licensing and registration and efforts to increase transparency of regulatory agencies and reduce red tape are welcome. The decision to revitalize the privatization process will help to scale back the influence of the state in the economy and support private sector-driven growth. A strengthening of the financial supervisory and regulatory framework will contribute to the soundness of the banking system," Mr. Kato said.

Statement by Age Bakker, Executive Director for the Republic of Moldova and Victor Yotzov, Advisor to Executive Director March 12, 2008

The Moldovan authorities appreciate the continued constructive dialogue with the management and staff over the last several years. They attach great value to the close relationship with the Fund, whose advice continues to support the policy formation process in Moldova. Now that the external shocks of 2006 seem to have receded, the authorities remain firmly committed to stick to the core goals and policies agreed under the PRGF arrangement. Those policies are consistent with the National Development Strategy (NDS) as well as with the action plan agreed upon with the European Union. European aspirations and prospects of growing financial assistance from the EU and international donors continue to complement the authorities' reform efforts.

For the years to come, Moldova's overriding policy priority remains promoting sustainable growth and reducing poverty. To this end, the policies set forth for 2008 aim at further modernizing the public service and reducing state involvement in the economy, developing the financial sector, creating a favorable investment environment, encouraging the development of small and medium businesses, rehabilitating infrastructure, promoting exports, and creating new jobs and providing social protection to vulnerable categories of the population. As always, the authorities stand ready to take additional measures that may become appropriate for reaching these objectives.

Recent developments and performance under the program

Macroeconomic developments in 2007 were favorable despite the severity of the external shocks that the country suffered in the previous years. The economy grew strongly in the first half of 2007, but slowed somewhat in the second half due to a weak harvest caused by the summer drought. Nevertheless, excluding agriculture, growth remained robust. Importantly, its pattern appears to be changing: there are already signs that the earlier model of consumption-driven growth financed by remittances is shifting toward more sustainable investment-based growth. Export performance, too, has stepped up considerably and the recovery in the foreign sector is set to accelerate further as wine exports to Russia resumed late last year. Even though imports in 2007 grew faster than exports, fuelled by rapidly increasing FDI and strong remittances, the current account deficit has narrowed due to improvements in net income and transfers. Strong inflows of foreign exchange led to an appreciation of the leu, but the exchange rate remains broadly in line with fundamentals.

Recent favorable developments, however, have presented some challenges as well. The most important among them are the surge in net capital inflows and the associated appreciation pressures that complicate the conduct of monetary policy. On top of that, inflation continues to be stubbornly in double digits, which requires additional fiscal efforts. As similar trends have been observed and dealt with in other countries in the region and elsewhere, the authorities are willing, with the help of the Fund, to benefit from their experience so that negative consequences be mitigated to the extent possible.

Performance under the PRGF-supported program has been strong and except for a few instances, the authorities have implemented the measures as stated in the last Memorandum of Economic and Financial Policies. All end-September quantitative performance criteria were observed while only one quantitative benchmark was missed. All structural PCs have been met but some structural benchmarks were missed, partly due to technical reasons.

Given the strengthened independence of the National Agency for Energy Regulation (ANRE), and the demonstrated effectiveness of the system for these items, the authorities request to drop a continuous structural benchmark that electricity and natural gas tariffs remain at cost-recovery levels. The authorities would also like to indicate that the missed end-September structural benchmark on the transfer of tariff-setting responsibility for heat to ANRE does not comply with the constitutional division of rights between local and central governments and should therefore be dropped as well.

Fiscal Policy

Fiscal performance remained strong in 2007, as the year ended with a deficit of 0.3 percent of GDP which was below the programmed 0.5 percent. Revenue performance was driven by higher VAT on imports, while expenditures were kept in line with budget commitments. Notwithstanding this achievement, fiscal policy continues to be severely constrained by two conflicting needs – the need to substantially increase development spending in line with the approved NDS, and the need to subdue rising inflation. In this regard, the authorities and staff have agreed that fiscal policy should remain sufficiently tight until disinflation is entrenched. Spending of revenue overperformance will be contingent on bringing inflation down into the single-digit territory, and will be directed solely to investments. In line with the above, the 2008 budget was approved in accordance with the disinflation objective, implying higher negative domestic financing than in 2007. Negative domestic financing may increase even further if privatization proceeds exceed projections. Any budget rectification will be contemplated in the framework of the program and the upcoming fourth review.

In the medium-term, the authorities' plan is to keep the budget deficit at about 0.5 percent of GDP, while providing for greater fiscal space for social and investment spending through downsizing and reduction in spending inefficiencies. Further strengthening of tax administration is also given high priority.

With regard to downsizing the role of the state in the economy and rationalizing the structure of employment in the budget sector, the government just recently announced that it is cutting 10 thousand budget-sector positions by 2010, starting with 3 thousand in 2008. In addition, the authorities intend to pass a law that would consolidate all forms of remuneration in base pay for civil servants by end-September 2008, with a view to implementing it in the 2009 budget. Public sector wages will be further increased in 2008 in order to keep qualified workers, though the total wage bill as share of GDP is expected to remain unchanged owing to a phasing in of the future increases.

The biggest change in the 2008 budget is the major reform of the corporate income tax system, that cut the CIT rate to zero on reinvested profits, as well as a wide-ranging amnesty of tax arrears and a liberalization of capital legalization regulations that aim at promoting both foreign and domestic investment. The authorities are aware that these

reforms may imply certain risks, in particular with respect to budget revenues, but they strongly believe that possible shortfalls will be compensated by improved tax collections. For that purpose, the authorities will speed up the implementation of Tax Administration Strengthening Strategy, including by reorganizing the State Tax Inspectorate. At the same time, the authorities intend to develop a modern accounting and information technology platform, and ensure adequate resources for these reforms.

Monetary Policy

Strong appreciation pressures caused by persistent inflows of foreign exchange have continued to complicate monetary policy in 2007, facing the monetary authorities with difficult choices. Despite the tightening up early in the year, reserve money continued to grow which prompted the central bank to raise reserve requirements to 15 percent at end-September, accompanied by an increase in the sterilization rate. The build-up of reserves at the end of the year exceeded US$ 1.3 billion which was well above what was projected under the program. Against this background, and in order to clear up any misinterpretations regarding its policy objectives, the NBM's independence has been strengthened, while disinflation was established as its central objective, with a planned move to an inflation targeting framework over the medium-term.

The authorities and staff agreed that monetary policy should remain tight until disinflation is firmly reestablished. To this end, the monetary program for 2008 envisages locking in the overperformance in 2007 on NDA and NIR, and tighten reserve money to ensure the objective of single-digit inflation is achieved. In addition, the NBM has declared readiness to promptly increase reserve requirements and/or interest rates at the first signs of reversal of trend disinflation. To further improve effectiveness of monetary policy, the NBM will streamline its instruments by adopting a base rate as a main policy rate to remove the ambiguity between the two rates, and shifting sterilization operations to shorter maturities. At the same time, the planned securitization of the government debt to NBM in the first quarter of 2008 will provide the central bank an additional liquidity management tool.

As regards the planned move to a formal inflation targeting framework, the authorities acknowledge they are still at an early stage of implementation. Nevertheless, they are undertaking important steps to improve the current framework of monetary policy and lay the foundation for a new regime. In particular, starting with the 2008 Budget, the Budget Law will no longer oblige the NBM to roll over state securities, including those acquired through securitization. Instead, the NBM and the Ministry of Finance will conclude yearly agreements on the annual redemption of state debt to the NBM. Further improvements are also envisaged with respect to the communication strategy and policy transparency, aiming to raise public awareness of risks to inflation as well as to strengthen the signaling function of the NBM. In this regard, the authorities have requested technical assistance from the Fund in monetary research and capacity building for monetary policy implementation.

Reform Agenda

With regard to financial sector reforms, the authorities continue to strengthen the supervisory and regulatory framework and ensure transparency to promote stability and steady development. Following the recommendations of the recent FSAP update all entities