

Country Strategy Paper 2002-2006

National Indicative Programme 2002-2003

Moldova

2002-2006 COUNTRY STRATEGY PAPER FOR MOLDOVA

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Summary

1. EU/EC cooperation objectives

2. Moldova's policy agenda

3. Country analysis

- 3.1 Political analysis
- 3.2 Economic analysis
- 3.3 Structural reforms
- 3.4 Sustainability of current policies
- 3.5 Medium-term challenges

4. Past and ongoing EC cooperation – Other donors' cooperation

- 4.1 Past and ongoing Tacis technical assistance
- 4.2 Other EC instruments
- 4.3 Member States activities and other donors' assistance

5. EC Response strategy

6. 2002-2003 Tacis National Indicative Programme

- 6.1 Support for Institutional, Legal and Administrative Reform
- 6.2 Support to the Private Sector and Assistance for Economic Development
- 6.3 Support in Addressing the Social Consequences of Transition
- 6.4 Support to micro, small and medium enterprises (MSME)
- 6.5. Childcare and family assistance

7. Indicative Budget

8. Conditionality

Summary

The Moldova Country Strategy Paper (CSP) was adopted by the Commission on 27 December 2001 and provides the strategic framework within which EC assistance will be provided for the period 2002-2006. The CSP follows the guidelines set out in the Framework for Country Strategy Papers, and takes its basis from the Regulation for the provision of assistance to partner countries in Eastern Europe and Central Asia (Council Regulation (EC, Euratom) No. 99/2000 of 29 December 1999). The CSP constitutes the Indicative Programme as described in article 3.2. and 3.3. of the Regulation and revises and updates (as foreseen in article 3.6 of the Regulation) the Indicative Programme for 2000-2003 adopted in 2000. The CSP sets out EU cooperation objectives, policy response and priority fields of cooperation based on a thorough assessment of Moldova's policy agenda and political and socio-economic situation as well as lessons learnt from past and present cooperation. The National Indicative Programme (NIP) (chapter 6 of the CSP) sets out the EU response in more detail, highlighting programme objectives, expected results and conditionality for Tacis in the priority areas fields of cooperation for the period 2002-2003.

Since Moldova is located directly on the border of an enlarged EU, instability and poverty in this country are a matter of concern for the EU.

On the political side, democracy is established in Moldova although further progress is needed to consolidate civil society, public governance and the rule of law.

Voters' deception - in the face of their deteriorating social and economic conditions as well as promises of fighting corruption - left the Communist party with a landslide victory in the 2001 presidential and parliamentary elections. The party won 71 of the 100 seats in Parliament.

The Transdnistrian issue remains a serious threat to the political and economic stability of the country. Transdnistria, situated east of the river Dniestr, has since 1991 tried to become an independent state with the initial military help of the Russians. Since 1992 the open conflict is "frozen" and the Moldovan government is trying to incorporate Transdnistria as an autonomous region into its territory but doing so from a centralised point of view. The Russians still have military units posted in Transdnistria as well as a huge arsenal of outdated weapons. According to the 1999 Istanbul agreement Russia should destroy these arms and pull out its troops by the end of 2002. Without Russian support no settlement of this case seems possible.

The new Moldovan government has entered into negotiations with the Transdnistrian side but up to now without tangible results..

The economic situation is characterised by extreme poverty and a very difficult social situation with problems similar to those of developing countries. Some 800,000 Moldovans have left the country, most of them coming from the countryside. Moldova's financial fragility makes it strongly dependent on external financing and/or debt rescheduling. The new Government's economic policy requires further clarification before international macro-financial assistance is resumed.

All available EC cooperation instruments should be used to contribute to the political, economic and financial stabilisation of Moldova and in particular assistance in form of Food-security programmes. Economic stabilisation policies for Moldova need to be three-pronged: tackling poverty and social destitution; building the legal framework for a market economy and promoting enterprise development in view of creating conditions for economic growth; and providing macro-financial assistance consistent with support from international financial institutions.

Cooperation

The potential of the Partnership and Cooperation Agreement (PCA) should in this case be used as a vehicle to facilitate an improvement in Moldova's business climate and diversification of its exports.

The EU will contribute through its cooperation to fighting crime, corruption, smuggling and illegal migration. Improved public administration and rule of law are also needed to improve the investment climate, as a condition for achieving economic growth.

Within this context, and taking into account the country's objectives, as well as those of the Partnership and Cooperation Agreement, the EC National Indicative Programme for technical assistance 2002-2003 can most effectively assist the partner country by focusing on

- 1) Institutional, legal and administrative reform (consolidation of the rule of law, approximation of legislation including the reform of the health sector, cross-border cooperation, fight against crime, PCA support, civil society development and training (vocational and higher education), statistical infrastructure as well as environmental issues.
- 2) Private sector and economic development (in particular enterprise development in rural and urban areas and trade/export (wine)/investment promotion), and
- 3) Alleviation of the social consequences of transition (poverty reduction, social assistance via strengthened NGOs, health and childcare).

1. EU/EC cooperation objectives

Moldova is a small country located on the border of the future enlarged EU, located between Romania and Ukraine with important resources in the agricultural (especially wine) and agro-industrial sector but without indigenous energy resources. Political instability in Moldova, especially the internal territorial conflict concerning Transnistria, and extreme levels of poverty by European standards are potential causes of future instability.

The EU's cooperation objectives with Moldova are to foster respect of democratic principles and human rights as well as transition towards a market economy. They are based on the Partnership and Cooperation Agreement (PCA), which forms part of a proximity policy, reflecting the political and strategic importance of Central and Eastern Europe to the EU. The strategic importance of this relationship will increase as the EU enlarges to the east.

The PCA provides for regular political dialogue, trade liberalisation and wide ranging cooperation, based on respect of democratic principles and human rights. PCA provisions governing goods, services, labour, and capital introduce extensive, legally binding requirements. The PCA is an important instrument in harmonising Moldova's legal framework with the single European market and the World Trade Organisation (WTO) system. EC technical advice is the main assistance instrument supporting the implementation of the PCA, assisting Moldova in the strengthening of democracy and the rule of law, the consolidation of a market economy and the strengthening of administrative capacity linked to the implementation of the agreement, particularly in the areas of trade and the internal market.

The PCA offers the possibility for far reaching economic cooperation, and its evolutionary potential includes a provision for the parties to consider the developments in the implementation of PCA commitments, with a view to the possible establishment of an EU-Moldova Free Trade Area (FTA).

The EU's economic and trade relations with Moldova are minimal, and trade and investment potential is limited for the EU. However, the EU's objective is to help Moldova overcome the current economic crisis by improving its position in international trade through diversification of its export markets and an increase in exports to non-NIS countries by improving the quality of its products, in order to achieve sustainable economic growth and to fight extreme poverty and social degradation.

A further EU objective is to assist Moldova in the fight against certain criminal phenomena. Corruption in both the private and the public sector has a negative impact on economic and trade development. In order to make support in this field more efficient a pilot scheme might be tested on local administrations. The absence of an anti-money laundering regime fosters laundering of illegal proceeds received from bribery.

2. Moldova's policy agenda

The first reference document for Moldova's policy agenda is the 2001-2005 Programme of the Government. The economic policy chapter identifies many priorities that fit in well with the need to modernise the economy and make it more adapted to market rules, e.g. by improving the legal framework for business, streamlining the tax system, developing the strategic agro-industrial sector and developing the export promotion policy.

The Programme envisages strengthening the cooperation with the International Monetary Fund (IMF), the World Bank (WB) and other international financial institutions, confirming the commitment to comply with the contractual obligations and the intention to negotiate a re-scheduling of foreign debt.

The Programme also includes elements, such as price controls on some essential goods and controls on imports and exports, aimed at protecting domestic producers, a cautious approach towards privatisation, a strong role of the state in the economy and the possible creation of new state monopolies, which appear not entirely consistent with a market reform agenda.

With regard to social policy, the Programme identifies priorities in the areas of health, education, family and social security, e.g. improvement of the minimum level of healthcare, development of primary care, rationalisation of the system for procuring medicines, development of vocational education, and a policy for children and families. These elements may be too ambitious in view of existing budgetary constraints.

Macro-economic targets for the period up to 2005 include an annual GDP growth of 5%, annual inflation of 10%, a budget deficit of 1.5% of GDP and a reduction of the current account deficit to 6 % of GDP, through improvement of the trade balance.

The programme also includes fighting against crime, corruption and the shadow economy by strengthening judicial and law enforcement agencies and enhancing cooperation with international bodies. This is in line with recent efforts made by the Moldovan Government.

Moldova has fixed itself the goal of joining the EU although Moldova up to now is not considered by the EU as a potential candidate. Since its main export markets are still Russia and Ukraine and increasingly Belarus, it has to maintain close relations with these countries. In this context Moldova is considering joining the customs union of Russia, Belarus, Kazakhstan and Kyrgystan and the economic structures of the Russia-Belarus Union. These objectives may be incompatible because of the legal obligations which would derive from belonging to different organisations.

A further reference document for Moldova's policy agenda is the interim Poverty Reduction Strategy Paper (I-PRSP) produced under the previous government in 2000, with the assistance of the WB and of the IMF. A full PRSP is expected to be prepared in 2002. The interim PRSP identifies three pillars of poverty reduction: i) sustainable economic growth, ii) human development policies (health and education) and iii) social protection. The I-PRSP also provides for the reform of public administration and the civil service, the strengthening of the judiciary and improved management of public expenditure. On the basis of this document and of the Government's performance, the IMF concluded a financing arrangement with Moldova under the Poverty Reduction and Growth Facility (PRGF) at the end of 2000.

The first pillar concentrates on the development of the private sector, especially those sectors in which Moldova has a comparative advantage (rural and agro-industrial activities and services performed by small and medium-sized enterprises). Structural reforms are proposed to create a stable environment for business and for foreign investors, deregulate the private sector, facilitate access to cheaper credit, privatise key industries, improve corporate governance and the institutional and legislative environment. Export promotion is very high on the Government's agenda in order to find new markets and consolidate old ones.

The second pillar, human development, concentrates on health and education, including primary health care and disease prevention, improvement of resource allocation, developing the

autonomy of hospitals, training of general practitioners and health managers, improved management of basic and secondary education, and adaptation to demands of the labour market. The third pillar, social protection, highlights the need to create a social assistance system that is transparent, fully funded and sustainable. Specific priority sectors are child protection, pensions and protection of the unemployed.

Because of the political changes which occurred in Moldova after the February 2001 parliamentary elections, and given the new Government's ideological background and election programme, a fully consistent economic policy line has not yet emerged and structural reforms have slowed down. This caused the international financial institutions (IFIs) to withhold disbursements, highlighting the urgency for Moldova to resume cooperation with the IFIs in order to obtain external financing. In view of these developments, the prospects for the resumption of IMF financing in the near future are still not clear.

3. Country analysis

Area (km ²) 33.800	Population (million)(2000) 4,3	GNP/capita (USD) (2000) 500
Real GDP growth rate/2001 estimate 7%	Real level of 1999 GDP as % of 1989 GDP 30%	Inflation rate 2000 18,4%

Moldova is a small, very poor country, land-locked between Romania and Ukraine and confronted with a secessionist movement in Transdnistria. Historically, it has been torn between different neighbours and allegiances, and this is partly reflected in the mix of its population. (63,9% Rumanian, 14,3% Ukrainian, 12,8% Russian and 3% Gagauzian) Before independence, it was fully integrated in the Soviet system and had little connection with the outside world. After independence, Moldova had to face a completely different situation, being without internal resources and totally dependent on external trade, including importing of energy. Moldova's geographic position for the transit of goods from and to the Black Sea port of Odessa gives it some importance as a transit country. But for the international community Moldova is in a relatively marginal geographical position. This, together with its small size and lack of resources, may explain why there has been relatively little interest shown by the international community in Moldova, despite the country's burning problems.

Internally Moldova managed to solve one problem with its Gagauzian population (Christian Turks in the south) by acceding to a limited autonomy for Gagauzia in turn for its constitutional integration in Moldova.

The situation in the rural areas has deteriorated. In addition to inadequate health and school facilities, roads and transport, training and credit and with often unclear land ownership, a lack of business/work opportunities is considered to be one of the main causes for the migration from the countryside to the capital and to foreign countries. About 800,000 Moldovans are estimated to have left the country in the last 10 years.

The lack of minimum revenues in the countryside but also in the cities has created the problem of the so-called "social orphans"; children who cannot not be supported by their parents and were put into state institutions. Conditions there are often worse than in the families without revenues.

3.1 Political analysis

The political scenario in Moldova changed after the parliamentary elections of early 2001 in which the Communist Party won a 70% majority of seats and a new president was elected in an internationally recognised democratic process. After ten years of volatile coalition majorities and short-lived governments, since May 2001 Moldova has had a strong majority in parliament and a government that should be able to work for the full duration of its mandate.

The landslide change at the elections was mostly explained by the discontent with the very difficult social situation after ten years of weak governments. The Communist Party campaigned on the basis of a classic socialist programme and a more pro-Russian orientation in foreign policy. However, the first messages and actions of the new leadership seem to indicate a moderate and pragmatic approach both in foreign and economic policy, and several key ministers (foreign affairs, finance, economy) were maintained as a sign of continuity.

Remaining inconsistencies and lack of clarity of government policy (see above) need to be followed closely. Due to its clear majority, the new leadership has a unique opportunity to advance on consistent policy. This, together with an increased awareness of Moldova's problems on the part of the international community, could lead to a new momentum for the country.

With regard to foreign policy, the current leadership shows an interest in developing cooperation with all main partners, namely the CIS, the enlarged EU, Russia, Ukraine, Romania and the USA. Moldova needs to keep good relations with all. In the first half of 2001, Moldova has joined the WTO, the Stability Pact for south-eastern Europe as a full member and has been invited to attend the European Conference.

The eventual entry of Romania into the EU will have an incidence on that country's preferential relation with Moldova

Made up of the region east of the river Dniestr, **Transdnistria** is mainly populated by ethnic Russians and Ukrainians (250,000). Its industrial sector (one steel company, main energy production and transformation companies) is relatively developed. It claimed independence in 1991. Even though the military activity has ceased in 1992, the conflict has not been resolved, and Transdnistria continues with its own government, its own army, police, border guards and border posts. Russian forces have not yet withdrawn, although they have undertaken to do so by the end of 2002 and the process has begun (see below).

The Transdnistrian dispute heavily affects Moldova's foreign relations and economic development. Moldova can only make limited progress towards democratic consolidation and economic improvements as long as the Transdnistrian issue continues.

The economic relevance of Transdnistria for Moldova is enormous. The only big power plant of Moldova and the only modern and competitive steel mill are located in Transdnistria. The gas pipelines which supply Moldova cross Transdnistria. Moldova is thus unable to control its borders and experiences the flows of goods and capital with its eastern neighbours. Without effective customs controls on the goods crossing Transdnistria, smuggling is flourishing with serious consequences on the government budget and the rule of law. The Transdnistrian leadership, which lacks democratic legitimacy, has unlimited political and economic power in the region and is not willing to accept any control from Chisinau, the capital. Operators based in Moldova and abroad earn important profits from legal and illegal business with Transdnistria.

Russia has political and economic interests in Moldova. Russian support to Transdnistria has been often considered as part of a wider context of Russian opposition to expansion of western influence, especially of NATO. Latest developments seem to indicate Russian readiness to comply compliance with its Istanbul commitments with regard to the Transdnistria provision to pull out its troops by the end of 2002 and destroy the weapons maintained in this area.

Although the new Moldovan Government seemed to have better chances to resolve the Transdnistria problem because of its more pro-Russian orientation it took until June 2001 that the Russians started to speed up the destruction of weapons. Many observers believe that Moldova cannot achieve durable political and economic stabilisation, unless the Transdnistria problem is solved.

3.2 Economic analysis

Moldova is the poorest country in Europe and its GDP per capita of US\$ 326 in 2000 is at developing country level, even taking into account the importance of the shadow economy. Life expectancy has fallen by ten years since independence, and school attendance has also significantly decreased. Hospitals, schools etc. are in a state of dilapidation.

The Moldovan economy has contracted by over 60% since independence. It was not until 2000 that sound financial policies, in combination with an improvement of the economies of Moldova's main trading partners, brought about some financial and macro-economic stabilisation, although at very low level. GDP rose by some 2%. The effects of the drought in 2000 were less severe than originally expected, with agricultural output down by a mere 2.1%, whereas industrial production recovered by 2.8% after an 11% decline in 1999. This modest recovery continued in the first quarter of 2001.

After a sharp acceleration of inflation in 1999 to about 45%, a substantial tightening of the fiscal and monetary policy mix succeeded in reducing the consumer price index (CPI) increase to just under 20% in 2000. In the first five months of 2001, inflation was kept in line with the 10% inflation target set by the central bank.

Fiscal policy developments in the last two years were impressive, largely through a rationalisation of health care, education and public sector expenditure. The budget deficit was reduced from over 8% in 1998 to 3% in 1999 and just over 1% in 2000. In 2001 the fiscal developments are expected to be broadly under control. Monetary policy was successfully tightened in 2000. Strong foreign exchange inflows caused the exchange rate to appreciate slightly in real terms, but allowed the central bank to replenish its international reserves in spite of a trade deficit. The current account deficit widened in 2000 to about 8% of GDP, largely due to higher imports. Exports increased by 5%, while imports rose by over 30%. The trade deficit increased further in early 2001.

Despite some success in reducing the government budget deficit, the burden of servicing the already accumulated external debt causes concern (recent joint IMF-WB study on Moldova's debt sustainability). In 2000, steps were taken to reduce arrears on debt service obligations, and energy imports and rescheduling discussions were successfully launched with a number of commercial creditors. Notwithstanding these efforts, the sustainability of Moldova's external debt remains at risk, given the heavy burden of debt servicing in the coming years (in 2001 roughly EUR 125 million). A resumption of international financing is indispensable for Moldova.

3.3 Structural reforms

Political developments prompted a standstill in reforms in 1999, in particular with the failure of the Parliament to pass legislation for privatisation in the wine and tobacco sector. However, in 2000, substantial progress was made with privatisation in the energy sector. In addition, the key privatisation of wineries and tobacco plants was finally approved in October 2000, although actual privatisation is proceeding slowly. The preparations for the privatisation of Moldova's national telecom company have proceeded with difficulty. However, an independent regulatory body has been established to assist in restructuring this sector and a competent company has been selected to assist the Government in the privatisation process.

There has been a significant acceleration in land reform. By 2001 more than 2/3 of the agricultural land belonged to private owners, while half of the land parcels were registered in the national cadaster system. The next stage of agricultural reform presupposes the development of

new private enterprises (farms, joint stock companies etc.), creation of cooperatives and farmers' associations, processing enterprises and infrastructures.

Restructuring and bankruptcy procedures have been formally initiated for a number of industrial firms with large debts to the budget, some of them long overdue.

While substantial progress was made in the area of structural reform in 2000, further progress in the reform in restructuring and privatisation of industry and in the legal and regulatory environment is crucial for improving governance and the investment climate.

In the energy sector, the creation of the ministry for energy should strengthen the administrative capacity and promote energy sector reform.

In the past, the country attracted little foreign direct investment (FDI), in total EUR 515 million (EUR 140 per head). In the first quarter of 2001, net FDI inflow amounted to just EUR 11 million, a fall by 30% compared to the same quarter one year ago. Uncertainties regarding the intentions of the new Government with respect to further restructuring and privatisation of key economic sectors have clearly fuelled investors' pessimism.

In May 2001, Moldova became a member of WTO. This is an important achievement for the future of the country and it could lead to an improvement of the investment climate. It is now necessary to concentrate on the implementation of WTO commitments.

Moldova has to develop its economic with all its partners and clearly the NIS are the main trading partners. Moldova will need to ensure WTO compatibility in its trade relations, including the CIS.

3.4 Sustainability of current policies

After the change of government in 2001, Moldova's economic and social policy orientations require further clarification. The unsustainability of Moldova's debt burden will have to be tackled urgently in cooperation with the IFIs and Moldova's international partners and this should bring about the clarification required.

In 2002, at Moldova's debt service peak, servicing is roughly estimated at 50% of its budget revenue. This will put great pressure on the country with inevitable consequences on public expenditure, especially in the social sector. An increase in emigration and social unrest could be the consequence, since expenditures in the social sector are already at very low levels. . Moldova will therefore continue to rely on external financing and/or debt restructuring to maintain a satisfactory level of budgetary spending.

The other factor of possible instability is, as mentioned above, the unsolved Transdnistrian integration into Moldova.

3.5 Medium-term challenges

The legal and administrative environment for business has to be significantly improved in order to allow local entrepreneurs and foreign investors to work in stable conditions, otherwise FDI will remain insufficient. Given the size and structure of the Moldovan economy, SMEs are the most promising form of entrepreneurship in Moldova. SMEs are active in various areas, such as the agro-industrial sector, textiles and footwear. Support to the development of this potential is one of the medium-term challenges requiring an improved framework for business, a stable political situation and continuity of reform-oriented economic policies.

Moldova's dependence on exports to the NIS exposes her to the consequences of crisis in these markets, as was experienced in 1998. Moldova needs to diversify its export markets. However, Moldova's strategic products (agriculture) face strong competition. For them, as well as for other products, it will be necessary to improve quality, packaging and marketing and to increase the use of international technical standards.

Remedying the very difficult social situation (low life expectancy and school attendance) is another medium-term challenge.

Furthermore, justice and home affairs remains one of the most important issues to be addressed. In particular, corruption in the private and public sector as well as money laundering limit the development of the Moldovan economy.

Resumption of economic growth, reform of the fiscal system and the establishment of an efficient system of border management (including that of the eastern parts of Moldova) are a precondition for an improvement in the economy and the social sector..

Lasting political stability and confidence in the country's future are unlikely to be achieved without solving the Transdnistria problem.

4. Overview of EC past, on-going and other donors' cooperation

4.1 Past and on-going EC assistance

Since 1991 Tacis has been one of the leading technical assistance programmes supporting the transition process in Moldova. Tacis has allocated around EUR 95 million for the period 1991-2002 in form of National Action Programmes, Regional and Cross-Border Cooperation (CBC) Programmes.

To start with, EC cooperation in the National Action Programmes centred on the transformation of the agricultural sector. In order to support the necessary transition of the country to a market economy, other key cooperation areas were support to public administration reform and the social sector, as well as strengthening private sector development, including SMEs.

Regional Programmes in Moldova concentrated on transport, environment, and justice and home affairs. CBC is active on the western border of Moldova and provides assistance for the modernisation of border crossings, economic development and environment issues in border regions.

A Tacis country evaluation undertaken in 2000 came to the conclusion that the Tacis approach was broadly correct in the selection of priorities and in the relevance of actions. Problems were recorded with regard to co-ordinating strategies and objectives with other major donors and to the sustainability of certain projects, which depended very much on the volatile political situation in Moldova. The evaluation recommended removing agriculture from the priority areas and replacing it with broader rural development in a more targeted approach. The results of SME support were seen as mixed. Given the presence of other donors, strong prioritisation was recommended. Relevance of Tacis activity in public administration and in the social sectors was considered good, but less concentration on higher education was recommended. Tacis technical support to Moldova's accession to the WTO and PCA implementation proved rather successful. Standard Tacis projects were considered in some case too big and not flexible enough to react to changing political aspects, whereas the Policy and Legal Advice programme was highlighted as an effective instrument.

The 2000-2003 Tacis Indicative Programme for Moldova reflected the requirement of achieving PCA objectives, the analysis of the political and economic situation of the country, the programme of the Government and the experience of past intervention in Moldova. It concentrated on three priority areas of cooperation:

- Support for institutional, legal and administrative reform
- Support to the private sector and assistance for economic development
- Support in addressing the social consequences of transition.

The 2001 Tacis National Action Programme for Moldova has a bi-annual budget of EUR 21 million, including an allocation for the Small Projects Programme. In compliance with the priorities identified in the 2000-2003 Indicative Programme, the EC is funding projects in the following areas:

- Strengthening of the civil and commercial judiciary
- Approximation of standards and norms
- Strengthening of the customs and statistical services

- Improving border management
- Higher education development (Tempus)
- Small and medium-sized enterprises
- Health promotion and disease prevention
- Capacity building in social policy reform with emphasis on child protection.

Technical assistance remains an appropriate instrument for EU-Moldova cooperation, but the wider opportunities allowed by the current Tacis Regulation (N° 99/2000) with regard to investments are of particular interest for Moldova, especially in the social area. A better co-ordination of the sequencing of TACIS intervention with those of other donors and in particular with World Bank are envisaged for activities foreseen in the NIP below.

4.2. Other EC policies and instruments

European Initiative for Democracy and Human Rights (EIDHR). Its overall objective is to consolidate democracy in Moldova by supporting institutions and NGOs dealing with civil and human rights. This programme amounted to about EUR 1.7 million for the period 1991-2000 covering a variety of projects, such as training related to human rights, setting up of trade union rights, and assisting independent media and local government.

Humanitarian Assistance. The already difficult social situation in Moldova deteriorated further in the wake of the Russian financial crisis of 1998. In 1999 the EC allocated around EUR 4 million for exceptional humanitarian aid. Projects concentrated on medicines, vaccines and food supplies for children and elderly people. In 2000, ECHO allocated EUR 0.81 million to continue some of the above-mentioned actions and in 2001 EUR 0.78 million. ECHO is phasing out this type of assistance, because the Moldovan situation derives from structural problems and not a temporary emergency and, therefore, does not fall within ECHO's mandate.

Food Security Programme. A EUR 5 million programme from the 2000 budget provides budgetary aid in the form of a grant and will be implemented from 2001. It will create a counterpart fund from which social programmes will be implemented. The counterpart fund will most likely be spent in favour of children's homes and family assistance, building on the previous work of ECHO and other donors. According to the conditions of the programme, the Government will also have to start structural reform of the social assistance system. The Food Security Programme is a suitable instrument for Moldova because it brings direct grant assistance to needy people and commits the Government to social reforms. Interaction between the Food Security Programme and Tacis is essential to obtain the expected results. In view of the ongoing very difficult financial and social situation of the country the EU considers Food Security Programs such as outlined above as an efficient instrument to contribute to poverty reduction. Food Security should therefore continue to be a priority in the future EU contributions as indicated in the NIP below.

Macro-financial assistance. By 1999, two balance of payments loans for a total amount of EUR 60 million had been disbursed to Moldova. A third loan of EUR 15 million was approved in 1998. It could be disbursed in 2002-early 2002, if the IMF arrangement under the Poverty Reduction and Growth Facility is reactivated in the next few months. The third EU loan will bring relief to Moldova in the short run; from a longer-term perspective, the EU will need to continue its cooperation with the IFIs in addressing Moldova's financing problems, especially given the country's possible difficulties in servicing its external obligations

Generalised System of Preference (GSP). The GSP allows Moldova to export to the EU industrial and agricultural goods at a reduced customs tariff. Moldova benefits also from the social incentive scheme, involving further reductions of tariffs, since it implements the ILO

conventions provided for in the relevant GSP Regulation. GSP will continue to apply to Moldova. It is most appropriate as Moldova is trying to diversify its export markets. Technical assistance to the Moldovan Export Promotion Organisation will be complementary, in order to enhance the country's export policy.

Research and Technological Development. Moldova is participating in the EU's Framework Programme activities, in particular INCO-Copernicus, as well as in INTAS projects. With regard to the European Research Area and the new Framework Programme, the objective for the Newly Independent States (NIS) will be twofold: stabilise their research potential and tackle problems of mutual interest where research can provide appropriate solutions and responses (i.e. non-proliferation, health and environmental safety related to industrial changes). This objective is achieved by strengthening partnerships and exchanges with the scientific communities of the EU.

4.3 Member States' activities and other donors' assistance

Member State donors include the Netherlands, Germany, Sweden, the United Kingdom, France and Denmark. The **Netherlands** made available substantial budgetary support in grant form to strengthen the democratisation process as well as human rights. **Germany** provided mainly technical assistance in the areas of legal reform (civil code), and rural financing. **Sweden** focuses on democratic governance, support to the social sector and land reform. The **UK** provides assistance for rural development, credit unions, social protection, civil society and follow-up to WTO accession. **France** focuses on public administration (at central and local levels) and judiciary system reform. France supports initial and vocational training for civil servants, mayors, magistrates and public prosecutors.

Other donors are UNICEF (assistance for institutionalised children), UNDP and the Soros Foundation.

IMF funding between 1993 and 2001 amounted to 260.83 million SDR. IMF contributions are linked to the achievement of agreed financial and structural reform targets. The latest screening took place in July 2001, with a rather positive position on further funding. In December 2000 the IMF gave approval in principal to a Poverty Reduction and Growth Facility amounting to EUR 162 million. An initial disbursement took place in December 2000 with a further disbursement of 9.24Mio SDR in February 2001 .

IBRD/IDA. Moldova benefits from IDA conditions and has received in total about EUR 440 million for 13 projects. EUR 64 million went to the agricultural sector, EUR 50 million to private sector development and EUR 43 million to public administration/social sector. IBRD's Country Assistance Strategy targets macroeconomic sustainability, private sector development and public sector reform, in order to ensure economic growth and poverty reduction. The World Bank has taken the lead in assisting the drafting of the Poverty Reduction Strategy Paper for Moldova (see section 2 above).

USAID is by far the largest grant donor to Moldova. For 1998 and 1999, EUR 90 million were allocated, about EUR 73 million were foreseen in 2000 and EUR 57 million in 2001. Its main priorities for Moldova are enterprise restructuring, fiscal reform, improvement of the policy environment, development of capital markets, and land reform including de-collectivisation and energy efficiency measures.

European Bank for Reconstruction and Development (EBRD). By the end of 2000, the EBRD had invested some EUR 178 million in support of projects totalling about EUR 300 million, of which 29% were in the financial sector, 34% in the private corporate and agribusiness sector, and 37% in infrastructure. The current EBRD Strategy for Moldova dates back to 1999 and is under revision at the time of writing this CSP. The focus of EBRD's action is on privatisation and strategic investments (energy and telecommunications), SME and micro-business, and the financial sector.

5. EC Response Strategy

Moldova will be a direct neighbour of the enlarged EU. It is in the EU's interest to use its cooperation instruments as efficiently and coherently as possible, taking into account the EU cooperation objectives mentioned in section 2 above. This has to be achieved by adopting suitable measures on the basis of this 2002-2006 CSP.

The EU should use its cooperation instruments primarily for the political and economic stabilisation of Moldova. This includes continued efforts through political dialogue, in the context of the OSCE and with Russia, to resolve Moldova's fundamental problem, the Transdnistria conflict. If in future this conflict is resolved, and if Moldovan reform policies are credible, the EU may want to consider stepping up its assistance to Moldova and/or encourage even closer ties with the EU, using, for instance, the evolutionary potential of the PCA.

Economic stabilisation policies for Moldova need to be three-pronged: tackling poverty and social destitution; building the framework for a market economy and promoting enterprise development in view of creating conditions for economic growth and dealing with the problem of debt servicing.

Formally Moldova is more advanced than other NIS neighbours in its international and EU trade relations, since the country has joined the WTO and there are hardly any trade issues between Moldova and the EU. But this is due to the limited relevance of trade and economic relations with a country which is small and very poor.

Moldova still has to complete a difficult and painful economic transition. The potential of the PCA should in this case be used as a vehicle to facilitate improvement of Moldova's business climate and diversification of its exports away from excessive orientation towards the NIS.

Within the PCA political dialogue the fight against crime, inter alia corruption and money laundering, is of particular importance in order to strengthen good governance, the rule of law and the judiciary as well as law enforcement and public administration. This is irrespective of the negative impact which poverty and the Transdnistria problem have on the state of justice and home affairs. Good governance and enhanced public administration will also be required for improving the investment climate and producing economic growth. Creation of civil society organisations is necessary to support this development and will complement and consolidate formal democracy.

Moldova can benefit from the following types of EC assistance:

- Macro-financial assistance
- National Tacis budget allocations
- Allocations under the Tacis Regional and Cross-Border Cooperation Programmes
- Food Security Programme allocations and
- EIDHR allocations.

Among the structural adjustment criteria linked to EC macro-financial aid, there will most likely be an undertaking by Moldova to enhance foreign investments and to develop the means for poverty assessment and monitoring. Technical assistance will be directed to the same objectives in order to help the authorities to meet them.

The memorandum of understanding of the Food Security Programme, that is necessary to continue beyond 2002, will provide for spending the counterpart fund on the creation of a system of childcare and assistance to families reintegrating children. Technical assistance will accompany these measures, also by funding social investments and building on the EC experience on the same subjects in Romania.

The objective of the EU Generalised System of Preferences will be supported by technical assistance supporting Moldovan export policy and PCA implementation.

EIDHR will be complementary to the main Tacis Programme, concentrating specifically on the consolidation of democracy and civil rights.

Over time and if funding permits, EC assistance could be focused on pilot regional development activities.

As for Transdnistria it is impossible under the present political conditions to establish cooperation, except for minor actions benefiting private entities such as NGOs. EC cooperation should be extended to Transdnistria, if an internationally recognised political agreement is reached on the status of the region.

On the basis of the above analysis, the amended **EC National Indicative Programme 2000 - 2003** for technical assistance will focus in the years 2002-2003 on the following areas:

Support for institutional, legal and administrative reform

- Consolidation of good governance and the rule of law. The EU-Moldova Cooperation Council of May 2001 confirmed the importance of this subject and identified priorities for joint work. The PCA lists areas in which EU and Moldovan laws have to become compatible.
- Approximation of legislation and law enforcement, customs and cross-border cooperation, fight against crime and follow-up to the feasibility study on the EU-Moldova FTA.
- Civil society development. Strengthening the position of NGOs, professional associations etc. to ensure more respect for the rule of law and control of the Government's action, engagement in the social sector and provision of direct assistance to needy people.
- Administrative reform, in particular of the health system
- Continuation of university cooperation under Tempus as well as studying the possibilities for vocational training

Support to the private sector and assistance for economic development

- Enterprise development focusing on the strategic sectors for the economy like rural development (on and off-farm), micro-credit as well as export promotion

Addressing the social consequences of transition.

The thrust will be on poverty reduction, including financing social investments, with a focus on health and childcare

Particular attention will also be paid to the opportunities for achieving horizontal environmental benefits in the activities proposed below for the National Indicative Programme 2002-2003..

6. Tacis National Indicative Programme 2002-2003 (amended version of NIP 2000-2003)

Support for institutional, legal and administrative reform

6.1 Approximation of legislation and administrative reform

6.1.1 Background and justification

Under its 2001-2005 Programme, the Government identifies the need to modernise the economy by improving the legal framework for business, and to fight against organised crime and corruption. Considering the importance of the EU as a trade partner and Moldova's recent accession to the WTO, approximation of legislation to EU and international standards would be key to further integration into the world economy. Law enforcement is the logical and necessary consequence of legislative approximation. It implies a well functioning judiciary, efficient enforcement of courts' decisions, as well as well-functioning administrative bodies responsible for the application of the law (e.g. prosecutor's offices, police, customs, tax administration, bodies responsible for the enforcement of bankruptcy regulations, environment and statistics office etc.). EC assistance will target the judiciary and the law enforcement and administrative bodies dealing with economic and commercial, anti-corruption and anti-money laundering and environmental activities.

6.1.2 Objectives

Main Objective

To assist government in applying good governance and the rule of law and thus consolidating democracy, thanks to improved conditions for law enforcement and the development of business.

Specific Objectives

- Creation of an anti-corruption policy and programme aiming at establishing a comprehensive network on this issue, including relevant legislation, institution building, prevention, awareness raising and enforcement.
- Development of an anti-money laundering regime, in particular creation of appropriate legislation and of a Financial Intelligence Unit (FIU).
- Improvement of the business environment for local and foreign enterprises, in order to encourage trade and foreign direct investments;
- Improvement of available information for poverty assessment and monitoring
- Improvement of environmental awareness in the public and private sector

6.1.3 Expected results

- Moldovan laws and regulations capable of catering for the needs of a democratic country with a market economy, following the EU model;
- Increased reliability of the Moldovan legal system, with a consequent improvement in the environment in which individuals and business entities operate.

6.1.4 Description of programmes

a. Legislation approximation

- Support for implementation of WTO commitments to adapt the internal legislation and regulations, including elimination of technical trade barriers and introduction and application of intellectual property rights legislation;
- Support to customs legislation and regulations, building on the experience of cooperation so far. Actions shall be identified taking into account complementary projects under CBC;

- Legislative approximation in justice and home affairs as regards corruption and money laundering, taking into account complementary projects under CBC and the Regional Programme. co-operation

b. Law enforcement

The programme will concentrate on (i) customs issues and (ii) justice and home affairs as regards anti-corruption activities in the private and public sector (i.e. judicial and law enforcement entities, including customs and border guards, and public administration) and anti-money laundering activities, in particular the creation of a Financial Intelligence Unit in parallel to bringing into force the appropriate legislation. All related support actions may also contain a substantial equipment component.

c. Statistical infrastructure

Continued assistance to building a statistical infrastructure able to provide the necessary information for policy and poverty reduction

6.1.5 Conditionality

The Government and the Parliament should be prepared to draft and bring into force the relevant laws and regulations required. Moreover, assistance will be conditional upon respect by Moldova of the PCA provisions and of the priorities agreed by the PCA bodies, in the specific areas covered. The success of cooperation in law enforcement will depend on the commitment of the Moldovan authorities and between the relevant authorities and state services will be a pre-condition for success. Hence, the selection of projects will be based on priorities agreed with the administration. In addition, the special situation existing in the region of Transnistria requires careful attention.

6.1.6 Indicators

- Relevant legislation and provisions are brought into force;
- National anti-corruption action plan agreed within the government and its implementation launched;
- Anti-money laundering activities identified and implementation launched.

6.1.7 Indicative budget: EUR 4 million

6.2 Health system reform

6.2.1. Background and justification

Moldova is reforming the health sector. The lack of financial resources hampers the implementation of new policies. Tacis has started providing advice to the Ministry of Health under a 1999 project, and a large initiative supporting health promotion and disease prevention under the 2001 Action Programme. Responsibility in health sector management has been devolved to regional and local administrations, but the capacity to develop services responding to people's needs is seriously limited by financial constraints and slow progress in reorganising the system.

6.2.2 Objectives

Main Objective

- To improve the living standards of the population and to reduce social disparities

Specific Objective

- To contribute to the development of an efficient and cost-effective health system

6.2.3 Expected result

- Improvement of the management and delivery of health services in Moldova.

6.2.4 Description of programmes

Tacis will provide assistance in order to organise the system of procurement of medicines in the most cost-effective manner and will support other administrative reform in the health sector as necessary. If required, this assistance will be undertaken at regional/local level in order to improve skills and organisation of those involved in the regional/local health system. It will provide equipment and supplies, using the possibility of funding social investments allowed by the Tacis Regulation, as well as the fund to be created under the EU-financed Food Security Programme. Special attention will be given to the most vulnerable groups of the population in order to facilitate their access to healthcare and to optimise the use of scarce public budgetary resources.

6.2.5 Conditionality

Support to the reform of the health system, in particular at regional/local level, will be conditional upon the approval/implementation of an adequate legislative framework and structures.

6.2.6 Indicators

- Improvement of the quality of services provided in the areas of Tacis intervention and the sustainability of these actions

6.2.7 Indicative budget: EUR 1 million

6.3 Civil society and education development

6.3.1 Background and justification

Moldova's civil society is an essential element for a democratic state applying market economy rules. Cooperation with the administration (e.g. ministries, judiciary, police etc.) and with private bodies should help increase the role of citizens' organisations in social life and in relations between citizens and the administration. The same applies to the role of citizens' organisations in the economic life of the country. The Tacis instruments for this sector focus more on social and environmental projects, whereas EIDHR's main target is human and civil rights.

The reform of training and education is also an important element of the transition process towards a democracy and a market economy governed by the rule of law. Tacis support has focused on the reform of educational systems and their management, on legal training, on management and economics training. One of the main instruments in this area is the Tempus programme, which was allocated about EUR 3.3 million between 1994 and 2000 in Moldova. Tempus activities in Moldova target the priority areas of university management, applied economics (with preference given to agriculture, agro-food industry, energy, environment, transports and tourism); marketing; law (including international law and EC law) and international relations.

6.3.2 Objectives

Main Objective

- To contribute to socio-economic reform, democracy and the rule of law through the development of the training and higher education systems and support to civil society in Moldova.

Specific Objectives

- To create a better legal and administrative framework for NGOs and improve their management;

- To provide direct assistance to people by means of NGOs;
- To promote the reform of higher education institutions in view of improving the quality of academic teaching and learning in line with changing political, social and economic needs .
- To promote international cooperation and partnerships between EU and Moldovan institutions.

6.3.3 Expected results

- Improved legal and administrative framework for NGOs;
- Improved NGO management and assistance to vulnerable members of society, especially in the social area;
- Improved environmental awareness
- In the framework of TEMPUS activities, up-grading of curricula and teaching materials, strengthening of higher education institutions in the society, implementation of staff and students mobility, and development of professional skills in public and private institutions

6.3.4 Description of programmes

- Improving the organisational and management skills of NGOs and social communities;
- Supporting NGO projects providing direct assistance to needy people in the framework of established control mechanisms, exercised by the local target community or by local authorities or both.
- Support to local and private sector activities in the environmental sector (Regional Environment Centre for Moldova)
- Tempus aims at supporting the reform and restructuring of the partner countries' higher education systems and their adaptation to the new socio-economic needs. It does so through interaction and balanced cooperation between institutions in the EU Member States and the partner countries organised in consortia. Consortia create long term cooperation links between the partners which should evolve towards issues such as academic recognition, credit transfer and development of joint-curricula. Priority areas of Tempus activities are jointly defined by the European Commission and national authorities in line with the areas of cooperation in the mainstream Tacis programme. Projects address in particular: (1) issues of curriculum development and renewal in priority areas; (2) reform and modernisation of the structure and management of higher education institutions in view of strengthening their role in the society; (3) development of skills-related training to address specific higher and advanced level skills shortage during the economic reform, in particular through improved and extended links with industry; (4) contribution of higher education and training to citizenship and the strengthening of democracy".

6.3.5 Conditionality

Government support is required for progress in developing the legal and regulatory framework for the emerging civil society organisations. Another condition is the continuation of the education reform process in Moldova. Since the Tempus programme has a "bottom-up" and decentralised approach, working with committed higher education institutions, the risk of it being affected by changes in policy are limited.

6.3.6 Indicators

- Entry into force of appropriate legal, administrative and tax provisions;
- Skills of NGO managers improved;
- Share of higher education institutions involved in cooperation activities with EU partners increased;
- Modernisation of the structure and management of higher education institutions, curricula development according to national priorities and development of the administrative and institutional structures of the country through the delivering of training courses successfully established.

6.3.7 Indicative budget: EUR 3.0 million

Support to the private sector and assistance for economic development

6.4 Support to micro, small and medium enterprises (MSMEs)

6.4.1 Background and justification

Since independence Moldova has made great progress in private sector development. Most agricultural land is privatised, the Association for Restructuring Enterprise (ARIA) has systematically restructured the bulk of the viable SMEs and, in doing so, created substantial resources of business consultants, and a large number of new enterprises have appeared. However, the size distribution of enterprises in Moldova is still sub-optimal and more needs to be done to transform it into a modern industrialised economy. The proportion of large enterprises is still a little higher than would be the case in an EU country. However, the proportion of SMEs is very much smaller while the proportion of micro enterprises with 5 or fewer employees is overwhelmingly greater. They account for over 80% of all enterprises and the bulk are "zero-employee enterprises". Many operate in the informal sector. However, they are commercially oriented, vibrant enterprises and many may be expected to develop into the SMEs which Moldova so badly needs. In the EU SMEs account for 60 or 70 % of employment and a similar proportion should be the goal for the Moldovan economy. As Moldova is predominantly an agricultural country, it is likely that most of these, including both farms and other enterprises, will be in the rural economy.

6.4.2 Objectives

- To stimulate the enterprise development
- Specific objectives**
- To promote the development of existing and potential Micro, Small and Medium Enterprises (MSMEs), especially those in rural areas, with the aim of increasing productivity, exports and employment.
 - To improve the business environment.
 - To promote the use of Moldovan providers of services to business.

6.4.3 Expected results

The results will include an improved business environment, including simpler registration arrangements and more pro-business tax arrangements; a higher proportion of registered micro-enterprises; more SMEs; more jobs and more exports.

6.4.4 Description of Programmes

- Tacis will work with government, including local government, to improve the business environment and will help the government develop schemes for promoting enterprise.
- Tacis will assist the development of MSMEs through schemes using mainly local services to improve all aspects of private sector activities including management, production, quality control, marketing, partner-search and export.
- Building on past experience and using the resources already established in Moldova by Tacis and other donors, Tacis will pay special attention to the needs of the rural economy. While aiming to cover a wide an area as possible, Tacis will co-ordinate activities with other donors to ensure that the maximum impact is generated with the minimum overlap. Potentially, all private sector activities should be addressed, including farms. Although economic activity in rural areas is likely to be predominantly agricultural and food processing (wine sector), given the high manning-levels of farms in the Soviet era, diversification into other areas of economic activity is likely to be a feature of the programmes.

6.4.5 Conditionality

A general precondition for the development of the economy is an improvement in the business environment. This is an objective of this project and requires the full participation of the Moldovan Government. A further key condition will be the selection of regions and targets in a way that both identifies potential "winners" and complements the work of other donors.

6.4.6 Indicators

Indicators of achievement should include more registrations by micro enterprises (indicating a better environment), a large number of SMEs (indicating transition from micro to SME status), higher exports (indicating better productivity and marketing skills) and more jobs. During project preparation, numerical target should be sought for each indicator.

6.4.7 Indicative budget: EUR 8 million"

Support in addressing the social consequences of transition

6.5 Childcare and family assistance

6.5.1 Background and justification

The current system of child protection fails to protect children at risk. Children living in orphanages are especially exposed to the social crisis. Foreign aid is urgently needed. Tacis has launched a project in this area in 2001. The EC Food Security Programme includes the condition that the Government will spend part of the counter-part funds on assistance to children at risk. Tacis will ensure coherence with and follow-up to, the Food Security Programme.

6.5.2 Objectives

Main Objective

- To improve the living conditions of children.

Specific Objectives

- To alleviate the hardship of children living in institutions;
- To support families in order to avoid children being abandoned and to facilitate the return to families.

6.5.3 Expected result

- Elaboration and implementation of a government policy for children and a gradual improvement of their material living conditions.

6.5.4 Description of programmes

Assistance will support the measures adopted by the administration in the implementation of the Food Security Programme. Special attention will be paid to the experience gained in technical assistance in Romania in the same area.

6.5.5 Conditionality

Children and family assistance will be linked to the commitment of the authorities to develop an appropriate policy and to fulfil the conditions of the Food Security Programme.

6.5.6 Indicators

- Adoption and implementation by the Government of a policy to protect disadvantaged children and the sustainability of this policy.

6.5.7 Indicative budget: 4 million

7. Indicative Budget

The Programme will be financed through an EC grant of EUR 20.0 million in 2003, allocated as follows among the different priorities:

Area/priority	Indicative Budget in Mio.€
<u>1. Support for institutional, legal and administrative reform</u>	<u>8,0</u>
• <u>Approximation of legislation, law enforcement and administrative reform</u>	<u>4,0</u>
• <u>Health system reform</u>	<u>1,0</u>
• <u>Civil society and education development</u>	<u>3,0</u>
<u>2. Support to the private sector and assistance for economic development</u>	<u>8,0</u>
<u>3. Support in addressing the social consequences of transition</u>	<u>4,0</u>
• <u>Childcare and family assistance(including assistance/re-integration for “institutionalised children</u>	<u>4,0</u>
<u>Total</u>	<u>20,0</u>

8. Conditionality

Assistance in the period of 2002-2003 is provided on the basis of the existence of the necessary elements for the continuation of cooperation through assistance, in particular respect of democratic principles, human rights and a market friendly, politically pluralistic framework as well as the obligations of Moldova as set out in the Partnership and Cooperation Agreement.

Annex 1**Selected economic and social indicators****MOLDOVA****GENERAL**

Area (square km):	34,000
Population 1999 (million):	4
Urban Population (1999):	46.2 %
Life Expectancy (1999):	66.6 years
Population growth rate (1990-99):	-0.2 %
Fertility Rate per woman (1998):	1.7
Human Development Index (HDI) Rank:	98

ECONOMY

Nominal GNP (1999) (US\$):	1.6 billion
GNP per capita(1999) (US\$):	370
GDP Breakdown by sector value added (1999) :	
Agriculture:	21 %
Industry:	24 %
Services:	55 %
Real GDP growth rate (2000):	1.9 %
Estimated real level of 1999 GDP as of 1989 GDP :	31 %
Inflation:	
1997	11.8 %
1998	7.7 %
1999	39.3 %
2000	31.3 %
External debt stock (1999): US\$	1,055 million
Debt Service: (1999):	34.5 % of current account revenues, excl. transfers

(All figures for 1999 in million US \$)	(all figures in million € for 1999, unless otherwise stated)
Exports of goods&services : 580	Exports to EC: €
Imports of goods&services: 752	Import from EC: €
Current account balance: -23	Trade balance with EC: €
FDI: (1999) : 34	FDI of European origin: €

Social Development

Adult Literacy Rate:	98.7 %
Primary Enrolment Rate (2000):	not available
Secondary enrolment rate (2000):	not available
Infant mortality (1999):	27 per 1,000 births
Under 5 mortality (1999) :	34 per 1,000 births
Contraceptive prevalence rate (1998):	74 %
Access to essential drugs :	66%
Access to safe water (1990/96):	56%
Access to sanitation: (1990/96)	50 %
Under 5 malnutrition:	not available
Number of doctors/100.000 people	309

Sources: World Development Report 2000/2001; Human Development Report 2001; UN Economic Survey of Europe 2001 (1); Transition Report 2000 (EBRD); IMF World Economic Outlook (May 2001); World Bank website.

