TWICE HIT – BADLY WOUNDED
The Devastating Cost of an Inadequate Transformation in Moldova

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Abstract: Moldova holds the unenviable distinction of having suffered the largest fall in GDP and living standards among the former socialist countries in Europe. By mid-1999 GDP had fallen to less than 30 per cent of its level in 1990, while living standards had plummeted from a situation of relative well-being before independence to one of abject poverty. This development has neither been God-given nor the result of particularly bad governance. Indeed, Moldova was for a long time praised by IMF and others as a progressive reformer and 'over-achiever' in terms of macro-economic stabilisation policies. The present study is devoted to an analysis of the economic and political development of Moldova since independence and to the social consequences of the economic collapse. The final chapter discusses the reasons behind the dismal development.

Keywords: Moldova, economic transition, economic and social development.

JEL-Classification: I31, P27

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CHAPTER ONE The Great Fall

The Republic of Moldova probably holds the unenviable record of having suffered the most devastating peacetime decline in economic performance and living standards of any country in modern times. From a state of relative well-being per capita GDP has fallen to a mere 300 USD, placing the country almost at par with the poorest in Africa and Asia. Recent living standard surveys and demographic indicators provide grim evidence on the impact of this well-being on the population.

Table 1.1
Development of real GDP.

	1991	1992	1993	1994	1995	1996	1997	1998 est.
% change	-17.5	-11.9	-24.1	-31.0	-3.5	-8.0	1.3	-8.6
Index: 1990=100	82.5	72.7	55.2	38.1	36.7	33.8	34.2	31.3

Sources: Economic Trends Moldova, July - September 1997 (Chisinau: European Expertise Service and Ministry of the Economy and Reform) p. 7; *Economic Trends Moldova, November 1998 (*Chisinau: European Expertise Service and Ministry of the Economy and Reform) p. 4; *Infotag* 05.02.1998.

The decline is all the more remarkable as Moldova by any standards has ranked among the best achievers with regard to macro-economic policies, institutional and economic reform and democratisation among the CIS countries. The achievements in terms of creating a sovereign state based on democratic principles and the rule of law have been impressive, not least when seen in the light of the dismal starting point at the time of independence in 1991. Similarly, the achievements in the field of macro-economic policy earned for a long time the praise of the IMF and the World Bank and turned the country into a regional show case.

The main immediate factors behind the virtual collapse of the economy have been two severe external shocks. The first resulting from the collapse of the former Soviet Union and the second in the wake of the financial collapse in Russia in the autumn of 1998. As a small, highly integrated part of the Soviet economy, but with little contact with the rest of the world, the Moldovan economy was predestined to suffer a severe blow as the Soviet Union imploded. However, although it was arguably in worse position than most other republics in the former Soviet Union, it was hardly alone in this predicament. The Baltic countries, too, were in an economic position not too dissimilar of that of Moldova on the eve of the collapse of the Soviet Union. Yet, their successful economic development after an initial, inevitable, decline contrasts sharply to the disastrous decline of Moldova. A main factor behind this difference in development would seem to be the fact that the Baltic countries, in contrast to Moldova, have successfully detached their economies from those of the rest of the former Soviet Union and of Russia, in particular.

The economic shock resulting from the collapse of the Soviet Union took two main forms.

First, Moldova suffered shortly after independence a deterioration in its terms of trade equivalent to approximately 16 per cent of its GDP, the main cause of which was Moldova's complete dependence on imports for its energy needs.[1] The cost of energy import increased from 1.4 billion roubles in 1991 to 40 billion roubles in 1992, equivalent to 55 per cent of the cost of all imports. In addition, almost all raw materials and inputs,

[1] *Moldova: Moving to a Market Economy* (Washington D.C.: The World Bank, 1994) p. 6.

apart from agricultural inputs, must be imported in Moldova. In one year, 1992, the cost of gasoline and natural gas increased forty-fold and the cost of coal rose one hundred-fold.[2] Apart from creating an acute balance of payment problem, the price shock also had a severe depressive and inflationary effect on the domestic economy. A parallel may be drawn with the oil crisis in 1973, when a 'merely' threefold increase in oil prices was enough to derail the economies of Western Europe and push them into a long period of stagflation.

However, it was the long term effects of the price increases for energy which proved to be most devastating. Although Moldova has virtually no energy sources of its own, the entire society had during the Soviet times been constructed on the assumption of unlimited access to virtually free energy. In 1990 the energy intensity of GDP was 1.4 koe per USD, which, although lower than that of Russia and Ukraine, was still far above the average of 0.6 koe per USD for the OECD countries.[3] The shift to world market prices rendered in one blow almost the entire production technology, in agriculture as well as in industry, and the physical capital and infrastructure associated with this technology economically unviable. It also made the highly inefficient central heating by means of uninsulated underground pipes in urban areas an unaffordable luxury and the cost of private heating of dwellings in rural areas beyond the means of most of the population. In the winters of 1993 and 1994 harrowing scenes could be seen of urban dwellers huddling around bonfires in the court yards of unheated apartment blocks for warmth and to cook food. Today, seven years after independence, heating and hot water in urban areas remain luxuries restricted to major national holidays and brief pre-election periods.

Second, as a small economy highly integrated into the Soviet system, Moldova suffered a paralysing disruption of trade links and distribution channels, and lost both its main source of inputs and its market for outputs as the centrally planned economy of the Soviet Union imploded and disintegrated. The effect of this disruption of trade links was particularly severe for Moldova because of its very high degree of integration in the Soviet economy and almost complete isolation from the rest of the world.

The civil war and *de facto* separation of the Transnistrian region from the rest of the republic further aggravated the problem, as much of the manufacturing is or was located in the breakaway region.[4]

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

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

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[2] *Ibid*. p. 65

[3] *Ibid*. pp. 65-66.

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

Short-term crisis management rather than strategic and long-term reform policies has dominated the political and economic agenda ever since the initial collapse. The ambivalent attitude towards fundamental reform of the Sangheli Government contributed to the patchy and slow implementation of reforms, as did the country's relative isolation from the West. Externally, the country vacillated in its political orientation, while emphasis was given to the re-establishment of traditional trade links with the CIS rather than to fundamentally re-orient the trade pattern.

The dangers inherent in the geographical imbalances in the trade pattern and the export dependence on Russia were brought into the open by the financial crisis in Russia in the autumn of 1998. The direct impact of the Russian crisis on Moldova's economy was severalfold. It resulted in a severe drop in exports, a negative effect on the budget and a sharp increase in the external debt burden as the leu was depreciated. The modest growth achieved in 1997 was reversed. The GDP fell by 8.6 per cent in 1998 as a direct consequence of the crisis and is expected to fall by up to 25 per cent in 1999, lest exports pick up again.[5]

Today Moldova is in severe crisis. The acute expressions of this crisis are a highly negative trade balance, a crippling debt-service burden and a public sector on the brink of financial collapse. However, beyond these acute problems is a more fundamental crisis of disastrous economic decline, dramatically deteriorating living standards to the point where large parts of the population live in abject poverty, a virtual collapse of social security and health care, a serious erosion of the educational system and increasing mental and physical fatigue and a feeling of despondency among the population at large. While the acute macro-economic and budget problems must receive full and immediate attention, the more fundamental problems must also be addressed in a much more resolute and decisive manner than has so far been the case. The political conditions for addressing these problems are today probably better than at any previous time since independence. However, the country needs timely and comprehensive external help to get back on its feet again.

The present study reviews the economic, social and political development and situation in Moldova, with a focus on the present. Following a review of the reform and development of the main economic sectors, the factors leading up to the present balance of payment crisis are analysed in some detail. In a subsequent section, the political and institutional situation is examined. The public sector is scrutinised with a particular emphasis on the budgetary aspects. This is followed by an analysis of the decline in living standards and increase in poverty and the extremely worrisome deterioration of the social sectors. The main conclusions and recommendations are presented in the final chapter.

[5] Statement by Prime Minister Ion Sturza, quoted in *Infotag*, April 8, 1999.

CHAPTER TWO Reform and Development of the Real Economy

2.1 Agriculture

Agriculture and related activities form the cornerstone of Moldova's economy. This sector accounts for almost 40 per cent of GDP, over 75 per cent of total exports, and provides the main source of livelihood for well over half the population. While Moldova has always been an agricultural country, the importance of this sector has increased considerably in the 1990s as other sectors of the economy have contracted sharply. The agricultural sector is of key importance to the future development of the economy, not least because demand-led growth will depend on improved conditions and incomes in agriculture.

Just as the rest of the economy, the agricultural sector has suffered substantial decline since independence. By 1997 total production had fallen to about 70 per cent of the 1991 level in constant prices. Animal production has fared worse than crop production. The former fell by almost 50 per cent compared to slightly more than 20 per cent for the latter.[6] Rural incomes have plummeted to dismally low levels and the rural – urban income gap appears to have widened. By the second quarter of 1998, average disposable income in rural areas had fallen to a mere 97 lei, that is 20.5 USD, per month and a quarter of the rural population earned too little to satisfy their most basic physiological needs for food, clothing and shelter.[7]

Yet, the situation is not altogether grim.

Agriculture, like the rest of the economy, has suffered several severe shocks since independence. It experienced a dramatic deterioration in its terms of trade shortly after independence, as prices for energy and energy-intensive inputs like fertilisers increased manifold more than the prices of agricultural produce. It has also suffered from a sharp contraction of both the external and the domestic market. The former, which had began to pick up in the mid-1990s suffered a new and devastating blow as the Russian market all but collapsed in the autumn of 1998.

The sharp deterioration in the terms of trade resulted in a death blow to the traditional mode of capital and energy intensive large scale socialist farming, and by consequence to the large collective and state farms. A transformation of agricultural production towards small-scale labour intensive farming became not only ideologically desirable, but also economically imperative in order to restore agriculture on a commercially viable footing. Major steps towards a decollectivisation began already in 1991, but this process ground to a halt a few years later as the Parliament and Government put in place after the 1994 elections had strong vested interests in retaining status quo. Official support to privatisation of agriculture by the Sangheli Government (1994 – 1997) contrasted sharply to the numerous bureaucratic and administrative obstacles created to this process.[8] Several of these obstacles were clearly unconstitutional and some were removed by order of the Constitutional Court in January, 1996.[9] Yet, the political climate towards decollectivisation remained hostile and individual farmers who attempted to break out of the kolhozes in order to set up their own farm encountered numerous and often insurmountable obstacles.

[6] *Economic Trends Moldova*. 1998c. P. 10.

[7] *Economic Trends Moldova. 1998c.* Pp. 34-38.

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

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

The situation changed for the better after the installation of the Ciubuc Government in early 1997, but it was only after the Parliamentary elections in March 1998 that the political establishment changed decisively in favour of privatisation of agriculture.

The decollectivisation is carried out in two stages. The first involves the transformation of the kolhozes and sovchozes into various forms of joint stock companies or limited liability firms. In the course of this process, the individual members receive land shares and value shares in the newly formed company and the right to vote on the management of the farm/company as part owners. This process has more or less been completed and only a few traditional kolhozes and sovchozes remain today. However, this external reorganisation has only seldom been accompanied by any internal restructuring of the farms. A recent World Bank survey showed that over 70 per cent of the farms had retained the old central management structure.[10] Similarly, the mode of operation and management has in most cases also undergone very little change, despite the economic imperative to fundamentally restructure.

6 Table 2.1

Land privatisation.
Per cent of individuals with the right to a land share who have already received land.

	July 1996	April 1997	January 1998	October 1998
Central region	18.6	25.6	30.5	37.9
Northern region	3.2	4.8	8.4	13.0
Southern region	4.9	7.6	10.8	13.3
Whole country	9.0	12.9	17.0	22.3

Source: Economic Trends Moldova. (1998b). P. 101.

The second, decisive stage is when individual or groups of farmers demand to receive their land and asset shares and leave the enterprise-farm in order to set up their own farm(s).[11] This process is now, at long last, in full swing (Table 2.1). By October 1998 some 22 per cent of those entitled to land shares had actually received the land and set up their own farm, as against only 13 per cent one and a half year earlier. The process is most advanced in the central parts of the country, where 38 per cent of those entitled to land had actually received land by October 1998. In some districts, such as Nisporeni, Straseni, Orhei and Causeni, the percentage exceeded fifty. By contrast, the northern and the southern parts of the country lag behind, albeit for different reasons. In the relatively more prosperous north, the somewhat less disastrous state of the collective farms may reduce the incentive to leave them, while parts of the south are still firmly under communist rule. In the Autonomous Region of Gagauzia and in the district of Taraclia, which has a large Bulgarian population, both of them bastions of communism, less than five per cent of those entitled to land had received any by October 1998.

Bureaucratic hurdles apart, the actual distribution of land and value shares is far from straightforward or simple. The average land share is only 1.5 – 1.7 hectares, divided into 4 - 6 plots of orchard, vineyard, garden and arable land. Distribution of the asset shares is even more difficult, as most of the physical assets are indivisible, as there are problems of valuation and as the net assets to be divided in many cases are negative because of heavy indebtedness. Stories of individual farmers who have received a spare wheel for tractor as

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[10] World Bank. 1998a. Pp. 37-43.

[11] For details on the mechanisms involved, see World Bank. 1998a.

their asset share abound, but more often than not farmers voluntarily group together in order to overcome the problem of indivisibility of machinery and other physical assets.

Most collective farms, irrespective of whether they have remained traditional kolhozes or have been transformed into joint stock companies, run constant losses and are in deep financial crisis. Fully 80 per cent of the large farm enterprises surveyed by the World Bank in 1997 operated at a loss in 1996. Average revenue was only 2.7 million lei, while average production costs were 3.6 million lei, resulting in an average loss of 900,000 lei, that is the equivalent of one third of the sales revenue.[12] All farms had substantial outstanding liabilities, averaging 2.4 million lei. Tax arrears and arrears in payments to the social fund made up approximately half of the liabilities. In addition, there were large arrears in wage payments to the members of the farm. Virtually all (95 per cent) of the farms reported arrears in wage payments. The median delay was five months, but 12 per cent of the farms had not paid any wages for over a year.[13] Thus it comes as no surprise that most farms complained about poor profitability. Only 7 per cent of the farms reported that livestock production was profitable, while 35 per cent stated that crop production was profitable. Low prices, compared to production costs, was seen as a main problem by three quarters of the farm, but 46 per cent of the farms also stated that they had difficulties because of untimely payment for delivered produce. The latter can largely be explained by the continued reliance on state procurement of produce. Half of the farms also engaged in export, mainly to the CIS countries.

Table 2.2
Living standards and privatisation.
A comparison between private farmers and member/employees of farm enterprises.

	Private farmers	Member/employees of farm enterprises
Change in economic situation in past 2-3 years		
- Better	61	3
- No change	25	13
- Worse	14	84
Expectations for the next 2-3 years		
- Better	72	18
- No change	16	42
- Worse	12	35
What does the family income buys?		
- Below subsistence	21	39
- Minimum necessities	54	52
- Food and clothing	22	9
- No material difficulties	3	0

Source: World Bank. 1998a. P. xix.

Deplorable and deteriorating living standards and poor prospects for any improvement among members and workers on farm enterprises are relentlessly and remorselessly pushing the privatisation process forward. Some 84 per cent of the member/employees on the farm enterprises have suffered a fall in their living standards in the past few years and an equally high share do not believe that it will improve in the coming year (Table 2.2). Almost 40 per cent state that they live below the subsistence level, while for 52 per cent the income is only enough for minimum necessities. Yet, only a quarter of them stated (in 1997) that they intended to claim their land and asset shares to set up their own farm or to

[12] World Bank. 1998a. P. 54.
[13] World Bank. 1998a. P. 53.

invest them in a new organisational entity.[14] Among these, push factors provided a stronger incentive than pull factors. Thus, 59 per cent desired to set up an independent farm because the farm enterprise did not ensure a minimum standard of living, while only 32 per cent stated 'independence from bosses', 20 per cent 'personal fulfilment' and 14 per cent 'increased prestige and respect' as main reasons. The main deterrents to breaking out of the farm enterprise among those who had no plans to do so were 'shortage of capital (52 per cent), 'difficulties with purchase of farm inputs' (48 per cent) and 'unwillingness to assume the risk involved' (33 per cent). For some 22 per cent old age or poor health were the main motive.

Yet, the survey shows that in most cases the establishment of a private farm has been associated with improved standards of living. Thus, 61 per cent of the private farmers covered by the survey stated that their standard of living had improved in the past two to three years, while only 14 per cent thought that it had deteriorated (Table 2.2). This stands in glaring contrast to the development for those who had remained on the farm enterprise. The private farmers were also quite optimistic about the future. They also reported somewhat higher standards of living than those who had remained on the farm enterprise.

While one reason behind the improved incomes among those who have set up their own farm may be that they constitute a positive selection in terms of entrepreneurial talent and spirit and aptitude and capability for farming, analysis of the economics of the different types of farming support the conclusion that the establishment of a small-scale private farm is likely to result in improved incomes.

Although yields to land and livestock were reported to be broadly similar in the farm enterprises and in the new small private farms, the latter gave much more positive statements about the profitability of both livestock and crop cultivation than the former. This somewhat subjective impression is corroborated by calculations by the World Bank based on their survey in 1997. Thus, it was found that average per worker income may have been more than twice as high in the private farms as in the farm enterprises (370 lei per worker and month as against 170 lei).[15]

7 Table 2.3

Share of main ownership forms in total agricultural production.

	1990	1995	1996	1997
Enterprises	82	60	48	48
Private producers	18	40	52	52
Total	100	100	100	100

Source: *Republica Moldova in Cifre*. 1998. P. 206.

The higher profitability and incomes in the private farms than in the large farm enterprises, despite unimpressive yield levels, can primarily be explained by lower costs of production and more profitable and flexible product mixes. The high and increasing importance of private farming and its higher efficiency is also reflected in statistics at the macro level. Thus, the contribution of private producers to total agricultural production increased from 18 per cent in 1990 to 52 per cent in 1997 (Table 2.3).[16] Yet, in the latter year still only a quarter of the arable land was privately cultivated.

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[14] World Bank. 1998a. P. 66.
[15] World Bank. 1998s. P. 8.
[16] Including production on own plot by members/employees of farm enterprises.

Development of Agricultural Production

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

8

9 Table 2.4

Development of agricultural production, 1990 – 1997.

	1990	1992	1993	1994	1995	1996	1997
Cereals							
Area, 1,000 ha	747.5	746.6	910.7	830.1	929.0	911.0	1,063.5
Output, tonnes	2,989.2	2,099.8	3,340.2	1,753.8	2,668.5	2,010.0	3,519.0
Yield, kg/ha	3,400	2,800	3,700	2,100	2,900	2,200	3,300
Sunflower							
Area, 1,000 ha	134.1	130.9	125.5	139.5	163.3	255.2	199.2
Output, tonnes	234.4	197.2	194.1	149.2	231.6	316.0	201
Yield, kg/ha	1,900	1,500	1,500	1,100	1,400	1,400	1,000
Sugar beet							
Area, 1,000 ha	81.5	82.6	83.0	83.0	90.3	84.0	76.3
Output, tonnes	2,749.3	1,973.4	2,248.7	1,526.7	2,083.6	1,917	1,873
Yield, kg/ha	29.1	23.9	27.1	18.4	23.1	22.8	24.6
Vegetables							
Area, 1,000 ha	71.7	73.7	73.1	68.1	75.4	62.9	64.8
Output, tonnes	1,123.2	787.5	777.2	598.5	604.7	393.0	419.0
Yield, kg/ha	15,700	10,200	10,000	8,300	7,600	5,800	6,100
Tobacco							
Area, 1,000 ha	32.1	28.1	31.2	28.4	20.2	16.4	17.3
Output, tonnes	65.7	45.0	50.2	42.0	27.2	19.0	23.0
Yield, kg/ha	2,100	1,500	1,600	1,500	1,400	1,100	1,300
Grapes							
Area, 1,000 ha	171.0	167.3	171.1	167.7	177.0	175.0	185.8
Output, tonnes	917.3	823.9	927.8	670.2	875.5	789.0	310.0
Yield, kg/ha	5,400	4,900	5,400	4,000	5,000	4,500	1,800

Sources: *Anuarul Statistic 1996*. 1997. Pp. 326-331; *Republica Moldova in Cifre*. 1998. Pp. 201-209; *Economic Trends Moldova*. 1998b. P. 84

Remark. All figures include Transnistria. Output for 1990 refers to average for 1989-91.

As noted above, overall crop production fell by approximately 20 per cent between 1991 and 1997. A more detailed analysis of the development of production in physical terms yields a somewhat mixed picture (Table 2.4). Cereals and sugar beet production would appear to have fared best, as both output and yields for these crops, although fluctuating, have declined only slightly or not at all. However, within the umbrella category of cereals, there has been a shift from mechanised crops such as wheat and peas to maize, which not only tends to give higher yields but is also more amenable to unmechanised cultivation. Sunflower production, too, has remained more or less unchanged. However, this has largely been achieved by an increase in the area cultivated to compensate for a fall in yields.

By contrast, production of high value crops such as vegetables, tobacco and grapes has fallen quite sharply, primarily as a result of declining yields.

Table 2.5
Fertiliser use in agriculture.

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

Source: *Republica Moldova in Cifre*. 1998. P. 205.
Remark. Figures for 1995, 1996 and 1997 exclude Transnistria.

The declining production should be seen in the context of the very sharp reduction of the use of cash inputs in agriculture. Fertiliser use has fallen from 184 kilograms per hectares in 1985 to virtually nothing in 1997 (Table 2.5). The use of pesticides has registered a similarly dramatic decline from very high levels to close to nothing. Seen in this context, and in the light of the sharp fall in mechanised farming and problems of marketing, the declining yields and production levels are hardly surprising. Indeed, it may come as a surprise that the falls have not been more drastic.

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

Table 2.6
Animal production by ownership form.

	1990	1995	1996	1997
Meat, 1,000 tonnes				
- enterprises	281	58	49	43
- private	85	79	82	84
- total	366	137	131	127
Milk, 1,000 tonnes				
- enterprises	1,232	344	251	154
- private	280	493	493	512
- total	1,511	837	744	666
Eggs, million				*25*
- enterprises	821	244	253	225
- private	308	319	357	357
- total	1,129	563	610	582
Wool, tonnes				
- enterprises	1,248	510	417	341
- private	1,795	2,414	2,419	2,402
- total	3,043	2,924	2,836	2,743

Source: *Republica Moldova in Cifre*. 1998. P.211.

Animal production has declined much more sharply than crop production. Meat and milk production has fallen to little more than a third of their levels in 1990, while production of eggs has fallen by approximately fifty per cent (Table 2.6). The fall in production is in most instances the result of both declining productivity (yield per animal) and a fall in the animal stock. Thus, the cattle stock (excluding milk cows) has fallen to half its level in 1990 and the number of hogs has fallen to little more than 40 per cent of the level in 1990 (Table 2.7). Poultry, too, has fallen to approximately half the 1990 level, while the decline in milk cows has been somewhat less drastic.

Table 2.7
Animal stock by ownership form, 1990-1997. Thousand heads.

	1990	1993	1994	1995	1996	1997
Cattle, excl. milk cows						
- enterprises	767	335	370	281	210	129
- private	182	335	370	363	369	354
- total	949	815	750	644	579	483
Milk cows						
- enterprises	262	188	147	114	85	54
- private	95	189	220	228	236	235
- total	357	377	367	342	321	289
Pigs						
- enterprises	1,355	609	510	501	441	269
- private	216	404	436	409	442	459
- total	1,671	1,013	946	910	883	728
Poultry						
- enterprises	13,164	n.a.	n.a.	3,400	2,247	1,882
- private	11,461	n.a.	n.a.	11,340	11,163	11,564
- total	24,625	n.a.	n.a.	14,740	13,410	13,446

Sources: Economic Trends Moldova. 1998b. P. 84; *Republica Moldova in Cifre.* 1998. P. 205.

Remark: Figures for enterprises include kolhozes and sovchozes and their subsequent enterprise forms.

The decline has almost entirely been confined to the large scale farm enterprises, that is the former kolhozes and sovchozes (Table 2.7). Private, small scale production has actually increased, particularly for milk. The overall decline can largely be attributed to the near collapse of the external market and the very sharp contraction of the domestic market that has followed from the dramatic fall in incomes and meat consumption. The virtual collapse of large-scale industrial meat production on the former kolhozes and sovchozes is in line with experiences elsewhere in the former socialist countries. As fodder and energy are charged at full cost, this type of production almost invariably becomes economically unviable.

The New Private Sector and the Road Ahead

Seen from the bird's eye perspective of planners and outside experts, the transition from large-scale collective farming to small-scale private farming invariably seems very messy. It inevitably results in severe mismatches of access to production factors such as land, labour and capital at the level of the newly established farms as well as mismatches between the needs of the new small units to have access to inputs, markets and other services and the ability of the existing structures, typically dominated by large state monopolies, to serve these needs. There are also the practical problems of land demarcation and issuing of land titles. Yet, the experience from other countries in the region that have gone through this process shows that these dislocations and problems tend to be temporary and that, given a conducive economic and institutional environment, they are gradually solved. This is likely to be the case also in Moldova. A positive factor in Moldova is that the transformation as such would not appear to result in production losses, largely because of the deplorable state of the large scale farms. On the negative side may be noted that the majority of the farming population appears to be pushed rather than pulled towards private farming.

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

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

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

Although the bulk of the production is consumed on the farm, some 80 per cent of the farmers sell at least some of their output. However, the amounts sold tend to be rather small; on average a mere quarter of the total production. Only one tenth of the farmers reported that they sold more than half of their production. Most of the sales take place at nearby markets or directly to the consumers. Low prices are seen as a main obstacle to commercialisation of the produce, but some 29 per cent also found it difficult to find buyers and a quarter complained of difficulties with transportation. For key crops, such as vegetables and grapes, transport problems were much more common.

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

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

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

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

2.2 The Industrial Sector

The restructuring of the industrial sector is taking place in the context of a virtual collapse. The break-up of the Soviet Union had an immediate impact on industrial production, which fell by more than a third between 1990 and 1992 (Table 2.8). A further fall was registered in 1994 and after several years of fairly stable, but low, levels of production, there was yet another decline in 1998 by 11 per cent, largely as a consequence of the Russian crisis.

Table 2.8
Development of GDP and of industrial production. Index: 1990 = 100.

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

Sources: *Anuarul Statistic 1996*. 1997. P.288; *Republica Moldova in Cifre*. 1998. P. 178; *Infotag* February 5, 1999.

Remark: Excluding Transnistria.

In retrospect, much of the industrial decline in the early years of independence was probably inevitable. The Moldovan industry was very closely integrated in the Soviet economy. Except for agro-processing, much of Moldova's industry consisted of highly specialised component manufacturing for industry elsewhere in the Soviet Union. The plants were invariable designed with the Soviet rather than the Moldovan market in view and many were entirely dependent on the supply of inputs from outside Moldova as well as markets for their outputs in the other republics. Thus, the collapse of the Soviet economy had an extremely disruptive effect, which was aggravated by the fact that under central planning vertical linkages via planning authorities in Moscow were the norm and direct horizontal linkages between economic agents were poorly developed and generally discouraged. The civil war in Transnistria and the *de facto* separation of that part of the country, which had much of the industrial basis, further added to the economic dislocation.

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

Table 2.9
Development of industrial production by branches. Index: 1992 = 100.

	1993	1994	1995	1996	1997
Food processing	106	80	84	76	74
- meat processing	60	37	35	34	27
- fruit and vegetable	130	90	88	69	103
- wine production	130	112	141	131	143
Tobacco	102	95	71	79	75
Textiles	81	47	24	24	20
Garments	81	46	40	39	36
Chemical industry	73	44	24	17	14
Engineering and metal processing	112	71	55	44	35
Non-metal minerals	86	64	65	78	91
All branches	100	73	70	65	65

Source: *Republica Moldova in Cifre*. 1998. Pp. 178-181.

Table 2.10
Utilisation of productive capacity in manufacturing 1994 and 1996. Percentages.

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

Source: *Anuarul Statistic 1996*. 1997. Pp. 286-288.

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

The decline in production is also reflected in the very low degree of capacity utilisation in the existing plants (Table 2.10). For most products, it is well below a quarter. It is notable that even for core industries, such as wine production and canning of fruit and vegetables, it is below 30 per cent. This reflects not only the decline of production in recent years, but also the fact that there was considerable over-capacity to start with. While the huge underutilisation of productive capacity reflects a sharp decline in production and a giant destruction of physical capital, it should not be seen as an indicator of a potential to increase production. Most plants would need complete retechnologisation in order to become economically viable again.

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

Large scale privatisation began in 1993 with the distribution of patrimonial bonds (vouchers) to all citizens, supplemented by additional bonds based on employment record. The bonds could be used for acquiring shares. In addition, small units have been sold through auctions or by tender. By mid-1997 some 1,150 medium and large scale enterprises had been at least partially privatised through the National Patrimonial Bonds scheme and an additional 1,393 small scale enterprises had been sold as single units in auctions for National Patrimonial Bonds and fully privatised. In retrospect, the large scale privatisation by means of voucher distribution, though well intended, was not very successful. The ownership of the enterprises was dispersed among a huge number of patrimonial bond owners, who were neither capable of providing funds for re-technologisation of the enterprises or to ensure effective ownership.

In recent years there has been a shift in focus towards privatisation for cash. However, initial results have been rather disappointing. Out of 1,375 items place for sale during the first nine months of 1998 only 133 were sold for a total sum of 24 million lei.[17] New and more favourable conditions for potential buyers, including instalment plans for domestic buyers and so-called investment tenders whereby the buyer can purchase the object at a reduced price against promises to invest in it, were introduced in 1998 and appears to have facilitated the sale of some objects. The privatisation of some major objects, such as Moldtelecom, are in the pipeline and the Government budget as well as the balance of payment projections for 1999 depend on much increased incomes from privatisation.

A main impediment to the privatisation of industrial enterprises has been very poor economic, financial and managerial state of most of the units. Partly in order to address this problem, an Agency for Enterprise Restructuring and Assistance (ARIA) was established with support from the World Bank in 1996 to help sanitise enterprises financially,

[17] *Infotag,* February 5, 1999.

restructure them and strengthen their management structures in order to facilitate effective privatisation. Over the past few years ARIA has assisted in the restructuring of more than 70 enterprises. The restructuring is supported financially by the World Bank, TACIS, USAID and EBRD. This approach has been successful and has gained in importance. Meanwhile, ARIA has developed into a large consultancy organisation with some 200 professionals.

Foreign direct investments have began to increase in recent years, although the volume is still comparatively modest. Thus, by October 1998 there were 1,532 enterprises with foreign capital in the republic, some 370 units more than a year earlier. Most of them (70 per cent) are joint ventures with a mixture of local and foreign capital. Aggregate investment in these enterprises was 302 million USD, of which 173 million was foreign capital. The biggest investments have come from Russia, the United States, Germany and Ireland.

The FDI display a very diverse character. It includes major investments in agro-processing and wine-making by reputable western firms as well as, mainly Russian, small-scale investments in retail outlets and restaurants. The latter sell primarily imported products and account for the very large share of foreign-owned enterprises in total imports.

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

Recent detailed statistics on the development of small and medium-sized enterprises are unfortunately not available. In the beginning of 1998 there were 14,377 small scale private enterprises, with a total labour force of 110,500 and a turnover of 7,568 million lei (*sic!)* in 1997.[19] Of these 743 were partly or fully foreign owned. Despite the relatively small number, this sector is clearly emerging as a force to reckon with in terms of employment. By comparison, the large and medium scale industrial enterprises employed only 142, 300 people in 1997.

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

- bureaucratic and cumbersome registration procedures.
- frequent administrative controls and often predatory behaviour by local officials.
- involuntary payment to criminal groups, so called roofs (*acoperisuri)*, which often act in conjunction with individual representatives of the authorities.
- shortage of starting capital and poorly functioning banking sector.
- lack of market information and of management skills.
- high taxes and unfair competition from informal sector activities that do not pay taxes.

The conversion of previous large state enterprises into industrial campuses for small and medium-sized enterprises has proved to be a most successful way of promoting the development of new enterprises. The most spectacular case is probably the conversion of

[18] *Infotag,* February 5, 1999

[19] *Republica Moldova in Cifre.* 1998. P.139. The figure refers to juridical entities registered with the authorities.

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

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

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

Although detailed statistics are lacking, it is clear that development of small new enterprises has so far primarily been concentrated to the large cities. This is hardly surprising. Purchasing power in rural areas is very low and, more importantly, the kolhozes and sovchozes have traditionally catered to the needs of the rural population for non-farms goods and services as well as for non-farm employment opportunities. Under the system of large scale farming there were, in Moldova as elsewhere, few local backward and forward linkages to agriculture, while those that existed were integrated within the collective farm complex.

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

2.3 The Energy Sector

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

Table 2.11
Energy balance 1990 – 1996.
Thousand tonnes of standard fuel equivalent.

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

Source: *Anuarul Statistic 1996*. 1997. P. 302.

Remark: Figures for 1994 to 1996 exclude Transnistria.

Consumption of energy has fallen dramatically. By 1996 it stood at a mere third of the level in 1990 (Table 2.11). Since then it has fallen even further. At first sight this sharp reduction seems to suggest that Moldova has been highly successful in energy conservation. However, this is unfortunately hardly the case. The decline in energy consumption matches the decline in GDP. Thus, the very high energy consumption per unit of GDP produced before independence has hardly changed at all. Energy conservation requires large investments in new production technologies, insulated houses, more efficient heating systems, better transmission systems of electricity etc. Such investments have not been made for lack of resources. It is true that the nascent private agriculture and the new enterprises that are slowly emerging bring with them more energy efficient technology and that future economic growth will not be accompanied by any commensurate increases in energy consumption. However, large investments will also be required within the energy sector itself to reduce waste.

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

Table 2.12
Domestic electricity use 1990 – 1996. Million KwH

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

Source: *Anuarul Statistic 1996.* 1997. P. 302; *Infotag*, January 29, 1999.

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

The case of the electricity sector may be used to exemplify the situation. In 1998 Moldova consumed 4,366 million kWh of electricity, that is a third of the level in 1990 (Table 2.12), of this 1,000 million kWh was generated by Moldova's own plants, 1,450 million kWh by the Moldavskaya plant in Transnistria, while 1,800 million kWh were imported, mainly from Ukraine.[20] Of this, approximately 1,120 million kWh, that is 26 per cent, was lost through theft of technical losses. The absolute amount of losses is in line with those of previous years, although it should be noted that despite a decline in total electricity consumption by 65 per cent since 1990, transmission losses and theft has not declined at all and has increased in relative terms from less than ten per cent in 1990 to two and half times as much in 1998. In 1998 some 15,200 reports of theft were made, totalling 80 million lei, yet only six million was recovered.

However, even when the electricity reaches its intended consumers, payment is far from assured and arrears are chronic. The largest arrears are owed by the agro-industrial sector and by the public sector. Overdue payments from the central and local budgets alone amounted to 68.3 million lei by the end of 1998. To add to the financial woes; when payment is eventually received it is more often than not in kind. Only 26 per cent of the payments received in 1998 were in the form of cash. The disastrous liquidity of the electricity companies that follows from the poor enforcement of payment is transmitted to the producers of the energy. Thus, by the end of 1998 the national energy sector owed 218 million lei to Ukraine and 203 million lei to the Moldavskaya plant in Transnistria. Periodic curtailment and stoppage in the supply of electricity is used by the Ukraine suppliers, in particular, to enforce payment.

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

The entire energy sector is presently being demonopolised and privatised. Indeed, this is a precondition for resumed lending by IMF and the World Bank. These steps are no doubt necessary. In order to clear up the present morass of debt and inefficiencies, firm financial discipline and accountability must be enforced. However, while necessary to solve the problems in the energy sector, it will hardly be enough.

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

Secondly, and more importantly, most households in Moldova can no longer afford to pay for their basic energy needs. The average cost of basic heating and electricity of a 30-50 square meter apartment is 200 – 250 (25 – 30 USD) lei per month.[21] This amount should be compared with the average disposable income of 135 lei per person (163 lei in urban areas), and the 17 lei per month that the average urban dweller presently spends on housing rents and utilities.[22] In other words, the cost of basic heating and electricity alone would amount to at least two thirds of the total disposable income of an average household of three persons, which is clearly impossibly much. The situation in the rural areas is hardly better. Lack of forests (only 9 per cent of the land surface is forested) means that there is precious little fuel wood and that most rural households depend entirely on commercial sources of energy.

[20] *Infotag,* January 29, 1999.
[21] Hot water supply is so rare as to hardly be of any consequence.
[22] *Economic Trends Moldova.* 1998b. For more details, see Chapter Six.

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

CHAPTER THREE The External Sector

3.1 Foreign Trade

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

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

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

The past few years have seen a deterioration in the overall trade balance. The trade deficit increased from 95.2 million USD in 1995 to 292.8 million USD in 1997, to 389.1 million USD in 1998 (Table 3.1). This increase has taken place within the frame of a contracting economy and as a consequence the trade deficit as per cent of GDP has increased from 6.6 per cent in 1995 to an untenable 24 per cent in 1998 (Table 3.3). The very large trade deficit in 1998 is partly due to the near collapse of exports to Russia in the wake of the Russian financial crisis, but the trade deficit had reached alarming levels even before this crisis.

The deterioration of the trade balance has been accompanied by increasing geographical imbalances in the trade pattern. The share of exports to the CIS countries actually increased from 63 per cent in 1995 to 70 per cent in 1997 and reached a peak of 76 per cent during the first half of 1998, before the onslaught of the Russian financial crisis (Table 3.2). This increase was entirely due to increased exports to Russia and during the first half of 1998 alone Russia accounted for 62 per cent of Moldova's exports, up from 48 per cent in 1997.

Exports outside Russia and CIS have registered a dismal development. Exports to the European Union have stagnated at a very low level of approximately 85 million USD per year, while exports to East Central Europe have fallen sharply. Taken together, exports outside the CIS fell from 279 million USD to 205 million USD, or by 26 per cent, between 1995 and 1998, while total exports outside Russia fell by 22 per cent (Table 3.1).

The increasing export dependence on Russia has been accompanied by a reduced diversification of the product mix. As the industrial sector all but collapsed, the share of agricultural products in total exports increased from 41 per cent in 1993 to 72 per cent in 1998.[23] Wine and other alcoholic beverages produced from grapes alone accounted for 30 per cent of the exports in the latter year. The CIS markets, and Russia in particular, are the

[23] Nota informativa. 1998.

recipient of the overwhelming part of the agricultural exports, reflecting a failure to penetrate the European markets.

Table 3.1
Geographical structure of foreign trade. Million USD.

	1995	1996	1997	1998	Sept. – Dec. 97	Sept. – Dec. 98
EXPORT						
Total	745.5	801.6	879.6	636.4	348.1	168.0
CIS	466.9	546.1	612.5	431.1	213.6	76.1
- of which Russia	360.1	430.1	509.8	337.3	178.3	51.2
Non-CIS	278.6	255.5	267.1	205.3	134.5	91.9
- East Central Europe	158.7	132.4	95.7	81.6	n.a.	n.a.
- European Union	86.2	78.3	90.4	83.6		n.a.
IMPORT						
Total	840.7	1,079.2	1,172.4	1025.5	427.5	259.6
CIS	568.9	664.1	612.4	445.1	210.7	120.8
- of which Russia	278.0	295.3	305.1	222.4	106.6	55.4
Non-CIS	271.8	415.1	560.0	580.4	216.8	138.8
- East Central Europe	120.4	179.5	240.9	239.5	n.a.	n.a.
- European Union	115.2	162.6	227.2	269.2	n.a.	n.a.
TRADE BALANCE						
Total	-95.2	-277.6	-292.8	-389.1	-79.4	-91.6
CIS	-102.0	-118.0	0.5	-14.0	2.9	-44.7
- of which Russia	82.1	134.8	204.7	114.9	71.7	-4.2
Non-CIS	6.8	- 159.6	- 292.9	-375.1	- 82.3	-46.9
East Central Europe	38.4	-47.1	-145.2	-157.9	n.a.	n.a.
European Union	-29.0	-84.3	-137.3	-185.6	n.a.	n.a.

Sources: *Tendinte in economia Moldovei.* 1998. P. 46; Nota informativa. 1998.

Remark: Figures for 1998 are preliminary. Preliminary figures from IMF suggest that the trade deficit was 413 million USD, but do not offer any breakdown.

By contrast, the geographical distribution of imports has been considerably diversified since independence. The share of CIS countries in imports has fallen from 68 per cent in 1995 to 52 per cent in 1997 and 43 per cent in 1998, while the share of the countries in East Central Europe and European Union, in particular, has increased commensurately (Table 3.2). The declining share of CIS countries in imports is largely attributable to the falling share of energy in total imports and, in 1998, to the impact of the financial crisis in Russia. The share of energy and other mineral products in total imports has fallen from 56 per cent in 1994 to 32 per cent in 1998, largely as a consequence of the rapid economic decline rather than the introduction of new energy-saving technologies. Machines, electronic devices and equipment, but also consumer goods, account for the bulk of the increase in imports from the rest of Europe.

Table 3.2
Geographical distribution of trade. Percentages.

	1995	1996	1997	1998	Sept. – Dec. 97	Sept. – Dec. 98
EXPORT						
CIS	62.6	68.1	69.6	67.7	61.4	45.3
- of which Russia	48.3	53.7	58.0	53.0	51.2	30.5
Non-CIS	37.4	31.9	30.4	32.3	38.6	54.7
- East Central Europe	21.3	16.5	10.9	12.8	n.a.	n.a.
- European Union	11.6	9.8	10.3	13.3	n.a.	n.a.
All countries	100.0	100.0	100.0	100.0	100.0	100.0
IMPORT						
CIS	67.7	61.5	52.2	43.4	49.3	46.5
- of which Russia	33.0	27.4	26.0	27.7	24.9	21.3
Non-CIS	32.3	38.5	47.8	56.6	50.7	53.5
East Central Europe	14.3	16.6	20.5	16.6	n.a.	n.a.
European Union	13.7	15.1	19.4	18.1	n.a.	n.a.

Source: Table 3.1.

Table 3.3
Trade imbalances.

	1995	1996	1997	1998	09-12.97	09-12.98
Trade balance as % of GDP	-6.6	-16.6	-15.6	-23.9	-12.3	-16.8
Trade balance with Russia as % of GDP	5.6	8.1	10.9	7.0	11.1	-0.6
Trade balance with other countries as % of GDP	-12.2	-24.7	-26.5	-30.9	-23.4	-16.2
Per capita export, USD	207	221	243	177	98	47
Imports as % of exports						
All countries	113	135	133	161	123	155
Russia	77	69	60	66	60	108
Other CIS	272	318	299	237	295	263
Non-CIS	98	162	210	283	161	151
East Central Europe	76	136	252	293	n.a.	n.a.
European Union	134	208	251	322	n.a.	n.a.

Sources: *Tendinte in economia Moldovei*. 1998. Pp. 4, 46 and 49; Nota informativa. 1998.

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

The consequence of these contrasting developments has been a highly unbalanced trade pattern. While exports to Russia exceeded imports by 67 per cent in 1997 and 52 per cent in 1998, imports from the non-CIS markets exceeded exports by nearly three times by the latter year (Table 3.3).

The increase in imports from the countries of the European Union and East Central Europe is not a problem in itself. It is largely due to an increased import of machinery and equipment, which is sorely needed to modernise the domestic production technology, and as such may be seen as an investment in the future. As foreign direct investments remain at a low level, [24] this modernisation has so far had to be paid for by domestic resources and loans. However, a less positive development has been the increasing imports of various agricultural products and other consumer goods. Import of agricultural products from the non-CIS countries reached 116 million USD or 20 per cent of all imports from these countries in 1997.[25] The combination of low or non-existent tariffs on the Moldovan side and, in many instances, export subsidies in the sending countries put Moldovan food producers at a distinct and unfair disadvantage in their home market. The lack of symmetry in agricultural trade, where the European Union in particular provide their producers with protection against imports as well as export subsidies, while on the Moldovan side the producers benefit from neither, is clearly detrimental not only to Moldova's external trade, but also to its economic development in general.

To conclude, at the heart of the problem of Moldova's foreign trade is its failure to increase exports to non-CIS countries. There are several reasons for this failure.

- Moldova has no tradition of trade outside the former Soviet Union. After the virtual collapse in 1992/93, it has followed the road of least resistance and tried to recapture old markets in Russia/CIS where Moldovan products are well known and quality standards are less of a problem, rather than to try to penetrate new markets.
- The failure to attract FDI has no doubt contributed to the difficulties of penetrating non-CIS markets and lack of market information, contacts and marketing channels outside the CIS remain a formidable problem.
- The successful macro-economic policies, until the onslaught of the Russian financial crisis, made the Moldovan leu one of the hardest and most stable currencies in the region. The backside of the coin is that as a consequence there was a considerable appreciation of the leu vis-a-vis the USD and most European currencies in real terms, which eroded the competitiveness of Moldovan products on the world market.
- The slow re-technologisation of the manufacturing sector made it difficult to achieve and uphold quality standards and to meet EU requirements with regard to product and package standardisation, hygiene standards etc.
- There has been no forceful Government policies to promote Moldovan exports to non-CIS countries.
- The trade with the CIS countries has been and remains largely outside Government control and has largely been in the form of barter. Under, respectively over invoicing provides considerable opportunities for illicit gains by both parties concerned in the trade and provides an additional, important, disincentive to divert trade from the traditional CIS markets to new markets where these gains are less easily obtained.
- Last, but not least, it takes two to dance the tango. The formidable protective barriers imposed unilaterally by the European Union against Moldova's main exports, that is agricultural products, has been and remains a main obstacle to exports.

The severe geographical imbalances in the trade pattern and the very strong dependence on the Russian market for exports have extremely negative consequences for Moldova. First and foremost of these is the vulnerability to external shocks, as amply proved by the recent financial crisis in Russia. However, it has other negative features as well. The fact that much of the trade with the CIS countries continues to be in the form of barter or in non-convertible currencies, while the trade with the non-CIS countries is based on convertible currencies aggravates the imbalance. The lack of control and the possibilities of illicit gains

[24] Direct foreign investments has averaged 71 million USD per year in the past five years (*IMF estimate).*
[25] Nota informativa. 1998.

in the trade with the CIS countries are obstacles to the establishment of the rule of law and a sound market economy and also affects the Government's ability to collect revenue negatively. Last, but not least, the export dependence on Russia has political implications as well and is detrimental to the country's endeavour to strengthen its still rather frail independence. These aspects are dealt with in turn below.

The Impact of the Russian Crisis on Foreign Trade

The effect of the Russian crisis on Moldovan foreign trade has been dramatic. Payment of goods already delivered were frozen, while new contracts came to a virtual standstill. During the last four months of 1998, total exports to Russia amounted to a mere 51.2 million USD or 29 per cent of the level during the same period in 1997 (Table 3.4). As exports collapsed and the trade deficit increased uncontrollably, the leu came under strong pressure and the protection of the exchange rate became impossible. On November 3 the National Bank abandoned its attempts to support the leu and as a result, the currency was effectively devalued by approximately 50 per cent. The impact of the near-collapse of exports to Russia was aggravated by a fall in exports to other markets as well. Thus, exports to non-CIS countries were 32 per cent down during the last four months of 1998 as compared to the same period a year earlier. It is still unclear if this decline in dollar terms was due to low price elasticity of exports or other factors. However, it may be concluded that Moldova so far has failed to compensate the decline in exports to Russia by exports elsewhere.

As a result of the sharp decline in exports and the devaluation of the leu, imports, too, fell. Imports from the CIS countries fell by approximately 43 per cent during the last four months of 1998 as compared to the same period the previous year. Much of the decline in imports can be attributed to a decline of energy imports and as such were largely involuntary as Ukraine and Russia unilaterally decided to curtail delivery of electricity and gas. The fall in imports from the non-CIS markets, on the other hand, was no doubt largely due to the sharply increased cost of imports following the devaluation of the leu.

Due to the rapid fall of imports, the impact of the near collapse of the exports to Russia on the trade balance has so far been less devastating than one might have expected. The trade deficit during the last four months of 1998 was 92 million USD or 12.2 million more than it had been during the same period in 1997. More importantly, the trade deficit with the non-CIS countries, fell sharply from 82 million USD during September - December in 1997 to 47 million USD the same period in 1998 (Table 3.1). As a consequence of the crisis the geographical imbalances in the trade structure were, at least temporarily, reduced. Unfortunately, this improvement of the balance was exclusively due to the curtailment of exports to Russia and imports from the non-CIS countries. Moldova's external trade contracted sharply in 1998. Total turnover fell from 2,046 million USD in 1997 to 1,662 million USD in 1998. Exports fell from 880 million USD in 1997 to 636 million USD in 1998 or from 244 to 177 USD per capita. The decline in trade has continued in the present year. It's impact on economic development and on living standards has been highly detrimental. The GDP fell by 8.6 per cent in 1998, mainly as a consequence of the crisis and is expected to fall by up to an additional 25 per cent in 1999 unless exports pick up.[26]

[26] Statement by Prime Minister Ion Sturza, *Infotag* April 8, 1999.

Table 3.4
Comparison of external trade in the period September - December 1997 and 1998. Million USD.

	Exports			Imports		
	1997	1998	1998 as % of 1997	1997	1998	1998 as % of 1997
Total	348.1	168.0	48.3	427.5	259.6	60.7
CIS	213.6	76.1	35.6	210.7	120.8	57.3
- Russia	178.3	51.2	28.7	106.6	55.4	52.0
Non-CIS	134.5	91.9	68.3	216.8	138.8	64.0

Source: Nota informativa. 1998.

The near collapse of the Russian market and the sharp devaluation of the Russian ruble has clearly also led to a sharp terms of trade deterioration for Moldova. While almost all of Moldova's imports are priced at world market prices, its exports to Russia have largely been priced in Russian rubles. The magnitude of this deterioration in the terms of trade can not yet be established, but is likely to be considerable and lasting.[27]

The Problem of Barter Trade

The geographical imbalance in the trade structure is aggravated by the fact that while trade with non-CIS countries is in convertible currency, trade with other CIS countries is largely in the form of barter or non-convertible currency. Thus, a surplus in the trade with the latter countries does little to solve the problem of a deficit in the trade with the former countries.

The trade in convertible currency has gradually increased from 42 to 58 per cent for exports and from 54 to 74 per cent for imports between 1995 and 1998. At the same time the officially registered barter trade has fallen from 26 to 15 per cent for exports and from 18 to 9 per cent for imports (Table 3.5).[28] Well over 80 per cent of the registered barter trade takes place with the CIS-countries, in particular with Russia, Belarus and Ukraine.

As a consequence of the barter trade, the foreign exchange earnings from exports (as well as the foreign exchange payments for imports, are much smaller than the total trade figures suggest. Thus total foreign exchange earnings from exports in 1998 were only 371 million USD instead of 636 million USD. Similarly, the cost in terms of foreign exchange of the imports were 762.4 million USD instead of 1,026 million USD. As the trade in barter and non-convertible currency is more or less balanced, the trade deficit that has to be covered by foreign exchange is only affected slightly in absolute terms. However, it does imply that the capacity of the economy to generate foreign currency is much smaller than total trade figures suggest, which negatively affects important indicators, such as debt servicing as per cent of exports and imports as per cent of exports.

Apart from being inefficient, the barter trade is also detrimental from the point of view of control and tax collection.

[27] Since mid-1998, the ruble - leu exchange rate has fallen from 0.80 to 0.42, that is by almost 50 per cent.
[28] As discussed below, there is also considerable unregistered barter trade.

Table 3.5
Trade by nature of payment.

	Million USD				Per cent			
	1995	1996	1997	1998	1995	1996	1997	1998
Convertible currency								
Export	312.6	378.6	500.4	371.1	41.9	47.2	57.2	58.3
Import	452.6	708.3	792.9	762.4	53.8	65.6	67.7	74.3
Balance	-140.0	-329.7	-292.0	-391.1				
Import as % of export	145	187	158	205				
Barter								
Export	191.4	154.8	125.3	97.9	25.7	19.4	14.3	15.4
Import	154.9	162.4	127.8	93.7	18.4	15.0	10.8	9.1
Balance	36.5	7.6	2.5	-4.2				
Other								
Export	241.5	268.2	253.9	167.4	32.4	33.4	28.5	26.3
Import	230.2	208.5	251.7	169.4	27.8	19.4	21.5	16.6
Balance	11.3	59.7	2.2	2.0				

Source: Nota informativa. 1998.

Unregistered Trade

The main forms of unregistered and illegal trade in Moldova are smuggling, 'pseudo-barter', 'pseudo-export', 'pseudo-transit trade' and falsification of invoices. Barter trade, established practices of under, respectively over invoicing, generally lax border control towards Ukraine and an absence of border controls towards Transnistria provide ample opportunity for illicit trade operations. A comparison of Russian and Moldovan trade statistics reveals glaring discrepancies (Table 3.6). Thus, according to Moldovan statistics Moldova exported wine to Russia in the amount of 92,643 thousand USD, while according to Russian statistics the value of the imported amount was 231,634 thousand USD. Similar discrepancies, albeit of a lesser magnitude were registered for most other agricultural products, tobacco and footwear. For the items for which statistics were collected, the Russian statistics suggested an import in the amount of 416,355 thousand USD, while according to the Moldovan statistics the value of exports was only 230,005 thousand USD. With regard to imports to Moldova, the Russian sources stated much higher amounts than the Moldovan sources. The difference was 193,435 thousand USD versus 138,612 USD.

Table 3.6
Comparison of Moldovan and Russian trade statistics for 1996.

Item	Unit	Imports to Moldova						Export from Moldova					
		Russian source			Moldovan source			Russian source			Moldovan source		
		Qty.	1000 $	$/unit	Qty.	1000 $	$/unit	Qty.	1000 $	$/unit	Qty.	1000 $	$/unit
Vegetable oil	1000 tons							2.0	1895	936	1.2	1051	875
Sugar	1000 tons							67.0	35423	529	60.7	29761	490
Canned vegetables	1000 tons							38.4	28931	753	25.1	20261	807
Fruit juice	1000 tons							9.6	6040	627	27.0	16213	600
Jam	1000 tons							3.7	4479	1223	3.2	4174	1323
Champagne	100000 lt	2.4	50	20.84	0	0	0	1739.3	31889	18.33	2343	30685	13.10
Vermut	100000 lt	3.4	73	21.68	0	0	0	286.2	4758	16.62	153	1356	8.84
Other wines	100000 lt	7.3	70.3	9.68	51.6	416	8.06	21775	231664	10.64	12179	92643	7.61
Alcohol ethilic	100000 lt							239	2931	12.26	87	720	8.30
Vodka	1000 lt.	28.86	91	3.15	4.0	50	12.4	4134	17185	4.16	4063	14050	3.46
Raw tobacco	1000 tons	0.05	83	1733	0.03	59	1913	13.8	19612	1422	8.5	11085	1310
Cigarettes			191.8			0			2927			6698	
Coal	1000 tons	137.4	6232	45.36	106.1	6519	61.44						
Fuel	1000 tons	38.9	2937	75.61	119.7	13041	109						
Natural gas	mil. m3	3154	182947	58	2038	118209	58						
Footwear	1000	57.4	760	13.24	25.8	319	12.34	4179	28652	6.86	304	1308	4.30

Source: *Moldova in Transition.* 1998. P. 67.

While the discrepancy with regard to imports may to a certain extent be explained by the fact that Russian figures include trade with Transnistria, which Moldovan figures do not, the discrepancy in the export figures can not be as readily explained. To a large extent it must probably be explained by under-invoicing on the Moldovan side, that is sheer theft by the exporters from the producers (notably by the management of the kolhozes from the farmers). It should be remembered that in 1996 agriculture was still largely collectivized and the management of the kolhozes arranged much of the trade themselves. This figures also suggest that the trade dependence on Russia in reality has been higher than official figures suggest.

Political Aspects on the Trade

Although it is beyond the scope of the present study to dwell on the geopolitical aspects of trade, it should nevertheless be noted that the very high trade dependence on Russia not only is a source of vulnerability, but also of dependence. The large debts for energy delivery, the unresolved conflict with Transnistria and the continued and uninvited presence of a large contingent of Russian troops on Moldovan soil add to this dependence. The financial crisis in Russia could potentially serve as a catalyst for weakening this dependence. However, this would require an effective diversion of trade and not just a contraction of trade. The importance of the political aspects of trade should not be underestimated. At a recent visit by the Moldovan Parliament, headed by the President of the Parliament Mr. Diacov, to the Russian Duma, the delegation reportedly got a very frosty reception indeed, and were informed in no uncertain terms that Russia would not tolerate an attempt by Moldova to distance itself from Russia and to become more closely integrated in the European economic and political structures. This attitude was further underscored by an unwillingness on the Russian side to arrive at a negotiated settlement of Moldova's debt to Gazprom, even on very favourable terms to Russia.

3.2 Balance of Payment and the Foreign Debt

The deficit in the current accounts was until 1995 to a large extent covered by IMF credits and arrears in energy payments. After that, IMF loans fell sharply to virtually zero in 1997. In 1998 there were net repayment of IMF credits in the amount of 67 million USD as no new credits were given, while reimbursement of earlier credits had commenced. Instead, general government loans (in 1997) and government issues of Eurobonds were increasingly being resorted to, to cover the current account deficit (Table 3.7). However, largely as a consequence of the turmoil on the global financial markets, the Moldovan Government found it increasingly difficult to finance the current account deficit through these sources, as the risk premium demanded by overseas takers of the loans became very high. As a result, the growing current account deficit in 1998 was increasingly funded through a decrease of the domestic foreign reserves, which in previous years had built up at an impressive rate. Hence, Moldova was facing increasing difficulties in financing the current account deficit even prior to the onslaught of the Russian crisis.

Table 3.7
Balance of payment 1995-1998. Million USD.

	1995	1996	1997	1998
Trade balance	-55	-234	-384	-413
Balance of services	-96	-78	-63	-57
Current transfers & net income	36	103	138	153
Current account	-115	-210	-309	316
Direct investments	73	53	79	80
Portfolio investments (1)	0	53	240	-58
Medium and long term loans (net)	74	96	14	25
- Disbursements	132	119	89	104
- World Bank	50	0	38	50
- EBRD	5	34	23	18
- Amortisation	-58	-23	-76	-79
Other capital flows	-75	-17	74	0
Capital account	71	186	406	47
Errors and omissions	-10	-13	-11	-44
Overall balance	-54	-37	87	-313
Financing				
IMF credits (net)	65	25	1	-64
Change in official reserves	-78	-58	-51	199
Debt rescheduling	0	46	8	79
Debt arrears	21	-38	33	-33
Arrears on energy deliveries	47	61	-76	-1
Gross official reserves	257	315	266	167

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

Sources: National Bank of Moldova and IMF estimates.

The sharp deterioration of the overall balance in 1998, from plus 87 million USD in 1997 to minus 313 million USD in 1998 resulted from a combination of several factors, some of which were directly related to the impact of the Russian crisis. Thus, the rapid deterioration of the current account had started much earlier, but was accentuated by the Russian crisis. The capital account fell from a large surplus of 407 million USD in 1997 to a mere 47 million USD in 1998. This sharp deterioration was largely due to a decline in portfolio investments, that is mainly issue of bonds and securities overseas, from plus 240 million USD in 1997 to minus 58 million USD in 1998. The situation was further aggravated by net repayment of loans to IMF in the amount of 64 million USD in 1998. Thus, Moldova went from a situation of considerable accumulation of foreign reserves in 1997 to a domestic financing need in the amount of 249 million USD in 1998. This was mainly done by drawing on the foreign reserves, which declined from 366 to 167 million USD, but also by defaulting/rescheduling of debt.

The collapse of the Russian ruble did not result in any immediate currency crisis in Moldova, as the currency reserves were large enough to withstand initial speculation and as foreign investment in Moldovan treasury bills and other short term papers had been limited. However, in October the speculative pressure on the leu increased and after a futile attempt to defend the leu to the tune of approximately 100 million USD, the National Bank withdrew its support of the leu on November 4 to let the currency float freely. After a rapid fall, the leu stabilised at approximately 8.7 lei to the USD by the end of the year. The uncontrolled fall of the leu had the immediate effect of bringing the magnitude of the external debt burden out into the open, as it virtually doubled in GDP terms (Table 3.9).

Table 3.8
External debt (end-year). Million USD.

	1994	1995	1996	1997	1998
Total	509.4	679.3	814.5	1,084.5	*1,300*
IMF	164.2	230.2	247.3	234.1	*170*
Total, excl. IMF	345.2	449.1	567.2	850.5	*1,130*
- of which public debt					*832*
Multilateral creditors	161.6	203.3	220.5	254.6	329
- IBRD	97.8	145.8	145.8	185.0	253
- EBRD	0	0	0.3	3.3	6
- EU	63.8	57.5	74.4	66.3	70
Bilateral creditors	160.0	177.5	171.9	155.7	n.a.
Commercial creditors	0	21.5	90.7	276.7	n.a.
- Commercial banks	0	21.5	60.7	31.7	n.a.
- Eurobonds	0	0	30	105	75.0
- Gazprom	0	0	0	140	230.0
Commodity loans	17.2	21.4	21.4	20.7	n.a.
Publicly guaranteed debts	0	14.0	44.4	73.7	229.6
Private non-guaranteed debt	3.4	11.4	18.3	69.1	n.a.

Sources: *Economic Trends.* 1998a. P. 89; Ministry of Finance projections for end-1998.

Remark: Figures in italics are estimates.

Table 3.9
External debt as per cent of GDP.

	1994	1995	1996	1997	Sept. .98	31.12.98
External debt, Million USD	509.4	679.3	814.5	1,084.5	1,300	1,300
GDP in Million USD	1,164	1,443	1,665	1,933	1,761	1,061
Real GDP growth	-30.9	-1.4	-7.8	1.6		-8.6
Debt as % of GDP	44	47	49	56	74	123

However, it should be clearly understood that while the Russian crisis acted as a catalyst triggering the present balance of payment and debt crisis, its root causes lie elsewhere. The external debt, which consists primarily of public and Government guaranteed debts has been built up gradually since independence from 166.5 million USD in 1993 to 679 million USD in 1995, to approximately 1,300 million USD at the present. In terms of GDP, it has increased from about 50 per cent in 1995 to 120 per cent at the present. Yet, it was only recently that the full scale and implications of the debt became common wisdom. The main causes behind the debt problem contain the following elements:

- The loans taken were primarily used to pay for the cost of energy imports and to soften the blow of the economic collapse on the public sector. Little, if any, was used for productive investments and they were not accompanied by much needed reforms of the real economy.
- At the same time as the debt has increased in absolute terms, the economy has continued to decline and external trade has stagnated at a dismally low level. Thus, a shrinking economy has been forced to shoulder an increasingly heavy debt.
- The rapid and sustained appreciation of the leu in real terms, the deteriorating trade balance and the rapidly increasing debt burden combined was a certain recipe for

disaster.[29] It has been clear for quite some time that a comprehensive devaluation of the leu would sooner or later be inevitable. It has been equally clear that such a devaluation would abruptly and sharply increase the debt burden in domestic terms. The Russian crisis merely triggered this devaluation.

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

- The credits given have been on short term and at high commercial interest rates, even though Moldova by any standards should have been eligible for soft loans on IDA terms. This deplorable situation is largely attributable to the refusal of the World Bank to scale down their GDP estimates for Moldova to a realistic level, despite ample evidence that their GDP estimates were absurdly high.[30] Thus Moldova only attained DAC status, thereby qualifying for soft credits, in 1997. Moldova is presently paying a heavy price for this prevalence of prestige over reason.
- Lending was for a long time unaccompanied by any meaningful technical assistance, with the exception of the strengthening of the national bank. Even today technical assistance to the reform process remains fragmented and incoherent. Nor was lending for several years accompanied by much control or conditions with regard to its use. Excessive attention was paid to the successful macro-economic stabilisation, mainly inflation control, while little attention was paid to the poor record of reform of the real economy. Much of the credits were extended to the Sangheli Government, which had little interest in genuine reform and which was rife with corruption. By contrast, the election of a more reform-minded Parliament and Government in 1997 came to coincide with a sharp curtailment in lending.
- An illusion was created that there was no fundamental difference between external and internal borrowing. The crucial differences between an internal and external debt, particularly in a situation of an overvalued currency, was apparently not clear to the Moldovan Government(s) and it appears that little was done to advice them on this matter. As short term loans at high interest rates were presented as ‘money granted as a “reward” for achievements in the field of economic reform and stabilisation’, the question of the advisability for the Moldovan side to accept the credits was never put in question.
- Despite strong evidence that the leu was increasingly overvalued, it would appear that IMF strongly supported the policy of maintaining the fixed exchange rate and a strong leu. As late as in mid-1998, IMF concluded that there was no reason to believe that the leu was overvalued, based on the flimsy argument that wages in Moldova were very low.[31] The detrimental impact of this policy on Moldova can hardly be overstated. As a small open economy in desperate need of export-led growth, an undervalued rather than overvalued currency was clearly called for. A gradual devaluation of the currency would also have brought the alarming increase in the external debt out into the open much earlier.

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[29] Between January 1994 and mid-1998 the leu appreciated in real terms by more than 150 per cent vis-a-vis the USD. In the same period the trade deficit increased from 54 million USD in 1994 to 413 million USD in 1998.
[30] In 1993 the World Bank’s estimate of Moldova’s per capita GDP was 1,060 USD, that is three times higher than the domestic estimate of 323 USD. Two years later, the gap in the estimates had been reduced to 920 versus 394 USD. There is today a near consensus that the domestic estimates were fairly close to the truth.
[31] IMF. 1998.

Moldova today finds itself in a debt trap not unlike that which has hamstrung countries in Latin America and Africa for decades. As a new and frail country that has suffered a devastating blow to its economy and living standards and which is undergoing a difficult and painful societal transformation, Moldova can ill afford years of extreme austerity in order to service a debt burden with no light in the tunnel in sight.

Table 3.10
Public debt servicing in 1999. Million USD

	Interest	Principal	Total
United states (cereal supplies)	1,264.9	0	1,264.9
World Bank	15,867.5	4,270.0	20,237.5
IDA	420.5	0	420.5
Japan	1,455.0	2,160.0	3,615.0
Romania	0	4,093.0	4,093.0
EU	3,500.0	0	3,500
Russia (Gazprom, Oneximbank etc.)	17,262.0	54,950.0	72,212.0
Merrill Lynch (Eurobond)	7,450.0	0	7,450.0
Tureximbank	285,0	0	285,0
Commerzbank	0	7,500.0	7,500.0
KfW	1,067.0	2,195.0	3,262.0
EBRD	790.0	0	790.0
Sub-total	*49,361.9*	*75,268.0*	*124.629.9*
Arrears from 1998			
Russia			69,901.0
State guarantees fallen due in 1998			8,058.8
Sub-total			*77,959.8*
State guaranteed loans 1999			*13,450.0*
Total			**216,039.7**
IMF			70,000
GRAND TOTAL			**286,040**
Not yet active state guarantees			229.600
Expected to become active in 1999			12.100

Sources: *Ministry of Finance estimates; verbal information from IMF.*

Remark: According to information in early April, 1999, from the Deputy Ministry of Finance, the total debt servicing scheduled for 1999 was 296 million USD, of which 221million USD was due by the Government and 75 million USD by the National Bank (to IMF).

While realistic estimates of the total, public and private, debt service in 1999 for Moldova are not available, detailed figures on the public debt (including IMF), provide a very grim picture. Servicing the public debt, which is believed to account for 70 - 75 per cent of the total debt, is estimated to amount to approximately 300 million USD in 1999.[32] Of this, 49.4 million will be interest payments, 75.3 million USD scheduled amortisation and 78.0 million USD payment of arrears in debt payment (Table 3.10). To this may be added approximately 25.6 million USD of state guaranteed loans that have already become or will become active. In addition, there are more than 200 million USD in state guaranteed loans, most of which is likely to become active sooner or later.

When put in the context of the small and declining economy of Moldova, the gross debt service burden in 1999 appears truly crippling. It amounts to well over 20 per cent of the expected GDP, 77 per cent of the estimated public revenues and 34 cent of the export

[32] Of which 70 million USD are repayment of IMF credits and thus strictly speaking do not pertain to the public sector.

revenues in 1998. Considering the large current account deficit, the strain that the debt service will put on the balance of payment becomes truly awe inspiring.

On the positive side should be registered an expected inflow of approximately 150-165 million USD, of which some 60 million USD from the Word Bank, 85 million from IMF and 7.5 million USD from the EU. In addition, approximately 10 million USD have been pledged as balance of payment support in the form of grants by the Netherlands, Sweden and other countries and it is hoped that some 50-60 million USD will be obtained from privatisation of Moldtelecom.

Table 3.11
Balance of payment scenarios for 1999. Million USD.

	1998	1999	
		IMF	Alternative estimate
Trade balance	-413	-291	-413
Services, income & current transfers	96	102	102
Current account	**-316**	**-189**	**-311**
Direct investment	80	173	100
Loans			
- Disbursements	104	150	150
- Amortisation (incl. Portfolio)	-137	-109	-216
Other flows , errors & omissions	-44	3	3
Capital account	**3**	**217**	**12**
Overall balance	**-313**	**27**	**-299**
Financing			
IMF credits (net)	-64	37	37
Financing gap	**377**	**64**	**-262**

Sources: IMF estimates; Prognosis from Ministry of Finance.

Remarks: Alternative estimate based on following assumptions; trade balance same as in 1998, other entries in current account according to IMF estimate, direct investments up 20 million USD from 1998, disbursement of loans according to IMF estimate, amortisation according to Ministry of Finance prognosis, IMF credits (net) according to IMF estimates.

The balance of payment prognosis elaborated by IMF presents a rather more rosy picture. It assumes a positive balance of 27 million USD (Table 3.11) to which may be added net credits from IMF in the amount of 37 million USD. However, even a casual analysis of this prognosis suggests that it is not only optimistic, but utterly unrealistic. In order for this scenario to materialize:

- The trade deficit will have to decrease considerably through a sharp increase in exports, assuming either a recovery of the Russian market or a remarkable increase of exports to non-CIS-countries, and a sharp curtailment of the already much reduced levels of imports. It is difficult to see how this equation will work out. Preliminary trade figures for the first two months of 1999 show that exports were at only 28 per cent of the level of the same period in 1998, while imports were down to 42 per cent compared to the same period in 1999. Thus the collapse of the trade that followed in the wake of the Russian crisis shows no sign of abating.
- Foreign direct investments would need to more than double from its level in 1998. It is very difficult indeed to see the basis for such an assumption.

- Lending will increase above the present expectations,[33] while debt servicing will be less than half of that calculated by the Ministry of Finances for the public debt alone.

If either of these assumptions do not materialise, the balance of payments will become negative rather than positive. An alternative scenario, using the IMF prognosis, but assuming that (i) exports and imports will remain at the levels of 1998 (which judging from the performance so far is unrealistic), (ii) that FDI will increase by 25 per cent rather than by more than 200 per cent, and which (iii) use the detailed Ministry of Finance calculations as a basis for the debt service, arrive at a financing gap for the year of about 260 - 270 million USD. Given that the foreign reserves at the present stand at a mere 150 - 160 million USD, this clearly suggests a very high risk that there will be an acute balance of payment crisis in the course of the present year. Unfortunately, this is unlikely to be an overly pessimistic scenario. It suggests that Moldova will face the option of a renegotiations of its debt, a further accumulation of debt arrears or a default. In either case, this is likely to result in a further strong downward pressure on the leu, which in its turn will further increase the already intolerably high debt burden in domestic turn and wreck havoc to the public sector budget.

As almost half of the debt payments scheduled for 1999 are due to Russia, a debt rescheduling would need to involve Russian credits, mainly Gazprom. A swap of debt for equity in Moldenergo at highly advantageous terms to the Russian party was already proposed by Moldova, but received a rather cool reception. It would appear that Russia is more interested in exerting a political rather than an economic price for the debt. Negotiations are now underway to 'buy out' the debt accumulated until 1997 at a reduced price. Similarly, the possibility of buying out the 75 million Eurobond issue prior to its maturity at a reduced cost is being explored.[34] The Government is hopeful that debt renegotiations will reduce total debt servicing (including to the IMF) this year by a third; from 296 million USD to about 200 million USD. Sweden is providing technical assistance to the Moldovan Government to this end.[35]

However, a rescheduling would inevitably involve the IMF and the World Bank as well, to whom more than 100 million USD are due in 1999 alone.

While one might understand that IMF has an interest in presenting a scenario that makes full debt servicing possible, it is also clear that this kind of unrealistic prognosis that was made for 1999 undermines any serious economic planning on the Moldovan side and by consequence is very much to the detriment of Moldova's legitimate interests. It is also to the detriment of realistic and timely renegotiations of the external debt.

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[33] Loans and grants within the frame of technical assistance do not have a commensurate effect on the balance of payment, as there is a large return flow to pay consultants and other expenses in the country of origin.

[34] *Infotag April 1, 1999.*

[35] The figures do not tally with those in Table 3.10 because of a difference in the time of the estimate.

CHAPTER FOUR: Political and Institutional Development

Although barely noticed in the West, Moldova, just as the Baltic countries, embarked on a process of detachment from the Soviet Union and independent nation-building well in advance of the achievement of formal independence. In June, 1990, a newly elected legislature adopted a far-reaching declaration of sovereignty within a genuine federation. In the following months a number of new laws were introduced which further undermined Soviet authority in Moldova.[36] In June, 1991, Moldova instituted its own citizenship and in the same month the Moldovan National Bank was established. A month later, all all-Union enterprises in Moldova were subordinated to Moldovan control. The abortive coup in Moscow in August, 1991, precipitated Moldova's decision to proclaim independence from the USSR. On August 27, the Moldovan Parliament proclaimed the independence of the Republic of Moldova and during the ensuing weeks Moldova left the all-Union structures and enacted a series of legislation endowing the republic with the attributes of full-fledged statehood.[37] Yet, it was only after that Moldova had joined the CIS in December 1991, which paved the way for Russia's recognition of its independence, that the international community recognised Moldova's independence.[38]

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

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

Despite the inauspicious start of Moldovan statehood, progress in the fields of democratisation, creating a national cohesiveness and institution-building in general has

[36] For example a law stipulating that Moldovan law had precedence over all-Union law and a law suspending military conscription. For more detailed accounts of the process towards independence and political development in the late 1980s and early 1990s, see Socor (1995a) (1995b) and Crowther (1997).
[37] Socor (1991).
[38] Only two countries, Romania and Lithuania, recognised Moldova as a sovereign state immediately following its own declaration of independence in August.

been impressive in the parts of the country that have remained under Chisinau's control. The strong ethnically based emotions, and not least rhetoric, abated soon after the war in Transnistria, as moderation gained the upper hand over extremism on all sides.

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

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

3.1 Towards Political Pluralism

A firm party structure is only slowly crystallising and the past years have seen a bewildering formation and dissolution of political constellations and alliances, often centered around individual persons. The Agrarian Democratic Party which won a landslide victory in the Parliamentary election in 1994 portrayed itself as a democratic force ideologically close to the social democratic movement. However, most of the leading political figures in the party had a past in the upper echelons of the past political structures and many found it difficult to fully embrace the sweeping political changes that had taken place. The attitude towards economic reforms and the establishment of the rule of law was often one of incomprehension and reluctant compliance rather than wholehearted support. This was particular true for reforms in agriculture, as the interests of the kolhozes were firmly entrenched in Parliament. As a platform for a wide range of diverse and competing political personalities, the party lacked cohesion. In the presidential elections in 1997 the top three candidates – Mircea Snegur, Petru Lushinschi and Andrei Sangheli – all came from the Agrarian party, although the former two had already began to distance itself from it. The presidential election, which was eventually won by Petru Lushinschi, was perhaps most remarkable for the devastating defeat suffered by Andrei Sangeheli, the Prime Minister, and, by implication, the lack of confidence it expressed in his Government. As a consequence of the elections, the Sangheli Government was forced to resign and a new government was formed, headed by Ion Ciubuc, the former head of the Court of Accounts. The Presidential elections was a death blow to the Agrarian Party and left the Parliament weakened.

In the run-up to the Parliamentary elections in March 1988, there was massive defection from the Agrarian Party. A few months before the elections, some 60 per cent of the representatives of the Agrarian Party in the sitting Parliament were found on the lists of other political parties. The Russian dominated Edinstvo (Unity) party suffered a similar disintegration, as most of its representatives left for the Communist Party and the centrist party 'Movement for a Democratic and Prosperous Moldova'.[39]

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

The Communist Party of Moldova is ideologically akin to the Communist Party in Russia. It decries capitalism as the source of the economic and social evils that have befallen on Moldova and sees the IMF and the World Bank, in particular, as the harbingers of Western colonialism. It sees national salvation in a reversal of the reform process and strengthened ties with the CIS countries, with a view to a future resurrection of a reformed Soviet Union. It has been characterised as a party of protests and nostalgia and as such it responds to sentiments that are increasingly widespread in society. Although its core constituency is found among the Slav minorities in the country, it is not primarily an ethnic party. In the 1998 elections about 40 per cent of the votes came from those over the age of 60 and about half of the votes from the ethnic minorities.

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

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

[39] Stawila. 1998.

- The Party of Democratic Forces (*Partidul fortelor democratice*), headed by Valeriu Matei, received 8.8 per cent of the votes. This is a party based on social liberal principles and is on most issues close to the Democratic Convention.

These three parties and alliances formed after the elections a majority coalition named Alliance for Democracy and Reform (*Alianta pentru democratie si reforme*). The task to form the new Government fell once more on Ion Ciubuc. This choice was widely seen as the result of strong pressure by President Lushinschi and a failure by the coalition members to unite behind a single candidate. The new minister posts in the new government were distributed in strict proportion to the seats of the respective parties in the Parliament. Although many names in both the parliament and in the cabinet remained the same as before, the election nevertheless implied a major break with the past, as decidedly reform- and west-oriented forces came to the fore. As a consequence the political spectrum became highly heterogeneous.

The new Government installed after the Parliamentary elections in March 1998 lasted for less than a year. In February, 1999 Prime Minister Ciubuc, apparently under pressure from the President, stepped down as, in his own words, his Government had failed to live up to the challenges of the economic crisis. Hopes of a rapid formation of a new government, led by Ion Sturza, came to naught as the Cristian Democratic Popular Front (CDPF) unexpectedly refused to vote for the new government, on grounds that (i) they would not be sufficiently represented in the proposed cabinet, and (ii) that the proposed Cabinet contained several names that were associated with allegations of corruption. In the end, a cabinet headed by Ion Sturza, but without the participation of CDPF was voted in. The vote of the famous dissident Ilie Ilasco, who is imprisoned in Tiraspol by the Transnistrian regime since 1992 as well as a member of the Moldovan Parliament, was obtained in writing in somewhat mysterious manner to ensure the 52 votes needed in Parliament to approve the proposed new government.[40]

The division of responsibilities and authority between the legislative and the executive has also yet to find its final form. Although specified in the Constitution, it has been and remains subject to contention. In particular during the past few years, since the election of Petru Lushinschi as President, the President's Office has repeatedly attempted to encroach on the Parliament's authority. The President's heavy hand in Prime Minister Ciubuc's resignation is a case in point, as were the attempts by the President to get the Parliament to accept not only Serafim Urucheanu as the new prime minister, but also to bestow the new Cabinet with considerably enlarged power, including an insurance of two years of uninterrupted rule. At the same time, on February 4, Petru Lushinschi formally forwarded a law proposal to the Parliament for adoption, which would have entailed a massive transfer of power from the Parliament to the Government. Using the severe economic crisis as a justification the draft law stipulated that:

- The Government during a period of two years should be allowed to issue 'decree-laws' of economic, social and fiscal nature, which normally fall within the purview of the Parliament and that the Parliament would abstain for a period of two years to modify these 'decree-laws'.
- The Parliament would have to decide within a period of 72 hours on draft laws forwarded by the Government. Failing this, the laws would automatically be considered to be adopted and would be forwarded to the President for promulgation.

[40] Ilie Ilasco is kept in strict isolation at the prison in Tiraspol and is not allowed to communicate with the outside world. The Transnistrian authorities maintain that it would have been impossible for him to write and forward to the Moldovan Parliament any message whatsoever, while his wife, who is the outside person to have visited him during the period concerned states that she has not been given or delivered any message.

- The Prime Minister would have the right to form his own cabinet and to reorganise the structure and mode of functioning of the Government.
- The present law proposal would have priority over other existing legislation.

The Parliament rejected the candidacy of Urucheanu as Prime Minister as well as the above draft law proposed by the President. The latter was to be expected, as the proposal was clearly and on all points in contradiction with the constitution. This incidences highlight a sharpening power struggle between the Presidency and the Parliament, which also has clear ideological implications as the President has a much more ambivalent attitude to economic and political reform and increased orientation towards the West than the majority coalition in the Parliament has. The struggle recently took a new twist as the President announced in late March that a consultative referendum on the introduction of presidential rule in Moldova will be held on May 23, in connection with the local elections.

3.2 Political and Administrative Reform

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

A number of control organs have been established to monitor the executive powers. Thus, the newly established Court of Accounts is playing an active and on the whole constructive role in monitoring the use of public finances. The past few years have shown that it does not shy away from exposing misuse of funds even at the highest levels, although the effect of these exposures has not always been what one might have expected and wished for. There is also a Department of Control and Auditing, which has branches in all the districts. A functioning treasury has been established at the central level, but not yet at the local levels.

Decentralisation of power from the central level to the district and commune level is now high on the agenda. Transforming the elected local authorities from mere extended arms of the central government to independent bodies with responsibility for and the power to decide on local matters, and which are answerable to the local electorate rather than to the central government, has emerged as a main task in the overall process of democratisation of the Moldovan society. A highly controversial reform of the system of local administration has at long last been approved by the Parliament. This reform consists of two parts: (i) a restructuring of the administrative territorial division, whereby some 44 districts and cities have been merged into 12 large units (10 counties, the city of Chisinau and the autonomous territory of Gagauzia)[41], and (ii) an entirely new relationship between the central and the local powers modelled after Western practices. The new system is based on a division into two levels, apart from the central one.

At the local level, the communes and towns will be run by directly elected councils and mayors. These units will be responsible for all affairs of local interest, such as physical planning, environmental protection, provision of local public services and public order, as well as for primary education and primary health care. They will also have the right to levy

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

fees and taxes, within the framework of the law, and will be responsible for budget planning and management.

At the middle level, there will be a directly elected council, which in its turn will elect a president, vice president and an executive committee (permanent bureau) and recruit a non-political secretary. The county council will co-ordinate the activities of the communes, where applicable, and also provide them with technical or legal support and help them with economic planning and environmental protection. The counties are also responsible for secondary education, health care, socio-economic development planning and labour market activities, as well as other activities that trespass the boundaries of the primary communes. They will have the right to levy fees and taxes and responsibility for the planning and management of their own budgetary resources. The state will be represented at the county level by a prefect, appointed by the Government. The prefect will be responsible for ensuring that the local authorities act within the frame of the existing legislation and will also prepare periodic reports for the Government on the economic, social and administrative situation in the county. The law explicitly states that there will be no relationship of subordination between the county council and the prefect.

The draft law on local finances, if adopted, would imply a very far reaching financial autonomy for both the communes and the counties. The counties as well as the communes would be bestowed with full responsibility for their own budgetary planning and management and fiscal flows between the central and the local levels would become strictly regulated and codified. It is also proposed that the local authorities would not only be responsible for the levying of taxes and fees, but also, within certain limits, for determining the tax rates. It is hoped that the decentralisation of budgetary control and responsibility will serve to make the link between taxation and public services more transparent and straightforward as well as enhance local democracy.

Progress in other fields of institution- and nation-building has been mixed, but on the whole positive. The successful establishment at an early stage of a strong central bank and a consensus on the need for macro-economic stability has been most important. After a havoc-wrecking experience of galloping inflation in 1992 and 1993, monetary independence was at last established through the launching of the Moldovan leu in October 1993. Since then, austere monetary policy has made it possible to gradually curb inflation from over 2000 per cent in 1993 to 5 per cent in 1996 and 11 per cent in 1997.

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

The relationship between the legislative and executive powers on the one hand and the judicial powers on the other has so far been relatively free from open tension. The constitutional court is active and by and large respected. The public prosecutor, however, still suffers from being too powerful as well as too closely linked to the Government. Yet, by and large, the judiciary is fairly independent, although it is not immune to outside pressure. There are also examples of political interference in the execution of sentences.

3.3 Present Issues and Problems

The political and institutional scene is characterised by extreme heterogeneity. This is perhaps best illustrated by the sharp contrast between Prime Minister, Ion Sturza, and the President of the Republic, Petru Lushinschi. The former is a young man, not yet forty years of age, English speaking and West-oriented, who has made his career as a private businessman and who is untainted by any involvement in the former political structures. The latter has spent his adult life making a career within the Soviet nomenclature, rising to the post of First Secretary of the Communist Party in the Moldovan SSR before the collapse of the Soviet Union, and for whom Moscow is the natural centre of political power. Although he has solid credentials dating back before independence as a friend of reform, he clearly finds it difficult to put aside ingrained ways of thinking and management styles.

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

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

There are also vast differences in management styles. Old habits of solving all problems at the very top and of making no distinction between petty and strategic issues still linger.[42] An anecdotal case may be used to exemplify this. Thus, at one point not long ago one of the deputy prime ministers was summoned to the (former) Prime Minister where he was ordered to go to Vulcanesti in the south of the country to solve a problem of lack of diesel fuel in one of the remaining sovchozes. A query if this was really the best use of his time was met with complete incomprehension. Yet, there are also examples of institutions were modern management practices prevail.

Corruption and 'group interests' at the highest level have been castigated as a main evil and reason behind the lack of economic progress.[43] There is clearly a great deal of truth in this. There are plenty of examples of both corruption and unsound links between politicians and more or less legitimate business interests at the highest levels. To give a few examples:

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

[42] The 'everything is of utmost importance and requires our immediate attention' syndrome.
[43] The most vocal proponent of this view is perhaps the present resident representative of the IMF.

- The by far most infamous mafiosi in Moldova, a certain Mr. Bolgar, is known to have rubbed shoulder with some of the highest leaders in the country. Shortly after being arrest and sentenced to a long term of imprisonment, he mysteriously escaped and is believed to have left the country. A large petrol company (Boiana Petrol) which he owned was reportedly among those exempted from all payment of taxes for a period of ten years.

The list is long and sordid. The Romanian saying that 'the fish rots from the head down' partly explains the persistence of more petty corruption at the lower levels

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

There is a tendency among foreign experts to automatically assume ulterior motives whenever things are not done the way they expect them to be done, although more often than not it is merely a question of differences in culture and practices. These gross simplifications and suspicions are mutual. Among Moldovans there is an increasingly widespread belief that IMF and the World Bank have a hidden agenda that features colonial economic and political subjugation of the country.[44] This atmosphere of increasing mutual suspicion is very unfortunate. It is also a strong argument for a stronger emphasis on bilateral assistance based on partnership and for a strong element of intensive contact, dialogue and exposure in this assistance.

It would also be wrong to conclude that high level corruption has increased in recent years. Indeed, the opposite is likely to be the case. Moldova inherited a particularly bad legacy of corruption from the Soviet period, even by Soviet standards. This was partly the result of close ties between the Moldovan leadership and the Brezhnev patronage network. Two consecutive Communist Party leaders in Moldova, Ivan Ivanovich Bodyul, who was in power through out the 1960s and 1970s, and Simion Grossu, who was in power until 1989, left behind a particularly nasty legacy of power abuse and corruption. Despite a pronounced pro-reform platform, Andrei Sangheli, who became Prime Minister in 1992, did little to break with the sordid political traditions. The composition of the subsequent two governments led by Ion Ciubuc were more diverse and were weeded of some of the most blatantly corrupt elements of the past. The fact that corruption has become more visible to outsiders as mass media has gradually come to play a more active and assertive role in exposing it and as it is now more freely talked about should be seen as a healthy sign and not as an indication that the phenomenon has worsened.

Closely linked to corruption as well as to the weak law enforcement has been the increasing influence of, primarily Russian, mafia groups. Although poorly documented, anecdotal evidence and hearsay, as well as the increasing number of heavily guarded luxury villas in the outskirts of Chisinau, suggest that the increasing grip of mafia groups on the economy and society is indeed a severe problem.[45] It is not only a problem of justice, that a small group enriches itself at the expense of the rest of the population in an conspicuous but illegitimate manner, but more importantly, a problem of economic development. The fact

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

[45] Many of the houses are also owned by present or former members of Parliament and senior government officials.

that entrepreneurship and enterprises depend on connections and protection and that legitimately earned income is siphoned off to mafia groups acting as ‘roofs’ not only distorts the playing field for the various economic agents, but constitutes a severe obstacle to domestic entrepreneurship and enterprise development as well as a possible deterrent to foreign investments. Yet, the severity of this phenomenon should not be overstated. Unlike the situation in Russia, these criminal organisations in Moldova appear to be made up by a multitude of largely uncoordinated and rather weak groups. Being a predominantly Russian phenomenon its base is also likely to be confined to the larger cities and to be weak in the countryside where the overwhelming majority of the population is Moldovan. Its existence clearly depends on contacts at various levels within the public sector. It is commonly believed that the mafia continues to prosper because of a lack of political will, rather than a lack of means, to combat it. It is unfortunate that the President has so far not expressed such a will in a firm and convincing manner.

The financial crisis in Russia has brought into the limelight the issue of Moldova’s economic and geopolitical orientation. Until recently, this issue was more or less hidden under official declarations of the need to maintain neutrality, to serve as a bridge between the West and Russia and to seek harmonious and closer contacts in both directions. The Russian crisis served as a useful reminder of Moldova’s vulnerability as a small nation trade-dependent on Russia. However, other factors, too, have served to bring the issue of Moldova’s relationship with the rest of Europe to the fore. Firstly, since the Parliamentary elections in the spring of 1998, both the Parliament and the Government are dominated by ‘pro-Western’ or ‘pro-European’ forces. Secondly, the increasing integration of other countries in East Central Europe into the structures of the European Union is making it clear that Moldova risks ending up on the wrong side of the fence of the European ‘fortress’. Thus, the free flow of goods and people would be impeded not only with the countries of the European Union, which is already the case, but also with its immediate western neighbours. The announcement by countries like Poland, the Czech Republic and Bulgaria that they intend to introduce visa requirements for Moldovan citizens in order to comply with EU requirements is serving as a painful reminder that Moldova may soon end up alone in the cold outside Europe.

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

The unresolved Transnistrian conflict remains an open sore that inflicts a very heavy economic and political cost on Moldova. The fact that status quo has prevailed for a number of years does not imply that the situation is stable or that the threat that this conflict imposes on Moldova’s economic and political stability, if not survival as an independent nation, has in any way diminished.

The economic cost of this conflict on Moldova is severalfold.

- Firstly, there is the cost of dislocation, as much of the industrial and economic capacity of the country is in Transnistria. This cost was inflicted immediately after the partition and is gradually diminishing as the old economic structures become increasingly obsolete.
- Secondly, there is the cost of foregone foreign direct investments, due to the image of political instability that the conflict gives Moldova abroad. However, this cost is difficult to estimate, but is likely to be smaller than commonly believed as other factors, too, have acted as a deterrent to FDI.

- Thirdly, and most importantly, the open border with Transnistria and Transnistria's role as a small haven for trafficking in arms, refugees and narcotics, smuggling in general and for money laundering is imposing a very heavy cost on Moldova in the form of foregone public revenue and increased illegal and underground economic activities. The open border with Transnistria implies that the ability of the Moldovan authorities to levy value added tax, excise duties and customs duties (which are main sources of public revenue) are effectively undermined. Minister of Interior, Victor Catan, estimated the total loss in foregone revenue due to smuggling via and from Transnistria to be some 800 million lei, that is equivalent to 35 per cent of total realised public revenue, in 1998. While this may be an exaggeration, it is nevertheless clear that the economic cost in terms of foregone public revenue of the open border is very substantial indeed. To this should be added the cost of increased criminality and economic crime, as those engaged in these kinds of activities can act out of Transnistria with impunity.

A law stipulating the establishment of border controls to control the flow of goods to and from Transnistria was passed in the autumn of 1998, but has yet to be introduced in practice. The failure of the Moldovan Government to act decisively on this issue has been interpreted as a sign of weakness and as proof that there are people in high positions who have an economic interest in maintaining status quo. While it is clear that there are unsavoury economic and political interests in Moldova and, particularly, in Russia in maintaining Transnistria as a haven for criminal activity and as springboard for pursuing such activities in Moldova, the issue as seen from Chisinau's perspective is rather more complex than one of simply mobilising the political will to establish a border control.

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

- That the President should take steps to seek a solution to the conflict that would ensure equal status of Transnistria and the Republic of Moldova within the frame of a common state;
- that measures should be taken to strengthen the financial and logistic provision of the Russian 14th army in Transnistria in the interest of Russia's geopolitical interests;
- that Transnistria should be granted the status of permanent observer at the Parliamentary Assembly of the Russia-Belarus Union, and;
- that the Russian Government should conclude an agreement on economic, scientific, technological and cultural co-operation between Russia and Transnistria.[46]

[46] *Infotag*, February 25, 1999.

Russia’s threat to the integrity and independence of Moldova, both by refusing to withdraw its troops from Moldova, and by its support to Transnistria as an entity with equal status to that of the Republic of Moldova, effectively ties Moldova’s hands in seeking a solution to the conflict. Indeed, it is difficult to see how Moldova would even be able to put in place effective border controls, much as they are needed, in the absence of firm support from the West.

The economic collapse, the increasing popularity of the communist party, fuelled by non-payment of wages and pensions, and the Russian pressure to create some kind of a federation in which the legitimate regime in Chisinau and the Russian puppet regime in Tiraspol, that lacks any democratic credentials and international recognition, would have equal status, provide the ingredients of a nightmare scenario whereby Moldova’s achievements in creating an independent state based on democratic principles and the rule of law as well as its aspirations to become a full member of the European family of nations would completely undermined. Moldova clearly faces a basic choice in its economic and political orientation between east and west. However, in the absence of strong and constructive support from the West, this may well become a choice with only one option.

CHAPTER FIVE The Public Sector

5.1 The Structure of the Public Sector

Moldova has a three tier administrative system, consisting of the central government/state sector and two levels of local authorities. Until recently, the middle level was made up of 38 districts (*raioane*) and four cities *(municipii*).[47] In addition the areas with a Gagauzian majority population formed a separate autonomous region. At the primary level there were some 61 towns and 925 rural communes. Following the administrative reform adopted in early 1999, the division into districts and cities has been replaced by a division into ten counties,[48] one city (Chisinau) and the autonomous region of Gagauzia. It is also foreseen that the communes at the primary level will be merged, although this process has yet to commence. The division of authority and responsibility between the various levels of authority was only vaguely codified in the past, but has become less ambiguous and more explicit in the new legislation. A main difference compared to the previous system is that under the new law there will no longer be any subordination between the central and the local authorities.[49] In the past, while directly elected, the local authorities were *de facto* directly subordinated to the line ministries. There are still overlaps between the primary and the middle level of local authorities, but this matters less as the law explicitly adheres to the principle of subsidiarity and also states that the middle level should confine itself to matters that transcends the interests or competence of a single commune.[50] According to the new legislation, the primary communes/towns have the following responsibilities:

- Local physical planning.
- Construction and maintenance of local physical infrastructure, incl. local roads and open public spaces.
- Construction and maintenance of public buildings.
- Water supply and purification, sewage, garbage removal and treatment and maintenance of a clean environment.
- Local transport.
- Public hygiene.
- Social assistance and protection, including social protection of those unemployed.
- Primary education, kindergartens and day care centres.
- Local culture, including cultural clubs and libraries.
- Promotion of sports and maintenance of sport grounds/complexes.
- Other youth activities.
- Protection of young families, of mothers and children and protection of children’s rights.
- Promotion of equal opportunities between men and women.
- Local police, civil protection and fire fighting.
- Maintenance of graveyards.

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[47] Chisinau, Balti, Benderi (Tighina) and Tiraspol.
[48] Balti, Cahul, Chisinau, Dubasari, Edineti, Lapusna, Orhei, Soroca, Tighina and Ungeni. The county of Dubasari corresponds more or less to the area on the left bank of the river Dniestre.
[49] Legea privind administratia locala. 1999. Article 109.
[50] Legea privind administratia locala. 1999.

The middle level – counties – have the following responsibilities:

- Regional socio-economic development.
- Maintenance of regional roads.
- Regional public transport.
- Construction of major public infrastructure, such as hospitals, schools, major roads, and other objects according to necessity and means.
- Health care.
- Maintenance of social and sanitary public institutions.
- Protection of young families and of mothers and children.
- Promoting equality between men and women.
- Social assistance and protection, including social protection of the unemployed.
- Environmental protection.
- Maintenance of public order and peace.
- Secondary and professional education.
- Youth and sport activities.

As may be seen from the above lists, the social sectors, that is education, health care and social security, are primarily the responsibility of the local authorities. However, some functions such as higher education and specialised health care is the responsibility of the state. Education and health care also make up the bulk of the expenditures at the local level.

The public sector budgets are made up of the state budget, local budgets, the social security budget and extra-budgetary funds. The state and local budgets together comprise the consolidated budget.[51] The distinction between the state and the local budgets has so far been rather fluid. The annual budget laws specify which taxes and fees remain at the local level and which taxes and fees are transferred to the state budget. In brief, it may be seen that income taxes and real estate and land taxes go to the local budget, as do fees for exploitation of natural resources. Most indirect taxes, such as excise taxes, customs duties and most of the value added tax go to the state budget, as do road and vehicle taxes and fines for financial and fiscal offences. A number of taxes, most notably the profit tax and the value added tax on domestically produced goods, are shared between the state and the local budgets according to a formula that may vary from district to district and from year to year.

As the revenues of the local authorities almost invariably are inadequate to cover the their costs, transfers are made from the state to the local budgets. Although certain criteria exist for determining the amount of the transfers, such as budgeted cost per pupil in school, hospital bed etc., the transfers are far from automatic. The criteria ruling the size of the transfers vary from one year to another and the size and timing of actually made transfers to a large extent also depend on completely discretionary decisions and on bargaining power. Thus, it has been very difficult for the local authorities to pursue any kind of budget planning. It is hoped that with the introduction of the new law on local finances, this situation will ameliorate.

Indirect taxes make up the bulk of the tax revenue. In 1997 they made up two thirds of the tax revenue in the consolidated budget.[52] Of the indirect tax, the value added tax yielded the most revenue, 43 per cent of the tax revenue, followed by excise taxes (18 per cent) and taxes on external trade[53] (6 per cent). Direct taxes only accounted for 31 per cent of the total tax revenue; of which personal income tax 13 per cent, profit and other enterprise

[51] According to the Law on the Budget System and the Budgetary Process, adopted on May 24, 1996.

[52] Detailed figures for 1998 are not yet available. It should be noted that 1997 was an unusually good year in terms of budget revenue.

[53] Mainly customs duties.

taxes 11 per cent and real estate and land taxes 7 per cent. Other taxes, such as environmental taxes, made up 2 per cent of total tax revenue. Apart from tax revenues, the consolidated budget also contained other incomes, such as proceeds from privatisation, on the credit side. In all, tax revenues accounted for three quarters of the total revenue of the consolidated budget and other incomes for the remaining quarter.

Table 5.1
Structure of consolidated budget in 1997. Million Lei.

	Consolidated budget	State budget	Local budget
Revenues	**2,941.7**	**2,118.3**	**823.5**
Direct taxes	681.4	147.9	533.5
- income tax	282.0	0.8	281.1
- profit tax	244.2	147.1	97.1
- real estate and land tax	155.2	0	155.2
Indirect taxes	1,477.5	1,355.0	122.4
- excise taxes	401.1	401.1	0
- value added tax	948.9	846.6	102.3
- taxes on foreign trade	127.4	107.3	20.1
Other incomes	782.9	615.3	167.6
Transfers		**- 432.3**	**432.3**
Expenditures	**3,608.4**	**2,637.0**	**1,403.7**
- Education	889.7	277.4	612.3
- Health care	537.0	179.8	357.3
- Social security	455.6	379.1	76.5
Deficit	**666.7**	**518.7**	**148.0**

Source: Ministry of Finance

Remark: The figures exclude net credits from the state to the local budgets and contributions to the social fund.

In 1997, the local budgets accounted for about 28 per cent of the revenues in the consolidated budget and for 39 per cent of the expenditures. Transfers from the state to the local budgets amounted to 432.3 million lei, or 34 per cent of their total revenue (Table 5.1). A main problem is that direct taxes, which are most easily levelled and controlled at the local level remain very small both in absolute and relative terms. The very low amounts of direct taxes are primarily due to the depressed economic situation, but also to an inadequately developed system for collecting income and enterprise taxes and not least arrears in wage payments. The very small amounts collected in income tax constitutes a special problem, as the transfers to the social fund for payment of pensions are linked to this tax. Employers and employees are together expected to contribute the equivalent of about 30 per cent of the gross wage to the social fund.

5.2 The Budget Crisis

The public sector has suffered a decline parallel to that of GDP in the 1990s, albeit with an initial delay (Table 5.2). In 1996 public revenue amounted to about a quarter of the level in 1990, while the expenditure level was about a third of the level in 1990. Yet, in terms of GDP, public revenue was a respectable 27 per cent.

Table 5.2
Development of public sector revenue and expenditure as % of GDP.

	1992	1993	1994	1995	1996	1997	1998 *
Revenues	19.4	16.8	24.9	26.2	27.1	34.0	25.3
Expenditures	40.5	23.0	29.7	31.1	36.9	41.7	27.0
Surplus/deficit	-21.1	-7.5	-5.9	-5.9	-9.8	-7.7	-2.3
Development over time Index: 1990 = 100							
GDP	72.7	55.2	38.1	36.7	33.8	34.2	31.3
Public revenue	40.1	26.3	26.9	27.3	26.0	33.0	23.1
Public expenditure	90.9	39.2	25.0	35.2	38.5	44.0	31.6

* Provisional figure..
Sources: Economic Trends Moldova. 1998a. Pp. 51-52; IMF estimates.

The adjustment of expenditures to the sharp fall in revenues since independence has been very painful indeed. Not only have capital investments been foregone, but severe cuts have been made across the board. Expenditures in key sectors such as education, health care and social services have been dramatically curtailed, although their share in total expenditures until recently remained high (Table 5.3).

The initial decline of the public sector bottomed out in 1994, and the following three years saw an increase in real terms of particularly the public expenditures. Public revenue increased, too, albeit at a much slower pace. However, the apparent improvement of the public sector budget was not based on either any improvement of the real economy or on any fundamental reform of the fiscal system, which remained inadequate and inappropriate for the needs of a market economy. Furthermore, payments in kind and various netting operations, whereby debts are cleared against each other according to often complex and obscure formula, remain widespread and still account for a considerable share of the public revenues.

The budget deficit increased from a comparatively low level in 1994 and 1995 to 9.8 per cent of GDP in 1998 and 7.7 per cent in 1997. The failure to keep the budget deficit under control in 1996 and 1997 incurred the displeasure of IMF and as a consequence lending was suspended in early 1997. In the absence of new credits from IMF and other international and governmental creditors, the Moldovan Government increasingly resorted to funding the budget deficit by issuing treasury bills denominated in lei. The Government was also successful in raising funds outside the country in 1996 and 1997. In 1996 sale of bonds on the external market totalled some 39 million USD and in mid-1997 Moldova succeeded in raising a 75 million five year Eurobond loan on the US and European markets. In addition, the public revenue benefited from the proceeds of the sale of MIG fighters to the tune of 40 million USD in 1997.

Table 5.3
Public sector revenue and expenditures 1995 – 1999. Million Lei.

	1995	1996	1997	1998 plan	1998 actual	1999 plan
Revenues	*1,916*	*2,074*	*2,942*	*2,750*	*2,228*	*2,900*
Taxes	1,531	1,656	2,209	2,307	1,723	2,486
- Profit tax	392	359	244	330	160	240
- Income tax	201	219	282	160	190	155
- VAT	568	614	949	860	843	920
- Excises	186	197	401	590	322	683
- Foreign trade taxes	51	95	127	120	83	265
- Other taxes	130	174	185	247	125	250
Non-tax revenues	385	417	643	443	505	414
- National Bank transfers	0	106	131	130	170	80
- Privatisation proceeds	0	38	239	80	70	105
Expenditures	*2,345*	*2,827*	*3,609*	*3,050*	*2,373*	*3,100*
Education, research	567	833	924	764	571	565
Health care	366	521	537	487	347	405
Social security	n.a.	167	456	468	311 est.	502
Interest payment on debt	173	132	213	443	402	691/798
Capital investments	135	155	234	111	163	65
Surplus/deficit, cash	-437	-753	-667	-300	-250	200
Change in arrears, domestic	145	364	-287	0	520	-120
Change in arrears, external			3	0	- 20	
Deficit, total	*-582*	*- 1,117*	*383*	*300*	*-750*	*80*

Source: Ministry of Finance data, IMF estimates.

Remark: Figures for 1995 and 1998 are estimates based on IMF data, all other figures based on Ministry of Finance data. Due to differences in the mode of calculation, the deficits recorded by Ministry of Finance and IMF do not entirely coincide. Social fund contributions/expenditures are excluded. For interest payment on debt for 1999 both Ministry of Finance and IMF estimates are given.

A combination of discreet incomes from sale of military equipment and improved tax collection resulted in a marked increase in public revenue in 1997. Successful external and internal financing, through the raising of a large Eurobond loan abroad, and issuing of treasury bills permitted the Government to run a large non-inflationary budget deficit in 1997, despite the lack of fresh IMF and WB credits. Thus, public expenditures increased considerably in 1997 over 1996 (Table 5.3). The Government also managed to reduce the arrears in payment that had accumulated over the past years.

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

Table 5.4
Financing of public sector deficit.

	1995	1996	1997	1998 est.	1999 plan
Net central bank	112	-62	142	400	-80
Net domestic banks	69	42	189	-119	0
Treasury bills & non-bank	9	151	76	-79	13
Net arrears	145	364	-287	520	-120
Domestic financing	*335*	*495*	*120*	*722*	*-187*
Net lending	248	452	284	49	413
- Borrowings	422	505	596	278	537
- Amortisation	174	53	312	638	817
Rescheduling	0	0	0	518	198
Net arrears	0	0	0	-109	0
Privatisation proceeds	0	0	0	0	495
External financing	*248*	*452*	*284*	*49*	*413*
Total financing	*582*	*947*	*401*	*750*	*226*

Source: IMF.

Thus, the Russian crisis hit a budget that was already reeling. The impact of the Russian financial crisis on the Moldovan public sector was threefold.

- An involuntary reduction of the budget deficit as the market for treasury bills collapsed. Not only could the Government no longer expand this form of short term borrowing, but it had to honour payment of T-bills that were falling due to the tune of 350 million lei (75 million USD) over a period of only four months (July – October), without being able to sell any new ones.[54] However, in contrast to Russia, the Moldovan government had the stamina and determination to weather the storm and did not default on its payments. The cost of the redemption of the T-bills was covered by loans from the National Bank and by diverting Government revenue from scheduled expenditures on education, health care etc. and by further non-payment of wages and pensions.
- Tax revenues fell further as the external sector and the economy as a whole contracted sharply.
- The involuntary devaluation of the leu virtually overnight doubled the size of the external debt and the already high debt service burden.

While the former of these three effects was short-natured, the consequences of the latter two are proving to be lasting and will continue to affect the public sector during 1999 and beyond.

The response to the crisis was threefold:

- Continued non-payment of wages and salaries, with the result that the accumulated arrears reached truly dangerous levels, both in terms of the months of non-payment and the amounts involved (Table 5.5).
- De facto default on part of the external debt, primarily that due for energy imports from Russia.
- Panic cuts in operational expenditures of all sorts and non-payment of incurred costs.

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

Table 5.5
Arrears in wage payments in the public sector as of February 18, 1999. Million Lei.

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

Source: Ministry of Finance.

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

It was in this situation that the budget for 1999 was negotiated with IMF in November 1998 and approved shortly afterwards. As a basis for the elaboration of the budget lay a forecast from the Ministry of Finance that total revenues for 1999 would be 2.1 billion lei. Judging from past records and in view of the extremely depressed economic situation, this was hardly an overly negative forecast. Yet, following the negotiations with IMF, by the time the budget was approved by Parliament, this figures was revised upwards by 800 million lei to 2.9 billion lei, seemingly without any justification. It is not clear why and how this inflated budget was approved by IMF. However, the consequences are clear: Moldova is once again stranded with a totally unrealistic budget, which, as was the case in 1998, will wreck havoc to any attempt at budgetary and financial planning of the public sector.

Table 5.6 puts the official budget prognosis in a perspective by putting it alongside two alternative scenarios. The alternative scenarios take the more realistic Ministry of Finance estimates as a basis for estimated revenues and assumes slightly lower incomes from privatisation. Against the projected revenues are cast debt servicing. The alternatives scenarios are based on the more detailed Ministry of Finance figures for the cost of servicing the external debt, including arrears, while IMF estimates on payment of interests and domestic bank and T-bill financing are used. Furthermore, it is assumed that the arrears inherited from 1998 in the budget are honoured in full, but that arrears owed to the budget are not paid.[55] Alternative I is based on the present exchange rate of 8.7 lei to the USD, while the latter assumes an average exchange rate of 12 lei to the USD (assuming a further devaluation in the wake of a balance-of-payment crisis). In either case, it is found that there would be little or no money left over for current operational expenditures, as net debt servicing will consume almost all revenues (alternative I) or even exceed total revenue (alternative II).

[55] By February 1999, arrears owed to the budget amounted to 900 million lei. However, there was little hope to recover but a fraction of this amount.

Table 5.6
Public sector scenarios for 1999. Million Lei.

	IMF	Alternative I	Alternative II
Revenues, excl. privatisation	2,893	2,100	2,100
Proceeds from privatisation	621	526	726
Total revenue	*3,514*	*2,626*	*2,828*
Non-operational expenditures			
External debt, interest	458	430	539
- principle	817	655	904
- payment of arrears	(incl. above)	679	936
- state guaranteed debt	(incl. above)	117	161
Internal debt, interest	340	340	340
- payment of arrears	120	750	750
- net bank & T-bill financing	67	67	67
Total non-operational costs	*1,802*	*3,038*	*3,751*
External borrowing	*537*	*667*	*740*
Rescheduling of ext. debt	*198*	*0*	*0*
Left for Operational costs	*2,447*	*225*	*- 183*

Sources: IMF, Ministry of Finance.

Remark: The two alternatives assume (i) revenues as originally forecasts by the Ministry of Finance, (ii) proceeds from privatisation of Moldcom 60 million USD, (iii) external debt serving as forecast by Ministry of Finance, (iv) interest on internal debt and net domestic bank lending and T-bill operations as per IMF, complete payment of outstanding domestic arrears, (v) no rescheduling of the external debt.
Alternative I assumes the present exchange rate of 8.7 lei to the USD, while Alternative II assumes an exchange rate of 12 lei to the USD.

Obviously, neither scenario will materialise. The point of the above exercise is not to provide alternative forecasts, but to show:

- That the budget situation has become impossible and that the state by any standard is facing bankruptcy.
- That actual outcome will primarily depend on factors beyond the control of the Ministry of Finance, such as sale of state assets through privatisation and rescheduling of the external debt.
- That realistic forecasts cannot be made and thus budget planning has become impossible.

The budget law for 1999, resulting from the negotiations with the IMF, states in its second article that servicing the external debt together with payment of wages and pensions shall have top priority.[56] A closer look at the budget makes it clear that it is the debt to the Western and international lenders that is meant by the external debt, while most of the debt to Russia for energy deliveries is presumed to have been rescheduled, which it has not yet been. It is also clear that the priority to wage payments refers to current wages and not to wage arrears. Domestic arrears are assumed to be reduced by a mere 120 million, that is about 20 per cent, rather than to be honoured in full.

Thus, it is stipulated that the external debt to the West shall be honoured in full, while the accumulated debt to the public sector employees, pensioners and others shall more or less be neglected and in reality unilaterally written off. This is not only ethically

[56] Legea bugetului pe anul 1999. 1998.

questionable, to put it mildly, but also economically and politically very short-sighted. While domestic employees and pensioners are too poorly organised to enforce their rights with the same vigour as western and international lenders, the accumulation of arrears in payment of wages and pensions over a long period of time is extremely detrimental to overall societal development and undermines the country's ability to pursue reforms and effectively tackle its economic problems.

- It inevitably breeds corruption at all levels as public sector employees are forced to demand payments from the public for the services they provide. This is not only socially unacceptable, as children are deprived of education, the sick of treatment etc. unless they pay up front for these services, but it also throws a spanner into the overall reform process, as corruption, which is recognised as a main impediment to reform and growth, becomes impossible to combat.
- It undermines the revenue side of the budget, as people who are not paid wages or pensions are unable to pay any taxes themselves or to pay the cost of public utilities like heating and electricity. Furthermore, tax collection suffers as those responsible for collecting taxes do not receive their wages for months on end themselves.
- The arrears refer not only to wages and pensions, but also to economic agents. A case in point is reimbursement of value added tax to exporters. This reimbursement presently takes place after long delays or not at all. Thus, an export tax of 20 per cent is in reality levied on those who export legally. The economic implications of this in a situation when the country desperately needs to promote its exports are obvious.
- The political cost, too, is likely to be high as people in despair turn their eyes and minds towards the past and begin to look eastwards for solutions. The local elections in May may well prove to be the first visible proof of this.

Table 5.7
Development of public sector incomes and expenditures in real terms. Index: 1995=100.

	1995	1996	1997	1998	1999 plan
Revenues	100	82	103	72	67
- tax revenues	100	82	100	69	74
Expenditures	100	92	103	62	58
- Education	100	112	101	62	44
- Health care	100	108	98	58	49
- Interest on debt	100	58	82	143	176/203

Source: Table 5.3.

Remark: Average annual rates of inflation used to calculated development in real terms. For 1999 IMF estimates for inflation were used.

Apart from pensioners and public sector employees, it is the social sectors that suffer most from the budget crisis. Even according to the unrealistically optimistic official prognosis, allocation to health care and education will fall in real terms in 1999 to approximately half of the already dismally low levels in 1997 (Table 5.7). In per capita terms the allocation is planned to be a paltry 17 USD for education and 12 USD for health care. In reality it is likely to become rather much less.

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

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

Problems of Tax Collection

As tax revenue amount to approximately a quarter of the GDP,[57] it might at first sight appear as though the share of public revenue in GDP is quite respectable by regional standards. However, this is fallacy as the figure hides on the one hand high tax rates and on the other hand poor collection rates. The system of tax collection is still very imperfect and has yet to develop as an efficient instrument for tax collection in the context of a market economy.[58] The responsibility for tax collection is divided between the customs department and the state fiscal inspectorate (*Inspectoratul Fiscal*). The former has a staff of some 2,300 officers. Apart from its headquarter in Chisinau, it has offices in all districts. There are separate tax audit offices attached to all the offices of the fiscal inspectorate. The problem of tax collection is severalfold.

The share of indirect taxes in total tax revenue has increased in the past few years from an already high level. Yet, there are severe shortcomings in the collection of these taxes. The main problem is (i) the absence of any control over the flow of goods between Transnistria and the rest of Moldova, (ii) the porous border with Ukraine and (iii) corruption. The lack of control over the goods coming into the country from Transnistria and, to a lesser extent, from Ukraine carries a very heavy cost in the form of foregone revenue from value added tax, excise duties (particularly on petrol, alcohol and tobacco) and customs duties. Estimates of these losses vary widely. According to the Minister of Interior, Mr. Victor Catan, total losses due to smuggling via and from Transnistria amounted to 800 million lei in 1998. While this is likely to be an overestimate, it is clear that the foregone revenue can be measured in hundreds of millions of lei. The discrepancy in the Russian and Moldovan trade figures shown in Table 3.6 above, give a rough indication of the amounts involved. Information on individual items are more precise. Thus, it is estimated that taxes and duties were only levied on 7 per cent of the cigarettes consumed in Moldova in 1996.[59] The lack of border control not only means that much potential revenue is lost, but also effectively means that the Government has very limited room to levy taxes on luxury or toxic items, such as alcohol and tobacco, or on petrol. The reasons for the lack of border control have been discussed above.[60] Political pressure from Russia and a general reluctance to set up barriers and controls towards a region that is considered an integral part of the country have been and remain important reasons. It is also likely that there are illegitimate business interests, both in Moldova and in Russia to maintain status quo. However, it should be noted that a law has been adopted stipulating the

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[57] 25.6 per cent in 1997.

[58] The tax inspectorat (*Inspectoratul fiscal*) has the main responsibility for tax collection. Apart from its main office in Chisinau, it also has branches in all district.

[59] *Moldova in Transition.* 1998. P. 67.

[60] See Chapter Four.

establishment of border controls with Transnistria and that there is an increasing consensus within Moldova, as well as strong pressure from IMF, that this should be effectuated. The Ministry of Finance has also expressed an interest in technical assistance to help establish an effective system of customs.[61]

The problem of the poor collection of direct taxes is different and somewhat more complex. It reflects on the one hand rather high tax levels and on the other hand a poor capability to enforce these taxes. Corporate income tax and tax on capital gains are set at a uniform rate of 32 per cent, with some temporary reductions for agricultural enterprises. There is a two-bracket system of personal income tax. Incomes up to 10,800 lei are taxed at 20 per cent, while income in excess of this amount is taxed at 32 per cent. To the personal income tax should be added mandatory contributions to the social fund amounting to approximately 30 per cent of the gross income.

Despite these high rates, revenues from direct taxes remain very small. The main reason is the limited tax base, resulting from the very sharp reduction in overall income from wage employment and the virtual collapse of the industrial sector. However, it is also clear that much of the economic growth takes place in the informal sector rather than in the formal sector. The combination of high tax rates and poor enforcement pushes increasingly larger proportions of the economic activities into the shadow economy. Calculations made by the Centre for Strategic Studies and Reforms suggest that the volume of evasion of direct taxes has increased from about 65 million lei in 1994 to about 500 million lei in 1997, that is from 4 to 20 per cent of the consolidated budget income.[62] The damage is not only in the form of foregone revenue. At least as important is the detrimental impact on the economy, as the formal sector is hamstrung by a heavy tax burden and an inability to compete with informal sector activities. There is an urgent need to revise and modernise the entire system of collection of direct taxes, whereby tax collection is made more efficient and comprehensive, fiscal controls toughened and tax rates lowered.

Some technical assistance is already provided in the field of tax collection, in particular by USAID, while the World Bank and IMF has advised on the redesign of the tax system, the introduction of new tax codes and of international accounting procedures for enterprises Yet, the external assistance provided still fall far short of the needs, particularly in field of enforcement.

A related problem is that of arrears in tax payments. By the end of 1998 the accumulated tax arrears amounted some 900 million lei. To a certain extent this is also a problem of poor enforcement of tax collection. However, in most instances it is at least as much due to an inability to pay as to unwillingness to pay and reflects the deplorable financial situation of most enterprises. Most of the arrears were due by former kolhozes, that are either collapsing or being dissolved, and to other state enterprises, most of which are financially ruined. Hence, there is little hope of ever collecting much of these arrears.

[61] Personal communication by Vice Minister Valentina Badrajan during a meeting in February, 1999.
[62] *Moldova in Transition.* 1998. P. 62.

CHAPTER SIX The Social Dimensions

6.1 Transition to Poverty

Introduction

From a social perspective, the post-independence development in Moldova qualifies the epithet a “monumental disaster”. The transition to market economy has become a transition to poverty.

Since it became an independent state in August 1991 as the successor to the Moldavian Soviet Socialist Republic, the Republic of Moldova has been suffering from a deepening social crisis. The main elements of this crisis are an enormous decline in income and growing income differentiation, decreasing expenditure and consumption, growing poverty and sharply deteriorating nutrition. Below, a detailed examination is given of the effect of eight years of transformation on the living standard of the Moldovan population. The economic context in which this dramatic social decline has taken place was already described in the previous chapters.

Although because of its very unfavourable starting position in 1990 a major crisis was clearly unavoidable, Moldova's recuperation seems to have been postponed by unfortunate policy packages and by a hesitant attitude of the successive governments.[63] Despite the disastrous economic decline during the first years of independence, the social dimensions have not featured very highly on the policy agenda laid down by the international organisations, while the governments have failed to reform the social sectors in tune with new situation.

Mechanisms Behind the Falling Living Standards

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

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

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

The hyperinflation in 1990-1993, when Moldova was still a part of the rouble zone, effectively wiped out all personal savings. By the end of 1993, prices had increased 1,255 times over the level at the end of 1990. As a consequence, life long savings for a secure old age bought little more than a week's supply of bread. Old people, in particular, were hard hit by the inflation. Not only did it wipe out their savings, but the value of their pensions, too, fell to ridiculously low levels. The problem of the payment of pensions was not only a consequence of an erosion of the pension fund, but also that Moldova lost access to the centralised pension funds in Moscow when the Soviet Union broke up. Hence, since independence pensions have had to be paid out of the current expenditure budget of the new Government in Chisinau, at a time when this has been under extreme pressure. The average

[63] UNDP. 1998.

pension by end-1998 was about 90 lei or slightly more than 10 USD, implying a fall to a mere quarter of the level in 1990 in real terms.[64] To which might be added that there were delays of several months in the payment of the pensions.

With the start of independence, the real value of wages and social benefits started to decline rapidly, particularly as a result of the hyperinflation in the first half of the nineties. In the period 1992-1994 the real value of wages fell by 73.5 per cent to 26.5 per cent of their 1991 level while the collapse of pensions was even worse (Table 6.1). In 1994 pensions equaled to only 14.4 per cent of their 1991 value. After 1994, when inflation slowed down, the decline of real wages and pensions also slowed down and in 1997 a slight improvement in wages can be observed. As a result, six years after independence wages and pensions stand at respectively 29.9 per cent and 11.6 per cent of their 1991 level. In the past year the situation deteriorated further as the economic crisis in the wake of the Russian financial crisis has had a severe negative impact on employment as well as on the real level of wages and pensions.

Table 6.1
Development of the real value of wages and pensions 1991-1997.

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

Sources: UNDP. 1997. P.53*; Economic Trends Moldova*, 1998b and 1999.

Remark: Wages refer to January of the respective year.

The impact of the economic decline on the labour market (and thus on incomes) has taken two main forms: a sharp decline in wage employment and a dramatic decline in real wages. Less and less people are entitled to wages. Official registered unemployment remains extremely low (2.3 per cent by mid-1998) because employment offices have hardly anything to offer to people looking for work. They have almost no vacancies; extremely limited funds for active labour market policies and only one-fifth of registered unemployed are entitled to unemployment benefits. Still, the number of people in employment has been falling steadily. Only between 1995 and 1997 the total number of employed fell by 149.100 or 11.7 per cent.[65] Apart from this, large numbers of formally employed persons have been put on unpaid leave, affecting 11.6 per cent of all employed in the first nine months of 1998.

[64] *Economic Trends Moldova*, 1998c. P. 49-51.

[65] The available labour market data on Moldova are not always completely reliable and a regular labour force survey was started only in late 1998. Still, they give an indication of developments on the labour market.

Table 6.2
Wage employment by sector of activity, 1990 — 1998, Thousand persons.

	1990	1991	1992	1993	1994	1995	1996	1997	1998
Total labour force	2,071	2,070	2,050	1,954	1,941	1,276	1,200.0	1,126.6	1,065
Agriculture and forestry	678	743	749	730	767	549.3	510.7	474.0	430.0
Manufacturing industry	456	424	415	245	232	176.9	156.7	141.5	125.0
Construction	172	153	146	105	91	48.6	34.7	34.7	30.0
Trade	145	136	132	116	107	81.8	54.1	48.8	40.6
Transport & communication	112	108	105	75	73	66.8	62.3	58.5	56.3
Health care	115	116	116	96	98	93.3	90.9	88.8	86.7
Education	232	224	223	166	168	150.8	149.4	145.3	142.5

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

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

The figures presented in Table 6.2 provide a broad picture of the development of wage employment. By far the most important sector has been and remains agriculture. The manufacturing sector comes second after agriculture. Comparing the figures over time it can be seen that largest declines have been registered in agriculture and manufacturing, although virtually all sectors have registered a decline in wage employment.

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

The economic crisis has severely affected the capacity of the economy to generate wage employment. Among the first to be affected were rural youth entering the labour market, who for lack of wage opportunities are often forced to join the ranks of underemployed or self-employed in agriculture. Since 1991 the drastic reduction of the wage/state sector labour force as a result of closing down of industrial enterprises and separation of the Transnistria, where the biggest part of these enterprises are located, has not least affected the rural labour force commuting to urban jobs. Consequently, many of the households which in the past had a diversified income basket, where wage income often made up a dominant share, have lost their main source of income and have increasingly become more dependent on farm income. For lack of alternatives, agriculture has been forced to assume the role of an employment buffer. As incomes are generally much lower in agriculture than in industry, it is reasonable to assume that the shift from industry to agriculture has been largely involuntary.

There also appears to have been a shift from industry to the, primarily urban, informal sector (Table 6.3). At the same time as the labour force involved with trade, commerce and repair activities has increased considerably, to the point where it today considerably exceeds the labour force in manufacturing, the share of wage labour in this sector has fallen to a mere 21 per cent. Although some may have gone from wage employment in industry to successful self-employment, it is more than likely that the majority, for lack of alternative income opportunities, have been forced into distress activities, such as petty trade.

Table 6.3

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

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

A: % of wage workers affected by involuntary reduced working time in 1996.
B: % of wage workers affected by involuntary leave in 1996.

Source: *Anuarul Statistic 1996*. 1997. Pp.127-137.
Remark: The average period of involuntary leave was 77 days.

Apart from flight into low-productive self-employment in agriculture, petty trade and services, unemployment and underemployment takes three main forms:

- By September 1998 registered *open unemployment* had reached 33,800 or 3.2 per cent of the wage labour force.
- An additional 120,900 or 11.6 per cent of the labour force were put on *involuntary leave without pay* in 1998.
- Some 39 900 suffered *involuntary reduction in the working time and pay*.

Involuntary leave has been most frequent in manufacturing and construction, where in 1996 about 60 per cent of the wage labour force have been affected. However, even for those who effectively retained their employment, wages have not always been forthcoming, as payment in kind, particularly in agriculture and manufacturing, and long delays in the payment of wages and pensions have become a norm rather than exception. The cumulative effect of involuntary leaves and arrears in wage payments may be gauged by the fact that during the first three quarters of 1998 some 21 per cent of the permanent wage labour force were not included on any payroll.[66] According to BASA Press News Agency, Moldova, in September 1998 the state had started repaying pensions and salaries arrears in agricultural products, such as wheat, corn, sunflower and sugar. Yet, by end-1998, total wage arrears in the economy had reached 638.2 million lei, of which 247 million was owed by the Government to public sector employees. In addition, there were 297 million lei in pension arrears.[67]

By January 1994, average real wages had fall to a mere 22 per cent of their level three years earlier. Since then, and in the context of increasing price stability, real wages have increased slightly, particularly in the past two years. At present they stand at less than a quarter of their level in December 1990 (Table 6.4).

In nominal terms, the average wage by the end of 1998 was 250 lei per month or approximately 28 USD.[68] However, there were large variations across sectors. The by far lowest wages were paid in agriculture, where the monthly wage was only slightly more than half of the national average. Wages in education and health care, too, were well below

[66] *Economic Trends Moldova*, 1998b, P. 21.
[67] *Basapress* 20.09.98; *Infotag* 05.02.99.
[68] *Infotag 05.02.99.*

the national average, while average wages in manufacturing, construction and transport ranged between 350 and 400 lei.

Table 6. 4
Development of real wages. Index: December 1990=100.

Dec. 1990	Jan. 1991	Jan. 1992	Jan. 1993	Jan. 1994	Jan. 1995	Jan. 1996	Jan. 1997	Jan. 1998	Jan. 1999
100.0	83.7	51.6	50.1	22.2	22.4	21.3	24.4	26.9	23.8

Sources: World Bank. 1994. P.104*; Economic Trends Moldova*. 1998b. P. 37-38.

The sharp decline of real wages and pensions has led to an enormous deterioration of the population's purchasing power. At the start of 1994, the average wage covered only some 33 per cent of the minimum consumption budget calculated by the government. Since then the situation has gradually improved somewhat but at the end of 1997 the average wage, then standing at 219.8 Lei, still equaled only around 50 per cent of the minimum consumption budget.[69] For pensions the situation is even more problematic as at the start of 1998 they covered only 18-20 per cent of the minimum consumption budget. Other benefits have reached similar levels. For example, unemployment benefits averaged 80 Lei per month at the end of 1997.

[69] *Economic Trends Moldova*. 1998a.

Table 6.5
Purchasing power of the average monthly disposable income in 1990 and 1996 in selected CIS countries. Kilograms.

	Wheat bread	Potatoes	Beef	Milk	Butter	Eggs, pieces
Belarus						
1990	312	403	60	718	47	1739
1996	84	283	25	192	17	644
Kazachstan						
1990	336	183	29	494	28	1055
1996	72	115	19	96	10	305
Moldova						
1990	364	131	38	579	33	1109
1996	81	71	18	89	7	278
Russia						
1990	390	239	37	626	37	1327
1996	100	223	29	155	20	742
Ukraine						
1990	393	165	39	565	37	1177
1996	103	89	20	118	9	362

Source: *Statisticeskii Ejegodni.* 1996. P. 41

A concrete picture of the decline in incomes can be obtained from measuring it in terms of purchasing power. Table 6.5 puts Moldova in a comparative regional perspective and also shows the change over time. While the average monthly disposable income in 1990 bought 364 kg. bread, 38 kg beef or 579 litres of milk, by 1996 the average Moldovan could only afford 81 kg. bread, 18 kg beef or 89 litres of milk. The Moldovans have also become relatively poorer than their ethnic neighbours.

According to the Institute of Economics of the Moldovan Academy of Sciences, the purchasing power of average wage in 1996 was equal to that of about 30 years ago (in 1967), while purchasing power of wages in health care, education and culture was equal to that of 1958. We should not forget that at this time, in 1958-1967 social protection offered by the state played a far more significant role than at present[13].

The ***collapse of public social security system*** was the third mechanism, which has led to the fall in the living standards of population.

The efforts made in Moldova to adjust the economy to a free market have had a heavy bearing on the social sector. As it will be explained further, there are several causes of the near collapse of the public social security system.

The Social Security Fund (SSF), which was operated under the coordination of the Ministry of Labour and Social Protection, consisted of

- Pension Fund
- Social Insurance Fund
- Reserve Fund

Like in other FSU countries, the SSF in Moldova was providing a wide range of benefits: retirement pensions, disability pensions, pensions for women who have raised three or more children, social pensions, military and special merit pensions, as well as benefits for short term sickness, unemployment, pregnancy, death, children allowances, and student stipends, together with free health care services.

[13] Cohanskaia and Stremenovskaia. 1997. P.11.

The SSF is financed largely by a payroll tax on the wage fund. The rates of contributions were originally set at 37 per cent for state enterprises and agricultural cooperatives and 60 per cent for all other organizations, 1 per cent for individuals. In 1992 new rates were decreased to 30 per cent and 45 per cent respectively.

In 1992, 60 per cent of expenditures for these purposes were made through the budget and 40 per cent by the Social Security Fund, together amounting half of all public expenditures.[14]

Old age pensions were by far the largest item, absorbing two-thirds of all benefit expenditures.[15] In 1992 the ratio of people aged 55+ (women) and 60+ (men) was 28 per cent to the working age population, which indicates that Moldova did not have a particularly elderly population by Western, FSU or Central European standards. For comparison we can present the data on Russia, where the corresponding pensioner/working age population ratio was 34 per cent in 1989; in Belarus 34 per cent in 1989; and for Romania 34 per cent in 1990. However, all these countries have high dependency ratios due to their low retirement ages (60 for men and 55 for women), together with numerous exemptions to the retirement age, the inclusion of years of higher education when calculating length of service, and universal coverage. During the transition years there have been changes in the age structure of the population and an increase in dependency ratio. This issue will be highlighted further in the section on demographic consequences.

The process of market transformation, in particular the privatization of state industrial enterprises and state and collective farms led to a collapse of the social security system, due to the fact that the privatized enterprises have stopped their contributions to the SSF. The social sector was squeezed as well by the fall in the government contribution to the SSF budget as the whole economy contracted. Even though the percentage share of funds allocated in the government budget to the social sector has remained almost the same as compared to pre-independence years, in reality this share is highly insufficient, in real terms.

The new legislation with regard to social security system, which was supposed to cushion the social impact of transition, was not put in place at the beginning of the reforms. Thus the population of the country was left under the intolerable strain of massively increasing social costs.

The problem of the payment of pensions was not only a consequence of an erosion of pension funds, but also of the break-up of the Soviet Union. These pensions suddenly had to be paid of the current expenditure budget of the new government in Chisinau, at a time when this budget was under extreme pressure.

[14] IMF. 1993. P.86.
[15] World Bank. 1994. P.49.

Government Budgeting for the Social Sector during Transition

Moldova shares with most of the other economies in transition the constraints of mobilizing necessary revenue sources for the budget, as well as facing the hard choice of cutting down on public expenditure. This represents a particularly acute problem.

The public sector has suffered as the economic base has shrunk, although it has by and large maintained the share of GDP. According to official statistical estimates public sector revenue fell by almost 75 per cent between 1990 and 1993. It recovered somewhat in 1997, but fell again in 1998 (see Chapter Five).

The adjustment of expenditures to the sharp fall in revenues since independence has had serious consequences for the social sector. Public services have crumbled as a consequence of the decline of the available resources at the same time as the demand on the public sector to provide basic social services and security has increased. The past year has seen a further sharp fall from the already low level of spending, as the external debt servicing is crowding out all other budget expenditures (see Chapter Five). The combination of a sharp reduction in budget expenditure and a lack of reform has resulted in a deterioration of the situation of health care, in particular, to the point where basic medicine, heating and hot water is lacking in many hospitals.

Table 6.6
Structure of expenditure as percentage of the GDP, 1996-1998

	1996	1997	1998 Realized	Govt. expenditures per capita US$ in 1998
Total expenditure	38.6	38.6	34.3	153.3
National Defense	1.0	0.8	0.6	2.7
Education	11.0	7.8	7.3	32.5
Health Care	7.1	5.6	4.5	19.9
Social security and support	2.3	2.3	4.1	18.3
Public debt service	3.3	4.2	4.8	21.4
Capital Investments	2.1	2.1	2.3	10.4

Sources: *Moldova in Transition*. 1998. P.17; *Economic Trends Moldova.* 1996. P.36; *Economic Trends Moldova*, 1997. P.51; *Economic Trends Moldova*, 1998b. P.52; Ronnas. 1998c. P.7.

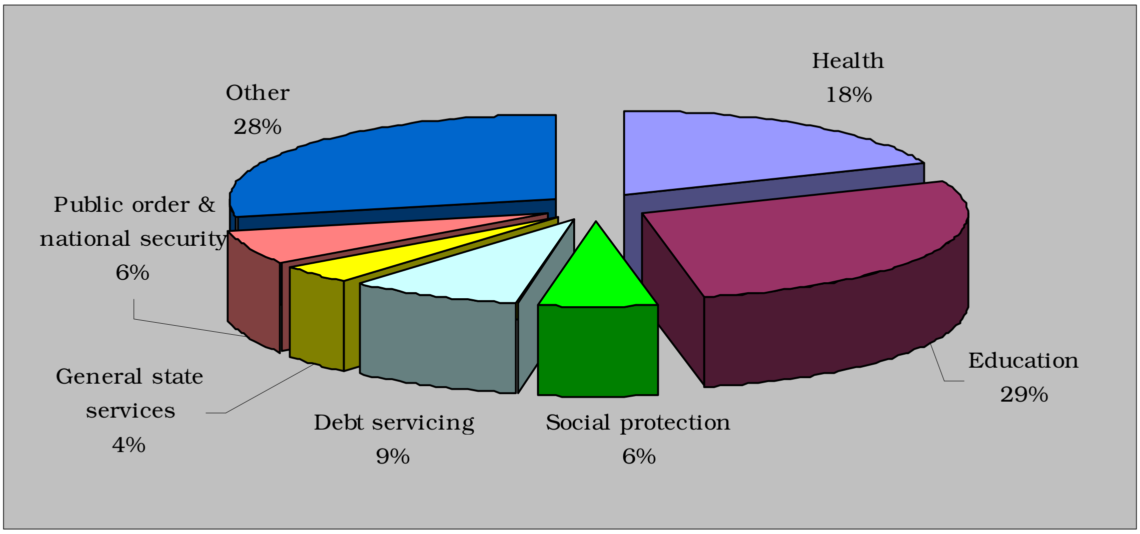
Looking at the structure of expenditures as provided by Table 6.6 we observe that although the biggest items of expenditure have been education and health respectively throughout the period concerned, figures in that table confirm the falling relative significance of these vital areas in last six years of transition (from 11 per cent for health and 7 per cent for education in 1996 to 7 per cent and 5 per cent respectively in 1998).

As an illustration of this negative trend can be presented the following: per capita Government expenditure on health care in 1998 had fallen to only 20USD, for education the expenditure stood at 32USD and for social security at 18USD (Table 6.6).

Another consequences of fall in public revenue are the chronic arrears in salary and wage payment .[17]

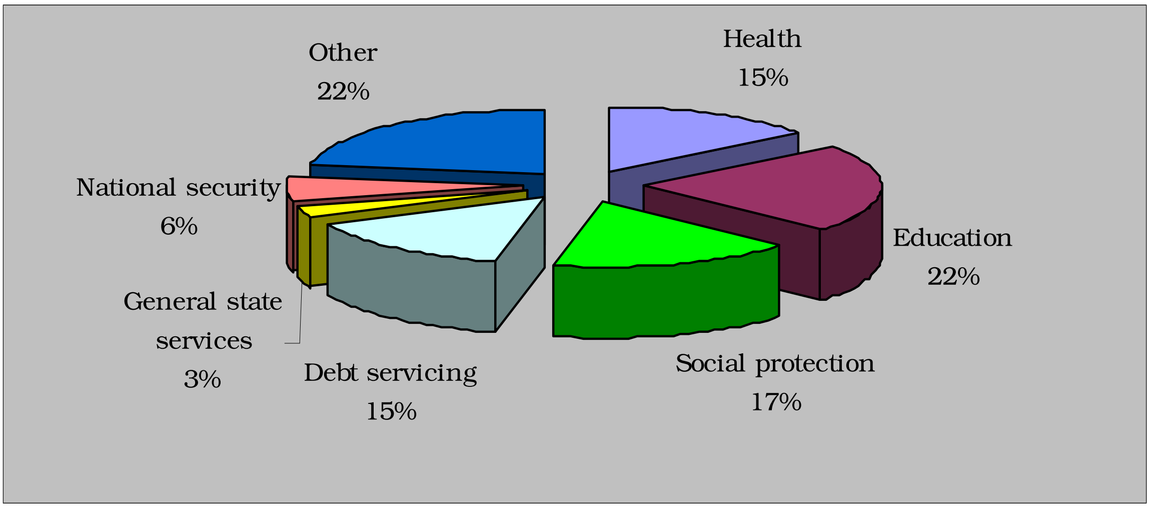
[17] Ronnas. 1998c. P.6.

Figure 1
Breakdown of budget expenditures by share % in 1996



Source: *Economic Trends Moldova*. 1997. P.51.

Figure 2
Breakdown of budget expenditures by share % in 1998



Source: *Economic Trends Moldova*. 1998c. P.89-91.

Figures 1 and 2 offer a comparative view on the changes in the structure of public expenditures in Moldova in a time frame of 1996 –1998.

The problem is exacerbated by the fact that the funds are being spent inefficiently. At the same time, health workers and teachers are grossly underpaid (annual salaries ranging from the equivalent of USD 330 to 600 for doctors and an average of USD 430 for teachers) and wages are paid with long delays that often exceed half a year. In both health care and education there is an established informal system of payments for the services, in cash or in the form of “gifts”, thus creating a de facto system of private medicine and education.

The poor are suffering most because of this development, being unable to afford these informal fees and thus loosing the access to the most important services.

6.2 Changes in the Income during Transition

In the 1990s three major changes in income can be observed.

- First of all, total real income has plummeted mainly as the result of the rapidly declining real value of wages and social benefits, the major income sources.
- Second, there have been major shifts in the structure of income including a decreasing importance of some of the major traditional income sources and a rapidly growing weight of new ones.
- Third, the differentiation of income has increased, widening the gap between different population groups. Below we will look in more detail at these three developments.

The decline of real income as a result of inflation, growing unemployment and hidden unemployment, as well as a result of the collapse of the public social security system was discussed above. Now we will concentrate on the next two major developments in the income of population in Moldova.

Changes in the Structure of the Population’s Income

Traditionally the main sources of income in Moldova have been wages and social benefits, the latter consisting principally of pensions. Their combined share in total income before 1991 used to float around 90 per cent. Wages and salaries have always constituted the main source of money income in Moldova. The analysis of the structure of the household income over a time span of eleven years (1987- 1997) shows a decreasing share of wage component in the total household income as a result of growing unemployment and underemployment since 1993 (Figure 3). With the decline of their real value and growing arrears, the share of wages and benefits in total household incomes has been falling in the period 1992-1997 (Table 6.7). The most dramatic has been the decreasing importance of wages, which accounts for only 34.9 per cent of total income in 1997, compared to over 70 per cent before 1994.

Figure 3. Percentage share of the wage income in the total household income (1987 - 1997)

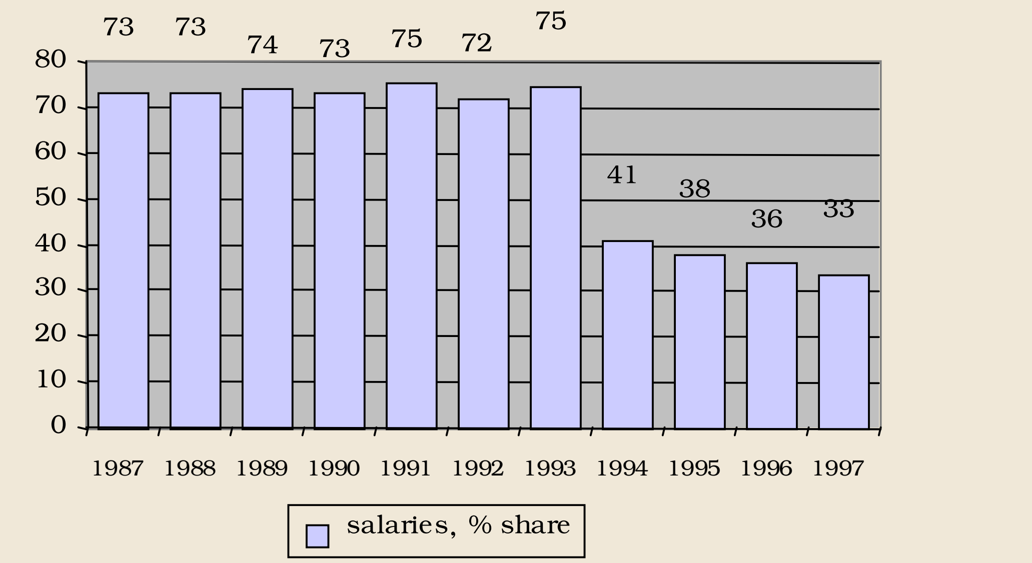
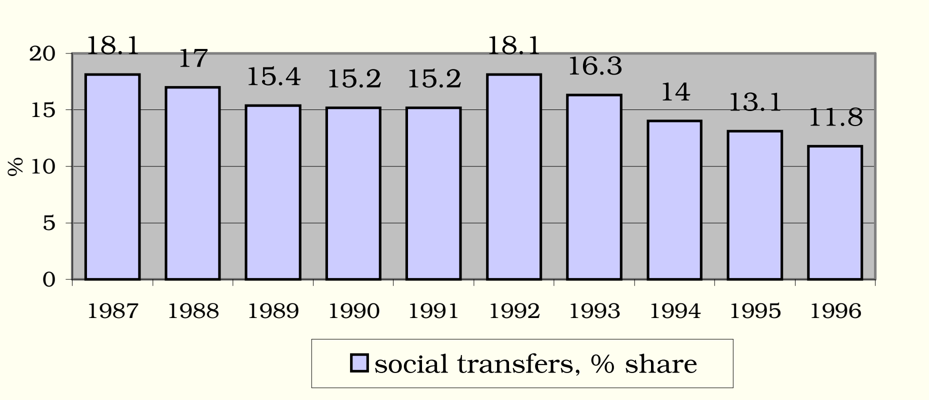


Table 6.7
Percentage share of the wage income and social transfers (pensions, indemnities and scholarships) in the total household income (1987-1997).

Year	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Wage income	72.9	73.1	74.0	73.0	75.0	71.6	74.5	40.6	37.7	36.0	33.1
Social transfers	18.1	17.0	15.4	15.2	15.2	18.1	16.3	14.0	13.1	11.8	14.8 (prelim.)

Sources: *Anuarul Statistic 1989*. 1990. P.71-73; *Anuarul Statistic 1990*. 1991. P.62-65; *Anuarul Statistic 1991*. 1992. P.38-40; *Statisticeskii Ejegodnik*.1997. P 366; *Economic Trends Moldova*. 1998b. P.37.

Figure 4. Percentage share of social transfers in the total household income (1987-1996)



The share of the social transfers in the income has fallen as well in the period of 1991 – 1997 as compared to pre-independence years (Figure 4, Table 6.7). Clearly, because of their plummeting real value, wages and social benefits have to a large extent lost their significance as providers of decent incomes. This is further exacerbated by the fact that they are often not paid or paid with substantial delays. Enterprises have experienced major revenue declines because of the low levels of production and sales and have often not had the funds to fully pay their workers. The government has accumulated important wage debts as well. By the beginning of 1999 total wage arrears amounted to 639 million Lei, equivalent to 8.3 per cent of the GDP for 1998. The agricultural sector, that is mainly the old kolchozes and sovchozes, accounted for a third of the arrears, while most of the rest, some 270 million lei, was owed by the public sector.[18] Pension arrears amounted to 264 million Lei in October 1998.[19] Other benefits were also paid with substantial arrears. Benefit arrears are mainly the result of the mounting debts of economic agents to the social fund and of the reduced government budget.[20] However, the structure of the budget also plays a role. In 1997, only 5.9 per cent of public expenditure were channeled to social security and social support (Table 6.8).

Table 6.8
Per capita income by rural/urban areas and consumption expenditure quintiles.
April-June 1998. USD.

	Total	Urban	Rural	Consumption expenditure quintiles				
				I	II	III	IV	V
Total disposable income	24.3	30.8	20.6	7.6	13.5	19.7	29.4	51.6
- wage income	8.7	18.3	3.3	1.9	3.9	6.9	8.2	4.8
- non-wage income	10.7	3.4	14.8	4.5	7.4	9.5	15.0	17.1
-- agriculture	9.7	1.5	14.4	4.4	7.1	9.1	13.4	14.8
-social benefits	1.9	3.0	1.2	0.5	1.0	1.3	3.3	3.4
- other transfers	2.8	5.6	1.2	0.7	1.3	2.0	2.9	7.1
-- of which gifts	2.5	5.2	1.0	0.7	1.2	1.8	2.6	6.3

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

Remark: Calculated at the exchange rate 1 USD = 4.72 lei. Since the lei started to float in November 1998, the rate has fallen to 1 USD = 9.30 lei (April 1999).

Recent income-expenditure surveys provide a grim picture of dismally low levels of income, large and increasing inequality in the income distribution and a reduced importance of wages in the formation of incomes.

In the second quarter of 1998 personal disposable income averaged 115 lei per month or 24.32 USD at the somewhat inflated exchange rate at the time.[21] At 31 versus 21 USD, the average income was considerably lower in the rural than in the urban areas (Table 6.8). Cash incomes were much lower, as 42 per cent of the average income was obtained in kind. The very high share of in kind income reflects a demonetisation of the economy that has followed in the wake of its collapse.

[18] *Economic Trends Moldova*. 1999. Chapter 5.
[19] *Economic Trends Moldova*. 1998c.
[20] In 1997, public revenue equaled 33% of its 1990 level and public expenditure 44% (Orlova, 1998).
[21] 13.11 USD at the present exchange rate

Table 6.9
Quintile distribution of household disposable income, April — December 1997.

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

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

A particular change in the structure of income has been the increasing weight of payments in kind over payments in cash. Many wage payments are not made in cash but in kind, especially in the agricultural sector. This is possibly best illustrated by the fact that in 1997, no less than 22.7 per cent of the cereals, 29.7 per cent of the vegetables and 51.5 per cent the potatoes produced were used for salary payments. Lately also the government is paying pension and wage arrears with agricultural products such as wheat, sugar, corn or sunflower. Of total income in 1997, 38.0 per cent was in kind.[22] In urban areas this percentage was much lower (17.6 per cent) while in rural areas more than half of all income (55.9 per cent) was in kind. Some 87 per cent of the incomes from agriculture are in kind, primarily consumption of own produce. In rural area non-wage incomes from agriculture dominate entirely. Together with the fact that these incomes were almost entirely in kind, this confirms the picture that rural Moldova has regressed into a subsistence economy with exceedingly low cash incomes.[23]

Income Inequality

The third feature of income developments in Moldova since the beginning of this decade has been the increasing income inequality.

Research on the 1997 household budget survey has identified five social groups running the highest poverty risk:[24] large families (the more children, the greater the poverty risk); incomplete, single-parent families; families with unemployed parents; certain categories of pensioners; and people active in agriculture. They are on average worse off than the rest of the population. However, above all it must be concluded that income has plummeted for virtually the entire population in the last seven years, leading to widespread poverty. This is expressed, among other things, in a sharp deterioration of the population's consumption and nutrition, which will be discussed below.

The decline in incomes has been accompanied by a dramatic widening of the income gap. Large disparities exist between the lower and higher income groups in Moldovan society. The average disposable income per person, per month of the richest 20 per cent of society was 6.8 times that of the poorest 20 per cent in 1998 (Table 6.10). The richest quintile accumulates practically half of all disposable income in the country while the poorest quintile has only 4.3 per cent. In 1997, a fifth of the population received almost half

[22] *Economic Trends Moldova.* 1998c.
[23] Orlova, 1998.
[24] UNDP, 1998. This analysis focused on people living in absolute poverty, then identified as people with an income of 70 Lei (US$15.3) or less per month. 21% of the population belonged to this group.

of the income, while at the bottom end less than five per cent of the total income accrued to the 20 per cent poorest of the population (Table 6.9). According to the latest available survey the disposable income for the lowest quintile averaged a mere 7.5 USD per person per month (Table 6.8). However, the fact that some 60 per cent of the population lived on less than 20 USD per month clearly show that poverty has come to affect the majority of the population.

Table 6.10 provides some additional information on income inequality. Noticeable is the large difference in income between urban and rural areas: in rural areas the average per capita income (including agricultural produce from private plots) is only 66.8 per cent of urban per capita income.

Table 6.10
Disposable income (per month per person) by place of residence* and quintiles.**

	Total	Urban	Rural	Consumption expenditure quintiles				
				I	II	III	IV	V
Total disposable income* (Lei)	114.8	145.5	97.3	35.7	63.7	93.0	138.9	243.0
Share of total income (%)**	100.0	-	-	4.3	9.8	14.8	22.5	48.6

Note: * refers to second quarter 1998, ** refers to April-December 1997. Quintiles are based on per capita household consumption expenditure.

Source: *Economic Trends of Moldova*, 1998b.

The Gini coefficient increased from 0.258 in 1990 to 0.386 in 1996,[25] and to 0.61 in the first half of 1998,[26] which is high even by the standards of most developing countries and a far cry from the relatively even distribution that prevailed as recently as a decade ago. For comparison, the Gini coefficient in Western countries is about 0.35, in Poland, Hungary and Czech republic is about 0.43.[27] Considering the relatively even income distribution that prevailed in Moldova only a decade ago this means contrasts have been sharpened very much in this short period of time.

Recent calculations, based on data from the second quarter of 1997, suggest that 19.3 per cent of the population live below the poverty line, implying that they are incapable of satisfying their physiological needs for food, clothing and shelter.[28] The incidence of poverty is much higher in the rural areas (25 per cent) than in the urban areas (11 per cent). More than three quarters of those living below the poverty line reside in rural areas.[29]

As wage employment has declined and the value of wages has eroded, the importance of wage employment as a source of income has been reduced sharply. In rural areas wage incomes contributes a mere 16 per cent to the total income, that is little more than three USD in absolute terms. In urban areas, the share of wages in total income remains higher – 59 per cent – yet it is considerably lower than a few years ago.

Non-salaried agricultural activities have become by far the most important source of income in the rural areas, accounting for over 70 per cent of the average income. Benefits from the social security system, primarily pension, play a rather significant role in income

[25] World Bank. 1998b. Pp. 68- 71
[26] *Moldova in Transition*. 1998. P.85
[27] Ibid.
[28] *Economic Trends Moldova*. 1998c.
[29] Ibid.

formation. However, these benefits tend to exacerbate rather than reduce differences in incomes, as they are much higher in urban than in rural areas (14 versus 6 lei) and as they are positively correlated with total income. While the poorest fifth of the population received a mere 2.2, that is less than 0.5 USD, in social benefits on average per month, the top quintile received 16 lei on average. However, compared to 1997, the contribution of social benefits to total income had been reduced considerably in 1998.

6.3 Expenditure, Consumption and Nutrition

As a direct result of the enormous decline in real incomes, expenditure has suffered similar erosion. An analysis of expenditure patterns confirms the picture of a population struggling with the problems of basic needs satisfaction. On average, food and non-alcoholic beverages accounted for two thirds of total expenditure in 1998.

Table 6.11
Size and structure of expenditures by consumption quintiles and place of residence, 1998.

	Total	Urban	Rural					
				I	II	III	IV	V
Total expenditure, USD	27.0	31.9	24.0	7.4	13.3	19.6	28.5	62.5
% distribution								
- food	66.9	59.3	73.1	86.6	83.7	79.0	72.6	54.5
- alcohol & tobacco	4.0	2.5	5.2	3.1	3.2	4.1	3.8	4.3
- clothing	7.9	10.5	5.7	1.9	3.2	4.1	5.9	11.6
- housing and heating	6.5	19.6	3.1	2.1	3.0	4.3	6.8	8.3
- health care	3.0	3.8	2.3	1.5	1.0	1.8	2.9	4.0
- transport	5.6	3.8	7.1	2.0	1.3	2.3	2.8	9.2
- entertainment	0.8	1.4	0.2	0.1	0.2	0.4	0.5	1.2
- gifts given	4.5	4.1	4.8	..	..	..	..	..

.. No data

Source: *Economic Trends Moldova*. 1998b. Tables 4.8 and 4.9.

This proportion was higher in rural than in urban areas (73 versus 59 per cent) and was also much higher among the poorer strata of the population than among the higher ones (Table 6.11). Thus, food accounted for a staggering 87 per cent of the expenditures of the lowest quintile. Yet, at a mere 30 lei (6.35 USD), this did not even suffice for a small loaf of bread per day. The extremely high share of food in total expenditure is not a characteristic of the poorest strata alone. Fully 60 per cent of the Moldovan population spend four fifth or more of their income on food (Table 6.11).

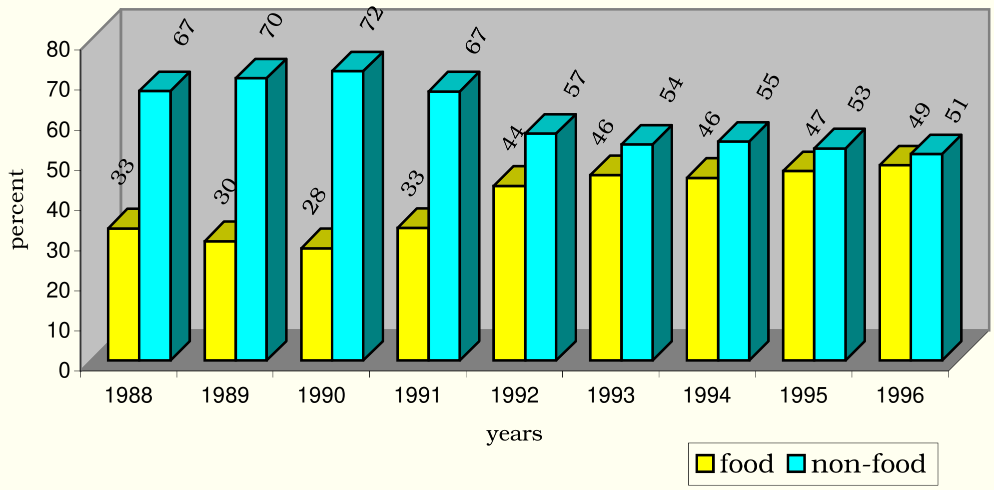
The changes in the structure of the household expenditure in the time frame of 10 years (1988-1998) are presented in Figure 5.

Between 1991 and 1996, the average household's expenditure on food increased from 33 per cent to almost 50 per cent from the total expenditure. In 1998 it reached 67 per cent. The expenditures on non-food items (clothing, shoes, furniture, etc.) have decreased commensurately, while the proportion of expenditures on services and taxes has increased.[30] The growing relative expenditure on food is a clear sign of increasing poverty as expenditure is reoriented more and more towards the most basic goods. In the poorer rural areas expenditure on food has a much higher relative importance than in the urban

[30] Statisticeskii Ejegodnik. 1997. P.367.

areas. The lowest two quintiles even dedicate far over 80 per cent of total expenditure to food items.

Figure 5. Structure of the household expenditure (% share on food and non-food expenditures)



Sources: *Anuarul Statistic 1989*. 1990. P.71-73; *Anuarul Statistic 1990*. 1991. P.62-65; *Anuarul Statistic 1991*. 1992. P.38-40; *Statisticeskii Ejegodnik*. 1997. P.367.

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

Similarly, the very low expenditure on rents and utilities hardly reflects the real costs. The real cost of modest heating and electricity of a 2-3-room apartment of some 50 square metres is presently in excess of 200 lei per month. Compare this with the per capita expenditures of 15 lei per month in urban areas on rent and utilities. The discrepancy comes up in the energy companies' poor rate of revenue collection and huge operating losses, which in their turn are reflected in large and increasing debts to energy supplies in Russia.[31]

One of the main consequences of the fall in expenditure has been the deterioration of nutrition. Table 6.12 gives the average annual per capita consumption of basic food products for the period 1985-1996. Whereas in the period 1985-1990 consumption slightly increased for some food products and slightly decreased for others, in the period 1990-1996 the average consumption of all basic food products declined by at least a quarter, with the exception of potatoes. Consumption of meat and meat products, fish and fish products, and sugar even dropped below 50 per cent of the level of six years before. The consumption of milk and diary products, eggs, vegetables and vegetable oil suffered enormous declines.

[31] See Chapter 2.3.

Table 6.12
Average annual consumption of basic food products, 1985-1996 (kg per capita).

	1985	1990	1996	1996 as % 1990
Meat and meat products	54.0	58.0	25.0	43.1
Milk and dairy products	294.0	303.0	161.0	53.1
Eggs (pieces)	209.0	203.0	116.0	57.1
Fish and fish products	13.4	12.0	3.5	29.2
Sugar	44.9	48.9	22.5	46.0
Vegetable oil	12.3	14.1	8.2	58.2
Potatoes	79.0	69.0	71.0	102.9
Vegetables	129.0	112.0	65.0	58.0
Fruit, including grapes	64.0	79.0	59.0	74.7
Bakery products (bread, cakes, flour, oatmeal, etc.)	173.0	171.0	127.0	74.3

Source: UNDP. (1998).

There is a strong overall decrease in the quality of nutrition of the population and the composition of the daily food intake has become less diversified. Most people are encountering difficulties in purchasing everyday basic products. In 1996, a person could daily buy 3.6 kg bread with an average salary, 1.5 kg bread with an average pension, 911 grams of bread with a social pension, and 474 grams of bread with the minimum unemployment benefit.[32] A survey assessing the food consumption of families showed that in 1996, only the few richest per cent of the population managed to maintain a diet comparable to the average 1985 diet.[33] Only 3.4 per cent have a normal diet in line with their preferences and wishes. 44.4 per cent have a poor diet, buying the cheapest products. No less than 8.2 per cent of families have a very bad diet, many pensioners and families with several children among them. The decline in living standards can be seen from average daily nutritional value of food intake per person, which fell from 2970 kcal in 1990 to only 1976 kcal in 1998.[33] This is less than the minimum nutritional threshold of 2100 kcal per day calculated by FAO. Thus malnutrition in Moldova is spreading very fast, compromising the security of nourishment.

Malnutrition particularly affects the poorest strata of the population. It is estimated that the poorest 20 per cent of the population receive a daily average of only 1,775 kcal or 84.5 per cent of the national average. Some 10 per cent of the population have a diet under the critical nutrition level of 1,500 calories, qualified as extreme under-nourishment by the FAO and is actually experiencing famine.

[32] UNDP. 1998.
[33] Ibid.
[33] *Moldova in Transition*. 1998. P.85.

Table 6.13
Per capita consumption of selected food products.

	Vegetables & potatoes, kg.	Meat, kg.	Milk, kg.	Eggs, pieces
Belarus				
1990	248	75	425	323
1996	271	59	364	295
Kazachstan				
1990	160	71	307	222
1996	120	51	205	70
Moldova				
1990	181	58	303	203
1996	138	25	158	107
Russia				
1990	195	75	386	297
1996	195	51	235	208
Ukraine				
1990	233	68	373	272
1996	212	37	230	162

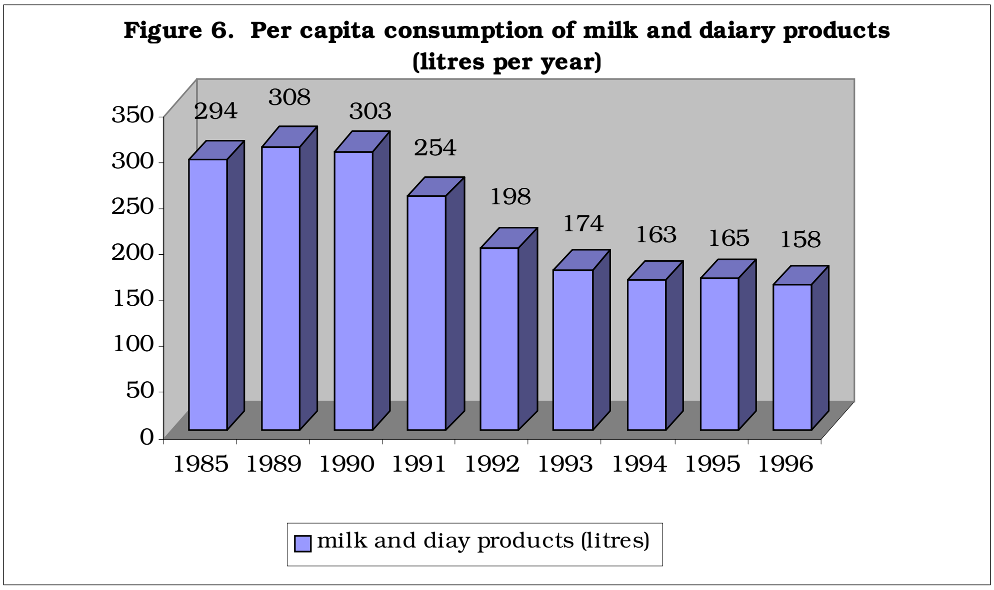
Source: Statisticeskii Ejegodnik. 1997. P.41-45.

Consumption of meat, dairy products, eggs and vegetables has fallen to approximately half of the 1990 level. As may be seen from Table 6.13, the decline in consumption has been sharper in Moldova than in the neighbouring CIS countries and the level of consumption of main food products was by 1996 much lower in Moldova than in the neighbouring countries. As a consequence of the deterioration of the diet, anaemia has become endemic.

The reduction in purchasing power led to a substantial shrinkage of food consumption. From a society with a scarcity of consumption goods on the market Moldova has become a society with low individual consumption. All components of consumption decreased (foodstuff, durable goods, and services). However the most significant fall was registered in basic foodstuffs: meat – a fall by 57 per cent, milk – 49 per cent, fish – 84 per cent, as compared to the 1990's level.[34] Consumption is now close to the critical limits, threatening people's normal development as human beings.

The following figures (Figures 6 - 10) give a picture of changes in the structure of nutrition of the population.

[34] *Cercetarea Bugetelor Gospodariilor*. 1997. P.41, 72.



Sources: *Anuarul Statistic 1989*. 1990. P.92; *Anuarul Statistic 1991*. 1991. P.19; *Statisticeskii Ejegodnik*. 1997. P.45; World Bank. 1995. P.70.

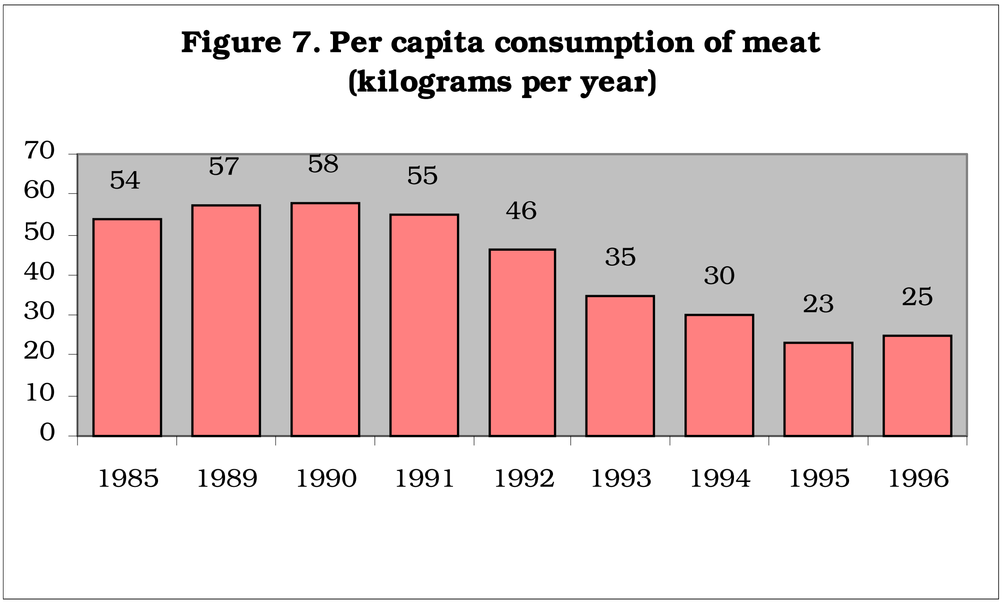


Figure 8. Per capita consumption of eggs (pieces per year)

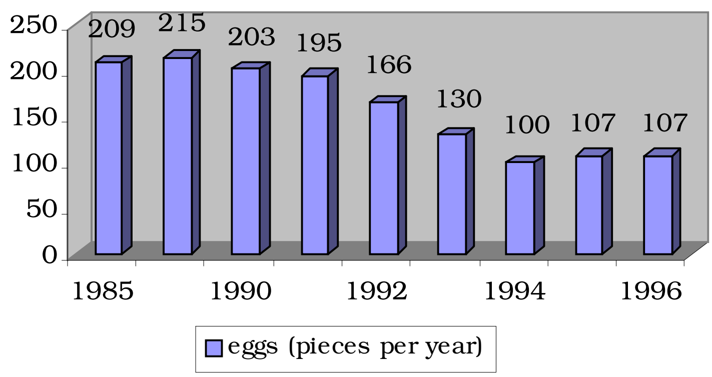


Figure 9. Per capita consumption of bread (kilograms per year)

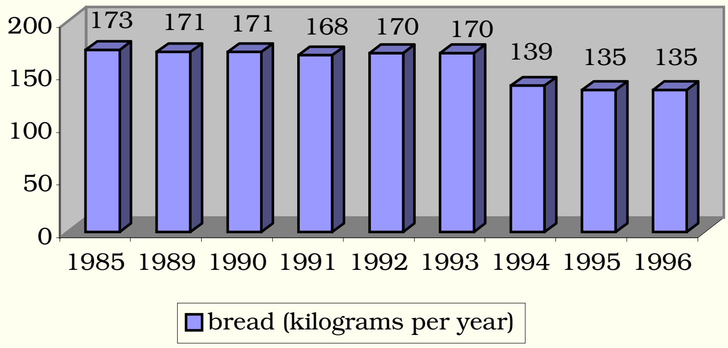
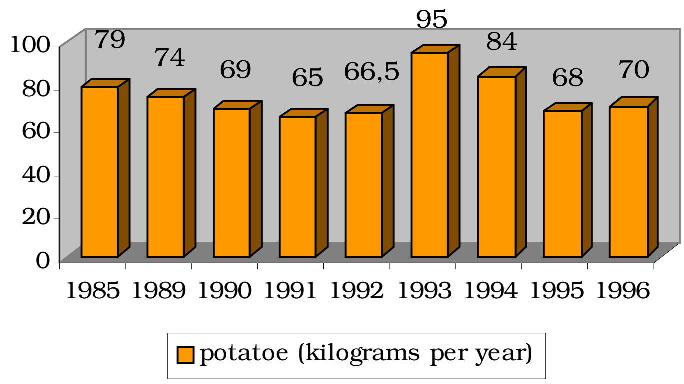


Figure 10. Per capita consumption of potatoes (kilograms per year)



The diagrams presented above are based on the Table 6.12, and reveal a sharp decline in per capita consumption of meat, diary products, eggs, and even bread and vegetables, while the consumption of potatoes has increased during last seven years. There is an overall decrease in the quality of nutrition of population, as well as in the variety of the diet. The composition of daily food intake became less diversified.

The problem of malnutrition has affected children and women particularly hard, which has caused an alarming situation in the sphere of protection of the health of mothers and the newly born children. This issue will be discussed in more detail in the section on health.

6.4 Demographic Consequences

The fall into poverty has very disastrous consequences on the health condition of the population. The implicit effect of malnutrition is reflected in demographic aspects as well. One of the features of transition observed in most of the formerly socialist countries in Central and Eastern Europe has been a harsh human security crisis, as reflected by a marked upsurge in the levels of mortality. This crisis has been particularly severe in Moldova, where average life expectancy has dropped to levels lower than those encountered in many developing countries.

Basic demographic indicators, such as infant mortality, life expectancy, fertility and morbidity, also reflect the sharp fall in living standards. Beginning with 1985 the *birth rate* has been falling continuously from 22 per 1000 persons to 11.9 in 1997, or by almost 50 per cent. The death rate indicator points to the extremely poor health of the population. The *crude death rate* (CDR) (death rate per 1000 persons) increased from 9.7 per thousand in 1990 to 11.9 in 1997. The *Infant Mortality Rate* (IMR) is one of the main indicators of the state health of the population, as well as of the level of development of the given society The infant mortality rate in Moldova increased from 19.0 per 1000 live births in 1990 to 20.2 in 1996.[35] In the same year the maternal mortality rate was 40.2 per 100,000 live births, which exceeds three times the average in Europe.[36]

Compared to 1990, the CDR has increased by 15 per cent while the crude birth rate has dropped by 38 per cent.[37] In 1998 for the first time in modern times in Moldova the death rate exceeded the birth rate. Consequently, the annual natural growth has fallen in Moldova from 8.0 to 0.5 per thousand (16 fold) in 1996 and to 0.0 in 1997. In 1998 the annual growth rate become negative (-0.2 per 1000). The average life expectancy in Moldova has also decreased, from an average of 67.7 years in 1991 to 65.8 years in 1995, for men, it fell from 64.3 to 61.8 years and for women from 71.0 to 69.7 years.[38]

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[35] *Ocrotirea Sanatatii in Moldova*. 1997. P.8.
[36] UNICEF. 1999. P.2.
[37] *Moldova in Transition.* 1998. P.85.
[38] Tintiuk. 1997.

Figure 11
Crude death rate, crude birth rate and annual natural growth per 1000 inhabitants. Infant mortality rate per 1000 inhabitants. Moldova 1940 – 1997.

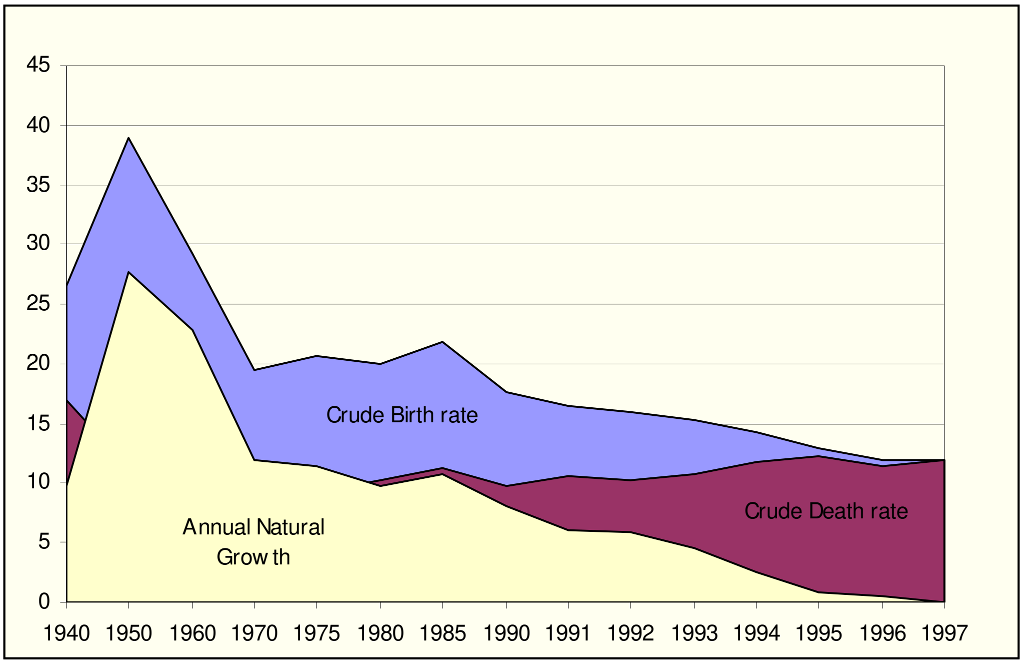


Table 6.14
Crude death rate, crude birth rate and annual natural growth per 1000 inhabitants. Infant mortality rate per 1000 inhabitants. Moldova 1940 - 1997.

Years	Crude Birth Rate	Crude Death Rate	Annual Natural Growth	Infant Mortality Rate
1940	26,6	16,9	9,7	172,0
1950	38,9	11,2	27,7	120,0
1960	29,3	6,4	22,9	48,0
1970	19,4	7,4	12,0	23,0
1975	20,7	9,3	11,4	43,0
1980	20,0	10,2	9,8	35,0
1985	21,9	11,2	10,7	31,0
1990	17,7	9,7	8,0	19,0
1991	16,5	10,5	6,0	19,8
1992	16,0	10,2	5,8	18,4
1993	15,2	10,7	4,5	21,5
1994	14,3	11,8	2,5	22,6
1995	13,0	12,2	0,8	21,2
1996	12,0	11,5	0,5	20,2
1997	11,9	11,9	0,0	19,9

Source: *Ocrotirea Sanatatii in Moldova,* 1997. 1998. P.8.

A recent study on demographic processes in Moldova revealed the main tendencies related to the development of demographic health factors: [39]

[39] Matei. 1998. P.8.

- The hard economic situation leads to the creation of unbearable living conditions in towns, and a part of population, in pursuit of resources for life, migrates to rural areas or in other directions;
- Changes in the age structure of the population show the high rate of growth of population of retirement age. The share of elderly people during 1959-1995 increased from 15.6 per cent to 22.5 per cent.
- The share of children and young people has considerably decreased. The share of children under nine years in 1995 is smaller by 6.3 per cent in comparison with 1959. The number of newborn children in 1997 was only two thirds of the 1990 level.[40]
- The share of population able to work (aged 20-29 years old) has decreased by 21.3 per cent.

The analysis of the age and gender structure of the population indicates that population unable to work accounts for 44.4 per cent of the total population. The process of aging of the population has a territorial aspect and by gender structure. In many rural areas these indicators are much higher than the average in the republic, the demographic burden significantly increases in rural areas. In 1996 there were 78 dependents to each 100 people able to work in the rural areas.[41]

6.5 Health

The economic decline during transition years which has translated into a dramatic fall in the living standards of the population and emergence of major social problems, as well as limited resources available to the system of health care to provide the population, in particular the vulnerable groups, with accessible and qualified medical care, have lead to the spread of almost all nosologic forms of diseases, and subsequently, to the deterioration of the population's health. One of the most alarming situations has built up with the programme of immunization of the population. Although the State has given a promise to secure the necessary amount of vaccines, it has not honoured its obligations. The national programme of immunization has received support in the form of the humanitarian aid offered by the governments of USA, Japan, UNICEF, but still the problem persists. The lack of vaccines is felt and is expressed already in the high contraction rate of infectious diseases. Thus the epidemiological situation is still tense.

In 1996 among the diseases contracted, on the first place stand respiratory diseases – 32 per cent, second – injuries and poisoning –15 per cent, third – infectious and parasitic diseases – 11.8 per cent. Among children up to 14 years of age these three categories of diseases account for 75 per cent of all diseases.[42]

The increase in the occurrence of several nosologic forms of diseases is explained by the low medical attendance rates per inhabitant, and in particular by the inability of most individuals to purchase the necessary medicines, as well as by the lack of means of transportation or fuel, to transfer the patients to the hospitals and check-ups in the medical institutions.

The morbidity of the population - the incidence of diseases such as tuberculosis, hepatitis, malignant neoplasms, syphilis and circulatory diseases has increased rapidly since independence. The incidence rate of intestinal diseases, especially of viral hepatitis, is particularly high.

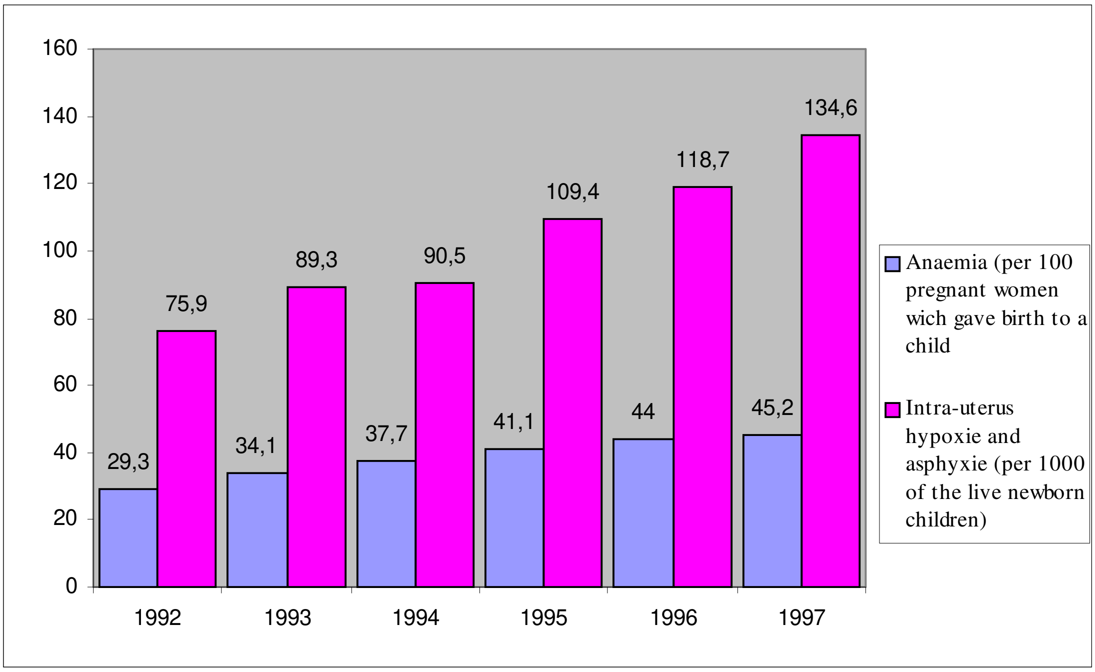
[40] *Ocrotirea Sanatatii in Moldova, 1997*. 1998. P.47.
[41] Matei, 1998. P. 14.
[42] Tintiuk. 1997. P.10.

Another escalating problem is the increasing incidence of the malign tumors (167.5 per 100,000 inhabitants in 1997).[43] One of the causes that led to the increase in oncological diseases in Moldova was the Chernobyl catastrophe in 1986. An unprecedented increase in the number of syphilis cases was also registered during the recent years – in 1997 this number was 10 times higher as compared to 1991.[44]

As mentioned above the fall in living standards has translated into a poorer diet and malnutrition, which especially affected the pregnant women, breast feeding mothers and children. The level of anemia of the pregnant women has increased from 25 per cent in 1990 to 44 per cent in 1997. More often that not these women are unable to breastfeed and anemia also weakens of the immunity of pregnant women to infections. Thus the incidence of inter-uterus infections of the fetus rose by two times during the transition period. The malnutrition of the pregnant women provokes heavy complications during delivery, such as anemic women dying from extensive hemorrhage during delivery ten times more often than the healthy women. The undernutrition of pregnant women is causing chronic intra-uterus hypoxia of the fetus, which in its turns leads to an increase in the number children with congenital malnutrition and affected central nervous system. In recent years 67 per cent of the newborn children are suffering from different nervous disorders, caused by the intra-uterus hypoxia.[45] The malnutrition of the children under one year of age causes a high level of morbidity during the first year of life – anemia – 187 per cent and dystrophy – 84.6 per cent.[46]

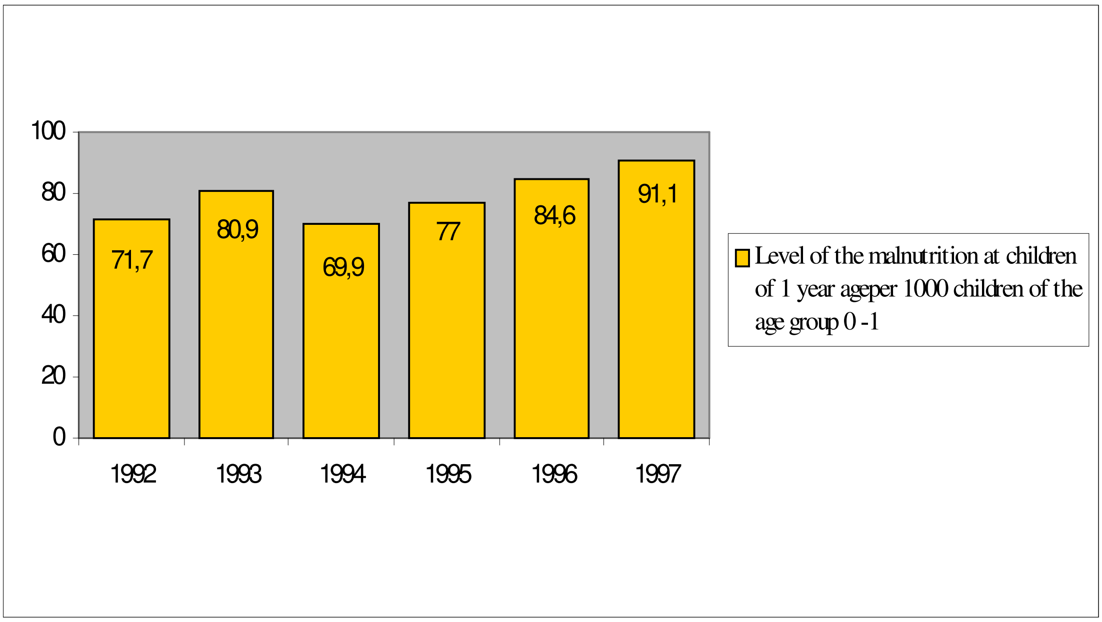
[43] *Ocrotirea Sanatatii in Moldova* 1997.1998. P.135.
[44] Ibid.
[45] UNICEF. 1998.
[46] Ibid.

Figure 12.
Anemia at pregnant women, intra-uterus hypoxia and asphyxia of the newborn children during the delivery



Source: *Ocrotirea Sanatatii in Moldova, 1997*. 1998. P.18.

Figure 13
Level of malnutrition among children of 1 year of age per 1000 children age group 0-1



Source: *Ocrotirea Sanatatii in Moldova, 1997*. 1998. P. 18.

According to a study performed by UNICEF, Ministry of Health of Moldova and the International Family and Child Center in Paris, over 75 per cent of the children are born with a body weight of less than 2,500 grams, while 30 per cent are born premature. Undernutrition among children is one of the most stringent problems of the society. Children in the pre-school institutions receive 38 per cent less meat, 60 per cent less diary products, 30 per cent less vegetables and 40 per cent less fruits. As the results of the study showed, this situation has contributed to the low amount of nutritive substances received by a child: 38 per cent less calories, 60 per cent less proteins.[47] This study on nutritional level of the children under 5 years old revealed that 9.5 per cent of this category of population have retarded development (weight / age), which denotes an chronic undernutrition with insufficiency of many nutrients (vitamin A, D, iodine), necessary for normal development. There have been registered 28 per cent of anemia, 35.5 per cent dystrophy (an increase of 35 times as compared to 1985), 36.7 per cent of endemic goitre (iodine deficiency)[48].

Access to Medical care

In connection with the privatisation of the pharmaceutical network the accessibility of the population to drugs has become a major problem in Moldova. The patients do not follow the medical prescriptions given in cases of ambulatory treatment. In most cases, this situation can be explained by the impossibility to find the necessary drugs and the high costs of the drugs. This led in its turn to an increase in addresses to the hospitals, as they can sometimes provide the patients with drugs at lower cost or free of charge.[49] Although there is no official law adopted by the Parliament which would stipulate the charging of user fees in the health care system, the chief doctors of the hospitals are given the silent permission to establish the price list of the hospitals and medical laboratories. There is an unofficial price list for surgeries and other interventions, although the medical care is still guaranteed by the constitution of Moldova free of charge. Thus, illnesses needing hospital care are particularly unaffordable, since the patient must provide everything from bed linens to syringes. For the poor adequate treatment of illness has become an unaffordable luxury. One may ask one-self whether the introduction of user fees in health care will improve the situation and will secure the access to these life important services for the poor.

Overall, poor families are visiting primary health care services almost 40 per cent less often than the non-poor.[50] The expenditures of the poor on health was only 7.5 per cent of their non-food expenditures, compared to 12 per cent of the non-poor.[51] The study on accessibility to medical care performed by UNICEF and Medical State University of Moldova has determined that the level of this accessibility from the financial point of view is unsatisfactory.

6.6Education

Education, too, has suffered crippling cuts in resources. In real terms, public expenditures on education fell by 60 per cent between 1992 and 1997, although its share in total public expenditure fell only slightly.[52] Since then it has fallen further. The precarious

[47] UNICEF. 1996. P.32.
[48] Ibid. P.17, 30, 35.
[49] UNICEF. 1999-2000.
[50] Tintiuk. 1997. P.15.
[51] UNICEF and Medical State University. 1997.
[52] See further Chapter Five.

situation in the educational sector is particularly worrisome as it leaves the graduates from the educational system poorly equipped to face the demands of a rapidly changing society and labour market and implies that Moldova's human capital, its main asset, is rapidly being ruined. The falling demand for education is due to rising cost and precarious material situation of the poor households. This situation is affecting the poor the worst.

The access of poor children to good education is being reduced by a combination of factors. These include deterioration of infrastructure, the outflow of qualified teachers, the cost of school supplies and even the lack of adequate clothing in winter. With the inability of the state to adequately fund education, private schools, teachers, and private institutions of higher education have moved in. But the quality of education offered by them varies, and they are unaffordable for the poor. In addition, the number of dropouts among the school children has rapidly increased and is becoming endemic, as they drop out to join the labour force, primarily in subsistence or wage agriculture and petty trading. According to the World Bank, over 15 per cent of the poor children are not going to school, the problem being worst for girls in rural areas. Among youth between age 17-24, only 14 per cent of poor Moldovans were enrolled in higher schools, compared to 40 per cent of the youth from non-poor households.[53] This difference in educational access threatens to have serious consequences for the future, as the children from the poor households will have less chance to get education and skills, and thus will remain poor.

According to the data of the Center for Social and Human Ecology of Moldova the negative tendency in the educational sector is reflected in a decrease in the number of pre-school institutions by almost 36 per cent (from 2322 in 1990 to 1480 in 1997). The number of children attending pre-school institutions decreased by 59 per cent. The total number of educational institutions of all grades has decreased by 8 per cent, while the school attendance decreased by 14 per cent as compared to the level of 1990. Some 13,834 children (age 7-16 years old) did not attend school in 1996.

The cumulative effect of the social costs of transition is reflected in Human Development Index (HDI), which is a synthesis of demographic parameters as life expectancy at birth, educational attainment (school enrollment) and living standards measured by the level of income per capita. According to the estimations of UNDP, Moldova's HDI dropped from the 75th place in 1992 in the world to 113th in 1997.[54] The low value of HDI is a warning of difficult situation that persists in the social sector. The main indicators of HDI are at critical value and could undermine further development of economic reforms, and even put into a great danger the economic security of the state.

6.7 Emergence of the "New" Poor

Besides the fast deterioration in the living standards of the population in Moldova a new dimension of this process is being observed during the years of transition. The main feature is the emergence of the category of so-called "new" poor. The existing vulnerable groups of population, such as unemployed, disabled, elderly, families with many children, incomplete families, institutionalized children and old people, have found themselves in a disastrous situation. The deepening poverty and destitution of the vast majority of population is expressed in the loss of access to medical care, education and other social services which were early provided by the state free of charge. The present reforms in the systems of health care, education and social protection promoted by the World Bank are not likely to improve the situation of the population, given the economic background of these reforms.

[53] World Bank. 1997. P.viii.

[54] NHDR Moldova. 1997.

Abandoned Children

An alarming tendency during the transition years has been the growing number of the abandoned children. The root of this phenomenon incontestably lies in the critical socioeconomic situation of the young families, as well of the vulnerable families with many children and when the parents are unemployed or do not receive their wages despite being employed, while the system of social protection for the vulnerable groups collapsed entirely – the unemployment benefits, benefits in case of handicap, benefits for the families with many children practically are not being paid.

The number of children, which are being transferred in the state responsibility and care according to the wish of their parents, is continuously increasing. This denotes the extremely harsh socioeconomic conditions and the deterioration of the human and cultural values in Moldovan society.

But let us not blame the victims.

There are many factors which cause such social manifestation as abandoned children, among which are economic and social (poverty, hunger, mystery, diseases, lack of shelter, low living standards, low level of medical and social care, etc.), psychological (as social norms which provoke the abandonment - the ostracism of single mothers, low moral and culture, incomplete education, etc.), and other.

During the past decade was noticed an increase in the number of the single mothers. A high percentage of the abandoned children are the children of "single" mothers. Thus, in 1992 11.6 per cent of all births were referred to this category of women. [55]

Single and unemployed mothers, being faced with the threat of lack of sources for survival take the decision to leave their newborn children under the supervision of the state. There are many cases when a vulnerable family (both parents are unemployed, or handicapped, or alcoholics) being unable to provide the minimum of their children's needs (clothes and shoes) and faced with the threat of hunger sell the flat in order to move in to a cheaper one, and send the children to state institutions or to the streets for work (washing the cars at the petrol stations, selling newspapers, etc.).[56]

Often this kind of development ends up with a family loosing shelter, living in the basements of houses and children being exposed to the threat of the street life, prostitution, drugs. These children who constitute a group of "new poor" must be given the absolute priority in the programs of social protection.

The results of the Household Budget Survey performed since April 1997, the first one of this kind during the independence years suggests that children who are a quarter of country's population account for 32 per cent of the nation's poor.[57] According to the latest statistical data from the total number of orphans and children without parental care 7719 children are placed in families, and 2000 children are institutionalized. Most of the institutionalized children do have parents, which cannot perform the functions of the parents.

According to a study done by the Center for Medical and Socio-Demographic Family Studies in Moldova 88 per cent of the institutionalized children have an unfavourable social background and 94 per cent have unfavourable biological background (pregnancy and delivery with pathology, neonatal illnesses). All children from the sample were institutionalized during their first year of life, 75 per cent were transferred to these

[55] Ibid.
[56] Ibid.
[57] The World Bank. 1997.

institutions from the maternity and neonatal hospitals, the police found 3 per cent and only 6 per cent were given by the parents into the state care.[58]

At present 66 per cent of all abandoned children are socially abandoned, the parents are motivating this by the lack of material possibilities to raise the child. Two thirds of these children were born prematurely and 94 per cent have developmental difficulties.

One of the reasons behind the retarded physical and psychical development of these children is intrauterine hypoxia of the fetus caused by undernutrition and illness of the mother during the pregnancy, premature delivery and asphyxia during the delivery.[59]

Since 1992 in Moldova was established the practice if international adoption. In 1993 was created the Committee on Adoption of the Republic of Moldova. From the total number of 1,569 children registered by this committee 401 were adopted in Moldova, 148 returned to their biological families and 302 were internationally adopted. (USA – 200, Italy – 48, Germany – 6, Belgium – 8, Switzerland – 9, France – 2, Greece – 1). All the orphans who were adopted internationally have serious health problems.[60]

According to Mrs. Mariana Petersel, Head of the NGO “Save the Children” in Moldova, the procedure of the international adoption is very complicated and expensive. The cost of one adoption is about 3000USD. There is a lack of transparency in all these procedures. A simple calculation shows that this money would be enough to organize an alternative, more efficient system of reintegration of the orphans and abandoned children in their own biological families or relatives in Moldova and cover the subsistence costs for these children by giving the money to the parents instead of keeping them in the institutions. It is well demonstrated that the children, which are raised within the frame of their own family, are best “ equipped” and prepared to adult life. This issue relates to the cost effectiveness of the whole system of the institutionalized children in the country. The multitude of the cases of fraud and theft in these institutions question the viability and usefulness of them as such. The cases of inhumane treatment of the children in the orphanages, where the orphans are suffering from cold, hunger and punishment, or simple indifference to their problems, are rather norm than exception. This should be one of the most ardent areas in need of urgent intervention by the state and international aid organizations.

We may argue that the social and economic decline during transition to market economy in Moldova gave a start to a vicious circle : cuts in public expenditures on health care, a devastated system of medical care, fall in living standards, poverty, undernourishment and anaemia of the young mothers, handicapped newborn children, collapse of the system of social protection , together with other social factors - all of these being transferred into the phenomenon of social abandon of children.

6.8 Conclusions

In Moldova one of the main outcomes of the transformation period has been a profound social crisis, expressed in a sharp deterioration of the standard of living. Income, expenditure, consumption and nutrition all suffered important reductions, dragging the majority of the population into poverty. Unlike in many other countries that encounter similar problems, poverty in the Republic of Moldova affects many social groups, the majority of which have become poor in the last seven years. The "old" have-nots, represented mainly by elderly with small pensions, families with many children or one-

[58] Shivacenco and Tintiuc. 1998. P. 3
[59] Ibid.
[60] Ibid.

parent families, have been joined by an impressive number of "new" poor, represented by the families with breadwinners with small or unpaid salaries, or without employment.

The massive and rapid impoverishment of the Moldovan population has made the country a truly developing country on the periphery of an affluent Europe. Unfortunately, in past few months the situation is only getting worse under influence of the Russian crisis. A major change in economic and social policy is obviously needed in Moldova. The past seven years have shown that a narrow neo-liberal approach to economic reform, combined with a hesitant attitude of government can have disastrous consequences. It would be wrong though to conclude reform has not been "deep" or "fast" enough. It has been going in the wrong direction neglecting microeconomic and social needs while narrowly focusing on macroeconomic stability.

CHAPTER SEVEN Conclusions and Recommendations

7.1 What Went Wrong?

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

The failure to reconstruct the economy in tune with the new economic and geopolitical situation is reflected in the ill-fated continued and, until recently, increasing orientation of exports towards Russia. The reasons behind this development have been discussed above. However, the failure to break out of the colonial trade patterns of the past is hardly the core problem, but a reflection of a more fundamental failure to reconstruct the economy in tune with the dramatically altered conditions after independence. For Moldova, 'transition' from being a peripheral cog-wheel in a huge centrally planned economy to being a small, open market economy has entailed an enormous amount of destruction, but precious little reconstruction.

As noted above, the blame for the economic decline can hardly be put on grossly incompetent or predatory governance. All things considered, the post-independence governments in Moldova have in most respects performed no better and no worse than the average West European government, and their record is a great deal better than that of most other CIS countries.[70] Although from a Moldovan viewpoint, the reform process may appear to have been painstakingly slow, this is clearly a question of perspective. Compared to the pace at which most governments in Western Europe and the European Union have been adapting themselves to the new political and economic realities of post-1989 Europe, the pace of change in Moldova appears almost breathtaking. Yet, a failure to adapt to the fundamentally different economic situation after independence is clearly at the heart of the failure to achieve economic recovery after the initial, arguably inevitable, immediate post-independence decline.

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

[70] Although they share a legacy of corruption with the other CIS states.

comparison of Moldova with the Baltic countries may therefore be useful, not so much for the similarities it presents as for the dissimilarities. Three dissimilarities would appear to have been of decisive importance.

Firstly, the Baltic countries were much better mentally prepared to exploit the political and economic opportunities and challenges presented by the collapse of the Soviet Union, as they were in the forefront in the drive for independence as the Soviet Union began to disintegrate. This mental preparedness made them eminently well placed for a flying start and to embark on the monumental task of transforming their countries into full-fledged members of the European family of modern democracies and market economies once independence was achieved. This task was also clearly facilitated by their past experience as independent countries still in living memory.

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

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

By contrast, Moldova's achievement of independence was almost unnoticed by the outside world. Only Romania expressed enthusiasm, as it saw it as a first step towards Moldova's reintegration in Romania. However, Romania's initial warm support soon turned sour as it became clear that the Moldovans were not disposed to replace one master by another. In the absence of any substantial bilateral assistance, Moldova has had to rely primarily on international organisations and programmes, primarily IMF and the World Bank, for assistance. It is probably fair to say that Moldova received an undeservedly raw deal. As a small and rather unknown fish in the sea of transition economies, Moldova did clearly not attract the attention and interest of the most prominent experts. The advise dispensed by the international agencies was, with few exceptions, little more than a standard fare of clichés and common sense, which is hard to contradict, but of little practical help, and scant attention was paid to the particularities of the situation in Moldova. In retrospect, the complete failure to fully grasp the complexity and profound and acute nature of the problems confronting the new country suggests an astounding naiveté and a disinterest and/or inability to undertake anything more than a superficial and perfunctory analysis of the situation. In many instances the Moldovans probably had a better understanding of the problems they faced than those who came to advise them. Yet, more often than not they failed to convey this to the foreign experts who arrived on brief visits armed with textbook knowledge and ready-made recipes.

In terms of financial assistance, too, Moldova was niggardly treated. For reasons best know to itself, the World Bank stubbornly stuck to its own absurdly high estimate of Moldova's GDP, based on extrapolations of estimates of the earlier GDP of the Soviet Union, and refused to accept fresh calculations made on the ground with foreign assistance and generally recognised by other international expertise, including the IMF, as reasonably accurate.[71] As a consequence Moldova did not receive DAC-status and, thus, did not qualify for concessionairy loans until 1997. This high level squabble over GDP estimates cost Moldova dearly. Not only was it denied concessionary credits at a time when it needed it most, but this dispute also delayed an awareness among potential bilateral donors of the precarious situation in the country.

The receipt of DAC status in 1997 opened the door to more substantial bilateral assistance, primarily from the Netherlands, Germany, Sweden and U.S.A. However, there were no initial benefits in terms of access to cheap credit from IMF and World Bank sources, as IMF suspended all lending to Moldova as a sign of dissatisfaction with the pace of reform and with the growing budget deficit. Thus, as discussed above, Moldova was forced to resort to expensive commercial credits on the world market to uphold basic public functions and services in the face of the near-collapse of the domestic revenue base and, increasingly, to service the expensive loans received earlier, mainly from IMF and the World Bank.

A third difference between Moldova and the Baltic countries is that for Moldova indpendence came at the cost of bloodshed and loss of control of part of its territory. Seven years after independence and the brief civil war, the renegade, self-proclaimed Transnistrian republic remains an open sore to Moldova. The conflict is of a political rather than ethnic nature and received the initially active and subsequently tacit support by Russia. The self-styled republic is run by self-appointed hard line communists - turned - hooligans and has become a haven for trafficking in arms and narcotics, money laundering and other shadowy businesses. The conflict has cost and continues to cost Moldova dearly in terms of foregone economic development and national consolidation. Yet, a solution to the conflict remains elusive as long as Russia prefers status quo, with the opportunity it implies to keep a thumb in the eye of Moldova and to maintain a military presence close to the Balkans, to the political settlement it officially pays lip-service to.

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

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

To conclude, the dismal economic development in Moldova since independence has neither been God-given nor the result of particularly bad governance. Rather it is the inevitable consequence of the failure of Moldova to address the extremely difficult task of nation-building and economic and societal reconstruction in the wake of the economic collapse on a broad front and with sufficient force, urgency and cohesiveness, and, one might add, of the failure of the outside world to extend a strong and desperately needed helping hand at the time when this was most needed.

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