Economic policy outlook

EUI country report, August 2007

Moldova has cleared the last hurdles in the way of securing an autonomous trade preference (ATP) deal from the EU. These now appear likely to begin at the start of 2008.

Economic forecast

The drought of recent months will slash harvest volumes this year, which in turn will affect agro-processing. Given the importance of agriculture and agro-processing, the Economist Intelligence Unit now expects slower real GDP growth in 2007, of around 5%.

Economic policy

The IMF has released a US$33m loan. Parliament has approved a new regulatory body for the non-bank financial sector. Ukraine has sought to raise electricity prices. The national budget deficit was Lei48m (US$3.8m) in January-June. Parliament has agreed parameters for the 2008 budget. The National Bank of Moldova (NBM, the central bank) has increased foreign-exchange purchases and sterilisation. Russia has begun to reopen its wine market. The path has cleared for an autonomous trade preference (ATP) deal with the EU.

The domestic economy

Real GDP grew by 7.3% year on year in January-March, helped by base-year effects in construction and strong household demand. Industrial production has begun to recover, also owing to base-year effects. Agriculture has suffered from drought. Annual inflation fell to 10.4% in June.

Foreign trade and payments

The trade deficit rose to US$825m in January-May, with import growth far outpacing export growth. Although remittances have continued to offset much of the trade gap, the current-account deficit in the first quarter of 2007 was still at a record high, of 21% of GDP. A surge in foreign direct investment (FDI) and a rise in private-sector debt arrears has provided financing.

Economic structure: Annual indicators

	2002[a]	2003[a]	2004[a]	2005[a]	2006[a]
GDP at market prices (Lei bn)	22.6	27.6	32.0	36.8	44.1
GDP (US$ bn)	1.7	2.0	2.6	2.9	3.4
Real GDP growth (%)	7.8	6.6	7.4	7.5	4.0
Consumer price inflation (av; %)[b]	5.2	11.6	12.4	11.9	12.7
Population (m)[c]	3.6	3.6	3.6	3.4	3.4
Exports of goods fob (US$ m)	660	805	994	1,105	1,054
Imports of goods fob (US$ m)	-1,038	-1,428	-1,748	-2,296	-2,644
Current-account balance (US$ m)	-25	-135	-59	-263	-404
Foreign-exchange reserves excl gold (US$ m)	269	302	470	597	775
Total external debt (US$ bn)	1.8	1.9	1.9	2.1	2.5[d]
Debt-service ratio, paid (%)	20.2	10.3	14.9	10.3	11.3[d]
Exchange rate (av) Lei:US$	13.57	13.94	12.33	12.60	13.13

[a] Actual. [b] Annual and quarterly series from different sources. [c] Excludes Transdniestr. [d] Economist Intelligence Unit estimates.

Origin of gross domestic product 2004	% of total
Agriculture & fishing	21.3
Industry	19.1
Construction	4.8
Services	54.3

Components of gross domestic product 2005	% of total
Private consumption	91.6
Public consumption	16.9
Gross fixed investment	24.4
Increase in stocks	5.4
Net exports	-41.7

Principal exports 2006	% of total
Food products	26.3
Textiles	21.7
Vegetable products	13.0
Mineral products	2.6
Metals	7.2

Principal imports 2006	% of total
Mineral products	24.6
Machinery & equipment	14.1
Chemicals	8.3
Vegetable products	2.7
Metal & metal products	8.1

Main destinations of exports 2006	% of total
Russia	17.3
Romania	14.8
Italy	12.2
Ukraine	12.2
Belarus	7.0

Main origins of imports 2006	% of total
Ukraine	19.2
Russia	15.5
Romania	12.8
Germany	8.0
Italy	7.3

Economic structure: Quarterly indicators

	2005			2006				2007
	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr
Consolidated government finance (Lei m)								
Revenue	3,350.5	4,045.9	4,328.5	3,576.6	4,119.1	4,703.7	5,450.2	4,910.8
Expenditure	3,325.4	3,568.3	4,202.3	3,396.4	4,360.6	4,324.8	5,896.7	4,525.7
Balance	25.1	477.6	126.2	180.2	-241.5	378.9	-446.5	385.1
Employment, wages & prices								
Unemployed, registered (end-period; '000)	26.7	25.1	n/a	27.2	24.0	24.3	n/a	n/a
Nominal monthly wages (Lei)	1,290.1	1,322.2	1,517.8	1,454.3	1,672.7	1,731.5	1,921.5	1,783.0
Nominal monthly wages (% change, year on year)	18.6	17.7	18.4	26.7	29.7	31.0	26.6	22.6
Consumer prices (2000=100)	162.9	161.1	167.8	176.2	182.1	184.0	191.7	197.1
Consumer prices (% change, year on year)	13.6	11.0	10.2	10.8	11.8	14.2	14.2	11.9
Financial indicators								
Exchange rate Leu:US$ (av)	12.60	12.58	12.70	12.93	13.11	13.31	13.17	12.83
Exchange rate Leu:US$ (end-period)	12.58	12.59	12.83	13.01	13.29	13.29	12.91	12.52
Deposit rate (av; %)	13.5	12.7	11.5	11.4	11.1	11.8	13.3	14.0
Lending rate (av; %)	19.6	18.7	17.8	18.1	17.7	18.2	18.5	18.6
Money market rate (av; %)	4.5	5.0	7.1	6.0	8.8	11.1	12.1	11.4
Treasury-bill rate (av; %)	2.6	3.5	4.8	3.0	7.3	8.3	10.6	13.4
M1 (end-period; Lei m)[a]	5,997	6,910	7,333	6,992	7,672	7,584	8,268	7,947
M1 (% change, year on year)	40.3	39.1	31.8	26.4	27.9	9.8	12.8	13.7
M2 (end-period; Lei m)[a]	9,258	10,506	11,126	11,066	11,592	11,308	12,485	12,716
M2 (% change, year on year)	51.0	47.7	36.7	31.2	25.2	7.6	12.2	14.9
Sectoral trends								
Retail sales (Lei m)	2,574.6	3,165.9	3,260.0	2,486.4	3,219.4	3,887.5	4,008.0	3,251.1
Foreign trade (US$ m)[b]								
Exports fob	265.70	274.65	312.77	243.04	220.95	252.09	337.40	272.01
	138.96	140.51	157.32	125.23	88.08	94.09	123.43	92.47

CIS[c]								
Imports fob	-571.89	-598.23	-690.78	-524.69	-609.19	-671.73	-838.77	-734.11
CIS[c]	217.12	227.14	274.23	230.37	228.14	249.04	297.63	284.97
Trade balance	-306.19	-323.58	-378.01	-281.65	-388.24	-419.64	-501.37	-462.10
Balance of payments (US$ m)								
Merchandise trade balance fob-fob	-306.2	-323.6	-378.0	-281.7	-388.2	-419.6	-501.4	-462.1
Services balance	1.9	-1.5	-18.4	-0.8	3.5	-0.5	-8.2	12.3
Income balance	90.2	118.3	128.4	73.5	67.0	132.7	126.3	54.0
Net transfer payments	130.1	145.8	165.4	150.7	181.0	236.0	226.0	220.5
Current-account balance	-83.9	-61.0	-102.6	58.2	-136.8	-51.4	-157.3	-175.2
Reserves excl gold (end-period)	482.6	582.1	597.5	593.2	632.9	648.0	775.5	786.1

[a] National Bank of Moldova. [b] Balance of payments basis. [c] Commonwealth of Independent States.
Sources: National Bank of Moldova; IMF, International Financial Statistics; Interstate Statistical Committee of the CIS; Department of Statistics and Sociology.

Underworld undergoes belated expansion
Oxford Analytica, Monday, June 11 2007
SUBJECT: The upsurge in organised crime.
SIGNIFICANCE: Endemic and institutionalised organised crime is spreading, facilitated by and feeding off the serious problem of endemic and institutionalised corruption, which is encouraging a culture of cynicism.
ANALYSIS: On May 21, an opposition deputy, Vasile Colta, was sentenced to five years in prison for embezzlement, though the sentence was suspended. Colta's parliamentary immunity was lifted at the end of last year after a series of high-profile incidents, which one senior Moldovan official said could no longer be ignored:

In 2006, he was arrested and fined by Romanian customs officers while trying to smuggle 11,000 packets of cigarettes out of Moldova.
This year, he was found guilty of illegally privatising land in Hancesti (a town 20 kilometres from Chisinau, where Colta used to be mayor) at artificially low prices.
Critics of the regime have noted that while immunity was lifted for Colta, of the Our Moldova Alliance, it has not been lifted for members of the ruling Communist Party.

Undeniable corruption. The need to combat corruption in Moldova has been a recurring theme of international assessments, which have noted the extent to which it is evident throughout the political system:

The Centre for Combating Economic Crime and Corruption last year noted that two-thirds of all cases it investigated involved senior local and national government officials. While some were disciplined, many others received either token fines or had their cases dismissed.
This contributes to a widespread culture of cynicism and acceptance of corruption. A recent survey found that 78% of respondents believed that corruption had worsened in Moldova in recent years, and 64% that it was a normal and inevitable phenomenon.
Expanding organised crime. Initially, Moldova escaped the worst forms of open organised crime evident in Russia, Ukraine and other post-Soviet states following the Soviet collapse. Ironically, its very poverty deterred Slavic networks from extending into the country. However, conventional wisdom within the police and Information and Security Service is that there are 35 criminal 'clans', comprising around 300 smaller gangs, though many are still relatively petty smuggling rings. A more credible figure is that perhaps a dozen serious organised crime groupings operate in Moldova, and another half-dozen in breakaway Transnistria.

Nonetheless, this represents a substantial expansion and consolidation since 2000-01, and is being driven by four main factors:

People trafficking. The country's poverty -- despite recent economic expansion, per capita GDP remains around 900 dollars (see MOLDOVA: Recent slowdown threatens poverty reduction - August 31, 2006) -- has made it a favoured recruiting ground for people traffickers, preying on young women desperate for employment abroad. Moldova is a major source of women and girls destined for sexual exploitation, who are trafficked throughout Europe and the Middle East, increasingly to Turkey, Israel and the United Arab Emirates. International demand has so outstripped local supply, that it has also become a transit country, as Moldovan gangs increasingly act as import-export agents, bringing in girls from Ukraine and other former Soviet states.
Police activity. President Vladimir Voronin's campaign against overt gangsterism has largely hit the smaller, less efficient and less politically connected gangs. While several high-profile campaigns and the deployment of large numbers of police and paramilitary carabinieri to patrol the streets of Chisinau have led to a decline in open violence, they have also accelerated a process of consolidation in the underworld. The level of corruption has also ensured that groups close to the government, so long as they do not operate too blatantly, can do so with relative impunity.
Transnistrian connection. Moldova's underworld has increasingly become linked with that of the self-proclaimed separatist Moldovan Republic of Pridnestrovie (Transnistria), especially in providing smuggling routes into Romania and so into Europe, or even into Ukraine during Kiev's occasional campaigns to secure its border with Transnistria.
Narcotics. Moldova is turning into a secondary drug-trafficking hub for heroin being moved from Ukraine to Europe via Romania, and from Turkey into Ukraine and on into Russia. While the total flows are relatively modest compared with primary routes through the Balkans and Russia, in such a poor country the resulting economic opportunities have been disproportionately attractive and significant to criminals. Moldova's climate and soils are conducive to both marijuana- and poppy-growing, and while the domestic market for both remains limited (though rising by 6% annually), there is some evidence of the beginnings of commercial criminal cultivation. In last year's 'Operation Poppy', a regular summer eradication programme, 447 hemp fields and 964 poppy fields were destroyed.

Further abroad. Moldova's underworld is increasingly connected to wider criminal networks. Its gangs, albeit still relatively primitive and local in their operations, are becoming linked into criminal enterprises operating more broadly in Ukraine, Russia (see RUSSIA: Killings rise as criminal groups settle scores - January 24, 2007) and Europe:

Transnistria. The separatist entity remains a source of criminal contamination. It is thoroughly criminalised, and while the governments in Chisinau and Tiraspol remain deadlocked over negotiations for reunification (see MOLDOVA/RUSSIA: Reported Transnistria deal is unlikely - April 27, 2007), their respective underworlds have proved willing and able to cooperate. For example, the region produces and exports counterfeit goods, which have a ready market in Moldova itself (according to the Business Software Alliance, 94% of all software used there is counterfeit), or are re-exported to Europe, the Middle East and Africa. Moldova may also be used to smuggle illegal weapons, imported by the Transnistrians from Ukraine, drawn from existing stocks or produced in local factories in Bender (Tighina), Rybnitsa (Rabnita) and Tiraspol.
Russian-Ukrainian integration. As criminal organisations in Transnistria become increasingly integrated into larger Russian and Ukrainian combines, so too their Moldovan counterparts are beginning to be drawn into these wider networks.
Imported goods. People-trafficking routes out of Moldova are now acquiring a 'reverse flow' of criminal commodities, especially synthetic drugs from Russia and Europe destined for Chisinau's small middle class. Given its proximity and economic and cultural ties to new EU-member, Romania, Moldova has become of increasing interest to transnational crime groups as a gateway into Europe, and smuggling routes are being expanded and given new functions.
Outlook. The December 2006 report from the European Commission on cooperation with Moldova under the European Neighbourhood Policy notes that Chisinau had made progress in addressing intellectual property crime, money laundering and people trafficking. However, at issue is not so much Chisinau's formal commitment to combating organised crime, as its political will and practical capacity. Moldova has in many ways exemplary laws on its statute books. However, corruption from top to bottom of the administrative structure and a serious and lasting lack of resources undermine any attempts to apply them. International efforts to clean up Moldova are serious and well meant, but their impact can only be limited, especially as the Voronin regime and the Transnistrian entity alike continue to protect and harbour criminals.

CONCLUSION: Moldova escaped the organised crime explosion which characterised much of post-Soviet Eurasia in the 1990s, but a combination of entrenched corruption, lasting poverty and the smuggling opportunities provided by its location and relationship with Romania is driving a largely hidden but serious expansion in its underworld.

Economic policy: IMF disburses a tranche and others provide funds too
EUI country report, August 2007

In mid-July the IMF approved a US$33m disbursement from Moldova's US$167m poverty reduction and growth facility (PRGF). Moldova has now received almost US$100m in three separate tranches since the PRGF was agreed in May 2006, and expects to receive an additional US$17m in October. The latest disbursement followed the Fund's recent positive appraisal of the government's performance, in which it described the government's reform progress as "encouraging". It also stated that over the past year the government's policies had helped to limit the consequence of various external shocks, including Russian trade restrictions and higher energy prices, and described the fiscal position as sound. The only "waiver" required from the IMF was for the non-observance of an end-2006 pledge to raise heating tariffs in Chisinau, the capital, to 55% of cost-recovery level. The government is now on track with that as well, with legislation in place to bring consumer utility tariffs to cost-recovery levels by end-September 2008, accompanied by a targeted social assistance programme for those unable to afford the increase.

Other donors have also been providing concessionary financing and grants in recent months. They include US$30m from the Netherlands for budgetary support, technical finance and small businesses; a US$15m concessionary credit from Poland for developing drinking water networks; and a US$4.5m grant under the World Bank's Global Environmental Facility for wastewater treatment in the north-eastern city of Soroca. In June the European Investment Bank (EIB) issued its first loan to the country in the form of a €30m (US$41m) credit for road rehabilitation. The World Bank and the European Bank for Reconstruction and Development (EBRD) are co-financing the project to the sums of US$16m and €30m respectively.

Economic policy: Small budget deficit prompts 2007 budget revisions
The national budget deficit in the first half of 2007, at Lei48m (US$3.8m), was much smaller than the planned deficit of Lei2.7bn (US$218m). This reflected better than expected revenue inflows. The national budget—which consolidates the state and municipal budgets, the social insurance fund, the compulsory medical insurance fund and other extrabudgetary funds—received Lei716m more revenue than anticipated, helped by relatively strong economic expansion and the continued import boom. The strong rise in imports boosted earnings from value-added tax (VAT), which were 4% above target, and produced a 31% increase in customs income, which amounted to Lei3.7bn in January-June. The one-off receipt of US$4m from Eventis Mobile, the Cypriot-Moldovan company that won the country's third Global System for Mobile Communications (GSM) licence at the end of 2006, also helped.

An even more important factor contributing to the smaller than expected deficit, however, was the degree of underspending witnessed during the first half of the year. Expenditure was Lei2bn below target, which reflects ongoing weaknesses in budget planning and, presumably, a decision by government agencies to defer spending until as late as possible in the year. The government is targeting a full-year deficit of Lei701m, or 0.5% of the government's GDP target.

As a result of higher than expected revenue, parliament voted in June to approve a Lei620m increase in the state budget's revenue and expenditure for 2007. The increase raises projected state budget revenue to Lei12.71bn and expenditure to Lei12.78bn. The additional expenditure includes Lei115m on two gas mains, Lei100m for the construction of a rail link between Cahul and the newly opened oil terminal at Giurgiulesti, Lei90.4m on road repairs, Lei150m for salary increases in the public sector, Lei29m on agricultural subsidies and Lei14m for the vineyard plantation fund.

Economic policy: Autonomous trade preference deal from the EU is imminent
EUI country report, August 2007
Moldova's attempts to diversify away from the Russian market will in theory benefit greatly from an autonomous trade preference (ATP) deal with the EU. An ATP arrangement now seems almost certain to come into effect at the start of 2008. The EU has already drafted the terms of the deal and will most likely make it public by October. The government cleared the last remaining hurdle at the end of July, when it handed the customs department responsibility for issuing preferential rules of origin certificates for exports to the Commonwealth of Independent States (CIS). This responsibility, which currently resides with the chamber of commerce, will start in 2008. The chamber of commerce had successfully delayed this step for several months, having already lost its powers to issue similar certificates for trade with the EU and the Central European Free-Trade Agreement (CEFTA). The EU had pushed to make the certificates a customs responsibility so as to increase transparency. The experience with certificates for exports to the EU, which became a customs responsibility in July 2006, has resulted in a reduction in the unofficial costs involved for exporters.

Moldova had agreed to undertake a number of other reforms in order to secure an ATP arrangement. It has committed to continue strengthening its capacity to conduct random auditing of exporting companies before, during and after the issuing of rules of origin certificates. It has also agreed that all registered companies in the breakaway region of Transdniestr can qualify for these certificates. The Moldovan authorities had previously sought to limit access only to Transdniestrian firms that had registered permanently with them. Transdniestr's inclusion in the ATP arrangement has created friction between companies in the region—who are eager to benefit from preferential trade and are permitting Moldovan customs officials to audit their premises—and the Transdniestrian leadership, which is unwilling to see the Moldovan authorities extend their control in such a way.

The ATP deal is of particular interest for the food and beverages sector, which is Moldova's most important source of exports. Other sectors, such as textiles, already enjoy preferential trade terms from the EU as a result of the so-called GSP+ arrangement. This took effect in 2006, but has been criticised for leaving out Moldova's most important export categories. Significantly improved terms of trade are now likely for fruit and vegetables producers, and the wine sector will also benefit, although to a lesser extent. At least initially, export volumes are nevertheless unlikely to increase sharply, as most wine, fruit and vegetables producers still lack the know-how and financing needed to become competitive on the developed EU market, and producers of dairy, meat and eggs are still unable to meet the EU's phytosanitary requirements.

The domestic economy: Real GDP rises by 7.3% year on year in January-March
Real GDP grew by a robust 7.3% year on year in January-March 2007, largely owing to an almost 40% surge in capital investment. The record increase in investment is to some extent explained by base-period effects: the cold winter in 2006 affected construction activity, in contrast to the far milder winter in 2007, when construction activity continued during the first quarter of the year. Given the role played by these base-period effects, it is likely that capital investment growth will slow considerably over the remainder of the year, as measured in year-on-year terms. Moldova also experienced a surge in foreign direct investment (FDI) in January-March, which helped to push up fixed capital investment growth during that period. Moldova is benefiting from foreign interest in sectors such as textiles, banking and mobile telecommunications, as well as from greenfield investment sparked by the country's newfound proximity to the EU (neighbouring Romania acceded to the EU at the start of 2007).

EU takes half of Moldova's exports, as Russia's share drops
EUI country report, August 2007

The fact that exports to Russia more than doubled in year-on-year terms in April-May similarly disguises the crisis prompted by Russia's wine ban. Sales to Russia were still down by 22% for the first five months as a whole, and the EU has now supplanted Russia as Moldova's most important export destination. The EU now takes more than half of all Moldova's exports, and Russia's share has fallen from 30-40% during the first half of the decade to around 15%. However, most of that shift reflects the loss of the Russian wine market, the EU accession of neighbouring Romania at the start of 2007 and the export of textiles to Germany and Italy. Only a small part of the shift to the EU reflects the redirection of Moldova's traditional, agriculture-linked export offering to west European markets. These sectors still largely lack the quality control and marketing skills needed to penetrate more developed markets. They also continue to be hampered by EU trade restrictions, although these are set to ease as a result of the EU trade agreement expected to come into effect at the start of 2008 (See Economic policy).

Moldova's wine sector illustrates these difficulties. Despite some success in penetrating new markets, such as Poland and the UK, improvements came from a negligible base, and Moldova's four largest EU markets still bought alcoholic beverages worth just US$2.7m from Moldova in the first quarter of 2007. This is a fraction of the US$60m in wine that it sold to Russia in the year-earlier period. In the absence of the Russian market, in January-March 2007 Moldova was only able to sell wine worth US$15m. This is even less than the value of what it sold outside of Russia during the year-earlier period, and illustrates the extent to which only a limited number of Moldovan producers have the skills, financing and quality needed to sell to the EU. Most producers had tended to rely on Russia's willingness in the past to take low-quality wine in bulk and have now had to cut production sharply

Voronin pins hopes on encouraging investors
Oxford Analytica, Monday, May 14 2007
SUBJECT: President Vladimir Voronin's economic liberalisation initiatives.
SIGNIFICANCE: A broad new effort to boost investment in Moldova is both long overdue and a response to external shocks to the economy from Russia's continuing ban on the wine it imports from Moldova and higher prices for its gas exports.
ANALYSIS: On May 4, Economy and Trade Minister Igor Dodon announced that the government had set up a supervisory committee to follow up President Vladimir Voronin's economic liberalisation proposals. Parliament passed

the package on April 27, with 67 deputies (out of 101) in favour, and only minor revisions from the first reading.

The initiative has three parts:

Fiscal amnesty. Arrears amassed before January 1, 2007, will be cancelled, and not investigated by the authorities. However, penalties for not paying taxes will increase from now on.
Capital amnesty. Companies will be allowed to apply to legalise material and physical assets, and individuals to legalise both capital and assets, until January 1, 2009. All legalised capital and assets will be taxed, but at a lower 5% rate.
Tax-free reinvested profits. Legal entities will pay no taxes on profits that are reinvested in Moldova. Profits that are used for consumption and dividends will continue to be taxed at the standard 15% rate.
Shadow economy. The fiscal and capital amnesty initiatives are targeted at reducing the shadow economy and increasing the tax base. In proposing the initiatives to parliament on April 20, Voronin argued that Moldova could no longer judge the past on the basis of the criteria of the present. This suggests that the government is willing to ignore some potentially illegal activities in the past if enterprises and individuals are willing to cooperate with the government in future. He referred to this as a "new page" in Moldova's economic history.

Moldova has a relatively large shadow economy. According to 2004 estimates by the International Labour Organisation, employment in the informal sector, with unregistered or unregulated enterprises, accounts for 14.6% of total employment in Moldova, or about 207,000 people. In addition to this, there are formal companies that hold assets that are not declared to the government for tax purposes, and individuals who do not declare incomes earned abroad or in unregistered work. With just 25% of the working-age population of Moldova working, at least part-time, in jobs abroad, the amount of undeclared capital is likely to be substantial.

Goals. By granting these companies and individuals the ability to declare assets and capital at a lower tax rate, Moldova's government is hoping for three positive outcomes:

The value of capital and assets that the government has a record of, and can be taxed, even if at a lower rate, will increase.
Capital and assets that had previously been difficult to reinvest because of their non-legal status, may now be used for investment, entrepreneurship and growth.
The size of the unregulated and illegal economy will decrease.
The fiscal amnesty plays an important part in this, since it affords individuals and enterprises some guarantee that they will not be pursued later for unpaid taxes on undeclared assets and capital prior to the current fiscal year.

Criticism. The move has its share of critics. During the debate on the proposal in parliament, Gheorghe Susarenco described the law as an attempt to legalise everything that had been stolen over the past ten years. Valeriu Prohnitchi of the Expert Grup non-governmental organisation criticised the legislation at a press conference, saying that the amnesty favoured those groups that had acted illegally over those which had obeyed the law.

Prohnitchi also questioned whether Moldova would receive much revenue from the venture, pointing out that Kazakhstan had received only 500 million dollars from its amnesty, and whether the amnesty would hold if another political party came to power.

Spurring investment. The least controversial of the measures in this economic initiative was the decision to lift taxes on profits that are reinvested in Moldova. Moldova's barriers to capital flows and investment have been an obvious weakness in its economic programme. In the Heritage Foundation's 2007 Index of Economic Freedom, Moldova scores 59.5% overall, indicating a 'mostly unfree' economy, with a particularly weak score (30%) for investment freedom. Similarly, the World Bank, in its 2007 Doing Business report, placed Moldova 103rd out of 175 countries surveyed.

In this light, the economic incentives are a long-overdue effort to bring investment into the economy, and come at a time when Moldova's economy is especially vulnerable. After seeing industrial production drop by 6.9% in 2006, Moldova faces continuing challenges in 2007. Much of this can be attributed to Russia's delay in lifting its ban on Moldovan wine. First promised at the beginning of the year, it now looks as though Moldova will have to spend most of this year without its biggest export market (see MOLDOVA/RUSSIA: Reported Transnistria deal is unlikely - April 27, 2007). This and the rising cost of natural gas will, according to the IMF, have the effect of reducing annual growth by 2-3% and widen the balance of payments gap by more than 9% of GDP in 2007.

With the country in need of capital and investment, Voronin hopes that eliminating the tax rate on investments will give incentives for badly needed diversification and expansion. In his speech in parliament on April 20, he admitted that Moldova was starting from scratch, compared with many of its neighbours.

Free trade zones. According to Voronin's speech in parliament on April 20, this is only the beginning of legal efforts to increase investment. The next big initiative will be to set up full-scale industrial parks in free trade zones around Moldova. The goal of these industrial parks will be to develop areas that are free of corruption and provide the necessary infrastructure for local and foreign investors to develop their business effectively and rapidly. Voronin characterised this next project as a major imperative for development.

International role. On May 3, shortly after the adoption of the president's economic initiatives, Voronin met the IMF mission head for Moldova, Thomas Richardson. Richardson reportedly stressed the IMF's willingness to give additional support for the president's liberalisation efforts, and for helping Moldova avoid the inherent risks in these reforms. Richardson also noted some signs for optimism in Moldova's economy, including state budget revenues in the first four months of 2007 that were 42.5% higher year-on-year.

At the same time, the International Development Agency (IDA), part of the World Bank, announced a loan agreement of 16 million dollars for road reconstruction and improving the capacity of the State Road Management. The loan was provided on preferential IDA conditions, free of interest for 40 years, including a ten-year grace period. According to Transport and Roads Minister Vasile Ursu, 80% of Moldova's roads are damaged, and this poses a major obstacle for both foreign and domestic investment. This is the first time the World Bank has given a loan for road repair.

CONCLUSION: Moldova has a long way to go in encouraging investment and diversifying its economy. While these new reforms are encouraging, it is unclear how successful any programme can be as long as external barriers to growth persist.