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ANNEX 1: ACTION FICHE REPUBLIC OF MOLDOVA

1. Identification

Title/Number	Economic Stimulation in Rural Areas CRIS: ENPI/2010/21782		
Total cost	EUR 45 million		
Aid method / Method of implementation	Sector Policy Support Programme (SPSP), centralised management		
DAC-code	14010	Sector	Economic Stimulation of Rural Areas

2. Rationale and country context

2.1. Country context and rationale for SPSP

The objective of this Sector Policy Support Programme is to contribute to the sustainable economic development of rural areas in the Republic of Moldova. It will offer a flexible instrument to support the development and anti-poverty agenda of the new government, the *Alliance for European Integration* that was sworn in on 25.9.2009.

The programme responds to priority areas 3, *Enhancing competitiveness*, and 5, *Regional development*, of the National Development Strategy (NDS) 2008-2011. A recent UN-mapping of aid in the Republic of Moldova has shown that these are the areas of the NDS which receive the least donor support. On gender, the budget support will contribute to NDS-priority area 4, *Developing Human Resources, Providing Employment Opportunities and Social Inclusion*. This budget support will also support the new government's Economic Stabilization and Recovery Program ('Anti-Crisis-Plan') 2009-2011, in cooperation with EU Member States and the World Bank, which plans a similar budget support of USD 40 million in early 2010. As a first in the Republic of Moldova, this intervention has been developed in joint programming with Swedish Sida, with important inputs received also from UK DfID.

2.1.1. Economic and social situation and poverty analysis

The Republic of Moldova is the poorest country in Europe, with a per capita GDP of circa EUR 1,000 in 2009. It has the lowest level of urbanization, as almost 60% of the population live in rural areas. Since independence, the countryside has been hit hard by phenomena of poverty, migration, ageing of the population and abandoning of social and economic infrastructure.

Economic growth in the Republic of Moldova in recent years (50% cumulatively 1999-2006) has been concentrated in urban areas and is now being partly reversed by the severe global and regional economic crisis that has hit the country since autumn 2008. For 2009, the new government foresees a GDP-decline of 9%, contributing to a budget deficit of several hundred million euro (EUR 160 million in Jan-Aug 2009), compared to a roughly EUR 1 billion national budget.

The crisis makes the current economic profile of the country – based on import, consumption and remittances – even more unsustainable. It leads to severe negative social effects and asks for urgent stabilisation and liberalisation efforts, supported by aid. Imports currently exceed exports by a factor of three (EUR 1.5 billion / EUR 600 million in 1-9/2009). Remittances are falling or stagnating. Contrary to popular belief, the Moldovan economy is much less dependent on agriculture - contribution of roughly EUR 300 million to a GDP of EUR 4 billion in 2008 - than on services with EUR 2.5 billion and industry with EUR 600 million.

The very low GDP leads to very low salaries and pensions, and high poverty. As of September/October 2009, the average (official) salary was 2,701 Moldovan Lei (MDL), or EUR 164, and the average pension 775 MDL or EUR 47. This hides an even more pronounced poverty in rural areas. Unemployment is officially still quite low at 6.1% in the second trimester of 2009, but this figure hides massive migration and underemployment.

2.1.2. National development policy

The 1998 EU-Republic of Moldova Partnership and Co-operation Agreement and the 2005 Action Plan under the European Neighbourhood Policy (ENP) are still the leading documents in EU-Republic of Moldova relations, although negotiations on a new political agreement will start on 12.1.2010. The most elaborated national development document is *the National Development Strategy 2008-2011*. On economic stimulation and regional development the NDS stipulates that 'generating economic growth outside the capital city, and especially in rural areas, which suffered from the loss of traditional agricultural markets, has been a major challenge for Moldovan authorities...' and foresees concrete initiatives under its priorities 3, enhancing the competitiveness of the national economy, and 5, regional development. The *Anti-Crisis Plan* of the new government, adopted in November 2009, also includes many relevant elements.

This budget support will provide grant financing for continuation and up-scaling of key government interventions under the NDS and the Anti-Crisis-Plan, as well as relevant sector strategies and laws. It will cover policy issues, institutional development, stimulation of business development, regional development, and improvement of public finance management. As women are especially hard hit by rural poverty, gender aspects are a priority of this programme and have been elaborated through joint programming with Sweden. Technical assistance for promoting economic empowerment of women is planned and activities foreseen in the policy matrix are gender mainstreamed.

2.2. Sector context: policies and challenges

The budget support is consistent with regional, economic and social policies, as it will contribute to the strengthening of economic, social and territorial cohesion, to the reducing of disparities inside the country, and to the strengthening of the overall economic performance of this European neighbourhood and Eastern Partnership country. A reduction of illegal migration through the creation of jobs in the Republic of Moldova's rural regions can also be expected.

The programme will help to implement the EU-Republic of Moldova Action Plan, especially regarding art. 22, *promote balanced regional development, reduce economic and social disparities across the country...promote growth of SMEs in regions and rural areas*, and art. 43, *developing appropriate infrastructure for SMEs*. It answers to a negative assessment in the last Republic of Moldova ENP Progress Report (4/2009) which found limited progress on

rural/regional development. The programme will also help implementing art. 23, *approximation of employment and social policy*, and art. 8, *ensuring equal treatment*.

As mentioned, the previous government of the Republic of Moldova has elaborated the National Development Strategy for 2008-2011, which followed the Economic Growth and Poverty Reduction Strategy Paper 2004-2007. Under NDS-priority 3, 'enhancing competitiveness', a vision is described to transform the national economy from being cost-factor determined to being determined by efficiency and quality. This implies improvement in the business environment, SME promotion, more efficient use of public assets, modernization of physical infrastructure and investments in human capital. A regional development strategy is foreseen in priority 5 of the NDS. In the meantime it has been drafted and shall be approved by Parliament in early 2010. From the six development regions of the country, the North, Central and South zones have started activities, whereas Chisinau, Gagauzia and Transnistria shall follow later. The NDS also aims to promote so-called secondary growth-poles - towns located in rural areas such as Ungheni, Orhei, Hincesti and Cahul and Floresti – which are planned to become engines for rural development in the surrounding regions.

2.3. Eligibility for budget support

On eligibility criteria 1, sector development, reform policy and strategy, the proposed budget support falls into the category of 'non-traditional sectors', as defined in the internal Guidelines Support to Sector Programmes. A number of laws and strategies exist already on regional development, SME support and investment and export promotion. There is however a considerable scope for prioritization, harmonisation and more realistic budgeting of these laws and strategies.

On eligibility criteria 2, stability-oriented macroeconomic policy, the Government has adopted an *Economic Stabilization and Recovery Plan 2009-2011 ('Anti-Crisis Plan')* that foresees priority measures to stabilize public finance, foster economic recovery and provide social protection. The Republic of Moldova's development partners consider the plan to be a well-balanced mix of tax and income raises (luxury goods, alcohol, tobacco, road tax; reinforced privatisation programme), spending cuts (non-essential administrative spending, freezing of public sector pay with exception of education sector), easing of administrative burdens (liberalisation of import-export regulations, simplified tax reporting procedures) and selective economic stimulation facilities (loan guarantee fund, facility for young entrepreneurs, regional development fund/budget line). Together with the new IMF loan that is expected to be accepted by the IMF board in January 2010 the foundations for a more sustainable macroeconomic policy have been laid by the new government in a very short time.

On eligibility criteria 3, relevant programme to improve public finance management, there is active cooperation between the Finance Ministry and the World Bank in the framework of a donors-financed multi-annual Public Finance Management (PFM)-project, and with the European Commission on Public Internal Financial Control with DG Budget. An up-dated Public Expenditure and Financial Accountability (PEFA) assessment in 2008 noticed a positive trend as compared to the first PEFA in the Republic of Moldova in 2006. Following an invitation by the Moldovan Finance Ministry, a fact-finding mission of DG BUDG is likely to take place in the first quarter of 2010. Regular Medium Term Expenditure Framework (MTEF)-planning will restart after the political crisis in 2009. However, major reforms are still outstanding (e.g. new organic budget law, introduction of a Financial Management Information System) and the practice is often not as rosy as the theory, as several corruption and public procurement scandals have shown throughout 2009.

2.4. Lessons learnt

The following lessons can be drawn from previous -EU budget support programmes in the Republic of Moldova, as well as interventions financed by other donors and International Finance Institutions (IFI):

- Sector budget support is an adequate aid delivery method for the Republic of Moldova, but requires significant inputs for policy guidance, leadership and government – donors dialogue from both the Republic of Moldova and EU side.
- Implementation of the policy matrix has to be followed on a constant basis, otherwise there is a danger that disbursements will be used to fill budget gaps, with subsequent delays in the implementation of the matrix.
- Technical assistance that accompanies budget support has to be prepared in time. This requires increased staffing of the EU Delegation, which is foreseen for 2010.

2.5. Complementary actions

The World Bank (WB) has recently provided a *Rural Investment Support Project II* for crediting existing and new businesses in rural area. The *National Programme for the Economic Empowerment of the Youth* (USD 1.6 million per year) will be financed using financial resources of the Revolving Funds of the WB financed RISP Project and International Fund for Agricultural Development (IFAD) Projects. *Rural Industries Equipment Grant Scheme* (USD 1 million per year) will provide financing for acquisition of small industrial equipment using its own revolving resources over the period of next 3 years. DfiD/Sida are financing the leading *Regional Development Project* (EUR 3.2 million) which has assisted the Government of Moldova determine its National Strategy for Regional Development and successfully establish three Regional Development Agencies, which could now be considered for financing from this budget support programme. A Sida/UNIFEM project is targeting women's economic empowerment through increasing employability. The European Commission's *Development of Sanitary and phytosanitary systems regarding non animal origin food exports* develops conditions for agricultural exports of non-animal origin to the EU. On a large scale (USD 102 million), US MCC will finance the *Rehabilitation of central irrigation system and transition to high value agriculture*, including eleven irrigation systems on the Nistru and Prut rivers.

2.6. Donor coordination

At Governmental level, donor coordination is led by the External Assistance Coordination Unit subordinated to a State Minister and the Prime Minister. The unit strives to ensure that all assistance is provided in line with policies promoted by the Government of the Republic of Moldova and that there is no overlapping of the actions from different donors. On regional development, a long-standing donors group exists in the Republic of Moldova, formerly centred on a Tacis 2003 project and now led by DfiD. Given the planned retreat of DfiD from the country, the European Commission will become more active. This also makes sense given the willingness of the Moldovan administration to voluntarily align to standards of EU regional policy (NUTS regions, development agencies and councils, etc.), even without having a membership perspective yet. There is also an active donors group on gender. Finally, care will be taken to optimise coordination with a parallel technical assistance -programme on Women's Economic Empowerment (EUR 2 million) to be implemented by Sweden.

3. Description

3.1. Objectives

The objective of this budget support is to contribute to the sustainable economic development of rural areas in the Republic of Moldova. This will be achieved through the support of interventions in (i) the economic and SME sectors and (ii) on regional development that are foreseen in the policy matrix, as well as technical assistance and policy dialogue.

3.2. Expected results and main activities

This budget support will give a significant boost to the implementation of the NDS and the Anti-Crisis-Plan, in close cooperation with member states and other development partners. The expected result is the successful implementation of significant parts of the Anti-Crisis-Plan. Main supported activities include (mentioned in order of listing in the Plan):

1) Streamline the network of secondary vocational schools and colleges; 2) Reduce the administrative burden of starting and doing business by creating one-stop shops at the State Registration Chamber and simplifying licence procedures; 3) De-monopolize key import-export regimes, e.g. on meat, and stop systemic under-declarations of the value of imports; 4) Cut down the dues for customs clearance regarding the operation of free economic zones and other custom regimes; 5) Increase the loan volume under the National Programme for Economic Empowerment of the Youth; 6) Capitalize credit lines to stimulate competitiveness of producers and (potential) exporters in rural areas; 7) Raise the annual allocations to the Fund for Securing Loans; 8) Provide financing for the purchase of equipment by SME through existing credit lines financed by Japan and the EU (2KR) and World Bank (RISP); 9) Mainstream gender aspects, empowering female economic activity in rural areas; 10) Launch a new programme (PARE 1+1) to stimulate the investment of remittances in the set-up of new rural businesses; 11) Create a network of business incubators and industrial parks; 12) Ensure the functioning of the regional development agencies and regions North, Centre and South.

3.3. Risks and assumptions

The biggest risk for this budget support is political, linked to potential instability of institutions following the unsuccessful election of the State President in December 2009. This could lead to a change of the Constitution and repeated elections in 2010. If a new government in 2010 or 2011 would no longer subscribe to the Anti-Crisis-Plan, this budget support would have to be renegotiated.

It is assumed that the current government will remain committed to the aims of the NDS and the Anti-Crisis-Plan, and that sufficient capital for at least partial implementation of the latter will be raised. This is plausible in the sense that the Plan itself includes a number of income-generating and expenditure-cutting measures (e.g. raise of excise taxes, reduction of custom frauds, cutting of non-essential administrative expenditure). However, a detailed financing plan still has to be drafted and several foreseen activities concretized (e.g. establishment of a development fund from privatisation proceeds).

The cross-sectoral nature of this budget support also poses a danger in terms of aid coherence and visibility. It has to be noted that the identification phase of this budget support was based largely on the NDS, whereas the Anti-Crisis-Plan of the government emerged only in the formulation phase but imperatively had to be taken into account.

3.4. Stakeholders

Aid coordination in the Republic of Moldova is the task of the State Chancellery under the Prime-Minister, it will therefore be the European Commission's institutional counterpart in this budget support. Other institutions include the Ministries of Economy and Trade (esp. SME Department), Finance, Agriculture and Food Industry, Construction and Regional Development, Labour, Social Protection and Family, the six development agencies, SME Organization, and Chamber of Commerce and Industry. Cooperation with other development partners will be assured.

3.5. Crosscutting Issues

This Programme should have a neutral impact on the environment. The issue of good governance will be addressed by the programme through a series of activities related to public finance management. Gender issues are widely addressed in this programme and were the subject of a specific study in the formulation period.

4. Implementation issues

4.1. Method of implementation

Centralised management: Following the approval of the financing decision by the Commission, a Financing Agreement will be signed with the Government. Modality of aid delivery will be untargeted sector budget support under centralised management. Funds will be channelled to the State Treasury. The technical assistance component of the programme will be managed centrally and directly by the Commission.

4.2. Procurement and grant award procedures

All contracts implementing the action must be awarded and implemented in accordance with the procedures and standard documents laid down and published by the Commission for the implementation of external operations, in force at the time of the launch of the procedure.

4.3. Budget and calendar

The foreseen budget is EUR 45 million, with a first fixed tranche of EUR 15 million and two variable tranches of max. EUR 14 million and EUR 13 million. The variable tranches will be based on independent reviews of the implementation of the Policy Matrix in 2011 and 2012. A technical assistance package of circa EUR 3 million will be defined before signing of the Financing Agreement. The indicative operational implementation period is 48 months.

4.4. Performance monitoring and criteria for disbursement

A steering committee will be foreseen in the Financing Agreement, including institutions mentioned under 3.4. It will be chaired by the State Minister under the Prime-Minister. However, in order to avoid parallel structures and donor-led procedures, existing Moldovan monitoring institutions will be used to a maximum extent.

The Anti-Crisis-Plan foresees notably that the State Chancellery compiles a quarterly report on its implementation. Semi-annual reports will include quantitative and qualitative monitoring indicators. A Programme Board will include donor representatives and as a condition for this budget support, the European Commission will ask for a seat on it. If the

reporting mechanism and programme board work efficiently, the overseeing of EU budget support would be covered to a large extent. On the PFM-part, IMF staff reports under its new programme will be used, as well as assessments of World Bank, DG ECFIN, BUDG and other sources.

4.5. Evaluation and audit

The Anti-Crisis-Plan foresees an evaluation at its end in 2011. The European Commission reserves its right to contract independent evaluations. Standard procedures for audit of EU budget support apply. Furthermore there are plans to include budget supports in the Results-Oriented Monitoring.

4.6. Communication and visibility

In the Financing Agreement, the Government shall commit itself to ensure that the visibility of the EU contribution is at least equivalent to that given through media to other donors supporting the National Development Strategy and the Anti-Crisis-Plan. The EU visibility guidelines apply.