



**THE IMPACT OF THE GLOBAL
FINANCIAL CRISIS ON PUBLIC SERVICE
DELIVERY IN ECONOMIES OF THE
FORMER SOVIET UNION**

COUNTRY PAPER - MOLDOVA

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BACKGROUND

- After a period of considerable growth from 2003 to 2008, which was mostly externally driven, the international financial crisis started to hit Moldova in late 2008.
- From an economic point of view, the country suffered a triple shock: (1) a recession in the industrialized countries; (2) a severe drop in commodity prices and in the terms of trade; and (3) a growing financial vulnerability.
- A triple shock like this would be enough to affect any economy severely, but in the case of Moldova, remittances, which represented some 36% of GDP in 2007, started to fall strongly.

BACKGROUND (cont.)

- The situation was further complicated by the political motivation of the previous government, which continued to promote populist policies during the election campaign until the end of its mandate (September 2009), rather than addressing the crisis.
 - The consequences of the crisis were diminished partially by the monetary policy conducted by the National Bank of Moldova who targeted several objectives, by means of:
 - reducing of the level of inflation,
 - maintaining a competitive exchange rate, and
 - accumulating international reserves.
- The huge flow of remittances also contributed to avoid the great depreciation of the national currency.

MAIN MACROECONOMIC INDICATORS (I)

Indicators	Unit	2006	2007	2008	2009	2010
Nominal GDP	MDL billion	44,8	53,4	62,9	60,4	71,8
Real GDP	%	104,8	103,0	107,8	94,0	106,9
Consumer price index, average	%	112,7	112,3	112,7	100,0	107,4
Exchange rate, year average	MDL/USD	13,13	12,14	10,39	11,11	12,2
Trade balance	USD million	-1641	-2348	-3308	-1991	-2273
Unemployment rate (ILO)	%	7,4	5,1	4,0	6,4	7,4

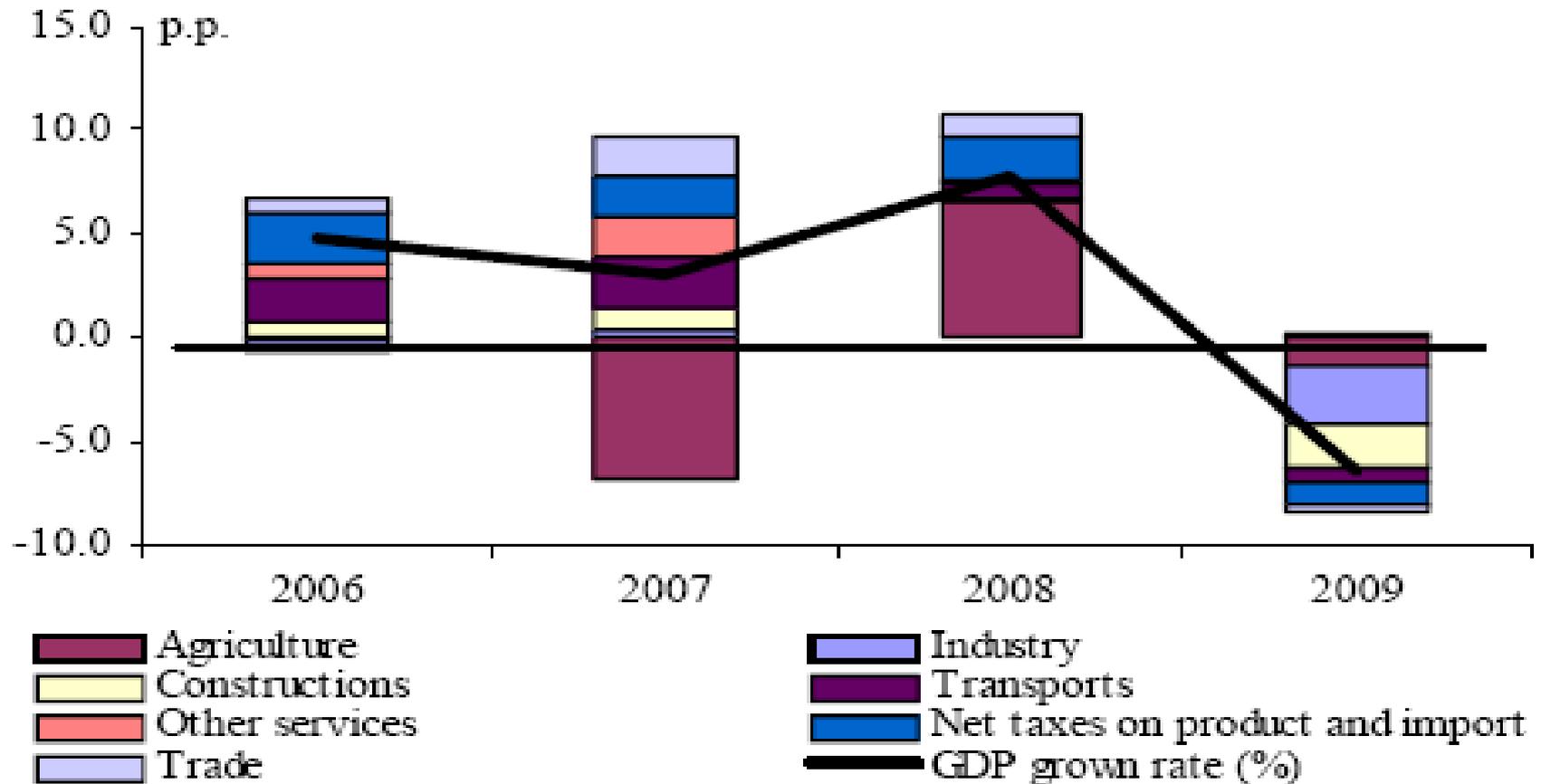
MAIN MACROECONOMIC INDICATORS (II)

Indicators	Unit	2006	2007	2008	2009	2010
Industrial production, current prices	MDL billion	22,4	26,2	30,0	22,6	27,1
<i>Compared to the same period of last year in real terms</i>	%	95,2	98,7	101,5	78,9	106,3
Agricultural production, current prices	MDL billion	13,7	12,8	16,5	13,3	19,7
<i>Compared to the same period of last year in real terms</i>	%	98,9	76,9	132,1	90,4	107,9
Investment in fixed capital, current prices	MDL billion	11,0	15,3	18,1	10,8	12,9
<i>Compared to the same period of last year in real terms</i>	%	124,0	121,9	101,7	65,1	116,7

COST OF THE CRISIS

- In 2009, real GDP shrank by 6%, which stayed in sharp contrast with the 7.8% GDP growth in 2008.
- Significant decrease was registered in construction - by 27.6%, industry – 21,1%, agriculture – 9,6%, transport and communication - 7%.
- Falling remittances and FDI inflows and recession experienced by major trading partners (Russia, Ukraine and the EU) were the main transmission channels through which the global crisis hit Moldova.
- Exports also fell substantially while imports decreased even more sharply, in line with the slump in domestic demand.
- With the trade balance improving due to imports contracting faster than exports, the current account deficit decreased markedly, from around 16% of GDP in 2008 to 9% of GDP in 2009.

GDP GROWTH BY SECTORS (%)



FISCAL SITUATION

- The *fiscal situation* has deteriorated rapidly: as a result of strong reduction in imports led to deep fall in indirect tax collection (the key source of budget revenue), the national public budget revenues during January - December 2009 shows a slump by 8.9 percent as compared to the same period of the previous year.
- At the same time, in 2009 the total spending of the national public budget was by 4.6% more as compared to 2008. Growth of spending was caused by increases of wages in education and health as well as by increase of pensions.
- Both the crisis and pre-election increase of spending (like wage and pension increases) resulted in a large fiscal gap: the execution of consolidated budget (state budget + local budgets) in 2009 resulted in the highest deficit for last 10 years – 6,4 % in GDP.
- The budget deficit was financed exclusively by issuing government securities: this led to the increase of internal debt with more than 30% compared with the end of 2008 year.

NATIONAL PUBLIC BUDGET BY COMPONENTS (%GDP)

	2006	2007	2008	2009	2010
	Executed				Approved
Total revenue	39.9	41.7	40.6	39.2	39.0
State budget	24.6	26.2	25.4	23.1	23.8
Local budgets	5.9	5.7	4.6	4.4	4.0
State social insurance budget	8.2	8.2	8.7	9.3	8.9
Mandatory medical insurance funds	1.2	1.6	1.9	2.4	2.3
Total expenditure	40.2	42.0	41.6	45.6	46.2
State budget (without inter-budgetary transfers)	15.8	18.2	17.3	16.9	16.9
Local budgets	11.3	10.5	10.2	10.9	11.2
State social insurance budget	9.8	9.8	10.0	12.7	12.9
Mandatory medical insurance funds	3.3	3.5	4.1	5.1	5.2
Deficit (-)/ Surplus (+)	-0.3	-0.3	-1.0	-6.4	-7.2
State budget	0.2	-0.4	-0.8	-5.7	-6.4
Local budgets	-0.6	-	-0.5	-0.4	-0.4
State social insurance budget	-0.1	-0.2	0.1	0.0	-0.4
Mandatory medical insurance funds	0.2	0.3	0.2	-0.3	-
Nominal GDP, in MDL million	44,754	53,429	62,922	60,043	64,300

IMPACT OF CRISIS ON SERVICES PROVIDED BY LOCAL PUBLIC AUTHORITIES

- Financing of local public tasks is dependent on major transfers from the state budget (in 2009 - 58% of total local expenditures, including Chisinau and Balti, and 70%, excluding these two municipalities), making them financially weak in performing their responsibilities.
- In 2009, transfers from state budget to local budget constituted 6,1 % in GDP compared with 5,1% in 2008.
- Under the current budgeting system, a fundamental role is played by the so called normative expenses, defined by the Ministry of Finance and included in the amount of expenditures during budgets equalization.
- They are used to determine the resources for local authority to perform targeted public tasks – education, culture or social assistance, etc. The healthcare function is exercised mostly by the compulsory medical insurance.

LOCAL BUDGET EXPENDITURES BY FUNCTIONS, SHARE IN TOTAL (%)

Total expenditures	2006	2007	2008	2009	2010 Approved
1. General services	6.6	6.8	7.3	6.8	5.7
2. National defense (enrolment in the army)	0.1	0.1	0.1	0.1	0.1
3. Public order	3.1	3.6	3.2	3.7	3.5
4. Education	46.2	49.7	53.1	59.9	62.6
5. Culture, art, sport and youth activities	5.2	4.8	5.2	4.8	4.9
6. Healthcare	1.7	1.6	2.3	1.1	1.2
7. Social welfare	4.1	8.3	10.1	8.1	7.8
8. Agriculture, forestry, fishing	1.2	1.4	1.5	0.2	0.2
9. Environmental protection	0.0	0.0	0.0	0.0	0.0
10. Industry and construction	0.2	0.2	0.2	0.2	0.2
11. Transport and communication	2.8	3.9	4.1	3.3	2.4
12. Communal services and housing	17.8	11.4	8.7	7.4	7.9
13. Fuel and energy sector	5.5	5.0	1.4	1.4	0.2
14. Other economic activities	0.1	0.1	0.1	0.1	0.1
15. Expenses not distributed elsewhere	5.4	3.1	2.7	2.9	3.2
Total	100	100	100	100	100

EDUCATION AND HEALTH IN GDP AND NPB (%)

	2006	2007	2008	2009	2010 Approved
Education					
Share in GDP	8.1	8.0	8.2	9.4	10.0
Share in NPB	20.1	19.0	19.8	20.7	21.6
Health					
Share in GDP	4.7	4.9	5.4	6.4	6.3
Share in NPB	11.7	11.7	13.0	14.1	13.6

MAIN EDUCATION INDICATORS (2009)

- **Pre-school education**
 - 125.0 thousand children
 - 1,362 pre-school institutions
- **Primary and general secondary educational**
 - 413.7 thousand pupils and 1,526 institutions, including 35 special schools and 7 evening schools
- **Secondary vocational education**
 - 24.2 thousand students and 73 vocational schools, including 21 school of trades (2 of them - private) and 52 professional schools
- **Secondary specialized education**
 - 32.2 thousand students and 46 colleges (5 of them - private)
- **Higher education**
 - 109.9 thousand students and 33 institutions (14 of them - private)

STRUCTURE OF EDUCATION EXPENDITURES

- Preschool education (18-20%)
- Primary and general secondary education (52-53%)
- Vocational and specialized secondary education (4-5%)
- Higher education (12-13%)

POLICY REFORMS AND ACHIEVEMENTS IN EDUCATION (II)

Reforms on the compulsory education

- develop curriculum for grades 1-9, upgrade assessment and examination system, provide teacher training and develop a sustainable system of textbook financing
 - The first World Bank project “Moldova General Education” (1997 – 2004)
- revise and modernize curriculum for grades 10-12, improve the quality of education, increase access to education and increase efficiency of using financial resources
 - The second World Bank project “Quality Education in Rural Areas of Moldova” (2006 – 2012)

POLICY REFORMS AND ACHIEVEMENTS IN EDUCATION (I)

Reforms in pre-school education

- elaborate policy documents, provide teacher and manager training, renovate and equip pre-school institutions
 - Education for All – Fast Track Initiative (2006-2010)

Reforms in higher education

- the country joined the Bologna Process and most of legal reforms in were adopted in 2005
- it is important to continue the reforms in order to create a comprehensive legal framework for universities' autonomy in such areas as management, elaboration curricula, admission policies, institutional funding

Reforms in vocational education

- reforms started and then have been cancelled, experiments and pilot attempts have not been properly evaluated, and there is no clear continuity of efforts

CRISIS IMPACT ON EDUCATION

- As a share of GDP, the education expenditure increased from 6.0% in 2001 to 9.4% in 2009 (8,2% in 2008).
- Thus, the Government has protected the education budget from the impact of the financial crisis, increasing the resources to the sector constantly over the last years.
- Since independency, a number of reforms were implemented in the education sector, but one of the basic problems is continued to remain the inefficient use of public finances.
- The global economic crisis has provided the opportunity to pause and reflect on Moldovan education system, how it is founded and what priorities should be.

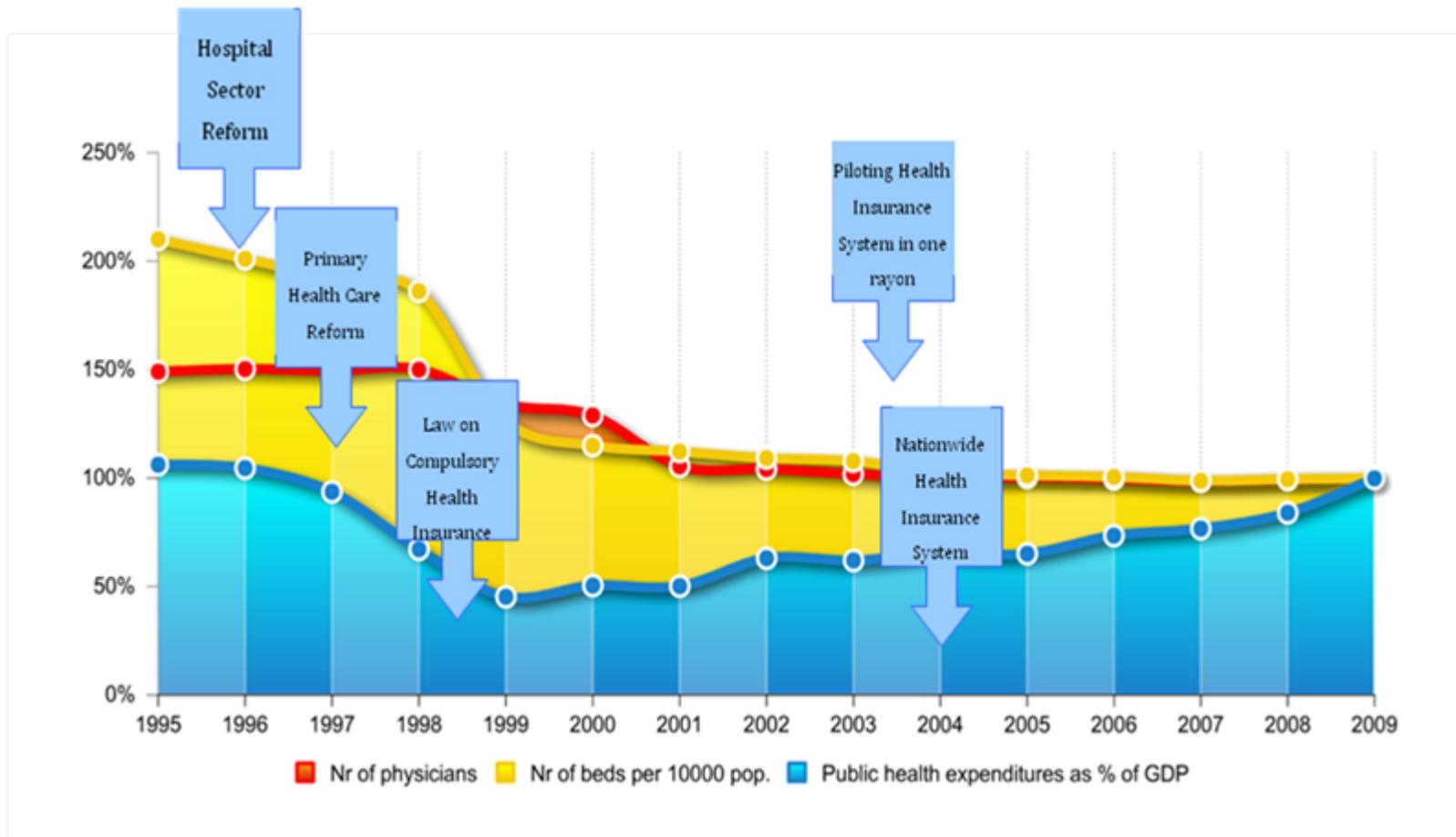
CHALLENGE FOR REFORMS IN EDUCATION

- The crisis can provide a drive to optimize the efficiency of available resources in order to continue the efforts without any compromises or reductions to quality: money has to be channeled to the most problematic areas.
- To address inefficient policy on education spending, the Government has recently initiated with donors support the optimization of the school network and the reform in financing of the general compulsory education.

HEALTHCARE

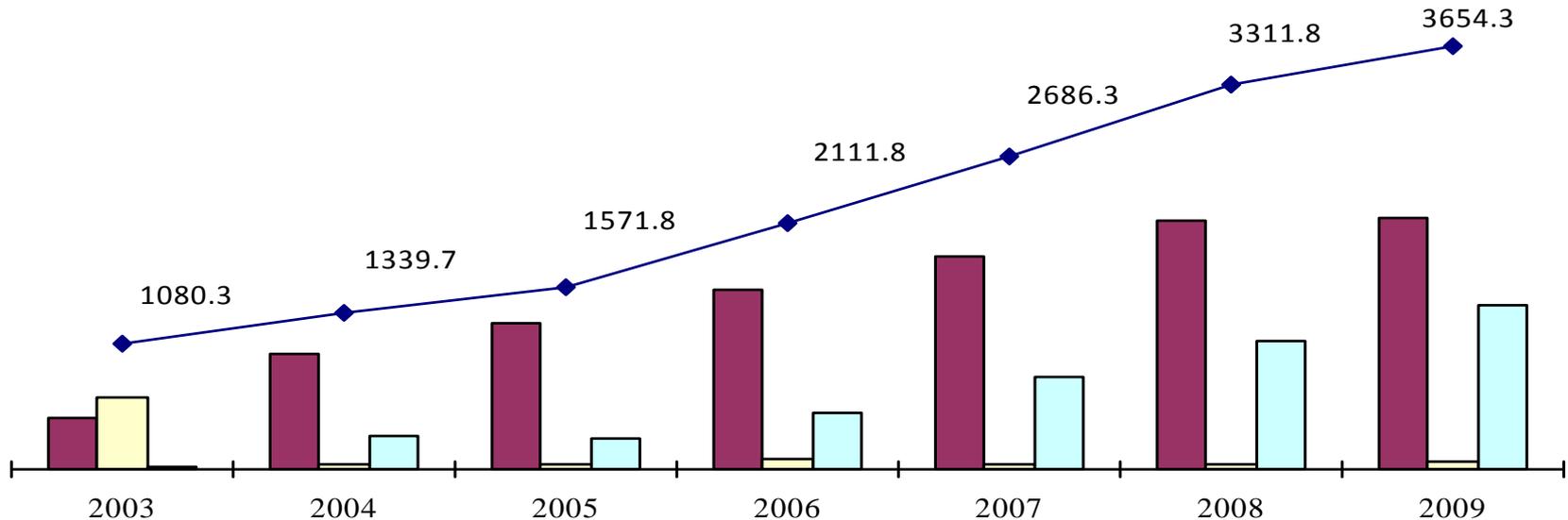
- Implementation of the Mandatory medical insurance with the aim to:
 - redefine the financial mechanisms;
 - redirect financial resources to the most important and efficient areas of medical care;
 - put into operation a system of mandatory medical insurance;
 - outpatient treatment and family doctors – became new type of health service.
- The reform started in 2004 in one administrative territorial unit and was implemented in 2005 in all country.
- Healthcare system in Moldova is supported from different sources of financing. The biggest share in total resources - 56% in 2009 belongs to state budget followed by premiums for medical insurance, 37% and local budgets.

POLICY REFORMS IN THE SECTOR



HEALTHCARE CONSOLIDATED BUDGET

	2003	2004	2005	2006	2007	2008	2009
State budget	42%	75%	81%	73%	68%	65%	59%
Local budgets	57%	4%	2%	4%	2%	2%	2%
Insurance premiums	1%	21%	17%	23%	30%	34%	39%



REFORMS ACHIEVEMENTS IN HEALTHCARE

- The health insurance scheme implemented in Moldova represents a mixed model based on both social taxes, as well as direct contributions from citizens. The principle of universal coverage and, therefore, universal access to basic MMI package is stipulated in the legislation.
- Contributions to the MMI fund have a stable character. New funding mechanism can improve the situation regarding the quality and accessibility to their services only in conjunction with hospital reform and primary medical care. Although attention is given to primary health care field there are still many problems related to access to services, human resources, finance, etc.
- The coverage of MMI increased little in recent years, but the uninsured rate is still high. Every fourth citizen is not included in the MMI system, most often the root cause is poverty, indifference and low level information.
- Since the beginning of the implementation of MMI people's access to emergency services has increased, reducing the gap between rural and urban population.

CRISIS IMPACT ON HEALTH

- The share of health budget in GDP (including all budget levels and Mandatory Medical Insurance Funds) is around 6% in 2009. It was growing up from 4%, an indicator registered before the start of the reform (2004).
- The Mandatory medical insurance implemented in Moldova helped the Government to maintain the level of medical service financing despite 2009 economic crisis.
- The crisis influence on health sector was minimized by improving management of collected resources and support from the donors' community, especially in investment projects.
- Donors support very costly projects connected with procurement of high performance equipment, capital renovation, and staff training.

MANAGING ECONOMIC CRISIS IMPACT

- A new challenge came with the Economic Stabilization and Recovery Programme of the new government (end of 2009) backed by the IMF.
- According to this program, country's macroeconomic policies are built around four pillars:
 - (i) reversing structural deterioration of fiscal policies in 2008–2009 over the next three years while safeguarding public investment and social spending priorities;
 - (ii) flexible monetary and exchange rate policies to keep inflation under control, facilitate adjustment to shocks, and rebuild foreign reserves;
 - (iii) ensuring financial stability by strengthening the legal framework for bank resolution and close monitoring of the financial sector, accompanied by swift actions if and when necessary; and
 - (iv) structural reforms to unlock and raise the economy's potential.

MANAGING ECONOMIC CRISIS IMPACT (cont.)

- The Memorandum with IMF unblocked the previously frozen financial assistance to the country from foreign donors to finance budgetary needs.
- Moldova has made progress towards strengthening the economic integration with the EU as well, including negotiation with the EU on a Deep and Comprehensive Free Trade Agreement, the signing of which will facilitate Moldovan exports to the EU.
- Moldovan Government has presented its vision of transforming the country to the Donor Consultative Group Meeting - Moldova Partnership Forum, held in Brussels on March 24, 2010. The meeting has been attended by donor countries and international organizations - European Commission, World Bank, UN, DFID, SIDA and European financial institutions.
- As a result, the development partners have pledged financial support to Moldova in the amount of approximately USD 2,6 billion for the years 2010-2013, of which 52% are grants.

CONCLUSIONS

- In the Republic of Moldova, while macroeconomic and structural reforms have started to make an impact, significant economic management efforts have to be undertaken in order to make the process sustainable in the future. A more balanced policy approach will be the best response to the challenge for development.
- The authorities aim to continue removing administrative and institutional barriers, de-monopolizing and liberalizing the economy, modernizing educational system and ensure its integration into the European area of education and knowledge.
- Further reforms are necessary to ensure long-term financial sustainability and to improve the quality of services.