 in response to flood damage.