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Introduction

Given the recent adoption of a Partnership and Cooperation Agreement (PCA) which entered into force on 1 July 1998, the immediate focus for the European Commission will be that of its implementation. However, within the context of enlargement and the Republic of Moldova's self-confessed medium/long-term aspirations of full membership, SWP-CPN was asked to assist the process of reflection on the policy the EU should develop beyond the PCA, the purpose of the study being to integrate the EU policy vis à vis Moldova into a comprehensive approach to the region.

In light of the above, a workshop took place on the 9th November 1998 in Brussels in the presence of representatives from the European Commission, the European Parliament, the EBRD, the OSCE and external experts. Three discussion papers were commissioned to be used to animate the workshop: (1) *The Conflict in Transnistria: Its Dynamics and Possible Solutions* (Andrew Williams, University of Kent); (2) *The Impact of Moldova's Economy on the Country's Stability* (Ian Manners, University of Kent); and (3) *The European Union and Moldova Beyond the PCA* (Lucia Padure, KPMG Moldova). Additionally, two fact sheets were produced by Klemens Buescher (Cologne University): (1) *Republic of Moldova: Domestic Politics*; and (2) *Republic of Moldova: Foreign and Security Policy*. The papers were then amended in light of the discussion and the external experts were asked to draft operational conclusions.

Executive Summary and Conclusions

An independent state since 1991, the Republic of Moldova faces both an economic decline and an on-going conflict involving the separatist movement in Transnistria which, although open hostilities ceased in 1992, still simmers. Security tensions and a lack of trust exist between the two sides and until they are overcome there will continue to be a risk of violent conflict, an issue of concern to the international community given the fear of „balkanisation“ in the region. At the same time, a situation of dispute, as it exists in Moldova, affects both the economic and political security of the country by destabilising trade, energy supplies, the monetary system, the budget and the investment performances of Moldova, as well as the stability of the region.

The enlargement process the EU is presently undertaking will bring substantial changes to the geo-strategic set-up of Central and Eastern Europe. In this context, the EU's relationship with the Republic of Moldova needs to be integrated into a comprehensive EU strategy in the region. The perspective of direct neighbourhood between an enlarged EU and the Republic of Moldova raises totally new challenges. Security is no longer limited to military threats. The tensions resulting from political and socio-economic conflicts (soft security risks) are equally menacing. The EU, therefore, has a long-term interest in the consolidation of Moldovan independence, sovereignty and territorial integrity in order to safeguard European peace and stability.

The EU and the Republic of Moldova signed a Partnership and Cooperation Agreement (PCA) in 1994, which has only recently entered into force. Although in the near future, the emphasis will be on implementing this agreement, there is a need to (re)define the medium/long term policy vis à vis Moldova in light of EU enlargement and Moldovan aspirations to full membership. Any such policy will have to address the issues of the future status of Moldova, its internal conflict and its relations with its near neighbours.

Against this backdrop, some brief operational conclusions can be drafted following the workshop held in Brussels:

- The conflict is frozen in a stalemate where neither side will currently make much movement in the direction of the other. The Transnistrian position is firmly held, unlike the Moldovan position which is subject to many splits, often due to changes in negotiating personnel since 1992. The main sticking point in discussions hinges around the problem of the status of Transnistria within a Moldovan „space“. Other cleavages between the parties can be summarised as: ones predicated on economic and political ideology; differences of view about which way „Moldova faces in Europe“, West or East; and what kind of state arrangements can be arrived at. The recommendation is that the EU increases its role in a conflict which is a major element in the problems of successfully implementing the economic liberalisation advocated in the PCA. Any intervention must take into account the sensitivities of the key regional players, notably Russia and Ukraine. A forceful policy towards Moldova could inflame public opinion unnecessarily in

Russia, including against the EU. Bearing this in mind, the EU should, however, take "full advantage of diplomatic channels through bilateral and multilateral fields such as the United Nations, OSCE meetings and elsewhere". The UN resolution can be an effective tool, as was shown in the withdrawal of the Soviet Army from the Baltic states.

- On the specific issue of economic development within the PCA and Tacis, the EU should: encourage Moldova's integration into the world economy by supporting its application to join the WTO and assisting in its compliance with GATT; develop programmes providing technical assistance and policy advice in agriculture, transport and energy thereby assisting Moldova to overcome its "seasonal dependence"; and consider the development of freer trade amongst CEECs and other PCA states.
- The EU should play a more proactive role in regional relations by: heightening the attention given to Confidence Building Measures (CBMs); encouraging the Trilateral between Moldova, Ukraine and Romania as a means of encouraging cross border co-operation; considering EU strategy towards the Black Sea Economic Cooperation, through member states or through observer status.

I. Briefing Papers

The Impact of Moldova's Economy on the Country's Stability

Lucia Padure

I. Executive Summary

While Moldova may have achieved an increase in the number of people who own private property, relatively stable exchange rates and low inflation, it still faces serious economic problems. Large budget and trade deficits (in 1997 over 10% of GDP and US\$ 344 million respectively) and an increasing public debt (60% of GDP) result from the absence of political will to reform the public finances and establish clear guarantees for property rights. Political decisions should have been taken to increase the age of retirement, change the administrative-territorial structure, settle the Transnistrian issue, privatise major industries, and promote land reforms.

Public finances have been based on overvalued revenue projections, inflated social costs and increasing debt service. Low tax collections and inefficient budget spending have resulted in huge arrears on the salaries of budgetary employees and pensioners. Current borrowing is less than half the trade deficit and is used to pay past and present liabilities of the government instead of funding production investment. The trade account shows large sources of unidentified external flows of funds.

The poor trade performance shows that a considerable portion of imports is accounted for by consumer goods instead of capital. Trade with the CIS predominates because of large energy procurements. A considerable effort should be made to encourage exports to the EU member states, which are currently net-exporters.

Moldova's energy-related security is seriously eroded by the huge accumulated external energy debt to Russia and Ukraine. The delivery of gas and energy will be threatened if the debt is not restructured and the Moldovan government does not make the quarterly payments.

Direct foreign investment amounts to only US\$ 142 million. This can be explained by the failure of mass privatisation to create a clear system of ownership, the overwhelming bureaucracy and corruption of local officials involved in privatisation tenders, the instability of investment legislation, and the slow privatisation of the agricultural sector.

The analysis of the GDP in terms of output, expenditure and the impact of the informal sector shows that the most probable reasons behind the slight increase in the GDP in 1997 (by 1.3%) are the increase in agricultural production and consumption, as well as the large informal economy. A stable exchange rate and low inflation were brought about not by improving the economic activity and

export promotion, but by the large barter economy, arrears, and the fact that the prevailing share of credits is in the National Bank's reserve.

The as yet unresolved Transnistrian issue – border disputes, the stationing of XIVth Russian army and weapon stockpiles – has resulted in the uncontrolled movement of goods, fuel, money, criminality, weapons and drugs from the eastern side to Moldova. This affects both the political and economic security of the country by destabilising trade, energy, the monetary system, the budget and the investment performances of Moldova, and the stability of the region.

In the 1998 parliamentary elections, the population of Moldova demonstrated its displeasure with the (former) government's policies – the previous ruling majority did not even reach the 4% threshold of the popular vote needed to enter the Parliament and the Communists gained 40 seats. The Coalition for Democracy and Reforms has been established by three other centre-right parliamentary parties with a democratic and market economy agenda, but the policies of the newly created government demonstrate the unstable nature of the coalition.

The following policies and activities should be undertaken by the EU in the context of implementing the Partnership and Co-operation Agreement (1994) and producing an overall improvement in the Moldovan economy:

- increasing the role of the EU in the political settlement of the Transnistrian issue by taking full advantage of the bilateral and multilateral channels available (UN, OSCE, etc.). In addition, the rapid withdrawal of the XIVth Russian army and the removal of Russian weapon stockpiles should be called for, as should the release of Moldovan political prisoners in Transnistrian prisons, and the drafting of a clear statute proclaiming Transnistria as an inseparable part of Moldova;
- providing technical assistance and policy advice to Moldova on issues necessary for the success of market reforms, such as the development of an export promotion concept, the establishment of a real exchange rate, the settlement of the debts of large agricultural, industrial, and energy complexes, the drafting of new legislation (e.g., concerning social funds, private pension funds, community developments and mutual funds), and the elimination of the current legal constraints on privatisation;
- providing continued financial support through credit lines aimed at giving marginalised groups within the population access to credits with lower rates of interest to enable them to start-up businesses, especially in rural areas;
- assisting Moldova in its negotiations with Russia and Ukraine on issues such as: readjusting relative prices in barter transactions; transit payments and collateral; harmonising VAT and customs regimes to conform to international standards; and delimitating clear and non-porous borders with Ukraine.

- assisting Moldova's integration into the world economy by supporting its application to join the WTO, by encouraging cross-border co-operation in the region, and by promoting Moldovan integration within the Trans-European Networks (TENs).

II. Introduction

Macroeconomic stabilisation has been considered one of Moldova's greatest successes in its efforts to adopt a market economy undertaken since its independence in 1991. The following facts demonstrate the irreversibility of these changes:

- the development of the legal framework and institutional structures needed for a market economy;
- the fact that the private sector accounts for 40% of GDP;
- a stable national currency and low inflation (0.9% monthly inflation rate in 1997, and 0.25% for the first 6 months of 1998); and
- the liberalisation of prices and trade, and the abolition of the centralised system of distribution of resources.

The small decline in GDP of only 2% in 1995 (following the 31% decline in 1994) was viewed as a further indication of the recovery of the economy. Furthermore, the figures for 1996 are expected to show real economic growth (see Annex 1). Foreign experts and the Western economic press have called Moldova a "model of sound reforming," and, "a perfect laboratory of reforms" (The Economist, March 1995). The flow of foreign credit increased and for a while euphoria concerning the anticipated 'economic miracle' prevailed over rationality when it came to spending by the public. Later, publications, including Moldovan ones, analysed the economic decline and the continuing pauperisation of the Moldovan population and gave several reasons for it. Firstly, the disintegration of the USSR resulted in the loss of traditional production and markets, in an increase in the cost of imported energy resources and raw materials, and in higher transport costs.¹ In addition, the resources and potential of the newly created state were overestimated.

While the negative impact of the above-mentioned factors cannot be denied, the main reason for the current critical situation of the Moldovan economy is the absence of political will to reform the public finances and establish clear guarantees for property rights. The presidential and parliamentary elections held between 1996-1998 meant that politicians were unwilling to take tough economic and social measures. Reforms have been delayed and political decisions have not been taken on issues such as: increasing the age of retirement (and with it the financial implications for the social fund); changing the administrative-territorial structure in Moldova by reducing the number of units; diversifying private health care and education; settling the Transnistrian issue; privatising vital sectors including telecommunications and energy; and promoting the land market.

1 In the former Soviet Union Moldova's population represented 1.5%, but Moldova supplied 30% of the FSU tobacco production, 20% of table grapes and wine, 13% of fruit and 10% of vegetables.

The purpose of this paper is to show the major economic problems and developments of Moldova in the current political environment, to question some of the officially-announced macroeconomic achievements, and to make policy recommendations to the EU regarding what could be done to support economic improvement in Moldova. The first part of the paper will analyse the public finance statute and property rights in Moldova. Given the impact the unresolved Transnistrian issue has on the political and economic stability of the country, a separate paragraph is devoted to a comparative economic analysis of Moldova and Transnistria. The second part of the paper will look into the current trade regime of Moldova, the development of trade flows between it and both the CIS and the EU, and the issue of energy security that must be addressed given Moldova's huge reliance on imported fuel.

III. Moldova's Economic Performance: Major Trends and Problems in the Reform Process

1. Public Finance Statute

The budgets of 1996, 1997 and 1998 all contained the following three elements – over-optimistic revenue projections, inflated social expenditure and increasing debt service.

The following problems exist on the revenue side:

- high tax rates: even with the new Tax Code of 1998, the basic rates are 20% for natural persons (15% for those with a income of less than 6000 lei per year) and 32% for legal persons, (30-32% contributions to the Social Fund and 20% VAT);
- frequent changes to the tax legislation and annual budget laws;
- poor tax administration: the unclear status of Transnistria and the largely porous border with Ukraine stimulate large-scale illegal trafficking in cigarettes and fuel;
- high levels of barter payments (around one fifth of all revenues).

As a result, the actual rate of revenue collection at 1 October, 1998 is only 59% of the annual projected rate. Tax evasion is estimated at 15% of all public revenue, and uncollected taxes at the border amount to US\$ 50 million.

On the expenditure side, social expenditure accounts for 58% of the total expenditure. Education (24% in 1997) and health (15% in 1997) continue to be at the top of the government's priorities, but they are not always used rationally (see Annex 2). Some examples:

- the major share of the education budget is still directed at the provision of dormitories;
- half of the wage payments in the education sector go to technical staff;
- low pupil to teacher ratios (15:1 in high schools, 6.5:1 in higher education) result in an oversupply of teachers and low salaries;
- lack of utility meters makes it impossible to control the utility expenditures;

- expensive care in hospitals accounts for almost 80% of health expenditure (compared to 55% in France and 44% in Germany), while primary and preventive care are under-funded;
- excessive number of doctors (40 per ten thousand people) and special medical staff;
- an over-capacity in terms of beds and staff, but not enough money for drugs and equipment.

In addition to public education and health care, the public budget is overburdened by: the high cost of large subsidies to those working in the production of food and utility companies; subsidised electricity, gas, heating, and rent for some sections of the population; as well as the cost of early retirement, free coal and free transportation for many groups. Inefficiency in budget spending results in huge salary arrears for public officials (100 million lei) and pensions (280 million lei) and the rapid growth of the informal education and medical sectors. For example, UNICEF estimated that an average family spends 6% of its total income on private medical services.

Another critical budgetary issue is the alarming increase in the public debt service from 8.6% in 1996 to 14% in 1998, and the huge level of the public debt (60% of GDP). Meanwhile, capital investments have remained stagnant at only 5% of public expenditure in 1998.

As a result, GDP declined in 1996 by 8% (including a fall in industrial production by 35% and agricultural production by 13%), while the budget deficit increased from the 1994 and 1995 level of 5.9% to 10.3% (see Annex 1), which is even higher if the pension and salary arrears are included. The figures for 1997 were very controversial: GDP increased by 1.3%, but the budget deficit continued to be very high at 7.7% of GDP. It is still not clear whether this growth is sustainable – the forecasts of various organisations have differed on this point. What is clear, however, is that macroeconomic stabilisation seems to be overvalued when determining conditions of high budget and current account deficits. In this context, a relatively stable currency and low inflation were based not on an improvement in economic activity and export potential, but on the large barter economy, the considerable arrears, and the significant share of IMF loans in the National Bank reserves (70%). The financial crisis that had swept Russia reached Moldova with a time-lag of two months and the leu was devalued by 100% in just two months.

In this context, further analysis of GDP in terms of output, expenditure and the impact of the grey market activity provides enough evidence to suggest that the most probable sources of GDP growth will be increases in agricultural production and consumption, as well as in the large informal sector.

a. Agricultural Activity

Agriculture (not including processing agriculture) now represents one third of GDP. This increase of 11% since 1997 (see Annex 3) is mainly as a result of the increase by 20% in the crop-growing sector brought about by an augmentation in the area under cultivation and an improvement in the yield per hectare. Estimates of the output suggest increases of 78% in the production of fruits, 72% in cereals, 21% in tobacco, and 11% in vegetables as compared to 1996.

Although the output of tobacco increased in 1997, during the last few years the country has produced only one-third of the tobacco that it used to produce. Moreover, the farmer-producers have had little incentive to cultivate a "strategic" crop that has seen its price steadily falling. Consequently, the government adopted a programme to develop the tobacco sector by investing in growing seedlings, and in upgrading facilities for tobacco drying, sorting and packaging. However, the greatest improvement in this sector would be achieved through a privatisation in which strategic investors took control.

Grape growing and wine making are the most important sectors of the Moldovan economy as they have large shares in external markets. Vineyards account for 7% of agricultural land and ensure annual budget revenues in the excess of US\$ 100 million in excises, VAT and tax on profits. This represents roughly 60-65% of the total revenue from the national agro-industrial complex. In the past years, the area used for vineyards shrank by 40,000 hectares and early frosts and severe floods also affected output, meaning that only 39% of the 1996 volume could be harvested in 1997. In conformity with the national programme of viticulture development, damaged vineyards are to be restored, new intensive-type vineyards will be planted, and trellis will be installed. The commercial banks providing credits for the rehabilitation and development of vineyards will receive exemptions in their profit tax liability of between 50 and 100%, depending on the terms and conditions of the credit.

Animal husbandry declined by 8% in 1997, a rather curious development given the rising demand for and consumption of meat products. One explanation for this is that the ongoing land privatisation in the countryside and the distribution of the related assets, including animals, has proven problematic. Lines of activities requiring indivisible assets have been abandoned, no matter what their potential market demand may be. However, the post-privatisation husbandry has been maintained in some pilot projects by, for instance, creating new forms of collective production.

b. Consumption

If one analyses GDP by expenditure, one can see that in 1997 the final consumption component of the expenditure constituted 96.6% and the gross capital formation was 24.2% (see Annex 4). In other words, the nation is consuming more than it is producing. The only way this can be sustained is for imports to exceed exports. This model is confirmed by Moldova's persistent trade deficit over the last few years.

Comparing the rise in consumption expenditure with the changes in CPI and PPI (see Annex 5), the official figures indicate a fall in real consumer spending in 1994 followed by a significant recovery in 1995 and a small recovery in 1996. In real terms, the consumer spending in 1997 is around 6% higher than the same period in 1996, still being less than that of 1993. Gross fixed capital formation can be seen to continue its decline as a share of GDP, although in absolute terms it increased by 12.2%. The high rise in the inventories combined with an almost identical decline in exports, indicate

a situation of depressed markets both at home and abroad. At the same time the index of construction prices rose by 35%. This is an exceptionally high rise, normally indicating an increase in the level of activity rather than a fall. It does seem quite probable that the official figures are not picking up a significant proportion of activity, possibly work in progress.

The main feature of GDP by expenditures is the deterioration in the recorded balance of goods and services. It seems probable that a significant proportion of the increased imports in 1997 and the first quarter of 1998 have been financed by unrecorded exports.

c. The Informal Sector

It can be argued that the real level of production continues to be seriously under-estimated, due to the increasing share of unrecorded activities in the economy. The fastest growing sectors of the economy belong to the informal economy and are, therefore, absent from the official data. There are of course no concrete figures to support this argument but there is abundant evidence in Moldova that this is the case. Specifically: flourishing construction activities, including those in the private property and residential sectors; booming consumerism in Chisinau; and the fact that cash payments are the main, if not the sole, method of payment in the absence of credit facilities.

All this suggests that the average disposable income is higher than the official estimates would suggest. The interpretation of the available data by different organisations has produced a range of estimates for the per capita income in 1997 – the Moldovan Department of Statistics (DS) suggests a figure of lei 443 while the World Bank (WB) estimate is lei 600. Grey market activity is estimated by the DS to amount to almost 12.7% of GDP in 1993, 14% in 1994, 15% in 1995, and 15-16% in 1996. There are no official estimates for 1997 yet, but analysis conducted in Moldova suggest that grey market activity may add as much as 50-60% to the country's GDP (see, e.g., publications of Moldovan Economic Trends and Centre for Strategic Studies).

2. Establishing Property Rights

Although the consolidation of the private sector and mass privatisation are viewed as important achievements of economic reforms in Moldova, the share of the private sector in GDP is estimated by the European Bank for Reconstruction and Development (EBRD) at 45% which is less than in other transitional countries (60% in Latvia; 50% in Slovenia, Ukraine, and Bulgaria). According to the Ministry of Privatisation, Moldova is lagging behind because of the lack of funds of local entrepreneurs and the poor interest shown by foreign investors. Foreign investments totalled US\$ 142 million – the major investors being Russia (37%), USA (13%) and Liechtenstein (6%) – and were concentrated in the agricultural processing and service sectors. Several facts are to be mentioned.

Firstly, the mass privatisation that occurred in Moldova consisted of a formal distribution of the state property to the people through patrimonial bonds, and did not involve any movements of capital or direct investments in production, especially as far as the undeveloped capital market was concerned. A fundamental weakness of this mass privatisation was that it failed to create a clear system of ownership. The reorganisation of existing privatisation investment funds has been delayed. According to the law on investment funds, all of the funds had to be reorganised into interval, reciprocal, or non-reciprocal ones. Most of the 42 funds have already held meetings with their shareholders, but only a few have transmitted the necessary documents to the National Commission on the Security Market. The deadline for their reorganisation has now been extended to 1 October. Cash privatisation is supposed to be the last phase of privatisation (1997-98) and is taking place very slowly. For example, in 1998 the government plans to obtain lei 200 million from privatisation, however during the first five months only lei 32.7 million have been transferred to the consolidated budget.

Secondly, some of the major reasons behind the insignificant capital investments are the bureaucratism and corruption of the local functionaries involved in privatisation. Another negative factor was the fact that the results of the privatisation tenders of the tobacco, telecommunications, carpet and cement production sectors have been abrogated several times. These sectors have all been successfully privatised by foreign strategic investors in the neighbouring countries (e.g. Romania and Russia). Other barriers to foreign investment are the instability in Moldova's investment legislation, the frequent incompatibility of this legislation with other laws, and the inconsistency of governmental decisions. Several examples are:

- the Land Code that prohibits the privatisation of the associated land of enterprises whose shares partly belong to the state, while most large enterprises still have state shares in their statutory funds;
- only two months after the new Fiscal Code had been adopted, several amendments were made to enhance the tax privileges of foreign investors as was stipulated in the law on investments;
- the VAT exemptions for joint-ventures with more than US\$ 1 million in their statutory fund were annulled in August 1998; and
- the VAT and excises exemptions that the residents of the free-enterprise zone in Chisinau had enjoyed were abolished.

In addition, the unresolved Transnistrian issue has resulted in a border dispute. Criminals and drug traffickers have taken advantage of the situation and this is a further destabilising factor as far as foreign investors are concerned.

Thirdly, the share of agricultural land controlled by private farms and farmers' associations has risen from 4% of the total cultivated area in January 1995, to 10% in January 1997. However, large scale formerly state-owned and collective farms still dominate the scene – in 1997 they accounted for 70% of the total land and were responsible for 98% of Moldova's tobacco and sugar production,

87% of the sunflowers, 75% of fruit, 62% of cereals, and 55% of grapes. The major constraints limiting the development of private farms are:

- existing limitations on agricultural land tradability;
- the undeveloped rural finance system. The WB and the EBRD have started to provide preferential credit lines to be administered through the network of newly created Savings and Credit Associations;
- the high tax burden on farmers vis-à-vis those in large agricultural enterprises. Private farmers cover only 5.5% of the agricultural land, but provide a disproportionate 10% of the agricultural revenues. The rate of tax collection from such private farms is almost 100% and they pay taxes either in cash (as opposed to the mutual settlements used by large agricultural enterprises) or by selling grain reserves to the state at sub-market prices;
- the poor market management. After half a century of centrally supplied inputs, marketing and distribution, it is unrealistic to expect farmers to develop the skills necessary for a market environment overnight; and
- the historical arrears of collective agricultural enterprises.²

The parliamentary elections of March 1998 demonstrated the Moldovan people's feelings towards the government's policies. The Democratic Agrarian Party held 56 of the 104 seats in the out-going parliament (see Annex 6) and represented the directors of state and co-operative collective farms, conservatives and those opposed to radical changes in the economy, especially in the agricultural sector. However, they did not even reach the 4% threshold of the popular vote necessary to be allocated any seats in the new parliament.

The current distribution of seats in the parliament is as follows: 40 seats for the Communists, with the remaining 61 seats being divided between three centre-right parties (see Annex 6). The large share of the vote gained by the Communists in Moldova (31%) is in line with other states in the region (e.g. Ukraine, Russia and Armenia) and demonstrates the nostalgia that many still have for the old communist days. In particular, 750,000 pensioners voted for the Communist party which stood on a platform of free health care and social assistance.

After two months of negotiations, the newly elected centre-right parties created the Coalition for Democracy and Reforms, united behind the economic principle of further market reforms. The Coalition subsequently formed a government, though the Communists' large share of the vote meant that four of their members were appointed chairmen of various parliamentary committees. The government itself does not include any Communists and the posts within the government were distributed among the three parties in the coalition according to the formula "2+2+1" representing their relative sizes. The government outlined its programme which targeted a 3% growth rate in the economy for 1998, to be achieved by tightening budgetary expenditure, improving the method of tax

² 1,640 million lei at 1.01.1998 to Social fund and public budget (40.1%), energy sector (5%), banks (4%), other creditors (50.9%).

collection, reforming the social fund, and promoting administrative reform. The first positive sign was the amendment to the 1998 Annual Budget Law. It was made more realistic by cutting subsidies to production, increasing excises on imported fuel and cars, and abolishing several exemptions (e.g., VAT exemptions on imported goods for natural persons up to a limit of US\$ 250). The government has since pushed through the Law on Electricity and Gas, adopted by the Parliament, and the Laws on Local Public Finance and Administrative Reforms, and is committed to taking tough social decisions such as increasing the pension age, and imposing tariffs on utilities.

However, the government's activities since June 1998 have shown major divergences within the newly created coalition. Besides advocating the same economic reforms, the coalition parties have little in common and this has raised some serious doubts.

3. Transnistria and Moldova: A Comparative Analysis

Transnistria undertook a number of measures in 1992-93 to underline its independence and separation from the rest of Moldova.³ In the economic and financial spheres these included: issuing a separate currency (which is not recognised outside Transnistria); declaring an independent fiscal policy; maintaining its own distinct trade regime and customs service; a refusal by the Transnistrian authorities to recognise the basic legal framework adopted by Moldova in recent years; and not providing any statistical data on Transnistria to the Moldovan authorities.

A comparison of Transnistria to the West Bank of Moldova, which has itself experienced some serious economic difficulties, shows that the economic conditions in Transnistria are, if anything, worse in many aspects (see Annex 8)⁴:

- Transnistria's historical comparative advantages have largely been lost. Industrial and agricultural production has declined by two thirds. The major factor contributing to such a decline was the disintegration of the USSR and the resulting loss of economic ties. Industrial enterprises in Transnistria were as a rule part of the military complex of the USSR, and were oriented to meeting the needs of the Soviet Union.

Armed conflict was an additional shock. The reasons that have prevented the industrial and agricultural sectors from recovering are: an unstable macroeconomic environment; a lack of structural reforms; no legal framework for land reform and privatisation; the continuing practice of preferential credits; subsidies; and the centralised procurement of agricultural products at fixed prices.

- While the average monthly inflation rate in Transnistria has fallen from 10.4% in 1996 to 3.7% in 1997, it remains high. Moreover, prices are highly unstable and sharp monthly swings in inflation are still recorded. Employment is characterised by high, hidden unemployment – under-

³ For figures on Transnistria's contribution to the Moldovan economy before declaring independence see Annex 7.

⁴ Data on Transnistria are based on the WB Report, see Bibliography.

employment in the public sector (23.3% of the labour force is on unpaid leave or works part-time) and a very low number of officially registered unemployed (0.6% of the labour force). Grey market activity obviously absorbs a large part of the unemployed workforce. The household budget survey launched in 1997 showed an average unemployment rate of about 7%, which is about the same as the rest of Moldova. During 1995-96 the average monthly wage in Transnistria was 20-40% lower in US\$ terms than in the rest of Moldova (US\$ 50-55). While the administration artificially increased wages to reduce the difference, the 100% devaluation of the Transnistrian rouble in March 1998 made this a very temporary balancing out.

- The exchange rate of the Transnistrian rouble is far from stable. In 1995, it depreciated on about 70 occasions. Direct intervention of the Transnistrian Republican Bank (TRB) on the foreign exchange market is substantial, and during 1996 and 1997, in parallel to the slowing down of inflation, the local rouble depreciated on three occasions and by 13%. However, a black market exists indicating an underestimation of the commercial exchange rate as managed by the TRB. At the end of 1997, the difference between the black market rate and the commercial rate was about 10-15%. Lack of trust in the local currency has led to a high level of substitution by foreign currencies. According to rough estimates from the TRB, about half the cash in circulation in Transnistria is not local currency. Only 40% of households' cash assets are held in Transnistrian roubles compared to 42% in US dollars, 10% in Moldovan lei and 8% in Ukrainian grivnas.

The consequences of such significant inflows of foreign currency into Transnistria, are exacerbated by the general anarchy in the economy and the prolonged period following the fighting in which there was little economic management. Another channel of transfers is the presence of the military contingent of the Russian Federation in Transnistria. Even conservative estimates indicate that the annual transfer of salaries to the military staff (about 6,500 people) exceeds US\$ 10 million

The Transnistrian authorities have taken several steps to establish control over the monetary and credit situation in their territory: introducing a more realistic re-finance rate in late 1995; replacing symbolic interest rates with budgetary credits; imposing the obligatory repatriation of export revenues; and setting standards of prudence for banks by increasing the statutory capital from US\$ 200,000 to US\$ 500,000 in 1996. These measures have brought some improvements, but the overall financial situation remains volatile. Internal arrears in Transnistria were about US\$ 33 million in 1996 and salary arrears have become chronic.

- The largest and most acute problem for the Transnistrian authorities is the huge stock of accumulated external debt – US\$ 328 million as of the beginning of 1997. Of this sum, US\$ 300 million is owed to GASPROM (including penalties) and US\$ 28 million are loans from the Russian Federation received between 1992 and 1994. In fact, gas deliveries without payment by GASPROM have become a massive subsidy to the economy, and remain a crucial factor in its survival (see III.3 below).

- Transnistria, despite its economic difficulties, has not so far lost all of its potential. In 1996 it registered exports amounting to 28% of the exports registered for the rest of Moldova. However, these statistics are not reliable given the porous border, weak customs controls, and methodological problems in data collection. In particular, analysis by the World Bank shows that a large share of the energy imports are not reflected in foreign statistics, creating a positive balance while the continuing accumulation of external energy arrears indicates instead a negative trade balance.

Between 1995 and 1997 the following steps towards partial reintegration were taken:

- the creation of a centre in Tiraspol for transactions between the commercial banks of the two territories;
- the elimination of most of the differences between the national trade regimes; and
- the agreement on the final status of Transnistria as an economic autonomy within a unified national framework (Memorandum on the principles of the conflict settlement [May 1998]).

It should be mentioned, however, that the timetable for implementing the points mentioned above has not been settled and that after the agreements have been signed – both in the political and economic spheres – they often break down or dissolve into disputes over interpretation. For example, while Transnistrian authorities have proclaimed their intention to take part in the reintegration into Moldova as a separate independent state, they still regard trade between the two territories as being foreign trade. In addition, Transnistria has already tightened customs controls, requires the registration of all foreigners, including Moldovans, and intends to introduce a transit fee between the two territories. On the other hand, Moldovan customs are supposed to collect excises on exported goods – including those going to Transnistria – though this would obviously reduce transit through Transnistria as Moldovan exporters would opt for the direct border with Ukraine (see III.1 below).

Transnistria has managed to avoid a complete collapse thanks to the following factors:

- de facto liberalisation in a number of areas, even against the will of the Transnistrian authorities;
- availability of massive external subsidies (free energy resources, salaries to military staff, etc.); and
- partial reform and reintegration efforts with the rest of Moldova.

Through economic reintegration, Moldova could strengthen its internal economic potential and increase its external competitiveness. At present the Moldovan authorities do not exert control over the whole territory and its import-export operations. Reintegration should stabilise the revenue flows on the one side, and increase foreign investments on the other. For Transnistria, economic reintegration would mean stable ties with economic agents in Moldova and the outside world, greater access to international markets, financial and technical assistance from the international community, and promotion of market reforms. At the same time, it is obvious that the adjustment would take time and would not be easy. Further analysis is required in order to estimate the costs of reunification on both sides.

IV. Developments of Moldovan External Trade Balances

1. Current Trade Regime

The liberalisation of trade, which began at the end of 1993, included the elimination of export taxes, and the decrease in quotas. At present, import licensing only covers medical, cultural, and national security items (including fuel). As far as exports are concerned, in addition to firearms, poisons, and chemicals, some agricultural goods (unbottled wine, spirits, tobacco, etc.) must also have an export licence. Most of Moldova's existing import tariffs are equal to or less than 15%. Since the enactment of the Free Trade Agreement in 1993, there are officially no customs barriers to trade between the CIS countries. On the whole, goods seem to flow relatively freely. Non-tariff barriers such as regulations related to disease and health problems do not appear to constitute a major impediment to trade.

The major difficulties occur with regard to the differing VAT and excises regimes. Until 1998, the CIS countries applied the "country of origin" principle. In other words, Moldovan exports are subject to Moldovan VAT at the border, and no further duties are imposed by the importing CIS country. It was against this background that Ukraine switched to the world-wide principle of the "country of destination" (i.e., duties are imposed on imports on the border) as part of its preparation for membership to the WTO in November 1996. This resulted in Moldovan exports to Ukraine being taxed twice, once in the country of origin and once in the country of destination. This change may have contributed to the regulation requiring Moldovan exporters to deposit funds for goods in transit equal to the value of the goods. In addition, the regulations relating to trade transiting through Ukraine caused serious disruptions to wine exports to Russia in the first half of 1997.

The principle of providing preliminary information concerning changes in economic foreign policy to other members of the free trade agreement is often violated. For example, the decision to impose a ten-fold increase in Russian excises on imported alcoholic goods was taken in the middle of March, but it took effect much earlier on 1 February.

Given that it is often difficult to come to an agreement among all the CIS members (Russia was opposed to changing the destination principle), several bilateral agreements on Customs Unions have been signed (Russia-Belarus, Ukraine-Moldova, etc.) and these sometimes contradict the principles of the Free Trade Agreement.

When trading with countries other than Russia and Belarus, the principle of the country of destination is applied, i.e. duties are imposed on imports at the border. Moldova has signed Free Trade Agreements with 10 countries and Most Favoured Nation Agreements with 14. The most important agreement for Moldova is the Free Trade Agreement with Romania. In addition, countries classified by the UN as "least developed" are exempt from import duties.

The European Union has included Moldova in its "Generalised System of Preference" scheme which enhances Moldova's access to the EU market, though exports of wine, fresh fruits and vegetables do not qualify for these benefits. However, a range of processed agricultural products benefit from up to a 30% reduction in import tariffs. For example, exports of concentrated juices fall under the "sensitive" category and receive a reduction of between 11-17% of Common Customs Tariff duty (CCT). Moldova is the only NIS country that benefits from a 15% reduction in import tariffs, as well as having no quotas to comply with on textile exports to the EU. Moldova is also undergoing the first negotiations to join the World Trade Organisation. At the first working meeting in Geneva in March 1998, Moldova held 16 bilateral meetings and aims to raise this figure to 21 at the next meeting.

The major areas of concern to the WTO as far as Moldova is concerned are: subsidies to agriculture; the competitive environment (commercial law, business registration, tax regime, anti-monopoly policy, privatisation); protection of intellectual property rights; and market access. It would be hard for Moldova to accept relatively free access to its market and lower tariffs for several reasons:

- tariff revenue is needed to help balance the budget (e.g., in addition to tariffs a surcharge import tax of 5% is suggested in the new 1999 budget by the Ministry of Economy);
- the desire to protect domestic sectors from competition; and
- the need to protect fragile emerging sectors like banking, insurance, and telecommunications.

Moldova needs to explore ways to promote exports without violating WTO principles.

2. Developments in Trade Flows Between Moldova, the CIS and the EU

The Moldovan trade deficit is increasing – in 1996 it constituted US\$ 277 million and in 1997 it was US\$ 344 million. In 1997 exports registered a 9.7% increase in value compared to 1996, slightly ahead of imports, which increased in value by 8.6% over the same period. This slight improvement was due to the one-off sale of 20 MIG fighter planes to the USA at the end of 1997. However the trade deficit remains high with imports standing 33% higher than exports in 1997.

If we analyse new borrowing in 1996 and 1997, it was not sufficient to cover the trade shortfall, in fact it was less than half of that amount. The very large Errors and Omissions item appearing in the payments account represents all the sources of unidentified external flows of funds, such as:

- a high degree of non-repatriation of export earnings due to a lack of registration of exports (e.g., through Transnistria) and under-invoicing;
- delays in repatriation due to the relatively long time-lag legally allowed to exporters (i.e., 180 days);
- non-accounted repatriated earnings of emigrant workers in Moldova; and
- private deals covering the leasing of equipment as part of informal partnerships or subcontracting arrangements.

A considerable portion of imports is accounted for by consumer goods rather than capital. External borrowing is used to service existing debt – the past and current liabilities of the state – and not investment and creation of production capacity. Substantial impediments to investment are created by the slowness of structural reforms, the unclear regulatory framework, general uncertainty, increasing rents, and corruption.

There has been no significant re-orientation of the country's exports. An analysis of the import-export structure reveals that 65% of foreign trade is with the CIS countries (especially Russia and Ukraine), 18% with CEE countries, and 13% with the European Union (see Annex 9). A geographical analysis of the trade performance shows that most of the deficit actually occurs in trade with the EU, while the much more sizeable trade with Russia and other CIS countries is almost balanced.

Several factors deserve a special mention when looking at Moldovan exports and imports.

- Agricultural products (cattle, vegetable products, food-stuff, alcoholic beverages and tobacco) make up the largest part of Moldovan exports (see Annex 10). The share of agricultural production (see lines 1 to 3 in Annex 10) has increased from 40% in 1992 to 72% today. At the same time chemical and mineral products, machinery, electrical equipment and means of transport, which accounted for 42% before 1992, now represent only 11.8%.
- The lack of appropriate packaging corresponding to international standards has increased the practice of exporting raw agricultural materials to non-CIS countries, where they are then packed and often re-exported. Exports have shifted notably away from finished consumer goods to semi-finished bulk products such as concentrates, pastes and bulk wines, which has led to a loss in added value. For example, concentrated apple juice and ketch-up are exported to Germany where they are diluted and packed; in 1996-97 one third of Moldova's wine was exported to Bulgaria; and white Moldovan cherries are used for producing oriental sweets in Turkey, etc. In order to limit its loss in revenue, the government introduced an excise tax on the export of bulk wine and non-fermented tobacco in 1998.
- Thirdly, 13% of total imports in 1997 were agricultural. Imports of food products and livestock are increasing. The increase in imported food products from Poland and Turkey as well as from EU countries (particularly Italy and Germany) by private entrepreneurs in the free trade zones has affected the sale of local food on the Moldovan market. In July 1998, the free enterprise zones were deprived of any tax privileges on trade, and excise taxes on imported and domestic exported goods have been equalised in order to protect domestic agricultural producers.
- Fourthly, although the share of barter in CIS trade has decreased since 1997, it still represents 15% of exports and 10% of imports.
- Fifthly, in 1997 mineral products (including energy) remained the most important import, increasing by 4.2% from 1996 (see Annex 11). However, its share decreased slightly from 37% in 1996 to 35.3% in 1997. Import figures show a substantial increase in the import of chemicals (by 56.9%). Imports of machinery, devices and equipment declined by 3.9% from 1996. These basic categories represented a combined total of 57.7% of imports in 1997.

Several considerations emerge from this analysis. Trade with its eastern neighbours is an important asset for Moldova, as it depends on them for its procurement of energy (see III.3 below for more details). A determined, targeted effort must be made to increase exports to the EU member states which are currently net exporters to Moldova. In the short-term, at least, the country is likely to continue to rely on traditional products of export such as wine, tobacco, processed fruits and vegetables. This will inevitably cause some difficulties given the strong position of agricultural producers in the EU, but it seems necessary to raise the issue in bilateral and multilateral discussions.

Several steps have been taken to meet the packaging, bottling and ecological standards of the EU necessary to penetrate the western European markets (e.g., a joint-venture with a Spanish manufacturer to build a new wine-making line). Moldova is finding a new niche for itself as a low wage producer in relatively labour intensive activities such as light industry, especially garment production. The direct co-operation between some donors (GTZ, for instance) and Moldovan companies is successful. GTZ is currently co-operating on a systematic basis with 41 companies.

The potential for corrective actions to improve the trade accounts lies in adopting export promotion and energy conservation as a basic strategy to achieve economic growth. This highlights the issue of the appropriateness of the high exchange rate, as well as the opportunity to use administrative and fiscal instruments to discourage the acquisition of certain imported goods by Moldovan citizens (e.g., cars). Within the framework of the country's present international economic relations, and in conformity with the Partnership and Co-operation Agreement signed with the EU in 1994, it is not possible for Moldova to introduce mandatory import restrictions. A suffrage tax following the model of that introduced in Rumania had been suggested but it remains unclear how it would work in the framework of the free trade agreement between Moldova and Ukraine.

The issue of devaluing the lei is also very difficult. Agricultural and food commodity exporters whose prices are fixed internationally (e.g., apple concentrate) have seen their earnings in lei significantly eroded. Consequently, they view devaluation as a means of supporting exports. Devaluation might reduce the penetration of some imported consumer goods, encouraging a switch to domestically produced goods. But it would also increase the costs of imported capital goods and internal capital formation. Serious consideration should be given to the short and long-term consequences of devaluation.

In addition, experts analysing exports and imports in Moldova suggest that the current system of purchasing energy from Russia and Ukraine with agricultural commodities and industrial processed food products involves a variety of mechanisms which result in unfavourable terms of trade penalisation for Moldova. Further analysis is required to establish whether readjustment of the relative prices is possible, or whether payment in cash would in fact be more beneficial to Moldova.

3. Moldova's Energy Security

The energy sector's role in supplying electricity and heating to enterprises, and thereby ensuring their continued operation, makes it a item of national security. The energy complex comprises approximately 15% of the overall industrial manufacturing sector. The revenues of the Moldovan energy sector represent US\$ 485 million, of which the gas sector accounts for 33%, the power sector 31%, other petroleum products 27%, mazut-heating 6%, and coal 3%.

Local energy sources are very limited: there are two hydroelectric power stations which provide only 0.5% of Moldova's demand. Extraction has increased four-fold through gas exploration, but still remains at a very low level (1.4% of demand, see Annex 12). Imports account for 91%, though increased prices for energy resources and the difficult economic situation in Moldova has decreased imports significantly (see Annexes 12, 13). The most important imports are natural gas (51%) and liquid fuel (24%) (see Annex 14). 84.4% of gas transits throughout Moldova. Moldova's right bank consumption is 8.2%, and Transnistria left bank consumption, 7.5%.

Imported mineral goods for use in production represent 38% of total imports (see Annex 15), and further analysis shows that, as a result, there is a heavy dependency of Moldova's economic performance on Russia and the Ukraine. Electricity (10% of productive imports) comes exclusively from the Ukraine, natural gas (30%) from Russia and coal (12%) from the Ukraine and Russia. The share of non-CIS imports of strategic capital goods is only 5%, 4% of which is accounted for by Rumania and 0.15% by the EU.

A major threat to Moldova's energy security is the huge accumulated external debt for energy to Russia (US\$ 600 million) and the Ukraine (US\$ 217 million) and the unclear status of Transnistria which produces 38.1% of the electric energy consumed by Moldova, while another 37.6% are imported from the Ukraine through Transnistria. This situation generates three major problems in the Russia-Ukraine-Transnistria-Moldova relationship.

First of all, both Russia and the Ukraine have broached several times the possibility of halting gas and energy deliveries if the debt is not restructured and quarterly payments are not made by the Moldovan government. Though technically and politically it would be difficult to actually implement this threat⁵, gas deliveries have been reduced twice during the summer. Debt restructuring started in 1996 when US\$ 40 million of state securities were issued and transferred to GASPROM. At the end of September 1998, US\$ 90 million⁶ of debt had been restructured to be re-paid over a period of seven years with 7.5% interest.

⁵The system is so interconnected that cutting off Moldova results automatically in cutting Odessa region and Transnistria

⁶Out of these 90 million, 20 belong to budgetary organisations, 70 - to population and enterprises

As a result, the quarterly debt servicing from the public budget increased from US\$ 2.5 million to 4.5. The servicing of external debt is one of the IMF's conditions of financial support, and is always violated. The servicing was not done in April and June 1998, and experts in the National Bank believe that it will also be difficult in October. Another means of repaying the debt that is currently under consideration is the establishment of a joint-venture for gas transmission in which 50% of shares would be distributed to GASPROM, 35% to Moldova, 14% to Transnistria, and 1% to other shareholders. Moldova owes US\$ 60 million to Russia.

Secondly, half of Moldova's gas-related external debt to Russia is on behalf of Transnistria (see Annex 16). As there have not been any budgetary relations between Moldova and Transnistria since the early 1990s, Transnistria has not been transferring any tax revenue to the Moldovan budget. In 1995, debts owed to GASPROM were officially separated into those from the West Bank of the Moldovan territory and those from Transnistria. According to data from the Moldovan Department of Energy, at the end of 1995, arrears run up in Transnistria amounted to US\$ 160 million (not including penalties). In 1996 this amount grew by more than US\$ 70 million, equalling the annual budget revenues.⁷ Transnistria had been notified by GASPROM that the practice of chronic non-payments must be stopped and that future deliveries would only be made against payment. In 1997, the growth of arrears decelerated, but did not stop. Any further financing of the economy through the accumulation of energy arrears will be problematic. Possible options for a settlement include meeting some of the debt through the provision of equity in Transnistrian enterprises.

Thirdly, it is estimated that Chisinau owes Tiraspol US\$ 21 million for electricity purchases. Moldova buys gas from Russia at US\$ 58 per thousand cubic meters and sells it to Transnistria for US\$ 90. Transnistria then sells the energy to Moldova at prices which are not convenient for Chisinau.⁸ A settlement schedule was approved at a joint meeting in February 1998, but the Transnistrian side stated at a meeting in July that the agreed scheme was not working. On the other hand, Moldova has no control over fuel imports through Transnistria, which results in the non-payment of revenues to the Moldovan budget. Moldova introduced a license for fuel imports in 1997. It also demands the prepayment of excises in Moldova and has established a mobile customs post along the river.

Though Transnistrian and Moldovan counterparts meet regularly to discuss major economic problems, both sides consider the results unsatisfactory. Moldova does not pay its debts to Transnistria, and Transnistria claims that this could result in the Russians switching off the gas on their side. Consequently, the President of Transnistria has appealed to the Russian President to settle the matter. Given the problems that Russia is currently facing, there has been no direct intervention from the Russian President up until now. Experts believe that Transnistria will become an issue nearer the presidential elections in Russia. If this is the case, there could be a difference in policies towards

⁷In this context, Transnistrian official budget deficit of about 6.7% of revenues appears to be absolutely artificial.

⁸Other information on prices is not available.

Transnistria depending on whether Luzkov becomes the next president (e.g., defending the Russian minorities), or Lebed (given the problems he has had with the Transnistrian authorities).

Generally speaking, the idea that Moldova – and more generally the CIS countries as a whole – is largely dependent on Russia, and should therefore support Russian policy in many international matters is still prevalent amongst the Russian public (even among academics and students). The idea is that if these states do not show sufficient deference to Moscow, the gas and energy "taps" should be closed. Hence the fact that Moldova's joint military exercises with NATO draw much opposition in Russia, and that there is not much support for resolving Transnistria's administrative status or repatriating the Russian XIV Army from Transnistria.

There are two ways of increasing Moldova's energy security. The first is to decrease Moldova's economic dependency on Russia and Ukraine. This would entail reorienting Moldovan exports to new markets and diversifying the energy sources through other imports (Turkmenistan, Uzbekistan, Gulf countries) and alternative sources within Moldova itself (experts estimates that this could amount to 5-8% of total energy consumption and could produce tremendous savings). In this context the delimitation of clear borders becomes essential, as does the resolution of the conflict with the Ukraine on the Moldovan segment of Danube so that construction work on the terminal can be resumed. It is also necessary to develop a stable plan for external debt repayment to GASPROM and Ukrainian energy companies, in order to decrease the external debt.

The second way would be to increase the efficiency of the energy sector itself. Current analysis shows huge domestic arrears in this sector (see Annex 17), high generation costs due to out-of-date equipment (sometimes more than twenty years old), large losses in the transportation of the energy to consumers (an estimated 70% loss in heat energy), a high level of barter operations (60-65% of total turnover), and accounting and guarding problems. In 1997, losses in urban areas accounted for 20-30%, while in the countryside this figure was 50-60% (one in every two rural houses has a hidden outlet to power lines). In comparison, the losses in neighbouring countries are 11% in Romania, 13.3% in Hungary, and 9.3% in Russia. Urgent measures considered by the government involve improving accounting and metering, including imports at border areas of Moldova, differentiating tariffs (at least three types) and tariff zones (seven), and developing a transparent system of public procurement tenders for budgetary needs. Cancelling the debts of energy companies, and cutting off the supply to those enterprises that do not pay will accelerate the privatisation of the sector.

V. Policy Recommendations

The Partnership and Co-operation Agreement (PCA) signed between the EU and Moldova in 1994 defines the major areas of future co-operation. Technical assistance to the Republic of Moldova includes the exchange of experts; provision of early information (especially on relevant legislation); and the organisation of seminars and training activities etc. (see Article 50). The Tacis indicative

programme for 1996-99 defines the scope of co-operation in the fields of food production, processing and distribution, policy advice, human resource development, restructuring enterprises and private sector development. Taking these programmes into account, as well as the current economic situation in Moldova, major EU policies and activities which aim to implement the PCA and improve the Moldova's economy could be organised in several blocks.

- The unsettled Transnistrian issue – unclear borders and the deployment of the XIV Russian Army – results in the uncontrolled penetration of goods, money, criminality, weapons, and drugs from the eastern side into Moldova. This has a negative impact not only on the economic performance of the country and on the "...harmonious development of the region" (Article 51.4), but it also threatens stability in the region. The Russian Parliament has not yet ratified the Agreement with Moldova, and the withdrawal of Russian Army has not been implemented. Given that it is unlikely that the matter can be settled between just the Russians and the Ukrainians, the EU could take a more active position. Article 8 of the PCA states the necessity of taking "...full advantage of diplomatic channels through bilateral and multilateral fields such as the United Nations, OSCE meetings and elsewhere". The historic act of withdrawing the Soviet Army from the Baltic states showed that the UN resolution can be a very efficient tool.
- The EU could do a great deal to improve co-operation on trade matters, especially by providing technical assistance and help in international negotiations in the following areas: (1) developing Moldova's export promotion concept, elaborating a national marketing strategy for agricultural production and a strategy for tourism development; (2) enlarging the analytical capacities of the National Bank of Moldova in determining the real exchange rate of the national currency, analysing the consequences of leu devaluation and determining which policies should be taken; (3) assisting in negotiations with Russia and the Ukraine on the readjustment of relative prices in cases of barter transactions, the possibilities of cash trade, as well as with the Ukraine on payments for transit through the Ukraine, including collateral; (4) putting pressure on Russia to agree to changing the system of VAT collection to the destination principle along with other CIS countries; (5) assisting in negotiations with the Ukraine on establishing clear and non-porous borders, as well as on reaching a final settlement on the Moldovan section of the Danube. Disagreement on the length of the segment resulted in a halt in the construction of the Giurgulesti Terminal on Moldovan territory (which was financed by the EBRD), the terminal being essential for Moldova's energy security; and (6) assisting Moldova's integration into the world economy by supporting Moldova's accession to the World Trade Organisation, by encouraging cross-border co-operation (especially with Romania and the Ukraine), and by promoting the integration of Moldova in Trans-European Networks (road and rail transport in Corridor IX from Helsinki to Chisinau via Kiev onto Bucharest and Alexandroupoli).
- Continuing financial support from the EU is necessary to provide marginalised groups of the population with access to credits with lower interest rates for business start-ups, by, for example, micro-financing through credit unions for the poorest parts of the rural population.

- Policy advice is needed to improve the statute on public finances, to create new legislation on the social fund and non-state pension funds, community development funds, mutual funds, etc., as well as to elaborate efficient mechanisms of intergovernmental subsidies and transfers, and nominal compensation on increased utility tariffs for vulnerable groups. The EU could also help to improve the performance of the public sector, e.g., by assisting the recently created National Agency for Public Procurements, by providing equipment and software for the creation of databases, foreign experts, and training programmes.
- Accelerating privatisation and restructuring in industry and agriculture requires continued EU technical assistance and policy advice, specifically in: (1) the development of non-agricultural sectors, both in the rural areas and in cities; (2) the acceleration of the distribution of land property certificates and land plots; (3) the elimination of the land code constraints on the non-tradability of land and the prohibition on privatising the associated land of enterprises whose shares partly belong to the state; (4) settlements of the debts of large agricultural, industrial and energy enterprises; and (5) the implementation of decentralisation in the context of the administrative reform, e.g., how licensing and business registration could be done at a local level, how to regulate the activity of non-governmental organisations which should create the basis of a civil society, how to administer property tax, etc.
- In order to tighten economic co-operation and improve regular political dialogue, a representative EU office could be established in Chisinau. This will be particularly important after the transitional period expires on 31 December 1998, as is stated in Article 10. After this point, new PCA provisions will start applying in such areas as customs clearance, transit, warehouse, transshipments, etc.

*Annex 1. GDP and GDP per capita; 1993-1997**

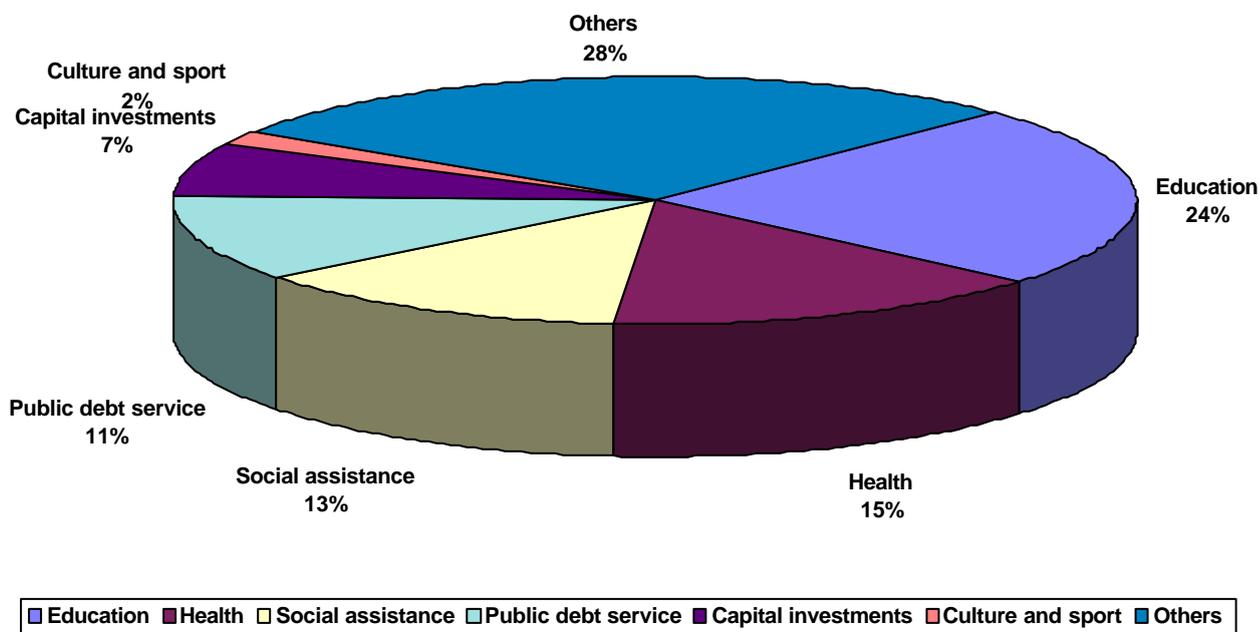
	1993	1994	1995	1996	1997
GDP (million lei)	1821.1	4736.8	6375.0	7317.1	8655
Population (thousands)	3608	3609	3604	3600	3591
Average exchange rate (US\$)	1.45**	4.06	4.49	4.59	4.61
Average monthly rate of inflation	32	6.2	1.8	1.2	0.9
Budget deficit, % of GDP	-7.5	-5.9	-5.9	-10.3	-7.7
Annual change in real GDP, %	-1.2	-30.9	-1.9	-8.0	1.3

*data excluding Transnistria

**before national currency lei had been introduced

Source: Department of Statistics of Moldova

Annex 2. Breakdown of consolidated budget expenditures; 1997



Source: 1997 Budget, Explanatory Note of the Ministry of Finance.

Annex 3.

A. GDP by output; percent to GDP (1995-1997)

	1995	1996	1-9.1996	1-9.1997
Agriculture, fishing, hunting	29.3	27.3	30.8	28.1
Manufacturing industry, electric energy, gas and water supply	25	25.4	23.5	21.7
Construction	3.5	3.8	2.6	2.5
Trade and services	8	7.4	8.6	9.6
Transport and communications	5.1	5.6	5.1	5.9
Net taxes on goods and services	11.4	10.7	11.3	14.5
GDP	100	100	100	100

Source: Department of Statistics

B. Main macroeconomic indicators in comparable prices of the previous year

	Industrial production	Agricultural production
1990		100.0
1991		89.9
1992	100.0	83.6
1993	100.3	109.9
1994	73.0	75.7
1995	70.0	104.0
1996	65.0	87.0
1997	97.7	111.0

Annex 4. GDP by expenditures; percent (1991-97)

	1993	1994	1995	1996	1997
Final consumption	55.9	75.4	82.9	95.9	96.6
Gross capital formation	55.8	28.8	24.9	24.4	24.2
Net exports	-11.7	-4.3	-7.8	-20.2	-20.8
Total, %	100	100	100	100	100

Source: MET, Jan-Mar.1998, p.9.

Annex 5. Nominal annual percentage change in GDP by expenditure components

	1994	1995	1996	1997
GDP	260.1	136.8	118.2	113
Final consumption	351	150.3	136.6	114
Gross capital formation	134.4	118	115.9	112.2
-gross fixed capital formation	323.5	113.1	146.7	111.7
-changes in inventories	-61.5	128.1	60.6	113.5
Net exports	-94.6	-249.6	-307.4	-116.4
Annual change in CPI	587	130	124	112
Annual change in PPI	994	154	132	120
Annual change in construction prices	940	133	120	135

Source: MET, Jan-Mar.1998, p.9.

Annex 6. Results of Moldovan Parliamentary elections (as of 22 March 1998)

Political party	% Votes	Seats	% Total Seats
Communist	30.8%	40	40.0%
Democratic Convention	19.3%	26	25.0%
Democratic and Prosperous Moldova	18.1%	24	23.5%
Democratic Forces	8.9%	11	11.5%
Others	22.9%	0*	0.0%
TOTALS	100.0%	101	100.0%

1994

Political party	% Votes	Seats	% Total Seats
Agrarian Democratic	43.2%	56	53.8%
Socialist / Edinstvo	22.0%	28	26.9%
Peasants and Intellectuals	9.2%	11	10.6%
Christian Democratic	7.5%	9	8.7%
Others	18.1%	0*	0.0%
TOTALS	100.0%	104	100.0%

* A political party must receive at least 4% of votes cast in order to be seated
Source: Based on the results of elections

Annex 7. The share of Transnistria in Moldovan economy (1991)

Major indicators	Percentages of Moldovan totals (%)
Territory	12.4
Population (of which Moldovans - 35% and Russians, Ukrainians - 30%)	17
Industrial output:	38
– electricity generation	85
– cement production	50
Agricultural output	15

Source: Republic of Moldova: Economic Review of the Transnistria Region. June 1998, World Bank, Moldova, p.3.

Annex 8. Selected macroeconomic indicators for Transnistria in 1995-97.

	1995	1996	1997
Average monthly inflation	50.4	10.4	3.7
Annual average exchange rate to US\$	61,300	410,083	650,417*
Industrial output (% , 1990=100)	36.2	31.3	31.1
Agricultural output (% , 1990=100)	32.7	30.0	n.a.
Exports (millions of US\$)	n.a.	225	n.a.
– Non-FSU countries	n.a.	70	n.a.
Foreign debt, end-year (millions of US\$)	n.a.	328	n.a.
– Debt to GASPROM	n.a.	300	335
Average monthly wage (US\$)	26	39	50
Refinancing rate (%)	120	n.a.	80

* The depreciation in mid-March 1998 was significant, the rate becoming 1,200,000, implying a potentially important erosion in real wages. The last available data from August 11, before the crisis in Russia, was 741,000 achieved by issuing state securities and exchange certificates.

Source: Republic of Moldova: Economic Review of the Transnistria Region. June 1998, World Bank, Moldova, p.17.

Annex 9. Breakdown of Moldovan exports and imports by major trade partners in 1996 and in 1997 (in percent).

Country	Exports				Imports			
	1996	1997	1-5.97	1-5.98	1996	1997	1-5.97	1-5.98
CIS	68.1	69.6	73.3	76.2	61.5	52.2	54.7	41.7
Russia	53.4	62	63.3	62	27.4	28.7	30.1	25.1
Ukraine	5.9	5	4.1	8	26.6	17.9	20.8	12
EU	9.8	10.3	10.2*	10*	15.1	19.4	16.5*	27.1*
Germany	3.7	4.1	4.1	2.8	6.0	8	7.6	10.2
Italy	2.7	2.9	2.9	2.7	3.2	4.2	3.6	6.4
CEE	16.5	15.1	10.9**	7.3**	16.6	20.5	12.7**	19.8**
Romania	9.6	7	6.5	6	6.8	8.6	5.8	10.8

* data available on major EU partners: Austria, Denmark, France, Germany, Greece, Italy, Great Britain, Netherlands, Spain

** data available on major partners: Bulgaria, Cehia, Lithuania, Poland, Romania, Hungary

Source: Calculations based on Quarterly Statistical Bulletins, 1996-1998.

Annex 10. Breakdown of Moldovan imports by product and area in 1997 (in percent)

	total	CIS	non-CIS
Chemical products	9.6	5.6	14
Vegetable products	3.2	2.3	4.9
Mineral products	35.3	60.2	8.4
Textiles	5.3	1.9	8.9
Machines, equipment	12.9	6.2	20.2
Metals, metal products	4.5	5.0	3.7
Other	29.2	18.8	40.6
Total, %	100	100	100

Total US\$ (mil.) CIF	1171.9	609.8	562.1
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Source: MET, Jan-Mar.1998, p.79.

Annex 11. Breakdown of Moldovan exports including re-exports by product and area in 1997 (in percent).

	Total	CIS	non-CIS
Live animals, animals products	8.6	9.5	6.6
Vegetable products	8.6	7.4	11.5
Food, beverages, tobacco	54.8	64.8	31.8
Textiles	6.6	2.3	16.7
Machines, equipment	5.2	6.1	3.2
Metals, metal products	1.0	0.4	2.2
Other	15.2	9.5	28.0
Total, %	100	100	100
Total US\$ (mil.) FOB	875.2	609.1	266.1

Source: MET, Jan-Mar.1998, p.78.

Annex 12. Balance of fuel and energy of Moldova (thousands of tonnes of conventional fuel).

	1990	% to total	1996	% to total
Total resources	18225	100	5334	100
Hydroelectric production	84	0.5	28	0.5
Extraction	51	0.3	73	1.4
Imports	16703	91.6	4720	88.5
Total distribution	18225	100	5334	100
Transformed fuel into energy	7724	42.4	3001	56.2

Production consumption	6545	35.9	2044	38.3
Exports	2449	13.4	1	0

Source: Statistical Annual Bulletin of Moldova, 1997, p.301.

Annex 13. Evolution of fuel prices imported to Moldova (average price, in dollars per ton)

Fuel Type	1992	1993	1994	1995
Coal	17	32	23	31
Gas	9	38	80	58 ⁹
Crude oil	57	72	92	86
Diesel	73	169	143	185
Gasoline	83	131	179	217

Source: Statistical Annual Bulletin of Moldova, 1997, p.302.

Annex 14. Structure of the imported fuel (thousands of tons of conventional fuel).

Type	1992	% to total	1996*	% to total
Liquid fuel	4181	37	1141	30
Natural gas	4157	36	2391	43
Solid fuel	1538	14	678	15
Electricity	1498	13	510	12
Total	11374	100	4720	100

*Data for 1997 not available yet

Source: 1996 Statistical Annual Bulletin of the Republic of Moldova, 1997, p.303

⁹ Moldova consumes annually some three billion cubic meters of gas. It used to pay \$80 per 1000 cubic meters. After Moldovagas state company and Gasprom set up two years ago Moldovatransgas Joint-Venture (51% Gasprom and 49% Moldovagas) to operate some 100 km gas pipelines crossing Moldova to the Balkans, Gasprom reduced the price to \$58 per 1000 cubic meters

Annex 15. Major imports to Moldova (used in production), 1996, thousand US\$

	CIS countries	Russia	Belarus	Ukraine	Non-CIS countries	Romania	Other Countries
Coal	47486.9	6518.6	-	40959.2	-	-	-
Fuel (aircraft)	1520.7	-	1520.7	-	44.6	44.6	-
Fuel (cars)	31248.6	5826.0	332.9	25089.7	14080.2	12887.7	Bulgaria, Israel
Oil (medium)	2804.3	14.4	2704.3	85.6	56.9	56.9	-
Diesel oil	72212.9	28763.4	8084.3	32827.6	389.6	358.4	-
Fuel oil	33907.2	13041.0	1940.4	18293.5	-	-	-
Lubricant oil	11428.8	3566.4	4213.4	1183.5	1081.3	54.8	Germany (348) Belgium (216)
Liquid gas	5671.4	3825.3	-	1846.1	-	-	-
Natural gas	118208.8	118208.8	-	-	-	-	-
Electricity	39623.9	-	-	39623.9	-	-	-
Fertilisers	4581.2	75.2	-	4402.8	262.9	262.8	-
Wood	18829.1	10524.5	3526	2435.4	140.9	-	Turkey (95.6)
Paper	12708.6	10398.0	859.5	1443.4	6156.5	3062.8	Lithuania (899), Germany (782), Finland (401)
Total	400232.4	213120.6	23181.5	168190.7	22212.8	16728.0	
Structure (in %)	100%	53.4%	5.8%	42%	100%	75.3%	
Total imports	664085.1	295298.8	61034.5	297140.8	415111	72100.2	
Total imports for production to total imports (in %)	60.2%	72.2%	38%	56.6%	5.3%	23.2%	

Source: Annual Statistical Booklet, 1996.

Annex 16. Breakdown of Moldova's debt to Russian Gasprom (January 1, 1998)

	November 1997	First quarter 1998
Total	480	600
Transnistria	240	335
Right bank of Moldova	140	
of which for 1994-95	120	

Source: "Restructuring Energy Sector" (WB Project in Moldova), 1997

Annex 17. The growth of domestic consumers for power, gas and fuel arrears to respective state companies (million lei).

	1992	1993	1994	1995	1996	1.11.1997	1.04.1998
Power	1	21.5	275.8	336.7	360	406.2	405.5
Gas	0.5	36.5	986.8	na	800	1115.4	1282.4
Fuel	1	6	80	140	231	282	206.7

Source: 1992-1995 agency "Infotag", 1996-97 - "Restructuring Energy Sector" (WB Project in Moldova), 1998 - Hagler Bailly.

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The Conflict in Transnistria: Its Dynamics and Possible Solutions¹⁰

Andrew Williams

I. Executive Summary

The paper looked at the history of the conflict, the nature of the main parties involved and the current state of the conflict resolution process. It came to the following conclusions:

- Constitutional arrangements: (1) the ultimate solution to the Moldovan (MD)/Transnistrian Moldovan Republic (PMR in its Russian version) conflict must be in some sort of complex unitary state. It must be with some sort of guarantees. There must also be a proper agreement on the division of competencies; (2) the key problem of how people readjust to peace must be addressed. There must be solid agreements about how the future will be organised. This includes finding jobs for those who inevitably lose theirs; and (3) the use of "sunset clauses" in the constitutional arrangements has been suggested.
- There needs to be a closer examination of the *role of third parties*.
- There needs to be consideration of what further *Confidence Building Measures* might be useful.
- It is considered that more *grass-roots contact* might be useful to reduce distrust among the general population and to encourage economic development. Some ideas that might be explored are those of twinning between towns and help in reconstructing ruined buildings and agricultural land. Facilities might be provided by joint local/ international financing initiatives.
- *Economics* is another key, although everyone has their own definition of how economic development might be implemented given the different ideological views of the two sides. The MDs are concerned that economic growth for the PMR merely means criminalisation. The Russians see economics through the prism of their own problems. If they can get sorted out MD will fall into place. MD fears this, and wants to fall into European soil, not the Bear's embrace, however friendly.
- *The Russian factor* is the key in all this. Consideration in particular needs to be given to whether there is a Russian intention to withdraw and to the impact of the recent changes in Russia.
- Some ideas about the EU's role: (1) the EU must be seen as being neutral and helpful to all parties; and (2) the best option is for the EU to consciously encourage economic growth in the area, by which I mean both sides of the Dniestr and also in the regional sense.

The main overarching necessity is that the EU shows concrete support for continuing economic reform in the entire region, not just in Moldova. The recent economic crisis, with Ukraine and Russia

10 "PMR" and "Left Bank" are often used interchangeably in this paper to indicate the political authority in Transdnistr and the geographic location. The "Right Bank" indicates the rest of Moldova. Kishinev is used to indicate the capital of Moldova, but it is often referred to as Chisinau in Moldovan. This paper was written on the assumption that there will be detailed papers also provided about Moldova's domestic politics and foreign and security policy.

now in technical debt default, will only strengthen the hand of those who wish to go the route of a regional trading system that stops at the river Prut (i.e. on the border of Moldova and Romania) and does not integrate Eastern into Central Europe as a whole.

II. The Major Elements of the Transnistrian Conflict

1. Origins

The conflict in Moldova has its origins in rival interpretations of history by the various parties concerned and in a multiplicity of reactions to the break-up of the Soviet Union after about 1989. It is, therefore, essential to at least briefly map out the process that culminated in the declaration of independence by the new state of Moldova in August 1991, along with many other parts of the former Soviet Union (FSU).¹¹ This independence created a new relationship with Russia and other states, both from the former Soviet Union, notably the Ukraine, and outside it, notably Romania.

The past history of Russia's involvement in the area now taken up by Moldova is complicated by Moldova's geographical position as a cross-roads of Europe. Before 1812 the area taken up by the "right bank" of the Dnieper (or Dniestr in Russian) River which flows through Moldova on its penultimate stretch before it enters the Black Sea, was part of the Ottoman Empire. After the Russian annexation in 1812 it remained Russian until 1918, when the Russian Revolution gave Romania (established as a state in the late 19th Century) the chance to incorporate it. The area returned to Russia as part of the Molotov-Ribbentrop Pact of 1939 on 2 August 1940 and was incorporated, together with a thin sliver of land on the left bank of the Dniestr with a population (now) of barely 700,000 (known as "Transdniestr" or "Transnistria") into the new Soviet Socialist Republic of Moldavia.

2. Moldova Post-1991

The new Moldova (MD) of post-1991 has a mixed ethnic composition and consequently linguistic complexion (the implications of which will be discussed later). Its new status as a state was immediately compromised by a quasi-simultaneous declaration of the left bank area of the river Dniestr as the Transnistrian Moldovan Republic (known as PMR in its Russian version). MD and the PMR proceeded to parallel presidential and other elections, with Mircea Snegur being elected in MD in the capital Kishinev (or Chisinau) and Igor Smirnov being elected in the PMR "capital" of Tiraspol. In subsequent years two effectively separate state structures emerged on the two sides of the river, with (after 1994) separate currencies, economic and educational systems.

¹¹ Vladimir Socor, "Moldavia proclaims independence: Commences secession from USSR", *RFE/RL Report on the USSR*, 18 October 1991.

3. The War of 1992 and its Aftermath

Armed clashes ensued between the MD police and the newly formed PMR forces and culminated in a short but brutal war in June 1992, in which between 500 and 5000 soldiers and civilians lost their lives, especially in Bendery (the only town on the West Bank still held by the PMR) which saw the worst fighting. There was also widespread destruction of property, most importantly to many of the bridges over the Dniestr, and some refugee problems. Central to these events was the presence of General Alexandr Lebed's (ex-Soviet) 14th Army which intervened on behalf of the PMR to push back the lightly-equipped MD forces over the Dniestr. A cease-fire was brokered from Moscow in July 1992 and Russian Federation (and latterly Ukrainian) peace-keeping forces have remained ever since to separate the two sides in a "Security Zone". Lebed's presence proved controversial as did the 14th Army, but he was very popular with the majority of the PMR population who saw him as a source of great stability.¹²

After June 1995 Lebed resigned his post and was replaced by Major-General Valery Yevnevich and his army renamed, and downgraded to, the "Operational Group of Russian Forces in Moldova."¹³ Lebed meanwhile has gone on to a significant political career in Russia, which has led to him having been elected as Governor of Krasnoyarsk in Siberia. It is to be assumed that he will be running for election as Russian President in the year 2000. Given the recent developments in Russia over the Summer of 1998, and the emergence of a much stronger "Red-Brown" (Communist-Nationalist) alliance, Lebed's role in the future development of the Moldovan conflict cannot be underestimated. His reputation is based on his independent stand in MD, which on one occasion led to him refusing to allow the Russian Defence Minister to land in the PMR.¹⁴

The main advance in the resolution of the conflict was initialling a Memorandum on 17 June 1996 by Presidents Snegur of MD and Smimov of the PMR accepting a "special status" for the PMR within a Moldova that is defined by its international borders. The key point is that the PMR has taken this to mean that they now had a con-federal arrangement with a large measure of autonomy for the PMR, whereas the MD side took this to mean a "unified" (*edinstvo*) MD. This has proved a contentious point ever since. As a result President Snegur then declined to sign the Memorandum in the run-up to the Presidential elections (in which the PMR did not participate, rather re-electing President Smimov)

12 It might be noted that this was also felt to be the case by the Russian Duma, who on two occasions as late as 1996 pointed to the "stabilising influence" of Russian troops in the area: cf. M.F. Hamm, "Introduction" to "Moldova: The Forgotten Republic", Nationalities Papers, Vol. 26, No. 1, March 1998, page 11.

13 See for example "Women stop Russian general landing", an episode where some 500 Moldovan women blocked the runway to protest about Lebed's removal and his replacement by Yevnevich and the down-grading of the 14 Army: *The Independent*, 17 June 1995.

14 One interesting question is whether his experiences in MD and his subsequent successful mediatory role in Chechnya may have convinced him of the futility of any military solution in MD (or anywhere else in the FSU).

In November 1996 Petru Luchinski was elected the new President of MD on a ticket which was widely assumed would lead to him signing the Memorandum upon taking office on 15 January 1997. He did not do so, but did sign a modified version on 8 May 1997, again followed by disputes about what "unified" meant. Security tensions still exist between MD and the PMR, exacerbated by periodic reports of illicit sales of ex-14th Army weaponry and by the continued re-organisation of the PMR's armed forces. A lack of trust still exists between the two sides and until this is overcome there will continue to be an unresolved conflict situation, although the chances of war breaking out are considered far less than in 1992. An agreement was reached in Odessa in the Ukraine on 26 March 1998 brokered by the OSCE. This included various confidence-building measures and in particular an agreement to rebuild the bridge at Dubossari.¹⁵

III. The Main Actors Since 1992

An overall point that has to be made is that all of the states in the region of Moldova have been suffering more or less acute economic crises since the break-up of the FSU in 1991. The old 'radial' pattern of trade, that was a feature of the USSR and its satellites, has proved very difficult to replace.

1. Russia

Moldova is important for Russia's internal politics, as Lebed's role demonstrates, but by no means their principal concern. There has been a major shift in Russian thinking about the way to deal with conflicts in the FSU since 1992, and they now present their peace-keeping troops in a much more neutral light. Numbers have now been reduced to about 600 and they are outnumbered by PMR peacekeepers, with whom they share duties at delicate points along the River Dniestr. Since 1992 Russia's role has been ambiguous, with some very publicised links between the PMR leadership and the Red-Brown alliance, as well as physical support, as in the printing of the PMR's banknotes (issued 1994), and the use of old-style Soviet passports by PMR citizens (where they are recognised).

The greatest hold that Russia has had over the situation in Moldova, apart from the presence of the 14th Army (which has been downgraded as noted above), has been economic. Moldova's markets (on both banks) lie primarily in the FSU.¹⁶ Virtually all Moldova's energy supplies come from Russia via a Gazprom pipeline and the PMR is in effect able to use this at no cost to itself. Increases in gas prices, as Russia has increased its exports in line with world prices since 1991, have provided a constant problem for the MD Government. The economy is still very fragile, as a recent World Bank Report indicated. With the recent economic and political upheaval in the FSU and Eastern Europe it

¹⁵ First reported in *RFE/RL Newslines*, 27 March 1998.

¹⁶ As one indicator of how important this is, the PMR has opened a shop in Moscow where its (excellent) cognac can be bought for prices exceeding \$100.- in some cases.

is undoubtedly in very poor shape, as agricultural exports produce most of Moldova's foreign currency.

The main pivotal factor for the future of Russian involvement in Moldova will be primarily economic, no matter what happens to Russian peacekeeping forces (see below for some possible scenarios).

A final important point is that Russia has provided a mediator in the conflict since 1993, and this mediator, a personal representative of President Yeltsin, is a member of the Joint Control Commission (JCC). It will also probably have to provide some of the "guarantees" necessary in any final settlement, if only to satisfy the PMR. There is much doubt in MD that the Russians are honest brokers in a conflict that can be said to have pitted Romanian against Russian speakers. However, given that I do not believe that this is a mainly ethnic/ linguistic conflict (see below), and given Russia's own problems, I have a feeling that most of the Russian elites only crave stability in the area. This even applies to many members of the nationalist camp in Russia, as is shown by Lebed's repeated denunciations of the PMR leadership, even while he was protecting them.

2. Romania

There was a real risk after 1991 that the Romanian Government would stir up nationalist feelings as a way of hiding its economic problems and this manifested itself in Romania and Moldova by an encouragement of Romanian nationalism, often organised by the extreme right-wing Romania Mare Party, as well as other less fascist conservative nationalist elements. This never went as far as overt encouragement by the Romanian Government for a real 're-integration of the Motherland' with Moldova, but there were some widely publicised 'spontaneous' incursions into Moldova by Romanian citizens which did little to calm the fears of the PMR population about *Roumanizatsia*, the policy of Romanising the Moldovan state. Such activities have been constantly used as evidence by the PMR elites of bad faith by the MD Government. Recently an informed observer (a Romanian speaking Moldovan) told me that he considered a figure of 6-7% of Moldovans desirous of reintegration with Romania was probably accurate.

Romania has suffered an economic crisis since 1989 as much as any state in Eastern Europe, compounded by the presence of old-style Communists remaining in power until 1996, when a glimmer of hope appeared with the election of Emil Constantinescu.¹⁷ The new President's reforms – which include increased efforts to integrate Romania into the European economic and political space – are inevitably going to be slow, as the recent refusal of NATO membership proved.

Romania is now far too wedded to the idea of EU and NATO membership to risk any real attempt to reverse the Molotov-Ribbentrop Pact of 1939, but it must be said that there are always those who advocate this move. A recent speech by Mr Ioan Oneisei, Romanian Under Secretary of State

¹⁷ See The Financial Times, special section on Romania, 28 September 1998.

to an OSCE-sponsored Conference in Kishinev, was significantly entitled "Local Administration and Euro-Regions"¹⁸, which indicates a desire above all for EU membership, which would be put at risk by continuing demands for integration of Moldova into Romania.

Romania has not played a large role in the MD-PMR conflict mediation process. It was, however, part of a short-lived quadripartite mechanism in 1992.

3. Ukraine

Ukraine has also provided an intermediary in the form of a personal representative of the Ukrainian President since 1995. It talks of the Left Bank as the "area of conflict". Ukraine has borders with MD and will be also be a potential guarantor of MD and of a special status for the PMR in the event of any settlement. There is a significant Ukrainian minority in MD, and especially in the PMR region. Suggestions that Ukraine has any designs on parts of MD are probably unfounded.

In any case it is equally disadvantaged by its need for Western approval to protect its economy, although recent talks between the two Presidents of Russia and Ukraine indicate a desire to revitalise the Commonwealth of Independent States (CIS). Ukraine also looks West and is a member of NATO's Partnership for Peace. It also relies heavily on Russia for energy and has had to negotiate difficult agreements over the Crimea and the Black sea Fleet, among other issues. Ukraine is not an entirely free actor in spite of its formal sovereignty.

4. The CSCE

The CSCE (since November 1994, the OSCE) has acted within the main forum for a settlement of the conflict since 1993, the Joint Control Commission (JCC) – made up of representatives of the MD and PMR governments, as well as representatives of Presidents Yeltsin of Russia and Kuchma of the Ukraine – was initially set up in the aftermath of the conflict in July 1992.

Initially the OSCE, in its "13th Report" of 1993, largely condemned the Transnistrian Government as a non-representative power (and a renegade Soviet hangover) that should be rapidly reintegrated into the homeland politically, economically and territorially. However the Report was rightly seen as a breakthrough in that it addressed the causes of the conflict seriously in a reasonably non-partisan way and held out the possibility of special status for Transnistria, a possibility that has been discussed at length ever since. The OSCE has attempted to act as an honest broker within the JCC in very difficult circumstances ever since.

18 "OSCE Seminar on the Interrelationship between Central and Regional Governments", Chisinau, 1-2 July 1998.

IV. *An Assessment of the Background to the Conflict*

The main questions that will be addressed here are: Is this an "ethnic conflict"? and; What are the competing arguments for the rationales used by the main parties to the conflict (MD and the PMR).

1. Identity and Historical Factors

The ethnic question is the most difficult to address, and a recent edition of the *Nationalities Papers* (see above) came to a mixed conclusion. My own view is that this is not primarily an ethnic conflict. My evidence for this lies in the very mixed nature of the population on both banks of the Dniestr, the relative lack of any ethnic dislike (mixed marriage is extremely common) and the wide provision of educational establishments on both sides of the river for the main language groups. To that should be added the agreement reached with the Gagauz people of MD, which is seen by many as a model of how minority problems should be addressed in Eastern Europe.¹⁹ This is not to say that there is not some ethnic element to the conflict, but that it mainly has manifested itself in linguistic arguments, although that now seems to be a lower level problem than in 1992-4. It has, however, to be accepted that language continues to be a problem, especially on the left bank where the use of the Latin script is prohibited in state schools, even in Moldovan/Romanian. It also has to be admitted that most of the PMR leadership are Russian speakers. I would rather see it (and I am not alone in this) as a question of "identity". The question therefore has to be what this "identity" consists of.

Firstly, the PMR leadership sees itself as having been the victim of a violent attack in 1992 and virtual isolation ever since. Some of the strongest opponents of a settlement are from Bendery, which was the worst affected area in the war. The PMR leadership constantly evoke the historical separateness of the PMR region, and especially stress that the Left Bank was originally part of Ukraine (and the USSR) before 1939 and later attached to the Moldavian SSR by Stalin. They also stress its more slavic character and have produced maps and even an Atlas to "prove" this.²⁰ Secondly, the PMR was the only really industrialised area of the Moldavian SSR (although there is some industry around Chisinau), and therefore developed a different political culture, with a much stronger industrial and politicised proletariat. This political culture has left a large managerial class in Tiraspol that feels a great nostalgia for the Soviet past.²¹

2. Economic Differences?

The PMR leadership have consequently maintained a centrally planned economic structure and state system. This is in stark comparison to MD where there has been widespread privatisation and the

19 See, for example: European Centre for Minority Issues [From Ethnopolitical Conflict to Inter-Ethnic Accord in Moldova](#), Flensburg, ECMI, 1998.

20 [Atlas of Dniester Moldavian Republic](#), Tiraspol, DSCSU, 1997.

21 Tiraspol is the only place in the FSU (I believe) where one gets the distinct impression of being back in the USSR.

introduction of Western economic methods. It might, therefore, be said that the PMR identity is historically, ideologically and economically based. However, it must also be said that MD itself is a recent creation, indeed simultaneously with the PMR, and it therefore seems more than ever essential not to dismiss the population and leadership of the PMR as mere renegades. Whatever the misgivings that the population of the PMR may have about their own leadership, they are not much keener (on the whole) for the return of Moldovan troops and the system of capitalist liberalism that their families on the other side of the river have experienced.

The main bulk of the internationally recognised state of Moldova, but not the PMR, has been praised by the World Bank, the IMF and the EBRD for its economic efforts,²² It has also been granted membership of the Council of Europe, and has been very innovative and correct in its dealings with minorities, as with the Constitution and special status granted to its Gagauz (Turkic Christian) minority. Charles King supports this view and says that Moldova 'has demonstrated a willingness to compromise – sometimes at exorbitant political costs – in order to ensure peace and stability'.²³

Neither side of the river has what we in the EU would call a well-developed Civil Society. The universities are moribund and under-funded, the Church is a fairly negligible factor and there is only the beginning of a NGO sector. However, it may be in this area that the most promising advances have been made, with cross-river commerce and contact definitely reducing tension. This has made the general population a 'push' factor in keeping the two sides talking. A second track has also been operational (in which I have personally been modestly involved) that has done something to keep the official "track" on course.

*V. Present State and Dynamics of the Conflict*²⁴

The signature of the above mentioned agreements of 1996, 1997 and 1998 (in Odessa in March) has not done much to end the conflict. They have, however, stabilised it, although perhaps "normalisation" or even "institutionalisation" might be better words to use. The language being use by both sides remains fairly hard.

To summarise:

The *MD Government's* official position is still that there was a strong "external" (by which is meant Russian) implication in the 1992 conflict and that all attempts to resolve the conflict since then have run up against "methodological" differences, with the PMR hardening its position ever since. In the 1995 agreement on the status of the PMR (which later evolved into the 1996 Memorandum) two

22 EBRD Business Forum, Moldova, 1998 Country Profile, Kiev, EBRD, 1998 and: EBRD, Transition Report, 1997, London, EBRD, 1997, pages 187-89.

23 Charles King, Post-Soviet Moldova: A Borderland in Transition, London, RIIA, 1995, page 36.

24 Note: The following section is based on series of interviews by myself in recent months with various key actors in the conflict zone.

variants were agreed, based on the principle of equality of treatment and the need to define the legal division of competencies between the two sides. However "contradictions" had appeared, with MD giving specific status to one state and the PMR to two 'states'. The 1997 Memorandum had then been supposed to be the cornerstone of future status, but it was clear that the PMR was to be an integral part of MD.

The PMR points constantly to its increasing 'stateness' and the way MD had in effect "pushed" the PMR out of its space by its treatment over a number of issues, such as that of currency, for the PMR a creation of circumstances not of volition. They still feel there is a danger of *Rumanizatsia*, but they do now accept that few in MD want union with Romania. The security problem has still not been resolved. MD proceeds from "abstractions of international law", the PMR from "realities" (*realiya*). The PMR recognises international borders, so the problem in part one of internal agreement with MD. Any more pressure by MD will just "freeze" the conflict until the next explosion.

Meanwhile at Odessa (March 1998) the PMR feels it has proved its good faith by signing a series of agreements on CBMs, trust etc., but had also issued a "Declaration of Statehood" which accepts internal and external borders, and the need for a division of competencies and guarantees. An often heard refrain is also that "[t]his is a crescent of insecurity that stretches from Chechnya to Bosnia" and that the PMR is the linchpin so that peace there will ensure peace along the whole crescent. There may be some truth to this.

The Russian view, both from the Head of the Russian Delegation of JCC, and Yeltsin's personal representative to the conflict, is that the conflict is now based on a "unique" concatenation of "historical layers", the problem being "methodological". In the 21st Century we must change the debate and get away from strict and rigid agreements, based on states etc. Constant dialogue is needed, with a division into first and second order questions, though this must include preservation of territorial integrity. There is a need to remove emotional overload and concrete norms need to be established – through organisations such as the OSCE. There will be no document that can generate an identical discourse. We are not in a conflict now – this is a period of "normalisation". The Russian and Ukrainian governments are fully prepared to act as "guarantors" but the only real guarantees are economic stability in the region as a whole. Documents (*Doklad*) are only part of it.²⁵

The view from the *liberal intelligentsia in Moscow* is rather different. For them the main problem is one of Russian/Ukrainian stability. Russia is currently very weak and has many different actors replying to their own agendas. There is still no clear political class and no rules. Russia fears the outside and its own decreasing influence, plus it has a huge fear of getting involved in the PMR's conflict ("the tail wagging the dog"). Russia can still reduce the tension through a promotion of

25 The (perhaps) peculiarly Russian obsession with documents has been very important at every stage of the attempted resolution of this conflict.

dialogue in the context of the OSCE etc. The context is not important, though it should be *European*. Force cannot resolve the conflict, economics and dialogue should be the key.

Certainly the resources *the OSCE* is capable of committing at present are extremely thinly spread. The suggestion put forward by a former OSCE Ambassador that the Russian/PMR and Ukrainian Peace-keeping troops should be replaced by the end of next year by OSCE military observers (of whom I believe there are about a dozen) is a non-starter. There is no political will for a Dayton style IFOR, nor probably a need for it. The OSCE is now seen by observers in Russia and the West as being in the shade, even to some to have 'failed' in Moldova. Some feel that a new model of OSCE activity is emerging, as in Ossetia at a strategic level – to maintain dialogue and to create it – not its original role at all. [I was also told personally that the OSCE representative is rarely allowed to speak on the JCC in Moldova and that they feel very frustrated in their military observer role.] Nonetheless it is the organisation with by far the greatest in-house expertise on the political conflict in Moldova and must continue to play the major role in a resolution.

Ukraine – In a recent speech that I heard him make (May 1998) Ambassador Evgenii Levitskii talked of "Common Elements in the MD Conflict". These are: what are described as "changes in the constitutional structure", in other words an acceptance of the de-facto existence of the PMR as a "state"; that there have been "vertical splits" within the erstwhile Soviet ruling elites - cultural, political, breakdown of centralisation and that this has made a coherent Russian response impossible; that the conflict was exacerbated by the violent conflict in June 1992 and that the introduction of the OSCE has changed a lot, as has the introduction of peacekeeping forces. Finally there is a need to create trust. The Odessa Agreement is very good; and he then looked forward to other meetings to develop documents on guarantees and other matters.

It might be noted from the above that we could summarise the main sticking points in the negotiations as being of two kinds: "guarantees" and the "division of competencies". The first is an area that comprises internal and external guarantees and guarantors. This might be one where the EU could play a role. The second area is one that has dogged the discussions, that of how to divide up the internal and external duties and responsibilities of "statehood".

VI. Conclusions: The Conflict and the Possibilities for Its Resolution

The areas that might be examined:

Constitutional Arrangements – The ultimate solution to the MD/PMR conflict must be in some sort of complex unitary state (*šlozhvenaya edinstvaya statiya*). It must be with some sort of guarantees, still the biggest sticking point in my opinion. There must also be a proper agreement on the division of competencies. There is also the possibility of a Moldova-wide referendum. At various times federal, confederal and strictly separate suggestions have been made, *ad nauseam* in fact.

However, there is no constitutional solution possible while the conflict continues, BUT there might be a constitutional outcome from a solution of the conflict.

(One basis for this might be through a revised version of the draft Moldovan law on regional autonomy of November 1995, the provision of guarantees by the EU or other outside bodies, changing the OSCE mandate, etc.)

One key problem is that of how people readjust to peace. Peace is a hollow word if it is seen as just a return to a status quo ante. There must be solid agreements about how the future will be organised. This also includes finding jobs for those who will inevitably lose theirs, and naturally guarantees against reprisals - the model of South Africa or Northern Ireland springs to mind. This was manifested in Northern Ireland by the sections of the Agreement there that accepted the setting up of Commissions to examine the future of policing and the question of the decommissioning of weapons. The use of "sunset clauses" in the constitutional arrangements has been suggested, again drawn from the Irish and South African examples.

Perhaps there needs to be more examination of the *role of the third parties*. Can the two main states and the OSCE be said to have been successful in pushing the conflict towards resolution? How might their agendas be better defined? Might more informal meetings be useful, perhaps facilitated by a third party, perhaps outside of Moldova? Have the ones conducted so far been useful, or if not, why not?

Might more *Confidence Building Measures* be useful? If so what? The rebuilding of the bridge at Dubossari agreed at Odessa in March is an excellent initiative. Bridges are as important symbolically as they are in reality.

Might more *grass-roots contact* be useful? - twinning between towns has been one suggestion (Ribniza/Rezina for example). Help in reconstructing ruined buildings and agricultural land and facilities might be provided by joint local/international financing initiatives. But MAINLY it will have to be based on local co-operation. Outsiders have only a limited role to play. Ownership of whatever happens has to be with the local people. In short a democratic solution must have transparency, participation, representivity of, and responsibility to, the people. It must respect identity and security and open the way to development.

Economics is another key, although everyone has their own definition. The MDs are concerned that economic growth for the PMR merely means criminalisation. The Russians all see economics through the prism of their own problems. If they can get sorted out, MD will fall into place. MD fears this, and wants to fall into European soil, not the Bear's embrace, however friendly.

The Russian factor is the key in all this. Are they planning to withdraw? The tone of the comments by many Russians in recent months lead me to think so. The Russians are broke and they want to go home. OMON troops in Russia itself are to be reduced to 140,000 from the present 250,000. Does

Russia really have any strategic interest in MD now? What purpose does their presence serve? What is their mandate? Why spread 500 men along a 225 km border that is 5-20 km deep?

VII. The Current State of Discussions between the Main parties and Mediators

Since the Parliamentary elections of February 1998, there has been a certain deadlock in the official mediatory channels. The reason for this is the basically very unstable Governmental coalition of three democratic parties who are of widely differing political complexion and only united by a desire to keep the former Communists out of power. (It should also be remembered that President Luchinski is not party-affiliated). The "Moldovan Commission" (as the Expert Group has been called since the beginning of September 1998) has not met since March in Odessa, except with the President. A meeting with the mediators and the Expert Groups scheduled for 20-26 September did take place, but there are no great hopes for a rapid breakthrough at present.

VIII. Postscript: Some Ideas about the EU's Role

The exact nature of the EU's relations with Moldova will be dealt with in another paper, and the remarks below are in full knowledge of that relationship.

I would suggest that the EU should take the words of President Clinton in Northern Ireland²⁶ to heart that "people still hate each other. Everything you do must be towards reconciliation." The role of other international organisations has been somewhat compromised at times in the past by the perception, especially in sections of Russian opinion and the PMR, that they were 'taking sides'. The EU must not be seen as doing so.

The best option is for the EU to consciously encourage economic growth in the area, by which I mean both sides of the Dniestr and also in the regional sense. This would help in material terms, be creative in political terms and also reduce tension and suspicion. It would hopefully square the circle of Russian fears and the developing border around the edges of the EU (or candidate members) which has shifted the 'Silver Curtain' eastward. A positive EU response along these lines will encourage those in Russia who do not wish to see the West as a threat. Russia's role, I cannot but emphasise enough, is key in all this. The EU should not want to do anything that will encourage the Red-Brown alliance in Moscow. The PMR leadership are influential in those circles, or at least what they represent.

Anything that makes the PMR population and leadership think that the EU is playing a Romanian game will be detrimental to hopes for peace and stability in the entire Black Sea region. It might likewise encourage Romanian nationalists to think that they can push the EU into their camp and consequently destabilise another part of Eastern Europe.

26 President Clinton, speech in Omagh, 3 September 1998

The main overarching necessity is that the EU shows concrete support for continuing economic reform in the entire region, not just in Moldova. The recent economic crisis, with Ukraine and Russia now in technical debt default, will only strengthen the hand of those who wish to go the route of a regional trading system that stops at the river Prut (i.e on the border of Moldova and Romania) and does not integrate Eastern into Central Europe as a whole.

The European Union and Moldova beyond the PCA²⁷

Ian J. Manners

I. Executive Summary

"RECOGNISING in that context that support of independence, sovereignty and territorial integrity of the Republic of Moldova will contribute to safeguarding of peace and stability in the region of Central and Eastern Europe and on the European Continent as a whole,"²⁸

The preamble to the Partnership and Cooperation Agreement between the EU and Moldova appears to acknowledge implicitly that the latter party has significant problems in maintaining its independence, sovereignty and territorial integrity, which might threaten European peace and stability. These problems, combined with Moldova's small size, economic underdevelopment and geographical distance from western Europe, make it easy to understand why the European Union has had relatively little success in formulating a policy of any dimension towards the Republic of Moldova. It could even be said that a lack of policy towards Moldova has been a good approach to take in order to lessen the likelihood of tension between pro-Western, pro-Russian, and pro-Romanian forces within the country. This paper does not take the position that a lack of policy is a good approach, but it does warn that new policy formulations towards Moldova may not be intrinsically good, and will carry some risk. Given the current condition of Moldovan political and economic affairs this paper cannot suggest simple solutions which are easily recommended. Any policy recommendations will have to be analysed and adopted with care and caution regarding the internal and external tensions of the Moldovan situation.

1. Main Conclusions:

- The PCA is not an endpoint of the EU-Moldovan relationship but a starting point: if it is to have a positive impact then relations with Moldova must move forwards.
- The PCA has some weak points in its provisions which need re-evaluation: specifically on issues regarding agriculture, transport and energy.
- The unwillingness of the EU to address the Transdnestr conflict is a cautious approach: yet this conflict is a major element in the problems of successfully implementing the economic liberalisation suggested in the PCA.

27 The author gratefully acknowledges the help and assistance of Alexandra Dos Santos, Richard Sakwa, Andrew Williams, and Jennifer Moroney in the researching of this paper. However the writing, and any errors involved, remain entirely the responsibility of the author.

28 European Commission. 'The European Union and the Republic of Moldova: Partnership and Cooperation Agreement', DG1A, Information Unit – Tacis, July 1998, preamble, p. 2.

- Moldovan aspirations to reach associate agreements, and eventually full membership of the EU require that a strategy, if not policy, towards Moldova needs to be adopted.
 - The enlargement of the European Union is now underway and will make policy towards Moldova all the more necessary: but it is likely that such a policy may become more difficult to implement without successful economic development in Moldova.
 - Ultimately, the success of EU policy towards Moldova will depend on finding a peaceful settlement to the internal conflict: this will involve domestic actors, regional actors and the EU.
2. Recommendation I: Use the PCA as a Building Block for Economic and Political Development.
 - Every step must be taken to assist Moldovan compliance with GATT and membership of WTO.
 - The PCA and its cooperation councils must attempt to engage with, not ignore, the issues of concern in the Moldovan conflict.
 - The PCA needs to encourage multilateral dialogue, in particular between Moldova, Ukraine, Romania, and Russia.
 - Re-evaluation of the PCA needs to consider the development of freer trade amongst CEECs and other PCA states.
 3. Recommendation II: Use Tacis as a Means of Helping Moldova to Overcome 'Seasonal Dependence'.
 - The Moldovan conflict has restricted the Tacis programme, a fact which needs to be acknowledged and addressed.
 - 'Seasonal dependence' needs to be overcome through programmes in agriculture, transport, and energy.
 - The Tacis programme towards agriculture needs to liberate CIS market dependency for Moldovan producers and continue to contribute to privatisation.
 - Landlocked Moldova needs an emphasis placed on overcoming problems associated with PMR control of many transport links, with TEN corridor IX to Kiev and Bucharest being a part of this focus.
 - Energy dependency on Gazprom need to be ameliorated through addressing problems of efficiency, production and supply. GUAM and Caspian oil may help, but this is a risky strategy.
 4. Recommendation III: Use CFSP as a Limited Means of Providing a Political Dialogue with Moldova's Neighbours.
 - The largely declaratory nature of CFSP renders it a somewhat blunt diplomatic instrument, but it could be used in a symbolic way to raise awareness of Moldovan independence.
 - The EU's diplomatic presence could be improved in order to facilitate communication and indicate solidarity with Moldova.

- Existing political dialogue with Ukraine, Romania and Russia could be used to raise the issue of competing claims on Moldova's territorial integrity or, more positively, to encourage a constructive settlement to peacekeeping in Transdniestria.
 - It is recommended that the OSCE remain the primary organisation and conduit for resolving, with EU support, the Transdniestrian conflict.
5. Recommendation IV: Play a More Proactive Role in Regional Relations as a Means of Encouraging CSBMs, Multilateral Dialogue, and Regional Trade.
- The European Union needs to heighten the attention given to CSBMs (Confidence and Security Building Measures) in its relations, agreements and policies towards Moldova.
 - The Trilateral between Moldova, Ukraine and Romania needs to be encouraged as a means of ensuring cross border cooperation, including CBCs and customs matters.
 - Consideration needs to be given to EU strategy towards the Black Sea Economic Cooperation, through member states (Greece in particular) or through observer status (already accorded to Austria and Italy).
 - The EU needs to encourage regional economic relations between states awaiting membership (Romania and Bulgaria), some distance from membership (Turkey, Moldova and Ukraine), or not joining (Belarus and Russia).

II. Introduction

On the first of July 1998 the Partnership and Cooperation Agreement (PCA) between the European Union and Moldova entered into force, having been negotiated four years earlier. Although only a brief amount of time has passed since this event, there is a need to look into the distance and attempt to envisage what the future holds for the European Union and Moldova beyond the PCA. This paper intends to examine what the future might hold for this relationship, taking into account the impact of existing EU policy towards the Central and Eastern European Countries (CEECs) amongst others. The paper further intends to make several recommendations for an EU approach to Moldova which considers the future status of Moldova, its internal conflict, and its relations with its near neighbours. In doing so the paper acknowledges that it is attempting to break new ground as it tries to consider the 'wider international implications of its enlargement strategy', a path which David Allen has already suggested is unclear:

"The EU clearly accepts the long-term inevitability of enlargement but is not collectively strong or confident enough to be clear about the nature of the obligation it is prepared to accept, or *the wider international implications of its enlargement strategy.*"²⁹

29 David Allen, 'Wider but weaker or the More the Merrier? Enlargement and Foreign Policy Cooperation in the EC/EU' in John Redmond and Glenda Rosenthal (eds.) The Expanding European Union: past, present, future (Lynne Rienner, 1998), p. 114 – emphasis added.

The study will proceed in three sections in order to assess these implications and make recommendations. Section one will evaluate the current relationship between the EU and Moldova and will consider issues such as the background to the relationship, the PCA itself, Moldovan expectations, and how to proceed with the PCA. Section two will broaden the perspective in order to look at the interrelationship between EU enlargement policy and the EU relationship with Moldova. The final section will make recommendations of policies, dialogue and programmes in order to develop a more targeted policy towards Moldova.

III. Relationship Between the European Union and the Republic of Moldova

With the entry into force of the Partnership and Cooperation Agreement (PCA) between the European Union (EU) and the Republic of Moldova on the first of July 1998, this relationship has begun 'une phase nouvelle, qualitativement meilleure.'³⁰ Given the distinctive geopolitical position of Moldova it is interesting that the European Union appears to have little awareness of how exactly to proceed in this new phase.

Moldova has been alternatively described as some form of 'borderland' between east and west, as simply another 'Black Sea state', or passed off as 'one large vineyard'.³¹ As will be explored here, Moldova is all these things and more, which may help explain why the EU has been unable to formulate a policy towards it. But as the EU moves slowly closer to eastern enlargement, the necessity of reviewing the EU's relations with Moldova beyond the PCA becomes more apparent. Although neither of Moldova's immediate neighbours will be in the first wave of EU enlargement, it is likely that one will be in any second wave.

The question of economic relations between the EU and Moldova is not in the remit of this paper, but the interdependence between economic and political issues means that some coverage of this issue is necessary. The economic statistics alone tell some of the story of Moldova, its internal conflict and its relationship with the EU. Moldova is so far the poorest CIS state,³² with a PCA in force, with which the EU is developing a relationship. This fact, together with its largely agrarian economy, makes this landlocked, conflict-bound state one of the most problematic for the EU to help within its assistance programmes. Most informed observers agree that the disruption of commerce caused by the Transdnestr conflict has badly hit Moldova's economy. The central government's budget deficit is almost 8% of Moldova's GDP. The IMF has loaned Moldova \$52 million since 1996, but has suspended further loans until the Moldovan economy performance picks up. However, official Moldovan sources cloud the issue with counter claims such as the Ministry of

30 President Delors upon the signing of the PCA between the EU and Moldova, 23 November 1994 in European Commission, *What is the Partnership and Cooperation Agreement? A brief guide to the agreement signed between the European Union and the Republic of Moldova*, DG1A, Information Unit – Tacis, p. 1.

31 Charles King, *Post-Soviet Moldova: A Borderland in Transition* (London: RIIA, 1995), pgs. 34 & 35.

32 Estimated \$920 GNP per capita (1995 figures), *World Development Report 1997 UNDP*, p. 214.

Finance claiming that "the economy grew 1% in 1997" (which would have been its first growth since independence). In contrast, other governmental agencies claim that "GDP fell in 1997 by as much as 5%."³³ One set of statistics which is accepted as largely accurate concern the degree to which international trade is growing. While Moldovan imports of EU goods grew by 39% to \$227 million in 1997 compared to the previous year, exports to the EU grew by 15% to \$90 million in 1997 compared to the previous year (Economic and Reforms Ministry data).³⁴ The picture here is familiar and worrying, and has been seen previously in the CEECs, as it appears to indicate that the "development asymmetry" of the Moldovan economy is leading to an increasing trade deficit with the EU and other partners as trade barriers are reduced.³⁵

1. History of EU-Moldovan Relations

The history of EU-Moldovan relations is brief and slender, being primarily focused on three issues: the Transnistrian conflict, the PCA, and the Tacis programme. An indication of this relationship is provided by the fact that between 1991 and 1997 Moldova was mentioned in only 23 statements or memoranda issued by the Presidency on behalf of the Community/Union as part of EPC/CFSP.³⁶ The beginning of these relations was actually towards the end of the Soviet Union when, on 18 December 1989, the EC and the Soviet Union signed an agreement on Trade and Commercial and Economic Cooperation (Trade and Cooperation Agreement – TCA). The end of this specific relationship came on 27 August 1991 when Moldova declared independence from the Soviet Union. Less than 10 months later, on 25 June 1992, Moldova signed the Black Sea Economic Cooperation summit declaration which established the framework for the limited BSEC institutional structures. Following the conflict with Transnistria and the intervention of the Russian 14th Army ending fighting in July 1992, the new Moldovan constitution was put in place during July 1994. The outcome of these events left both Moldova and the EU confident enough to be able to initial, on 26 July 1994, the Partnership and Cooperation Agreement. From July 1994 until July 1998 the PCA underwent no radical revision as it was signed (28 November 1994), assented to by the EP (30 November 1995), came into force as an Interim Agreement (1 May 1996), and adapted for signatures by Austria, Finland and Sweden (15 May 1997). During this period the Commission put in place two Tacis programmes, one from 1991 to 1995, and in November 1996 set in place the new Tacis Indicative Programme which runs from 1996 to 1999. Following the election of President Petru Lucinschi in November 1996, Moldova signed an economic cooperation agreement with Russia on 15 April

33 Jamestown Foundation Weekly Fax Bulletin, Vol. 3, Issue 7, 23 February 1998 (http://www.jamestown.org/pubs/view/bul/003/007_001.htm)

34 News at Moldova.net, 'Moldova approves extended cooperation programme with European Union', 6 March 1998 (<http://www.moldova.net/News/fresh/English/March-98/n-6-8.asp>).

35 András Inotai, 'The CEECs: from the Association Agreements to Full Membership?' in John Redmond and Glenda Rosenthal (eds.) The Expanding European Union: past, present, future (Lynne Rienner, 1998), p. 163.

36 European Foreign Policy Bulletin (<http://wwwarc.iue.it/efpb2?nd=Moldova...>).

1997, and then a memorandum of understanding with Transdniestria on 8 May 1997 signed. This led the Dutch Presidency to publish, on 13 May 1997, a declaration welcoming the agreement reached between Moldova and Transdniestria.³⁷ Although this brief history greatly simplifies the domestic events in Moldova, it indicates that politically Moldova has passed through its period of turmoil, both internally and externally, under the Presidency of Mircea Snegur from 1992 to 1996.

2. The Partnership and Cooperation Agreement (PCA)

The PCA sets out, in 10 titles, the general principles and arrangements for "considering the links between the Community, its member states and the Republic of Moldova and the common values that they share."³⁸ As importantly, in five annexes, the PCA provides an indication of exclusions, reservations, and conventions referred to in the document itself. Possibly the single most substantial element is appended as a protocol on "mutual assistance between administrative authorities in customs matters." A number of observations of the PCA can be made in comparison to the other PCAs with Ukraine and Russia, and in comparison to the Europe Agreements (EAs) with the 10 CEECs.

A first observation is that, being based on Articles 113 and 235 of the EC Treaty, the general approach, style and language is very similar to the other PCAs with its references to 'common values' of human rights, democracy and economic liberalisation. The PCAs largely share the medium-term and long-term goals in somewhat generic terms. In the medium term they are to "support efforts of the Republic of Moldova to consolidate its democracy and to develop its economy and to complete the transition into a market economy."³⁹ In the longer term the PCA is "favouring a gradual rapprochement between the Republic of Moldova and a wider area of cooperation in Europe and in neighbouring regions and of the Republic of Moldova's progressive integration into the open international trading system."⁴⁰ Indeed, to a certain degree, some elements of the PCA appear to be the same as the Russian and Ukrainian agreements with the word Moldova substituted. Although this may be egalitarian and economical, it must be questioned how appropriate this approach is. Because of these similarities it could be argued, as some have done, that the Russian (and hence Moldovan) PCA seems to "amount to little more than a modest extension of the 1989 TCA."⁴¹ The other observations are of lesser relevance than this overriding concern about the PCA, but are as follows:

37 *Agence Europe*, 'EU/Moldova', 14 May 1997, p. 3.

38 European Commission. 'The European Union and the Republic of Moldova: Partnership and Cooperation Agreement', DG1A, Information Unit – Tacis, July 1998, Preamble, p. 2.

39 European Commission. 'The European Union and the Republic of Moldova: Partnership and Cooperation Agreement', DG1A, Information Unit – Tacis, July 1998, Article 1, p. 4.

40 European Commission. 'The European Union and the Republic of Moldova: Partnership and Cooperation Agreement', DG1A, Information Unit – Tacis, July 1998, Preamble, p. 3.

41 Jackie Gower, 'The Partnership and Cooperation Agreement: Prospects for a Constructive EU-Russia Relationship' paper for UACES Research Conference, Loughborough, September 1997, p. 6.

- The obvious way forward is membership of WTO, which will assist in achieving the logical culmination of the PCA in a free trade area (Article 4).
- The exclusions included in the annexes are saving up trouble which will have to be dealt with earlier rather than later, specifically on trade with the CIS, agriculture, and steel.
- The protocol on customs cooperation is obviously of great importance to the EU, but where is the encouragement for the Moldovans? It does not appear to be willing to address the real issue here.
- The issue of human rights is justifiably raised, although mechanisms for its monitoring are not fully spelt out – as this is clearly a crucial issue in Moldova, this area needs development.
- It does not specifically encourage multilateralism, although Article 3 refers to a need to "maintain and develop cooperation" amongst Newly Independent States, it does not really address the other logical partners in the CEECs.
- The most important issue in the entire PCA is what is not mentioned – specifically, the Transdniestr conflict
- Transdniestr contains more than a third of Moldova's means of industrial production,⁴² without settlement of the conflict reform measures can only ever be partially successful.

3. Moldovan Expectations of the PCA

Moldovan expectations of the PCA can be assessed in terms of two timescales:

a. Short-term

President Lucinschi has indicated short-term concerns for the Moldova surrounding the PCA:⁴³

- Improving the poor economic situation;
- Overcoming the transitional difficulties associated with reform;
- Improve foreign trade with the NIS & EU;
- Resolving the situation in Transdniestr;
- Use of EU Tacis aid in Moldova;
- The development of the PCA;
- The future status of bilateral relations between Moldova and the EU.

b. Medium-term

It is absolutely clear that the medium-term Moldovan expectation of the PCA is that it will become the basis for establishing a free trade agreement and then 'associate membership' of the EU.⁴⁴

42 Charles King, Post-Soviet Moldova: A Borderland in Transition (London: RIIA, 1995), p. 24.

43 Bulletin of the European Union, 'Bilateral Relations: Moldova', No. 1/2, 1998, point 1.4.115 (<http://europa.eu.int/abc/off/bull/en/9801/p104115.htm>).

4. Moving Beyond the PCA

As President Lucinschi has made apparent in a letter to the EU 15, the aim of Moldova is to become a member of the EU.⁴⁵ This desire is clearly a touchstone for Moldovan economic policy and is constantly re-emphasised.⁴⁶ The challenge for the EU is to plot a realistic path beyond the PCA, even if it fails to agree on an overarching strategy for relations with Moldova:

- Movement towards WTO membership;⁴⁷
- The normalisation of relations with Romania, Ukraine and Russia;
- Agreement on a free trade area with the EU;
- Rethinking Moldova's EU status (PCA & Tacis);
- Formulating an overarching strategy for relations which do not worsen the domestic solution.

In the longer term the EU has to contemplate whether Moldovan membership is to be considered "beyond the pale" in the future as some suggest,⁴⁸ or whether it could be considered when it is politically and economically "ready as others have observed."⁴⁹

5. Moldova and Trans-European Networks (TENs)

As was highlighted in a recent article in *Le Monde*, the question of transport networks, power networks, and oil pipelines amongst the CIS states is rapidly becoming one of 'transport et géostratégie'.⁵⁰ Moldova's status as a "have-not" CIS energy state,⁵¹ which is also landlocked, means that a transport strategy assumes new priorities:

44 News at Moldova.net, 'Moldova approves extended cooperation programme with European Union', 6 March 1998 (<http://www.moldova.net/News/fresh/English/March-98/n-6-8.asp>).

45 Jamestown Foundation Monitor, 'Moldova Seeks Early Start of Associate Membership Talks with European Union', Vol. 3, Issue 233, 15 December 1997 (http://www.jamestown.org/pubs/view/mon/233_010.htm)

46 Michael Shafir, 'Endnote: Walking the Moldovan Tightrope', RFE/RL Newswire, Vol. 1, No. 86, 1 August 1997 (<http://hri.org/balkans/refel/97-08-01.rferl.html>); and Agence Europe, 'EU/Moldova: exploit potentials of cooperation agreement before considering further developments', 15 July 1998, p. 6.

47 On the 17 July 1998 the Kyrgyzstan became the first CIS state to join the WTO (the 133rd member).

48 Phillipe C. Schmitter and José I. Torreblanca, 'Old foundations' and new 'rules' – for an enlarged European Union' European Integration Online Papers Vol. 1, No. 1, 10 April 1997 (<http://eiop.or.at/eiop/texte/1997-001a.htm>); and David Allen, 'Wider but weaker or the More the Merrier? Enlargement and Foreign Policy Cooperation in the EC/EU' in John Redmond and Glenda Rosenthal (eds.) The Expanding European Union: past, present, future (Lynne Rienner, 1998), p. 114.

49 Anthony Foster, 'NATO and EU Enlargement: Reluctance, Denial and Confusion?', paper presented to UACES Research Conference, Loughborough, September 1997, p. 6; Christopher Piening, 'Russia and the Newly Independent States (NIS)' in Global Europe: The European Union in World Affairs (London: Lynne Rienner, 1997), p. 66.

50 Jean Radvanyi, 'Transports et géostratégie au sud de la Russie', Le Monde Diplomatique, Juin 1998, pgs. 18 & 19.

- improve links with the other NIS, which help to overcome dependency on links through Transdnestr, 52 especially on the Bel'tsy-Vinnitsa-Kiev route.
- improve links with CEECs, especially on E581 to Bucharest;
- improve links with EU, especially through improvements on the Odessa-Iasi rail track;
- help overcome its landlocked status through the re-evaluation of the use of the Dniestr, but there are problems here through Bendery;
- investigate the combined impact of TRACECA and GUAM relations – can links to Odessa be improved? 53

IV. European Union Policy Towards Central and Eastern Europe

1. EU Policy Towards the CEECs and its Impact on Moldova

Inevitably the focus of the EU's policies to the east has been on the bordering states, rather than on those with the greatest need. These policies have led to four repercussions for Moldova (and other 'peripheral states'):

- the institutional focus on the CEECs and their European Agreements has led to CIS states being given second-class status within the EU;
- EU policy has led to trade diversion with the failure of FDI in Moldova partially reflecting this (amongst other factors);
- the budgetary importance given to Phare rather than Tacis has led to these a tendency to allocate on a political basis (i.e. preparation for membership) rather than an economic basis (i.e. in terms of relative developmental needs);
- as the first wave of enlargement draws closer it is likely that these patterns will become more exaggerated.

2. Future EU-Moldovan Relations Beyond Enlargement

As was recently made clear by the Austrian Foreign Minister, Wolfgang Schuessel, the EU needs to develop a strategy towards European countries for which "there is no short or medium term prospects for membership."⁵⁴ The Austrian Presidency of the EU intends to discuss such a strategy at the forthcoming conference (24 & 25 October), with particular reference to the role of the

51 Robert Ebel, 'Geopolitics and pipelines', Analysis of Current Events, Vol. 9, No. 2, February 1992, p. 1.

52 Charles King, 'Eurasia Letter: Moldova with a Russian Face', Foreign Policy, no. 97 (Winter 1994-95), pgs. 119-120.

53 Agence Europe, 'Conclusions of conference on management of gas and oil pipeline in Transcaucasia', 1 August 1996, p. 8.

54 Agence Europe, 'EU/Informal Meeting of Salzburg', 31 August and 1 September 1998, pgs. 3 & 4.

'European Conference' itself.⁵⁵ Such a strategy will be of vital importance for future EU-Moldovan relations beyond enlargement, but the status of European CIS states, or 'non-applicant European countries', must be reconsidered. Consideration needs to be given to allowing participation in broader multilateral political dialogue – such as a 'partnership for Europe' (Schuessel's idea). It may be possible to extrapolate two differing sets of observations on EU-Moldovan relations beyond enlargement, corresponding to wave one (probably including Poland, Hungary, Czech R., Slovenia, and Estonia), and wave two (possibly including Slovakia, Lithuania, Latvia, Romania, and Bulgaria).

a. Post-first Wave Enlargement:

EU and Russia

- It is highly likely that EU external relations and CFSP will become more oriented towards eastern relations;
- this could possibly lead to more negative EU-Russian relations;
- these relations will probably be exaggerated by the combined effects of NATO and EU enlargements, the prospects of a second NATO enlargement to include Austria, Slovenia and Romania, and an increased desire by Baltic states to join NATO.
- It seems necessary to attempt to pre-empt these problems by placing EU-Russian relations on a more formalised basis, encouraging political dialogue and participation, perhaps with something in the direction of the act between NATO and Russia, or even as far as something like the 'Transatlantic Partnership'.

Romania and Ukraine

- Following enlargement both Romania and Ukraine will both become EU border states, and hence the focus of more intense EU cooperation (while Moldova may not);
- Romanian expectations of, and Ukrainian desires for, EU membership will accelerate during this period;
- this will provide an crucial opportunity to increase leverage/dialogue with Romania to normalise relations with Moldova and relinquish all claims to assimilation.

Further enlargement

- However, internal EU resistance to further enlargement will inevitably increase, which will likely delay further enlargements;
- In addition, the EU is likely to receive more applications for membership – in particular from the remaining Balkan states.

55 Agence Europe, 'EP/Austrian Presidency', 17 July 1998, pgs. 4 & 4a.

b. Post-second Wave Enlargement :

EU and Eastern relations

- These will become qualitatively different as Moldova will become a border state;
- If they have not done so already, then Ukraine and Moldova seem likely to formally apply for membership;
- EU external relations and CFSP will become even more focused on relations with Russia, Belarus, Ukraine and Moldova, which could become more problematic unless dealt with in 1.iv (above).

EU and Regional relations

- If the BSEC is successfully functioning then EU should attempt to play a greater role, especially with Greece, Romania and Bulgaria as members;
- Moldova will have to be more closely associated with EU cooperation – especially in issues of eastern trade with Black Sea / Caucasus / Caspian regions; in relations with Turkey; transport links in this direction; energy links / pipelines in this direction; and JHA cooperation (inc. customs cooperation, fighting organised crime, and illegal migration).

3. Cross-border Issues Between Moldova and an Enlarged EU

Encouraging cross border cooperation (both within and without Moldova) is probably the best policy for the EU to pursue in the short term. In particular, projects aimed at encouraging cross-border contact and the building of a civil society are crucial to overcoming Moldovan-Transnistrian-Gagauz mistrust internally, and Moldovan- Romanian-Ukrainian mistrust externally. A number of observations can be made regarding the interrelationship between cross-border issues and an enlarged EU:

- If Romania joins the EU before Moldova does then a number of bilateral problems will have to be resolved;
- Schengen Visa obligations will become problematic unless cooperation and trust is built beforehand;
- the EU will be keen to prevent illegal border crossings, but this may impact on trade;
- the detrimental effect of introducing such barriers on relatively free crossing has most recently been seen with the imposition of a visa regime on the Polish-Belarussian-Ukrainian borders.

- The final problem is with the free movement between CIS countries, as spelt out in the PCA, Annex I, parts 5 & 6, which provide for "special conditions of transit" and "special conditions of customs procedures".⁵⁶
- It might be that Romania might not immediately qualify for free movement of persons after membership. By the time the Romania does qualify Moldova may be closer to membership, and might have at least resolved its CIS border issues (particularly if it maintains a similar status to Ukraine).
- Under the Tacis programme, all the references to Cross Border Cooperation and TENs appear to refer almost exclusively to the Moldovan/Romania border.⁵⁷ But it is Transdnestr which has become a major transit point for illegal goods (especially arms) being shipped between the CEECs, Russia, and the Caucasus.⁵⁸ Cross border issues must address the Transdnestrian-Ukrainian border, the flow of illegal migrants, and the flow of goods along the river Dniester.⁵⁹
- These projects must have two aims – one clearly functional, but one also in terms of building confidence between the local populations (and governments) in order to provide real economic and political stability.

4. EU Relations with Ukraine and Russia and their Impact on Moldova

Together with cross-border initiatives, the EU's relations with Ukraine, Russia and Romania provide an opportunity to constructively influence the conditions in Moldova. The new centre-right governing coalition in Moldova has publicly committed itself to three foreign policy goals with regard to its neighbours:⁶⁰

- consolidation of independent Moldovan statehood (implying no 'special' relations with Romania);
- good relations with 'neighbouring Ukraine and Romania' (in that order);
- pursuit of good relations with Russia and with other CIS states, without joining CIS political and military structures".

This clear statement of goals, together with the acknowledged importance of relations with Ukraine and Russia in resolving the Transdnestr conflict, leads to a number of suggestions regarding the question of EU foreign relations:

- The Moldovan question cannot be answered without addressing relations with its near neighbours (Romania, Ukraine, and Russia);

56 European Commission. 'The European Union and the Republic of Moldova: Partnership and Cooperation Agreement', DG1A, Information Unit – Tacis, July 1998, p.43.

57 Keesing's Record of World Events, 'Moldova: Visit by President to Romania', February 1998, p. 42090.

58 RFE/RL Newslines, 'Moldova, Ukraine, Romania to Jointly Combat Organized Crime', 14 November 1997 (<http://www.rferl.org/newslines/1997/11/141197.html>).

59 RFE/RL Newslines, 'Moldova: A Crossroads for Illegal Migration', 16 April 1996 (<http://www.friends-partners.org/cgi-bin/friends/refrl/waissearch.pl>).

60 Jamestown Foundation Monitor, 'Center-Right Coalition to Govern Moldova', 23 April 1998 (http://www.jamestown.org/pubs/view/mon/004/078_012.htm).

- firstly, Russian relations must be cultivated to improve the domestic situation (Alexander Lebed regularly denounces the PMR leaders);⁶¹
- secondly, good Ukrainian relations are important as they could provide exclusion zone peacekeepers as the Russian force is slowly rationalised. Ukrainian opposition to a greater Romania helps act as a guarantee of Moldovan independence;
- thirdly, EU encouragement of amicable Romanian relations with Moldova are crucial to independence, overcoming Transdniestrian fear of greater Romanian claims, and linking Moldova into a broader and more diversified pattern of pan-European trade.⁶²
- The value of Moldovan cooperation within the GUAM (Georgia, Ukraine, Azerbaijan, and Moldova) has to be questioned. Although it is based on a pro-Western orientation, it is essentially anti-Russian and likely to cause more problems, especially in the Transdniestrian conflict.⁶³ The attraction for Moldova of the GUAM relationship is the possibility that it may bring trade along the 'new silk road' (TRACECA), and might bring energy dependence in the form of Azeri oil from the Caspian fields.

What is absolutely certain, with or without Moldova, is the need for the EU to develop its relationship with Russia.⁶⁴ All predictions of this relationship emphasise the importance of Russia as it becomes a "major trading partner..." for the EU.⁶⁵ David Allen also makes the point that EU-Russian relations have "have never been properly thought out", largely because the EU does not currently possess the foreign policy capability to deal with such a difficult issue.⁶⁶ However for Moldova, Russia is clearly its largest exporting and importing partner, but trade diversion westwards is occurring and seems only likely to accelerate as result of the financial collapse in Russia during 1998.

V. Recommendations

EU relations with Moldova beyond the PCA, in the perspective of enlargement, require the EU to develop a policy which is pro-active and will involve three rather difficult steps. Firstly, the EU will have to involve itself in another internal conflict in Europe, which after Yugoslavia it is understandingly reluctant to do. Secondly, the EU will have to construct a long view on Moldova in order to arrive at

61 William Park, 'A New Russia in a New Europe: still back to the future?' in William Park and G. Wyn Rees (eds.) *Rethinking Security in Post-Cold War Europe* (London: Longman, 1998), p. 111.

62 *Jamestown Foundation Monitor*, 'Moldovan, Romanian Presidents Mending Fences', 2 January 1997 (http://www.jamestown.org/pubs/view/mon/003/001_011.htm)

63 RFE/RL Newline, 'Three CIS Presidents Support Baltic-Black Sea Summit Proposal', Vol. 1, No. 139, 15 October 1997 (<http://hri.org/news/balkans/rferl/97-10-15.rferl.html>).

64 Curt Gasteyger, *An Ambiguous Power: The European Union in a Changing World* (Gütersloh: Bertelsmann Foundation Publishers, 1996), p. 94.

65 Christopher Piening, 'Russia and the Newly Independent States (NIS)' in *Global Europe: The European Union in World Affairs* (London: Lynne Rienner, 1997), p. 66.

66 David Allen, 'Wider but weaker or the More the Merrier? Enlargement and Foreign Policy Cooperation in the EC/EU' in John Redmond and Glenda Rosenthal (eds.) *The Expanding European Union: past, present, future* (Lynne Rienner, 1998), p. 113.

a strategy which looks beyond the next ten years of enlargements. Finally, the EU is going to have to engage more thoughtfully with Russia, rather than leaving it to bilateral dialogue between Russia and Germany, France or the USA. The challenge for the EU is to develop a strategy which allows it to assist Moldova in "cultivating some degree of autonomy",⁶⁷ overcoming FDI reluctance of international business,⁶⁸ and helping it take advantage of its geographical position at the gateway to the east.⁶⁹

1. How Can the EU Best Use the Instruments at its Disposal?

The EU has a wealth of tools with which to strengthen its ties with the region, and develop a more targeted policy with Moldova itself. The skill for the EU will be to coordinate these somewhat disparate tools into a common strategy which is mutually reinforcing rather than contradictory. The recommendations here are based on two foreign policy instruments, the PCA and the Tacis programme.

a. Beyond the PCA:

For the EU and Moldova to move beyond the PCA the issues contained within its structures must first be addressed. The PCA must be fully implemented before the 'rendezvous', planned for 1998 (but will undoubtedly occur later) can occur. The question of Moldova's accession to the WTO and the associated protection of intellectual property rights must then be dealt with. Then the gradual alignment of legislation must be successfully before any free trade agreement can even be contemplated. Such free trade issues must also address the areas of wine and steel which were specifically excluded from the PCA. Finally, cooperation in several key sectors need to be realised, including FDI, R&D, education, transport, and cross border cooperation (where encouragement should be given to the 'Trilateral' as a viable basis). All five of these areas of cooperation would provide fertile ground for confidence and security building measures (CSBMs) in the Moldovan locality. As provisionally discussed in section 1, b, c, and d, above, some very broad recommendations in this area are given here.

<p>First recommendation: to use the PCA as a building block of economic and political development.</p> <ul style="list-style-type: none">– Every step must be taken to assist Moldovan compliance with GATT and membership of WTO.– The PCA and its cooperation councils must attempt to engage with, not ignore, the issues of concern in the Moldovan conflict.

67 Charles King, Post-Soviet Moldova: A Borderland in Transition (London: RIIA, 1995), p. 35.

68 European Bank for Reconstruction and Development. Moldova: 1998 Country Profile, Report to Annual Business Forum of EBRD, Kiev, May 1998, p. 15.

69 Interlik News Agency, Commentary: Search for new Strategic Partners in Europe', 9 December 1997 (<http://www.moldova.net/News/fresh/English/December-97/n-9-2.asp/>)

- The PCA needs to encourage multilateral dialogue, in particular between Moldova, Ukraine, Romania, and Russia.
- Re-evaluation of the PCA needs to consider the development of freer trade amongst CEECs and other PCA states.

b. Tacis

During the first five years of the Tacis programme (1991 to 1995) Moldova received ECU 29.1m, a figure which has since been increased for the next five years (1996 to 1999) to ECU 36m. In 1997 Moldova was the fourth largest recipient, but the largest per capita, although this was undoubtedly its high water mark. The six major programmes within Tacis are all critically important for Moldova: Cross-Border Cooperation, Trans European Networks, Agriculture, Small Projects Programmes, Human Resources Development, and the restructuring of enterprises and private sector development. As provisionally discussed in sections 1, e and 2, c above, some very broad recommendations in this area are given here.

Second recommendation: to use Tacis as a means of helping Moldova to overcome 'seasonal dependence'.

- The Moldovan conflict has restricted the Tacis programme, a fact which needs to be acknowledged and addressed.
- 'Seasonal dependence' needs to be overcome through programmes in agriculture, transport, and energy.
- The Tacis programme towards agriculture needs to liberate CIS market dependency for Moldovan producers and continue to contribute to privatisation.
- Landlocked Moldova needs an emphasis placed on overcoming problems associated with PMR control of many transport links, with TENs corridor IX to Kiev and Bucharest being a part of this focus.
- Energy dependency on Gazprom need to be ameliorated through addressing problems of efficiency, production and supply. GUAM and Caspian oil may help, but this is a risky strategy.

2. How can the EU Use its "Political Dialogue" to Assist the Resolution of the Conflict in Transnistria?

Continuing from the suggestions given above, the EU can use its 'political dialogue' with Moldova's neighbouring countries in order to assist the resolution of the conflict in Transnistria. The EU cannot choose to ignore the conflict in Moldova as "Transnistria has ceased to be a purely domestic

issue.⁷⁰ The government in Chisinau currently appears to be "walking the Moldovan tightrope" in an effort to pursue "serious, republic-wide economic reform" and achieve a degree of autonomy.⁷¹ On one hand it is criticised for being "subservient to Russia",⁷² while on the other it is criticised because of "the 'danger' of Moldova's reunification with Romania..."⁷³ While at the same time seeking to pursue associate membership of the European Union. As the EU has already declared:

"The EU remains of the opinion that completion of the process of a regulated withdrawal of the Russian troops from the region would be a significant contribution to the final settlement of the Transdnestrian problem."⁷⁴

As provisionally discussed in section 3, d above, some very broad recommendations in this area are given here.

Third Recommendation: to use CFSP as a limited means of providing a political dialogue with Moldova's neighbours.

- The largely declaratory nature of CFSP renders it a somewhat blunt diplomatic instrument, but it could be used in a symbolic way to raise awareness of Moldovan independence.
- The EU's diplomatic presence could be improved in order to facilitate communication and indicate solidarity with Moldova.
- Existing political dialogue with Ukraine, Romania and Russia could be used to raise the issue of competing claims on Moldova's territorial integrity or, more positively, to encourage a constructive settlement to peacekeeping in Transdnestr.
- It is recommended that the OSCE remain the primary organisation and conduit for resolving, with EU support, the Transdnestrian conflict.

3. How can the EU Cooperate with Other International Organisations?

The EU cooperation with other international organisations, in particular the OSCE, the BSEC, and eventually the WTO is of great significance in attempting to assist Moldova beyond the PCA. Clearly the Council of Europe is also important, but participation in NATO beyond Partnership for Peace should be actively discouraged because of the negative impact on the Transdnestrian conflict.

70 Charles King, *Post-Soviet Moldova: A Borderland in Transition* (London: RIIA, 1995), p. 36.

71 Michael Shafir, 'Endnote: Walking the Moldovan Tightrope', *RFE/RL Newline*, Vol. 1, No. 86, 1 August 1997 (<http://hri.org/balkans/refel/97-08-01.rferl.html>); and Charles King, *Post-Soviet Moldova: A Borderland in Transition* (London: RIIA, 1995), p. 36.

72 *RFE/RL Newline*, 'Moldovan Premier in Moscow', Vol. 1, No. 139, 15 October 1997 (<http://hri.org/news/balkans/rferl/97-10-15.rferl.html>).

73 Michael Shafir, 'Endnote: Walking the Moldovan Tightrope', *RFE/RL Newline*, Vol. 1, No. 86, 1 August 1997 (<http://hri.org/balkans/refel/97-08-01.rferl.html>).

74 Presidency of the European Union, 'Statement on a Memorandum of Understanding between Moldova and Transdnestria', Press Statement issued in Brussels and the Hague by the Netherlands, 13 May 1997, No. 97/070 (<http://wwwarc.iue.it/iue/efpbll?nd=97%2f070>).

Although WEU participation would not be so negatively received, it should also be handled very carefully. Both these latter two organisations would prove problematic in the medium term if Romania were to achieve full membership. Encouragement of regional economic cooperation including the strengthening of BSEC are likely to prove much more effective and productive measures in the long term. As provisionally discussed in section 2, a and b above, some very broad recommendations in this area are given here.

Fourth Recommendation: to play a more proactive role in regional relations as means of encouraging CSBMs, multilateral dialogue, and regional trade.

- The European Union needs to heighten the attention given to CSBMs (Confidence and Security Building Measures) in its relations, agreements and policies towards Moldova.
- The Trilateral between Moldova, Ukraine and Romania needs to be encouraged as a means of ensuring cross border cooperation, including CBCs and customs matters.
- Consideration needs to be given to EU strategy towards the Black Sea Economic Cooperation, through member states (Greece in particular) or through observer status (already accorded to Austria and Italy).
- The EU needs to encourage regional economic relations between states awaiting membership (Romania and Bulgaria), some distance from membership (Turkey, Moldova and Ukraine), or not joining (Belarus and Russia).

VI. Conclusion

The EU has divided Europe in two – the 'ins' and the 'outs'. The 'ins' are those offered European Agreements, incorporated into the Phare programme, given approximately ten times the amount of non-repayable aid per capita as Tacis states, and offered the prospect of membership. The 'outs' are those offered Partnership and Cooperation Agreements, incorporated into the Tacis programme, given approximately ten times less the amount of non-repayable aid per capita as Phare states, and generally put off membership. The EU has essentially recreated a slightly different division of Europe, one that is convenient in that it is relatively simple to define in terms of CIS membership, and would not seem to require addressing in the next 20 years until after the CEEC enlargements have taken place.

Such a strategy is short sighted and will create more problems than it solves. The EU needs to rethink its approach to the differentiation between 'ins' and 'outs'. This is particularly true given the assumption that the first wave of enlargement is unlikely to include all the 'ins'. Thus the EU is presented with an opportunity to rethink its relationship with these two groups of states in order to

promote good mutual relations, economic relations, and avoid replacing the 'iron curtain' with a 'paper curtain' based on differing economic agreements.

The EU's relations with Moldova beyond the PCA are focused on economic reforms, agricultural reforms, industrial reforms, transport reforms, energy reforms, and problems of illegal transit. But all of these policy areas are blocked by the Transdniestrian conflict. Thus, for the EU, the conflict must become an issue of concern.

One of the major reasons the conflict began was due to Transdniestrian fears of becoming part of a greater Romania. The EU can play an important role in overcoming these fears and contributing to a peaceful settlement in the conflict. The EU can guarantee Moldovan independence, can assist in providing for Transdniestrian autonomy, can help in guaranteeing minority rights, can encourage intra-Moldovan CBC, and can assist in improving the economic opportunities for all Moldovans.

The European Union can be part of a OSCE negotiated solution to the Moldovan conflict. But this can only realistically happen *prior* to Romanian membership of the EU. After this time the EU will be seen as being too pro-Romanian and will add to the conflict rather than assist in its solution.

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II. Fact Sheets

The Republic of Moldova: Foreign and Security Policy

Klemens Büscher

I. Foreign and Security Priorities

1. Codified Principles

The Moldovan Parliament adopted the country's first democratic Constitution on 28 July 1994 at a time when it was dominated by Agrarian Democrats and Socialists. The document proclaims the Republic of Moldova a neutral, sovereign, independent and indivisible state. In Article 11 Moldova declared i) its permanent neutrality and ii) the inadmissibility of the stationing of foreign military units on its territory.

These provisions are repeated in several Parliamentary decisions related to Moldova's foreign and security policy. In February 1995 the legislature adopted the country's foreign policy concept, which stipulates that Moldova "will pursue a policy of permanent neutrality and assumes not to participate in armed conflicts, political, military or economic alliances that have the aim of preparing for war." In addition, it is laid down that Moldova's foreign policy is based on the principles of transparent relations with all countries, on non-interference in the internal affairs of other countries and on the supremacy of human interests over ideological interests.

The national security concept adopted by Parliament on 5 May 1995 states that the country will not permit foreign troops to be deployed or foreign military bases to be established on its territory. This concept later served as the basis of a Law on State Security adopted on 31 October 1995. Finally, the military doctrine was adopted on 6 June 1995 which confirms and reiterates both the Constitutional principle of permanent neutrality and the prohibition of the deployment of foreign troops, with the exception of cases involving peacekeeping contingents deployed according to international agreements. Foreign troops deployed on Moldovan territory have consistently been regarded as a source of military threat to the country's security.

2. Priorities of the Political Elites

Although the ruling elites have changed since 1995, the codified principles of foreign and security policy have not been called into question. Even the right-wing parties, which are now part of the coalition Government together with the centrists, did not voice objections to the foreign policy principles. The issues of neutrality and the deployment of foreign troops are obviously related to Russia's former 14th Army (now Operational Group of Russian Forces), which is still deployed in

Transnistria. Thus, neutrality is seen as an important lever to assert and ensure effective independence.

President Petru Lucinschi, who was Chairman of Parliament in 1995, adheres strictly to the principle of neutrality. After being elected President he made clear statements that with these general principles remaining irrevocable, Moldova's strategic priority is an integration into European structures. There is a broad consensus in the political elite that eventual membership in the European Union should be regarded as the long-term objective of Moldovan foreign policy. However, the ruling parties associate this foreign policy priority with different implications. The centrists also accept membership in the CIS, given Moldova's geographical location, political culture, ethnic composition and trade relations. In contrast, the right-wing parties would like to see the country distance itself from the sphere of Russian influence. Membership in NATO, however, is not an option openly favoured by the Right as it would break the neutrality principle. Moreover, it is assessed as a completely unrealistic option for the foreseeable future. It should be noted, however, that the Popular Front, a constituent part of the ruling Democratic Convention, is sympathetic towards an eventual unification with neighbouring Romania which is itself striving to join NATO. On 21 April 1998 the centrists and the right-wingers signed a coalition agreement stipulating that a Government approved by the coalition will strive for European integration as well as for "strengthening the co-operation with Russia and the other CIS partners". Thus, the centrists who had (and continue to have) the theoretical alternative of allying with the Communist Party managed to force their views upon the coalition.

Notwithstanding the rather hypothetical discussions about the country's strategic orientation, leading figures in Moldovan politics are united around the principal objective that, given the deep financial and economic crisis, any foreign policy must above all serve the economic recovery of the country. Therefore, economic interests, besides the fundamental aim of ensuring independence, can be identified as main priority of Moldova's current foreign policy.

II. Bilateral Relations

1. The Russian Federation

Relations with Russia are at the core of Moldovan policy since they are closely connected with the country's independence and territorial integrity. Russia is Moldova's major trading partner and receives 60 percent of Moldovan exports, and, as a result, the current financial crisis in Moscow is felt strongly in Chisinau. A bilateral Basic Treaty on Friendship and Co-operation was signed in 1990 but has not yet been ratified by the Russian Duma. In June 1998 the Moldovan Speaker Dumitru Diacov agreed with his Russian counterpart Gennadi Seleznev that a new Basic Treaty must be drafted, thus meeting the long-standing demands of the Duma's deputies – the original document, dating from the Soviet period, is seen as "historically outdated".

Crucial issues in bilateral relations include Moldova's dependence on energy deliveries and the withdrawal of Russian troops stationed in Transnistria. Almost all Moldova's gas, crude oil and petrol, two thirds of its diesel and one third of its coal come from Russia. Moldova is in debt to Russia for such energy supplies to the tune of nearly US\$ 600 million, of which about 50% accounts for Transnistria's share. In total, the external debt for which the state is liable reached about US\$ 1.2 billion in the spring of 1998, equalling more than 50% of Moldova's GDP. The Russia company RAO Gasprom repeatedly reduced gas deliveries following Moldova's failure to pay its debt. In order to settle part of the debts, the Moldovan Government agreed to transform the state gas company into a Russian-Moldovan joint stock company 'Moldovagaz' giving Gasprom 50% of the stock.

The Operational Group of Russian Forces is a major concern for Moldova: besides violating the country's sovereignty it is seen as an important factor stabilising the separatist Transnistrian regime. On 21 October 1994 the Governments of Russia and Moldova signed an accord on the Army's exit from Moldova within three years. However, the Russian Duma has failed to ratify the accord. Instead, "patriotic" Duma deputies voice strong support for Tiraspol's striving to keep the Army in Transnistria. The Russian Government holds that according to the agreement withdrawal is to be synchronised with a settlement of Transnistria's status. Meanwhile the Operational Group's overall strength has been reduced from 7000 to about 2500. 500 troops act as peacekeepers in the security zone along the Dniestr together with Moldovan and Transnistrian troops. The withdrawal problem is complicated by huge stockpiles of ammunition located in the region which have to be destroyed or removed. Tiraspol claims ownership of the ammunition and equipment in the event of a Russian withdrawal.

2. Romania

Due to historical and ethnic links and the weak but noisy nationalist forces on both sides of the Pruth which are striving for unification, Moldovan-Romanian relations are quite delicate. Although negotiations on a basic bilateral treaty resumed after new presidents were elected in both countries in late 1996, the pending treaty has not yet been finalised. The most sensitive problem is how both sides will address the Molotov-Ribbentrop-Pact which led to the annexation of Bessarabia by Stalin and consequently to Moldovan-Romanian separation.

Notwithstanding occasional irritations between the ruling elites, general political and economic relations have improved between the two. Romania occupies second place in Moldova's exports and third place in its imports. Throughout the seven months of 1998, trade between the two states rose by 36.4 percent as compared to the same period of 1997. Relations in the cultural and educational fields have also intensified now that the Moldova's nationalist Right has returned to power.

3. Ukraine

President Lucinschi said in September 1998 that Moldova "treats Ukraine as its main political and economic partner." In March 1997 the heads of state announced their intention to establish a bilateral free trade zone. Ukraine ranks second in Moldova's imports and third in its exports. A long-term agreement on economic co-operation is to be negotiated this year. Ukrainian President Leonid Kuchma is scheduled to pay a visit to Chisinau in late October.

The bilateral Basic Treaty of Friendship and Co-operation signed in 1992 was ratified by both Parliaments in late 1996. In contrast, negotiations on an agreement over border delineation are proceeding slowly and several major border disputes remain to be settled. Plans to build an oil transfer terminal in Moldova are stirring opposition in Ukraine, since the terminal is situated on Moldova's sole, and extremely small, strip of the Danube's left bank south of the village of Giurgiurlesti. Since the common border is not yet established, Ukraine arbitrarily fenced off a section of the Danube estuary, thus restricting Moldova's narrow outlet to Giurgiurlesti.

Progress is being made with regard to Ukraine's involvement in the negotiations between Chisinau and Tiraspol. Acting as a mediator alongside Russia and the OSCE since 1995, Ukraine agreed in June 1998 to send ten peacekeepers to the security zone to act as additional military observers. Chisinau urges Kiev to further enhance its involvement in conflict resolution attempts.

4. Relations with Other Countries

Relations with the United States are of the "highest priority" for Moldovan Foreign Minister Nicolae Tabacaru. He paid a week-long official visit to Washington in August 1998. One of the visit's most important results was the inclusion of Moldova in the "US Action Plan for South Eastern Europe" alongside Romania, Bulgaria, the Former Yugoslav Republic of Macedonia (FYROM) and Slovenia. This initiative launched in late 1997 is aimed at creating a zone of security and stability in south-eastern Europe. Chisinau hopes for increased assistance from Washington for internal reforms as well as support in resolving the problem of Russian troop withdrawals.

A milestone in Moldovan foreign relations was the visit of French President Jacques Chirac in early September 1998, the first official visit to Moldova by a European Union leader. Bilaterally, the talks centred upon the improvement of economic and cultural relations. Predominantly romanophone Moldova is the only CIS country participating in the France-led Francophone Movement. Bilateral contacts have intensified since Moldova opened its embassy in Paris in 1997, with ex-Foreign Minister Mihai Popov as ambassador. Beyond this bilateral focus, Chirac's visit was interpreted as a signal that France may become the main supporter of the process of Moldova's integration into the EU.

Relations with Turkey improved considerably after Chisinau settled the Gagauz problem. Turkish President Demirel paid a visit to Moldova in June 1998 where he thanked Moldova for the autonomy solution of Gagauzia and pledged a grant of US\$ 35 million in credit.

Moldova maintains bilateral military co-operation with Romania, Ukraine, Russia, Belarus, Bulgaria, the US and Hungary. The corresponding agreements include joint exercises, military education and technical co-operation.

III. Multilateral Co-operation

1. Moldova in the CIS

Moldova ratified its CIS membership in April 1994 but only after Russia exerted considerable pressure on Chisinau. The country participates fully in economic and partly in political co-operation within the Commonwealth. In October 1997 Chisinau hosted a CIS summit meeting for the first time, the results of which were, as usual, rather sparse. The failure of the CIS to contribute to a solution to the various separatist problems in its member states discredits the organisation in the eyes of many Moldovan observers.

Moldova has not joined the CIS 1992 Tashkent agreement on military co-operation. Since 1992 Moldova has, regardless of its leadership, emphasised that its neutral status excludes any kind of participation in CIS military structures. This position was most recently confirmed at the CIS Special Interstate Forum in Minsk on 15-16 September 1998, when the Moldovan delegation proposed to exclude political-military co-operation from the CIS agenda.

2. Co-operation with NATO

In March 1994, Moldova became the twelfth state to enrol in NATO's Partnership for Peace programme. The Moldovan President made it clear, however, that the country does not intend to raise the possibility of eventual NATO membership and an Individual Partnership Programme for the period 1996-1998 was adopted in March 1996. Moldovan troops participated in several PfP manoeuvres, beginning in 1996 with a manoeuvre in Ukraine. The first PfP exercises in Moldova involving Moldovan and US Army medical troops were held in May 1997. In September 1998 the Moldovan military took part in exercises in Ukraine and Macedonia.

As far as NATO enlargement is concerned, Chisinau maintains a rather "diplomatic" position: Moldova has never regarded enlargement of NATO as a threat to its security, nor has it raised objections to eventual Romanian or even Ukrainian membership. At the same time, Chisinau is eager to stress that enlargement must not create tensions or dividing lines in Europe and that Russia's interests have to be taken into account.

3. Relations with EU

The Partnership and Co-operation Agreement (PCA) between the EU and Moldova, signed in November 1994, came into force on 1 July 1998. The PCA superseded an Interim Agreement on Trade and Related Aspects, which entered into force on 1 May 1996. The PCA aims to support Moldova's on-going transition to a market economy and liberal democracy. In order to implement its provisions, however, further efforts are needed from Moldova to adapt its legislative framework in various economic and commercial domains as well as in its administrative practices.

In December 1997 President Lucinschi requested support from EU leaders for the idea of Moldova starting negotiations on gaining EU associate membership, adding that Moldova hopes to become a full member one day.

4. Other International Organisations

In June 1995 Moldova was the first CIS country to become a member of the Council of Europe. This was widely seen as an acknowledgement of the country's significant progress in democratising its political life and building civil society. Intense efforts were made in Moldova to amend the Constitution and national legislation to comply with the European Convention on Human Rights.

Membership in the OSCE is of central importance with regard to the unresolved questions related to the breakaway region. At the OSCE summit meeting in Lisbon in December 1996 the final document approved unanimously by the participants called for the "early, orderly, and complete withdrawal of Russian troops." Most recently, OSCE meetings in Vienna in July and in September 1998 increased the pressure on Moscow, charging Russia with ignoring previous commitments to pull its troops out. A permanent OSCE Mission to Moldova was established in 1993 to facilitate negotiations between Chisinau and Tiraspol for a lasting political settlement of the Transnistrian conflict. Besides acting as mediator in the negotiation process, the OSCE Mission is charged with "closely following" the withdrawal of the Russian troops.

The Republic of Moldova is a founding member (June 1992) of the Black Sea Economic Co-operation (BSEC), the main role of which is seen by Moldova as promoting trade and economic relations as well as ensuring regional stability.

5. Multilateral Regional Co-operation Initiatives

Trilateral co-operation with Romania and Ukraine is an emerging priority for Moldova. In July 1997 the three Presidents declared their willingness to create two tripartite Euroregions (Lower Danube and Upper Pruth) and to set up a free trade area. The next trilateral Presidential summit is scheduled for late October 1998. The sides intend to review their economic relations and to discuss matters pertaining to the activities of the "Lower Danube" Euroregion.

A loose alliance links Moldova with Georgia, Ukraine and Azerbaijan (GUAM). The main strategies of the group are to counter-balance Russian influence in the CIS, intensify economic co-operation, and resolve separatist problems. Additionally, Moldova seeks to obtain access to oil springs from the Caspian Sea.

An international summit meeting on creating an energy transportation corridor to link Asia and Europe in early September 1998 was called "a historic event" by Moldovan President Lucinschi. The Forum gathered over 30 nations in Baku in order to create a energy transportation corridor linking Europe, the Caucasus and Asia (TRACECA), thus restoring the old "silk way".

IV. Moldova in the European Security Architecture

Before 1991, the territory of Moldova with a heavy concentration of MİK formed part of the Soviet Odessa Military District and was designed to serve as a springboard for Moscow's operations against the Balkans in the event of war. With the disintegration of the USSR Moldova lost its global strategic significance, although some people like former commander of Russia's 14th Army General Alexander Lebed continued to call the Dniestr a "key to the Balkans". In contrast to Ukraine, Moldova is not a key component in hegemony aspirations of Russian "national-patriotic" forces. In the same way, the existence of an independent Moldova is an important component but hardly a "keystone in the arch" of a European security architecture. Rather Moldova is located at a cross-roads where the interests of several states intersect.

Today, the country is closely bound in two opposite directions. The ethnic affinity link to neighbouring Romania is strong enough to establish a "special relationship" with that country even though unification is extremely unlikely. At the same time there is a certain historical and emotional link to Russia and Ukraine, at least for large parts of the population. Moreover, Moldova finds itself in economic double dependency on Russia (Gasprom) and the West (IMF and World Bank). Internally, independence has yet to be consolidated. The social and economic crisis appears dramatic, the secessionist problem remains unresolved and the national identity is under-developed. The potential of spill-over makes these domestic uncertainties an issue of regional security.

Given these factors, Moldova must balance its foreign policy between Russia and the West. A consistent policy of neutrality and non-adherence to any military alliance seems to be the most widely accepted role for Moldova in the European security architecture. Politically and economically, the country can contribute to and participate in regional co-operation, European integration, and transport and communication networks linking Europe and Asia. At the same time, strengthening the independence and ensuring the territorial integrity of Moldova will substantially reduce security risks.

The Republic of Moldova: Domestic Politics

Klemens Büscher

I. The Main Actors in Moldovan Politics

The Moldovan Constitution, adopted on 28 July 1994, provides for a "mixed" parliamentary-presidential system, with an popularly elected executive President and a Government which is to be approved by the Parliament.

Unlike other post-Soviet countries, there are no powerful economic or regional actors behind the façade of constitutionally established institutions in Moldova. There is no *Gasprom* or *Dnipropetrovsk clan* exerting decisive influence on legislative or executive structures. This is partly due to the secession of Transnistria, where the most powerful MİK and energy industry is located.

1. Parliament Factions and Parties

The second free parliamentary elections were held on 22 March 1998. International observers from the OSCE, the Council of Europe and a number of NGOs concluded that the elections themselves were completely successful, though improvements with regard to the legal framework could still be made. The parliamentary elections led to a real, peaceful political change and thus demonstrated substantial advances in the process of the country's democratisation. Although the party system in Moldova is far from being consolidated, politicians and parties can on the whole be classified into clear political-ideological positions.

For the first time centre-right forces now represent the majority of deputies. In contrast to the previous legislature which opposed the President's moderate reform course, there is now a general consensus between the leading political forces in Moldova to speed up reform policy. Only four parties or alliances managed to pass the 4% threshold required to obtain any seats meaning that 24% percent of the votes cast went to unsuccessful candidates and parties.

The *Democratic Convention of Moldova* (DCM), formed after the presidential election, is a reform-oriented coalition grouping consisting primarily of the nationalist Christian-Democratic Popular Front and the Party of Revival and Harmony led by ex-President Mircea Snegur. With 19.4% of the vote, the DCM obtained 26 of 101 mandates in the new legislature. The DCM represents moderate and extremist pro-Romanian intellectuals as well as followers of the still popular ex-President among the rural ethnic Moldovans.

The second right-wing grouping, the *Party of Democratic Forces* (PDF) is led by the moderate intellectual Valeriu Matei and gained 11 members in the Parliament (8.8% of the votes). Its anti-Communist, reform-oriented positions are to a large extent comparable to those of the Democratic Convention. Like the DCM, the PDF is a purely ethnic Moldovan party. A merger of the PDF into the DCM before the elections was prevented by personal disputes as well as the steady popularity of Matei, which guaranteed the party's success even running independently.

The only centrist force in Parliament is the *Block for a Democratic and Prosperous Moldova* (BDPM, 24 mandates), formed by several groupings supporting President Petru Lucinschi, who nevertheless remains non-partisan. Led by Parliament Speaker Dumitru Diacov, the Block pursues a consistent reform policy, which at the same time attempts to avoid any social and political polarisation. In contrast to the right-wing parties, which favour a rapprochement or even ultimately unification with neighbouring Romania, the BDPM adheres to a strict policy of neutrality which maintains equal distance between Romania and Russia. The electoral Block, which is gradually transforming into a party, gets support from representatives of all ethnic groups.

The *Moldovan Communist Party* (MCP), headed by Vladimir Voronin, won 30% of the votes and 40 seats in Parliament. Voronin, a popular and skilled politician, successfully presents himself as a "newcomer" without responsibility for the mistakes made in the years since independence. His programme accentuates the nostalgic and anti-Western moods of the population. Groups supporting the MCP include nearly the entire left-oriented camp, the older Russian-speaking and urban population, and a section of the Moldovan voters in the country-side. Notwithstanding its clearly anti-reformist stance, the MCP tries to avoid the image of an extremist force, showing some flexibility towards reform and privatisation issues. The MCP is the only party with organisational structures covering the entire country.

Among the many parties not represented in parliament, the only one with a certain political weight is the former ruling *Democratic Agrarian Party of Moldova* (DAPM). It gained only a disastrous 3.6% of the total vote, thus failing to enter the legislature in the 1998 elections. Following several defections which began in 1994 the DAPM has weakened substantially but still can count on prominent figures like former Premier Andrei Sangheli and former Speaker Dumitru Motpan. In certain districts the DAPM polled 15%, so that a certain success is to be expected in the upcoming local elections (1999). Since the DAPM did badly in parliamentary elections, the influence of the agrarian nomenclatura pressing for farming subsidies has been reduced significantly.

The *Socialist Unity Block* – which ranked second in 1994 but was almost erased in 1998 (1.8%) – has since transformed itself into a local party concentrated in the predominantly Russian-speaking northern city of Balti.

The failure of the newly formed *Civic Alliance "Furnica"*, won only 3.3% of the votes, caused some surprise. This grouping was founded and extensively financed by representatives of new

Moldovan business. In spite of its professional electoral campaign "Furnica" did not attract Moldovan electors, who identify successful businessmen mainly with criminals. The failure of "Furnica" confirms the primacy of political instead of economic interests in this small and relatively under-developed country.

After protracted negotiations between the four parties in the parliament, a fragile centre-right coalition government of the DC, PDF and BDPM, formally known as *Alliance for Democracy and Reforms* (ADR), was created consisting of 61 of the Members. This left the Communists as the only party in opposition. BDPM-head Diacov was elected Chairman of Parliament, with Matei and the DC co-chairman Iurie Rosca as his deputies. Mircea Snegur holds the position of the Alliance chairman.

2. Government

The ADR agreed to distribute positions in the Government according to the ratio "2+2+1" corresponding to the three faction's size. The programme adopted by the ADR parties provides for socio-economic reforms in accordance with the requirements placed on Moldova by international financial organisations.

It took another month for the ADR to agree upon the portfolios of the new Government. President Lucinschi insisted on the re-appointment of Ion Ciubuc as Prime Minister. The new Ciubuc Cabinet was finally confirmed by the Parliament on 21 May by 59 votes in favour to 36 votes against. The new Government includes well-respected former cabinet ministers such as Valeriu Pasat (Defence) and Nicolae Tabacaru (Foreign Affairs), young reformers like the 37 year old Deputy Prime Minister Ion Sturza and the 36 year old Finance Minister Anatolie Arapu, but also some former ministers representing the old nomenclatura.

The non-partisan Prime Minister is himself seen as a moderate – others say hesitant – reformer who attempts to avoid any political polarisation and therefore sometimes shrinks back from consistent political decisions. During a radio interview in August he characteristically called on the population to "avoid politics" and to "concentrate on the usual work" in order to let the government resolve the problems.

Nevertheless, under pressure from the dramatic economic crisis and urged on by the young reformers, Ciubuc managed to set in motion several substantial reform projects. Most important was the adoption of a revised state budget for 1998 (the original budget adopted by the previous Parliament included unrealistic revenue projections as well as some populist but completely unaffordable social benefits).

3. President

Petru Lucinschi, sworn in January 15th 1997, is sometimes portrayed as less reform-oriented than his predecessor, since he was elected with the support of the communist electorate. In fact he seems to be very inclined to compromises that take into account the interests of all parts of society. Not unlike Ciubuc, Petru Lucinschi pursues a cautious modernising course and presents himself as being non-partisan, thus aiming at national reconciliation.

The first 15 months of his Luchinschi's presidency were "lost" given the reform-hostile majority in the previous Parliament and the formation of the new Government can be seen as his greatest political success to date. Key positions are now held by his confidants Ciubuc and Diacov, while his personal rival Snegur was prevented from returning to power. However, it is not clear to what extent the President will be able to promote his policies by exerting influence behind the scenes.

II. Central Issues in Current Domestic Politics

1. Stability of the Coalition

Some observers predicted that the ADR would have disintegrated by the summer because of the personal and political differences between the constituent member parties and indeed to some extent *within* the parties. The right-wing factions unequivocally called for resolute economic reforms, whereas part of the centrist BDPM, which got support from the relatively weak Federation of Trade Unions during pre-election campaign, are more interested in avoiding social hardships for the population. In addition, neither the parliamentary factions nor the Prime Minister and President have any experience with an institutionalised coalition Government.

Since May, a few decisions have been adopted in Parliament by a centre-left majority of deputies from the BDPM and the MCP, but most of these decisions were of minor importance. With the beginning of the autumn session of Parliament in mid-September, the ADR members seem to have overcome their differences. According to ADR-chairman Snegur, both sides have managed to find acceptable forms of co-operation and intend unequivocally to support important laws aimed at promoting reform in Moldova. At the same time, deputy Prime Minister Sturza offered his resignation in late September after substantial differences within the Government emerged.

2. Reform Policy

In September the Cabinet and Parliament majority decided upon a package of economic and political reform laws which aim to meet the demands of the IMF and the World Bank. Further steps towards restructuring the energy sector were also taken in September when the Parliament adopted laws on electricity and gas reform. The Cabinet already drafted amendments to the Land Code as

well as important laws on local public administration, territorial-administrative reform, and reform of the pension system.

However, the budgetary crisis has still not been resolved and in September the Finance Minister called for another revision of the state budget. According to experts' estimations, Moldova has already lost at least US\$ 100 million because of the financial crisis in Russia and negotiations are continuing with international financial organisations. The IMF and the World Bank officials declared that the resumption of financial assistance to Moldova will be decided on in October.

In the meantime the Cabinet has approved a emergency programme with proposals to cut back public spending by 20 percent. This will be achieved by a 50 percent cut in energy consumption in public buildings, partial closure of village hospitals, introducing of fees for medical services, raising the accommodation fees for students, reducing the amount of time spent in compulsory education, and imposing new tariffs for electricity and heating. In addition, it is intended that a policy of export promotion and import reduction, unconditional repayment of debts for consumed energy, and restoration of ties with investors which have suspended their activities in Moldova will stabilise the economic situation.

3. Society

Another proposition included in the Government's emergency measures is a moratorium on strikes and other protest actions by trade unions. This is motivated by the series of strikes, mainly in the public sector (educational and health care system), which have shaken the country over the last months. During July wage arrears in the public sector increased by 50 million Lei to reach a record figure of 569 Million Lei (US\$ 121 million) on 1 August.

The decreasing willingness of the population to accept a further deterioration in their living standards is a serious challenge to the new Government. The Communists have tried to capitalise on this social protest – in September a group of MCP deputies demanded that a vote of no confidence in the Government be put to the Parliament.

Opinion polls reveal a deep division in Moldovan society on questions of social and economic reform. Although the general necessity of reform is acknowledged by a majority, concrete policies such as privatisation of large industry and public services find most support among the elite and little among the bulk of the population. However, parliamentary election results yield a clear mandate for continuing or even intensifying the reform process and observers do not expect any dramatic escalation of social protests in the next months.

4. Minority Policy

The legal framework for ethnic minorities, which constitute about 35 percent of the population, is widely seen as liberal. Citizenship was granted to all inhabitants regardless of their ethnicity or the time of residence in the Republic. There are no restrictions in law discriminating against minorities. The Language Law adopted in 1989 stipulates that officials are obliged to know Russian and Romanian/Moldovan to a certain degree. However, Parliament has postponed the implementation of the language testing indefinitely. Inter-ethnic relations in Moldova are generally eased by the fact that ethnic divisions do not align with differences within society on reform issues.

In January 1995, Moldova granted a special juridical status to *Gagauz Yeri*, a strip of land in the south which is inhabited predominantly by the Gagauzi, a Turcic speaking Orthodox Christian minority that has pursued independence since 1989. International experts described this as a pioneering example of ethnic-territorial autonomy. On 14 May 1998 the Gagauz regional parliament (Popular Assembly) unanimously adopted Gagauz Yeri's Main Law, the text of which was positively assessed by Council of Europe and Moldovan government experts. However, institutional uncertainties with respect to the delimitation of power between central and regional authorities remain. Nationalist opposition in Gagauz Yeri is growing while Gagauzia prepares for local elections to be held in 1999.

In 1995 the Moldovan Parliament drafted a far-reaching "autonomous republican" status for the separatist eastern districts (Transnistria). The Moldovan Constitution and the draft law on territorial-administrative reform also refer to Transnistrian autonomy. However, Tiraspol leader Igor Smirnov continues to reject Chisinau's compromise offers. Negotiations under the auspices of the OSCE have been deadlocked since the Odessa summit of March 1998, when the two sides agreed to repair an important Dniestr bridge and to invite Ukrainian peace-keepers as military observers into the region. In September, President Lucinschi appointed the members of a new Governmental Commission for the talks with Tiraspol. Premier Ciubuc met with his Transnistrian counterpart Victor Sinev on 22 September. A summit meeting between Lucinschi and Transnistrian leader Igor Smirnov is scheduled for early October.

