

The COVID-19 Crisis: how does the Republic of Moldova finance its budget deficit?

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April 24, 2020

Context

In addition to the threats related to the population's health, the crisis generated by the Covid-19 pandemic presents the first economic challenges. Quarantine and social distancing measures have significantly reduced the activity of companies, with the global economic growth forecasts being significantly revised towards a global recession of about 3%¹. The economy of the Republic of Moldova is no exception as several sectors are already registering a drastic decrease in the sales and revenues because of the impossibility to carry out the usual activity. In addition, the public finances are being put to a severe test - on the one hand they are affected by the reduction in the tax revenues, on the other hand, there is an increase in spending to support the healthcare sector. Also, the Government cannot leave the real economy without support, the expenses for supporting the enterprises and the population will increase considerably.

In the situation of a state of emergency imposed as a result of the spread of Covid-19, the Government and Parliament approved a significant budget correction². The adjustment is based on a somewhat optimistic macroeconomic scenario, with a decrease in GDP in real terms of (only) 3.0% compared to 2019, an average annual inflation of 2.8% and an average exchange rate MDL/ USD of about 19 lei. Even so, the revenues of the national public budget will decrease significantly, by more than 7.5 billion MDL, while the spending will increase by about 1.3 billion MDL. In this context, the budget deficit may reach 16.2 billion MDL, which is more than double than initially estimated (7.4 billion MDL at the time of approval of the State Budget Law for 2020).

Although the current level of public sector debt is not a problem, in the current context any expenditure must be thoroughly justified. Simultaneously with the review of existing spending programmes, the Government has included a number of new programmes to support the healthcare sector with immediate and longer-term impact. Expenditure programmes are also provided to mitigate the negative impact of the pandemic on the businesses and population. Credits attracted from international financial organizations and bilateral loans from the governments of other countries will serve as sources of financing for the envisaged measures. Creditors such as the International Monetary Fund (IMF), the World Bank, the Council of Europe Development Bank, the European Union (EU) and the Government of the Russian Federation are mentioned.

The core problem

¹ World Economic Outlook, April 2020, <https://www.imf.org/en/Publications/WEO/Issues/2020/04/14/weo-april-2020>

² Government Decision on the approval of the draft law on amending the State Budget Law for 2020 no. 172/2019, https://gov.md/sites/default/files/document/attachments/intr03_2_1.pdf

In the context of the state of emergency, the Republic of Moldova has several options for financing the budget deficit. The establishment of the state of emergency is a widely accepted reason for extending the budgetary expenditures beyond the limits imposed by the budgetary-fiscal legislation. While internally the financing options are limited (loans from banks, privatizations or, indirectly, money from the NBM), externally, the range of creditors becomes much more diversified. In the context of the Covid-19 pandemic, international financial institutions such as the IMF and the World Bank have made billions of dollars available to members through fast, cheap and unconditional reform instruments. For Moldova, the support announced by the two institutions amounts to about 300 million USD. In response to the crisis, the EU also announced non-reimbursable support for both member and associated countries. A non-reimbursable financial support of about 87 million EUR has already been announced for our country along with the possibility of providing assistance of around 100 million EUR.

In addition to the financial support from the IMF and the EU, the authorities also resort to less traditional creditors that can affect our country's external relations both financially, politically and even geo-politically. Recently, Moldova signed a loan agreement of 200 million EUR with the Government of the Russian Federation which, although presented as a response and support in the context of the Covid-19 pandemic, it is rather intended to support the electoral projects announced at the beginning of the year. A good part of the financial resources (1,3 billion MDL) has already been included in the budget rectification draft for the implementation of the "Road Infrastructure Development Programme with the support of the Russian Federation" Project, which is nothing more than a new "Good Roads" Programme. Obviously, we do not doubt that any public infrastructure works will help the economic agents somewhat in times of crisis, however, the most delicate question remains the opportunity of these works and how to achieve them in the context of the existence of several conditionalities.

The loan agreement signed with the Government of the Russian Federation raises several questions about both financial provisions and non-financial conditionalities. Though presented as a budget support loan, the Government cannot use this money as it sees fit, but only to support joint development projects and with the involvement of companies of that country. Thus, the Government does not seem to have the possibility to individually assess the project opportunities as the decision will be taken together with the Russian side. Another provision that deserves special attention and additional explanation is related to the consolidation of all debts of the Moldovan side, without clarity regarding the current situation of all the active obligations of the Republic of Moldova towards the Russian Federation. Such obligations cannot be accepted without expressly adding the list of existing obligations. Finally, the repayment terms, including the interest on this loan, seem to be among the toughest on the list of all financing agreements that our country has in force at the moment, or which are at an advanced stage of approval.

The agreement signed with the Russian side cannot in essence be compared with any financing instrument granted by other creditors, either in the context of the Covid-19 crisis or other budget-support loans. However, for a clearer picture on this issue, Table 1 shows the main conditions for attracting funding from various external partners, with a focus on the funds recently attracted from international financial institutions (multilateral creditors) and those contracted from other bilateral partners.

Table. The main features of the Financing Agreements concluded by the Republic of Moldova between 2015 - 2020 for the purpose of financing budgetary expenditures

Creditor	Amount allocated	Stated purpose	Conditions for granting the loan
International Monetary Fund	235 mil. USD	Urgent financial assistance to mitigate the economic and social impact of the Covid-19 pandemic aimed at meeting urgent balance of payments needs, catalysing support from development partners and supporting the imminent needs of the healthcare system.	Financial assistance is provided through two emergency financing instruments, with no need for a full programme with the IMF, namely: i. 78.4 mil USD through the <i>Rapid Lending Instrument (RLI)</i>. The interest rate for RLI loans is equal to 0%, the grace period for such loans is 5½ years, with 10-year maturity; ii. 156.7 mil USD under the <i>Rapid Financing Instrument (RFI)</i>. Financial assistance through RFI is granted under the same conditions as for stand-by agreements (at the moment, the interest rate is about 1.5%) and the maturity is between 3 and 5 years.
World Bank	53 mil. EUR	Loan for the implementation of the "Emergency response to Covid-19" Project with emphasis on strengthening the technical capacities of healthcare institutions for staff protection and serious cases management, and reducing the negative financial impact at the household level.	The 52.9 million EUR financing agreement negotiated with the World Bank is to be supported by the International Development Association (IDA) credit resources. The loan is provided at a cumulative interest rate (including service fee) of 0.75% per annum, with a grace period of 5 years and a maturity of 25 years.
The Council of Europe Development Bank	70 mil. EUR	40 mil EUR for endowing the hospitals with medical equipment and devices, and re-equipping the healthcare facilities; 30 mil EUR for granting loans on preferential terms to SMEs through commercial banks.	There is currently no public information on this loan. However, loans from the CEB are usually social in nature and are provided on fairly easy terms. For example, the 12 mil EUR loan contracted in 2018 to purchase ambulances was provided in two instalments, at an interest rate applied on international financial markets (around 1%), with a maturity of up to 15 years. At the same time, in case of delayed payments, penalties will be calculated in the form of + 2.5% interest to the already existing interest.

Government of the Russian Federation	200 mil. EUR	Loan granted for strengthening the relations between the Republic of Moldova and the Russian Federation and for supporting Moldova's budgetary needs.	The loan is granted at an annual interest rate of 2% and is to be repaid within 10 years on the basis of 20 equal half-yearly payments. Payments will be made on March 15 and September 15 of each year, starting in 2021. If interest is not paid within 10 calendar days of the respective date of payment, this debt will be declared outstanding and interest in the amount of 150% of the interest rate on the loan (essentially plus 3 percent) will be calculated starting from the respective date of payment and until the debt is paid. At the same time, the loan has a number of non-financial conditionalities, respectively, in order to expand trade and economic relations between the parties, Moldova will make efforts to achieve joint projects (so a joint decision is needed) with the involvement of the Russian companies.
Romanian Government	150 mil. EUR	Medium-term repayable financial assistance in the form of a loan.	The loan is granted in maximum three instalments based on a pre-established schedule with a 5-year maturity for each instalment and an interest rate of about 1.5%. The loan agreement has no conditionalities except for the existence of the financing facility concluded by the Republic of Moldova with the IMF, which in turn has certain conditionalities for reforms. If the repayment of the loan is not possible, the rescheduling of debts will take place under the same conditions and privileges as in the case of financing agreements from international financial institutions. At the same time, in case of delayed payments, penalties will be calculated in the form of a + 2% interest to the already existing interest or the + 3% EURIBOR interest.
European Commission	100 mil. EUR	Macro-financial assistance to reduce external financing constraints, support budgetary needs, strengthen foreign exchange reserves and overcome the external and financial vulnerabilities. It includes a 60 mil EUR loan facility and a 40 EUR million grant facility.	The loan facility is granted in three instalments with a maturity of up to 15 years at the interest rate at which the European Commission borrows on the international financial market (0.5% on average in 2019 for bonds issued with a maturity of 15 years). At the same time, the granting of the three tranches of assistance is conditioned both upon satisfactory balance in terms of the implementation of the loan agreement between Moldova and the IMF and by a positive assessment by the Commission, on behalf of the European Union, regarding the progress on a number of macroeconomic and structural adjustment measures.

Source: based on data from the Financing Agreements