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Moldova 2008: the new – old challenges for the economy

Galina Selari, January 31, 2007

The new year of 2008 traditionally began with summing up of the results for the previous year. We have to note that 2007 saw completion of both the first cycle of implementation of the "new economic policy" (Economic Growth and Poverty Reduction Strategy for 2004–2006 and the Moldova-EU Action Plan for 2005–2007) and preparation and approval of the National Development Strategy for 2008–2011.

At large, the work of the Government and the National Bank could be called successful in 2007 too, given that at a time of both external shocks and catastrophic draughts they managed to maintain stability at the macroeconomic level.

The official summing-up is yet to happen. However according to the Prime-Minister "almost all *issues* specified in the RM-EU Action Plan were basically implemented; and on the whole the country coped well with its home assignment". As the economic part – the most important component of the EU-Moldova Action Plan – in terms of its contents agrees with the Economic Growth and Poverty Reduction Strategy (EGPRS), then, obviously, everything is settled here as well.

Meanwhile it is obvious that expectations of the Government, and not only of that, were not fully realized. This is confirmed both by ratings given by leading international financial institutions and by debates that took place in the course of discussing the draft of then National Development *Plan* (2008–2011) – the first experience of partnership between authorities, business circles and civil society.

The general impression is that the NDP (National Development Plan) was drafted in a European-style, and though in most respects it repeats the goals and objectives of the EGPRS and those of the Moldova-EU Action Plan, understanding of implementation thereof has undergone significant changes: from a sector-based approach to a topical one. The form was also elaborated on: all development priorities are aimed at harmonization of the most important national policies with the European ones.

The key idea however, that transformation of the paradigm and quality of economic growth, improving the economy's competitiveness, has essentially remained the same. Risk factors remained quite sustainable as well: external vulnerability, energy dependence, tight export base, division of the country, poverty and the new social inequality. One cannot but feel doubts: how was the home assignment actually done? Has the country got just another declaration of intention or a working paper that has to be implemented despite its extreme complexity?

A piece of advice by a non-stranger

1. Given the aggregate of all existing circumstances in 2008, the main concern of the authorities, business circles and the population is still the *quality of public administration*. Opportunities for consolidating economic growth mostly through improvement of the legislation are virtually exhausted: it is already clear that it is not enough just to have good legislation, it is important to implement its provisions in practice, and that requires an efficient state machine, fair judicial system, decent law enforcement and consistent legal systems. Neither law will ever yield the results that are expected of it, unless public authorities provide for its implementation, unless a court protects a citizen or an entrepreneur in cases when their rights are violated.

2. *Inflation and investments*. One of the most challenging tasks in the conditions of growing income of the population is to hold back the growth of prices within the claimed limits. This is the more difficult with the inflation starting to accelerate.

We have to note, that according to the mid-term forecast, the *budget would retain its social orientation*. Salaries of public servants in Moldova will increase threefold by the end of 2009. Incomes of the population grow much faster than the GDP and labour efficiency.

World prices for food and oil will continue to grow (World Economic Forum report). The fact that the producer price index is higher here than the consumer price index (in 2007 growth was, respectively, by 28% and 13%) cannot be ignored. Thus, there is also a *"reserve" for further price growth*.

Possibilities to influence evolution of inflation processes are limited by the effectiveness of political instruments: budget revenues are significantly below the real needs for development, while with weak financial markets as a background, the National Bank practically does not have any monetary transmission mechanisms (Moldova: Conclusion Statement of the IMF Mission, December 21, 2007).

The economy has already adapted, not without the help of the National Bank, to the billion dollars in the form of remittances from labour migrants. The issue of their [remittances] transformation into investments is almost "settled" as well: all that has to be done is just to develop the criteria that will help to acknowledge (statistically register) the transferred amount as an investment. There is no answer to the question of channelling of such investments so far (from the statistics perspective also). But there is a draft of the currency regulation law providing for possible safeguard measures (prohibition or limitation of the withdrawal of payments and remittances in a foreign currency in the territory of the RM, introduction of mandatory reservation of a foreign currency on interest-free accounts, etc.), in case the flow of capital into/out of the Republic of Moldova causes or poses a threat of serious complications for reaching the goals of the monetary and/or currency policies. In addition, these safeguard measures can be applied to all, as well as just to some categories of residents/non-residents. It is rather doubtful that Moldova will "defend itself" against direct foreign investment or investment loans. A conclusion suggests itself: a mechanism of administrative forwarding of remittances from consumption to investment is being developed.

One should also keep in mind the "natural" *investment "pressure" on the inflation*. According to preliminary estimates, 2007 became a record-high year in terms of amounts of investment

(within only 9 months, as compared to the same period of 2006, the inflow of direct foreign investments grew two-fold). Has the country "matured" for the expected investment boom?

Moldova falls into the group of "above potential economies", meaning that under the existing economic structure absorption of investments is rather problematic. (World Investment Report 2007). Obviously, this is the reason why the NBM faces difficulties in coping with the inflow of currency into the economy. Given that big projects are designed for more than one year, the inflationary pressure of investments would last for another five years or so. And the danger is that only over time it would become clear how efficient these investments are, and whether they become a growth factor not only in the current period (when and while they are realized), but also in the long run. There is also a possibility for a conflict of interests: "instantaneous" support of the current growth or diversification of the economy and export.

3. *Creation of a business environment relevant to the needs of the society* – it is beyond Government's ability to fulfil this task alone, and that means that the society has the right to appeal to the social responsibility of business circles. Implementation of the NDP implies attraction of private resources in the first place, while the *amount of participation* of private business will become a specific indicator of trust towards the implemented reforms.

So far, though, business is still "sticking to the authorities" – more than 80% of economic entities are registered in Chisinau, and in the "rest" of Moldova a situation of depression persists, and that definitely does not facilitate and rather hampers any efforts to upgrade the economy, including the President's initiatives related to liberalisation, deregulation and demonopolization.

It is high time for Moldovan business that accumulated experience of independent (just for own good!) common arrangement in life to start thinking about *moral culture* as well. Not until late 2006 did the first 6 Moldovan companies – now there are 23 of them, mostly those with participation of foreign capital – join the *Global Compact* (*Global Compact* it is a – World UN Initiative the goal of which is to bring together economic growth processes and human development). We have to remind that a proposal from the UNDP-Moldova was announced back in November 2004. At the same time, the *wishes to the government*, that are not always disinterested and socially oriented, are presented already in details in two White Papers of the very foreign investors.

Looks like we should not expect soon appearance of business with a "human face".

4. *Europeisation of Moldova*. The end of the previous year was marked by obvious success in the European direction: an Agreement between the RM and the EU on visa system simplification and readmission, a Single Visa centre of the EU, a decision on granting autonomous preferences in trade with the EU. One question still remains open, *to what extent we will be able to use this asymmetry*. It is necessary to realize that a possibility to access markets (commodity, labour, capital) is a necessary, but not sufficient condition for being present in them.

It is clear that only common work of the whole society could help to avoid mistakes of the past, that the period of continuous, diligent work awaits us, and not a "rush campaign". The chances for implementing the reform scenario depend on the availability of political will, continuation and consistency of actions of the legislative and executive power; depend on whether there is a trust to them from the part of business society and the population.

Unfortunately, 2008 is again a pre-election year for us, which means that we cannot escape a PR-economy and lots of promises. However, hopefully, the growth momentum has already "matured", and conscious pragmatism would prevail in the economic policy, and we all are going to see a year of prompt actions combined in five "baskets" of the National Development Strategy.