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May 5, 2006

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Moldova: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

April 14, 2006

PRESIDENT OF THE REPUBLIC OF MOLDOVA

Chisinau, April 6, 2006

DEAR MR. DE RATO,

I would like to take this opportunity to express my support for the economic program prepared by the Government and the National Bank of Moldova. The Memorandum of Economic and Financial Policies is based on the medium-term objectives established in the Economic Growth and Poverty Reduction Strategy Paper (EGPRSP), and is consistent with the Republic of Moldova-European Union Action Plan.

The Memorandum of Economic and Financial Policies aims to ensure macroeconomic stability, which is a precondition for economic growth, and to promote structural economic reforms designed to improve the attractiveness of the Republic of Moldova as a destination for investment. Without economic growth, it will not be possible to achieve our poverty reduction objectives, including Moldova's Millennium Development Goals.

Moldova's international and European aspirations clearly depend on our ability to raise living standard and reform the public institutions in accordance with the European standards. With this goal in mind, I pledge my continuing support for the economic reform efforts outlined in the Memorandum of Economic and Financial Policies.

Sincerely yours,

Signature
Vladimir VORONIN

MR. RODRIGO DE RATO
MANAGING DIRECTOR
INTERNATIONAL MONETARY FUND
Washington D.C. 20431
U.S.A.

April 14, 2006

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. de Rato:

On behalf of the government and the National Bank of Moldova, we are pleased to submit herewith the Memorandum of Economic and Financial Policies (MEFP). The main objectives of our program over the medium-term are set out in the Economic Growth and Poverty Reduction Strategy Paper (EGPRSP) and in the Republic of Moldova–European Union Action Plan, and aim at achieving the Millennium Development Goals. These plans envisage creating conditions for sustainable and inclusive economic growth that reduces poverty.

In support of our medium-term program, we hereby request a new three-year arrangement under the Poverty Reduction and Growth Facility in a total amount of SDR 80.08 million (equivalent to 65 percent of Moldova's quota). We request that the first disbursement under the arrangement, in an amount equivalent to SDR 11.44 million, be made available following the approval of the new PRGF arrangement by the Executive Board of the IMF.

We believe that the policies set forth in the attached MEFP are adequate to achieve the objectives of the program, but are prepared to take any other measures that may become appropriate for this purpose. We will consult with the IMF on the adoption of these measures, in advance of revisions to the policies contained in the MEFP, in accordance with the IMF's policies on such consultation.

We will communicate to the IMF the information needed to monitor progress in implementing the program. Reviews with the IMF will be conducted throughout the period of the arrangement to evaluate the macroeconomic and structural reform policies and implementation of the program and to reach new understandings, as necessary. The first review will cover the progress made during the first six months of the program and is expected to take place before end-January 2007.

We are committed to disseminating the MEFP as well as the Technical Memorandum of Understanding and authorize the IMF to publish its staff report, which will be examined by the Executive Board.

Sincerely yours,

/s/	/s/
Vasile Tarlev	Leonid Talmaci
Prime Minister	Governor
Government of the Republic of Moldova	National Bank of Moldova

Attachments: Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

A. Introduction

1. The strong growth performance over the past four years has marked the transition from a decade of economic decline and rising poverty to a stage of robust growth and improving living standards. During the period of 2001–04, real GDP increased by more than 30 percent and the absolute poverty rate fell by 41 percent to a level of 27 percent in 2004. Inflation, although somewhat higher than desirable—owing to both internal and external factors—has been brought down to near single-digit levels. The exchange rate of the leu has remained stable and the reserves of the National Bank have increased considerably. Robust economic growth as well as prudent limits on external borrowing have reduced the ratio of public and publicly-guaranteed debt from 79 percent of GDP in 2000 to about 33 percent of GDP in 2005.

2. These achievements were made possible by maintaining prudent fiscal policies, focused on improving fiscal administration. Tax revenues increased by more than 6 percentage points of GDP from 2001 to 2005. Although corporate and personal income tax rates have gradually been reduced since 2002, revenue collections on these taxes have continued to increase, both in nominal and real terms.

3. Nevertheless, GDP per capita remains low, and living standards are far inferior to those in the European Union. This has triggered massive labor migration, and this phenomenon has given rise to new social and macroeconomic problems. According to the 2004 census, about 371,000 Moldovan citizens (19 percent of the labor force) now make their living abroad. Remittances, estimated at about 30 percent of GDP, stimulate consumption but also complicate the conduct of monetary and foreign exchange policy. A concomitant problem is the dilemma that labor migration poses for pension system finances, as the tax base for mandatory social insurance contributions is reduced accordingly.

4. In line with our Economic Growth and Poverty Reduction Strategy (EGPRSP) and the European Union-Republic of Moldova Action Plan, the government and National Bank are committed to promoting economic growth based on enhanced productivity and improved competitiveness. To this end, the authorities intend to accelerate the pace of structural reforms aimed at ensuring sustainable economic growth based on robust private sector investment, stronger competitiveness, an efficient public administration, and improvements in the businesses environment.

5. To implement the ambitious reform agenda discussed below, the authorities are counting on the technical and financial assistance of the international community.

B. Recent Macroeconomic Developments

6. Macroeconomic stability and robust growth continued during 2005. Real GDP grew by about 7 percent, while inflation fell to 10 percent (December-to-December). Fiscal policy remained tight, as general government revenues grew by almost 3 percentage points of GDP over the 2004 level. The surplus of the general government grew to about 1½ percent of GDP, in part because the government established a special account on which resources have been accumulated and aimed at reducing our arrears on external debt to Paris Club creditors. Moreover, in 2005 for the first time since independence, the government started to repay the

credits received previously from the National Bank of Moldova (in the amount of Lei 127 million, or 0.3 percent of GDP).

7. The budgetary process has been improved due to the implementation of our Medium-Term Expenditure Framework (MTEF), and by preparing estimates of the consolidated general government, including the state and local government budgets, the social insurance budget and the compulsory medical insurance budget, as well as extrabudgetary funds. In order to broaden the tax base, VAT exemptions have been eliminated on agriculture, as well as on the import and supply of pesticides and fertilizers, equipment, technology and complimentary parts. The VAT rate on medicine has been increased from zero percent to 8 percent.

8. In the absence of external financing for budget support, external debt service became a serious burden for the budget, reaching 40 percent of the total state budget revenues. Throughout 2003–05, the general government recorded primary surpluses of about 2½ percent of GDP, and Moldova's external debt indicators improved significantly. Although external arrears have been cleared to commercial and some bilateral official creditors, the government has not been in a position to make principal payments or clear arrears to Paris Club creditors.

9. The key challenge of monetary policy during 2005 was managing the pressure of foreign currency inflows. These inflows were mainly associated with remittances, and they had a significant impact on inflation and the exchange rate. During most of 2005, there was upward pressure on the leu, and it took considerable effort on the part of the NBM to bring inflation back down from near 15 percent in Q1 to almost single-digit levels by year-end (despite strong growth in energy sector prices).

10. The NBM maintains a floating exchange rate regime, intervening only to smooth out excessive volatility in the exchange rate. During 2005, the real effective exchange rate of the leu registered an appreciation of 2.4 percentage points, relative to December 2004. Reserves grew by almost $130 million in 2005, reaching 2.2 months of prospective imports at end-December.

11. At the same time, Moldova's external vulnerability continued to grow. Largely owing to the impact of higher energy prices, the trade balance deteriorated by almost 9 percentage points of GDP during 2005. This worsening was partially compensated by other items, leading to a growth in the current account deficit of about 4 percentage points of GDP. Diversification of Moldova's export markets remains limited, reflecting our continued dependence on traditional CIS markets, which in 2005 absorbed about 51 percent of total Moldovan exports (only about 30 percent went to EU markets). Trade relations were also complicated during 2005 by restrictions in Russia on imports of meat and farm product from Moldova .

12. Banking sector stability has been maintained over the past few years. Following the 2004 FSAP, parliament adopted amendments to the Law on the National Bank of Moldova and the Law on Financial Institutions aimed at bringing them more closely in line with European Union banking directives and modern central banking practices. The FSAP concluded that financial sector stability indicators are strong, and that, in general terms, Moldova respects the Basel core principles regarding effective banking supervision. Generally, the banking sector demonstrates impressive levels of revenues, capitalization and

liquidity, as well as a low level of nonperforming assets. The NBM's application of different analytical and stress tests have identified no systemic vulnerabilities of the banking sector.

C. Program Objectives

13. The main objectives of the government's program over the medium term are set out in the Economic Growth and Poverty Reduction Strategy Paper (EGPRSP) and in the Republic of Moldova—European Union Action Plan, and aim at achieving the Millennium Development Goals. These plans envisage creating conditions ensuring sustainable and inclusive economic growth that reduces poverty in Moldova.

14. The government realizes that consumption currently represents the major source of GDP growth, and that productivity needs to become the driving force for growth. In turn, improvements in productivity and competitiveness can only be ensured by improving the investment climate, rehabilitating infrastructure—including through increasing public investment—while also divesting from and improving the management of state assets.

15. Developing and implementing a comprehensive structural adjustment program and ensuring the promotion of efficient policies in the future will be facilitated by the modernization of the central public administration, optimization of the decision-making process, strengthening the management of public finances and improving human resource management, including through the reform of the public sector wage system.

16. The macroeconomic program for the next three years aims at maintaining inflation in the single digit range, gradually reducing it to about 7 percent by end-2008. Except for 2006, the budget deficit will not exceed 0.5 percent of GDP, while the current account deficit is projected to be in the neighborhood of 5 percent of GDP. The NBM will aim to increase foreign exchange reserves to at least three months of imports by end-2008. The government is committed to normalize financial relations with Paris Club creditors, including by seeking a possible debt restructuring.

17. The government intends to closely monitor the evolution of poverty and to accelerate reforms of the social assistance system which, together with the help of international development partners and robust economic growth, will allow for the further poverty reduction consistent with the EGPRSP.

D. Fiscal Policy

18. Fiscal policy over the coming years will be directed toward encouraging economic growth and ensuring debt sustainability. The program envisages a budget deficit of 0.8 percent of GDP in 2006, followed by deficits that will not exceed 0.5 percent of GDP during 2007–08. Any funds released as a result of external debt restructuring through the Paris Club would be directed to poverty reduction. As in previous years, the government intends to attain a primary surplus in order to restore external debt sustainability. In this regard, continuous efforts will be undertaken to: (i) improve tax administration, (ii) rationalize discretionary expenditures, (iii) reduce tax exemptions, and (iv) improve access to concessional external resources. Nevertheless, despite the government's intention to maintain tight fiscal policy, the possibility of external shocks—such as a sudden jump in energy prices—could make it appropriate to review our deficit target, in consultation with the IMF staff.

19. Coming on the heels of strong revenue growth in 2004–05, tax receipts are expected to remain in the neighborhood of 32 percent of GDP during the next three years. While income tax rates were reduced in January 2006, VAT tax exemptions equal to Lei 300 million were cancelled, and excise tax rates for some goods were indexed to inflation. Overall general government revenues are expected to remain at about 37 percent of GDP throughout the program period.

20. An important objective of the medium-term expenditure framework is to identify resources for increased public investment. This objective will be accomplished through rationalization of budget expenditures in line with recommendations to be made in the public expenditure review being conducted in 2006 with the support of the World Bank, and by ensuring greater access to concessional external funding. Social expenditures are not expected to diminish throughout the program. Additionally, strategic budget planning will be strengthened to ensure financing of EGPRSP priorities.

21. The government is determined to develop and implement a comprehensive tax administration reform, with assistance of the IMF, that will aim to reduce the administrative burden of the tax system as a means of stimulating business development. The strategy, which will be adopted by September 30, 2006, will focus on a risk-based approach to audit and enforcement, improvements to the VAT refund process and will promote the use of indirect methods of assessing tax liability, including as a means of combating underinvoicing in external trade.

22. The authorities affirm their intention to promote pass-through of higher prices for imported energy products to the tariffs paid by households, enterprises, and budget institutions. Nevertheless, continued growth in energy prices could give rise to a demand for additional transfers to poorer households, which would need to be accommodated within the agreed deficit target. In this regard the government is looking for support from the IMF and the World Bank in the form of a poverty and social impact assessment of growing energy prices, as well as in the development of efficient subsidy mechanisms in this respect.

23. The finances of the state social insurance fund budget deteriorated in 2005, in part because of pension increases in late 2004. Thus, in January 2006 the government began to implement a reform of agricultural pensions, and included judges and prosecutors in the state social insurance system. The authorities are committed to continue with the implementation of individual record keeping of state social insurance contributions. In order to ensure the financial sustainability of the social insurance budget, by 2008 we plan to introduce a new system to estimate benefits, including pensions, based on an applicant's contributions to the social insurance budget. In the meantime, by December 31, 2006, the government—with technical assistance from the international financial institutions—will develop a plan to ensure that the finances of the Social Fund are placed on a sustainable basis over the medium term (beginning with implementation in the 2008 budget cycle).

E. Monetary and Financial Sector Policies

24. From 2006, the National Bank of Moldova will orient monetary policy toward maintaining price stability in the single-digit range, recognizing that as a result, interest rates may need to rise and exchange rate fluctuations could increase. At present, the Law on the National Bank assigns the NBM the responsibility of ensuring the stability of the national currency, which can be interpreted to mean either the exchange rate or the price level. To

eliminate this problem of dual objectives, by July 31, 2006, the Law on the National Bank will be amended to clarify that the Bank's primary objective and responsibility is price stability. The amended law will also bolster the independence of the National Bank by prohibiting direct credit to government, and by strengthening the independence of NBM board members in the performance of their tasks and duties. At the next opportunity, the authorities also intend to propose an amendment to the Constitution to include an explicit reference to the independence of the National Bank of Moldova, and to clarify the NBM's role in the conduct of monetary policy.

25. The authorities intend to tighten monetary policies in order to ensure achievement of the inflation objective for 2006. Base money is projected to grow at a rate of 16 percent (December-to-December), in the context of which the NBM will continue to make use of indirect methods of monetary policy, such as deposit auctions and open-market operations, to achieve the inflation objective. In support of this objective, by March 31, 2006, the central government will move the deposits of the state budget (which does not include the Social Fund, the Health Fund, the special revenue and extrabudgetary funds, and up to MDL 100 million set aside to clear arrears on external debt) from the commercial banks to the NBM. During 2006, the NBM will stand ready to further tighten the stance of monetary policy if, in consultation with the IMF staff, such tightening is deemed necessary to ensure achievement of the inflation objective. To enhance the NBM's ability to conduct open-market operations, the NBM and the government—with technical assistance from the IMF—will study the desirability of converting the pre-2004 stock of outstanding direct central bank credits to government into marketable securities with maturities that are consistent with budgetary debt sustainability.

26. The National Bank intends to ensure financial sector stability and to promote sustainable development in the banking sector. In particular, changes in financial sector legislation were adopted in 2005 aimed at implementing recommendations of the FSAP, including lowering the threshold above which shareholders in banks need to be assessed as *fit and proper*. The revised legislation requires that the *fit and proper* test applies to all changes in ownership, which will improve the ability of the NBM to guard against related-party lending and owners who act in concert.

27. As recommended by the FSAP, the government is developing an exit strategy for those banks where the state has a significant shareholding, including Banca de Economii (BEM). Thus, the government's intention is to privatize BEM to a strategic banking investor who will bring new technology, strengthened management and fresh capital to the bank, and stimulate competition in the Moldovan banking system. The government will begin this process with an independent evaluation of the market value of BEM, conducted by an internationally reputable firm (the tender to be announced May 1, 2006, with bids to be submitted by August 31, 2006, and the tender winner announced by year-end), and completed in 2007. In the meantime, neither the government nor the NBM will provide preferential treatment to the bank, including as regards taxation, prudential regulation, or access to resources.

28. The government and the National Bank of Moldova will continue implementation of the objectives set in EGPRSP and EU-Moldova Action Plan with respect to financial and banking sector. In particular, Moldova remains firmly committed to the global effort to combat money-laundering and the financing of terrorism (AML/CFT). In this regard, the

authorities plan to develop a comprehensive plan to strengthen our AML/CFT regime, for which we plan to request the assistance of MONEYVAL and the IMF. In the near term, by March 31, 2006, the AML/CFT law will be amended to require that suspicious transactions—regardless of whether they take place between residents or nonresidents—be reported by financial institutions to Moldova's financial intelligence unit (the CCECC).

F. Structural Reforms

29. The main principle of the program is clarification of the role of the state in the economy. With this in mind, the key pillars of the structural reform agenda of the government and the National Bank are: (i) public administration reform; (ii) regulatory reform; (iii) improvements in public finance management; and (iv) improving management and divestiture of public assets.

Public administration reform

30. A major effort in the context of structural reforms is the implementation of the central public administration reform, which has the objective of establishing an efficient central public administration that operates according to the principles of good governance applied by European Union member-states. The reform calls for the reorganization of central public administration, optimization of the decision-making process, and improvement of human resource management. A strategy for Central Public Administration Reform was developed during the second half of 2005 in a process that involved all of the key stakeholders, including international development partners, and adopted by the government in December. The Strategy calls for: (i) redefining the competencies and functions of central specialized authorities of public administration; and (ii) reconfiguring the structure of the central executive institutions to better achieve the government's priorities. The first stage of the reform—a preliminary functional analysis of key central ministries and public administration agencies, and the assessment of the decision-making process of the central public administration—has been done. The second stage will be a detailed functional analysis of the central public administration agencies that covers the remaining agencies (not covered in the first stage) and extends down to local levels of central public administration (to be completed by December 31, 2006). Based on the functional review, the government will propose changes in personnel levels for individual agencies, recognizing that some agencies may experience downsizing, while others could be increased—especially in order to facilitate cooperation with European institutions.

31. The Strategy envisages preparation of a draft law on the civil service that would regulate the following: (i) the functioning of the central administrative agency responsible for managing the civil service employment; (ii) the hiring and promotion of civil servants on a competitive basis; and (iii) the separation of political and administrative functions. The draft law will be submitted to parliament by December 31, 2006. The Strategy also envisages elaboration and government adoption of a Code of Ethics of a public functionary by September 30, 2006. The government affirms its intention to implement the law on budget sector wages gradually, within the resource limits foreseen in the annual budgets and agreed with the IMF staff.

Regulatory reform

32. Regulatory reform is an important element of the public administration reform, which has the objective of creating an open and flexible business environment with low costs to facilitate investments and innovations in business. This reform envisages two major stages: (i) deregulation and simplification; and (ii) consolidation of good regulation capacities of governmental institutions. To that end, a number of actions pertaining to the first stage were undertaken in 2003–05: (i) simplification and centralization of licensing procedures; (ii) simplification of the procedure for business registration; and (iii) reduction of conflicts of interest between the role of inspections and the interests of individuals working in inspecting agencies. Under this "guillotine" process, the number of authorizations, permits, licenses and certificates that entrepreneurs need in order to operate was significantly reduced (and most now need to be provided free of charge, within a fixed number of days). For example, the number of activities requiring authorizations and licenses was reduced from 360 to 49, and their term extended.

33. The government is developing a draft National Strategy designed to make the regulatory reform a continuous process, and which is to be approved by June 30, 2006. According to the Strategy, the second stage of the regulatory "guillotine" will begin with the approval by the parliament of the law on the basic principles and mechanisms of regulating entrepreneurial activity in the first half of 2006 and will be accomplished in early 2008. This law will provide for the revision and simplification of the legal framework regulating the entrepreneurial activity. The Strategy also envisages improving transparency and the application of laws and regulations by establishing a regulatory impact assessment (RIA) system by September 30, 2006. Likewise, using the example of the one-stop shop for the registration of enterprises, a similar mechanism will be put in place for licensing by September 30, 2006.

Public finance management

34. The government will continue to improve public finance management by undertaking reforms necessary to align Moldovan fiscal institutions and legislation to EU requirements. The government's Public Finance Management Project, implemented with the support of the World Bank and other development partners, aims to introduce best international practices of budget preparation, execution, reporting, accounting, financial control and audit, and developing an integrated public finance management information system.

35. In order to improve cash management, the government has closed the regional revenue accounts of the social fund in commercial banks, using instead the accounts established in the treasury. The government also plans to close the cash accounts of the State Tax Inspectorate in the commercial banks and establish a system to allow the treasury to monitor, on a monthly basis, all remaining accounts of budget institutions in the commercial banks (by March 31, 2006). In the meantime, by September 30, 2006, the government will prepare a plan—with technical assistance of the IMF—to transfer the expenditure accounts of the Social and Health Insurance Funds and the special (own) revenue accounts of budget institutions to the treasury (e.g., the remaining accounts in the commercial banks will be zeroed out on a daily basis) in 2007. By 2010, when the integrated public finance management information system is fully in place, payments of the Social and Health Insurance Funds will be executed by the treasury.

Privatization and state asset management

36. The government intends to improve the management of state assets and revitalize the privatization process. To this end, during 2005 the government carried out a full inventory and evaluation of the performance of state assets in the economy, and conducted a thorough analysis of the privatization methods that have been used in Moldova. On the basis of these studies, we have developed a concept paper on management and divestiture of public property that envisages corporatization of enterprises subject to privatization in the near term, and implementation of the principle of corporate governance in all other state enterprises. Although it is not intended to corporatize all state-owned enterprises immediately (owing to cost considerations), these firms will be placed in conditions similar to joint stock companies. For example, they will calculate and, if appropriate, pay dividends, and will be managed by a board on which the majority of members will be representatives of the ministry of finance and ministry of economy and trade.

37. In order to promote budgetary transparency, the ministry of finance will conduct an annual analysis of the financial results of state enterprises and joint stock companies with state participation, in conformity with the IMF's 2001 Government Finance Statistics manual. Beginning with the budget process for 2008, the analysis of the financial results of these enterprises cover all state enterprises and joint stock companies with a state share of more than 51 percent. The results of this analysis will be submitted to the parliament as background material to the Explanatory Note for the draft Law on the state budget. By September 30, 2006, the government will take a decision to create a unit in the ministry of finance with the aim of carrying out this work. To effect these changes, amendments to the Law of State Enterprise will be submitted to parliament by June 30, 2006 and passed by December 31, 2006. During the first half of 2008, the government will assess the results of these reforms, and if necessary will propose full corporatization of all state enterprises.

38. In order to accelerate the divestiture process, the government is considering a variety of mechanisms, including public-private partnerships. We intend to amend government decrees with the intention of streamlining the privatization process during the first quarter of 2006, and we plan to revise and submit to parliament an expanded list of enterprises to be included in the privatization program on the basis of the analysis conducted in 2005. Moreover, a draft law on managing and divestiture of public property (including a public enterprise reporting framework based on the 2001 Government Finance Statistics manual) and of amendments to the Law Public Debt requiring mandatory reporting to the Ministry of Finance of all state-owned enterprise debts, will be submitted to parliament by September 30, 2006, and passed by December 31, 2006.

39. The government believes that the procedure currently applied to restructuring insolvent enterprises through the Council of Creditors needs to be improved. With the aim of reducing the budgetary impact of tax arrears accumulated by unprofitable enterprises, as well as with the goal of eliminating unfair competition, the government intends to propose amendments to the Law of Insolvency (No. 632-XV dated November 14, 2001), which will envisage replacing the Council of Creditors with a new system for handling insolvency by the start of 2007. In the meantime, the government will establish September 30, 2006 as the deadline, after expiry of which the Council of Creditors will not approve new cases of debt restructuring. Moreover, from February to September of 2006, the Council of Creditors will sign new restructuring agreements for a total amount of debt not to exceed Lei 100 million,

and with full repayment of each of the restructured debt not to exceed three years. To this end, we shall consider new agreements those that did not yet enter post-moratorium phases, that is, agreements referring to completely new cases and to cases for which the Council of Creditors had not approved restructuring plans before January 31, 2006. The Council of Creditors will be abolished by December 31, 2006, and its responsibilities for monitoring previously approved restructuring agreements will be allocated to the State Tax Inspectorate and the corresponding courts. At the same time, the government intends to improve—with the assistance of IMF—the legislative, regulatory and institutional framework concerning bankruptcy procedures.

40. The government intends to develop a new strategy of promoting exports aimed at improving Moldova's ability to penetrate external markets. In particular, we hope to diversify our commodity markets by reducing tariff and non-tariff barriers impeding development of external trade. The Asycuda World Informational System has been implemented at all custom offices since August 1, 2005, and the government intends to develop a strategy for customs risk management with the aim of creating risk profiles. Similarly, the requirement that grain exports must be transacted on the Moldovan Commodity Exchange will be abolished by September 30, 2006, and similar requirements will not be introduced for other export products. In addition, there are no restrictions specifying the mode of transportation (trains vs. truck) for agricultural products. At the same time, planned improvements in tax administration (noted above) will strengthen the capacity of the State Tax Inspectorate to combat the problem of underinvoicing.

41. Moldova is fully committed to implementation of the EU-Moldova Action Plan, signed in February 2005. The Plan covers almost all of the areas of political, economic and social activities of the state, and is consistent with the EGPRSP. In order to avoid duplication of effort, the Government intends to coordinate the implementation and monitoring of both plans in a consistent manner, in consultation with the European Commission, the World Bank, the IMF and other stakeholders.

Table 1. Prior Actions, Performance Criteria and Benchmarks

Prior Actions

Observe all quantitative macroeconomic targets for end–March 2006.

Transfer of central government deposits (with the exception of the Health Fund, the Social Fund, the special revenue and extrabudgetary funds, and up to MDL 100 million set aside to clear arrears on external debt) from the commercial banks to the National Bank.

Submission to parliament of amendments to the law on the NBM, establishing price stability as the Bank's core objective, prohibiting direct lending to government, strengthening independence of NBM board members in the performance of their tasks and duties, and giving the NBM full authority for monetary policy.

Revocation of amendments to Article 5(3) of the AML law regarding transactions involving nonresidents, as introduced by law No. 255-XVI.

Closure of cash accounts of the State Tax Inspectorate and the regional revenue accounts of the Social Fund in the commercial banks, using instead the accounts established in the treasury, and implement a system whereby the treasury monitors all remaining commercial bank accounts of budget institutions (including customs) on a monthly basis.

Announce tender for independent evaluation of the value of BEM.

Proposed Structural Performance Criteria and Structural Benchmarks

	MEFP	Dates
Structural Performance Criteria		
Neither the government nor the NBM will provide preferential treatment to Banca de Economii (whether by tax treatment, access to general government deposits, or prudential forbearance)	¶27	Continuous
Submission to parliament of amendments to the Law on State Enterprise establishing corporate governance conditions similar to joint stock companies.	¶37	June 30, 2006
Parliamentary passage of amendments to the Law on the NBM, establishing price stability as the Bank's core objective, prohibiting direct lending to government, strengthening independence of NBM board members in the performance of their tasks and duties, and giving the NBM full authority for monetary policy.	¶24	July 31, 2006
From February to September 2006, the Council of Creditors to sign new restructuring agreements for a total amount of debt not to exceed Lei 100 million, and with full repayment of each of the restructured debt not to exceed three years.	¶39	Sept. 30, 2006

Proposed Structural Performance Criteria and Structural Benchmarks

	MEFP	Dates
Government adoption of a tax administration reform strategy and implementation plan which has the overall aim of reducing the administrative burden of the tax system and strengthening revenue collection, and which would specifically include a risk-based approach to audit and enforcement, improvements to the VAT refund process, and the use of indirect methods of assessing tax liability, including as a means of combating underinvoicing in external trade.	¶21	Sept. 30, 2006
Structural Benchmarks		
Pass higher imported natural gas prices through to consumers (households and enterprises) by ensuring that tariffs are set at cost-recovery levels, while improving the cost effectiveness of the current system of targeted compensation.	¶22	Continuous
Establishment of a system responsible for conducting regulatory impact assessments of new legislation and regulations.	¶33	Sept. 30, 2006
Preparation of a plan to transfer special (own) revenue accounts of budget units, and of expenditure accounts of the Social and Health Funds, to the treasury (e.g., zeroing out the balances in the commercial banks) in 2007.	¶35	Sept. 30, 2006
Elimination of the requirement that grain exports must be transacted on the Moldovan Commodity Exchange.	¶40	Sept. 30, 2006
Government adoption of a strategy to strengthen bankruptcy procedures.	¶39	Sept. 30, 2006
Submission to parliament of a law on management and divestiture of public assets (including a public enterprise reporting framework based on the 2001 Government Finance Statistics manual), and of amendments to the Law on Public Debt requiring mandatory reporting to ministry of finance of all SOE debts.	¶38	Sept. 30, 2006
Preparation of a plan to put the Social Fund on a sustainable financial basis (for the 2008 budget).	¶23	Dec. 31, 2006
Submission to parliament of draft laws on civil service.	¶31	Dec. 31, 2006
Council of Creditors formally abolished, with STI to assume responsibility for monitoring tax debts and the corresponding courts to handle non-tax debts.	¶39	Dec. 31, 2006
Completion of detailed functional reviews of all central public administration ministries and agencies.	¶30	Dec. 31, 2006

Proposed Structural Performance Criteria and Structural Benchmarks

	MEFP	Dates
Announce winner of tender for independent valuation of BEM.	¶27	Dec. 31, 2006
Parliamentary approval of the law on management and divestiture of state assets and the law on public debt.	¶38	Dec. 31, 2006

TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This Technical Memorandum of understanding (TMU) defines the variables subject to quantitative targets (performance criteria and indicative benchmarks as shown in Table 1), established in the Memorandum of Economic and Financial Policies (MEFP) and describes the methods to be used in assessing the program performance with respect to these targets.

II. PROGRAM ASSUMPTIONS

2006

2. Loan disbursements of $38.5 million.

3. Receipts to the general government budget of privatization proceeds in the amount of MDL 67.8 million in 2006.

4. For program monitoring purposes, U.S. dollar denominated components of the NBM balance sheet will be valued at the program exchange rate. The program exchange rate of the Moldovan leu (MDL) to the U.S. dollar has been set at MDL 12.832/$. Amounts denominated in other currencies will be converted for program purposes into U.S. dollar amounts using the cross rates prevailing at end-2005.

5. To calculate the adjustments for disbursements from external sources exceeding the programmed amounts, the actual exchange rate at the time of the disbursement will be used. To calculate the adjustments for shortfalls of disbursement, the assumed exchange rate in the program for that disbursement will be used.

III. REPORTING REQUIREMENTS

6. Macroeconomic data necessary to assess performance criteria and indicative benchmarks to measure performance will be provided to Fund staff with including, but not limited to data as specified in Table 2. The authorities will transmit promptly to Fund staff any data revisions.

IV. Program Targets and Definitions

Floor on the Stock of Net International Reserves (NIR)

(In millions of lei)

Position on	Minimum Levels Net international reserves (Performance criterion)
March 31, 2006	6,410
June 30, 2006	6,791
September 30, 2006	7,866
December 31, 2006	8,276

7. **Net international reserves of the NBM** in convertible currencies are defined as gross reserves minus reserve liabilities in convertible currencies. For program monitoring purposes, gross reserves of the NBM are defined as monetary gold, holdings of SDRs, reserve position in the Fund, and holdings of foreign exchange in convertible currencies that are readily available and controlled by the NBM, including holdings of securities denominated in convertible currencies that are freely usable for settlement of international transactions, calculated using program assumptions on bilateral exchange rates. Excluded from reserve assets are capital subscriptions to foreign financial institutions, long-term non-financial assets, funds disbursed by the World Bank or other international institutions assigned for on-lending and project implementation, assets in nonconvertible currencies, and foreign assets pledged as collateral or otherwise encumbered, including claims in foreign exchange arising from transactions in derivative assets (futures, forwards, swaps, and options). Reserve liabilities in convertible currencies are defined as use of Fund credit, and convertible currency liabilities of the NBM to nonresidents with an original maturity of up to and including one year. Excluded from reserve liabilities are liabilities with original maturities longer than one year.

Ceilings on the Net Domestic Assets (NDA)
and Reserve Money of the NBM

(In millions of lei)

Position on	Maximum level NDA (Performance criterion)	Maximum level Reserve Money (Indicative target)
March 31, 2006	60	6,470
June 30, 2006	55	6,846
September 30, 2006	-477	7,390
December 31, 2006	-150	8,126

8. **Reserve money** is defined as currency in circulation (outside banks), vault cash of banks, total required reserves, and balances on correspondent accounts of banks in the NBM in lei.

9. **Net domestic assets of the NBM** are defined as the difference between reserve money (defined in paragraph 8) and net foreign assets of the NBM.

10. **Net foreign assets of the NBM** are defined as gross reserves in convertible currencies (defined in paragraph 7) plus foreign assets in nonconvertible currencies, funds disbursed by the World Bank or other international institutions assigned for on-lending and project implementation, and foreign assets pledged as collateral or otherwise encumbered, including claims in foreign exchange arising form transactions in derivative assets, and net other foreign assets, minus foreign exchange liabilities of the NBM to nonresidents.

Floor on the Overall Cash Balance of the General Government
(In millions of lei)

	Cash balance (Performance criterion)
Cumulative change from December 31, 2004	
December 31, 2005	634
Cumulative change from December 31, 2005	
March 31, 2006	-247
June 30, 2006	-417
September 30, 2006	-303
December 31, 2006	-350

11. The **general government** is defined as comprising the central and local government budgets. The central government includes also the Social Insurance Fund, the Health Insurance Fund, special and extrabudgetary funds, and foreign-financed investment projects.

The local government includes also special and extrabudgetary funds. The authorities will inform the Fund staff of any new special or extrabudgetary funds that may be created during the program period to carry out operations of a fiscal nature and will ensure that these will be included in the general government. Excluded are any government-owned entities with a separate legal status. Net credit of the banking system to general government is defined as outstanding claims of the banking system on the general government (exclusive of the claims associated with accrued interest, tax and social contribution payments by commercial banks, and foreign financed on-lending by banks), including overdrafts, direct credit and holdings of government securities, less deposits of the general government (excluding accrued interest on government deposits, and including the accounts for foreign-financed investment projects).[1] The Ministry of Finance will provide data on the holdings of government securities and foreign-financed investment projects.

12. The **quarterly limits on the overall cash deficit of the general government** are cumulative and will be monitored **from the financing side** as the sum of net credit of the banking system to the general government (excluding the change in the stock of government securities issued to recapitalize the central bank), the general government's net placement of securities outside the domestic banking system, other net credit from the domestic non-banking sector to the general government, the general government's receipt of disbursements from external debt[2] for direct budgetary support and for specific projects minus amortization paid, and privatization proceeds stemming from the sale of the general government's assets, after deduction of the costs directly associated with the sale of these assets. The calculation of the deficit as specified in this TMU may need to be reviewed, once planned amendments to the Chart of Accounts are introduced in April, 2006.

13. **Government securities** in the form of zero-coupon obligations sold at a discount to face value will be treated as financing items in the fiscal accounts, in the amount actually received from buyers. At the time of redemption, the sales value will be recorded as amortization, and the difference between amortization so defined and the face value will be recorded as domestic interest payments.

14. **External-debt limits** apply to (i) the contracting or guaranteeing of short-term non-concessional external debt (with an original maturity of up to and including one year) and (ii) contracting or guaranteeing of non-concessional medium- and long-term debt with original maturities of more than one year. Short-term debt includes all short term obligations, excluding import trade credits. Short-term debt denominated in currencies other than the U.S. dollar shall be valued in U.S. dollars at the exchange rate prevailing at the time of disbursement. Medium- and long-term debt denominated in currencies other than the U.S. dollar shall be valued in U.S. dollars at actual cross-exchange rates.

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[1] For the calculation of the net credit of the banking system to general government the following accounts will be excluded: 1731, 1732, 1733, 1735, 1761, 1762, 1763, 1801, 1802, 1805, 1807, 2711, 2717, 2721, 2727, 2732, 2733, 2796, 2801 and 2802.

[2] Debt is defined as in footnote 3 in the section on limits on external debt.

15. The term **debt** has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), adopted August 24, 2000).[3] This performance criterion applies not only to debt as defined above, but also to commitments contracted or guaranteed for which value has not been received.

16. For purpose of the program, the **guarantee** of a debt arises from any explicit legal obligation of the government or the NBM or any other agency acting on behalf of the government to service such a debt in the event of nonpayment by the recipient.

17. **Concessionality** will be calculated using currency-specific discount rates based on the OECD commercial interest reference rates (CIRRs). The ten-year average of CIRRs will be used as the discount rate to assess the concessionality of loans of an original maturity of at least 15 years, and a six-month average of CIRRs will be used to assess the concessionality of loans with original maturities of less than 15 years. To both the ten-year and six-month averages, the following margins will be added: 0.75 percent for repayment periods of less than 15 years; 1 percent for 15–19 years; 1.15 percent for 20–30 years; and 1.25 percent for over 30 years. Under this definition, only loans with a grant element equivalent to 35 percent or more will be excluded from the borrowing limits. The debt limits will not apply to loans classified as international reserve liabilities of the NBM.

18. For the purposes of the program, external payments arrears will consist of all overdue debt-service obligations (i.e. payments of principal or interest) arising in respect of any debt contracted or guaranteed or assumed by the government of the Republic of Moldova, or the NBM, or any agency acting on behalf of the government of the Republic of Moldova. The ceiling on new external payments arrears shall apply on a continuous basis throughout the period of the arrangement. It shall not apply to external payments arrears arising from external debt being renegotiated with external creditors, including Paris Club creditors; and more specifically, to external payments arrears in respect of which a creditor has agreed that no payment needs to be made pending negotiations.

19. Expenditure arrears are defined as the difference between payment obligations due, and actual payments made. They can arise on any expenditure item, including transfers, debt service, wages, pensions, energy payments and goods and services. Expenditure arrears for goods and services to suppliers are defined as obligations to suppliers, which are due but not paid for more than 30 days and are non-disputed. Arrears between the state budget, local government, social and health funds, and all extrabudgetary funds are not counted towards the expenditure arrears' ceiling on the general government.

[3] Debt is defined as a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt."

V. Adjusters

20. In the event that privatization receipts exceed the program assumptions, this will trigger consultations with Fund staff to agree on their use.

21. In case disbursements of external loans exceed the program assumptions, the limits on the overall cash deficit of the general government will be increased by the corresponding magnitude up to a cumulative cap of lei 125 million. In case of shortfalls, the limits will be decreased by the full amount.

22. The limits on net domestic assets of the NBM will be increased by the face value of government securities issued for recapitalization of the NBM and decreased by the face value of repayment of government securities previously issued for the same purpose.

Table 1. Moldova: Proposed Quantitative Performance Criteria and Indicative Targets, March 31–December 31, 2006 1/

	Stocks 2/ 31-Dec-05	31-Mar-06 Indicative targets	30-Jun-06 Indicative targets	30-Sep-06 Performance criteria	31-Dec-06 Indicative targets
1. Quantitative performance criteria					
			(In millions of lei)		
Ceiling on net domestic assets of the NBM (level)	569	60	55	-477	-150
Floor for general government fiscal balance 3/	634	-247	-417	-303	-350
Floor on net international reserves of the NBM (level)	6,436	6,410	6,791	7,866	8,276
Ceiling on contracting or guaranteeing of non-concessional external debt of the general government	...	0	0	0	0
2. Continuous performance criteria					
Ceiling on accumulation of external payment arrears 4/	...	...	0	0	0
			(In millions of lei)		
3. Indicative target					
Ceiling on reserve money (level)	7,002	6,470	6,846	7,390	8,126
Ceiling on change in domestic expenditure arrears of the general government	...	0	0	0	0
			(In millions of lei, unless noted otherwise)		
4. Baseline assumptions					
Concessional external debt financing	327	130	231	362	494
in millions of dollars	...	10	18	28	39
Privatization receipts	176	9	30	50	68

Sources: Moldovan authorities; and Fund staff estimates.

1/ Numbers for 2006 refer to cumulative flows from end-2005, unless noted otherwise. Quantitative targets for 2006 are based on the accounting exchange rate of MDL 12.832/US$.

2/ Except general government fiscal balance and concenssional external debt borrowing, which are flows.

3/ In case disbursements of external debt exceed the program assumptions, the limits on the overall cash deficit of the general government will be increased by the corresponding amount up to a cumulative cap of MDL 125 million. In the case of shortfalls, the limits will be decreased by the full amount.

4/ The requirement becomes effective with the approval of the Fund program.

Table 2. Moldova: Data to be Reported to the IMF

Item	Periodicity
Fiscal data (to be provided by the MoF)	
General budget operations for revenues, expenditure and financing (functional and economic).	Monthly, within three weeks of the end of each month
Domestic debt	Monthly, within two weeks of the end of each month
Domestic arrears	Monthly, within three weeks of the end of each month
Privatization receipts received by the budget (in lei and foreign exchange, net of divestiture transactions costs).	Monthly within three weeks of the end of each month
Monetary data (to be provided by the NBM)	
Monetary survey of the NBM	Weekly within one week of the end of each week
Monetary survey for the whole banking system	Weekly within two weeks of the end of each week
Net claims on general government (NBM and commercial banks)	Weekly within two weeks of the end of each week
Financial indicators of commercial banks (from NBM's Banking Supervision)	Monthly within four weeks of the end of each month
Foreign exchange cash flows	Monthly, within two weeks of the end of each month
Foreign exchange operations (NBM data)	Monthly, within two weeks of the end of each month
Foreign exchange market data (volume of trades, interventions, exchange rates)	Daily within 12 hours of the end of each day
NBM's sterilization operations	Weekly within one week of the end of each week
Interbank transactions (volumes, average rates)	Weekly within one week of the end of each week
Balance of Payments (to be provided by the NBM)	
Current and capital account data.	Quarterly within six weeks of the end of each quarter
Transfers/remittances through the banking system	Monthly within six weeks of the end of each month
External debt data (to be provided by MoF)	
Information on all new external loans contracted by the government or government guarantee.	Monthly within three weeks of the end of each month
Total debt service due by creditor, and debt service paid.	Monthly within three weeks of the end of each month
Disbursements of grants and loans by creditor	Monthly, within three weeks of the end of each month

Item	**Periodicity**
Other data (to be provided by NBS)	
Overall consumer price index.	Monthly within two weeks of the end of each month.
National accounts by sector of production, in nominal and real terms.	Quarterly within three months of the end of each quarter.
Export and import data on value, volume, and unit values, by major categories and countries.	Monthly within two months of the end of each month.