

## REPUBLIC OF MOLDOVA

### PRSP PREPARATION STATUS REPORT

Chisinau, April 24, 2002

#### I. INTRODUCTION

1. It has been over a year since Moldova's Interim Poverty Reduction Strategy Paper (I-PRSP) was finalized. At that time, it was envisaged that the preparation of a full PRSP would be completed towards the end of 2001, although it was recognized that this was an ambitious schedule. Shortly following the adoption of the I-PRSP, however, the preparatory process came to a standstill because of unforeseen political events. These events were set in motion in mid-2000, when the Moldovan Parliament adopted a major change in the country's constitution, changing Moldova from a presidential republic into a parliamentary republic. In December 2000, Parliament failed to elect a new President and, as a result, Parliament was dissolved and general elections were held in February 2001. These elections resulted in an absolute majority of the Communist Party of Moldova and the subsequent election of a new President and Government. The elections, the change in government, and the associated change in senior government officials, caused the PRSP process to temporarily stall. Although this was unfortunate, it was also unavoidable, and the result of a healthy democratic process.

2. An additional challenge was posed by the interruption of Moldova's relations with the international donor community because of the political uncertainty created by the elections and the change in government. The new Government has had to overcome an initial reluctance from the international community to offer support. Furthermore, Government needs to demonstrate its commitment to structural reforms toward a free market economy by implementing and advancing the reform measures. We believe that our Government, more than any previous government of Moldova, has had to prove itself in terms of policies and commitment to complete the transformation to a market economy. As a result, financial assistance (including for the PRSP process) has been considerably less than hoped for, while the need to reestablish relations with donors has required considerable time and effort of senior government officials.

#### II. RECENT POVERTY ALLEVIATION EFFORTS

3. While the process of developing a full PRSP was delayed, the Government's policy priorities since its installation have been very much attuned to the objective of alleviating poverty. The Government's efforts focused on three areas, consistent with the ideas outlined in the I-PRSP:

- **Achieving Sustainable and Inclusive Economic Growth.** The Government has maintained relatively sound financial policies, while continuing with the structural reform process aimed at completing the transformation to a market economy. Notably, several measures have recently been implemented to establish a market-oriented institutional framework. Inflation has continued its downward trend, while the economic recovery that started in 2000 is accelerating. In 2001, inflation at end-year fell to 6.3 percent, and the economy grew by 6.1 percent (the highest growth

achieved since independence). The overall cash deficit further declined to 2.7 percent of GDP, while arrears on domestic expenditure and external debt services have accumulated due to a lack of foreign financing.

- **Human Development and Social Protection.** The approved 2002 Budget places greater emphasis on the social sphere as social expenditures are budgeted to increase, in nominal terms, by 25 percent as compared to 2001. This implies a considerable increase in real terms and the first time for such increase following years of expenditures cuts. In addition, the Government is working closely with the World Bank and other international institutions to achieve greater efficiency in social spending in particular, and government spending in general. For example, the Government has eliminated excess capacity of infrastructure (beds and medical facilities) in rural and district hospitals and closed two hospitals. Meanwhile, budgetary wages and pensions have been increased this year, in particular those of war veterans, within the limits of available budget financing.
- **Medium-Term Expenditure Framework.** The Government has also begun implementing a Medium-Term Expenditure Framework (MTEF) for the 2003–05 Budget. As stated in the I-PRSP, the Government considers the MTEF as an important institutional mechanism that will contribute to greater fiscal discipline and efficiency in resource allocation and in operation. It will ensure that budget allocations are consistent with government policy and strategic prioritization, given the availability of resources. It is unfortunate that we cannot synchronize the PRSP process with the MTEF that is integrated in the 2003 budget process because of a delay in developing a full PRSP. The implementation of an MTEF in the first year will be limited to a strategic allocation of resources for education and health sectors. However, we will ensure the close alignment of the MTEF with a poverty reduction strategy that is being developed.

4. Parallel to the above effort, this Government has confirmed its commitment to the PRSP process by updating the I-PRSP. The document was approved by the Coordinating Committee chaired by the President and subsequently by the Government on April 21, 2002. The updated I-PRSP reflects new poverty monitoring data, an updated macroeconomic framework, a new institutional arrangement for PRSP, and a revised timetable for developing a full PRSP. The new poverty monitoring data introduces additional poverty indicators. A new institutional arrangement for PRSP process includes civil society organizations, external development partners, the private sector, and the poor in the participatory process. Recognizing that a quality participatory process requires strong capacity, additional time and financial resources to organize participation, we proposed to extend the timetable for completion of a full PRSP to March 2003 (Attachment 1).

5. At the same time, the Government has put much of its time and energy in trying to solve the Transnistrian conflict, in cooperation with the international community. This conflict has been a heavy burden for Moldova, both emotionally and economically. The re-integration of Transnistria would allow us to direct all our efforts toward the development of our country and the alleviation of poverty. Furthermore, the Government has recently spent a lot of time and effort to address domestic disputes as regards to

language, national identity, and cultural inheritance in order to find acceptable solutions to all parties involved.

### **III. THE ROAD AHEAD: CONSTRAINTS AND CHALLENGES**

6. In August 2001, the Government restarted the PRSP preparation process. A Coordinating Council was established, chaired by the President and consisting of senior Government members, as well as non-government members, to organize and implement the development of the full PRSP (see the attached Figure). Following this, a new Technical Committee was set up, headed by the Deputy Minister of Economy, responsible for organizing sectoral working groups within the government. The task of organizing civil society participation has been assigned to a Council of Experts, which includes representatives of organizations outside the government.

7. The preparation of a full PRSP, including a broad participatory process, is a first-time exercise for Moldova. In carrying out this exercise, the Government is facing a number of difficulties and constraints:

- **Poverty Analysis, Monitoring, and Evaluation.** There is a need to strengthen capacity in collecting information, monitoring poverty, and conducting policy analysis in order to develop informed poverty-focused policy. Additionally, there is a need to build consensus on the methodology to identify the poor and therefore to analyze the impacts of policies on the poor including an expenditure incidence analysis.
- **Government Capacity.** With the change in government, some officials that were involved in the preparation of the I-PRSP have left. Furthermore, government officials in line ministries and local public organizations do not have adequate technical and analytical skills necessary for costing various measures, ensuring consistency with the overall budget constraints, and developing performance and monitoring indicators. The limited capacity will delay the progress in implementation of a medium-term expenditure framework to other sectors apart from education and health.
- **Capacity and Interest of the Non-Government Organizations.** Although there is interest from a number of non-government institutions in participating in the process, awareness of the general population, especially of the rural poor, of the PRSP process is limited. The challenge will be not just to involve non-government organizations (NGOs) in the process, but also the poorest segments of the population, who are even relatively unaware of the activities of NGOs. For the process to be more inclusive, we must ensure that the opinions of these segments are adequately represented.
- **Financial Situation.** Moldova is facing a heavy external debt burden; in fact, almost half of central government revenues are needed to service the country's debts. At the same time, because of the need to reestablish relations with the international donor community, financial assistance provided to Moldova in 2001 has been much less than hoped for. Uncertainty about future financial assistance also makes it more difficult to develop a medium-term expenditure framework and to determine whether specific measures aimed at poverty reduction are affordable.

8. In light of these difficulties, it seems clear that, even without the change in government, the original time schedule for the preparation of the PRSP was too ambitious. To overcome these difficulties, the Government will be seeking assistance from the international donor community in the following areas:

- Improving poverty data and social impact analyses, to better target the poor and assess the impact of various policies on the poor. With the World Bank assistance, the Government will develop and implement a medium-term plan that clarifies the roles and responsibilities and improves the capacity of difference agencies involved in poverty analysis, monitoring and evaluation. This plan will identify the core indicators used for measuring different dimensions of poverty including consumption and human and physical assets. It envisages a clear assignment of responsibility for data collection and data sharing.
- Costing individual policy measures and ensuring their consistency with the overall budget constraints. This will require strengthening the implementation of a medium-term fiscal framework. We are currently seeking technical assistance from the U.K.'s Department for International Development (DFID) to provide continued technical assistance support in strengthening a medium-term expenditure framework that has already been underway.
- Finding new ways to ensure that the ultimate stakeholders in the PRSP, the rural poor, are duly represented in the preparatory process. To this end, the Government will seek assistance from our external development partners in conducting stakeholder analysis and designing a detailed participation plan that is appropriate to Moldova's conditions.
- Seeking financial assistance, either through debt restructuring or new resources on highly concessional terms, to create room for policies aimed at fostering economic growth and poverty alleviation.

#### **IV. PREPARATION OF THE PRSP: A TIME FRAME**

9. The attached table provides a time frame and outlines the various steps for the preparation of the full PRSP. The first phase, identifying the mechanism for managing the process has already been proposed and adopted by the Government. Clarifying the role and responsibility of all parties involved and strengthening of the institutional mechanism are being worked out with the assistance of the World Bank, in particular to ensure that all segments of society, and especially the poor, are well represented and participating in the process of developing a full PRSP. The next step, which is currently underway, is aimed at providing the informational basis for poverty reduction measures, assessing their impact and monitoring. With assistance of the World Bank, the Government established a poverty analysis working group under the Technical Committee to prepare a three-year action plan with the objective to improve poverty monitoring data, dissemination, and inter-ministerial coordination. The action plan, consistent with the World Bank recommendations, was approved by the Government on May 15, 2002 (GD No 619 of May 16, 2002).

10. Parallel with this, we will link the PRSP to a medium-term expenditure framework to ensure strategic prioritization and financial viability of the proposed poverty reduction strategy. We will aim at having PRSP sector strategies ready by the beginning of August 2002 and integrated the strategies into a full PRSP by November 2002. We expect to finalize a linkage between the PRSP and the 2003–05 Budget towards March 2003.