ANNEX 1

of the Commission Implementing Decision on the "Annual Action Programme 2014 in favour of the Republic of Moldova"

Action Document for "Support to Public Finance Policy Reforms in Moldova (PFPR)"

1. IDENTIFICATION

Title/Number	Support to Public Finance Policy Reforms in Moldova (PFPR) CRIS number: ENI/2014/033-684		
Total cost	Total estimated cost: EUR 37.0625 million Total amount of EU budget contribution is EUR 37 million, of which: - EUR 33 million for budget support - EUR 4 million for complementary support Estimated co-financing by potential grant beneficiaries: EUR 0.0625 million		
Budget support			
Aid method / Management mode and type of financing	Direct management Sector Reform Contract (SRC)		
Type of aid code	A02 – Sector Budget Support	Markers	BSAR
DAC-code	15111	Sector	Public finance management
Complementary support			
Aid method / Management mode and type of financing	Direct management – grants – call for proposal Direct management – procurement of services		
DAC-code	15111	Sector	Public finance management

2. RATIONALE AND COUNTRY CONTEXT

2.1. Summary of the action and its objectives

The proposed programme, Sector Reform Contract (SRC) "Support to Public Finance Policy Reforms in Moldova (PFPR)" supports the efforts of the Government of the Republic of Moldova[6] to progress in some of the crucial areas foreseen by the Association Agreement, which are linked with the improvement of public governance, economic recovery and growth.

Moldova initialled the Association Agreement with the European Union on 29th November 2013. This is considered as an important step towards the further economic integration of Moldova with the EU, and is expected to further deepen political, economic and trade relations between the two parties. Moldova is also a partner country within the European Neighbourhood Policy, and EU-Moldova ENP Action Plan defines the strategic objectives of political, economic and institutional reforms. Sound management and control of public finances, as well as improved public finance management and transparency, are key political dialogue and reform areas of the ENP Action Plan.

The reforms envisaged under this programme are largely aimed at enhancing transparency of and accountability in Moldovan public finances. At the same time, improvements in public finance policy are expected to contribute to the maintenance of fiscal sustainability and the promotion of economic policies, a necessary condition in support of Moldova's efficient growth and development in the medium and longer term.

2.2. Country context

2.2.1. Main challenges towards poverty reduction/inclusive and sustainable growth

Poverty in Moldova is a crucial socio-economic development aspect that is the running thread of action in the 2012-2020 National Development Strategy (NDS). Moldova's economic recovery since 2000 has reduced income poverty, though poverty reduction, especially in the rural areas, has recently stalled. Moldova is characterised by volatile economic growth and high levels of social exclusion and income disparities. The country's Gross Domestic Product (GDP) per capita increased from USD 950[7] in 2006 to USD 2 200[8] in 2012, but the country remains among the poorest in Europe. The proportion of the population living in poverty has decreased from 30.2 % to 16.6 % between 2006 and 2012. There are large and persistent region and urban/rural disparities in Moldova, particular in relation to access to education, health care, clean water or central heating. Non-urban areas in Moldova are characterized by lower incomes and poverty in non-urban rural areas was 12.9 percentage points higher than in the urban areas. Moldova is ranked 113 in the 2012 Human Development Index[9].

Significant improvements were made in easing conditions for the business environment in Moldova. Moldova has undergone a number of regulatory reforms in the last 5 years, and its ranking has advanced from place 86 in 2013 to place 78 in 2014 (out of 185 countries) in World Bank's Doing Business, with major improvements in starting business, access to financing and taxation[10]. Corruption though remained a main obstacle to development. The

[6] Hereafter referred to as Moldova
[7] World Bank, World Development Report, 2014
[8] IMF, World Economic Outlook, October 2013
[9] https://data.undp.org/dataset/Table-1-Human-Development-Index-and-its-components/wxub-qc5k
[10] http://www.doingbusiness.org/data/exploreeconomies/moldova

World Economic Forum's Global Competitiveness index placed Moldova 89th among 148 countries, stressing corruption and political instability among the top obstacles for doing business in the country. Poor state of road infrastructure (148th place out of 148), low independence of judiciary and inability of the country to retain talent (both at 145th place out of 148) are amongst factors that need improvement.

The growth was driven mainly by domestic consumption fuelled by remittances. The key challenge in the foreseeable future is to shift from the current consumption-based growth model towards one based on raising investments, increasing productivity and competitiveness, developing export industries, and promoting a knowledge-based society. The achievement of the development objectives set in NDS will require macroeconomic stability and timely implementation of structural and systemic reforms. This programme complements the public finance policy and public finance management reforms to provide macroeconomic stability.

2.2.2. Fundamental values

The Moldovan Government has adhered to the fundamental values of democracy, rule of law and human rights.

According to Amnesty International (2012), the Government has made significant progress in bringing legislation and practice in line with European and international human rights standards, but it still faces significant challenges in combating discrimination[11]. As per the latest report (2013) of the European Commission against Racism and Intolerance (ECRI), by adopting several action plans, the authorities have demonstrated their willingness to undertake major reforms, which would make it possible to combat racism and racial discrimination more effectively. These plans concern inter alia the honouring of Moldova's commitments to the Council of Europe and the European Union[12]. The latest report of Freedom House (2014) indicates that Moldova has a freedom status of "partially free". However, the scores for political rights and civil liberties are "3", which is the closest score to the "free" status[13]. The Law "On guaranteeing equality" No 121 was adopted on the 25th of May 2012[14]. The law provides for the establishment of a specialised body to combat racism and racial discrimination – the *Council to Prevent and Combat Discrimination and Ensure Equality*.

The issues of concern raised by ECRI and still to be addressed by the authorities include: (i) non ratification of Protocol No. 12 to the European Convention on Human Rights; (ii) cases of non-registration of ethnic minorities by municipalities; (iii) cases of police reluctance to register complaints of racism and racial discrimination; (iv) non-use of their power by Parliamentary Advocates to apply to a court to protect the interests of alleged victims of discrimination.

The 5th report on the implementation of the Visa Liberalisation Action Plan (VLAP), adopted in November 2013 by the European Commission, concluded that Moldova meets all the benchmarks set in the four blocks of the second phase showing positive progresses on data protection and human rights matters.

According to the most recent Human Rights Watch report of 2011 corruption remains a major drawback in guaranteeing protection of human rights and the anticorruption legislation needs to be broadened[15]. In the latest reports of Transparency International (2013), the corruption

[11] Towards Equality, Discrimination in Moldova, Amnesty International, 2012
[12] ECRI report on the Republic of Moldova (fourth monitoring cycle), October 2013
[13] Freedom House, Freedom in the world 2014:
http://www.freedomhouse.org/sites/default/files/Freedom%20in%20the%20World%202014%20Booklet.pdf
[14] http://lex.justice.md/viewdoc.php?action=view&view=doc&id=343361&lang=1
[15] http://www.hrw.org/news/2011/10/21/moldova-broaden-anti-discrimination-bill

perception index is 35, ranking Moldova 102nd out of 177 countries in 2013, dropping from 89th place four years earlier[16].

2.3. Eligibility for budget support

2.3.1. Public policy

Improvements in public finance policy are critical for the maintenance of fiscal sustainability and for the promotion of viable economic policies; preconditions to support Moldova's growth and development in the medium and longer term. The National Development Strategy (NDS) Moldova 2020 is the overarching public policy document in Moldova summarising the country's growth objectives. Moldova's public finance policy objectives are encapsulated within the overall objectives of the NDS. Therefore, for this sector programme it is decided to consider NDS as the public policy document within the framework of which budget support is provided.

The NDS Moldova 2020 represents the overall strategic development vision for Moldova and covers the period from 2012 to 2020. It is a well-defined policy, and it has been adopted by the Executive as well as by the Parliament, - thus acquiring - a high political status[17]. The policy objective of the strategy is to further economic development and poverty reduction. The main strategic policy direction is to support productive restructuring of the national economy enabling to maintain a higher pace of economic growth (setting a rising GDP growth target of 6% and above by 2020).

The NDS focuses on seven development priorities: (i) Aligning the education system to labour market needs in order to enhance labour productivity and increase employment in the economy; (ii) Increasing public investment in national and local road infrastructure, in order to reduce transportation costs and increase speed of access; (iii) Reducing financing costs by increasing competition in the financial sector and developing risk management tools; (iv) Improving the business climate, promoting competition policies, streamlining the regulatory framework and applying information technologies in public services for businesses and citizens; (v) Reducing energy consumption by increasing energy efficiency and using renewable energy sources; (vi) Ensuring financial sustainability of the pension system in order to secure an appropriate rate of wage replacement; and (vii) Increasing quality and efficiency of justice and fighting corruption in order to ensure equitable access to public goods for all citizens.

The final chapter of the Strategy describes the implementation, monitoring and evaluation arrangements. It is expected that the Strategy will be implemented through an update of the existing Consolidated Action Plan (CAP), which includes in itself actions from the Government's Activity Program and other national and strategic planning documents. The monitoring is done through regular reports including (i) Quarterly progress reports; (ii) Annual implementation report; (iii) Thematic evaluation reports; (iv) Intermediate implementation report to be produced after 2015; (v) Final report. The Government has supervision of the strategy implementation process, and will review the implementation progress. The State Chancellery is the main institution responsible for Strategy coordination, monitoring and evaluation. Ministries responsible for priorities ensure coordination and reporting in their areas of competency. The Parliament will review the Strategy implementation evaluation reports. The involvement of the civil society is ensured through the

[16] http://www.transparency.org/cpi2013/results
[17] Law 166 of the 11th of July 2012. Officially published at http://lex.justice.md/index.php?action=view&view=doc&lang=1&id=345635

National Participatory Council. Within such overall framework, Moldova's public finance policy reforms represent a critical policy component of the overall NDS, by enhancing efficiency and effectiveness in the allocation and oversight of public resources contributing to the growth of the economy and to the development of Moldova. At the same time, improved public finance governance will contribute to a more transparent and accountable stewardship over the use of public funds in all areas and sectors of the general government.

The policy is therefore considered relevant because, inter alia, it addresses the overall objectives of poverty reduction, sustainable and inclusive growth, and efficient governance. It also establishes the general framework for linking the objectives of the EU budget support programme with the objectives identified in the public policy, and puts the programme in conformity with the overall country context. The policy is therefore credible because, inter alia, Moldova has a positive track record in policy implementation. The previous NDS (2008-2012) proved to be an effective mechanism to mobilise support from development partners. The current development strategy is based on the outcomes of the previous NDS. The policy financing is organised through a medium-term expenditure planning process. The Medium Term Budgetary Framework (MTBF) of Moldova is the key document through which multi-annual strategy actions are prioritised and financed, the MTBF priorities and programmes being converted into expenditures in the approved annual budgets.

Based on the above assessment, it is concluded that the National Development Strategy Moldova 2020 is sufficiently relevant and credible for budget support programme objectives to be achieved and to be supported by the European Commission through the proposed programme.

2.3.2. Macroeconomic policy

During 2000-2008 the Moldovan economy experienced a period of sustained economic growth with an average annual real GDP growth rate of 5.9%. The GDP growth in 2011 was 6.4%. The economic growth was negative in 2012 with 0.7% contraction of GDP. The growth recovered the following year, and at the end of 2013 GDP came in at 8.9%. This was a much higher growth rate than expected. This growth was mostly contributed by the agricultural sector output of 30%, which had experienced a substantial 20% contraction in 2012.

The average rate of inflation in 2011 was 7.6%, slightly higher than the 7.4% rate registered in 2010. The increase in prices in 2011 reflected rises in the international prices for food and energy, as well as increases in the administratively-set tariffs for electricity, gas and heating in Moldova. The inflation rate decelerated in 2012 and 2013 to 4.6%. The drop in the inflation rate in 2012 reflected the drop in international prices of key components of the consumer price index.

The fiscal deficit dropped from 6.3% of GDP in 2009 to 2.5% in 2010, and was further reduced to around 2.4% in 2011. At the end of 2012 the fiscal deficit was 2.2% of GDP, and at the end of 2013 it was 1.8%. It is projected that it will increase to 2.6% of GDP in 2014. This is a result of much needed widening of capital spending which increased from 5.2% and 6.3% in 2011 and 2012 to 7.2% of GDP in 2013 and 2014 projected. At the same time, the Government continues to restrain the recurrent spending which is projected to be 32% of GDP against 34% in 2012.

The stock of public and publicly guaranteed debt as a share of GDP is modest and has followed a downward trend over the last three years. At end-2011 public and publicly guaranteed debt as share of GDP amounted to 28.3%, down from 30.2% and 32.4% at end-2010 and end-2009 respectively. In 2012 and 2013 the stock of public and publicly guaranteed debt was 31.1% and 30.2% of GDP and it is estimated that it will remain stable at this level during the following several years. Overall Moldova's public debt is at acceptable levels and is well below the regional averages.

Moldova has a fairly high tax revenue/GDP ratio (32%) compared to other Commonwealth of Independent States (CIS) countries. By this indicator Moldova is marginally below the maximum of lower Middle Income Countries - MICs (36.6%) and is well above the median of upper MICs (26.8%)[18]. The revenue collection is quite high for lower middle income countries and is higher than in many CIS and Eastern European countries. The Government continues intensification of its tax and customs administration efforts to safeguard fiscal revenue. These measures include (i) Improvements in customs clearance procedures to reduce the discretion of customs officers and the time spent by vehicles crossing the border; (ii) Intensification of inland control and inspections to monitor the final destination of imported products and reduce misclassification; (iii) Better monitoring of free economic zones' imports, production, exports, re-exports, and unjustified build-up of inventories to identify and correct inconsistencies.

The Moldovan economy is vulnerable to adverse external shocks on key markets for its exports and/or host countries for its migrants. The current account deficit increased from 7.9% in 2010 to 11.4% of GDP in 2011 and decreased to 7.7% and 7.1% in 2012 and 2013 respectively, mostly reflecting an increase in the trade deficit. It is expected that starting from 2014 the current account deficit will remain at the range of 7-8%.

In October 2012, the IMF identified the following elements as factors posing serious downside risks to the Moldova economy: (i) Possible intensification of the euro area crisis; (ii) Slowdown of world growth affecting Moldova's CIS trading partners; (iii) Sharp increase in world oil prices; (iv) Deterioration of Moldova banking system's soundness[19]. The year 2013 has confirmed the fragility and opacity of the Moldovan banking sector. More recently, the geopolitical destabilisation in the region related to the Ukraine crisis is another major source of further vulnerability for the small, open economy of Moldova.

The IMF supported the Moldovan Government's macroeconomic programme under the Extended Credit Facility (ECF) and the Extended Fund Facility (EFF) arrangements, which run from January 2010 until April 2013, for an amount equivalent to SDR 369.6 million (about USD 569.4 million).

In November 2013, the government of Moldova requested from the IMF a new financing programme. In January 2014, an IMF mission was in Moldova to negotiate a new programme and almost agreed on a 15-month arrangement, combination of a Stand-by Arrangement and a concessional Stand-by Credit Facility. In view of Moldova's relatively comfortable external financial situation (external indebtedness represented about 80% of GDP and foreign reserves represented five months of imports at year-end 2013), the planned arrangement was to be of precautionary nature: IMF funds would be drawn upon only in the case of an adverse shock. However, both parties agreed that the risks of an adverse shock materializing were quite high, in view of a possible impact of a slowdown in the Russian economy, trade restrictions imposed by Russia and lower remittances resulting from a tightening of immigration rules in Russia (Moldova depends heavily on remittances of its migrant workers in Russia). The fragility and opacity of the banking sector also exposes Moldova to a financial crisis and capital outflows which, should they worsen, could push the country in an unsustainable balance-of-payments' situation. However, no agreement was concluded, as the Moldovan

[18] IMF, 2011, Revenue Mobilisation in developing countries
[19] IMF Country Report No. 12/288, October 2012

authorities were reluctant to implement potentially unpopular structural policy measures advocated by IMF staff in an electoral year.

Still, Moldova has shown good economic performance over the last three years. The Government also managed to maintain acceptable levels of inflation (below 5% in 2012 and 2013). Authorities have manifested fiscal prudence: capital expenditure has increased faster than current expenditure within a decreasing overall fiscal deficit (below 2% of GDP in 2013). The Moldovan authorities also managed to maintain public debt at relatively low levels (around 30% of GDP at year-end 2013). Lastly, the Moldovan authorities have managed to remain broadly on track with the IMF programme implemented between 2010 and 2013, meeting most quantitative targets and structural benchmarks.

Based on the above analysis, and despite the vulnerability of the Moldovan economy to external shocks and the need to implement further reforms in key areas of the economy, it is concluded that, overall, the authorities pursue a credible, stability oriented macroeconomic policy.

2.3.3. Public financial management

In July-November 2011 the Government of Moldova updated the Public Expenditure and Financial Accountability (PEFA) assessment first undertaken in 2006 and updated in 2008. PEFA 2011 is the most recent diagnostic study of public financial management in Moldova covering fiscal years 2008-2010.

PEFA 2011 results show progress in overall public financial management (PFM), including (i) Improvement in twelve performance indicators; (ii) Stability in thirteen indicators, of which six with maximum score of “A”; and (iii) Deterioration in only three indicators.

The weaknesses of the existing PFM system include:

- Low quality of macroeconomic projections and revenue forecasting;
- The current Medium-term budgetary framework (MTBF) framework does not provide transparent expenditure discipline for the medium-term largely due to the inconsistency in the presentation of planned expenditures between the MTBF and the annual Budget appropriation structure;
- Cases of delays in meeting the deadlines of the budget calendar;
- Flaws in financial reporting and accounting standards;
- Weak management of operational risks and fragmented debt recording system;
- Members of Parliament have limited capacity in scrutinising the budgetary documents and have little experience in interpreting reports of the Court of Accounts (CoA);
- Weaknesses in the contents of the CoA reports, whose focus is often on cases for the law enforcement agencies and not necessarily on topics of interest for a parliamentary discussion;
- Unsatisfactory follow up of the CoA reports by the Government.

Following the PEFA 2011 study the Government drafted and approved the Strategy for Development of Public Finance Management 2013-2020 (PFM Strategy 2013-2020)[20], which formalised the Government’s commitment to improve in a sustainable way accountability and performance of public financial systems. The Ministry of Finance (MoF) has approved the 2013-2014 action plan[21] detailing the actions envisaged in the Strategy and establishing a

[20] Government of Moldova Decree N 573 of the 6th of August 2013
[21] Ministry of Finance Order N 130 of the 20th of September 2013

formal monitoring framework to follow up the implementation process. Therefore the current action plan and following action plans approved by the MoF along with their monitoring reports will be used by the EU Delegation to Moldova for both PFM performance and the reform programme annual monitoring. This will substitute the "Summary Table" provided in the budget support guidelines and will avoid duplication and reduce the monitoring transaction costs for both the EU Delegation and the Government.

The Government's PFM reform programme is relevant, because the approved PFM Strategy updates the status in crucial PFM areas, defines the areas of attention and weaknesses and presents the reform measures to address these weaknesses. The programme ensures full coverage of the weaknesses identified in PEFA 2011 and other PFM related technical documents. The PFM Strategy also constitutes a synthesis of on-going reforms by consolidating in one document the other policy actions and strategies already under way in several critical components of PFM[22]. The Strategy is in essence a summary of high level objectives in terms of short term realisable targets and longer term aspirations for meeting EU and international standards and practice.

Corruption risks related to the management of the capital budget, public procurement and payroll management are recognised and addressed in the Strategy. Also, measures related to improving internal control, financial inspection and fraud investigation are at the core of the PFM Strategy. These along with the establishment and staffing of internal audit structures in all central public authorities and in second level local authorities are reform measures to be implemented in short-term.

The PFM reform programme is credible, because the reform process is well sequenced, there is a high level of political commitment to reforms and clear leadership by the Ministry of Finance, the issues related to corruption and fraud are addressed, and there are clear arrangements for coordination and monitoring.

Based on the analysis above it is concluded that there is a credible and relevant programme (Strategy for Development of Public Finance Management) to improve public financial management.

2.3.4. Budget transparency and oversight of the budget

Moldova's draft and enacted budgets are published in the official gazette called *Monitorul Oficial*, and are made publicly available in printed form. In addition, the draft and enacted budgets are published on the website of the Ministry of Finance[23], as well as on the official website covering the entire legislation of Moldova[24].

The Executive's 2014 budget proposal was approved by the Government Decree No. 960 of 3rd December 2013. The budget proposal was published as a separate book. The budget proposal was also published and made available:

- In *Monitorul Oficial* No 284-289, Article No. 1066 of 6th December 2013.
- On the official website of the Moldovan legislation[25];

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[22] Including (1) Public Debt Management Reform Plan, Moldova; (2) Strategy for Developing Public Internal Finance Control, Moldova; (3) State Tax Service, Moldova State Tax Service Development Plan for 2011-2015; (4) State Customs Service, Strategic Development Programme of Customs Service of Moldova 2012-2014

[23] www.mf.gov.md

[24] www.justice.md

[25] http://lex.justice.md/viewdoc.php?action=view&view=doc&id=350544&lang=1

- On the website of the Ministry of Finance[26], including the text of the law, all seven annexes, as well as all explanatory, informative and analytical notes and tables prepared by the Government and accompanying the budget submission to the Parliament.

The 2014 budget was approved by the Parliament by the Law No. 339 of 23rd December 2013. The approved budget was published and made available:

- In *Monitorul Oficial* No 14-16, Article No. 34 of 21st January 2014.
- On the official website of the Moldovan legislation[27], including the text of the law with annexes.

Based on the evidence above the entry point is considered to be met.

The Government's intentions towards more transparency and oversight of the budget are relevant, because the PFM Strategy also addresses weaknesses in the area of transparency (a distinct section in the PFM Strategy), as well as PFM oversight and accountability.

The Government's intentions are credible, because there is a clear political commitment to further improve the transparency and quality of the budgetary information made available to the public. In addition, the Government has committed to participate in the forthcoming Open Budget index survey and start the publication of the Citizen's Budget, which are targets set in the PFM Strategy.

Based on the analysis above it is verified that the Government has published both the Executive's proposal and the enacted budgets, and that the eligibility on transparency and oversight of the budget is met.

2.4. Lessons learnt

Reviews of on-going and former programmes to assist the Moldovan Government funded by the EU as well as other donors have led to the following conclusions:

- There has been specific design problems in sector budget support programmes due to inconsistency together with a large number of Specific Conditions attached to disbursements. This practice has increased the risk of failure of programmes and decreased fiscal predictability.
- There is a need for clearer and more focused design:
  - to avoid delays in the implementation resulting from the plurality of state agencies involved in the attainment of the indicators; and
  - to remove differences in interpretation regarding performance and calculation of payments for the variable tranches between the Government and the EU.
- The programme must include a few, clearly defined conditions for disbursement and responsibility/accountability structures for the institutions responsible for the fulfilment of the variable tranche indicators. Visibility and publication is also a critical factor.

The specific lessons learnt during the implementation of previous sector budget support programmes is that technical assistance complementary to budget support has been essential in assisting the Government to meet its reform objectives.

[26] http://mf.gov.md/TranspDeciz/ProiecDeciz/bsparl

[27] http://lex.justice.md/viewdoc.php?action=view&view=doc&id=351191&lang=1

2.5. Complementary actions

The main project supporting the Moldova's PFM developments during the recent years have been the World Bank -funded Public Financial Management Technical Assistance Project (USD 15.7 million), which was completed in December 2013.

The EU's technical assistance in this area has been provided mainly through twinning projects, including:

- Strengthening Public Financial Management in Moldova with the Division of Harmonisation of Public Internal Financial Control of the Ministry of Finance: completed in November 2013;
- Support to Public Procurement system of Moldova with the Agency of Public Procurement of the Ministry of Finance: completed in October 2012.

EU has also been providing sector budget support in various areas, including health, social protection, water sector, energy, justice, economic development in rural areas.

IMF provides ongoing advisory support to the State Tax Service on strengthening tax administration. There is also a cooperation project, financed by the Swedish International Development Cooperation Agency, between the Main State Tax Inspectorate under the Ministry of Finance and the Swedish Tax Agency running from 2013-2016. Policy-oriented assistance has been provided to the State Tax Service and Customs by the EU High Level Policy Advising mission funded by the EU and implemented via UNDP Moldova since 2010.

The Court of Accounts currently benefits from three ongoing projects financed by Swedish Government, World Bank administered Trust Fund and EU twinning.

2.6. Risk management framework

The current risk profile of Moldova can be summarised as follows:

Risk	Level	Assumption and Risk mitigation
Governance and political		
Lack of commitment from the Government in undertaking targeted reforms	Moderate	Continuous policy dialogue with the Government within the framework of the Association Agreement

Macroeconomic		
Fiscal and balance-of-payments position could be negatively affected by: (i) slowdown in growth of main trading partners, in particular CIS countries; (ii) geopolitical destabilisation in the region related to the Ukraine crisis; (iii) possible trade restrictions imposed by Russia and lower remittances resulting from a tightening of immigration rules; and (iv) the fragility and opacity of the banking sector.	High	Continuation by the Government of stability-oriented macro-economic policy.

Public Financial Management		
Lack of commitment from the Government to implement PFM strategy	Moderate	Continuous dialogue with the Government on public finance policy issues and PFM reforms, use of the EU aid delivery mechanisms (budget support

		conditionality and complementary capacity building) to facilitate and embed the reforms

EU budget support programme		
Low predictability of budget support, delays in disbursements beyond the fiscal years they are planned for	Moderate	Use of clearly defined and realistic conditions for disbursement, clear and focused design of the programme, minimisation of the differences in interpretation regarding performance and calculation of payments

Corruption and fraud		
Political resistance to implementing anti-corruption measures and increasing public sector transparency	Substantial	Continuous dialogue with the Government to apply rigorously the anti-corruption legislation and rules, as well as monitoring of corruption cases and their legal consequences

Corruption and fraud are the risk areas for EU budget support programmes.

The on-going Public Administration Reform supported important developments towards an integral and efficient public service. A legal framework is being implemented which targets corruption (consisting of *Law on public service and status of public servant*, *Law on conflict of interest*, including a *Code of conduct*, *Law on public functions and Law on National Integrity Commission*) and includes subsequent bylaws. Laws and amendments on status and professional activity of judges and prosecutors were adopted that reduce their universal immunities and allow investigation and prosecution of magistrates for corruption related acts. The Introduction of professional integrity testing and lifestyle checks in the public sector is underway. Financial Management and Control systems are being introduced in the public sector that will ensure sound financial management of public funds. International Financial Reporting Standards (IFRS) are being introduced to the private sector. Low capacity and lack of political will for implementation are risks, despite a generally good legal framework.

Legislation to reform the National Anticorruption Centre, re-subordinated from the Legislative to the Executive, have been approved as well as the National Integrity Commission has been set up and made operational. The reform of the Prosecutor's General Office has been initiated with strong emphasis on the reform of the Anti-corruption Prosecution system.

3. DETAILED DESCRIPTION OF THE BUDGET SUPPORT CONTRACT

3.1. Objectives

The overall objective of this programme is to contribute to sustainable growth, maintained macroeconomic and fiscal stability and ultimately contribute to poverty reduction in Moldova.

The specific objective is to assist the Government (notably the Ministry of Finance), Parliament (notably the Committee for Economy, Budget and Finance) and the Supreme Audit Institution (Court of Accounts) of Moldova in the process of enhancing good governance, effective fiscal policy, transparent and accountable public finance policy and strengthened public financial management systems.

3.2. Expected results

The expected results of budget support are:

- Improved quantitative and qualitative analysis of the budget, including improved macroeconomic forecasting and revenue projection for setting fiscal targets and the level of expenditures compatible with these targets over the medium term;
- Enhanced consideration by the Government of the role of the independent public institutions in fiscal policy matters;
- Enhanced capacity of the Committee for Economy, Budget and Finance of the Parliament for budget oversight and scrutiny;
- Improved quality of external audit reports by the Court of Accounts, transparency in the processes of external audits, and greater follow up of the Court's recommendations;
- Improved annual and medium-term budget planning with enhanced budget discipline and credibility;
- Improved public financial management systems to ensure effective control of expenditure (including an adequate system of accounting and reporting), as well as to ensure efficient debt management to warrant lower debt service costs and minimise fiscal risks;
- Improved budget transparency along with better public access to key fiscal information, increasing citizens' understanding of the budget.

The expected results of complementary support are:

- Improved macroeconomic forecasting and revenue projection for setting fiscal targets and the level of expenditures compatible with these targets over the medium term;
- Improved annual and medium-term budget planning to enhance budget discipline and credibility;
- Improved budget transparency and public access to key fiscal information, to increase the citizens' access and understanding of the budget;
- Improved treasury management to ensure effective control of expenditure, including an adequate system of accounting and reporting;
- Improved debt management to guarantee low debt service cost and minimise fiscal risks;
- Improved mechanisms for prioritising capital proposals taking into account the economic and financial benefits of the projects;
- Improved capacity of the MoF to participate effectively in the formulation and coordinate the implementation of the EU budget support programmes;
- Enhanced capacity of local Civil Society Organisations (CSOs) for oversight of the budget and for dialogue on, and participation, to economic and public finance governance related matters.

3.3. Rationale for the amounts allocated for budget support

The total EU contribution allocated for budget support is EUR 33 million.

The rationale for this amount is based on a broad qualitative assessment that took into account, inter alia, an analysis of the following elements:

- Financing needs of the partner country;

- Commitment of the partner country to allocate national budget resources (including EU budget support) in line with development strategy and objectives and to follow standard national budget procedures;
- Track record and absorption capacity of past disbursements and how effectively agreed objectives were achieved with budget support operations.

Given the crosscutting nature of the public finance policy and financial management and the fact that they are part of general governance and not a distinct sector, it is considered that an increase in sector expenditure is not the key constraint to achieve the objectives of this SRC. The proposed SRC will add value through promotion and facilitation of the reforms envisaged under the programme and complementary support. The budget support component will have core importance within the overall intervention, particularly because of its financial significance and institutional reform incentives that it will provide to the Government.

The total 2014 budget approved for the Ministry of Finance amounts MDL 727 million (approximately EUR 40 million, representing 2.6% of total expenditure). This also represents 2% increase in expenditure against 2013 and 2012 budgets. The planned amount for 2014-2016 is MDL 2.2 billion which is approximately EUR 122 million. The proposed EUR 33 million budget support constitutes 27% contribution on the top of the above amount for 2015-2018.

Furthermore, this sector budget support represents approximately 0.7% of annual state budget revenues, 0.6% of annual expenditures and 7.5% of budgetary grant resources received by the government. The EU will be making a substantial investment in activities related to strengthening public finance policy and public financial management. This reflects the increased demand for PFM transparency and recognition that effective public finance policy and public financial management are pivotal to effective public administration reforms and economic growth.

It is also important to note that during the recent years EU budget support has been important for Moldova both in terms of a foreign exchange inflow, supporting the balance of payments and in terms of counter-value funds in national currency accruing to the budget:

- EU budget support makes up from 6% to 10% of current account balance every year, and;
- EU budget support makes up from 14% to 19% of capital expenditure of the government, and helps to reduce the cost of borrowing required to finance public investments[28].

This SRC will effectively provide additional fiscal space to the government at a macro level whilst focusing dialogue on results[29].

3.4. Main activities

Main activities to be carried out within the framework of this SRC will include:

- Continued policy dialogue with the Government with a particular focus on transparency and accountability in public financial policy and management;

[28] Data from Ministry of Finance, Division of External Financing and Debt calculations

[29] Section 2.3.1 of the EU Budget Support Guidelines: Programming, Design and Management (p. 75)

- Regular monitoring of budget support eligibility criteria, of macro-economic and PFM developments, budget transparency, as well as progress in implementation of the public policy;
- Transfer of funds to the State Budget against the results achieved according to the policy matrix;
- Monitoring of achievements of the reforms objectives agreed with the Government through independent reviews, regular briefings and discussions;
- Provision of complementary support to help the Government in its efforts to implement public finance policy and PFM reforms.

3.4.1. Budget Support

Main activities to be carried out within the framework of the Budget Support component of this SRC will include:

- Engagement in policy dialogue related to public finance reforms;
- Verification of conditions and subsequent disbursement of budget support against the results achieved according to the policy matrix.

3.4.2. Complementary support

Main activities to be carried will include:

- Grants/Call for Proposal to promote Civil Society Organisations' (CSOs) involvement in improving Moldova's economic governance and public finance management, enabling CSOs to oversee the budget and participate in public finance policy formulation and implementation;
- Procurement of technical assistance to the Ministry of Finance and other main stakeholders to accompany the implementation of the SRC. Technical assistance will be used for data collection to verify the fulfilment of the conditions for disbursement;
- Procurement of evaluation and audit missions.

3.5. Donor coordination

The donor coordination in Moldova is led by the Government of Moldova. There is a formal donor coordination mechanism approved by the Government that sets-forth all the procedural aspects and institutional grounds for coordination of bilateral and multilateral foreign aid[30]. In addition, the State Chancellery organises annual donor meetings and presents annual reports on the use of foreign assistance provided to Moldova.

The existing system for the donor coordination described above will be used for this Programme as well.

[30] Government Decree N 12 of the 19th of January 2010

3.6. Stakeholders

The public financial institutions in Moldova include the Central Government, the Administrative Territorial Units, the Compulsory Insurance Fund for Medical Assistance and the State Social Insurance Fund. The Central Government consists of 51 Central Public Authorities, including the Parliament, the Presidency, the Court of Accounts, the State Chancellery, the Constitutional Court, the Superior Council of Magistracy, the Supreme Court of Justice, 16 ministries and 28 other central public institutions.

The key stakeholders of the programme are:

- The Parliament of the Republic of Moldova, and namely its Committee for Economy, Budget and Finance, which has the responsibility for budget oversight and scrutiny;
- The Court of Accounts is the supreme audit institution (SAI) of the Republic of Moldova;
- The Ministry of Finance is the key executive institution dealing with public finance governance and outcomes.

Availability of reliable, relevant and timely information on public spending and information on institutional arrangements for public finances will enhance transparency and understanding of public policy priorities and resourcing. The PFPR programme also aims at supporting improvements in accountability by combining transparency with participation, better enabling non state actors to oversee and to participate in decision making and public policy implementation.

3.7. Conclusion on the balance between risks (2.6.) and expected benefits/results (3.2.)

The risks of non-intervention are: 1) Possibility of limited implementation of the PFM reforms in Moldova; 2) Delays in Moldova's compliance with the EU principles of fiscal governance and budgetary management; 3) Widened fiscal deficit and higher cost of borrowing.

It should be noted that Moldova has been running a current surplus[31] since 2004. Therefore, this SRC will effectively provide grant-financing of capital expenditure in Moldova preserving at the same time the debt sustainability and the current path of fiscal consolidation by the country.

Comparing the expected benefits and results as enumerated in section 3.2. to the risks listed in section 2.6. of this Action Document, the potential benefits/expected results of the envisaged budget support programme far outweigh any risks identified.

4. IMPLEMENTATION ISSUES

4.1. Financing agreement

In order to implement this action, it is foreseen to conclude a financing agreement with the partner country, referred to in Article 184(2)(b) of Regulation (EU, Euratom) No 966/2012.

[31] This measurement excludes revenue from grants (and thus budget support) and debt financing (borrowing)

4.2. Indicative operational implementation period

The indicative operational implementation period of this action, during which the activities described in sections 3.4 and 4.4 will be carried out, is 60 months from the date of entry into force of the financing agreement or, where none is concluded, from the adoption of this Action document, subject to modifications to be agreed by the responsible authorising officer in the relevant agreements. The European Parliament and the relevant Committee shall be informed of the extension of the operational implementation period within one month of that extension being granted.

4.3. Criteria and indicative schedule of disbursement of budget support

The general conditions for disbursement of all tranches are as follows: Satisfactory progress in the implementation of the National Development Strategy (NDS) Moldova 2020 and continued credibility and relevance thereof; implementation of a credible stability-oriented macroeconomic policy; satisfactory progress in the implementation of the Strategy for Development of Public Finance Management 2013-2020; satisfactory progress with regard to the public availability of timely, comprehensive and sound budgetary information.

There is no Performance Assessment Framework attached specifically to the NDS that can serve as a public policy monitoring document with respect to the specific public finance objectives. For the proposed budget support programme most of the specific conditions and the areas for determination of disbursement of the variable tranches are a result of the continuous policy dialogue between the EU and the Government of Moldova on improvements of the public fiscal policy.

Two specific conditions suggested by the Government are related to improved accounting/reporting and public debt management and are derived directly from the Strategy for Development of Public Finance Management 2013-2020. Thus, although the identified weaknesses in the area of PFM cannot be directly linked with the proposed specific conditions, there is full coherence between the programme objectives, the overall diagnosis of the problem, and the selected conditions and activities.

The specific conditions refer to the activities related to enhanced efficiency, effectiveness, transparency and accountability in Moldova’s public finances and to be implemented by (i) the Government of the Republic of Moldova, and namely by the Ministry of Finance; (ii) the Parliament of the Republic of Moldova, and namely its Committee for Economy, Budget and Finance; and (iii) the Court of Accounts, which is the Supreme Audit Institution of the Republic of Moldova.

The indicative schedule of disbursements is summarised in the table below (all figures in EUR millions) based on fiscal year of the partner country.

Country fiscal year	**2014**				**2016**				**2017**				**2018**				
Type of	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Total

tranche																	
Base tranche			8														8
Variable tranche						8				8				9			25
Total			**8**			**8**				**8**				**9**			**33**

4.4. Details on complementary support

4.4.1. Grants: call for proposal “Strengthening role of civil society in economic governance and public finance management” (direct management)

(a) Objectives of the grants, fields of intervention, priorities of the year and expected results

The objective of the grants is to enable Civil Society Organisations (CSOs) to oversee budget and participate in public finance policy formulation and implementation by facilitating the policy dialogue between the authorities and CSOs.

The expected results of the complementary support are the following:

- Enhanced capacity of local CSOs for oversight of the budget;
- Improved capacity of local CSOs for dialogue on and participation to economic and public finance governance related matters.

(b) Eligibility conditions

Local CSOs having experience and/or interest in economic governance and public finance policy formulation, implementation, monitoring and analysis will be eligible for this call.

In order to further capacitate national actors with expertise and/or interest in the field, partnerships between international and Moldovan CSOs will be welcomed.

(c) Essential selection and award criteria

The essential selection criteria are financial and operational capacity of the applicant.

The essential award criteria are relevance of the proposed action to the objectives of the call; design, effectiveness, feasibility, sustainability and cost-effectiveness of the action.

(d) Maximum rate of co-financing

The maximum possible rate of co-financing for grants under this call is 80%.

The maximum possible rate of co-financing may be up to 100 % in accordance with Articles 192 of Regulation (EU, Euratom) No 966/2012 if full funding is essential for the action to be carried out. The essentiality of full funding will be justified by the responsible authorising officer in the award decision, in respect of the principles of equal treatment and sound financial management.

(e) Indicative quarter to launch the call

1st quarter of 2015

4.4.2. *Procurement (direct management)*

Subject in generic terms	Type (works, supplies, services)	Indicative number of contracts	Indicative quarter of launch of the procedure
Technical assistance to Improve Public Finance Policy and Public Financial Management of Moldova	Services	1	Q1 2015
Evaluation and Audit	Services	2	Q1 2018

4.5. Scope of geographical eligibility for procurement

The geographical eligibility in terms of place of establishment for participating in procurement and grant award procedures and in terms of origin of supplies purchased as established in the basic act shall apply.

The responsible authorising officer may extend the geographical eligibility in accordance with Article 9(2)(b) of CIR Regulation on the basis of urgency or of unavailability of products and services in the markets of the countries concerned, or other duly substantiated cases where the eligibility rules would make the realisation of this action impossible or exceedingly difficult.

4.6. Indicative budget

Module	**EU contribution (in EUR millions)**	**Third party contribution (in EUR million, indicative)**
3.4.1 - Budget support	**33**	**N.A.**
3.4.2. – Complementary support	**4**	**0.0625**
4.4.1. - Call for proposals “Strengthening role of civil society in economic governance and public finance management” (direct management)	0.25	0.0625
4.4.3. - Procurement “Technical assistance to Improve Public Finance Policy and Public Financial Management of Moldova” (direct management)	3.5	N.A.
4.8. – Evaluation and audit	0.25	N.A.
Totals	**37**	**0.0625**

4.7. Performance monitoring

Monitoring of the Programme (both the budget support and technical assistance component) will be entrusted to a Steering Committee chaired by the State Chancellery and whose members will include representatives of the Parliaments’ Committee for Economy, Budget and Finance, Court of Accounts and the Ministry of Finance. Representatives of local CSOs with expertise and/or interest in the field will be also invited to the Committee's sittings. The Steering Committee will meet at least once a year.

Review missions will be used to assess the state of compliance with conditions and indicators attached to the disbursement of each of the budget support variable tranches envisaged under the programme.

4.8. Evaluation and audit

The European Commission foresees evaluation and audit after completion of the Programme.

4.9. Communication and visibility

Communication and visibility of the EU is a legal obligation for all external actions funded by the EU.

This action shall contain communication and visibility measures which shall be based on a specific Communication and Visibility Plan of the Action, to be elaborated before the start of implementation and supported with the budget indicated in section 4.6 above.

The measures shall be implemented either (a) by the Commission, and/or (b) by the partner country, contractors, grant beneficiaries and entrusted entities. Appropriate contractual obligations shall be included in, respectively, financing agreements, procurement and grant contracts, and delegation agreements.

The Communication and Visibility Manual for European Union External Action shall be used to establish the Communication and Visibility Plan of the Action and the appropriate contractual obligations.

As part of the Financing Agreement, the Moldovan government undertakes to ensure that the visibility of the EU contribution to the SRC is given appropriate coverage in the various publicity media. The accompanying technical assistance service contract will endeavour to further enhance the positive image of the EU in the context of its work in Moldova and specific provision for this purpose will be included in the technical assistance service contract.

At appropriate milestones during the SRC duration and after appropriate events, press releases will be issued, by MoF in co-operation with the EU Delegation to Moldova. In all these actions, the EU visibility guidelines will be strictly adhered to.