MOLDOVA'S FOREIGN POLICY STATEWATCH

Institute for Development and Social Initiatives "Viitorul"

Issue 2, April 2010

CHINA BECOMES A NEW PLAYER ON THE MOLDOVAN STAGE

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Moldova's Foreign Policy Statewatch represents a series of brief analyses, written by local and foreign experts, dedicated to the most topical subjects related to the foreign policy of Moldova, major developments in the Black Sea Region, cooperation with international organizations and peace building activities in the region. It aims to create a common platform for discussion and to bring together experts, commentators, officials and diplomats who are concerned with the perspectives of European Integration of Moldova. It is also pertaining to offer to Moldova's diplomats and analysts a valuable tribune for debating the most interesting and controversial points of view which could help Moldova to find its path to EU.

NEXT TOPICS TO BE COVERED:

- *Great Britain and Slovakia's contribution to Moldova's integration in the EU*
- *Novodnestrovsk – a sensitive issue on Moldo-Ukrainian agenda*

Moldova`s vulnerable financial position

In a time of sharply declining remittances and economic contraction, Moldova is in a critical position lacking the necessary resources to cover the budget deficit, ensure that salaries and pensions are paid on time, basic services are delivered and so needed sound economic reforms are promoted.

With the Consultative Group Meeting taking place on March 24, 2010, Moldova obtained a commitment from the Donor`s community on dispatching $2.6 billion USD (half of it in form of nonreturnable grants) for the next three years to support the priorities identified in the national development agenda.

Yet, at this moment, there are no signs about one of the biggest financial package promised by China - a Loan of 1 billion USD.

Background

Using its position as an emerging power and the financial leverage, China is gradually building ties with Russia's neighbors which seems to give additional tiers in negotiation with Moscow.

In 2009 China decided to invest more than1 billion USD to build power plants and roads in Tajikistan and in the same year China's central bank agreed a three-year currency swap worth 20 billion Yuan (2.93 billion USD) with another former Soviet republic, Belarus. China will invest another $10 billion in Belarus' economy in a series of projects spanning several industrial sectors, including cars, electricity and sugar. The total amount of Chinese investment into the Belarussian economy could reach $15.7 billion, including a $5.7 billion credit line agreed in December.

In the same time, Beijing decided a strategic positioning in South-East European countries (EU members or acession countries) which were most affected by the recent economic crisis through massive importation of Chinese capital - bilateral loans, investments and share placement through a long-term strategy. Recently, an agreement was concluded with Belgrad under a 200 million USD to build a bridge over the river Danube, a deal further strenghtened under a 150 million USD loan from China to Serbia with an interest rate of 3% and repayment period of 15 years. Moreover, under a loan of 1 billion USD Chinese companies were procured by the Serbian state to modernize electricity power stations.

In Moldova China traditionally has been positioning itself more as an observer than a player. Political and cooperation relationships between China and Moldova support a realpolitik point of view. Cooperation is exempt from political condititions as it separates economic interests from political reform. Estimation and evaluation of the Chinese aid is very difficult as it is favouring export led non-reimbursable aid and infrastructure projects.

Since the first agreement signed between the Republic of Moldova and People`s Republic of China (PRC) on economic and tehnic cooperation (July 24, 2002), the Chinese development assistance was registering growing trends with about 11 Grant Agreements and an estimated amount of 20 mil. USD.

China`s assistance comprises annual grants with elements of tied aid used for export promotion of chinese goods and services, usually providing different state institutions with equipment (medical, military, systems for traffic surveillance, computers etc).

Yet, an amount of 55 mil. Yuani (8,06 mil USD) untapped was decided for building the systems for traffic surveillance in Chisinau city, support for the participation of Moldova on Shanghai International Exhibition 2010 and promotion of Moldavian wine on Chinese market.

On July 24, 2009 China announced the availability to loan Moldovan Government with 1 billion USD at an interest rate of 3% (for the pilot project) for 15 years with a five-years grace period on interest payments (the annual interest rate for other projects being a subject of negotiations). It is important to mention that 90% of all labor force engaged in the carrying out of works under the construction contracts will be citizens and/or permanents residents of the Republic of Moldova.

The money will be directed through COVEC, a Chinese leading company for projects in roads construction, power and heat supply sector, social and environment infrastructure and the development industrialization of the Moldovan agriculture.

The value of the loan is unprecedented in proportion of the size of the country (doubling the foreign debt of Moldova) and the low interest rate suggests that China is more interested in export promotion, a new geo-economic positioning and exploiting the window of opportunity opened by the global financial crisis, a risk diversification of its massive financial reserves (estimated at some 700 billion USD). In this way, the Chinese government is trying to provide some additional sort of guarantee to its financial reserves in USD currency. Besides, exporting goods to the European Union via Moldova could significantly cut Chinese transport costs.

Problems

Significant frontloading of the possible loans for infrastructure projects from China (18,5 % of GDP) could raise significantly the debt burden in the medium term. Moldova already has had difficulties in debt distress when the external financing turned scarce, namely a Eurobond rescheduling in 2002 and a partial Paris Club debt rescheduling in 2006.

According to the provisions of the Memorandum regarding the economic and financial policies for 2010-2012 signed January 14, 2010, the Republic of Moldova has restrictions from contracting non-concessional loans aiming to avoid high country indebtedness.

In this respect, IMF program includes as a performance criterion, a ceiling of 125 million USD on contracting or guaranteeing of non-concessional external debt by the general government used for keeping government debt safe.

Another aspect important to mention are the political risks related to the inability of electing a President which could provoke early elections in the second half of 2010 and pose difficulties to country`s capacity for debt reimbursement, a development which may reduce external financial support pressuring the balance of payments again.

Policy options and recommendations

In the most probable case, the Loan Agreement could be signed after the first review of the IMF program (June 30, 2010) when conditionalities on the debt accumulation might be reviewed in light of the new policy on debt limits.

Moldova was assessed to be a higher capacity/lower debt vulnerability country, and thus could therefore be eligible to more flexible conditionality options under the new policy.

Considering the size of the loan the main option are to phasing disbursements over a number of years which will allow a better debt sustainability and projects objectives achievement flexibility.

In the same time, it should be mentioned that according to China`s development assistance principles applied for some similar projects in low income countries (LIC) (in Africa for example) the interest rate constitued about 0.25% to 1.25%.

In this regard, the interest rate (for the pilot project - 3%) should be carefully dealt during the further negotiations for other projects due to serious implications which it might have on country`s debt reimbursement capacity.

Additionaly, taking into account that China`s principles of providing assistance usually are based on the specific requests coming from the recipient countries, the national authorities should be more assertive in the dialogue with Chinese officials and apply for a larger contribution from China through different available cooperation instruments.

Another recommendation would be a more diverse sectoral approach in the usage of the non-reimbursable aid coming from China which could be used for different projects in industry, health, energy and other sectors.