



Republic of Moldova
Ministry of Finance

***Medium-Term Expenditure Framework
for 2007-09***

Chisinau 2006

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Summary

The 2007-09 Medium Term Expenditures Framework (MTEF) provides a comprehensive macro fiscal framework for planning the National Public Budget for 2007. It also sets out the medium term forecast of the available resources to support the implementation of the Moldova's socio-economic development programmes.

Macroeconomic context

Strong economic growth, declining inflation, exchange rate stability.

The economic situation in recent years has been characterised by strong growth in Gross Domestic Product (GDP) of over 6% annually, falling inflation from 15,7% in 2003 to 10% in 2005 and relative stability of the national currency against the key foreign reference currencies.

In 2006 GDP is estimated to rise to Mdl 43 billion, a real increase from 6,5% compared to 2005. The annual average inflation rate is projected at 9,9% and the average exchange rate at Mdl 12.9 per US\$. The average monthly salary in the domestic economy is estimated to Mdl 1650 in 2006 representing an increase of 14% compared to the previous year.

For the period of 2007-09 real GDP is projected to increase by 6% annually, driven by growth in the service sectors and industrial production and agricultural output. Inflation is forecast to continue to fall to 7% in 2009, while the recent stability in the exchange rate is expected to be sustained. The monthly average salary in economy is projected to increase by 12% annually in real terms, to Mdl 2860 in 2009.

Public Revenues

Tax equity, sustainability and transparency

Tax policy

During 2007-09 tax policy objectives will emphasise equity, sustainability and fiscal transparency, as well optimisation of the tax burden and extension of the tax base. The following policy measures will be implemented:

- § A reduction in the income tax rates on individuals, involving modification of the structure and annual taxation thresholds starting in 2008. The first two thresholds will be replaced by a single threshold covering annual taxable income up to Mdl 21000 lei to be taxed at a 7%, with taxable income over Mdl 21000 lei taxed at 20%;
- § An increase of the annual personal exemption, from Mld 4500 in 2006 to Mdl 5400 in 2007, Mld 6300 in 2008 and Mdl 7200 lei in 2009;

- § An increase of the annual exemption for dependents, from Mdl 840 in 2006 to Mdl 1440 lei 2007, Mdl 1560 in 2008 and Mdl 1680 in 2009
- § A progressive redistribution of State Social Insurance Fund (SSIF) contributions involving a reduction of 1% annually in employer contributions with a corresponding increase in employee contributions. In 2009 the rates will be 23% for the employer and 6% for the employee against 26% and 3% set in 2006;
- § To increase mandatory health insurance fund (MHIF) contribution from 4% in 2006 to 5% in 2007, 2,5% for the employer and 2,5% for the employee, by examining the opportunity of increasing it during 2008 and 2009;
- § To maintain the rate of income tax for the legal entities at the current level of 15%.
- § To provide additional investment incentives for private enterprise through adjustments to the list of expenditures that may be offset against income tax (interest payments, deductible expenditures, royalty payments etc.);
- § To maintain the current VAT rate and adjust the list of goods and services on which VAT is charged at 0%. From 2007 the 0% VAT rate on construction of residential apartments will be cancelled.
- § Adjustment of the excise rates to take account of inflation rate and an increase the rates for the alcoholic drinks with an alcohol content of over 25%;
- § Progressive implementation of the new taxation system for the different categories of real estate based on market value. In 2008 it is planned to apply the new taxation system to residential accommodation in municipalities and cities including localities under their subordination;
- § Application of Title IX of the Fiscal Code on “Road Taxes” starting in 2007; Development in 2007 of Title X of the Fiscal Code on “Social Taxes”. This will regulate the application of taxes in the form of SSIF contribution and mandatory medical insurance contribution which are required to be paid by the Employer and Employee.

Tax administration

The main **Tax Administration Policy Objectives for 2007-09** are: (i) to improve tax compliance; (ii) to increase the efficiency of control procedures and coordinate control activities; (iii) computerisation of tax procedures; (iv) improvement of tax administration mechanisms (lump sum taxpayers); and (v) extending the range of tax consultancy services.

Revenue Forecast

Budget revenues will increase as a result of economic growth

Recent trends in public revenues show a significant increase from 34% as a share of GDP in 2003 to 39,0% in 2005. This growth has been driven by the strong an economic growth that has been achieved in recent years, increased foreign trade, pay increases, as well as improvements in tax administration.

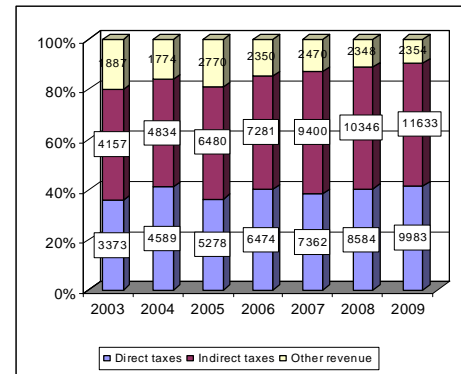
Total revenues of the National Public Budget are estimated to grow from Mdl 16,6 billion in 2006 to Mdl 24 billion in 2009, or by 15 % annually

Tax revenues will remain the main source of the public revenues increasing from 85,8% of total revenues in 2006 to about 90% in 2009 (Chart A) Revenues from direct taxes are projected to increase by around 59% in nominal terms primarily generated by increased collections of MHIF and SSIF contributions. GDP and import growth will lead to a significant increase of the non direct taxes, especially of those deriving from foreign trade and VAT.

During 2007-09 non tax revenues as well as special means and special funds revenues will remain at the estimated level for 2006, in nominal terms.

The approval of the Memorandum on Economic and Financial Policies between Moldova and IMF will lead to increased financing of the budget from external donors.

Diagram A. Public revenue structure, 2003-09.



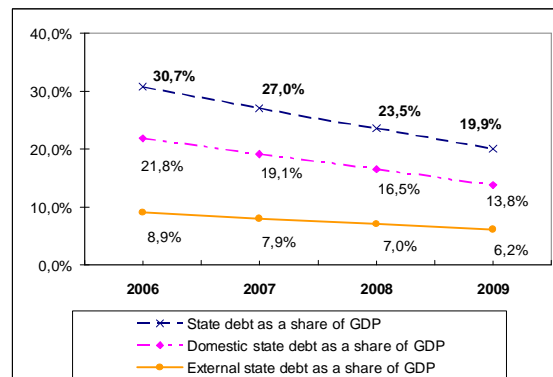
Government debt and the financing sources

State debt service will continue to decrease as a share of GDP

The level of public debt in Moldova has fallen from 57% of GDP in 2002 to 33,2% at the end of 2005. In the coming years this trend will be maintained, with public debt falling to 20% of GDP in 2009 (Chart B).

The State Debt forecasts take account of the macroeconomic projections, the expected agreement on bilateral debt restructuring through the Paris Club of creditors, and assumptions and forecasts on financing levels from external and domestic sources.

Graf B. State debt dynamics as a share of GDP, 2006-09



State external debt, which in 2006 amounts 71% in the total debt, will decline from US\$ 720,2 million at the end of 2006 (Mdl 9362,6 million) to US\$ 685,8 million (Mdl 8709.7 million) at the end of 2009. Domestic debt is projected to

increase from Mdl 3848,3 at the end of 2006 up to Mdl 3911,9 million at the end of 2009.

State Debt payments during the period 2006-09 will average around Mdl 1,3 billion annually, although the debt burden measured against State Budget tax revenues will fall from 17% in 2006 to 11% at the end of 2009.

Projections of government borrowing are based on maintaining the budget deficit at 0,8% of GDP in 2006 falling to 0,5% in 2007-09, assuming the restructuring the external State Debt through the Paris Club.

During 2006-09 it is expected that the Government will benefit from external grants and credits for investment project financing and budget support totalling US\$ 188,9 million. This is less than the repayments of external debt estimated at US\$ 249,9 million. New external borrowing will be targeted exclusively for investment projects.

The medium term State Debt Policy (2006-09) provides for the implementation of measures aimed at maintaining sustainable debt levels and providing necessary resources to cover the budget deficit and reduce the costs of debt servicing. The policy aims to reduce further the debt service burden, and to target new borrowing under more favourable conditions for investment purposes.

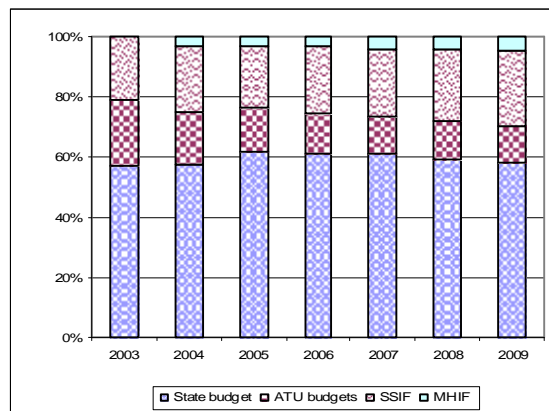
Medium-Term Fiscal Framework

Public revenues

SSIF and MHIF revenues will grow faster than revenues

Total revenues of the National Public Budget are estimated to increase from Mdl 16,6 billion in 2006 to Mdl 24 billion in 2009, thus registering a slight decrease from 38,5% to 37,9% of GDP. The State and Administrative Territorial Unit (ATU) Budgets account for the major share in total public revenue, about 74,5% in 2006 (estimated). However, MHIF revenues will continue to increase more rapidly and by 2009 will be doubled in nominal terms against the 2006 (estimated). The SSIF revenues will grow by 63 %, whereas the state budget' and ATU budget's revenues will have a slower increase, registering an increase by 38 % and 30%, respectively. (Chart C).

Diagram C. Public revenue by components, 2003-09



Public expenditure

Public expenditure will increase at an average rate of by 15% annually in nominal terms, reaching Mdl 23,9 billion in 2009. The annual growth in expenditure will

slow in the outer years, registering a slight decrease from 39,3% of GDP 2006 to 37,7% in 2009.

Expenditure under the MHIF and SSIF is projected to increase in nominal terms by 73% and by 57%, respectively, between 2006 and 2009.

The level of transfers from the State Budget to other budgets will increased by 38% from Mdl 2683,9 million in 2006 to Mdl 3698 million in 2009. Transfers from the State Budget to the MHIF will increase by 58% and to the SSIF by 40%.

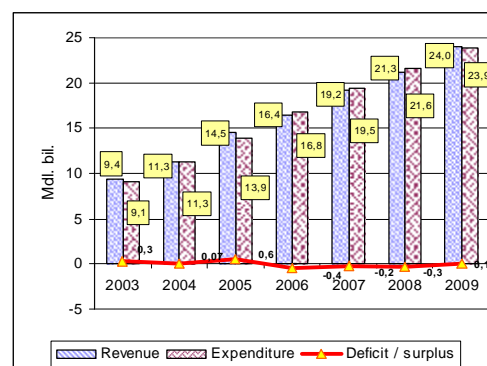
Global fiscal balance

Budget deficit will not exceed 0,5 % as a share of GDP

Taking into account the available sources of financing and the possibilities for restructuring State Debt under the Paris Club, the global fiscal balance is projected to move from a deficit of 0.5% of GDP in 2006 to a surplus of 0.2% of GDP in 2009 (Chart D).

The Budget surplus reflects the limited access to sources of concessional financing as well as the need to honour the commitments related to servicing and repayment external and domestic debt from the tax revenues account.

Diagram D. Global financial framework, 2003-09



Risk factors

The main risk factors that could have a negative impact on the medium-term fiscal framework are:

- § The increasing balance of payments deficit, which projected to rise by up to 50% as a share of GDP could generate problems related to external account sustainability.
- § The ban imposed by Russian Federation on the export of wine. If continued this will slow the level export activity in general and especially of wine and associated products.
- § Thee upward trend in world prices for oil and uncertainty in the international oil market which could impact negatively on economic growth and government revenues while generating additional expenditure demands in the budget sector.
- § Volatility in foreign currency inflows, particularly remittances, which could lead to exchange rate volatility while impacting significantly on budget revenues and expenditures.

Continuation of sound macroeconomic policies backed up by tight revenue and expenditure management and control over the budget deficit should help to reduce the negative economic and budgetary impacts of such risks.

Public expenditures policy for 2007-09

Public expenditures policy objectives for 2007-09

The main objectives relating to the public expenditure programme are as follows:

- § Restructuring of public expenditures to support improvements in the quality of public services and a gradual growth in public infrastructure investment.
- § Ensuring that the distribution of public resources between sectors and among programmes within sectors is consistent with the Government's overall policy framework priorities.
- § Supporting the implementation of public administration reforms involving the reorganisation of government ministries and public services and maintaining public employment at a reasonable level.

Wagebill reform in the public sector will remain a priority for the medium term

Expenditure priorities for 2007-09 are focused on achieving the socio-economic development objectives identified in the Government's main strategies and development programmes, including the Economic Growth and Poverty Reduction Strategy, the Government's Programme of Activities, and other national programmes.

Key factors impacting on the inter-sectoral expenditures priorities for 2007-09 include:

- § Gradual implementation (2006-10) of wage bill reform in the public sector.
- § Indexation of goods and services expenditures for general inflation and to adjust for oil price increases.
- § A gradual increase in allocations for public infrastructure investment needed to support and sustain economic development. During 2007-09 about 55% of capital investments will be targeted to the economic sectors.

The high costs related to the implementation of pay reform in the budgetary sector will utilise a considerable share of the available additional resources and will limit the scope for increasing spending in other areas, particularly public investment.

Sectoral expenditures

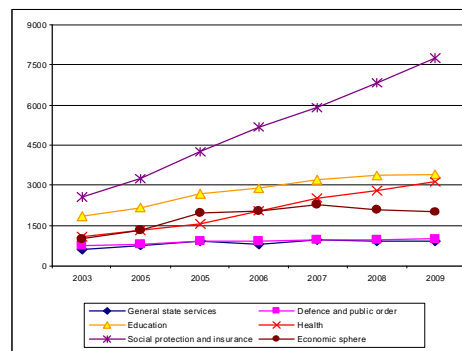
Social sectors will benefit from rapid increases in spending levels.

The forecast of Public expenditure for the main sectors (excluding the salary increase) for 2007-09 is presented in Chart E. The major increase in spending over this period will occur in the social sectors.

Expenditures in the health sector are expected to increase, due to the wider range of services that will be provided under medical insurance. Spending on social insurance and social assistance is also expected to increase rapidly.

A considerable increase in expenditure, of around 180%, is planned for science and technology, with spending reaching 0,7% of GDP by 2009.

Graph E. Public expenditure by sectors, 2005-09



Expenditures in the economic sectors are estimated to rise by 12% in 2007, with increased spending on agriculture, transportation and road management. In 2008-09 expenditures in these sectors will register a slight decrease as a result of completion of some externally funded projects. This decrease also reflects uncertainties over securing of additional external financing for new infrastructure projects.

The 2007-09 expenditure ceilings for the sectoral and central public authorities will serve as initial limits for budget planning for 2007 and provide indicative allocations for spending in 2008 and 2009.

Expenditures by economic categories

Discretionary expenditure comprises total expenditures less the State Debt service and net lending operations. It covers government spending on public services, public investment and social entitlement programmes. Current expenditures will continue to account for around 90% of total discretionary expenditure (Chart F).

Additional resources will be targeted for infrastructure investment.

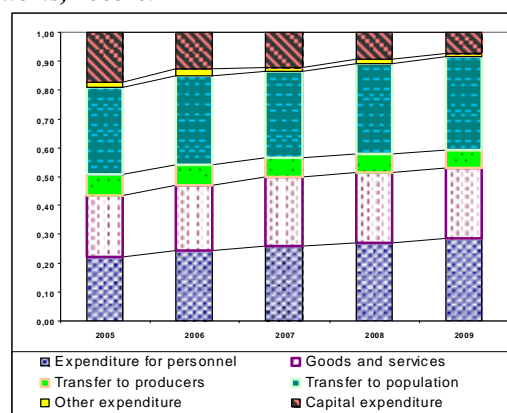
During 2005-09 public spending on salaries and related expenditure, transfers to the population and goods and services is projected to double in nominal terms and increase both as a share of total discretionary spending and of GDP.

About half out of the growth in expenditure on goods and services is attributable to increased spending on medical services provided under mandatory medical assistance insurance fund.

During 2007-09 the scope for increasing capital spending will be constrained by the costs of implementing pay reform as well as by uncertainty over external funding of some new investment projects. It is estimated that capital investment under the State and ATU Budgets will average Mdl 640 million annually.

However, it is expected that capital spending in the outer years will be significantly higher than the levels projected in the 2007-09 MTEF as additional external financing becomes available following signature with the IMF of the Memorandum on Economic and Financial policy. Additionally, the MTEF forecasts represent a relatively cautious revenue scenario and to the extent that additional revenues may become available to the State and ATU Budgets these will directed towards increasing capital investment spending.

Diagram F. Public expenditure by economic items, 2005-09



ATU Budgets and the relationship with the State Budget

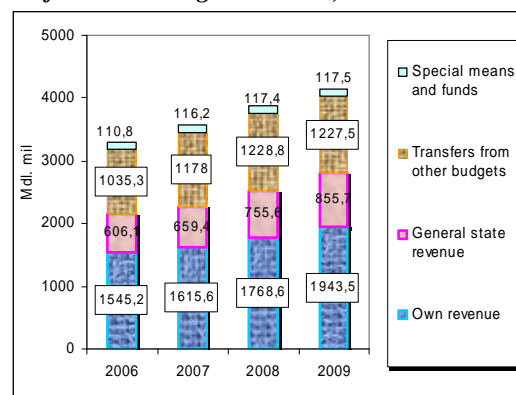
The level of ATU Budget expenditures covered by revenues will increase

ATU revenues and expenditures

In 2005 total nominal revenues of ATU Budgets, including transfers, increased by 27%, representing about 10% of GDP or 25% in total budgetary revenues.

Over the medium-term ATU Budget revenues are expected to increase by 26% in nominal value from Mdl 3297,4 million in 2006 to Mdl 4144,2 million in 2009. The growth will be covered mainly from own revenues and shared state revenues account (Chart G).

Graf G. ATU budgets revenue, 2006-09



Expenditure under the ATU Budgets is projected to increase by 25% in 2009 compared with the 2006.

However, these forecasts do not include the funds needed for the implementation of salary reform in the public sector, or expenditure on capital investment that is funded from the State Budget. Taking into account that a considerable element of such expenditure is managed locally, the real level of expenditure under the ATU Budgets will significantly exceed the level forecast in the MTEF.

The level of ATU Budget expenditures covered by revenues (without transfers and transferred means) shows a positive trend, growing from 57% in 2005 to 70% in 2009. However, the tax base of the ATUs remains below the level required to cover all expenditure requirements.

Inter-governmental financing

Inter-governmental financing cover the transfers from the state general revenues and the amounts transferred from the territorial financial support fund for the ATU Budgets.

During 2007-09 it is planned that the share transferred from the state general revenues will remain at the level of the 2006. Over the same period the level of transfers from the territorial support fund will increase from Mdl 994 million in 2006 to Mdl 1153,9 million in 2009, amounting to 28% of the total ATU Budgets.

Transfers from the State Budget to the ATU Budgets are determined by: (i) policy priorities identified for the given sectors; (ii) data from the National Bureau of Statistics on population and demographic structure; and (iii) expenditures norms. Expenditures norms are sector specific, being influenced by sectoral policies and priorities. The greatest increases in norms are expected to occur in education and culture.

*MTEF – an
element of the
Public
Finance
Management
Reform*

Strong public financial management represents one of the core pillars of a sustainable budget system. In the context of a wider public finance management reform agenda, the Government will take further steps to develop the MTEF process as a strategic tool of budget development. These will focus on: (i) further macro-fiscal forecasting capacity building, (ii) extending strategic approaches in budget planning to additional sectors and also to ATUs following the pilot exercises in four sectors and three rayons; (iii) building the analytical and strategic planning capacities of the public authorities; (iv) adopting a more strategic approach to setting expenditure ceilings for budget planning; and (v) implementing a communications strategy for the MTEF and annual budget.

The Government will also strengthen the mechanisms for better targeting of the financial resources towards EGPRSP objectives and priorities.

All the above measures are intended to encourage the achievement of the key MTEF objectives which are: (i) to ensure greater consistency between the budgetary forecasts and a sustainable macroeconomic and fiscal framework; and (ii) to develop a policy-led budget planning process that ensures better links between government policies and medium-term and resource allocations.

Introduction

MTEF 2007-09 Overview

1. The Medium Term Expenditure Framework (MTEF) is an analytical and rolling three year financial forecast paper, setting out the general fiscal characteristics and a strategic framework for the development of National Public Budget for the next year and the estimation of the latter one in the medium run. The 2007-09 MTEF provides an update of the previous MTEF forecast (2006-08) that was approved through a Government Decree no.1079, dated October 19th, 2005, and rolls forward the respective review and framework to include 2009.

2. The baseline for the MTEF estimates as well as the resource allocation proposals are the updated policies and fiscal and macroeconomic framework, State Debt objectives and the general policy frameworks guiding the allocation of resources. These frameworks comprises the Economic Growth and Poverty Reduction Strategy Paper (EGPRSP), the Government Activity Program for 2005-09 “Upgrading of the country is the well-being of people”, Republic of Moldova – EU Action Plan, and other national programmes.

3. The MTEF framework, as well as the additional costs of implementing the new salary system for the public sector, as approved by the Parliament in December 2005, emphasise the limited financing opportunities for new policy initiatives over the medium term. That is why the public expenditure policy for 2007-09 emphasizes the need to streamline the efficiency in the use of existing resources, and the importance of shifting the allocations from the least priority programmes towards the programmes with a greater impact on economic growth and poverty reduction.

4. One of the key goals when preparing the MTEF was to improve the link between resource allocation priorities and government’s policy priorities, specifically those set out in the EGPRSP. Considerable efforts have been made during the current year to sort this issue out, yet a review done and the experience to date show that there is need for improved mechanisms to be put in place and procedures applied, and for these to be implemented within a specific timeframe. It is planned to develop and implement a budget program classification in the coming years, which will contribute to a more strategic allocation of available resources and will provide for better monitoring of allocated resources in terms of their efficiency and effectiveness.

5. In preparing the 2007-09MTEF, a stronger emphasis was given to the review of sector-wide expenditure plans. In determining the allocations of public resources sector-wide policy priorities, as set out in the EGPRSP and other strategic papers, were emphasised in determining the allocation of public resources. This was backed by a more in-depth review of expenditure plans and priorities in four sectors –education, health care, social protection, and agriculture.

6. Considering the importance of public investment for economic growth, this aspect of public expenditure was subject to a more thorough review in the preparation of the 2007-09 MTEF¹. The review identified a number of shortcomings and areas requiring improvements in public investment management, and highlighted the need to give higher priority to investment in infrastructure.

Structure of the paper 7. The structure of the 2007-09 MTEF consists of the main text, annexes, and technical notes. The main text includes the following: (i) macroeconomic context and development opportunities; (ii) tax administration and tax policy goals and trends in public revenues; (iii) sources of budget financing and government debt management; (iv) medium-term fiscal framework for the National Public Budget and risk assessment; (v) public expenditure policy and priorities, and resource allocation by sector; (vi) ATU budgets and their relationship with the State Budget.

8. The detailed supporting tables, as well as spending ceilings for budget users are included as annexes to the main document. Technical notes provide more thorough reviews of key budget issues, conducted for the purpose of supporting 2007-09 MTEF conclusions. These include: the review of expenditure priorities by sector; strategic expenditure plans for the four pilot sectors (education, health care, social protection, and agriculture); an assessment of fiscal policy measures and their impact; an updated version of the technical notes on the review of employment and staffing costs within the public sector, as well as analysis of public investment trends and medium-term priorities.

¹ Technical notes on the current situation in public investments and medium-term priorities are annexed to the given paper.

Chapter I. Macroeconomic Context

A. World Economy in 2005 and Medium-Term Opportunities

Worldwide Trends 9. The world economy showed weaker growth in 2005, which slipped to 4.3% from 5.1% in the previous year. The slowing in growth started during the second quarter of 2005, caused to a great extent by the increase in the price of oil. The main sources driving the worldwide economic growth were the economies of China (with economic growth of 9.9%) and the USA (3.5%), whereas the pace of economic growth reported in the EU countries (EU 25) was quite modest (1.6%). Table I.1 shows the pace of growth in the GDP and the rate of inflation for a number of countries, as reported in 2005.

Table I.1 The pace of growth in the Gross Domestic Product, and the Rate of Inflation in 2005.

	GDP,%	Rate of Inflation (annual),%
U.S.A.	3.5	3.4
China	9.9	1.8
India	7.6	4.6
EU 25	1.6	2.2
Romania	5.2	9.0
Russia	6.4	10.9
Ukraine	2.4	10.3

10. The medium-term forecasts for worldwide economic growth are quite stable at about 4.4% annually over the medium-term. This growth will be determined, to a great extent, by the economic growth of the USA (2-3% growth annually), as well as by high levels of growth expected in China (around 8%) and India (around 6%), driven by thriving domestic and foreign trade, mostly due to considerable demand from the USA. Economic growth of about 2.5% is foreseen in the EU over the medium term.

11. The CIS reported growth of 8.4% in 2004, which slowed in 2005 down to 6%. Annual growth in CIS over the medium term is forecast at 5-6%, driven by the energy exports, increased foreign investment, and ongoing development of local consumer markets.

12. Romania, another key commercial partner of Moldova, recorded economic growth of 5.2% in 2005 with medium-term forecasts for average economic growth of about 6% a year.

B. Recent Economic Trends in Moldova

13. The evolution of macroeconomic indicators in Moldova through 2003-05 showed continued macroeconomic stability and the sustained growth in the GDP, both critical objectives for the Government in the context of poverty reduction and achieving better living standards for the population at large.

14. During this period, the economy has shown an increasing growth, alongside a reduction in the level of inflation, and relative stability of the national currency exchange rate against the key reference currencies. In particular:

Recent trends in the economy of Moldova

- GDP in constant prices increased at an average rate of 7% annually.
- The annual rate of inflation dropped from 15.7% in 2003 to 10% in 2005;
- The average annual exchange rate of Mdl to the US\$ appreciated by 9% through 2003-05, averaging Mdl 12.6 in 2005.

15. The restoration of economic growth has had a positive impact on the real sector. Industrial output grew by over 6% a year. Agricultural output was subject to significant fluctuations, with growth of 1% recorded in 2005.

16. The share of the services sector increased to about 54% of GDP in 2005. The significant increase in this sector was determined, to a great extent, by the increase in the purchasing power of the population.

17. The increase in net taxes on production and imports contributed towards the increase in the revenues in 2005 which grew by approximately 22.5% compared with the previous year. Taxes on imported goods account for the biggest share of this growth (around two-thirds of the total amount). Thus the main factor driving the increase in tax revenues was the significant growth of the volume of imports rather than the increase in production related tax revenues.

18. The export of goods and services² increased by 44% in 2005 compared with 2003. This growth has been sustained by the diversification of export destinations from the CIS to other regions of the world. The import of goods and services increased by 58% during this timeframe. As a result of this uneven growth, the trade balance deficit increased by 1.8 times, accounting for US\$ 1,211 million in 2005, or about 41% of GDP. The current account reported a deficit of 9.8% of GDP in 2005, with income surplus and unilateral transfers covering 76% of the trade balance deficit.

19. The average monthly wage in the national economy increased by 18% in 2005, whereas the average pension entitlement increased by approximately 48%.

C. Updating of Macroeconomic Indicators for 2006

20. The baseline forecasts for 2006 used when developing the MTEF for 2006-08 and the budget for 2006 provided for an average yearly rate of inflation of 10%, an average exchange rate of the national currency of Mdl 12.6 to the US\$, and real growth in GDP of 6.5%.

21. The subsequent updating of macroeconomic framework revealed the need to adjust for several indicators. That is:

² According to the NBM data (Moldova's payment balance for 2005)

- Although there will be a 6.5% growth in GDP, nominal GDP will increase to Mdl 43 billion compared with Mdl 44.2 billion previously anticipated. The economic growth will further be stimulated by:
 - § rising industrial output of 6.5% in real value compared with 10% initially projected;
 - § rising farm output of 1% compared with the baseline forecasts of 3%;
 - § growth in exports of 15% and import of 23% compared with 13% and 12% previously estimated. Thus, the trade balance deficit will go up by 30% compared with the earlier forecast of 11%.
- Average annual rate of inflation estimated at 9.9%;
- Gradual depreciation in the Mdl to US\$ exchange rate of some 2.4%.
- Average monthly wage increasing in real value by 14%, to reach a nominal value of Mdl 1,650.

D. Macroeconomic Forecasts for 2007-09 and Economic Growth Support Policy

22. Macroeconomic forecasts for 2007-09³ draw upon the review of trends reported in the real and social sectors, and take account the forecasts for the development of industry, agriculture and other sectors of the economy. Moreover, account has been taken of trends in the world economy as well as the government's strategic goals, as outlined under the EGPRSP and the Government's Plan of Actions "Upgrading the Country for the Wellbeing of People".

23. The main goal of macroeconomic strategy is sustainable economic growth. Economic policy will emphasise private sector growth in industry, services and information technology as the means of achieving high rates of economic growth.

24. It is expected that the process of monetisation of the economy will continue with accelerated pace during 2007-09, provided that the positive macroeconomic policy outcomes of recent years are consolidated and structural reforms are speeded up. The *Macroeconomic forecasts for 2007-09* National Bank of Moldova will continue its supervision of the financial sector with a view to maintaining monetary stability and ensuring the framework needed for a sustainable economic growth.

25. Consistent with this scenario, the target for economic growth for 2007-09 is 6% annually allowing for a gradual closing of the gap in living standards. This will be accomplished by ensuring that the following conditions are met:

- The rate of inflation falls and a stable exchange rate for the national currency is maintained.
- Channelling domestic and foreign investment towards the productive sectors;
- Creating new jobs, and increasing labour productivity;
- Streamlining the structure of imports by substituting locally made merchandise for certain types of imported goods.
- A real growth in the living standards of people.

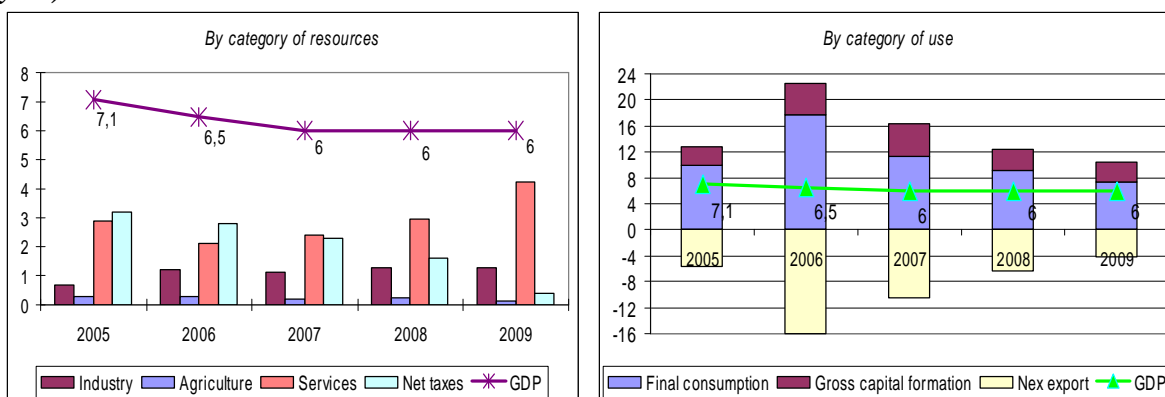
³ The Ministry of Economy and Trade developed it in March – April 2006.

26. The increase in the GDP throughout 2007-09 will be determined by:

- An annual increase in industrial output of about 7.5% and in farming output of 3%.
- The growth rate of investments made in fixed capital outpacing that of GDP by 2-4% as a result of re-orienting of investment policy towards programmes and performance, upgrading of domestic companies, and development of small business.

The contribution of the different components to the real growth in GDP during 2005-09 by category of resources and end-use is presented in Chart I.1.

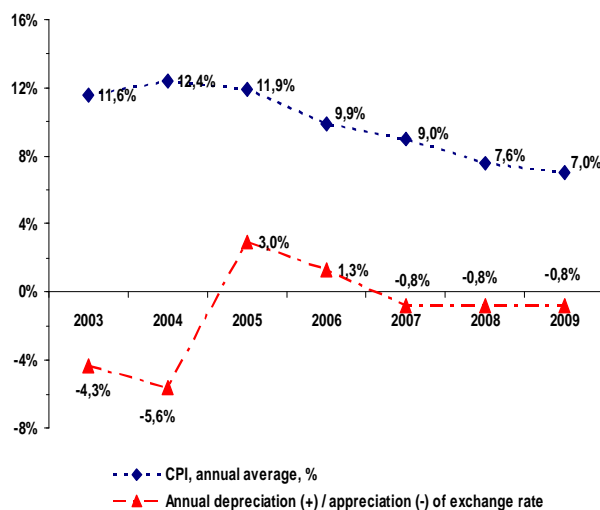
Chart I.1. Share of components in the real growth of GDP (per cent change compared to the previous year)



27. The exchange rate of the national currency will remain stable during 2007-09. This process will be secured by foreign remittances from Moldovans working abroad. It is forecast that the average annual exchange rate for 2007 will reach Mdl 12.8 per US\$ and that it will appreciate to Mdl 12.6 per US\$ in 2009.

28. It is anticipated that the recent fall in inflation will continue with inflation dropping to 7% in 2009. The causes of inflation will be mostly non-monetary in nature and will be

Chart I.2. Trends in the rate of inflation and the national currency exchange rate, 2003-2009.



determined by the increase in world price of oil, as well as by an upsurge in the purchasing power parity of population, due to an increase in the paid salaries, pensions and remittances.

29. By ambitiously targeting the rate of inflation, monetary policy will maintain its prudent stance through 2007-09. This will allow nominal interest rates to gradually decrease, as the rate of inflation falls. The National Bank of Moldova will manage its monetary policy with the main aim of securing stable prices.

30. The trends in inflation and the national currency exchange rate during

2003-09 are shown in Chart I.2.

31. It is expected that exports will increase by approximately 79% by 2009 compared with 2006, whereas the pace of growth reported for the imports slow with total imports increasing by 63% over the same period.

32. Factors that will contribute towards a gradual increase of exports during the forecast period are as follows:

- The reduction in trade tariffs on Moldova's exports arising from the free trade agreements within the framework of a Stability Pact for South-Eastern Europe.
- The liberalization of access to markets in the WTO member countries and the harnessing of preferential agreements granted by the EU (GSP+).
- An increase in the quality of exports, specifically due to the investments made in scaling up and upgrading of technology so that Moldovan products meet international standards.

33. The increase of imports will be determined by an increase in the flow of investments, and purchases of vehicles, electrical appliances, and mineral products. The relative importance of energy imports is expected to increase due both to the economic growth in the main sectors of the economy, and also to the increase in the price of natural gas. Moreover, the growth of imports will also be dictated by a higher demand for imported goods in communities, determined in turn by significant amounts of revenues and remittances transferred from abroad.

34. The trade balance deficit will continue to be substantial and is projected at about 47% of GDP by 2009.

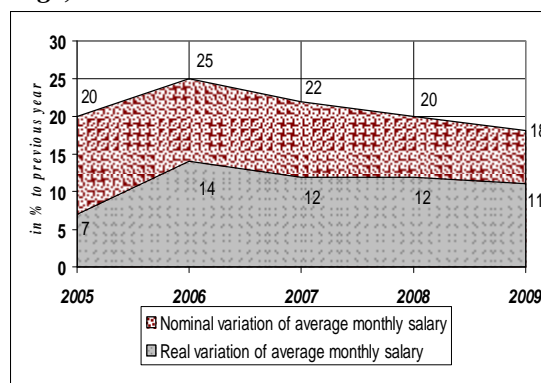
35. The nominal average monthly wage across the economy will increase by 70% during 2007-09 compared with 2006, to reach Mdl 2,860 by 2009. The labour compensation fund will increase by 60%, reaching Mdl 20.5 billion over the same period. Trends in the pace of real and nominal growth of the average monthly wage throughout 2005-09 are shown in Chart I.3.

36. The increase in the nominal average monthly wage and the labour compensation fund will be determined by the following factors:

- Strong growth in the real sector, due to the development of private sector and additional employment in small-size and medium-size business enterprises.
- The rise in the consumer prices.
- Improvements of the system for salary payments and motivation for employees.

37. The macroeconomic forecast is a key determinant for the estimation of public revenues, financing requirements and public expenditures that are discussed in the following chapters.

Chart I.3 Evolution of the average monthly wage, 2005-2009



Chapter II. Public Revenues

A. Recent Trends in Public Revenues

Recent trends 38. National public budget revenues increased by an average of 30% annually from Mdl 9,417 million in 2003 up to Mdl 14,528 million in 2005. Their share in the GDP also increased from 34.1% up to 39.5% over the same period.

39. To a great extent, the increase in revenue has been due to tax revenues that which grew from 27,3% of GDP in 2003 to 32% in 2005, accounting for 81% of total public revenues. This growth in tax revenue has been sustained by economic growth, the growth in foreign trade, the rapid rise in the level of wages. Measures to improve tax administration, specifically for indirect taxes, local fees and duties, have also had a significant impact.

40. Between 2003 and 2005 non-tax revenues were unchanged at around 2.9% of GDP. Revenues from special sources and funds dropped from 3.7% to 3.4% of GDP during this time interval, as a result of implementing the regulatory reforms and a reduction in the range of paid public services.

41. There has been a sharp increase of over 400% in the level of grants provided by donors to the public budget both for both general budget support and for the funding of ongoing projects.

42. Trends in National Public Budget revenues in absolute figures and as proportion of GDP throughout 2003-05 are presented in Table II.1 and Annexes 3.1-3.2.

43. Direct taxes increased from 12.2% of GDP in 2003 to 14.4% in 2005. This growth was due to the introduction in 2004 of mandatory health insurance and the increase in collections of the SSIF contributions, consequent on the increase in pay levels.

The share of income taxes and property taxes in GDP did has remained at around the same level since 2003

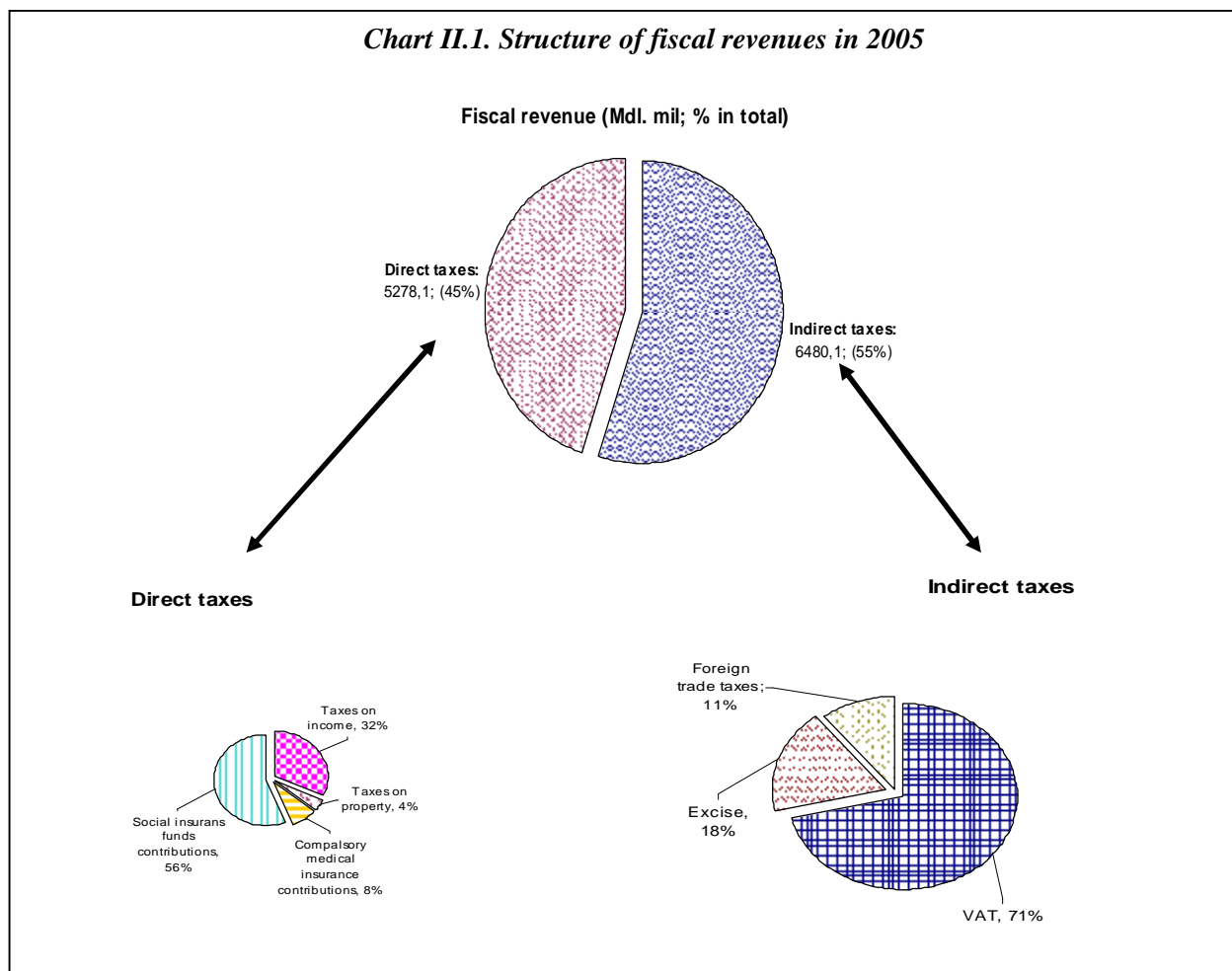
44. The increase in indirect tax revenues, including VAT, excise-duties and foreign trade and foreign transaction taxes during 2003-05 was at a higher pace than that of direct tax revenues. The former increased by the equivalent of 2.5% of GDP compared with 2003 reaching 17.6% of GDP in 2005. This growth was primarily due to the increase in the VAT on imported goods which increased by 2.4% of GDP due to the doubling of imports over the period. The increase in 2005 was particularly pronounced. As a result, the VAT collected

Table II.1. Trends in National Public Budget revenues, as share of GDP, for 2003-2005

	2003	2004	2005
Fiscal revenues	27.3	29.4	32.0
Non-fiscal revenues	2.9	2.3	2.9
Special means and funds	3.7	3.2	3.4
Grants	0.3	0.4	1.3
Overall revenues	34.1	35.3	39.5

on imported goods was equivalent to 11% of GDP in 2005. The share of excise-duties and foreign trade taxes in the GDP changed little.

45. The structure of tax revenues within the National Public Budget is displayed in the following Chart II.1 below.



B. Tax Policy Objectives and Measures for 2007-09

46. The main aim of tax policy is to establish an appropriate balance between the need to raise revenues as the main source of funding for government spending, and ensuring a supportive business environment, that is a key factor in sustaining economic growth. In this context, what is important for Moldova is that revenues increase at a quicker pace than the rate of inflation, while at the same time, adjusting the tax burden to a level that would facilitate the development of business environment and investments.

47. Tax policy measures implemented during the previous years have increased fiscal transparency and have had a positive impact both upon public revenues and upon the operations of economic agents and the savings of natural persons. A more in-depth review of the impact of tax policy measures implemented under the programme of tax reforms that started in 1998 is presented in Technical Note 1. The study provides a number of suggestions on the ongoing reform of the national tax system.

48. The overall tax policy goals for 2007–09 are as follows:

- To ensure the tax equity, stability and transparency.
- To streamline the tax burden and to scale up the tax system.
- To systematize and simplify the tax legal framework.
- To bring the principles underpinning the national tax legal framework in line with those in EU member countries.

49. In order to achieve these goals it is proposed that the following tax policy measures, split by basic categories of taxes, be implemented over the medium-term.

Personal Income Tax

50. The purpose of suggested changes in personal income taxes is to support those on low incomes and to gradually shift the tax burden towards those with average and above-average incomes. This will be done through:

- Ongoing reductions in the rates of personal income taxes, with a shift in the structure and the amount of annual tax thresholds, starting in 2008. Trends in the share of and the tax thresholds are presented in Table II.2.

Table II.2. Evolution of the share of income taxes paid by individuals during 2005 – 2009

Planned		Tentative		
2005	2006	2007	2008	2009
Up to Mdl 16,200 9%	Up to Mdl 16,200 8%	Up to Mdl 16,200 7%	Up to Mdl 21,000 7%	Up to Mdl 21,000 7%
From Mdl 16,200 up to Mdl 21,000 14%	From Mdl 16,200 up to Mdl 21,000 13%	From Mdl 16,200 up to Mdl 21,000 10%	-	-
Over Mdl 21,000 20%	Over Mdl 21,000 20%	Over Mdl 21,000 20%	Over Mdl 21,000 20%	Over Mdl 21,000 20%

- Further increase in the annual personal exemption and the annual exemption for dependents, the evolution of which is shown in table II.3.

Table II.3. Evolution of annual exemption for individuals and annual exemption for dependents during 2005 – 2009

	Planned		Tentative		
	2005	2006	2007	2008	2009
Personal exemption, Mdl a year	3,960	4,500	5,400	6,300	7,200
Exemption for dependents, Mdl a year	600	840	1,440	1,560	1,680

51. In order to boost the issuing and circulation of securities, it is planned to exempt dividends received by individuals holding corporate securities in the form of bonds.

Corporate Income Tax

52. The share of income taxes for legal entities for 2007-09 will stay at the level reported in 2006 and will account for 15%.

53. Starting with 2007, it is planned to introduce additional tax benefits to boost up private investments, in particular:

- Exemption from paying income tax on the dividends of legal entities holding corporate stocks as accounts receivable, issued with a maturity over three years and bank deposits with a maturity beyond three years.
- Full 100% exemption from paying income tax on the revenues gained by the microfinance organizations out of the credits granted for more than three years, as well as a 50% exemption on revenues gained from the credits granted for between 2 and 3 years.
- Deduction by the microfinance organizations of the provision to cover eventual losses as a result of non reimbursement of loans and associated interest rates.
- Increase in the tax-exempt expenditure from the amount of fixed assets earmarked for current and capital recovery of fixed assets, from 10% set in 2006 to 15% in 2007, and to give consideration to the opportunity of further increasing this spending by another 5% in 2009, depending on the outcomes yielded during 2007–08.
- Exemption from paying income tax by legal entities that make capital investments (spending), or the social capital of which is made up or increased by the amount exceeding the equivalent to US\$ 2 (5, 10, 20, 50) million, and which are re-invested in the development of the entities own production (works, services etc.), or in government programmes for the development of national economy, at least 80%, 50%, 25%, 10% and 0% of the income tax amount calculated and disbursed into the budget, with a duration of 3 years, 3 years, 3 years, 4 years and 4 years, respectively.
- Reduction the share of income tax, withheld from the payee, received as a royalty by non-residents, down to the level set for all incomes received by non-residents and taxable on payees (from 15% to 10%).
- Increase the time period for the reporting of tax losses, when calculating income tax, from 3 years to 5 years.

Social insurance and health insurance contributions

54. The process of shifting the cost of social insurance between the employer and employee will go on in 2007–09. The evolution of the share of SSIF contributions paid by employer and employee is shown in Table II.3. At the same time, consideration will be given to the opportunity of setting the employer’s share at 20% and the employee’s individual share at 8% by 2009.

Table II.3. Evolution of shares in State Social Insurance Fund contributions for 2005 – 2009

	Current		Tentative		
	2005	2006	2007	2008	2009
Employer’s contribution,%	27	26	25	24	23
Employee’s contribution,%	2	3	4	5	6

55. Starting in 2007, SSIF contributions for farming enterprises will be based on land surface area and land potential. Farmers working their own land on an individual basis will pay a fixed amount in contributions that will not be smaller than the annual amount of SSIF contributions, calculated based upon the minimum wage in the country, as set out by law.

56. In 2007, the level of the MHIF contributions is planned to be raised from 4% (2% paid by employer, and 2% by employee) to 5% (2.5% from employer, and 2.5% from employee),

with these rates to be maintained through 2009. In the period of 2007-2009 they are going to examine the possibility of an annual increase by 1 % of the mandatory health insurance premium. The purpose of this measure is to expand the package of health services, rendered to the population through mandatory health insurance.

57. In order to further systematize the tax legal framework, it is planned to develop and adopt in 2007 Title X of the Tax Code, “Social Taxes”, becoming effective as of January 1st, 2008. This law will regulate the application of taxes payable as SSIF contributions and MHIF contributions paid by employer and employee alike.

Value Added Tax (VAT)

58. The structure of goods and services with zero rate of VAT will be reviewed over the coming years. Starting in 2007, the zero rate of VAT will be cancelled for construction of residential accommodation and the standard 20% VAT applied. This measure is aimed at setting up equal tax opportunities for all individuals and legal entities involved in constructing residential buildings, as well as at simplifying the VAT administration.

59. Consideration will be given to lowering in 2009 the standard VAT rate of 20%, depending on the level of collections achieved during 2007-08. Based on current macroeconomic forecasts the revenue loss associated with a 1% reduction in the VAT rate is estimated at Mdl 463 million in 2009.

Excise-Duties

60. It is planned to raise the level of excise-duties on beer and tobacco products in line with the rate of inflation during 2007–09. In 2007 it is suggested to tally up the complex rate of excise-duties on spirits with a concentration of alcohol over 25 per cent vol from the current share of 35 per cent, yet not below MDL 0.25/per cent/vol/liter of absolute alcohol, to the share of 45 per cent, yet not below MDL 0.35 /per cent/vol/liter of absolute alcohol. It is also planned to diminish the complex rate of the excises on production with a reduced concentration of alcohol from 30%, yet not below MDL 0,10 lei/%/vol/liter of absolute alcohol, to the share of 10%, yet not less than MDL 0,10/%/vol/liter of absolute alcohol. These changes are aimed at ensuring the competitiveness of goods subject to excise-duties on domestic markets.

Customs Duties

61. Consideration will be given to the opportunity of increasing from 2007 the rates of customs duties payable upon the import of goods for which equivalent products are made locally and of lowering or cancelling duties for those import items that are strictly necessary as inputs into production and those goods that are not produced in Moldova, provided that such measures are in line with the commitments and requirements that the Moldova has assumed with the WTO.

62. It is planned to develop and adopt Title XI of the Tax Code “Customs Duties” in 2008, and for this to become effective as of January 1st, 2009.

Real Estate Taxes

63. A gradual implementation of the new taxation system, based on market price valuation, for various categories of real estate is planned. It is proposed that the first phase of the new taxation system be implemented in 2007 with its application to residential real estate assets, such as apartments and individual living houses located in municipalities and towns, including the communities adjacent to them.

Other Taxes and Fees

64. Title IX of the Tax Code “Road Taxes” will become effective starting in 2007. Currently road charges are regulated through a standalone law. Bringing them within the tax code will contribute to making the overall tax system simpler and to broadening of the tax base.

65. It is planned to develop and adopt in 2009 a last title under the Tax Code, Title XII “Other Taxes and Fees” that will regulate the taxes and fees/duties that are not included in the other titles under the Tax Code, yet which are part of the national tax system.

C. Tax Administration Objectives and Measures for 2007-09

66. Tax administration reforms during 2007–09 will be aimed at streamlining the tax administration, tax management and the authority of tax administration, as follows:

(i) Improvement of measures to secure the fulfilment of tax obligations

- Develop the tasks for implementing an electronic programme for keeping records on forced termination actions.
- Develop a new procedure for the evaluation and classification of debtors by groups, such as by the degree of solvency, and the capacity of taxpayers to pay off his/her debts by grouping taxpayers by criteria of assets availability.
- Improve the existing mechanism for trading of sequestered goods.
- Liberalize the leverages for cancelling bank account transactions and the recalling of cancellation should the tax obligation has been paid off.
- Develop a new way to phase settlement deadlines for tax liabilities over an interval of two fiscal years.

(ii) Streamlining the methods of control and coordination of control activities

- Implement cash-registers (CR) with fiscal memory for taxi services.
- Implement procedures for applying a fiscal seal to the CRs with fiscal memory.
- Develop a mechanism to apply the common law (precedent cases) when sorting out similar litigations and publishing court decisions.
- Develop a system for preparation of litigation cases, within tax entities, to the point of going to the court, if necessary.

(iii) Computerization of tax procedures

- Set up and implement an information system and a mechanism for electronic submission of tax returns.

- Set up and implement an automated taxpayer notification mechanism in cases of late submission of tax returns, late settlement of tax debts, errors in the tax returns, and punitive measures when the tax laws are violated.
- Develop and implement a standalone mechanism for taxpayers services through the worldwide web (www.fisc.md).
- Operate changes to the treasury norms set to service the National Public Budget, along with the implementation of an electronic signature for tax authorities, in that part that is dealing with the circulation of electronic papers from tax authorities to the Treasury.
- Develop the concept, mechanism and content of a system for making tax information available to the Government and local public authorities;
- Improve the mechanism of interaction with the information systems of government departments from other countries.
- Develop a mechanism to automatically plan for risk assessment based controls.

(iv) Improvement of tax administration mechanism

- Phase out the lump-sum tax payment regime relating to the trading of merchandise and the rendering of services. This will be implemented as outlined in Table II.4.

Table II.4. Phases of implementation of measures interdicting the trading of goods and rendering of services by business patent holders during 2007 – 2009.

Implementation phase	Type of activity	Implementation year
I.	Construction goods, furniture, household goods; transportation services provided to travellers taking cabs; production, processing and trading of lime.	2007
II.	Retail sales in booths and in other space occupying separate land, the surface area of which is under 7m ² or 12 m ² .	2008
III.	Retail sales from stands, counters and auto-vehicles on automated markets; retail sales of bottled water in places authorized by local public administration authorities; retail sales from stands, counters and other kind of trading units that are authorized by the local public administration authorities, trading books and other print-outs, as well as those trading music publications (notes).	2009

(v) Scaling up the array of tax consultancy services

- Create an unified Assistance Centre, or an Information Centre (Telephone Centre) within the Central Government Tax Inspectorate, which will provide taxpayers with advisory services.
- Develop and further improve national accounting and audit standards.
- Adopt internationally accepted principles for the evaluation of financial statements.

D. Forecast of public revenues 2006–09

67. The macroeconomic forecasts, for 2006-09, coupled with tax policy and tax administration goals for 2007-09, set the foundation for estimation of National Public Budget revenues. It is projected that during 2007-09 National Public Budget revenues will increase at an average annual rate of 14,9% to Mdl 24 billion in 2009.

68. As a share of GDP National Public Budget revenues will record a decrease from 38,5% in 2006 (estimated) to 37,9% in 2009. Forecasts for public revenues in absolute figures and as proportion of GDP are presented in Chart II.2. and Annexes 3.1-3.2.

69. During 2006-09 tax revenues in the form of direct and non-direct taxes will remain the main source for public revenues and will increase from 85,8% of total revenue in 2006 (estimated) to 90,2% in 2009. Tax revenues are also projected to increase by 1.1% of GDP between 2006 and 2009 mainly due to the increase in collections of direct taxes. Other revenues comprise non-tax revenues, special means and funds as well as grants for budget support and externally funded projects that are illustrated in diagram II.3.

Chart II.2. Trends in public revenues, 2005 – 2009

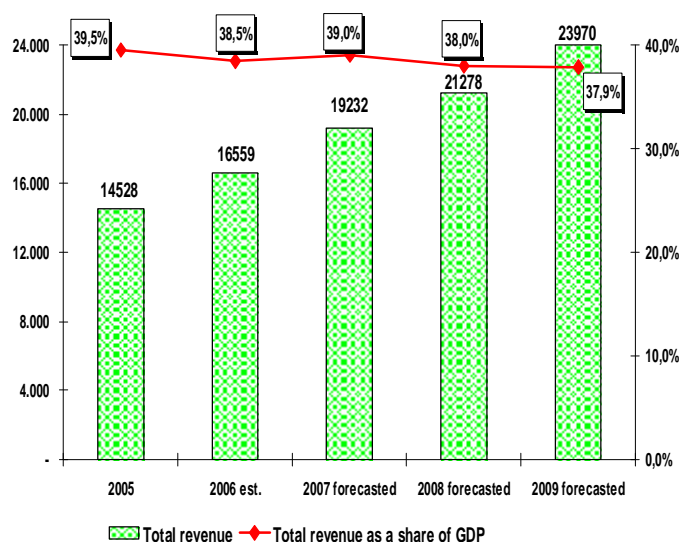
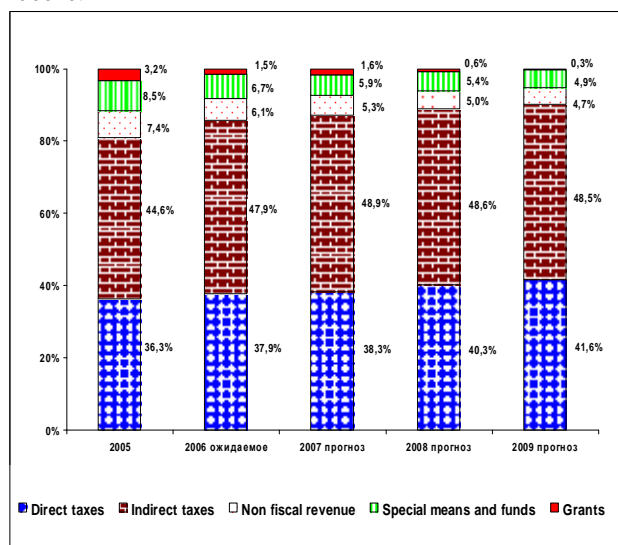


Diagram II.3. Overall revenue framework structure, 2005-09



70. The structure of public revenues for 2007-09 may change once the Memorandum on Economic and Financial Policy is signed between the Government and the IMF, as a result of which the financing of the budget from donor grants will become more active.

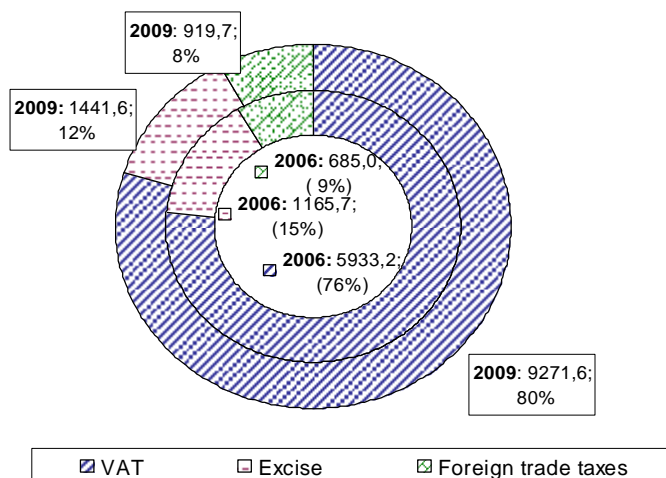
71. MHIF and SSIF contributions will be the main driving factor for the growth in direct tax revenues, increasing by about 106% and 63% between 2006 and 2009 respectively. This rapid growth is due to the projected increase in pay levels and the increase in MHIF contributions that will be introduced in 2007. Income taxes will stay flat during the forecast period. The share of property taxes in total revenues is

insignificant, yet will become more important the new real estate tax regime is implemented. Overall, the share of direct taxes in the GDP will increase from 14,6% in 2006 to 15,8% by 2009. The structure of direct tax revenues for 2006 and 2009 is outlined in Chart II.4.

72. Indirect taxes provide another source of considerable revenue growth, particularly the taxes on foreign trade. A review of recent trends reveals that VAT collections depend to a large extent on the growth of import of goods and on the level of consumption by the private sector.

The real growth in GDP and the increase in the imports during the given time interval will contribute to a rise of about 53% in VAT collections during 2006-09. The flat rates of excise-duties imposed on the basic goods subject to excise-duties will result in relatively slow growth in excise revenues which will fall from 2.7% of GDP in 2006 to 2.1% in 2009. Overall, the share of indirect taxes in the GDP will be around 18,7%. The structure of indirect taxes forecast for 2006 and 2009 is shown in Chart II.5.

Chart II.5 Structure of indirect taxes, 2006 and 2009: Mdl million;% in total



73. Non-tax revenues, revenues from special funds and means for the period 2007-09 will basically be flat at the level of those reported in 2006 in nominal figures, while decreasing as a proportion of GDP from 2,3 and 2,6 down to 1.8 per cent each by 2009. It is also planned to reduce the number of special funds, especially those which do not have own revenues, but are funded from general special means revenues or from transfers from the State Budget.

Chapter III. Public Debt and Sources of Financing

A. Recent trends in public debts and evolution of budget financing sources

Recent trends in government debts

74. The level of Moldova's State Debt has declined significantly in recent years. State debt accounted for 33.2% of GDP at the end of 2005, broken down between external debt (22.9% of GDP) and domestic debt (10.3% of GDP). This compared with total State Debt of about 57% in 2002. This reduction was due almost entirely to the fall in the level of external debt, domestic debt declining by only 3% of GDP over the period.

75. At the end of 2005 69% of State Debt comprised external debt and 31% domestic debt. Trends in the domestic and external State Debt are shown in Chart III.1 and Annex 8.

76. The Government repaid its domestic and external creditors some Mdl 2.3 billion during 2002–05, broken down between Mdl 2.2 billion repaid to external creditors, and Mdl 0.1 billion repaid to domestic creditors (net). Major repayments of external debt occurred in 2002 (Eurobond liabilities) and 2004 (Gazprom and Hewlett Packard). Following these transactions, external State Debt shrank, as did the level of amortization payments.

Chart III.2 Trends in the servicing and repayment of state debt in absolute figures and as share within State Budget fiscal revenues (GBFR), 2002-05

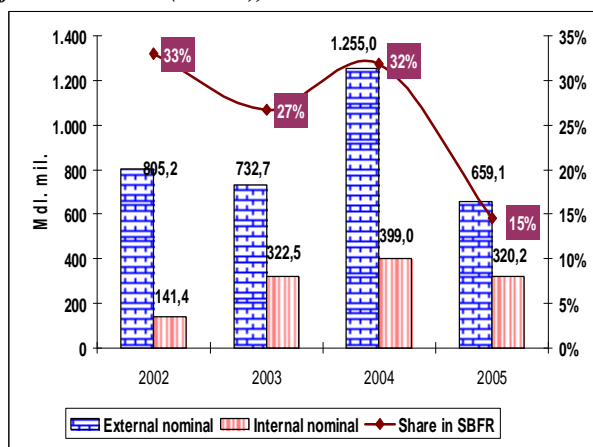
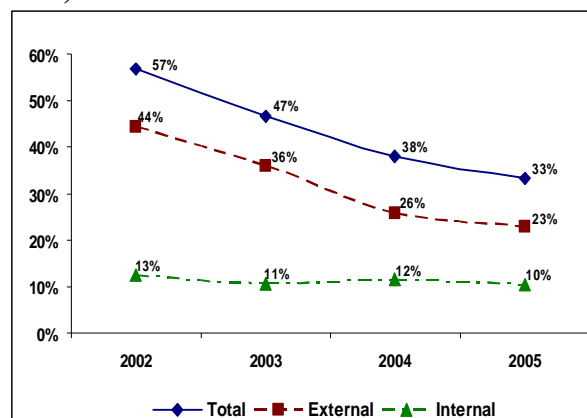


Chart III.1 Evolution of state debt as a share of GDP, 2002-05



77. Trends in the servicing and repayment of State debt (payment of interest and the repayment of the principal) in absolute figures, and tax revenues of the State and ATU Budgets, are shown in Chart III.2.

78. During 2003-05, the Government received grants and external credits totalling up approximately US\$ 163 million. The amount received is about 60% less than the level of repayments to external creditors that were made over the same period (US\$ 267.6 million). Of the external financing received, US\$ 39.4 million (24%) was for budget support and US\$ 123.6 million (76%) for financing investment projects. Trends in the entrance of grants and credits are shown in Table II.1.

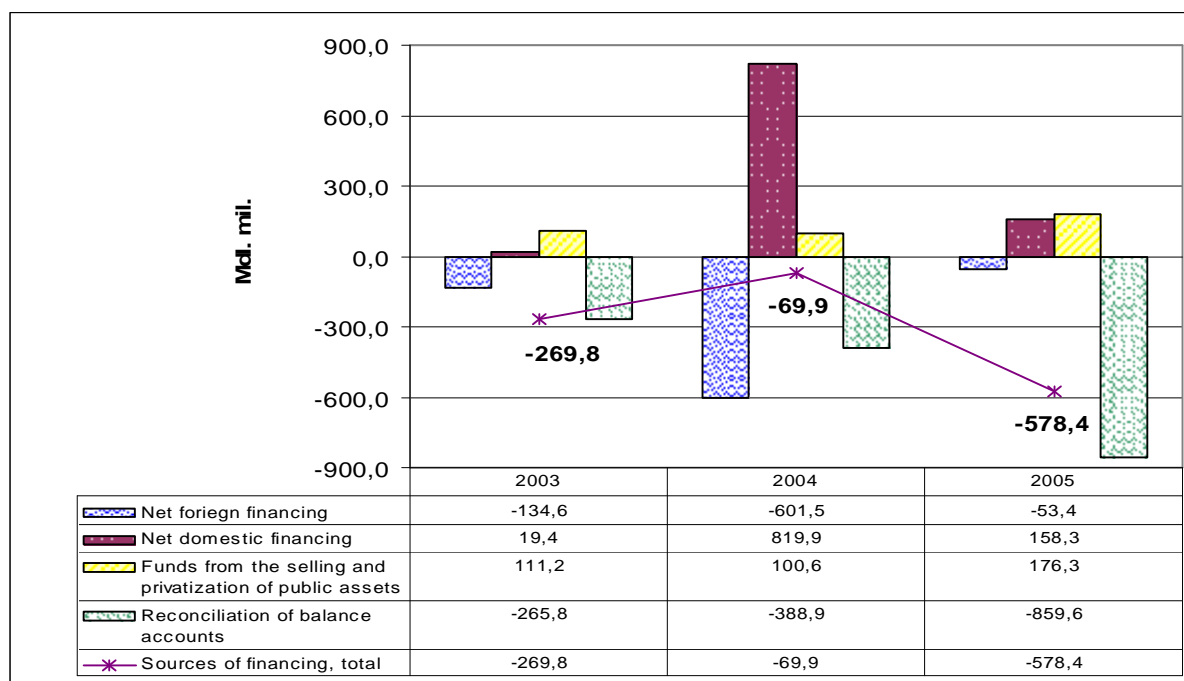
Table II.1 Trends in grants and external credits entering the country, 2003-2005.

	2003	2004	2005
Total	411	404	787
Grants	73	125	460
Credits	338	279	327
Budget Support	1	19	283
Grants	1	19	283
Credits	0	0	0
Project Assistance	410	385	504
Grants	72	106	177
Credits	338	279	327

Budget funding sources

79. The structure of budget financing sources was quite diverse during 2003-05, and resulted in the accomplishment of a budget surplus in each of these years. Total net financing of the National Public Budget was negative, the surplus varying from Mdl 269,8 million (1% of GDP) in 2003 to Mdl 578,4 million (1,6% of GDP) in 2005. The budget surplus was determined by the lack of funding sources other than budget revenues and the need to meet the repayment commitments on external and domestic debts from budget revenues. The trends for sources of financing are shown in Chart III.3

Chart III.3 Trends in funding sources, 2003-05



80. Positive financing has occurred in the area of net internal financing and revenues from the privatization of public assets during 2003-05. The net external financing was negative during the same time interval. This could be explained both by a drop in the amount of new

external credits and the settlement of a number of commercial credits in 2004 which has significantly reduced the burden of future external debt repayment. These transactions were domestically financed through loans provided by the National Bank of Moldova. Thus, the net domestic financing has increased to offset the repayment of the government's external debt.

81. In terms of revenues generated from the selling and privatization of public assets, the level of financing from these sources increased from Mdl 111.2 million in 2003 to Mdl 176.3 million in 2005. The growth in such financing that occurred in 2005 was due primarily to the selling of publicly owned land mainly by local public authorities.

82. The accumulation of financial resources on the accounts during 2003-05 (negative financing for the National Public Budget) was mainly to cover the requirement to settle debt arrears to the Paris Club creditors in 2006 and in order to implement the new salary payment mechanism for public employees. The National Social Insurance House and the National Health Insurance Company have accumulated some reserves earmarked for the payment of pensions and social benefits and for the provision of unforeseen medical services. Out of a total of Mdl 1514,3 million in reserves accumulated on the National Public Budget during 2003-05, Mdl 628,8 mil (41.1%) was attributable to the accounts of the National Social Insurance House and the National Health Insurance Company. The State Budget and the ATU Budget accounted for 59% of these funds which was mostly accumulated at the beginning of 2005.

B. Government Debt Management Policy for 2006-09

83. The overarching goal of the Government's debt management policy is to maintain the level of its debt within sustainable limits, and to secure the funds needed to finance the budget deficit and cover debt repayment at the lowest possible cost. To complement the controlled growth in public debt the Government will target the reduction of debt costs and budget risks.

84. The strategy of issuing government securities to finance the budget deficit and to refinance domestic State Debt, specifically through medium-term securities, will be continued.

85. Despite the State Debt position having improved in recent years, there are still outstanding issues. These include:

- .
- The legal framework regulating government debt does not match current international standards for public debt management.
- The quality of records-keeping, the receipt and submission of information on public debts requires improvement.

86. The measures for resolving these issues and achieving the Government's debt management objectives during 2006-09 are as follows:

- Active and ongoing collaboration with international financial institutions and external donors in order to obtain additional external financing under the most favourable terms.
- Compliance with recommendations and indicators listed in the basic agreements entered into with the international financial institutions.
- Restructuring of external debt through the Paris Club.
- Gradual repayment of debt owed to the National Bank of Moldova.
- Expand the range of participants in the primary and secondary securities markets.
- Update the legal framework on public debts, state guarantees and government on-lending to meet EU standards and those set by the IMF and the World Bank.

C. Forecasts for associated payments and State Debt balance for 2006-09

Government debt payments **87.** In order to service and repay State Debt, payments of about Mdl 5.0 billion are planned through 2006-09, including Mdl 2.7 billion for repayment of principal; and Mdl 2.3 billion for payment of interest charges.

88. These payments will be evenly distributed through the period, averaging around Mdl 1.3 billion annually. As such, debt payments will be at a sustainable level allowing the opportunity to finance the strategies under the MTEF.

89. Payments made on external and domestic government debts during 2006-09 are presented in Table III.2.

Table III.2 Disbursements made in repayment of government's internal and external debts

	2006		2007		2008		2009		total 2006-09	
	Mdl million	US\$ million	Mdl million	US\$ million	Mdl million	US\$ million	Mdl million	US\$ million	Mdl million	US\$ million
Repayment of external debt	892.7	69.2	686.1	53.6	697.2	54.9	909.8	72.2	3185.8	249.9
principal	630.8	48.9	473.6	37.0	486.4	38.3	612.4	48.6	2203.2	172.8
interest rate	261.9	20.3	212.5	16.6	210.8	16.6	297.4	23.6	982.6	77.1
Repayment of internal debt	457.7	35.5	459.8	35.9	463.7	36.5	445.1	35.3	1,826.3	143.2
principal	118.8	9.2	118.8	9.3	118.8	9.4	118.8	9.4	475.2	37.3
interest rate	338.9	26.3	341.0	26.6	344.9	27.2	326.3	25.9	1,351.1	106.0

90. The ratio of State Debt repayments to State Budget tax revenues is projected to decline over the next three years. This will fall from 17% in 2006 down to 11% in 2009.

91. It is expected that the Government will benefit from external credits and grants during 2006-09 to support the budget and investment projects totalling around US\$ 188.9 million. The amount received is around US\$ 61 million smaller than the payments that are scheduled to be made to the external creditors which are estimated at US\$ 249.9 million.

92. Estimates of receipts of grants and external credits during 2006-09 are shown in Table III.3.

93. Estimates of the grants and external credits entering the country during 2007-09 may undergo some change following signature of the Memorandum on Economic and Financial Policy with

Table III.3 Estimates of grants and external credits entering the country during 2006-2009, Mdl million

	tentative	estimated		
	2006	2007	2008	2009
Total	738	947	490	243
Grants	241	309	138	66
Credits	497	638	351	177
Budget Support	18	121	0	0
Grants	18	121	0	0
Credits	0	0	0	0
Project Assistance	720	826	490	243
Grants	223	188	138	66
Credits	497	638	351	177

the IMF. It is anticipated that there will be an increase in the levels of such financing. However, these could not be estimated at the present time.

Government debt balance 94. The level of public debt will depend on the evolution of macroeconomic indicators, the re-distribution of bilateral debt through the Paris Creditors' Club, as well as the incoming financing flows from external and domestic funds. Taking these considerations into account, it is forecast that total public debt will fall during 2006-09 from Mdl 13.2 billion at the end of 2006 down to Mdl 12.6 billion by the end of 2009.

95. This declining trend is more pronounced when public debt is expressed as a share of GDP with it decreasing from 30.7% of GDP at the end of 2006 to 19.9% by the end of 2009. Trends in government's internal and external debts during 2006-09 are shown in Chart III.4 and Chart III.5.

Chart III.4. Trends in government debts as percentage of GDP, 2006-09

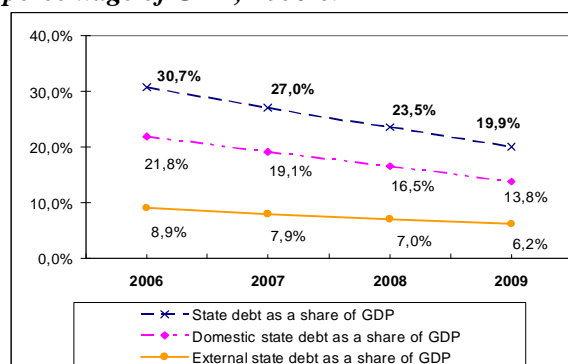
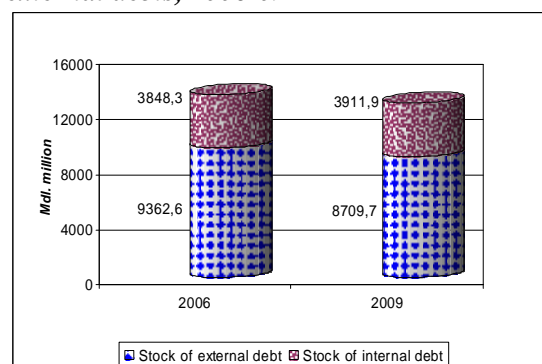


Chart III.5. Size of government's internal and external debts, 2006-09



96. Based on forecasted in-flows from external credits, as well as on the fluctuations of the national currency exchange rate, its forecast that external State Debt will decrease from US\$ 720.2 million at the end of 2006 (Mdl 9,362.6 million) down to US\$ 685.8 million (Mdl 8709.7 million) by the end of 2009. External State Debt as a share of GDP will continue to fall from 22% at the end of 2006 to 13.8% by the end of 2009. Compared to the end of 2005, when total state debt (external and domestic) was Mdl 12.2 billion, it will increase by about Mdl 1 billion by the end of 2006. This growth is due both to the influence of currency exchange rate on the external debt, and the restructuring of State Debt through the Paris Club in 2006.

97. With respect to the evolution of government's domestic debt, this will increase through 2007-09 in nominal terms from Mdl 3848,3 million at end of the 2006 to Mdl 3911,9 million by the end of 2009. Debt repayments made to the NBM and the avoidance of new contract loans together with the ongoing issuing of government securities provide the basis for this forecast. domestic State Debt as a share of GDP will fall from 9% to 6%.

D. Financing Forecast for 2006-09

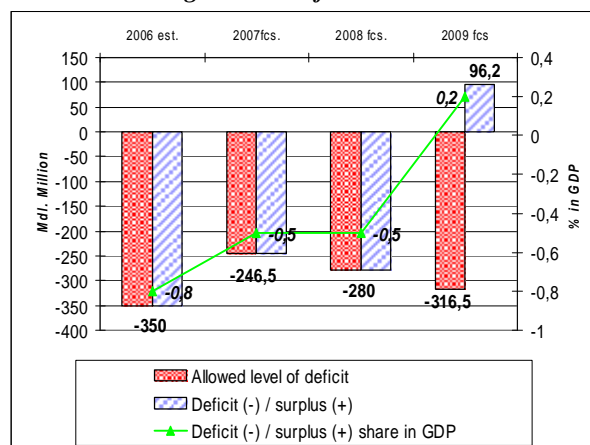
98. The forecast for financing of the National Public Budget for 2006-09 are based on the following assumptions:

- The level of budget deficit should not exceed 0.8% of the GDP in 2006 and 0.5% of GDP during 2007-09;
- Restructuring external State Debt through the Paris Club, the receipt of credits to implement investment projects within the framework of the World Bank's Country Assistance Strategy (CAS) will result in negative external financing, but in 2007, whereas otherwise it would have been positive.
- Maintaining a positive value of net domestic financing by issuing government securities to finance the budget deficit and to re-finance domestic State Debt, except in 2009 when the repayments will outweigh the issue of new debt.
- Receipts from the selling and privatization of public assets under the new privatization programme starting in 2007.
- The use of financial resources accumulated within the National Public Budgets from the previous periods to defray the respective budget costs.

99. The programmed level of National Public Budget deficit is Mdl 246.5 million in 2007, Mdl 280 million in 2008 and Mdl 316.5 million in 2009. The total amount of resources that may be attracted from both domestic and external financial sources is sufficient to cover these deficits in 2007 and 2008 only. However, currently identified sources of financing for 2009 are not sufficient to finance the programmed budget deficit. For this reason the National Public Budget is currently projected to be in surplus to the amount of about Mdl 96.2 million (0.2% of GDP) in 2009.

100. The budget balance for 2006-09 is shown in Chart III.6, whereas its source of financing are reflected in Annex 2.

Chart III.6. Budget balance for 2006-2009



Chapter IV. Overall Financial Framework

A. Public Resources

101. The aggregate level of revenues and financing for the National Public Budget sets the overall financial framework of public resources that are available to meet the costs of national public programmes. The resource framework of the National Public Budget for 2007-09 is presented in Table IV.1.

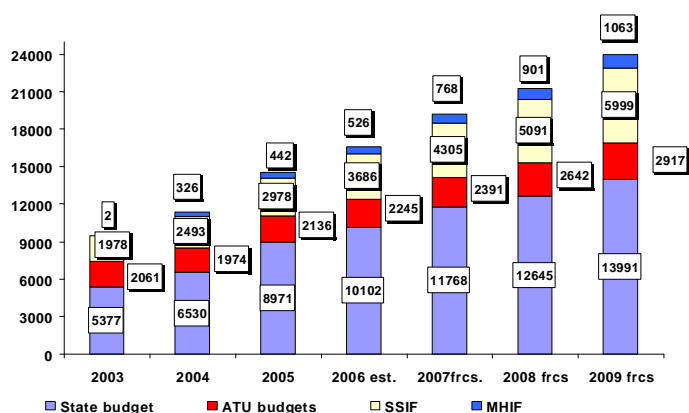
Table IV.1 Financial framework for National Public Budget resources for 2007-09

	<i>(Mdl million)</i>		
	2007	2008	2009
Public revenues	19,232	21,278	23,970
Sources of financing	247	280	-96
<i>Financial resources framework</i>	19,479	21,558	23,874

102. This overall resource framework comprises all the revenues and sources of financing that are distributed between public budgets and funds including:

- The State Budget (including the externally funded projects, special resources and funds).
- Budgets of Administrative-Territorial Units (ATU Budgets).
- State Social Insurance Fund (SSIF).
- Mandatory Health Insurance Fund (MHIF).

Chart IV.1 Evolution of National Public Budget revenues by components, 2003-2009



103. In terms of structure, MHIF revenues will show the most rapid growth, doubling in nominal terms between 2006 and 2009. SSIF revenues will increase by about 63% over the same period. State budget and ATU Budget revenues will grow more slowly, increasing by 38.5% and 30%, respectively. The basis for these projections is outlined in chapter II “Public Revenues”.

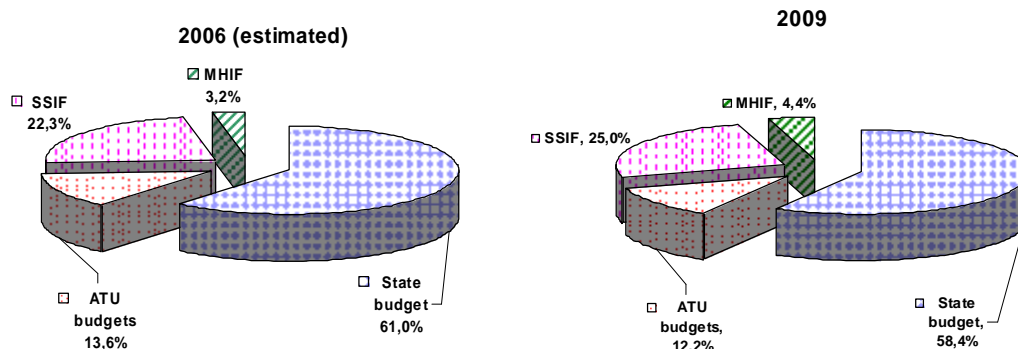
104. The distribution of the overall financial framework between its constituent components and their share

in the GDP are presented in Annex 2. A more in-depth breakdown is provided for the state budget parameters, ATU Budgets, SSIF and MHIF for 2003-09 is provided in Annexes 4–7.

105. The distribution of National Public Budget revenues by components is shown in Chart IV.1.

106. The uneven growth in revenues between National Public Budget components will result in an increase of the share of MHIF and SSIF and a decrease of the share of spending allocated to the State Budget and ATU Budgets. The comparative structure of revenues by components is set in chart no.IV.2.

Diagram IV.2 National public budget revenue structure by its components, 2006 and 2009



107. The distribution of the National Public Budget deficit for 2006-09 between its components, given the sources of financing that could be attracted by each budget separately is shown in Table IV.2.

Table IV.2. Financial framework for public resources by National Public Budget components, 2003-09

Indicators	completed			approved	tentative	estimated		
	2003	2004	2005	2006	2006	2007	2008	2009
Total revenues (net of cross-budget transfers)	9,418	11,322	14,528	16,105	16,559	19,232	21,278	23,970
State Budget	5,377	6,530	8,971	9,500	10,102	11,768	12,645	13,991
ATU Budgets	2,061	1,974	2,136	2,262	2,245	2,391	2,642	2,917
State Social Insurance F	1,978	2,493	2,978	3,816	3,686	4,305	5,091	5,999
Mandatory Health Insurance Fund	2		442	526	526	768	901	1,063
Overall balance (deficit + ; surplus -)	-270	-70	-579	374	350	247	280	-96
State Budget	-17	88		335	171	139	209	-87
ATU Budgets	-61	60	139	40	100	40	35	30
State Social Insurance Fund	-192	-179	2	0	79	68	36	-39
Mandatory Health Insurance Fund	0	-39	-174	0	0	0	0	0
Total spending (net of cross-budget transfers)	9,148	11,252	13,949	16,479	16,909	19,479	21,558	23,874

108. All National Public Budget components, except for the MHIF, will face deficits during 2006-08. In 2009 it is only the ATU Budgets that will report deficits, whereas the State Budget and SSIF will have a surplus due to the lack of new financing sources. The MHIF will be balanced during the given time frame.

B. Public Spending

109. Considering the General Resources Framework estimations as a background, public expenditure will increase by roughly 13% a year on average during 2007-09 and will account for Mdl 23.9 billion by 2009. The level of public expenditure will fall from 39.3% of GDP in 2006 (estimated) to 37.7% by 2009.

110. Based on the assessment of resource framework, the annual growth rate of spending for the next three years will slow from 15.0% forecast for 2007 to 11% in 2009. The average annual growth in expenditure for the next three years will be Mdl 2.3 billion.

111. Discretionary expenditure will show a steeper growth than total general public budget expenditure with growth rates of around 19% and 11% respectively. This is shown in Chart IV.3.

112. Traditionally, expenditure policies have emphasised spending on the social sectors for receiving priority in resource allocation. This will continue (with the exception of the funding earmarked for salary increases) with the social sectors accounting for 63% of all public expenditure in the future. Whereas about 12% of all expenditure is currently earmarked for economic sectors, this will fall to 8.5% by 2009.

113. The MHIF has will benefit in a steeper growth of expenditure in 2007 with an increase of 32%, followed by the State budget at 23 A quicker pace of 15 % growth will be recorded during 2008-2009 in case of BASS (SSIB) and FAOAM (MHIF), that could be explained by a

Chart IV.3 Public expenditure and discretionary expenditure, 2003-2009

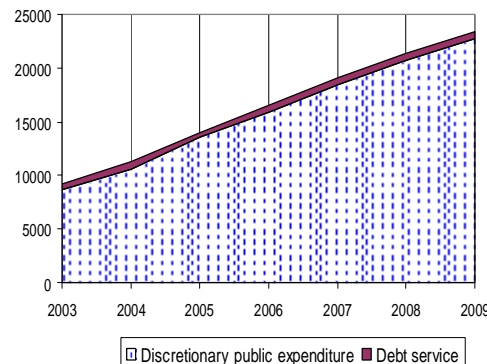
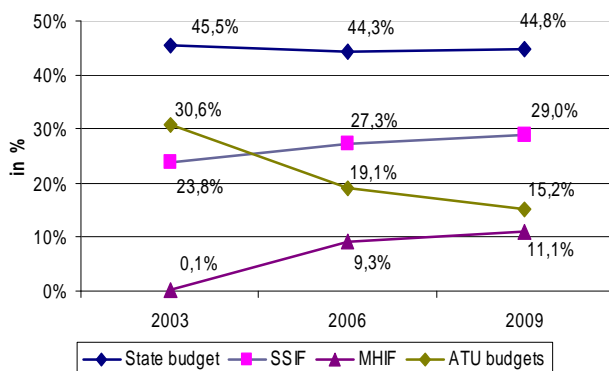


Chart IV.4 Evolution of expenditure by types of budgets as a share of the National Public Budget, 2003-2009



higher revenues growth rhythm of these budgets as well as the priority they will have. Trends in the expenditure by sorts of budgets during 2003-2009, as share of the national public budget, are displayed in chart no.IV.4.

114. State budget expenditure increased from 20% of GDP to 23% of GDP during 2003-06; and is expected to stabilise at 23% of GDP over the next three years.

115. SSIF expenditure for 2003-06 increased rapidly from 7.9% up to 10.2% of GDP. The increase in this

budget expenditure will slow down during the next three years and will account for about 11 per cent of GDP in 2009. Transfers from the State Budget to SSIF will increase from Mdl 688,3 million in 2006 to Mdl 965 million in 2009 an average increase of 13% annually. The share of these transfers in total SSIF spending is about 15%.

116. MHIF spending during 2004-06 increased from 2.9% to 4.2% of GDP, and is projected to grow to around 4.2% of GDP by 2009. It is worth mentioning that a considerable part of the MHIF (FAOAM) spending (about 66% in 2006) are covered from the account of transfers from the state budget. The amount of these transfers will considerably increase in the next three years from 1001,6 in 2006 up to 1526,7 in 2009, or by roughly 58 %. The amount of transfers from the state budget to the MHIF (FAOAM) are estimated to 12 % in

the period between 2007-2009 out of the total amount of state budget expenditures – which is the mean of the share for the previous three years.

117. In recent years ATU Budget expenditure has fluctuated between 10.1% and 7.1% of GDP. ATU expenditures are projected to fall to 6% of GDP by 2009. However, significant additional funding can be expected to be made available from the State Budget to cover the increase in salaries, capital investments and other obligations such that the eventual level of expenditure from ATU Budgets will be considerably higher than this forecast.

C. Risk Factors

118. The 2007-09 MTEF presents the basic scenario for the evolution of budget revenues and expenditures over the medium term. Two risks have been identified within the 2007-09 MTEF that could have a negative impact on the global framework for resources, namely macroeconomic risks and fiscal risks.

119. Macroeconomic risks refer to adverse changes in the economic parameters that underpinned the assessment of resources under the overall financial framework.

120. The trade balance deficit exceeded 40% of GDP in 2005 and it is expected that this will increase up to around 50% of the GDP over the medium term. This could cause challenges in terms of external account sustainability. Although exports are projected to grow more quickly, the rapid pace of import growth is still a concern and reflects the considerable growth in private consumption. The restrictions imposed by the Russian Federation on the export of wines may result in a decrease in the pace of export growth.

121. Another factor that could have adverse effects on the trade balance deficit is the evolution of world prices for oil and the impact these are having upon the import of energy resources. The uncertain situation over the price of natural gas is a further concern.

122. The exchange rate for the national currency, supported by massive remittances sent to the country could continue to appreciate, thus putting encouraging additional import growth and reducing export competitiveness.

123. At the same time, despite the relatively prudent currency and fiscal policies that still control for the level of inflation, the increase in the price of imported energy resources may have adverse effects in accelerating inflation.

124. Until new business markets are identified, the cessation of wine exports to the Russian Federation could slow down the growth of winegrowing and wine-producing industry and other associated industries.

125. Making allowance that Moldova is located in an area with agriculture at risk, the growing of farming products may be influenced by any natural disaster (droughts, excessive rains, hail etc.)

126. All of the above factors may negatively impact the pace of economic growth in the medium run and thereby give rise to fiscal risks.

127. Revenue performance will be influenced both by the impact of economic factors and by the efficiency of measures directed at collecting the revenues. The greatest risks relate to

the collection of VAT on imported goods, the most important source of income for the National Public Budget, which directly depends on the evolution of imports.

128. Changes in inflation and currency exchange rates can have a double impact on the budget, by affecting revenues and the spending at the same time.

129. Under these circumstances, the risk factors identified above can be mitigated by adopting a cautious budgetary stance involving tight control over the level of budget deficit together with sound macroeconomic policies.

130. In general, combination of sound macroeconomic policies could diminish the negative effects on national economy, and for a national budget especially, and reduce possible losses.

Chapter V. Public Expenditure Policy

A. General Goals of the Public Expenditure Policy

Key directions in the expenditure policy **131.** Public expenditure policy for 2007-09 emphasizes the importance of using available resources as efficiently and effectively as possible, with identification and harnessing of internal savings and channelling of resources made available to finance priority programmes.

132. The allocation of expenditure resources under the 2007-09 MTEF has been done in line with priorities of the general policy framework provided for under the EGPRSP, the Government's Action Program, and other national programmes.

133. A key objective under the MTEF is to ensure an appropriate structure of public spending that can support high quality of public services with a gradual increase in investment in public infrastructure.

134. At the same time measures will be taken to improve the quality of public investment projects involving the application of economic analysis of project costs and benefits and by introducing improved procedures for the management of public investments.

135. In order to ensure control over public expenditure, specifically staff-related costs, special attention will be paid to public administration and public sector reforms involving structural reorganisation and adjustments in staffing levels.

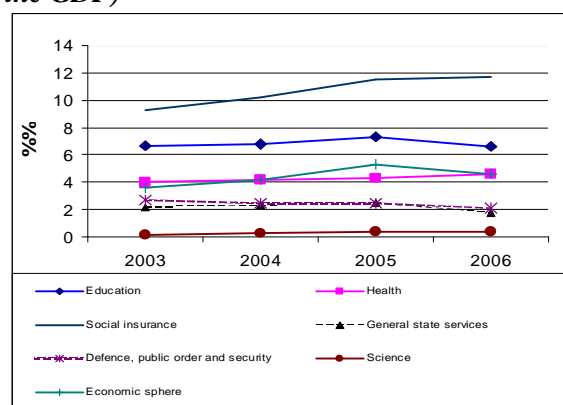
136. Pursuant to overall goals of the public expenditure policy for 2007-09, inter-sectoral and intra-sectoral expenditure priorities have been defined.

B. Public Expenditure Priorities

Recent trends **137.** Recent trends in the structure of public expenditure by sectors show considerable growth in the share of spending on the economic sectors from 10.9% in 2003 up to 14.1% in 2005, and in the share of social expenditure from 62.4% up to 63.6%.

138. At the same time, the expenditure on government's general services, public order and national security dropped from 14.8% in 2003 down to 13.2% in 2005. The same trends can be seen in sector spending

Chart V.1. Evolution of public expenditure by key sectors during 2003-2005 (per cent within the GDP)



patterns as a share of GDP, as outlined in Chart V.1.

139. These trends reflect the priority given to economic and social sectors in recent years, with direct impact upon economic growth and poverty reduction. Within the social component, most of the increase in spending was earmarked for social protection and healthcare, whereas in the economic sectors there were significant spending increases on agriculture, utilities and energy.

Cross-branch priorities

The allocation of resources under the 2007-09 MTEF has taken place based on analysis of sectoral expenditure programmes, making allowance for the scope for efficiency savings in the use of existing resources, as well as taking into account the priorities set out under the overall policy framework, specifically the EGPRSP. The public expenditure forecasts for 2007-09 by sectors are presented in Table V.1.

Table V.1. Public expenditure forecasts for 2007-09, % share in the GDP

	approved	estimated		
	2006	2007	2008	2009
Discretionary costs, total	35.9	38.4	37.5	36.7
1. Government general destination services	1.8	1.9	1.6	1.5
2. Economic activity	0.6	0.4	0.4	0.3
3. Justice and constitutional rights	0.3	0.3	0.3	0.2
4. Defense, public order enforcement and security	2.1	1.9	1.7	1.6
5. Social spending	23.7	24.4	24	23.3
Education	6.6	6.5	6.0	5.4
Healthcare	4.6	5.1	5.0	5.0
Social insurance and support	11.7	12.0	12.2	12.3
6. Science/research and innovations	0.4	0.5	0.6	0.7
7. Economic spending	4.6	4.6	3.7	3.2
<i>Including:</i>				
Agriculture, forestry, fishery and water services	1.4	1.5	1.3	1.2
Utilities and residential housing	1.7	1.6	1.1	1.0
8. Environment protection	0.2	0.2	0.2	0.1
9. Salary system reforms *	1.9	3.6	4.6	5.5
10. Other sectors	0.3	0.6	0.4	0.3
Informative: GDP, Mdl billion	43	49.3	56	63.3

140. The estimates by sectors do not include the costs associated with the implementation of salary system reforms. These are shown separately and will be distributed in the process of budget development, once the normative framework is completed.

141. The general factors that impacted upon cross-cutting expenditure priorities for 2007-09 include:

- Gradual implementation (2006-10) of pay reforms within the public sector. About one-third of all additional resources available will be earmarked for this purpose in 2007.
- Indexation of spending for goods and services depending on the evolution of the consumer price index and the increase in the price of natural gas. Taking these factors into account allocations will be increased by Mdl 81.3 million in 2007, Mdl 53.3 million in 2008 and Mdl 52.7 million in 2009.
- A gradual increase in allocations earmarked for capital investment which has a key impact on economic development. The level of capital investment financed from the State Budget and ATU Budgets basic expenditure will increase by around 4% by between 2006 and 2009. Around two thirds of capital investments made during 2007-09 will be channelled to the economic sectors.

142. In the context of inter-sectoral expenditures priorities, the social sector expenditure is further emphasised, with the biggest largest increase in funding taking up 33% from the total additional public spending for 2007. Within the social sectors, spending on health care will increase by about 25% in 2007, due to the scaling up of the package of services rendered through health insurance, while spending on social insurance and assistance will increase by some 14%. Spending on education, culture, arts, sports and youth programmes will increase by about 9% in 2007. Increased spending for these areas is also forecast for 2008-09, yet at a slower pace, taking into account the slower growth in the resource framework that is projected for these years.

143. A considerable growth in spending is anticipated in research/science and innovations of around Mdl 100 million annually. The share of this expenditure in GDP will increase from 0.4% in 2005 up to 0.7% in 2009. The increase is aimed at complying with the Code on Research/Science and Innovations, and the Partnership Agreement between the Government and Academy of Sciences. At the same time, resource constraints will make it impossible to achieve the targeted level of spending of 1% of the GDP by 2009.

144. Spending on the economic sectors is expected to increase by 11.6% in 2007, with spending on agriculture increasing by 17%, and on transport and roads by 15% compared with 2006. The share of this expenditure will slow downward during 2008-09. This can be explained by the winding up and completion of certain programmes, specifically those linked to the central provision of gas and water supply, as well as to the uncertainty with respect to the possibilities for securing additional external financing for infrastructure investment projects.

*MTEF –
EGPRSP
links*

145. The efforts during recent years to link EGPRSP priorities to MTEF expenditure priorities have achieved only limited success. An analysis⁴ conducted in 2005, highlighted a range of obstacles, particularly: (i) the lack of synchronization between EGPRSP and MTEF development processes, (ii) weak coordination in technical procedures and institutional arrangements, and (iii) limited capacity of public authorities for strategic planning and analysis.

146. The first annual Report on the evaluation of EGPRSP⁵ implementation also brought out a number of shortcomings that will have to be resolved, such as the limited efficiency and effectiveness of certain sector-wide expenditure programmes, as well as the need for a more thorough prioritisation of government programmes and policies so that these can be better linked to the resource allocations.

147. In contrast to previous years, a wider dialogue among the public authorities was initiated when preparing the 2007-09 MTEF with a view to better match the EGPRSP policies to MTEF resource allocations, by introducing necessary changes to the plan of actions for the development of MTEF and having a more-inclusive participation in the process of setting the priorities and expenditure ceilings. A key goal in the process of developing the resource allocation proposals for the 2007-09 MTEF was to support the implementation of policies

⁴ This analysis was conducted in December 2005 with support from the DFID-funded MTEF Support.

⁵ The first Annual Report on the evaluation of EGPRSP implementation was presented within the framework of a national Forum on March 23rd, 2006.

under the EGPRSP. The box below sets out a summary analysis of the links existing between EGPRSP and MTEF priorities.

EGPRSP priorities and their reflection in the MTEF

The EGPRSP sets out the following priority areas: *private sector; public administration; social protection; healthcare and education; infrastructure; regional development; and environment*. It is worth mentioning that these areas are not fully consistent with the classification of sectors used for budget purposes, as the priorities in the EGPRSP do not reflect exclusively the need for additional funding. However, in order to facilitate their matching with MTEF priorities, a conventional grouping has been accepted, as follows:

Social sectors (*social protection, healthcare, and education*) continue to hold the biggest share in the total amount of public spending – about 61% in 2006. These areas will benefit from over half (58%) of the total amount of additional funds during the resource allocation process for 2007-09. When one is looking at 2007 compared with 2006, the health spending will increase by about 23%, social insurance and protection related expenditure by 14%, and education by 10%.

Economic sectors (*infrastructure, regional development, and private sector*) has benefited from a priority approach in terms of resource allocation over the last years, accounting for about 12% from the total public expenditure in 2006. The share of these costs will stay at the same level in 2007, and will take a slow downward slope during 2008-09.

Public spending for *environment* protection is relatively small at about 0.4% of the overall public resources available. Allocations within this area will increase by about 33% over the medium run, almost twice the average level of public expenditure growth. Mostly, environmental funds will further be used to finance the activities in this area, specifically created for that purpose, alongside the funds coming in from external donors.

Public administration is using up about 5% of the total public expenditure. An increase in the allocations to this area of about 18% in 2007 is anticipated, with a slow decrease during the following years.

148. It is planned to strengthen the mechanisms for channelling of financial resources to meet the EGPRSP targets through consultations with central and local public authorities, as well as with the donor agencies. Additionally, it is planned to introduce a budget program classification, the implementation of which will contribute to a more strategic allocation of resources and will allow better monitoring of resources allocated from an efficiency and efficacy point of view.

Priorities within sectors

149. The public administration reform that was initiated in 2005⁶ is expected to contribute to the strengthening of capacity in the public authorities by setting up specific departments responsible for strategic planning and analysis tasks.

150. Spending priorities within sectors have been identified based on a review of existing expenditure programmes and in line with the sector-wide policy priorities as identified in the EGPRSP and other national programmes. These are outlined below:

⁶ The central public administration reform strategy is approved through the Government Resolution no.1,402, as of December 30th, 2005.

Government general services, justice, defence, and public order

151. Allocations earmarked for general government services will increase by 17.8% in 2007 when compared with the previous year, whereas the funds earmarked for defence, maintaining public order and national security will increase by 2.2%. Expenditure on general public services will fall from 1.9% of GDP in 2007 to 1.5% in 2009 and on defence and public order from 1.9% of GDP to 1.6% over the same period. The following priorities will guide news spending allocations: (i) implementing the public administration reform strategy and improvement in governance standards; (ii) implementing the strategy to build an information society “Electronic Moldova”; (iii) improving budget and tax management by developing the treasury, tax and customs systems; (iv) developing a system for training the staff in the field of justice; and (v) improving the conditions in prisons.

Education and Culture, Arts, and Youth-Targeting Interventions

152. In 2007, education will benefit from an increase funding allocations of 9.9% and culture, arts and youth programmes or 8%, with the level of increase slowing in the following years. Spending as a share of GDP will slightly decrease by 2009 accounting for about 5.4% and 0.7% respectively. The spending earmarked for these areas are designated to cover the following priorities: (i) increase the access to education, specifically to secondary education, linked to improvement in the quality of education services; (ii) additional incentives for young teachers working in the rural areas; (iii) increases in the food rations in schools and boarding houses; (iv) consolidation of teaching staff; (v) information technology development; (vi) fellowship support to students and pupils; and (vii) increased the access of youth to culture services and information sources by opening youth centres and by refurbishing cultural facilities.

Healthcare

153. Allocations earmarked for health 2007-09 will increase more rapidly compared with other sectors and will range between 24.8% and 11.1%. Additional allocations are aimed at: (i) expanding the package of health services rendered through the mandatory health insurance system and through the free government-guaranteed national health programmes, (ii) consolidating the material and technical resources of health facilities, and (iii) functionally separating the health services provided by government health facilities from those provided under health insurance.

Social Insurance and Social Protection

154. As in previous years, pending on social insurance and social protection will account for the largest share within the total public expenditure programme, increasing from 30.3% in 2007 up to 32.5% by 2009, and reaching about 12% of GDP over the period. This growth is mostly determined by the payments measures granted through the social insurance system. Additional funds will be targeting the following activities: (i) indexation or increase of social insurance provisions, (ii) intensifying social protection for families with children; (iii) development of social services and networks of social workers; and (iv) indexation of personal savings held at the *Banca de Economii* and other similar institutions.

Economic activities

155. Spending on the economic sectors will fall as a share of GDP from 4.6% in 2006 down to 3.2% in 2009. The relative growth in allocations earmarked for the economic sector in 2007 – 11.6 per cent, somewhat slowing down during the following years for certain sectors. The major budget priorities in the economic sectors relate to measures aiming to: (i) support the farming sector by an ongoing development of the farming subsidy system, (ii) develop food safety standard by adjusting institutional, normative and diagnostic standards to comply with international and in particular European standards; (iii) support the development of winegrowing and wine-producing sectors as a sub-sector of strategic importance; and (iv) renovate public roads as a critical factor for infrastructure development.

156. A more thorough review of policy priorities at the sector level that underpin the distribution of additional resources under the 2007-09 MTEF, is set out in Annex 10 “Reform Priorities by Key Sectors and Financial Implications for 2007-09”.

157. Spending priorities for the four pilot sectors subject to strategic analysis – education, healthcare, social protection, and agriculture, are identified and can be found in the strategic sector expenditure plans that are set out in Annexes 11-14. These provide an in-depth analysis of expenditure programmes within sectors, identify policy priorities for 2007-09, and evaluate the impact they will have upon the budget.

158. The spending ceilings for the State Budget by sector and central public authority for 2007-09 represent the limits within which the authorities will have to develop programme and budget proposals for 2007 and their forward spending commitments set for 2008 and 2009, in order to accomplish the priority goals set out under the EGPRSP and other social and economic development programmes.

159. Expenditure ceilings for the State Budget by sector and by public authority for 2007-09 are shown in Annex 9.

C. Public Expenditure by Economic Categories

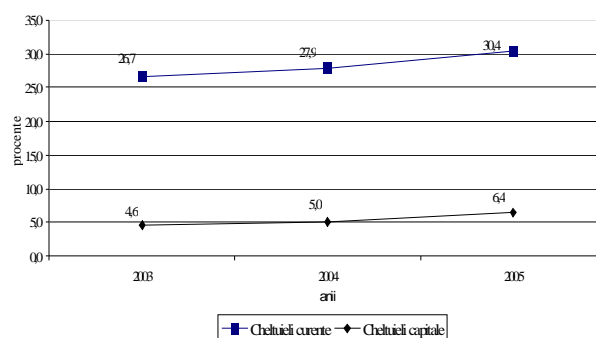
Analysis of current and capital costs

160. Current spending accounts for the major share of discretionary expenditure, amounting to about 80% of total spending. As a share of total spending it by and average of 1.3% annually during 2003-05.

Over the same time period, the share of capital spending increased from 14.6% to 17.3%. Current and capital expenditure as a share of GDP both increased during 2003-05. The evolution of the share of current and capital discretionary expenditure in the GDP during 2003-05 is shown in Chart V.2.

161. These trends have been marked off in particular by the social and economic development programme and strategy priorities that dictated the increase in the amount of capital investments from the National Public Budget. These priorities aim, in particular, at scaling up the supply networks for natural gas and water supply to residential buildings, community development, development of public roads infrastructure, and other.

Chart V.2 Trends in current and capital discretionary costs for 2003-2005 (proportion of GDP)



162. The share of current and capital costs in overall costs at sector level shows significant deviations from the average level reported in the National Public Budget for 2003-05. Hence, capital costs are most important in the infrastructure and fuel and energy sectors (99% of total spending), in agriculture (45% of total spending) and in utilities (40% of total spending). At the same time, the share of capital spending has been lowest for social assistance and support, transport, education, public order, defence, and national security.

163. The scope for increasing the level of capital spending during 2007-09 proved to be very limited. A key constraint to increased capital spending will be the implementation of the salary system reform that will use up most of additional resources that are expected to become available under the State and ATU Budgets during 2007-09. There are also uncertainties over the likely level of external project financing with a number of on-going projects due to be completed and few new funding commitments to fund additional investment projects. The considerable additional allocations to social welfare programmes as well as for health care services have also reduced the scope for funding new investment projects.

164. Taking into account the impact of above factors, current spending as a share of GDP will gradually increase from 32.3% in 2006 to 34.2% by 2009. Capital spending will be maintained at 2006 levels during 2007 but will fall to 7.1% of total discretionary spending and 2.6% of GDP by 2009. However, there is scope for increase capital spending in 2008 and beyond if additional external funding flows can be secured following the agreement on the new IMF programme. As these flows are quite difficult to estimate at the present time, they have not been included in the MTEF forecasts. Additionally, to the extent that additional revenues become available during 2007-09 these will be prioritised towards capital spending under the State and ATU Budgets.

165. Simultaneously, the planning and management of public investment will be strengthened over the medium term in order to ensure that public resources are utilised more effectively. The amount of capital investments expected to be financed during 2007-09 from domestic revenues is estimated at about Mdl 500 million annually. More detailed information on capital investment planning and analysis can be found in Technical Note 3.

166. Forecasts for key economic categories of public expenditure for 2006-09 are shown in Table V.3.

Table V.3. Forecasts for public expenditure by economic categories for 2006-09

Staffing costs 167. Trends in wagebill spending during 2003-05 show a decrease as a share of GDP from 9.6% in 2003 down to 8.2% in 2005. This fall was due to the reassignment of staffing costs within much of the health system to “goods and services” following the full implementation of mandatory health insurance in 2004 when wagebill spending dropped to 7.8% of GDP in 2004, before increasing by 0.4% of GDP in 2005.

168. Excluding salary related costs that were reassigned following the implementation of mandatory health insurance, wagebill spending as a share GDP was relatively stable ranging from 8% in 2003 up to 8.2% in 2005.

169. A salary system reform that started this year will have an impact on staffing costs in the following years. This reform will be gradually implemented by 2010, considering the limits of the available resources framework. The additional needs for this purpose are provided to be as follows for 2007-2009: MDL 968 million in 2007, MDL 792 million in 2008, and MDL 907,2 million in 2009.

170. It is estimated that the salary system reform will result in wagebill spending increasing from 9.1% of GDP in 2006 up to 10.5% in 2009. A more comprehensive analysis of the number of employees and associated public sector wagebill costs is presented in Technical Note 2.

Spending on goods and services 171. Spending on goods and services increased during 2003-05 due to the implementation of mandatory health insurance. As a result, the share of spending on goods and services increased by 1.6% of GDP. in 2004 to 7.8% of GDP. It increased by a further 0.1% of GDP. in 2005.

	2006 approved			Forecasted								
	MDL mil	% in total	% in GDP	2007			2008			2009		
				MDL mil	% in total	% in GDP	MDL mil	% in total	% in GDP	MDL mil	% in total	% in GDP
Spending, total	16.479,0		38,3	19.478,5		39,5	21.557,7		38,5	23.874,3		37,7
Debt service	607,1		1,4	553,3		1,1	556,0		1,0	623,0		1,0
<i>Internal</i>	338,9		0,8	341,0		0,7	344,9		0,6	326,3		0,5
<i>External</i>	268,2		0,6	212,3		0,4	211,1		0,4	296,7		0,5
Let lending	-39,8		-0,1	-23,8		0,0	-40,5		-0,1	-34,6		-0,1
Discretionary expenditure	15.911,7	100,0	37,0	18.949,0	100,0	38,4	21.042,2	100,0	37,6	23.285,9	100,0	36,8
Current expenditure	13.877,6	87,2	32,3	16.650,8	87,9	33,8	19.084,1	90,7	34,1	21.633,5	92,9	34,2
Expenditure for personnel	3.894,0	24,5	9,1	4.920,1	26,0	10,0	5.732,0	27,2	10,2	6.658,3	28,6	10,5
Goods and services	3.594,9	22,6	8,4	4.582,7	24,2	9,3	5.122,8	24,3	9,1	5.692,3	24,4	9,0
<i>from MHIF</i>	1.514,3	9,5	3,5	1.998,7	10,5	4,1	2.293,9	10,9	4,1	2.628,7	11,3	4,2
Production-bound transfers	1.134,2	7,1	2,6	1.212,1	6,4	2,5	1.319,6	6,3	2,4	1.415,1	6,1	2,2
Transfers to population	4.933,2	31,0	11,5	5.681,3	30,0	11,5	6.625,3	31,5	11,8	7.584,3	32,6	12,0
<i>From State Social Insurance Fund</i>	4.378,2	27,5	10,2	5.010,3	26,4	10,2	5.917,9	28,1	10,6	6.818,0	29,3	10,8
Other costs	321,3	2,0	0,7	254,6	1,3	0,5	284,4	1,4	0,5	283,5	1,2	0,4
Capital expenditure	2.034,1	12,8	4,7	2.298,2	12,1	4,7	1.958,1	9,3	3,5	1.652,4	7,1	2,6

172. Excluding spending on goods and services on health services under the mandatory health insurance scheme in the country, spending on goods and services fell by 0.3% of GDP to 4.9% of GDP in 2004 and remained at same level in 2005.

173. Spending on goods and services for the medium term will go up both in absolute figures and in real terms. They will grow up by 0.8% of GDP in 2007 to 9.3% of GDP. About one half of the overall growth is due to the increase in spending on health services provided within the framework of MHIF. Spending on goods and services will decline by 0.1% of GDP annually in 2008 and 2009, due to the slowing in the pace of growth in MHIF spending .

***Transfers
earmarked for
production***

174. Transfers earmarked for production consist mainly of transfers to support the farming sector, renovation works and public roads maintenance works, the subsidizing of certain culture-related facilities, as well as the community development works and real estate valuation works. The level of transfers earmarked for production showed an upward trend, increasing from the equivalent of 1.6% of GDP in 2003 to 2.6% in 2005.

175. The significant growth in transfers for production purposes reflects the social and economic development goals and was mainly due to the increase in transfers earmarked for land development financed from ATU Budgets (0.3% of GDP), transfers to support agriculture (0.2% of GDP), transfers for renovation works and public road infrastructure maintenance (0.1% of GDP) and for support provided to culture facilities (0.1% of GDP).

176. The share of transfers for production purposes will decrease during 2007-09 from 2.6% of GDP in 2007 to 2.2% in 2009. This reduction will occur both as a result of financial constraints, but also reflects the already relatively high level of financial provision to programmes for support the farming sector, and to support cultural facilities.

***Transfers made
to population***

177. The share of transfers made to the population is the largest single public expenditure item. The share of transfers made to the population in the overall structure of discretionary spending increased from 28.1% in 2003 to 30.3% in 2005 (8.8% of GDP to 11.1%).

178. Over 70% of transfers made to the population consist of social insurance principle benefits covered from the SSIF. The remainder represent the provision of social assistance rendered from the State Budget and from ATU Budgets.

179. The share of transfers made to mainstream population will continue to grow in the coming year from 11.5% of GDP in 2006 up to 12% by 2009. This increase will be mostly due to increased spending on benefits paid from the SSIF. Transfers made to the population funded from the State Budget will remain at around 1.2-1.3% of GDP.

Chapter VI. Budgets of Administrative-Territorial Units and Links to the State Budget

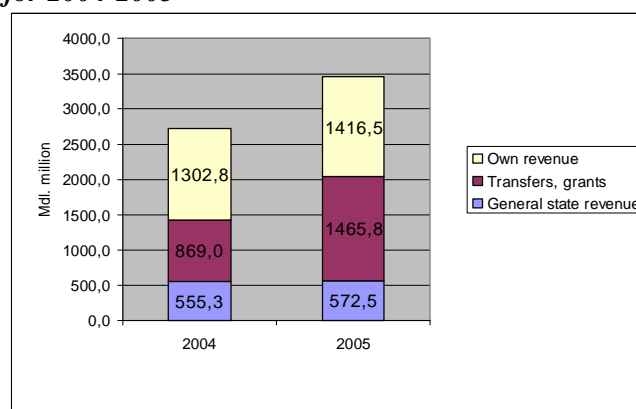
ATU Budget Revenues **180.** The amount of overall ATU Budget revenues in nominal figures grew by about 27% during 2004-05, representing 25% of total public revenues and equivalent to 10% of GDP. This above growth was divided between revenues from taxes, fees and other financial flows, about 21.4% of the total increase, and from transfers 78.6%. Trends in basic indicators of ATU Budgets for 2004-09 are presented in Table VI.1.

Table VI.1. ATU Budget revenues and costs for 2004-09

	Measure unit	Done		MOF estimates	Estimates		
		2004	2005	2006	2007	2008	2009
Total ATU Budget revenues	Mdl million	2,864.5	3,636.6	3,297.4	3,569.2	3,870.4	4,144.2
Including:							
1. Total core revenues, including:	Mdl million	2,727.1	3,454.8	3,145.3	3,391.5	3,682.8	3,953.1
<i>Share in overall revenues</i>	<i>per cent</i>	<i>95.2</i>	<i>95.0</i>	<i>95.4</i>	<i>95.0</i>	<i>95.2</i>	<i>95.4</i>
2. Special means	Mdl million	109.9	146.3	106.6	111.7	112.7	112.8
<i>Share in overall revenues</i>	<i>per cent</i>	<i>3.8</i>	<i>4.0</i>	<i>3.2</i>	<i>3.1</i>	<i>2.9</i>	<i>2.7</i>
3. Special funds	Mdl million	41.6	53.3	72.2	94.1	104.6	109.1
<i>Share in overall revenues</i>	<i>per cent</i>	<i>1.5</i>	<i>1.5</i>	<i>2.2</i>	<i>2.6</i>	<i>2.7</i>	<i>2.6</i>
Total ATU Budget spending	Mdl million	2,924.6	3,775.7	3,337.2	3,609.2	3,905.4	4,174.2
<i>Level of defraying the expenditure from total revenues net of transfers</i>	<i>per cent</i>	<i>67.5</i>	<i>56.6</i>	<i>67.8</i>	<i>66.3</i>	<i>67.6</i>	<i>69.9</i>

181. The amount of ATU Budget core revenues in nominal figures increased by 26.7% in 2004-05 due to a rise in ATU Budget own revenues of 8.7% (mostly because of increasing collections from salary income taxes (Mdl 72.3 million), transfers and of funds remitted from the State Budget by 68.7% (to cover salary increased etc), and government general revenues by 3% (see Chart VI.1).

Chart VI.1. Evolution of ATU Budget main revenues for 2004-2005



182. In 2005 there was an increase of 33.1% in special means revenues (owing to the increase in the number of services provided) and of 28.1% in special fund revenues for the social support of population during (owing to the funds transferred from the Republican Fund for population support and from the ATU Budgets). The evolution of these funds over 2003-09 is presented in Annexes 5.3 and 5.4.

183. During 2007-09 it is anticipated that the overall ATU Budget revenues (including transfers from the State Budget) will rise by 25.7%, mostly caused by an increase in own revenues (of Mdl 398.3 million mainly from increased personal income tax revenues) and in shared revenues (of Mdl 249.1 million mainly from business tax revenues).

184. More detailed information on the evolution of revenues and ATU Budget expenditure for 2003-09 is contained in Annexes 5.1 - 5.2.

185. This analysis highlights that the fiscal basis of the ATUs still is not sufficient to cover the assessed spending requirements for ATU Budgets. In only two ATUs do own revenues cover expenditure requirements and in only four out of 35 ATUs do own and shared revenues cover expenditure requirements (municipalities of Balti and Chisinau, districts of Basarabeasca and Rezina).

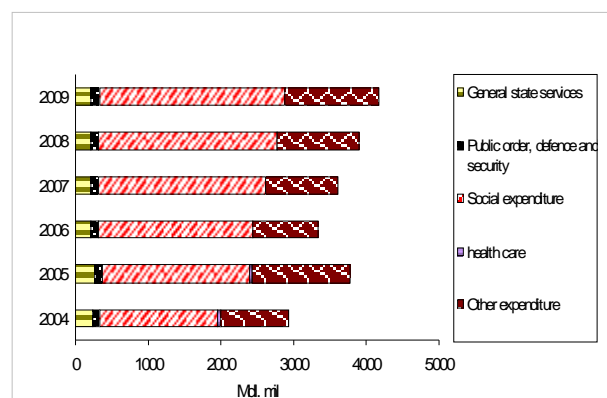
ATU Budget spending

186. Total ATU Budget expenditure increased by 1.2% of GDP during 2004-05 representing an increase in nominal spending of 29.1%.

187. Total expenditure incurred under ATU Budgets was covered by own revenues to the level of 67.5% in 2004 and 56.6% in 2005. This is projected to increase to 69.9% by 2009 (see Table VI.1).

188. In terms of operations conducted in 2005, the most significant expenditure is the costs of social and cultural nature, accounting for about 54.5% in the total amount of ATU Budget expenditure, whereas economic costs accounted for about 31.1%, with the remainder going as government general service costs – about 6.8%, and other expenditure – 7.6%. The evolution of ATU Budget expenditure by sectors is shown in Chart VI.2.

Chart VI. 2 Trends in ATU Budgets spending for 2003-2009



189. In nominal terms ATU expenditure will increase by 25.1% during 2007-09. The financial resources to cover the costs associated with pay increases following the implementation of a new salary system within the budget sector, as well as capital investment costs that will be provided from the State Budget, are not included in these figures.

190. There will be an increase in the nominal spending on operational expenditures under the ATU budgets to reflect changes in the consumer price index, as well as a number of other factors that are set out below.

191. Trends for the ATU Budgets in the main economic expenditure items for 2004-09 are presented in the Chart VI.3

Cross-budget relationship

192. The relationship between ATU Budgets and the State Budget for 2007-09 was estimated in line with provisions of the existing legal framework. These links are determined by setting up the norms for disbursements from government general revenues and the amount of transfers from the Regional Financial Support Fund.

193. When setting inter-budgetary relationships in order to ensure the continuity in promoting cross-budget policy and encouraging local public administration authorities to accomplish sustainable plans for the development of ATUs for 2007-09, it is planned that the share of general government revenue will stay at 2006 levels.

194. When determining the amount of ATU Budget expenditure and transfers from the Regional Financial Support Fund, considerations were given to the following: (i) priorities and policies identified for the areas in question; (ii) National Bureau for Statistics data on the number of population and the demographic structure of the latter one, as of January 1st, 2006; and (iii) unified norms for per capita spending levels.

195. The increase in the above norms was influenced by the policy driving the sectors in question, the main factors of which are as follows:

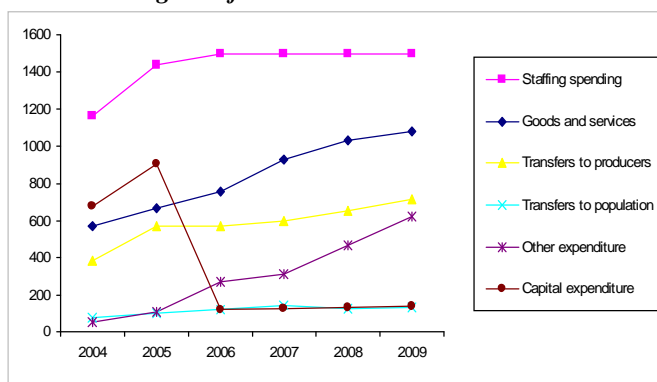
- Indexation of spending on goods and services depending on the evolution of consumer index;
- Increase the norms for food set for education facilities (increase the norm for hot meals for children of school years I to VI and in kindergarten);
- Refurbishment of education and culture facilities;
- Supply the education and culture facilities with teaching materials, stationery, procurement of textbooks and periodicals;
- Carry out the measures set out in the “SALT” programme;
- Gradually implement the natural norms for clothing, furniture, items of personal hygiene and toys for students in all sorts of boarding schools; and
- Implement the measures set in the “Moldovan Village” programme.

196. The average expenditure norms for the country that were used when estimating the ATU Budget expenditure and when determining the amount of transfers earmarked for the Regional Financial Support Fund for the next three years, are on an upward trend.

197. The average expenditure norms do not provide for the amounts needed to cover the costs associated with salary raises following the implementation of the new salary system in the budget sector, the funds serving this purpose are included into the State Budget.

198. Average expenditure norms and the pace of their annual increase throughout 2006-09 are presented in Table VI.2.

Chart VI.3. Trends in expenditure by ATU Budget core economic categories for 2004-2009



199. Estimates of the transfers from the Regional Financial Support Fund to ATU Budgets during 2007-09 are shown in Table VI.3.

200. ATUs, in which revenues for 2007-09 exceed the average expenditure requirements by more than 20%, will transfer the different to the Regional Financial Support Fund. These amounts are estimated to be equal to Mdl 278 million in 2007, Mdl 400.2 million in 2008, and Mdl 553 million by 2009.

Table VI.2 Pace of annual growth in expenditure norms for 2006-09

No.	Area		Average norms (Mdl)				Growth rate,%		
			2006	2007	2008	2009	2007/ 2006	2008/ 2007	2009/ 2008
1.	Government general destination services	One employee	27,208.94	27,807.3	28,346.49	29,005.1	102.2	101.9	102.3
2	Costs associated with running military centers	One person recruited	5,265.0	5,607.0	5,915.0	6,370.4	106.5	105.5	107.7
3.	Municipal police	One FTE	20,314.4	20,757.1	21,155.3	21,743.8	102.2	101.9	102.8
4.	Education:								
	-pre-school facilities	One child	2,642.375	3,241.096	3,463.123	3,690.195	122.7	106.9	106.6
	-primary school, upper and lower secondary school	One student	1,725.107	1,860.1437	1,950.346	1,984.174	107.8	104.8	101.7
	-boarding-house type facilities	One student	8,341.97	10,676.6	11,655.444	12,581.2	128.0	109.2	107.9
	-boarding houses with special regimen	One student	11,388.67	13,957.102	15,474.754	17,044.951	122.6	110.9	110.1
	-auxiliary facilities	One student	143.54	150.623	156.858	164.996	104.9	104.1	105.2
5.	Culture	One inhabitant	32.568	39.4238	48.7218	53.3664	121.1	123.6	109.5
6.	Sports and youth-targeting actions	One inhabitant	1.41	1.54	1.67	1.8	109.2	108.4	107.8
7	Social insurance and support:								
	-social assistance services at home	One FTE	6,276.4	6,363.7	6,425.41	6,487.41	101.4	101.0	101.0
	-asylums for the elderly and retired people	One tutored	16,188.6	17,357.41	18,497.5	19,643.01	107.2	106.6	106.2
	-day care social assistance centers for children	One tutored	7,413.4	7,817.95	8,212.6	8,609.11	105.5	105.0	104.8
	-social assistance centers for the placement of children	One tutored	11,609.6	12,243.12	12,861.2	13,482.09	105.5	105.0	104.8
	-psychosocial centers for rehabilitation of victims of family violence	One tutored	16,188.6	17,357.41	18,497.5	19,643.01	107.2	106.6	106.2
8.	Veterinary health service	One employee	14,134.3	14,436.4	14,706.2	15,028.3	102.1	101.9	102.2

**Strategic
planning for
ATU Budgets**

201. Making allowance for the role the local public authorities are playing in promoting and implementing the sector-wide policy at the local level, as well as in the management of some part of public finances, the practice of strategic planning at the level of ATU Budgets was expanded starting in 2005, by involving the public administration authorities from three districts, namely – Orhei, Ungheni, and Glodeni.

202. It is planned that the public administration authorities from the municipalities of Balti and Chisinau, as well as those from the districts of Cahul, Drochia, Edinet, Sangerei, and Straseni will also be involved in the process of strategic planning starting in 2007.

Table VI.3 Transfers from the Regional Financial Support Fund, 2007-09 estimates
Mdl, thousand

ATU name	Year		
	2007	2008	2009
<i>Districts</i>			
Anenii Noi	31,010.0	31,480.0	30,690.0
Basarabeasca	5,030.0	4,100.0	2,510.0
Briceni	28,280.0	30,190.0	30,010.0
Cahul	44,330.0	45,470.0	43,860.0
Cantemir	36,930.0	39,160.0	39,800.0
Calarasi	40,130.0	41,810.0	42,480.0
Causeni	41,140.0	42,770.0	42,530.0
Cimislia	31,930.0	33,500.0	34,010.0
Criuleni	37,960.0	39,570.0	39,910.0
Donduseni	15,940.0	16,450.0	16,500.0
Drochia	30,340.0	31,390.0	30,960.0
Dubasari	24,550.0	25,440.0	25,810.0
Edinet	26,200.0	26,670.0	25,790.0
Falesti	43,950.0	46,650.0	47,610.0
Floresti	35,580.0	37,200.0	36,800.0
Glodeni	26,460.0	27,710.0	28,170.0
Hancesti	58,310.0	60,650.0	60,590.0
Ialoveni	43,980.0	45,450.0	45,100.0
Leova	30,490.0	32,580.0	33,240.0
Nisporeni	40,750.0	42,900.0	43,960.0
Ocnita	21,120.0	21,790.0	21,870.0
Orhei	41,080.0	41,680.0	41,680.0
Rezina	21,730.0	22,280.0	21,940.0
Rascani	29,050.0	30,450.0	31,080.0
Songerei	50,520.0	53,240.0	54,470.0
Soroca	40,270.0	41,570.0	41,180.0
Straseni	40,080.0	41,400.0	40,830.0
Soldanesti	24,470.0	25,550.0	25,930.0
Stefa Voda	39,170.0	41,480.0	42,530.0
Taraclia	13,650.0	13,720.0	12,990.0
Telenesti	46,710.0	49,190.0	50,450.0
Ungheni	54,470.0	56,560.0	56,360.0
Total districts	1,095,610.0	1,140,050.0	1,140,120.0
ATU Gagauzia	20,890.0	18,550.0	13,780.0
Total ATU	1,116,500.0	1,158,600.0	1,153,900.0

Epilogue

203. The improvement and consolidation of public finance management is one of the key elements of a sustainable State Budget system and implies certain measures aiming at increasing the efficiency of public financial resources. Considerable efforts have been made over the last years in terms of improving the methods of budget planning and the way it budgets are presented.

204. As a strategic tool for budget development, MTEF was introduced in Moldova in 2002, since when it has become an integral part of the annual budget cycle, as well as a key element in the Government's public finance management reform programme. At the same time, it is recognised that the progress achieved in implementing of a more strategic approach into the budget planning process through the MTEF quite limited. The textbox below provides an insight into the basic challenges along the way of this process, as well as some measures to overcome them.

MTEF allocations don't reflect well enough the policy priorities in the context of the EGPRSP, as outlined below:

- ◇ EGPRSP initiatives and actions were considered as something additional to existing costs;
- ◇ Line ministries pay limited attention to EGPRSP priorities during the budget planning process;
- ◇ Need to focus upon ways to free up resources under the circumstance of restructuring the existing activities;
- ◇ Excessive expenditure commitments (e.g., on salaries) are using up most of additional resources within the MTEF;
- ◇ As a result, the opportunities to fund new initiatives under the EGPRSP are extremely limited; and
- ◇ Lack of a classification tool for programmes makes it difficult to make the expenditure meet the policies.

Below listed are the measures to be taken in order to improve the current situation:

- ◇ More realistic costs for the EGPRSP policies, making allowance for the overall amount of allocated expenditure;
- ◇ Budget procedures and ceilings make the ministries identify the savings reserves following the efficient harnessing of resources; and
- ◇ Develop a classification of programmes and implement it starting in 2008.

205. In this context, the main directions for the medium-term development of the MTEF process are as follows:

- Better integration of fiscal impacts of government policies, macro-fiscal forecasts and estimates of likely future funding levels of public investment projects in order to ensure that resource allocations under the MTEF are more credible from a policy perspective.
- Expansion of the strategic approach in public expenditure planning to all sectors. This is strongly linked to an implementation of programme classification, which is a critical element in promoting a more strategic approach to budget planning;
- Adoption of a more strategic and transparent approach in the process of setting the ceilings within the MTEF, that makes them conditional on budget implementers come up with proposals for the more efficient and effective use of budget resources;

- Development of strategic planning and analysis capacities in line ministries in the context of central public administration reform strategy, and implementing associated measure for staff training;
- Scaling-up of strategic planning and analysis skills at the level of ATUs, taking into account the pilot exercise that was initiated back in 2005 in the districts (Orhei, Ungheni and Glodeni). The purpose of this initiative is to improve budget planning at the level of ATU, to increase accountability and transparency, and ensure consistency with nation-wide and local policies; and
- Increasing the transparency of the budgetary process by implementing a communication strategy for the MTEF and annual budget, in particular the placing of information on the MTEF and budget on the MoF's website and publishing a popular version of the MTEF.

206. The planned measures will contribute to the reaching of the MTEF's key goals of: (i) ensuring the consistency between the Government's budget forecasts and a sustainable macroeconomic and fiscal framework; (ii) the development of a budget planning process, focused on achieving greater consistency between the Government's policy priorities and the allocation of resources within a realistic medium term resource framework.

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