

One year of IMF Agreement: what were the achievements in 2022 and what should we expect in 2023?

Opinion on the role of IMF support for the social protection dimension

Ecaterina Rusu

Program Director, Expert-Grup

January 2023

At the beginning of January this year, the IMF announced the release of the next tranche of budget support to the Republic of Moldova, the total disbursements under the Agreement reaching about USD 275 million. The IMF's financial support played a vital role in responding to the crises of 2022 and that continues to persist this year too. The budget support received from the IMF, as well as the financial resources it has catalysed from other donors and external lenders, has allowed prompt intervention on the social protection dimension to mitigate the severity of the crises and their impact on vulnerable groups. The purpose of this commentary is to analyse how IMF financing is being used, the progress made in fulfilling the commitments under the Agreement, and the opportunities it offers for strengthening the social protection function.

The Memorandum of Economic and Financial Policies concluded with the International Monetary Fund (IMF) has made available to the Government indispensable financial resources to respond to the effects of the combined crises that characterized the year 2022 and continue to linger into this year. The financial support under the Extended Credit Facility (ECF) and Extended Fund Facility (EFF)¹ arrangements available to the Republic of Moldova until 2025 is about USD 796 million², by USD 260 million more than originally foreseen when the Agreement was signed in December 2021. The additional funding was requested by the Chișinău authorities last spring in the context of complicated economic, social and security circumstances. Moreover, the approval of the decision to top up the program was accompanied by the immediate release of USD 145 million, which was fully earmarked to finance the needs of the state budget and allowed the authorities to act quickly. Thus, as of end-2022, USD 250.5 million has been disbursed under the IMF arrangement, with all disbursements on schedule. For 2023, about USD 216 million are planned to be disbursed. The release of the first tranche of around USD 27 million for this year was approved by the IMF Board in early January³. At the same time, it should be noted that this program is mainly focused on budget support (80%). Thus, only the tranches scheduled for 2024-2025 will be shared equally between the Ministry of Finance (budget support) and the National Bank of Moldova (for reserve asset consolidation).

¹ The Extended Credit Facility (ECF) provides financial assistance in a more flexible form and better tailored to the needs of low-income countries, including during crises. The Extended Fund Facility (EFF) provides assistance to countries with balance of payments imbalances caused by structural barriers or slow economic growth. In the case of the Republic of Moldova, funding through these mechanisms is based on an ECF/EFF resource distribution ratio of 1:2. The interest rate for ECF loans has been set at 0% up to and including 2023 year and the interest rate for EFF loans is floating (IMF rate for Special Drawing Rights).

² <https://www.imf.org/en/News/Articles/2022/05/11/pr22149-moldova-imf-board-concludes-adhoc-review-under-ecf-and-augmentation-under-ecf-and-eff>

³ <https://www.imf.md/press/pressw/press-230109ro.html>

The commentary was produced by the Expert-Grup Independent Think-Tank within the framework of the initiative 'Socially Responsible Management of External Financing', in partnership with the Institute for Strategic Initiatives (IPIS), with the support of the Soros Foundation Moldova.

This mix of resource distribution is in addition justified by the fact that the official reserve assets currently meet the sufficiency criteria, providing a solid safety cushion for the conduct of monetary and foreign exchange policy, and for coping with market uncertainty.

The disbursement of resources depends on the degree of implementation of reforms and compliance with the conditionalities. The Agreement is based on several structural benchmarks, divided into 4 blocks: (i) anti-corruption and the rule of law; (ii) fiscal management; (iii) financial sector supervision; and (iv) state-owned enterprises sector, and provides clear terms of implementation. In addition, the Agreement also requires compliance with quantitative performance indicators, ceiling the level of cash deficit of the general government, setting the floor of the net international reserves of the NBM and not allowing the accumulation of arrears on external payment arrears. Therefore, the IMF agreement also implies a systematic monitoring of the implementation of the reform processes, thus foreseeing 7 rounds of assessments during the entire program. One ad-hoc evaluation (in the context of the program augmentation) and 2 scheduled evaluations took place during 2022. The evaluation reports show that, despite the challenging context, the authorities have made progress on structural benchmarks (although some of them have been completed with delay), while meeting quantitative performance indicators. Reviewing the commitments made, the following progress can be noted:

(i) anti-corruption and the rule of law

- ✓ the Law on the Prosecutor's Office amended and the Chief Prosecutor of the Anticorruption Prosecutor's Office appointed;

(ii) fiscal management

- ✓ the report on the execution of investment projects financed from extra-budgetary funds for 2021 prepared;
- ✓ a comprehensive analysis of tax expenditures carried out;
- ✓ the Regulation on the method of keeping the Electronic Register of Employees amended, making the use of the system mandatory for all budgetary institutions;

(iii) financial sector supervision

- ✓ the solvency assessment of insurance companies completed;
- ✓ the regulatory framework on emergency liquidity assistance amended;
- ✓ the Law on the National Bank of Moldova amended, in terms of strengthening the independence of the institution by eliminating possible interference by other public entities in the decision-making process, but also by better regulating the process of resignation of members of the NBM's supervisory and executive boards⁴.

(iv) the state-owned enterprises sector

- ✓ the Strategy on the management of state property in state-owned enterprises and companies with full or majority state capital for 2022-2030 approved;

At the same time, in order to ensure the continuity in the implementation of the priority reforms, the list of commitments for 2023 has been updated by adding other six structural performance criteria. These include: (i) provide a separate budget line for the Anti-Corruption Prosecutor's Office so that it operates with an independent budget; (ii) extend the analysis of tax expenditure to include analysis of excise duties, customs duties and property tax; (iii) introduce in the Tax Code provisions related to the general anti-

⁴ <https://www.parlament.md/ProcesulLegislativ/Proiectedeactelegislativ/tabid/61/LegislativId/6298/language/ro-RO/Default.aspx>

evasion framework; (iv) implement an automated tax reporting monitoring program; (v) carry out a mapping of state-owned enterprises which will serve as a basis for the start of privatization efforts; and (vi) adopt secondary legislation on licensing, prudential requirements, qualified shareholders in the insurance sector.

Importantly, the IMF agreement recognises the need to strengthen the social protection function in order to reduce vulnerability and poverty. In particular, the IMF recommends authorities that the level of the targeted social spending⁵ should not fall below the threshold set in the Agreement. Moreover, taking into account the complicated context, during 2022, the IMF has increased the indicative target for this expenditure group from MDL 1,546 million to MDL 2,065 million for the whole year, and recommends a minimum level of MDL 5,989 million for 2023⁶. However, the IMF places a strong emphasis on adjusting social dimension programs in a way that relies more on indirect income assessment rather than just on the provision of social benefits by category of beneficiary. At present, only half of the payments are made based on the recipients' income assessment, which can leave the truly vulnerable and those in need of state support without support, creating room for inefficient use of resources.

The financial resources from the IMF and the support it catalyses from other development partners make possible to cover the financial needs of a deficit budget. Rising prices have put great pressure on household budgets and increased the risks of rising poverty, threatening social cohesion. According to Expert-Grup estimates⁷, the absolute poverty rate in 2022 increased to 27% (24.5% in 2021). At the same time, *energy poverty*, a concept describing people's inability to meet the costs of energy consumption necessary for a decent living, has been brought to the fore. In this context, in order to adequately address urgent spending priorities, during 2022 the state budget was adjusted several times, allocating additional financial resources to implement measures related to the protection of vulnerable groups and ensuring social inclusion. The state budget earmarked about MDL 19 billion for the social protection sector, which is MDL 5 billion more than the amount initially set when the State Budget Law was adopted. In total, following the adjustments, the 2022 national public budget has earmarked about MDL 39 billion for the social protection sector (Figure 1). As of the end of November 2022, 87% of social protection expenditure (MDL 34.4 billion) was executed, exceeding the volume of expenditure executed for the same period in 2021 (MDL 26.4 billion). The increased expenditure was mainly directed towards the adoption of social protection measures in the context of mitigating the impact of inflation, which has significantly eroded the real incomes of the population, particularly affecting the most vulnerable groups. In particular, the increases concerned the following measures:

- grant one-off financial support of MDL 1,500 to the recipients of pensions/social benefits, the amount of which does not exceed MDL 5,000;
- increase the aid for the cold season;
- establish, from 1 October, a monthly childcare allowance of MDL 1,000 for children up to the age of two;
- set up and finance the Energy Vulnerability Reduction Fund, for which MDL 870 million have been allocated for 2022 in order to provide support to certain categories of people in the context of rising costs of energy resources.

⁵ Well-targeted social assistance includes: unemployment benefit, Ajutor Social program, cold season aid and the Energy Vulnerability Reduction Fund

⁶ https://imf.md/press/SR_1MDAEA2023001.pdf

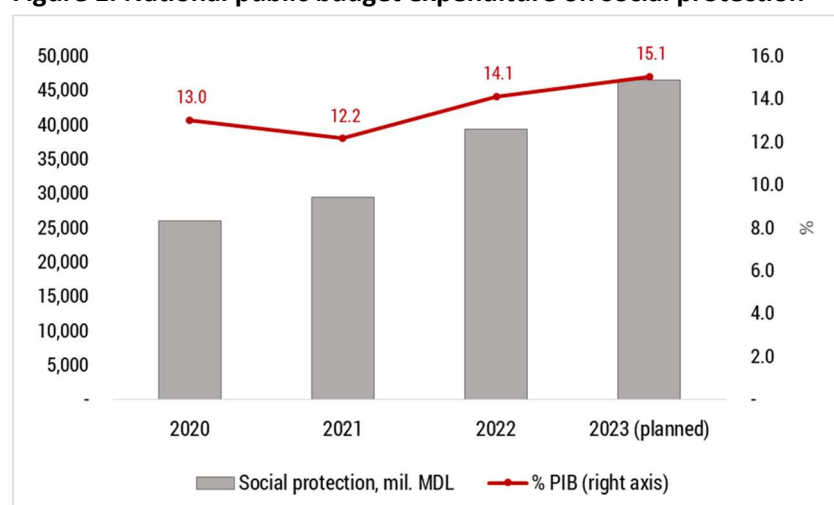
⁷ State of the Country Report, Expert-Grup, 2022 <https://www.expert-grup.org/ro/biblioteca/item/2436-raportul-de-stare-a-%C8%9B%C4%83rii-2022>

The year 2022 was marked by the adoption of policy documents and legislation positively impacting the social protection of vulnerable groups, but also requiring adequate funding. The National Employment Program for 2022-2026 and the Action Plan for its implementation were adopted⁸. The program inclusively focuses on involvement people with special needs and women into labor market and reducing informal employment. For the implementation of the actions envisaged in this program, it is estimated that about MDL 270 million is needed, with financial resources to be covered both from the state budget and by external development partners. At the same time, changes have been made to the Regulation on the method of determining and paying social assistance⁹. Thus, the new provisions of the regulation focus on: (i) stimulating the employment of working-age people from families receiving social aid. The wage income of unemployed or day laborers, who will be employed, will not be taken into account when assessing the right to social assistance and/or aid for the cold season for 3 consecutive months from the month of employment; (ii) increasing the number of families with children participating in the social assistance program by increasing the guaranteed minimum monthly income (GMMI) for each child by MDL 396 and further increasing the GMMI for children with severe or pronounced disability by MDL 169; and (iii) modifying the GMMI for disabled persons, differentiating its size according to the degree of disability for both adults and children. Thus, for an adult with a severe degree of disability, the GMMI has been further increased by MDL 273. In order to implement the new provisions of this Regulation, an additional allocation of about MDL 50 million was needed in 2022.

In 2023 a significant part of the national public budget expenditure will be also channeled to social protection (39%), amounting to MDL 46.5 billion. Therefore, in 2023 compared to 2022, social protection expenditure is expected to increase by 20% (MDL +7.2 billion). An important component of the planned increase in social protection expenditure for 2023 is represented by the compensation for energy bills for vulnerable energy consumers (MDL 5 billion), indexation of pensions, and other expenditure related to the measures adopted in 2022 (mentioned above).

About MDL 24 billion is planned to be allocated from the state budget, of which MDL 17 billion will be transferred to the state social insurance budget. As the state social insurance budget is in deficit, about MDL 6 billion of state budget allocations are earmarked to cover this deficit, the rest being special-purpose allocations for social benefits.

Figure 1. National public budget expenditure on social protection



Source: State Budget Execution Reports of the Ministry of Finance and the State Budget Law for 2023

⁸ <https://gov.md/sites/default/files/document/attachments/subiect-06-nu-488-mmpps-2022.pdf>

⁹ https://www.legis.md/cautare/getResults?doc_id=133839&lang=ro#

In order to implement new social assistance measures that require more resources, and taking into account the current budgetary constraints, external financial support becomes indispensable. For the year 2023, the national public budget deficit is estimated at MDL 18.3 billion, which will be covered mainly by external loans for budgetary support and specific projects. Thus, for the year 2023, it is estimated that MDL 12.5 billion of foreign loans will be received to support the state budget, of which 34% will be covered by IMF disbursements. For the implementation of projects covered from external sources, loan inflows of MDL 6.1 billion are expected. At the same time, it is important to note that the budget will be supplemented by external grants, which are expected to amount to MDL 5.5 billion.

Moreover, in addition to the social protection expenditure already provided for in the budget for 2023, a wide-ranging reform of social assistance planned for the coming period has been announced in the public arena, as well as the launch of the Silver Fund (which will target the implementation of measures for the active involvement of older people and increased payments for a small group of long-lived pensioners) and the adoption of new national programs for the protection of people with disabilities. In order to implement these measures it will be necessary to identify sources of funding, and the support of external donors/lenders will certainly become indispensable.

External financial assistance should be channeled towards increasing the impact of social assistance programs and achieving qualitative structural changes with a long-term effect. The social assistance schemes need to be adjusted accordingly as to increase their potential and efficiency and ensure fair access for disadvantaged groups, while keeping a high level of transparency. Moreover, particular emphasis should be placed on the preventive role of the social assistance in order to avoid the materialization of the risk to fall in poverty. In particular, these objectives take on a particular significance in the context of the national development strategy European Moldova 2030, which sets important social targets:

- reduce the absolute poverty rate to 23.7% by 2025 and to 10% by 2030;
- increase the coverage of the poorest population with social assistance benefits: 25% by 2025 and 35% by 2030;
- increase the share of social services in the social protection budget to 6.5% by 2025 and 9% by 2030;
- increase the number of people with disabilities who have benefited from training and vocational guidance programs for employment: 1,000 people by 2025 and 3,000 by 2030;

Achieving development objectives, including those related to the social dimension, must go hand in hand with strengthening budgetary sustainability. For the most part, social protection benefits provide limited security for the individuals and families dependent on benefits, and do not allow them to escape poverty. Therefore, adjusting existing programs and launching new social protection schemes to increase adequate access to social services remains imperative to achieve the objectives of poverty eradication and social inclusion. At EU level, spending on social protection exceeds 20% of GDP, with some countries spending around 30%¹⁰. In the case of the Republic of Moldova, although this indicator is increasing, it remains relatively low – 15% of GDP. Thus, social policies and measures are important and should be high on the Government's agenda, with sufficient resources mobilised to achieve them. At the same time, the dynamics show that the state social insurance budget is becoming increasingly dependent on transfers from the state budget to cover its deficit, pointing to problems of long-term sustainability of the social protection system, especially of the already fragile pension system. It calls for strengthening the system of collecting contributions to the state social insurance budget by raising the minimum wage, encouraging the formalisation of workers from the informal sector, eliminating institutional vulnerabilities in countering

¹⁰ https://ec.europa.eu/eurostat/databrowser/view/gov_10a_exp/default/table?lang=en

undeclared and under-declared work (such as reforming the State Labour Inspectorate¹¹), accompanied by improving the employment function.

Strengthening the social protection function is ultimately not possible without the promotion of reform-oriented macroeconomic policies that stimulate economic growth, which will translate into better domestic revenue mobilisation. In this regard, drawing on the provisions of the IMF Agreement, we conclude that the role of the IMF is not only to provide financial means that allow for the prompt mitigation of existing shocks, with short-term effect, but also to ensure commitment of state institutions to adopt the appropriate policy mix that will allow progress towards the achievement of sustainable and inclusive development objectives.

¹¹ How can the reform of the State Labour Inspectorate help combat undeclared work? Expert-Grup, 2023 <https://www.expert-grup.org/ro/biblioteca/item/2466-cum-reformarea-inspectoratului-de-stat-al-muncii-poate-contribui-la-combaterea-muncii-nedeclarete?>