

Republic of Moldova
Ministry of Finance

*2008-2010 Medium-Term Expenditure
Framework*

Chisinau 2007

C O N T E N T S

1. INTRODUCTION.....	3
2. MACROECONOMIC BACKGROUND.....	5
2.1 FOREIGN ECONOMIC CONTEXT.....	5
2.2 MOLDOVAN ECONOMY IN 2006.....	5
2.3 MACROECONOMIC PROJECTION FOR 2007-2010.....	6
3. FISCAL POLICY AND PUBLIC REVENUE.....	9
3.1 OBJECTIVES OF FISCAL POLICY AND TAX ADMINISTRATION POLICY.....	9
3.2 RECENT DEVELOPMENTS IN PUBLIC REVENUES.....	13
3.3 PUBLIC REVENUES PROJECTION FOR 2007-2010.....	15
4. THE BUDGETARY BALANCE AND STATE DEBT MANAGEMENT.....	17
4.1 BUDGET DEFICIT AND SOURCES OF FINANCING.....	17
4.2 EXTERNAL ASSISTANCE.....	18
4.3 PUBLIC DEBT MANAGEMENT.....	19
5. NATIONAL PUBLIC BUDGET.....	21
5.1 MAIN TRENDS.....	21
5.2 COMPONENTS OF THE NATIONAL PUBLIC BUDGET.....	22
5.3 FISCAL DECENTRALIZATION.....	23
6. POLICY AND STRATEGY OF PUBLIC EXPENDITURES.....	26
6.1 GENERAL OBJECTIVES AND STRATEGIC PRIORITIES OVER THE MEDIUM TERM.....	26
6.2 IMPROVING THE EFFICIENCY AND EFFECTIVENESS OF COST PROGRAMS.....	28
6.3 PUBLIC SECTOR WAGES.....	29
6.4 CAPITAL INVESTMENTS.....	31
6.5 PROJECTION OF EXPENDITURES BY ECONOMIC CATEGORIES.....	34
7. SECTOR EXPENDITURE AND RESOURCE ALLOCATION PRIORITIES.....	37
7.1 RECENT TRENDS.....	37
7.2 MEDIUM-TERM EXPENDITURE SECTORIAL PRIORITIES.....	37

ANNEXES

1. The dynamics of the major macroeconomic indicators, 2004-2010.....	42
2.1 The Dynamics of the National Public Budget, 2004-2010, mil.lei.....	43
2.3 The Dynamics of public national budget, 2004-2010,% of GDP.....	45
2.3 The dynamics of national public budget, 2004-2010, share of total.....	47
3. Expenditure Ceilings for State Budget for sectors and central public authorities for 2008-2010.....	49
4. Reform priorities by main sectors and their implications during 2008-2010.....	57
5. Strategic plan for spending on education for 2008 – 2010.....	71
6. Strategic Plan for Spending on Health Care for 2008 – 2010.....	81
7. Strategic Plan for Spending on Social Protection for 2008 – 2010.....	88
8. Strategic plan for spending on agriculture for 2008 – 2010.....	96
9. Strategic Plan for Spending on Culture and Tourism for 2008 – 2010.....	105
10. Strategic plan for spending on national defense for 2008 – 2010.....	109

1. Introduction

1. MTEF is the medium-term budget planning tool. The 2008-2010 medium-term expenditure framework (hereinafter “MTEF”) is an update of the projections of the previous MTEF (for 2007-2009) with the analysis and projections extended to 2010. The 2008-2010 MTEF sets the general fiscal parameters and strategic framework for the preparation of the 2008 national public budget and their estimates for 2009 and 2010.

Box 1. MTEF Development in Moldova

Consolidating the procedures and development of the MTEF is considered to be a key element of the agenda of the public finance management reform. Taking into account the accomplishments over the five years of the MTEF implementation in Moldova, especially those related to the MTEF integration in the annual budget planning cycle, consolidated presentation of the resource framework and enhanced transparency in the formulation of the medium-term government policies and priorities, efforts will focus on the following in the coming years:

- § Introduction of the more strategic approach in the process of setting the resource ceilings in order to ensure better correlation with policy priorities;
- § Development of the public authorities’ analysis and strategic planning capacity by training the public authorities’ policy analysis, assessment, and monitoring units and implementation of the broad training and capacity building program;
- § Raising the efficiency of decision-making regarding the MTEF proposals by revising the role of the MTEF Steering Group and involving the Government in the MTEF process at the initial stage.

2. Slower public expenditure growth rate is projected for the coming years. As a consequence of considerable growth of the national public budget in recent years, more moderate public expenditure growth is projected for the coming years, for which the relatively high public sector consumption level in the gross domestic product (hereinafter “GDP”) serves as the basis. Estimates of the medium-term resource framework suggest that the opportunities for financing new expenditure initiatives in the medium-term are limited. Therefore, the fiscal policy for 2008-2010 emphasizes the need to focus on raising the efficiency and effectiveness of the current expenditure programs, as well as the importance of switching the allocations under lower-priority programs to those that have greater impact on the economic growth and poverty reduction.

3. More efficient use of available resources and resources switching is a prerequisite for supporting the new policy initiatives. The need to increase the efficiency of use of available resources while switching the allocated resources to new policy initiatives also becomes more stringent due to the need to concentrate available resources mostly on the implementation of the new wage system in the budget sector, as well as on the support of

priorities under the 2008-2011 National Development Plan (hereinafter “NDP”) the development of which is underway.¹

4. *The underlying specificities of this year MTEF are:*

- § The need to increase the efficiency of current budgets with the possibility of switching the saved resources to the support of the new expenditure initiatives is highlighted.
- § Proposed approach of ensuring the correlation between the NDP and the budgetary process is highlighted. This presumes updating annually the Action Plan for the implementation of the NDP at the MTEF preparation stage. At the same time, clearer reflection of the NDP priorities in the MTEF will be possible starting from next year once the NDP and the Action Plan for its implementation is approved.
- § The practices of developing the strategic sectoral expenditure plans have been extended to include two new sectors: (i) culture and tourism and (ii) national defense.
- § Analysis was launched to select and prioritize investment projects in the two economic infrastructure sectors: (i) water and sanitation and (ii) roads.
- § The fiscal decentralization reform and changes in the intergovernmental fiscal relations framework are highlighted.

5. *Like in previous years, the 2008-2010 MTEF paper comprises the main text and attachments.* The main part includes: (i) macroeconomic background and outlook; (ii) fiscal policy and fiscal management policy objectives and public revenue projection; (iii) sources of budget funding and public debt management; (iv) medium-term projection for the national public budget and risk analysis; (v) public expenditure policy and strategic priorities; (vi) priorities and allocation of resources by sector. The attachments include tables on the national public budget pattern, reform priorities in the key sectors, expenditure ceilings for key budget users, as well as strategic expenditure plans for six sectors.

¹ Government Decision No.1495 of 28 December 2006.

2. Macroeconomic Background

2.1 Foreign Economic Context

6. The world economy revitalized in 2006. The global product² grew by 5.1 percent this year against 2005, especially due to the growing economic activities in the Euro zone, Japan, and Latin America. Growth of the world economic activities is projected to decline slightly to 4.9 percent in 2007 against 2006. Key factors still undermining the growth rate of the world economy are: high prices for oil products and economic imbalances in the United States of America and China.

7. The economic activities intensified in the European Union countries (euro zone). In 2006, growth in the EU reached 2.4 percent and in 2007 it will equal 2 percent mostly due to the investment activities. Real GDP growth in the major countries of the region is expected to amount to 1.3 percent in Germany and Italy and 2.3 percent in France.

8. Growth in the Community of Independent States amounted to 6.8 percent in 2006, which is higher than 6.5 percent in 2005. Real GDP growth for 2007 is estimated at 6.5 percent, influenced by higher oil prices, investment activities, as well as remittances from abroad.

9. In Russia, one of Moldova's key trade partners, 6.5-percent growth rate is projected for 2007, the main source of growth in this country being exports of oil products and gas, prices for which tend to increase. Growth is also expected in 2007 in other countries which are key trade partners of the Republic of Moldova – in **Romania**, 6.5 percent (generated by structural reforms and higher domestic demand) and **Ukraine**, 2.8 percent.

2.2 Moldovan Economy in 2006

10. Moldovan economy was affected by external shocks in 2006. Trade restrictions imposed by the Russian Federation, higher natural gas prices which almost doubled, and other things had a major impact on the macroeconomic situation. As a result, the real **gross domestic product** grew by 4 percent in 2006, which is 3.5 p.p. lower than that registered in 2005. Domestic demand went up, being supported by an increase in consumption and private investment. Annual average **inflation** reached 12.7 percent against 11.9 percent in 2005. Increase in prices at a greater pace began in May as a result of higher gas prices.

² Source: World Economic Outlook, September 2006

11. Foreign trade has a slight evolution, while current account deficit increased. In 2006,³ *exports of goods and services* increased by only 1.9 percent versus the previous year, and *imports* increased by 15.1 percent. Due to considerable gap between export and import developments, trade deficit in the amount of USD 1,596.9 mln built up in 2006, or USD 382.4 mln more than in 2005. Import capacity of exports decreased considerably – to 49 percent versus 55.4 percent in 2005. **The current account deficit** reached 11.9 percent of the GDP, having increased by 3.8 p.p. versus 2005. Foreign trade oh goods and services deficit was covered out of transfers and proceeds from abroad at approximately 75 percent. Large inflows of foreign exchange also contributed to the stability of the domestic currency. At end-2006, the **exchange rate of the domestic currency** depreciated by 0.6 percent against the US dollar in nominal terms and in real terms it appreciated by 10.75 percent versus end of last year. The annual average reached MDL 13.1 for USD 1.

12. The monthly average wage in 2006 increased by one third in nominal terms versus the previous year and amounted to MDL 1,697, and its real increase amounted to 14 percent. In 2006, implementation of the Law on Wages in the Public Sector started. As a result, the monthly average nominal wage in the budgetary system increased by approximately 45 percent in 2006 versus 2005. In the real sector of the economy, the increase amounted to 23 percent.

2.3 Macroeconomic Projection for 2007-2010

13. Economic projections for 2007-2010 build on the assumption that the business environment will remain stable and the economic growth of the key trade partners of the Republic of Moldova will not assume a downward trend. In order to support sustainable growth and its medium-term objectives, the macroeconomic stability and creation of a favorable investment climate will be further promoted.

14. According to the macroeconomic projections, the gross domestic product will grow at an average of 5 percent a year. Growth rates in industry and construction, sector are estimated to be higher than those of the GDP. **Economic growth** will be facilitated mostly by domestic demand which will build on an increase in private consumption and investment. The average **private consumption** growth rate will reach 6.8 percent over the medium term, exceeding that of the GDP growth. The growth will be facilitated by an increase in the monthly average wage, reduction in the profit tax rate, and increase in the non-taxable minimum. Remittances and income from work abroad which are assumed to remain high, but which will grow at an average rate slower than that in previous years will remain another

³ According to the balance of payments data.

source facilitating the private consumption growth. Investment will grow, fed by domestic and foreign financing. **Gross fixed capital formation** will grow at an estimated annual average rate of 13 percent. In this context, the share of investment will go up from 27.9 percent in the GDP in 2006 to 36.6 percent in 2010. Public capital investment is expected to increase, supported by foreign donors as well.

15. Foreign trade projections build on the resumption of exports following the external shocks of 2006, recovery of the old sales markets, and refocusing on the new ones. The goods exports growth rate will be higher than that of imports, which will have a positive impact on the trade balance and the GDP growth. At the same time, the trade deficit as a share of GDP will go up and will reach approximately 54 percent by 2010.

16. The exchange rate of the domestic currency will remain relatively stable over the medium term. In order to ensure national currency stability, National Bank of Moldova will continue to net purchasing of foreign currency on internal market, in order to reduce secondary factors of big foreign currency inflows from remittances.

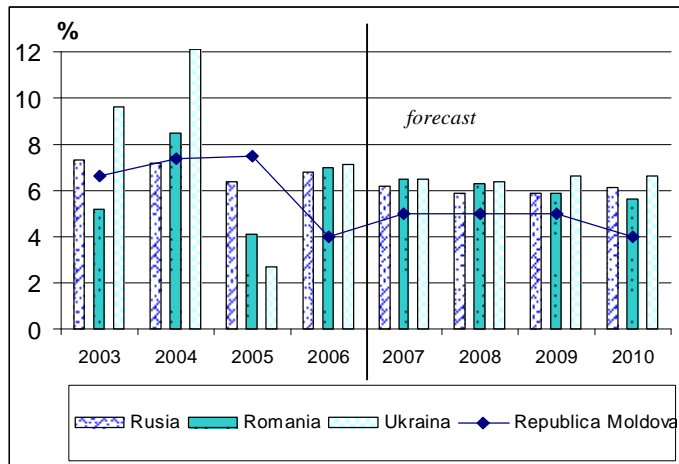
17. Slow depreciation of the exchange rate of the domestic currency will facilitate price stability. At the same time, the National Bank of Moldova will act on a priority basis in order to ensure price stability which is a key objective of the monetary policy. The disinflation process is expected to continue in 2007-2010 so that the end of period inflation rate is 5 percent in 2010. The inflation will be mostly non-monetary and will be caused by higher world prices for oil, as well as by an increase in the purchasing power of the population due to higher wages, pensions, and foreign exchange remittances of the nationals of the Republic of Moldova working abroad.

18. Increase of the average monthly nominal salary as well as increase of the size of wage fund will depend on the re-launching of real sector and improving the system of paying wages and the system of incentives for the public employees. During 2007-2010 the average nominal salary in ensemble across the economy will increase by 1.9 times and in December 2008 it will reach Mdl 3618 (or equivalent of 300 US\$).

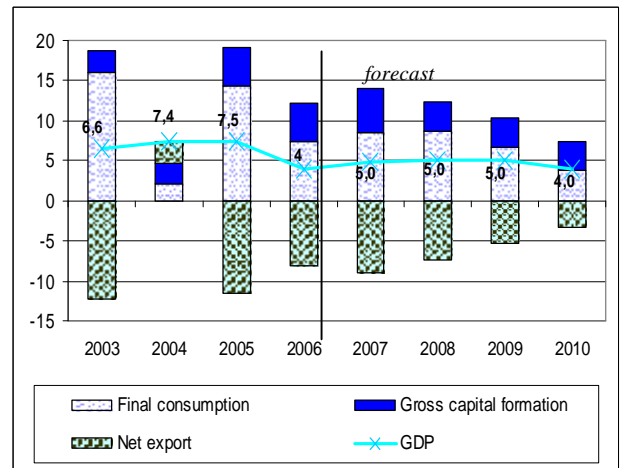
19. Development of key macroeconomic indicators and projection of such appears in Figure 1.

Figure 1. Key macroeconomic indicators

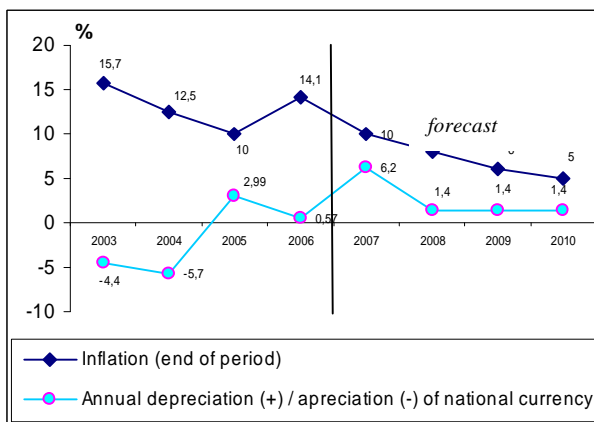
A. GDP in Moldova and main commercial partners (% compared to last year)



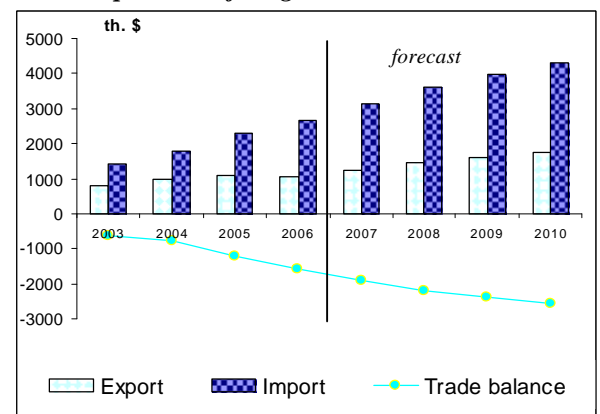
B. Contributions of components of uses to real change of GDP, %



C. Inflation and exchange rate



D. Developments in foreign trade



3. Fiscal policy and public revenue

3.1 Objectives of fiscal policy and tax administration policy

20. *The scopes pursued by the fiscal policy measures identified in the previous years served to enhance fiscal transparency and produced positive impact onto the volume of government financial resources as well as onto the economic growth and savings with the population.*

21. *General objectives pursued by the fiscal policy for 2008 – 2010 remain targeted towards:* (1) ensuring fiscal equity, stability and transparency; (2) optimizing fiscal pressure and extending taxation base; (3) systematizing and simplifying tax legislation; (4) harmonizing principles laid in foundation of the national tax legislation with such applicable by the European Union.

22. *Envisaged for medium term is a number of fiscal policy measures applicable to main types of taxes.* Development of income tax rates and such of social contributions appear in Table 3.1.

23. *The scope of amendments suggested on individuals income tax is to support persons with low income accompanied by phased out transfer of tax pressure onto the population with average and higher than average income.* To that end it is suggested to change the structure and size of annual taxation rate scales for 2008 by substituting the first two taxation scales with one to the size of annual taxable income up to Mdl. 25200 and setting 7% rate and maintaining the last scale of annual taxable income at Mdl. 25200 while decreasing maximum rate from 20% in 2007 to 18% in 2008. Besides, increased will be the size of annual personal exemption and that of annual exemption for dependent persons.

24. *With the scope of extending taxable base in 2008 it is suggested to withhold at the final source tax worth 10 % of the proceeds on fortune games gained by the natural persons and excluding such proceeds from the category of non-taxable income.*

25. *Beginning with 2008, with the scope of attracting to the country additional resources in the form of foreign and local investments, it is envisaged to make a comprehensive reform of the system of taxation of corporate income. Thus, it is expected to introduce 0% tax rate on corporate income, excepting distributed income, including such in the form of dividends.* At the same time, examined in 2009 will be the possibility of increasing by 5% the expenditures deductible from value base of fixed assets earmarked for current and capital repairs, when calculating corporate income tax. This shall enhance capital inflow to production sector.

Table 3.1 Development of income tax rates and social contribution rates in 2004 - 2010

	2004	2005	2006	2007	2008	2009	2010
	efectiv				medium term proposals		
Taxable income (ti) tax brackets and personal income tax rates, lei annual/%	ti<16200: 10% 16200 <ti<21000: 15% ti>21000: 22%	ti<16200: 10% 16200 <ti<21000: 14% ti>21000: 20%	ti<16200: 8% 16200 <ti<21000: 13% ti>21000: 20%	ti<16200: 7% 16200 <ti<21000: 10% ti>21000: 20%	ti<25200: 7% ti>25200: 18%	ti<25200: 7% ti>25200: 18%	ti<25200: 7% ti>25200: 18%
Annual personal allowance, lei	3.600 lei	3.960 lei	4.500 lei	5.400 lei	6.300 lei	7.200 lei	8.100 lei
Annual allowance for maintained persons, lei	240 lei	600 lei	840 lei	1.440 lei	1.560 lei	1.680 lei	1.800 lei
Corporate income tax rates, %	20%	18%	15%	15%	0%	0%	0%
<i>For reinvested income for distributed income, including dividends</i>					15%	15%	15%
State social insurance contributions rates, total, %	30%	29%	29%	29%	29%	29%	28%
<i>Employer's state social insurance contributions rates, %</i>	28%	27%	26%	25%	24%	23%	20%
<i>Employee's state social insurance contributions rates, %</i>	2%	2%	3%	4%	5%	6%	8%
Mandatory medical insurance rates, total, %	4%	4%	4%	5%	6%	7%	7%
<i>Employer's mandatory medical insurance rates, %</i>	2%	2%	2%	2,5%	3,0%	3,5%	3,5%
<i>Employee's mandatory medical insurance rates, %</i>	2%	2%	2%	2,5%	3,0%	3,5%	3,5%

26. ***Continued in 2008 – 2010 shall be the process of redistribution of the social insurance rate between the employees and employer.*** With the scope of reducing tax burden on employer the general rate of state social insurance will be reduced from 29% in 2009 to 28% in 2010.

27. ***In the next years it is envisaged to increase the size of the premium of mandatory health insurance from 5% in 2007 to 6% in 2008 and to 7% in 2009 and 2010,*** being broken down equally between the employer and employee. The purpose of that measure is to extend medical services package, which is offered to the population through mandatory health insurance.

28. ***Beginning with 2008, effective will be Title X of the Tax Code titled „Social Taxes”, these taxes at the moment are governed by the separate laws.*** This law is meant to regulate application of taxes under the form of social insurance tariffs (contributions) and mandatory health insurance premiums paid by the employer and employee.

29. ***With the scope of eventual investments into the national economy and lifting the unfavorable impact onto the business environment in regard to businesses capacity of financing operational and investment activity,*** it is suggested to refund VAT on material values, services referred to long term capital investments (expenditures), except for such earmarked for housing construction and transportation means and done beginning with 2008 in all the localities of Moldova, except for municipalities of Chisinau and Balti: in villages from 0 lei amount of VAT for VAT payers and from 10000 lei for non-VAT payers; in cities from 100000 lei amount of VAT for VAT payers. Examined in 2009 will be the possibility of decreasing the standard 20 % VAT rate.

30. ***List of excisable goods and size of excise tax rates will be amended through the following:*** (1) adjusting excise taxes rates on beer to the forecasted inflation rate for 2008 – 2010; (2) establishing in 2008-2010 excise tax rate on cigarettes depending of the maximum retail price of such instead of such rates as established on value of cigarettes or their value declared in customs, respectively at 6.0 lei + 4%, 6.0 lei + 5%, 6.0 lei + 6%; reducing in 2008 excise tax rate on cigarettes without filter from 4,4 lei to 3 lei, and maintain it at this level in 2009-2010; (3) increasing in 2008 by 11% of a composite rate of excise taxes on fortified alcoholic beverages with alcohol concentration of more than 25% by volume; (4) revising in 2008 excise tax rates on goods that do not correspond to the rates established by the World Trade Organization (applying single excise tax rate of 20% on caviar instead of 20% and 25%; and extending 10% excise tax applicable to perfumes on eau de toilette).

31. ***For the reported period changes in customs duties shall be done in full conformity with the rates established by the WTO.*** With the scope of further

systematization of tax legislation, drafted and adopted in 2008 shall be Title XI of the Tax Code titled „Customs duty”, which shall be made effective in 2009.

32. For medium term accordingly it is suggested to further phased out implementation of the new system of taxation for different categories of real estate depending on the market value of such. It is suggested to implement in 2008 the second stage of the new system of taxation by applying taxation to real estate assessed at its market value: (1) garages, gardening lots of land complete with structures found on such in municipalities and cities, including localities making part of such except for villages (communities); (2) real estate of commercial and industrial purpose.

33. In 2009 it is envisaged to accomplish systematization of tax legislation through drafting and adopting Title XII of the Tax Code titled „Other taxes and charges”, which will govern taxes and charges that were not covered by the effective Titles of the Tax Code although making part of the national tax system.

34. The progress marked in 2006 in the implementation of tax administration reform was due to the following: (1) finalizing the concept of the automated informational system for e-income declarations, approving new structure of the site maintained by the State Tax Service, initiating detalization of terms of reference on using digital signature and ensuring system security; (2) accomplishing works bound to developing automated informational system titled „Tax Cadastre”; (3) optimizing the procedure of verifying citizens by designing web-service meant for the identification of patent holders; (4) enhancing efficiency of record keeping and control over circulation of documents by designing automated informational system titled „Record keeping of blank form of tax invoices”; (5) introducing cash registers and control over taxi metered services; (6) updating procedure of sealing cash registers and control.

35. The objectives pursued by tax administration for 2008 – 2010 are targeted towards enhancing efficiency of tax administration and tax management as follows from the Strategy of state tax service development for 2006-2010. The actions envisaged for the purpose are presented in Table 3.2.

Table 3.2. Objectives of tax administration for 2008 – 2010.

No	Objectives	Actions	Year		
			2008	2009	2010
1.	Functional and structural consolidation of State Tax Service	<ul style="list-style-type: none"> • Providing for functional infrastructure, purchasing means of transportation, new office space and carrying out capital and current repair. 	P	P	P
2.	Consolidation of human resources	<ul style="list-style-type: none"> • Creating Center for training tax staff • Training State Tax Service staff in software used by tax service and taxpayers • Implementing performance assessment and system and system of incentives for the personnel 	P P P	P	P
3.	Enhancing the level of taxpayers servicing and broadening the spectrum of services extended	<ul style="list-style-type: none"> • Designing informational system for electronic presentation of tax reports • Designing the mechanism of self-servicing for the taxpayers by using Internet facilities • Popularization of tax legislation with the scope of creating high tax 	P P	P P	P

No	Objectives	Actions	Year		
			2008	2009	2010
		culture with the taxpayers and developing with them the spirit of voluntary observance of tax liabilities • Creating equipped offices and rendering taxpayers access to self-servicing • Rendering consultations on application of tax legislation through the Call Center	P	P	P
4.	Improving taxation procedures	• Creating laboratory in view of verifying software, cash registers and fiscal memory • Developing instruments and technologies for enhancing efficiency of the State Tax Service employees • Creating informational system and systematizing data on financial and tax discipline. Implementation of "Tax Record Log" • Developing mechanism of automated planning of tax audits based on risk assessment • Furthering implementation of the new system of taxation of real estate at their market value and ensuring updating of Tax Cadastre on the basis of information supplied by the Land Relations and Cadastre Agency • Furthering realization of the process of improving tax administration by crossing over from the activity displayed on the basis of entrepreneurial patent to new organizational-legal forms of doing business	P	P	P
5.	Development of informational technologies	• Enhancing efficiency of tax administration by improving informational resources maintained by the State Tax Service • Providing for information flow exchange between State Tax Service and commercial banks • Providing State Tax Service with hardware, software and printers	P	P	P

36. It is envisaged that accomplished in 2008 will be the period of capital legalization launched in 2007. which applies to financial means, tangibles and financial assets that were not declared by the citizens and legal entities residents of the Republic of Moldova both in the country and abroad. Application of an efficient mechanism of taxation to legalizaed capital will allow for further improvement of the investment climate and enhance inflow of investments into the entrepreneurial activity.

37. In order to enhance capitalization of activity and improve economic and financial indicators of domestic enterprises, **continued in 2008 – 2010 shall be implementation of tax amnesty reform launched in 2007.** The reform implies cancelling arrears on tax liabilities accumulated as at 1 January 2007 and benning tax administration authorities control over the accuracy of calculation and settling such tax liabilities for the fiscal periods before 1 January 2007.

3.2 Recent developments in pubic revenues

38. Revenues of the national public budget kept growing at high pace showing an average of about 24 percent throughout 2004-2006. In 2006 revenues amounted to Mdl. 17,847.8 million, marking an increase by 22.9 percent as compared to the previous year.

39. The share of public revenues in GDP in 2006 amounted to 40.5 percent registering the highest level during the recent years. The key factors that have generated these developments are the economic growth, higher income gained by the population, brisk

Table 3.3 Development of national public budget revenues as share of GDP in 2004-2006

	2004	2005	2006
Tax revenue	29,4%	31,2%	33,4%
Non tax revenue	2,3%	2,8%	3,0%
Special funds and means	3,2%	3,3%	3,4%
Grants	0,4%	1,2%	0,7%
Total revenue	35,3%	38,5%	40,5%

increase in the volume of imports as well as fiscal policy promoted in the domain of income tax, reduction of VAT exemptions and improving tax administration. Development of national public budget revenues in nominal terms and as a share

of GDP during 2004-2006 appears in Table 3.3 and Annexes No. 2.

40. Tax revenues remain the main source of revenues for the national public revenues. The share of these revenues in total public revenues stays at the level of about 82 percent. As a share of GDP these show an increase from 29,4 percent in 2004 to 33,4 percent in 2006.

41. The main share of tax revenues is generated by in direct taxes, which during the recent years is maintained at the level of about 55 percent. Increase of public revenues is basically due to growth in this group of revenues which in 2006 increased by 67.5 percent as compared to 2004. VAT remains the most significant source of revenues for the public budget, which practically increased by 1.8 times during 2004-2006 and at the moment amounts to about 35 percent in total public revenues.

42. Direct revenues as a share in total public revenues decreased from 40,5 percent in 2004 to 37,1 percent in 2006. This is due to lower growth pace of these revenues as compared to indirect. At the same time, direct taxes in nominal terms during this period increased by 44.3 percent. Revenues of state social insurance budget (hereinafter referred to as the BASS) and of mandatory health insurance funds (hereinafter referred to as the FAOAM) stand for about two thirds in total direct taxes and show an increase by 50 percent during 2004-2006. Direct dependence of these taxes in wages fund and salary as well as economic growth have led to their permanent growth more so that these economic indicators showed positive development during the reported period.

43. Nontax revenues, special funds and means as well as grants represent a less significant source of revenues, although their share is maintained relatively stable during the recent years, both as share of GDP and in total revenues. At the same time it is stated that disbursements of grants are nonuniform and influence onto the share of these revenues.

3.3 Public revenues projection for 2007-2010

44. *The pace of growth of national public budget revenues registered in 2004-2006 will gradually slow down during 2007-2010.* The national public budget revenues during this period is estimated to grow (annual average) by about 10.8 percent and in 2010 these will reach the figure of Mdl. 26,8 billion. Serving as the basis for assessing revenues of the national public budget for medium term was the macroeconomic projection for 2007-2010 as well as fiscal policy and tax administration measures envisaged for this period.

45. *It is projected that the revenues of the national public budget as share of GDP will decrease from 41,7 percent in 2007 (anticipated) to 39,9 percent in 2010.* Fiscal policy measures for medium term are meant to contribute to the decrease of the share of public sector in the national economy as well as to revival of the economy after the external shocks experienced in 2006. Projection of public revenues in nominal terms as share of GDP appear in Figure 2 and Annex 2.

46. *The share of tax revenues will grow from 33,4 percent of GDP in 2006 to 35.0 percent of GDP in 2010.*

This increase is by large due to rapid growth of contributions to the mandatory health insurance fund and to the state social insurance budget which taken together show 9.5 percent growth as share of GDP in 2006, which in 2010 will amount to 11.9 percent.

47. *Indirect taxes will grow more rapidly as compared to the rest of revenues.* Since the measures of fiscal policy are targeted more towards reforming direct taxes, the indirect ones will generate the biggest growth in public revenues showing annual average increase of 13.3 percent during herewith specified period.

48. *Disbursements of grants will serve as more and more important source in total public revenues.* During the subsequent years Moldova is expecting enhancement of external assistance⁴. About 40 percent of this assistance will be made available in the form of grants. Projection of grants disbursements presented in MTEF 2008-2010 is rather conservative and includes only such grants for which agreements were already signed or which are at the advanced stage of negotiations. Since Moldova as of this year became the neighbor of the EU, it is expected that the latter will be its main external donor in the future. At the moment Moldova is negotiating with the EU the Indicative National Plan which stipulates that Moldova could benefit on direct budget support worth about 104 million Euro during 2007-2013 in the form of grants. Thus, the process of signing this and other new agreements will be followed up by revised projection of grants.

Table 3.4 Projection of development of national public budget revenues as share of GDP during 2007-2010

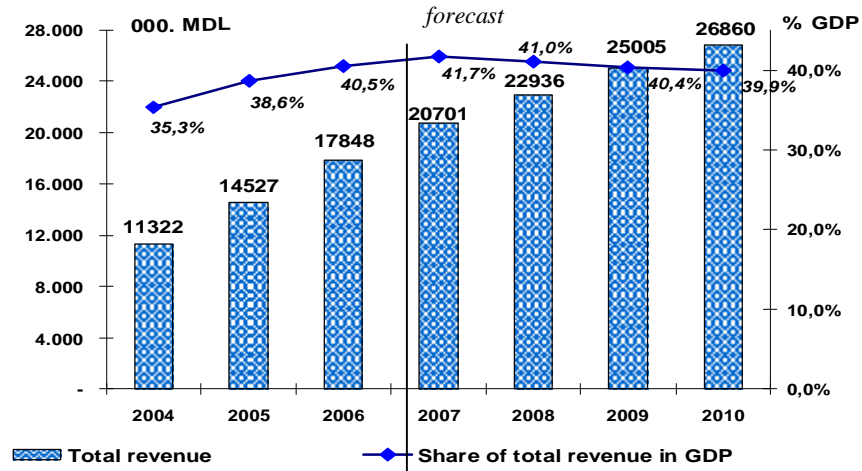
	2007 sc.	2008	2009	2010
Tax revenue	33,9%	34,6%	35,2%	35,0%
Non tax revenue	3,0%	2,8%	2,6%	2,5%
Special funds and means	2,5%	2,1%	2,0%	1,9%
Grants	2,2%	1,4%	0,6%	0,5%
Total revenue	41,7%	41%	40,4%	39,9%

⁴ see Box 2, Chapter 4.

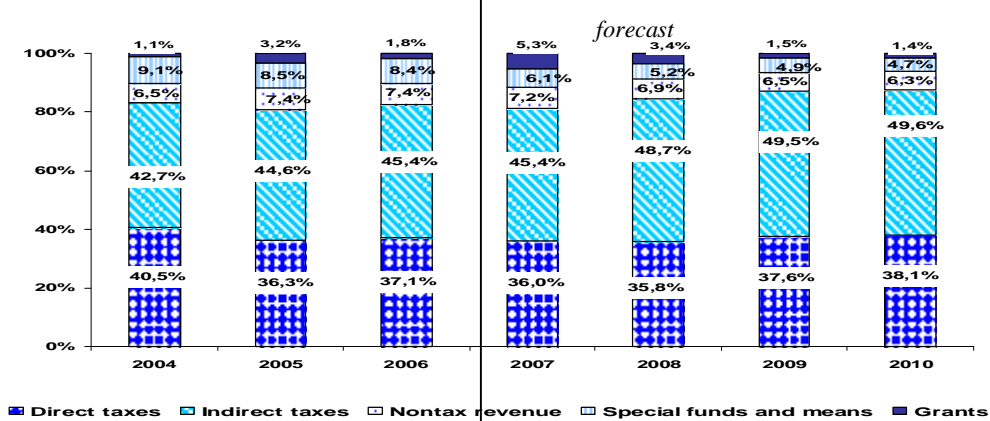
49. Evoluția veniturilor Bugetului Public Național și a structurii acestora se prezintă în figura 2.

Figure 2. Development of the national public budget revenues

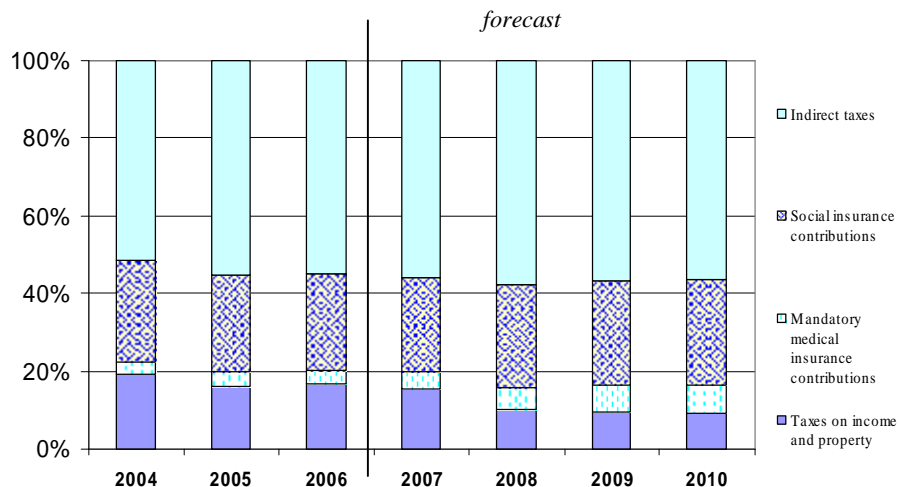
A. Development of National Public Budget Revenues, 2004-2010



B. The global structure of revenues, 2004-2010



C. Tax Revenues of the National Public Budget, 2004-2010



4. The budgetary balance and state debt management

4.1 Budget deficit and sources of financing

50. *The national public budget in 2006 marked a deficit worth Mdl. 126 million or 0.3 percent of GDP, which followed after three consecutive years of surplus.* At the same time beginning with 2000 the primary balance remained positive. Limitations of budget balance during the last years resulted in reduction of the level of state debt managed by the government by about 20 percentage points of GDP.

51. *The objective pursued by the government for medium term is to maintain budget deficit at a level that will not go beyond 0.5 percent of GDP.* Before 2006 budget deficit was financed preponderantly at the expense of internal sources from selling out public patrimonial (proceeds from privatization). For medium term it is expected that external sources will become the main source of financing budget deficit; however external loans will be attracted on concessional basis and used to finance the investment projects.

Table 4.1 The deficit of the national public budget and sources of financing, 2004-2010

Million lei

	2004	2005 executed	2006	2007 estimated	2008	2009	2010
					medium term forecast		
Budget deficit (-)/surplus (+)	69,9	578,4	-126,1	-233,0	-280,0	-309,5	-336,5
<i>Share in GDP</i>	<i>0,2%</i>	<i>1,5%</i>	<i>-0,3%</i>	<i>-0,5%</i>	<i>-0,5%</i>	<i>-0,5%</i>	<i>-0,5%</i>
Net internal financing	819,9	158,3	65,3	46,4	31,2	-18,8	-18,8
Net external financing	-601,5	-53,4	-230,4	298,4	550,7	356,1	-16,2
Funds from selling and privatizing public property	100,6	176,3	394,4	195,0	125,0	102,0	102,0
Changes in account balances	-388,9	-859,6	-103,2	-306,8	-426,9	-129,8	269,5

52. *Projection of the sources of financing for 2007-2010 are based on the following assumptions:*

- Net external financing will become the main source of financing budget deficit. External lending will bear investment nature.
- Net internal financing will gradually decrease and beginning with 2009 will become negative at the expense of continuing repayment of debt due to the NBM and reducing gradually the amount of T-bills issue.
- Obtaining proceeds from selling out and privatizing public patrimonial.
- Using financial resources accumulated on the accounts of the national public budget during the preceding periods for the purpose of financing expenditures of the respective budgets.

At the same time, during referred period it is envisaged to launch and implement incentives of attracting surpluses of cash resources in the market via new specific for capital

market instruments (corporate bonds), issued by economic agents who have 100% or majority state share.

4.2 External assistance

53. *For medium term is is expected an increase of external financing in the form of grants and loans.* This comes as a result of Consultative Group meeting with Moldova's developemnt partners that took place on 12 December 2006 in Brussels. Such financing shall include a mixture of certain disbursements to support budget deficit, financing investment projects and rendering technical assistance.

Box 2. Meeting of Donors Consultative Group for Moldova
12 December 2006, Brussels

During Donors Consultative Group Meeting for Moldova, which took place on 12 December 2006 in Brussels, the European Union jointly with the international financial organizations and external donors decided to alocate to Moldova about USD 1,2 billion during 2007-2010 to ensure efficient implementation of the Moldova-EU Action Plan and Economic Growth and Poverty Reduction Strategy Paper.

In practice, out of this amount about USD 520 million (43 percent) are new commitments and the rest USD 680 million (57 percent) are prior assumed commitments. Similarly, this amount is split in grants (USD 680 million) and loans (USD 520 million).

Pursuant to the most pessimistic calculations, the National Public Budget will get about USD 447 million (37 percent) in the form of grants and loans. Envisaged under the MTEF 2007-2009 was that the government will benefit on the external grants and loans worth USD 132 million. Thus, the external assistance to the National Public Budget will increase by at least three times in medium term.

54. *When estimating the size of external assistance for 2007-2010 taken into account were such external grants and loans for which the agreements were already signed of which are at an advanced stage of negotiations.* Projection of external resources will be revised in line with signing new agreements. Developemnt of disbursements of external grants and loans appears in Table 4.2.

Table 4.2. External Assistance for the National Public Budget, 2004-2010

	2004	2005	2006	2007	2008	2009	2010
	executed			estimated	medium term forecast		
Total	32,8	62,4	55,3	143,1	133,6	101,3	68,8
<i>Grants</i>	10	36	24,0	83,3	55,9	26,8	26,0
<i>Credits</i>	23	26	31,2	59,8	77,7	74,5	42,9
Budgets suport	1,5	22,4	4,8	65,4	36,9	18,9	9,2
<i>Grants</i>	1,5	22,4	4,8	55,4	26,9	8,9	9,15
<i>Credits</i>	0,0	0,0	0,0	10,0	10	10	0,0
Project implementation	31,2	40	50,5	77,7	96,7	82,4	59,7
<i>Grants</i>	8,6	14,1	19,3	27,9	29,0	17,9	16,8
<i>Credits</i>	22,6	26,0	31,2	49,8	67,7	64,5	42,9

4.3 Public debt management

55. During the recent years the state debt managed by the government was marking positive developemnt. Measures attempted in the field of state debt managed by the government during 2004-2006 as well as more stable economic situation have lead to reduction of the balance of state debt as share of GDP from about 40,4 percent at the end of 2004 to about 29,6 percent at the end of 2006.

56. In 2006 the Republic of Moldova managed to restructure its bilateral external debt with the Paris Club. Following negotiations between the republic of Moldova and bilateral creditors, members of the Paris Club displayed on 11-12 Masy 2006, an agreement was reached on restructuring external debt of the government The agreement signed consolidates about USD 150 million of the debts contracted by Moldova before 31 December 2000. This amount is composed from arrears (USD 68 million), accumulated before 30 April 2006 and the debt with maturity term between 1 May 2006 and 31 December 2008 (USD 81,8 million).

57. For medium term the external state debt will increase from Mdl. 9,2 billion (USD 718,2 million) at the end of 2006 up to Mdl. 12,7 billion (USD 886,1 million) at the end of 2010. External debt growth in nominal terms could be explained by higher than projected disbursement of loans as well as by the depreciation of the national currency. At the same time, as a share of GDP, this will decrease from 21 percent to 18.8 percent within the same period.

58. The policy in the field of domestic debt was and still remains based on repayment of debt due to the NBM and non-contracting of new borrowings. Envisaged for 2008 is conversion of the government debt on loans extended by the National Bank of Moldova into government securities. These will serve as monetary instrument used by the NBM for maintaining macroeconomic stability. The policy of issuing government securities will be based on selling reduced number of the types of T-bills with longer maturity terms.

59. The domestic debt will be maintained constant in nominal terms for medium term and shall amount to Mdl. 3,8 billion. As share of GDP, the domestic debt will decrease from 8.6 percent at the end of 2006 to 5.7 percent at the end of 2010.

60. Servicing external and domestic state debt during 2007-2010 will require Mdl. 5,4 billion. Out of this amount Mdl. 2,8 billion shall be earmarked for repaying principal and Mdl. 2,6 billion for repaying interest. Developemnt of external and domestic debt servicing appears in Tasble 4.3.

Table 4.3 Servicing state debt

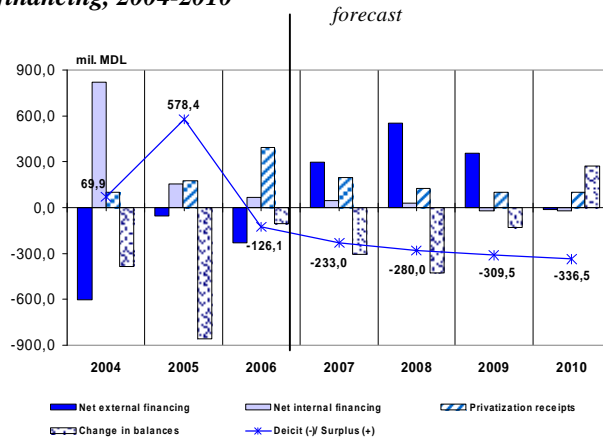
Million lei

	2004	2005	2006	2007	2008	2009	2010
	executed			estimated	medium term forecast		
External debt servicing	1.253,8	657,7	871,6	712,8	734,1	1.005,3	910,2
Principal	880,0	380,4	640,5	491,0	521,6	687,5	624,8
Interest	373,8	277,3	231,1	221,8	212,5	317,8	285,4
Internal debt servicing	399,0	320,2	316,3	539,8	574,0	501,2	445,6
Principal		127,0	118,8	118,8	118,8	118,8	118,8
Interest	399,0	193,2	197,5	421,0	455,2	382,4	326,8

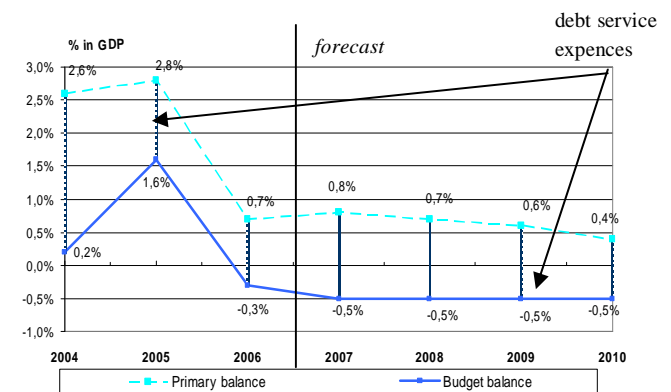
61. Development of budget balance, sources of financing and stock of external and domestic debt appears in Figure 3.

Figure 3. Development of budget deficit and state debt

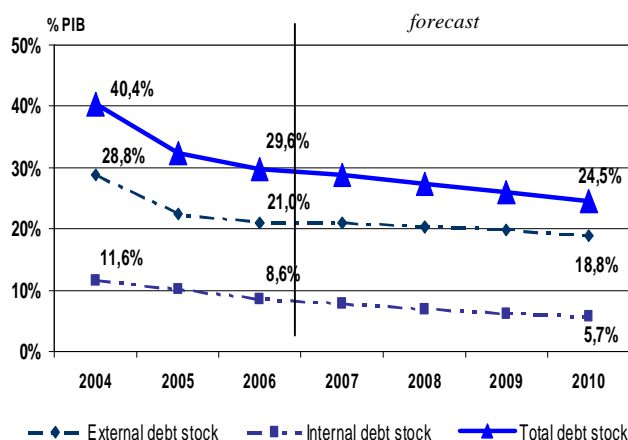
A. Development of budget deficit and sources of financing, 2004-2010



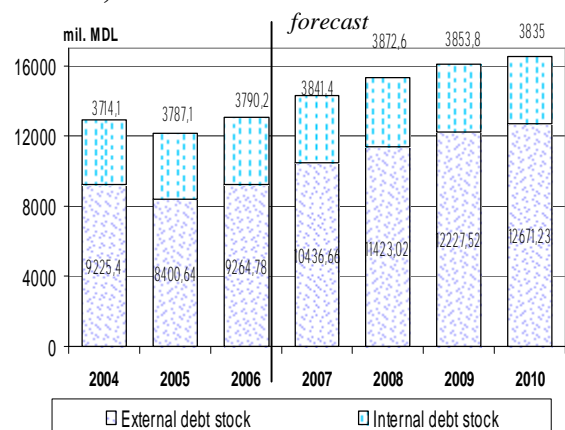
B. Budget balance and expenditures incurred with debt servicing, 2004-2010



C. Development of stock of external and domestic state debt, % of GDP, 2004-2010



D. Development of the stock of external and domestic state debt, 2004-2010



5. National Public Budget

5.1 Main trends

62. *The National Public Budget will continue to grow in nominal terms over the medium term.* Growth is expected to be slower both on the revenue and expenditures side but it will still exceed the level of inflation. Expenditures of the National Public Budget are expected to grow from 20,9 billion MDL in 2007 (estimated) to about 27,2 billion MDL in 2010 but with a simultaneous decline as a share in the GDP from 42,1 % to 40,4 %. A general financial frame of the National Public Budget for 2004-2010 is shown in Table 5.1.

Table 5.1 General Financial Frame of the National Public Budget, 2004-2010

Million MDL

	2004	2005 executed	2006	2007 estimated	2008	2009	2010 medium term forecast
Total revenue	11.321,8	14.527,3	17.847,8	20.701,0	22.936,3	25.004,8	26.859,5
<i>Share in GDP</i>	35,3%	38,6%	40,5%	41,7%	41,0%	40,4%	39,9%
Total expenditure	11.251,9	13.948,9	17.973,9	20.934,0	23.216,3	25.314,3	27.196,0
<i>Share in GDP</i>	35,1%	37,0%	40,8%	42,1%	41,5%	40,9%	40,4%
Debt servicing	772,8	470,5	428,6	642,8	667,7	700,2	612,2
<i>Share in GDP</i>	2,4%	1,2%	1,0%	1,3%	1,2%	1,1%	0,9%
Discretionary expenditure	10.536,4	13.523,8	17.606,8	20.353,7	22.589,1	24.648,7	26.618,4
<i>Share in GDP</i>	32,9%	35,9%	40,0%	41,0%	40,3%	39,8%	39,6%
<i>Real growth (discretionary expenditure)</i>		14,7%	15,5%	3,4%	2,1%	2,1%	2,4%
Budget deficit	69,9	578,4	-126,1	-233,0	-280,0	-309,5	-336,5
<i>Share in GDP</i>	0,2%	1,5%	-0,3%	-0,5%	-0,5%	-0,5%	-0,5%
<i>Gross Domestic Product</i>	32.032	37.652	44.069	49.700	56.000	61.900	67.300

63. *The general financial frame covers all revenues and financing sources distributed among budgets and public funds* (state budget, budgets of administrative-territorial units, social security budget of the state, mandatory health insurance funds). During 2008-2010 MIF and SIF expenditures will continue to grow both as share of GDP and as share in total expenditure of national public budget from 36% in 2007 to almost 40% in 2010, based on higher growth rates forecasted for these budgets. As a result share of state and local budgets will have a slow down tendency. A breakdown of the general financial frame by components and share of such components in the GDP is presented in Table 5.2.

Table 5.2 National Public Budget by components, 2004-2010

	Executed			Approved	Estimated			
	2004	2005	2006	2007	2007	2008	2009	2010
mil.MDL								
Total revenue (without interbudgetary transfers)	11322	14527	17874	19396	20701	22936	25005	26860
State budget	6530	8971	10977	12089	13141	14314	15168	16191
ATU budgets	1974	2136	2653	2411	2664	2365	2520	2620
State social insurance budget	2492	2978	3687	4154	4154	5131	5809	6346
Mandatory medical insurance funds	326	442	558	743	743	1127	1508	1702
Total expenditure	11252	13949	18000	19629	20934	23216	25314	27196
State budget (without interbudgetary transfers)	4652	5425	7213	8115	9217	9324	9805	10114
ATU budgets	2894	3718	4923	4493	4745	5369	5743	6148
State social insurance budget	2769	3698	4378	5084	5084	5960	6695	7542
Mandatory medical insurance funds	937	1108	1485	1938	1888	2564	3072	3392
Deficit (-) / Surplus (+)	70	579	-126	-233	-233	-280	-310	-337
State budget	-88	546	98	-73	-123	-348	-389	-163
ATU budgets	-60	-139	-267	-40	-40	-35	-30	-30
State social insurance budget	179	-2	-30	-120	-120	103	110	-144
Mandatory medical insurance funds	39	174	74	0	50	0	0	0
% in GDP								
Total revenue (without interbudgetary transfers)	35,3%	38,6%	40,6%	41,6%	41,7%	41,0%	40,4%	39,9%
State budget	20,4%	23,8%	24,9%	25,9%	26,4%	25,6%	24,5%	24,1%
ATU budgets	6,2%	5,7%	6,0%	5,2%	5,4%	4,2%	4,1%	3,9%
State social insurance budget	7,8%	7,9%	8,4%	8,9%	8,4%	9,2%	9,4%	9,4%
Mandatory medical insurance funds	1,0%	1,2%	1,3%	1,6%	1,5%	2,0%	2,4%	2,5%
Total expenditure	35,1%	37,0%	40,8%	42,1%	42,1%	41,5%	40,9%	40,4%
State budget (without interbudgetary transfers)	14,5%	14,4%	16,4%	17,4%	18,5%	16,6%	15,8%	15,0%
ATU budgets	9,0%	9,9%	11,2%	9,6%	9,5%	9,6%	9,3%	9,1%
State social insurance budget	8,6%	9,8%	9,9%	10,9%	10,2%	10,6%	10,8%	11,2%
Mandatory medical insurance funds	2,9%	2,9%	3,4%	4,2%	3,8%	4,6%	5,0%	5,0%
Deficit (-) / Surplus (+)	0,2%	1,5%	-0,3%	-0,5%	-0,5%	-0,5%	-0,5%	-0,5%
State budget	-0,3%	1,4%	0,2%	-0,2%	-0,2%	-0,6%	-0,6%	-0,2%
ATU budgets	-0,2%	-0,4%	-0,6%	-0,1%	-0,1%	-0,1%	0,0%	0,0%
State social insurance budget	0,6%	0,0%	-0,1%	-0,3%	-0,2%	0,2%	0,2%	-0,2%
Mandatory medical insurance funds	0,1%	0,5%	0,2%	0,0%	0,1%	0,0%	0,0%	0,0%
<i>Nominal GDP</i>	32.032	37.652	44.069	46.600	49.700	56.000	61.900	67.300

5.2 Components of the national public budget

64. *The state budget for 2008 will grow by 18,4 % on the revenues side and 20,5% on the expenditures side compared with the budget for the previous year.* This growth will be slower though, in the following two years – of about 5-6 % per year. Expenditures for programs financed directly from the state budget will also grow in nominal terms: in 2008 the growth will be of 26 % and in the following two years - 7 % and 6,4 %. More than 1/3 of state budget' expenditures are transfers to other budgets, which are forecasted to increase from 33.3% in 2007 to almost 38% in 2010 (see table 5.3). The state budget over the medium term is projected with a deficit, which in 2008-2009 will be in the range of 0,6% of GDP and in 2010 - 0,2%. Such deficit will be financed from external loans.

Tabel 5.3 Transfers from state budget to other budgets, 2004-2010

	2004	2005	2006	2007	2008	2009	2010
	<i>executed</i>			<i>approved</i>	<i>medium term forecast</i>		
Total state budget expenditure	6648,0	8482,5	11019,3	12161,4	14661,9	15557,0	16354,2
<i>including</i>							
Transfers to other budget, total	1996,2	3057,9	3806,2	4046,7	5338,3	5751,8	6240,5
% in total	30,0%	36,0%	34,5%	33,3%	36,4%	37,0%	38,2%
Transfers to ATU budgets	865,9	1465,6	2089,1	1979,6	2887,6	3104,1	3397,6
Transfers to State social insurance budget	455,9	717,8	661,1	810,6	932,4	995,3	1052,4
Transfers from Republican Fund of social assistance to population to local funds of social assistance to population	650,7	839,9	1001,6	1195	1436,8	1563,6	1690,5
	23,7	34,6	54,4	61,5	81,5	88,8	100

65. **During 2008-2010, BASS will grow by approximately 16,3 % per year.** In 2010, BASS will grow by about 49% on the revenues and expenditures side, as compared with 2007. This increase is due to the projected growth of the wage fund in the economy that will generate revenues and, by the growing trend toward social protection programs with a major impact on poverty reduction. In 2008-2009, BASS is expected to run with a surplus of about 0,2 % of GDP and in 2010 the deficit will be of about 143,6 million MDL or 0,2% of GDP, to be financed from own funds accumulated on accounts during the previous years.

66. **FAOAM will see the highest growth of revenues and expenditures over the medium term – 20,1 % per year.** In 2010, revenues and expenditures of these funds will grow by approximately 75 % compared with 2007. It is expected that revenues and expenditures of FAOAM will be balanced over the medium term.

67. **The budgets of administrative-territorial units (ATU) for 2008-2010 were projected on the basis of current legislation⁵.** Revenues of ATU budgets (less transfers from the state budget) are expected to decrease in 2008 due to the introduction of a zero income tax rate for entrepreneurial activity but in 2010 these revenues will get back to their level of 2007. In order to protect the expenditures of local budgets, such losses of revenues to the ATU' budgets will be compensated with transfers from the state budget. ATU' budgets for 2008-2010 are projected with a deficit of around 40-30 million MDL to be financed with proceeds from the privatization of assets owned by local authorities.

68. The evolution of key indicators of the national public budget by components is shown in figure 4.

5.3 Fiscal decentralization

69. **The new relevant legislation aims to improve the situation at the level of ATU.** A review of ATU' budgets has shown, that the fiscal base of administrative-territorial

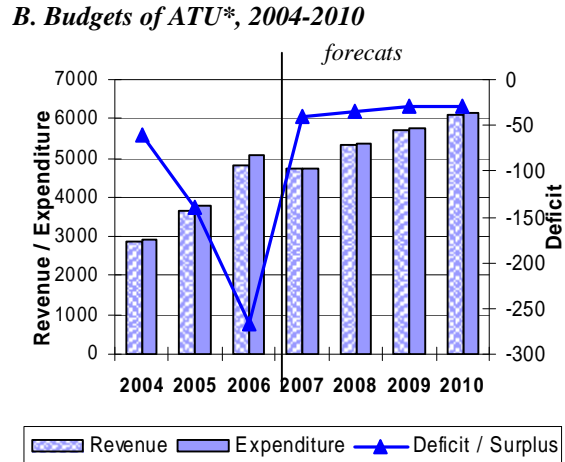
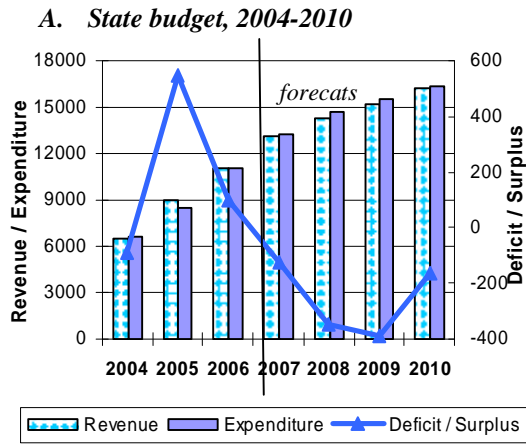
⁵ The new conditions may be taken into account after the promotion of the new draft Law on local public finance which is currently being developed.

units (except for Chisinau and Balti municipalities) remains inadequate to finance expenditures to be covered from the ATU budgets. To achieve a genuine financial autonomy and clearly separate the responsibilities between the state budget and ATU budgets at first and second levels, at the end of 2006 a number of laws were adopted (Law on Administrative Decentralization, Law on Local Public Administration, Law on Regional Development). The new rules underline the importance of strategic planning at the local level and the need to motivate and enhance the accountability of local public authorities both in terms of expanding the fiscal base and for executing budgetary expenditures.

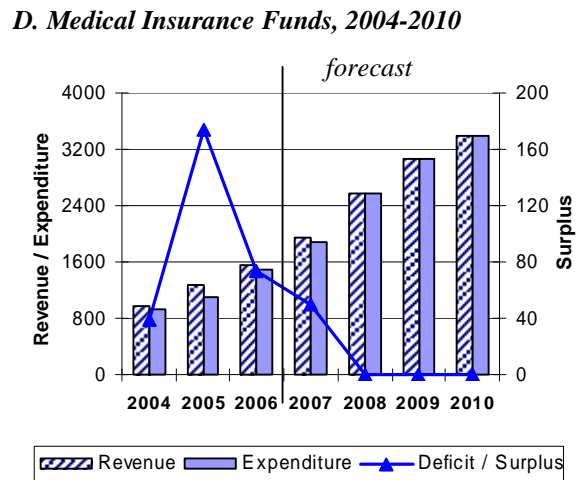
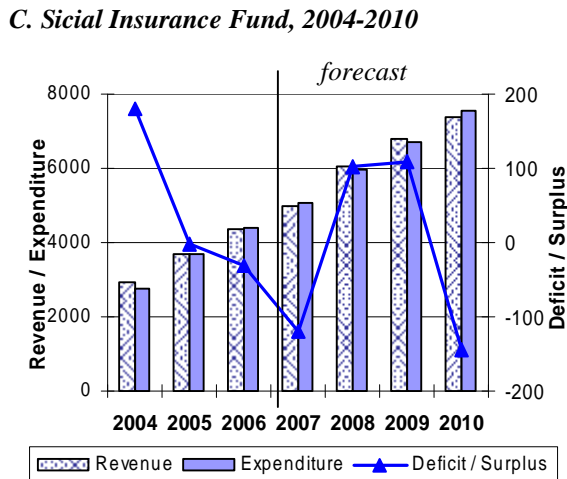
70. This major reform will involve significant changes in the system of inter-budgetary relations between the state budget and ATU budgets. The general principles and procedures underpinning the new system will be defined in the new law on local public finance that is currently being developed. The system will have the following key elements:

- § *Direct* inter-budgetary relations between the state budget and local budget at first and second levels;
- § Uniform and invariable norms for allocations from the general state revenues and re-distribution among budgets and various levels;
- § General-purpose transfers aimed at leveling out the financial possibilities of local budgets;
- § Special-purpose transfers as needed by local public authorities to implement functions delegated to them.

Figure 4. Revenues and Expenditures by components of the National Public Budget



* expenditures include transfers with specific designation



6. Policy and Strategy of Public expenditures

6.1 General objectives and strategic priorities over the medium term

71. During 2008-2010 public expenditures' policy shall be focused on the attainment of the following general objectives:

- Ø *Stop the growth of public sector as a share in the GDP.* Considering the current relative high share of the national public budget in the GDP, the fiscal environment needed for economic growth and poverty reduction should be created mainly from existing resources and, this will require (i) a re-distribution within and among sectors and (ii) greater efficiency and effectiveness of existing programs of expenditures.
- Ø *Gradual increase of allocations for capital investments in economic infrastructure coupled with improved management procedures for investment projects.* At the same time, a cap shall be put on the growth of payroll costs as a share of the GDP with a strong focus on rationalizing budgetary structures and streamlining the level of employment in the public sector. This will create a larger space for the growth of operating and investments costs.
- Ø *Modernizing governance and increased transparency of public expenditures.* This will be achieved through a further implementation of reforms in public administration and public sector.
- Ø *Improved management of public funds.* This objective shall be achieved through a further expansion of budgetary strategic planning at the sectoral level and implementation of budget management methods focusing on performance indicators and assesment of expenditures vs. outcomes.

72. Medium-and-long-term strategic priorities shall be based on the objectives outlined in the National Development Plan (NDP) for 2008-2011 which is currently being developed. According to the National Development Plan for 2008-2011, the available resources should concentrate and be directed toward the achievement of five major priorities:

1. *Building a democratic and modern state based on the rule of law* – modernizing and improving the judiciary, prevention and fighting corruption, border management and assuring security of the country;
2. *Settlement of the conflict in Transnistria and reintegration of the country* – improving the dialogue for a lasting political settlement and creating the necessary conditions for reintegration of Transnistria in the constitutional, economic, political, social and cultural space of Moldova;
3. *Enhancing the competitiveness of the national economy* – improving the business climate and supporting SMEs, developing the economic infrastructure and enhancing corporate efficiency;

4. *Developing human resources, greater employment and improved social inclusion* – improving the quality and access to education and healthcare services, increasing employment and improving labor skills, better social inclusion and social protection;
5. *Regional development* – enhancing the autonomy and capacities of local public governments, diversification of rural economy, development of social infrastructure in small towns and rural communities.

73. *The expenditure priorities in the frame of the MTEF for 2008-2010 shall be focused on achieving the social & economic objectives outlined in the Government Program „Modernizing the country – welfare for the people” and other national programs.* Starting with 2008, expenditure priorities shall be adjusted to reflect policy priorities set out in the NDP for 2008-2011. The Action Plan for the implementation of the NDP shall be developed and approved by the end of this year, which means that programs and actions of the NDP shall be better reflected in the MTEF starting next year. The box #3 below presents the NDP approach and its correlation with the budgetary process.

Box 3. National Development Plan and its correlation with the budget process

By its Resolution nr.1495 dated 26 December 2006, the Government has initiated the development of the National Development Plan for 2008-2011, setting out the objectives and strategic priorities for development of Moldova over the medium term. The NDP will integrate the existing fragmented strategic framework and shall be the main document for strategic planning over the medium term. This document will also serve as an instrument for correlation with the budget planning and assimilation of assistance from external donors.

The NDP comprises two components: 1) strategy document which outlines guidelines for activities and is aimed at identifying ways and mechanisms for achieving the identified objectives; and 2) action plan outlining specific actions for the attainment of identified objectives.

The NDP reflects a dynamic approach to strategic planning. Its action plan will be updated annually simultaneously with the development of the MTEF and shall be improved following a process of monitoring and evaluation and adjusted to the available funding.

The NDP will go through a development and consultation process culminating with its adoption by the Parliament at the end of 2007. Consequently, in 2008 the NDP will be correlated with the MTEF at the general level whereas the specific activities outlined in the action plan will be reflected in the MTEF of 2009-2011.

74. Considering the limited possibilities for a further growth of public expenditures and the need to support the priorities set forth in the National Development Plan for 2008-2011, ***the budgetary policy for 2008-2010 should focus on improving the efficiency and effectiveness of existing programs of expenditures by sectors.*** The released funds shall be re-allocated to improve the quality of public services under the existing programs of expenditures and support new policy initiatives by sectors, as outlined in the NDP. At the same time, it is necessary to approach realistically and cautiously the endorsement of new cost initiatives, subjecting such initiatives to thorough reviews, including a financial impact assessment and correlating them with the available resources.

6.2 Improving the efficiency and effectiveness of cost programs

75. *International experience in public finance management shows a greater emphasis being put on analyzing the efficiency of budgetary expenditures in terms of comparing the outcomes with the set objectives.* A number of countries use modern methods for allocating resources based on performance and efficiency in the use of existing budgetary resources. Permanent emphasis is put on identifying possibilities for providing public services in the most efficient way, as to avoid significant increases in public expenditures which may undermine macroeconomic stability and induce disparities with regard to public sector's share in the GDP.

76. *Budgetary procedures should include a requirement for resource savings.* Given the estimated budgetary constraints over the medium term and challenges related to the attainment of objectives outlined in the NDP, it becomes a pressing necessity to introduce into budgetary planning a requirement for attaining a certain level of resource savings, following a more efficient use of available resources. Such savings cover two major components:

a) Providing existing services at lower costs (through the introduction of information technologies, saving energy and costs for utilities following a more rational operational regime for institutions /recording systems /equipment replacement, etc.)

b) Strategic rationalization of non-efficient services or services not relevant for the implementation of policy objectives (reorganization of institutional structures and staff downsizing, streamlining the system of social benefits, etc.)

77. *The requirement for a more efficient use of resources is particularly highlighted during the preparation of the MTEF for 2008-2010,* with preliminary cost thresholds assuming savings of about 2-3% on the existing resources by sectors. At the same time, public authorities were urged to review the structure of existing cost programs by sectors so as to identify actions to support the savings commitments. These savings are to be used for funding new policy priorities for the relevant sector.

78. Even though public authorities have done little to analyze the efficiency of existing cost programs, a review of public funds management⁶ has shown that *there are still potential reserves for improving the quality of public services within the existing budgets.* This is also confirmed by money balances left unused at the end of reporting periods. Box 4 below shows a number of examples of inefficient use of resources by sectors.

⁶ Report on review of public finance management, produced by the World Bank in 2006.

Box 4. Examples of inefficient use of resources

- ✓ **Education:** Big improvements have to be made with respect to classroom occupancy and use of institutional capacities of schools, particularly in rural areas. The average size of a classroom varies tremendously across schools: from 1-5 pupils in primary schools (particularly in rural areas) to 15-20 pupils in a small rural gymnasium, to over 25 in an urban high school. Thus, the ratio pupils /teachers varies greatly across institutions, where schools with small classrooms involve the largest costs.
- ✓ **Social protection:** Most social benefits are allocated based on categories without accounting for the income or wealth of the beneficiary. This makes the system of social assistance highly inefficient when the state often supports beneficiaries who are not the poorest.
- ✓ **Agriculture:** Resources are allocated mostly for subsidizing specific products, which produces a short-term effect and does not contribute to overall sector development. It is necessary to reallocate expenditures toward enhancing the productivity and competitiveness as well as for developing the marketing infrastructure.

79. Two key aspects should be considered in the planning of next budgets:

- Ø *Defining a limited number of priorities,* - additional resources available over the medium term shall concentrate on achieving these limited priorities;
- Ø *Identifying potential reserves for making the programs of expenditures more efficient within the existing budgets* - money saved shall be used to finance fully or partially new reform initiatives in the sectors and improve the quality of services.

Table 6.1 Staffing costs – comparison across countries

	% in total non interest expenditure	% in GDP
Moldova	24,0%	9,6%
Albania	27,6%	6,8%
Romania	21,7%	6,9%
Bulgaria	17,1%	6,5%
Letonia	25,6%	8,8%
Slovakia	20,0%	7,2%
Slovenia	25,5%	11,8%
Ukraine	25,2%	9,6%

Source: IMF Statistics on Government public finance, 2005

6.3 Public sector wages

80. During 2004-2007, staffing costs⁷ in the public sector have grown circa 1,8 times, reaching a relatively high level compared with other countries, both as a % of public budget expenditures and as a share in the GDP. A comparative analysis across countries is presented in table 6.1.

81. In spite of this significant increase over the past years, the average public sector salary remains low - 1440 MDL in 2006. Given the existing number of public sector workers, a full implementation of the salary norms as defined in the Law on public sector wages would involve considerable costs and would require a further significant increase of such expenditures. Therefore, to avoid any distortions among cost categories, i.e. wages vs.

⁷ Covers wages, social security and health insurance.

operational and capital costs, the *MTEF for 2008-2010 keeps the staffing costs at an average of 9,6% of GDP*. This trend is shown in table 6.2.

Table 6.2 Staffing costs, 2004-2010

	executed			apoved	medium term forecast		
	2004	2005	2006	2007	2008	2009	2010
Personnel expences in NPB, mil.Mdl	2507,1	3000,6	4182,5	4433	5405	5957,4	6460
Share in GDP, %	7,8	8,0	9,5	9,5	9,7	9,6	9,6
Share in total expenditure of NBP, %	22,3	21,5	23,3	22,6	23,3	23,5	23,8
Average monthly salary, lei	828,3	992,5	1440	1614,0	2038,0	2330,0	2521,0
Average annual growth, %		19,8%	45,1%	12,1%	26,3%	14,3%	8,2%

Note: Average monthly salary for 2007-2010 it is forecasted taking into account optimization of personnel expences by 5%.

82. Public sector policy on wages in 2008–2010 shall focus on:

- Ø Further gradual implementation of the Law # 355-XVI dated 23 December 2005 *On Public Sector Wages*;
- Ø Developing a new motivation system for civil servants, as per the *Strategy for Reforming the Central Public Administration*;
- Ø Revising the salary system for the military and command staff of the national army, national security and public order bodies.

83. Streamlining the payroll structure is a precondition for the full implementation of salary norms as stipulated by the law. To assure a more uniform distribution of funds, as needed to increase public sector wages during 2008-2010 and, considering the possibility of adjusting the implementation terms for certain salary norms based on available resources, we developed several scenarios for the implementation of the above law with different implementation time frames. The scenario considered for the MTEF 2008-2010 stipulates the allocation of 2531,1 million MDL for this purpose, including budgetary allocations of 2050,1 million MDL or 81 %. The remaining 481 million MDL shall be covered from savings on wage bill and optimization and streamlining of payroll in the public sector.

Table 6.3 presents the costs for implementing the law vs. available resources. Estimates show that a 5% optimization of salary' and payroll' costs during 2008-2010 would produce an increase in the monthly salary, which by the end of 2009 shall reach the level of 2521 MDL, i.e. 3 times the salary level in 2004. Thus, objective to triple increase of public wages, stipulated in the Government's Action Program for 2005-

Table 6.3 Expenditures for wage increases during 2007-2010 mil. MDL

Years	Additional resources needed	Maximum budget allocation foreseen in MTEF	Economy from optimization of payroll
2007	338,1	338,1	-
2008	801,2	662	139,2
2009	606,2	550	56,2
2010	785,6	500	285,6
Total	2531,1	2050,1	481

2009, could be achieved by the end of 2009, with the condition personnel expenditure optimization.

84. *The current reform of central public administration addresses the rationalization of structures and payroll numbers.* The functional review however, currently covers only central public administration which is just a small part of the public sector. Therefore, the employment and payroll reform should cover in the future the whole public sector, including sectors like: education, culture, healthcare, national defense, public order and national security. Over the past years the number of employees in these sectors has increased even though the number of beneficiaries of these services is declining. Moreover, there are cases when human resources are not used efficiently, according to some analyses. Take education as an example where the ratio pupils/teachers and administrative staff /teachers is growing. Public authorities should therefore take actions to revise and rationalize the structures and payroll.

6.4 Capital investments

85. *Expenditures for capital investments tend to increase⁸, which shows that the state is giving high priority to investments.* Capital investments in 2006 from domestic and external sources were approximately 1,3 billion MDL, i.e. 3 % of the GDP. This level, however, is deemed relatively low compared with other relevant countries where this indicator varies from 2 to 6 % of the GDP.

86. *Investments will remain a priority in the future.* Considering the importance of investments for economic development, the MTEF for 2008-2010 seeks to avoid a decline in the existing level of internal investments as a share of the GDP, i.e. preserve the current level in real terms. Thus, during 2007-2010 total allocations from the state budget for capital investments will grow approximately 1,5 times. Recent trends and projections for capital investments are shown in Table 6.4.

Table 6.4 Recent trends and projection of capital investments from the state budget, 2004-2010
Million MDL

	executed			estimated 2007	medium term forecast		
	2004	2005	2006		2008	2009	2010
Capital investment, total	230	749	952	938	1.286	1.276	1.368
<i>Share in GDP, %</i>	1	2	2	2	2	2	2
<i>Pondereea in cheltuielile BPN, %</i>	132	121	124	168	205	184	181
Financed from:							
internal sources	174	617	767	558	628	693	754
external sources	56	132	185	380	659	583	614

⁸Refers to capital investment in constructions.

87. *With support from the state budget, capital investments will grow from 558 million MDL in 2007 to about 754 million MDL in 2010 or by 35 %.* At the same time, capital investments from external sources⁹ are projected to sharply increase during 2007-2008 with a small decline in 2009-2010 due to the completion of some projects.

88. *High priority shall be given in the future to investments in developing the economic infrastructure¹⁰, which shall account for about 80% of sectoral investments.* During 2007-2010 capital investments are expected to grow for the rehabilitation of roads, water supply and sanitation (Diagram 6.1).

89. *During 2008-2010, comparing to 2007 there will be a significant increase of investments in healthcare,* as needed to complete the construction of healthcare facilities with strategic importance, and national defense in connection with the implementation of a housing program for the military. Table 6.5 presents a projection of capital investments by the main sectors.

Diagram 6.1 Capital investments in infrastructure

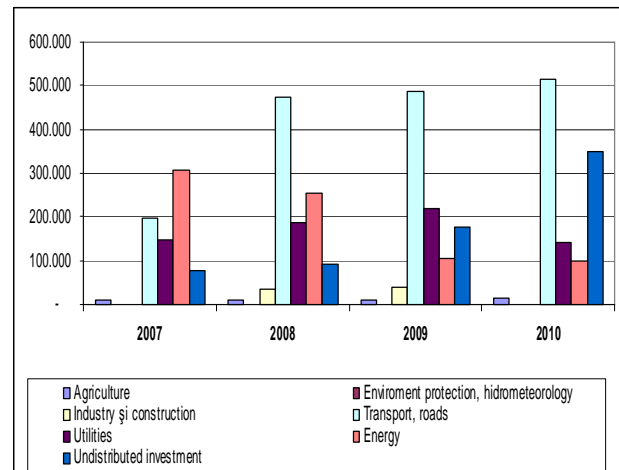


Table 6.5 Projection of capital investments from the state budget, by sectors, 2007-2010

	estimated			medium term forecast								
	2007			2008			2009			2010		
	Total	internal sources*	external sources**	Total	internal sources*	external sources**	Total	internal sources*	external sources**	Total	internal sources*	external sources**
Infrastructure	742,8	363,2	379,6	1.054,5	395,9	658,6	1.037,1	454,2	582,9	1.122,5	508,8	613,7
Education, culture and science	114,4	114,4	-	116,5	116,5	-	117,5	117,5	-	118,0	118,0	-
Health care and soacial assistance	19,2	19,2	-	27,0	27,0	-	28,1	28,1	-	29,2	29,2	-
State services and external activities	33,9	33,9	-	30,0	30,0	-	33,0	33,0	-	36,0	36,0	-
Defence and iurisdictions	26,9	26,9	-	58,1	58,1	-	60,2	60,2	-	62,3	62,3	-
Total	937,2	557,6	379,6	1.286,1	627,5	658,6	1.275,9	693,0	582,9	1.368,0	754,3	613,7

* Investments financed from state budget (base) expenditure

** sources from external sources include Government contribution

90. *During 2008-2010 a Regional Development Fund shall be created with proceeds for capital investments and within total expenditures therefrom.*

⁹ Including projects financed from external sources which are mostly capital investments. For example: water supply and sanitation, roads, Social Investment Fund.

¹⁰ Infrastructure includes agriculture, forestry and fishing, waters, environment and hydrometeorology; roads, information and communications technologies; utilities and housing, fuel and power facilities.

91. *The growing level of investments in Moldova will go together with a better management of such investments.* This implies the revision of existing procedures and definition of strict and transparent rules or criteria for the identification, selection, planning and financial approval of investment projects, as well as the implementation of certain judicial and institutional reforms regulating investments, as needed to unify the existing fragmented system of managing public investments from inside the country and abroad. The first step proposed in this direction is the improvement of decision-making mechanism on investment projects. This process shall be split in two phases: (i) pre-screening or project identification and (ii) project selection.

92. *As part of the current MTEF' preparation, we initiated a review as necessary to identify and select investment projects in two pilot sectors:* roads and water & sanitation, which, depending on their outcomes, could be replicated in other sectors. Preliminary conclusions of this review are presented in Box 5.

Box 5. Screening (identification) and selection of investment projects

This exercise was initiated in a bid to improve the decision-making process on investments and implement the World Bank' recommendations as outlined in the policy matrix for the Poverty Reduction Credit (PRSC). This initiative introduces pre-screening (pre-selection) which should be conducted at the initial phase of investment projects' identification and correlating project cycles with the annual budget cycle.

For the purpose of this exercise, a Project Identification Form (PIF) was developed and is to be used for the identification and screening of new projects in two pilot sectors: (i) water and sanitation and (ii) roads.

Information available about the two sectors at the level of the ministry, made it possible to fill out PIF for just 4 investment projects *dealing with roads* and 8 projects dealing with *water and sanitation*. Only two of the identified projects are new while the others are already under implementation with funding from the state budget. Following this exercise for the identification and prioritization of investment projects, one can underline the following conclusions:

- § Investment projects are proposed for financing on the basis of strategies and programs approved by the Government, as well as on Government decision regarding social and economic situation of ATU;
- § Line ministries have limited human capacities to evaluate projects and find it difficult to understand the concept of strategic planning for investments
- § The information presented is often limited or incomplete which makes it impossible to take decisions on project relevance or efficiency. .

6.5 Projection of expenditures by economic categories

93. In 2004-2006, there were significant increases in capital expenditures, payroll expenditures and transfers to the populace. This is mainly due to growing expenditures for investments, higher wages in the public sector and greater social protection of the populace. Recent trends and projections by economic categories are presented in Table 6.6 and figure 5.

Table 6.6 Public expenditures by economic categories, 2004-2010

	executed			approved 2007	medium term forecast		
	2004	2005	2006		2008	2009	2010
Expenditure, total	11252	13949	17973	19629,2	23216,3	25314,3	27196
Debt servicing	772,8	470,5	428,6	586,7	667,6	700,1	612,1
Net lending	-57,4	-45,2	-61,1	-59,2	-65,3	-71,8	-75,5
Discretionary expenditures, total	10537	13524	17605	19101,7	22614	24686	26659,4
from which							
Current expenditure	8924,4	11189	14088	16202,9	19392,7	21614,4	23722,6
Share in GDP	27,9	29,7	31,9	34,8	34,6	34,9	35,2
Personnel expenses	2507,1	3000,5	4182,5	4433	5405	5957,4	6460
Share in GDP	7,8	8,0	9,5	9,5	9,7	9,6	9,6
Goods and services	2485,1	2898,9	3634,5	4791,8	5769,7	6543	7069,1
Share in GDP	7,8	7,7	8,2	10,3	10,3	10,6	10,5
Transfers for production purposes	635,1	962,4	1042,9	961,2	947,7	969,7	1134,7
Share in GDP	2,0	2,6	2,4	2,1	1,7	1,6	1,7
Transfers to population	3091,7	4049,6	4892,3	5690	6912	7745,9	8649,4
Share in GDP	9,7	10,7	11,1	12,2	12,3	12,5	12,9
Other expenditure	205,4	277,9	335,5	326,9	358,3	398,4	409,4
Share in GDP	0,6	0,7	0,8	0,7	0,6	0,6	0,6
Capital expenditure	1612,5	2334,6	3517,6	2898,8	3221,3	3071,6	2936,8
Share in GDP	5,0	6,2	8,0	6,2	5,8	5,0	4,4

94. Greater emphasis shall be put over the coming years on optimizing payroll expenditures when these expenditures shall be capped at about 9,6 % of the GDP. This is because such payroll expenditures are already at a relatively high level. A further increase of payroll expenditures would distort the structure of public expenditures and constrain the growth of other expenditures – operational, running and capital costs.

95. Expenditures for goods and services will grow approximately 1,5 times, reaching the average annual level of 10 % of GDP. A significant growth in these expenditures starting with 2007 is due to higher healthcare costs under the mandatory medical insurance scheme and its relation with the state budget¹¹. Expenditures from the state budget shall be indexed to inflation as to avoid their decline in real terms.

96. Transfers to the populace will continue to grow significantly by about 1,5 times, over the next years, reaching the level of about 13% in 2010. This growth is mainly due to the target indexation or increase of social benefits, as needed to enhance social protection of the populace.

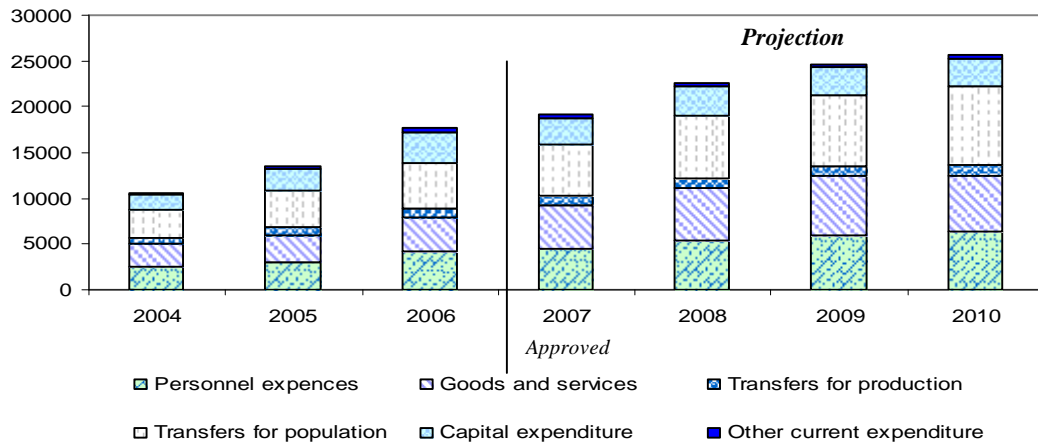
¹¹ Starting with 2007, transfers to the Funds for Health Insurance will be set at 12,1 % of the main expenditures of the state budget.

97. ***Projected capital expenditures will decline as a share of the GDP.*** This trend is influenced by two major factors: (i) in the estimation of external support for projects, we included only those grants and external credits where the agreements have already been signed or are at an advanced phase of negotiations and (ii) uncertainties in the projection of capital expenditures of administrative-territorial units since these expenditures are approved and executed under financial autonomy of local governments.

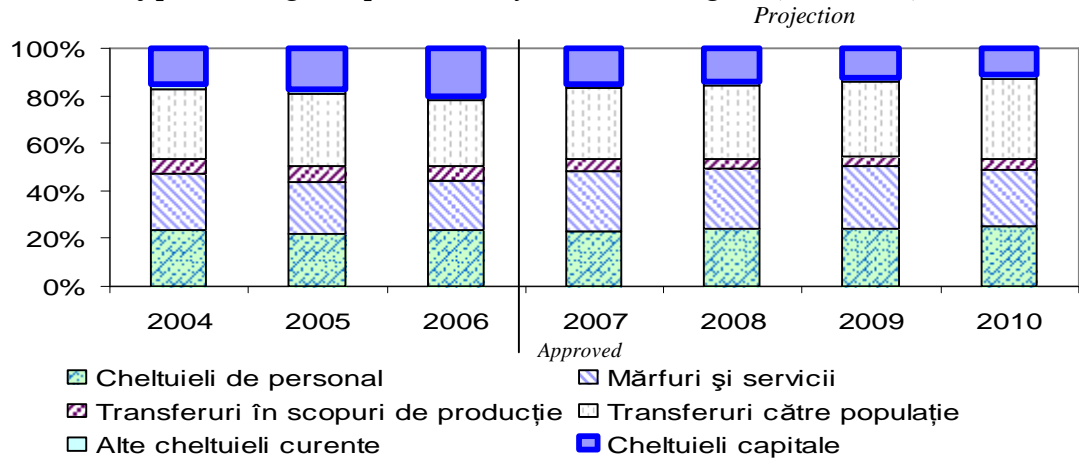
98. ***At the sectoral level there are significant deviations from the average level of expenditures by economic categories.*** Payroll expenditures in 2006 in areas like: education, public order and justice reached 60 %. Obviously this situation is specific to certain sectors but generally speaking, this shows an excess of personnel which affects the balance between payroll expenditures and other economic cost categories. ***Public authorities should, therefore, revise over the coming years the structure of expenditures and take measures to avoid a further distortion of budgetary structure.***

Figure 5. Public expenditures by economic categories

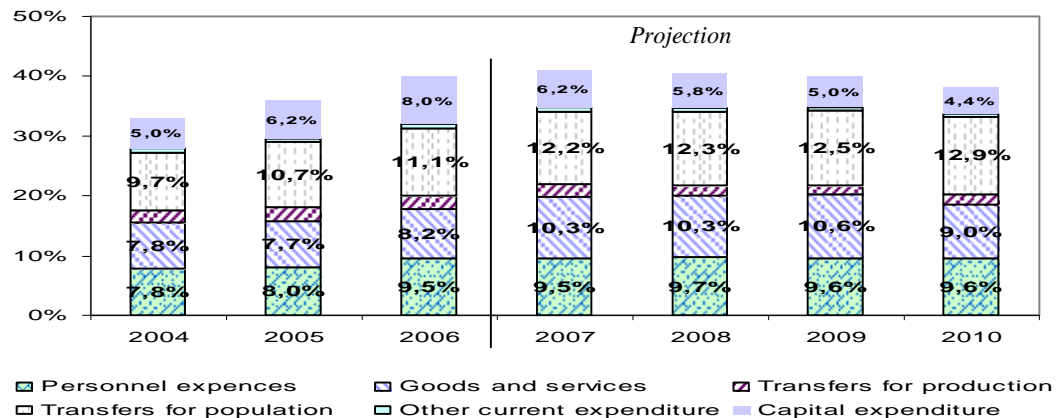
A. Evolution of public budget' expenditures by economic categories, million MDL, 2004-2010



B. Structure of public budget' expenditures by economic categories, % in total, 2004-2010



C. Evolution of public budget' expenditures by economic categories, % in GDP, 2004-2010



7. Sector Expenditure and Resource Allocation Priorities

7.1 Recent Trends

99. *The share of social insurance and assistance, agriculture, communal services and energy sectors has significantly increased in 2004-2006.* At the same time, the share of expenditures for general state services, public order, country defense and security in total expenditures has decreased. These trends reflect the prioritization of economic and social sectors in the past years, which have a major impact on economic growth and poverty reduction, and in compliance with Government priorities and strategies.

100. *Public expenditures for main function categories reflect to a great extent a similar structure of expenditures as in other countries of South –Eastern and Central Europe.* Table 7.1 below shows a comparative analysis to other countries. The most significant difference is in the rather high level of expenditures for education in Moldova. The figures in the table suggest that the increased efficiency of expenditures for education result in increased expenditures for other sector, in particular for economic infrastructure.

Table 7.1 Expenditures by sector – compared to other countries, % of GDP

	General government services and the judiciary	Country defense and public order	Economic activity	Health	Education	Social protection
Moldova	3,4%	2,7%	5,9%	4,7%	8,1%	11,6%
South-Eastern countries	2,6%	3,9%	4,8%	3,5%	3,8%	10,3%
Central Europe and Baltic countries	3,7%	3,3%	5,3%	5,3%	5,5%	14,6%

Notes:

(1) Data for Moldova are for 2006, for other countries – average for 2001-2004.

(2) South-European countries are Romania, Bulgaria and Albania.

(3) Central Europe and Baltic countries are Check Republic, Hungary, Latvia, Poland, Slovakia and Slovenia.

Source: MoF and the Statistical Yearbook of Government Financing of IMF, 2005.

7.2 Medium-Term Expenditure Sectorial Priorities

101. *The resource framework estimated for 2008-2010 provides for a limited annual increase of allocations to public expenditures* as follows - 3587 mil. lei, 2098 mil. lei and 1881.7 mil. lei, which reflects medium-term budget constraints. The same tendency is attested in the state budget (base component), which is estimated as 2375,8 mil. lei for 2008, 1246,9 mil. lei – 2009 and 1319,3 mil. lei 2010.

102. *Most of available resources, about 70%, were allocated for general and inter-sectorial priorities* (servicing public debt, increasing salaries for budget financed staff,

increasing capital investments, transfers for mitigation of financial imbalances between regions, adjusting expenditures to the level of consumer price index, etc).

103. In the next years resources will be allocated by sectors on the basis of the following criteria:

- Ø *Consistency with NDP priorities* – actions that, following assessment, would have a major contribution or impact on the achievement of NDP objectives will be mainly supported;
- Ø *Reserves for streamlining resource usage* – the findings of analytical studies on the efficiency and effectiveness of existing expenditure programs will be taken into consideration;
- Ø *Real terms decrease of expenditures* – expenditures for goods and services, social insurance pensions as well as other social benefits will be adjusted in compliance with current legislation.

Table 7.2 Public expenditures for main sectors, 2005-2010
mil.lei

	Executed			Approved	Forecast		
	2004	2005	2006	2007	2008	2009	2010
Expenditure, total	11252	13949	17974	19629,3	23216	25314	27196
from which							
General state services	748,2	919,6	1037,8	1153,5	1318,9	1404,8	1417,9
%in GDP	2,3	2,5	2,4	2,5	2,4	2,3	2,1
%in total	6,6	6,6	5,8	5,9	5,7	5,5	5,2
Public order, defence and national security	789,6	921,5	1206	1373,3	1450,7	1750	1867,3
%in GDP	2,5	2,5	2,7	3,0	2,6	2,8	2,8
%in total	7	6,6	6,7	7,0	6,2	6,9	6,9
Social expences	7034,6	8827,5	11360	12815,3	15615	17261	18836
%in GDP	22	24	25,8	27,5	27,9	27,9	28,0
%in total	62,5	63,3	63,2	65,3	67,3	68,2	69,3
Economic expences	1345,9	1964,5	2721,1	2444,1	2775	2689,8	2734,1
%in GDP	4,2	5,3	6,2	5,2	5,0	4,4	4,1
%in total	12	14,1	15,1	12,5	12,0	10,6	10,1
Other sectors	1334	1316,2	1648,8	1843,1	2057,1	2208,9	2341,2
%in GDP	4,1	3,7	3,7	3,9	3,6	3,5	3,4
%in total	11,9	9,4	9,2	9,4	8,9	8,7	8,6

104. The estimate of public expenditures per sector for the period 2008-2010 shows that social sector expenditures will continue to prevail representing about 2/3 of public expenditures.(table 7.2) On medium-term the share of social expenditures in total public expenditures will increase from 65,3% in 2007 to 69,3% in 2010. **Moreover, the highest increase of expenditures was recorded in the social sector.** In 2008 this category of expenditures will account for 78% of total

additional public resources. It will be mainly health expenditures – 28% more as compared to 2007 – that would increase due to extending the package of services provided through health insurance, followed by social protection expenditures – with about 21,3 percent, especially due to increasing expenditures financed by BASS. Expenditures for education, culture, arts, sports and youth are to increase with about 18 percent in 2008. ATUs obtained an augmentation of about 19 percent for 2008. ATUs budgets also secured a gain of 26,5 percent for general education programs for 2008. It is provided that expenditures for these sectors will increase in 2009-2010 as well, but slower, resulting from the additional amount

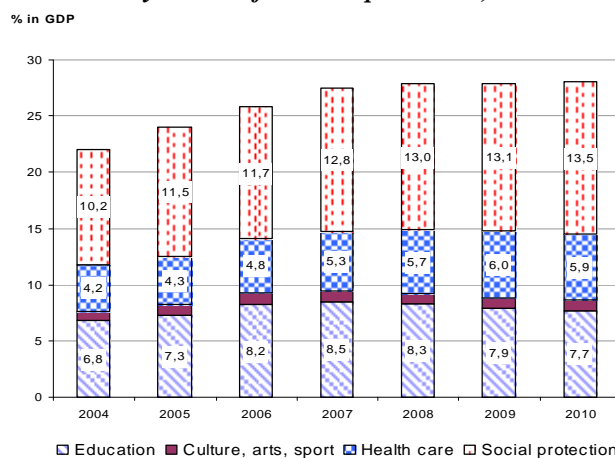
of resources estimated for these years. The evolution and structure of expenditures for social sectors is shown in chart 7.1.

105. These trends do not offer many possibilities of increasing other expenditures supporting economic growth. Therefore, *in the following years the new policy initiatives within social sectors will be mainly covered by re-distributing allocations within existing budgets.*

106. *General state service's expenditures over medium-term will increase by 23 percent in nominal terms.*

The reform agenda on public administration will continue to be implemented during the next years, which would add to improving the quality of governance in Moldova. A part of activities (elections, customs infrastructure development, etc.) will have financial implications, while other

Chart 7.1 The dynamics of social expenditures, 2004-2010



policy actions will be carried out with available resources. At the same time this expenditure will decrease as a share of GDP from 2.5 percent in 2007 to 2.1 percent in 2010. The same tendency will be shown as a share in total public expenditure.

107. *The nominal value of expenditures of the judiciary will increase, and the share of these expenditures in GDP will decrease* from 3 percent in 2007 to 2,8 percent in 2010. The financial support provided to this sector is mainly related to staff remuneration increase and public investments. New policy initiatives are to be financed by streamlining expenditures for this sector.

108. *Expenditure for science and innovations for 2008-2010 are forecasted at the level 0,5% of GDP.* Once the overall resource framework is revised, this expenditures will be revised annually to achive the level of 0,7% in GCP in 2008, 0.8% in 2009 and 0.9% in 2010.

109. *Economic sector expenditures will increase with 12 percent during the targeted period.* An increase of 13,5 percent is provided in 2008, especially, from the proceeds of allocations for road management which will be increased with 44,8%, as well as for the agricultural sector, which will be increased with 10,4% as compared to 2007. The external financing for the real sector branches will significantly increase and will be implemented predominantly through agricultural, water supply, road infrastructure etc. projects.

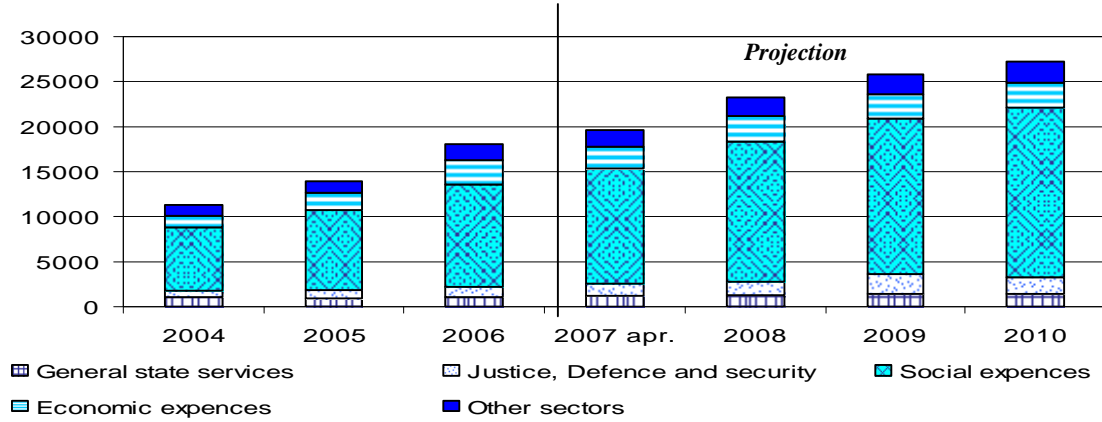
110. Expenditure ceilings for the state budget for 2008-2010 by sectors and public authorities are shown in annex 3. Ceilings include allstate budget resources. At the same time, sector and central public authorities's ceilings doesn't include additional allocation for salaries increase, which are reflected in a separate line.

111. The main policy actions defined for each branch determining the necessary changes and allocation of additional resources in 2008-2010 are presented in Annex 4 "Priority Reforms for the Major Sectors and Financial Implications for 2008-2010".

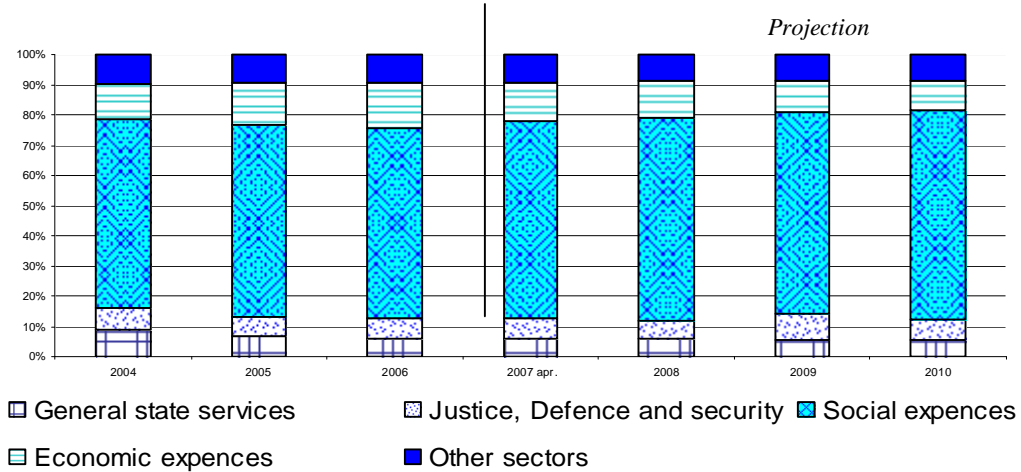
112. The strategic sector expenditure plans with distribution of allocations per programs in each branch are presented in Annexes 5-10.

Figure 6. Public expenditures by sectors

A. Evolution of public budget' expenditures, million MDL, 2004-2010



B. Structure of public budget' expenditures, % in total, 2004-2010



C. Evolution of public budget' expenditures, % in GDP, 2004-2010

