

**Center for Economic Policies of IDIS “Viitorul”**

# **Economic Statewatch:**

## **Quarterly Analyses and Forecasts**

Issue 7

Quarter 2, 2006

For any issue related to this report please contact the Center for Economic Policies of “Viitorul” Institute for Development and Social Initiatives.

Address: MD-2005, Republic of Moldova, Chisinau, str. Iacob Hancu, 10/14, IDIS “Viitorul”, for CPE;

Telephone: 37322-22-18-44, Fax/telephone: 37322-21-09-32;

e-mail: [vi@moldova.org](mailto:vi@moldova.org) și [idis\\_viitorul@mdl.net](mailto:idis_viitorul@mdl.net)

© IDIS Viitorul, 2006

### **About IDIS "Viitorul"**

IDIS "Viitorul" is a non-government non-profit research institute of the Republic of Moldova, without any political affiliation, member of several international networks of public policies. Its mission is to contribute to the establishment of an independent analytical environment that could foster the democratic process in the Republic of Moldova and strengthen the capacities of the civil society to participate in the development of policies and monitoring of the governing process.

### **Economic research at IDIS "Viitorul"**

The Center for Economic Policies (CEP) of IDIS "Viitorul" conducts economic researches and provides economic training to people. The CEP goal is to analyze economic policies, assure public education through promotion of economic knowledge, and influence the policy development process, offering anticipatory and integrated solutions on a wide range of economic issues.

### **The main areas of economic research**

- Macroeconomic policies (monetary, fiscal, commercial);
- Development and anti-poverty strategies;
- Competitiveness and sector analyses;
- Rural and agrarian economy;
- Public economy (social services, infrastructure);
- Socio-economic policies (labor, revenues, poverty, and inequality);
- Technological development and innovations;
- Globalization and regional integration;
- Structural policies and economic institutions;
- The economic policy of the European integration.

### **Type of provided services**

- Research and design of economic policies;
- Promotion of economic knowledge;
- Monitor and draw the attention over the current economic trends;
- Provide special consultations.

### **International Board**

The CEP National Board consists of:

1. Dumitru Moldovanu, PhD, university professor, dean of the International Economic Relations department, Academy of Economic Studies of Moldova
2. Natalia Burlacu, PhD, university professor, head of Management and Marketing chair, the International Free University of Moldova
3. Wojciech Marchlewski, Expert, Association of Experts in Public Administration, Warsaw, Poland

.....

*CEP tries its best to assure high quality economic researches. If a third party incurred losses or damages as a result of using the information from CEP publications, this person can bring to book neither IDIS "Viitorul", nor CEP, nor the experts and consultants of IDIS "Viitorul", nor the members of the CEP International Board.*

## ACKNOWLEDGEMENTS

This issue of *the Economic Monitor: Quarterly Analyses and Forecasts* was developed by the Center for Economic Policies of the Institute for Development and Social Initiatives "Viitorul". It was developed with the contribution of Igor Munteanu, Viorel Chivriga, Ghenadie Russu, Andrei Munteanu, Veaceslav Ioniță, Alexandru Net, Victor Sula, Dan Lavric and Tatiana Lariușina.

The Center for Economic Policies of IDIS "Viitorul" expresses its gratitude to the Open Society Institute of Budapest for the moral and financial support that made it possible for this series to appear.

We give our thanks to all foreign experts that provided pertinent comments on this report.

*The Economic Monitor* expresses the authors' personal views that may not coincide with the views of IDIS "Viitorul". No other third person, including IDIS "Viitorul" bears responsibility for the conclusions presented in this publication.

*Center of Economic Policies of IDIS "Viitorul"*

## ACRONYMS AND ABBREVIATIONS

The following acronyms and abbreviations are used in this publication:

"CBDMR"- "The Central Bank of the Dnestrian Moldovan Republic

NBM – National Bank of Moldova;

CSIR - Center for Strategic Investigations and Reforms;

CIS – Commonwealth of Independent States;

CEP - Center for Economic Policies, IDIS Viitorul;

DSS – Department of Statistics and Sociology of the Republic of Moldova;

CEE – Central and Eastern Europe;

IPP – Institute of Public Policies;

FDI – Foreign direct investments;

MDL – Moldovan Leu;

EM – "Economic Monitor: Quarterly Analyses and Forecasts";

MoE - Ministry of Economy;

MoF – Ministry of Finance;

MLSP – Ministry of Labor and Social Protection;

ILO – International Labor Organization;

HBS – Household Budget Survey;

EGPRSP – Economic Growth and Poverty Reduction Strategy Paper;

H – half year;

Q – quarter of a year;

e – estimations;

p – Forecasts;

aaer – average annual exchange rate;

agr – annual growth rate (the ratio of the end of this year to the end of the previous year)

aagr – average annual growth rate;

aa – annual average;

p.p. – percentage points;

CONTENTS:

<b>THE MAIN INDICES.....</b>	<b>6</b>
<b>SUMMARY .....</b>	<b>8</b>
<b>POLITICS.....</b>	<b>11</b>
<b>AGRICULTURE.....</b>	<b>27</b>
<b>BUSINESS .....</b>	<b>33</b>
<b>FOREIGN TRADE .....</b>	<b>40</b>
<b>FINANCIAL MARKET.....</b>	<b>43</b>
<b>PUBLIC FINANCE.....</b>	<b>47</b>
<b>PRICES .....</b>	<b>52</b>
<b>SOCIAL SPHERE .....</b>	<b>57</b>
<b>TRANSNISTRIA.....</b>	<b>62</b>

# THE MAIN INDICES

(excluding Transnistria)

	1999	2000	2001	2002	2003	2004	2005	2006p
<b>Production</b>								
GDP, million MDL, current prices	12322	16020	19052	22566	27297	31992	36755	40285
GDP – capita, USD, aaer	321	354	408	459	543	765.6	892	890
Real GDP, agr	-3,4	2,1	6,1	7,8	6,3	7,3	7.1	6.0
Real industrial output, agr	-11,6	8,0	13,7	10,8	16,0	5,0	6.3	5.0
Real agricultural output, agr	-8,4	-3,3	6,4	3,4	-13,6	20,4	1.0	2.0
Gross investments in fixed capital, % of GDP	18,4	15,4	16,7	16,3	17,1	15,6	19.6	20.3
<b>Households</b>								
Monthly available personal income, MDL	133	186	241	322	422	491,4	568.6	650
Real available income, agr	-18,7	6,1	17,7	26,5	17,4	3,5	3.4	5.0
Retail trade, agr	-29,6	27,4	15,1	34,3	21,1	11,0	5.3	10.0
<b>Prices</b>								
Consumer Price Index	143.7	118.4	106.3	104.4	115.7	112.5	110.0	113.2
Food Price Index	144	123.1	106.1	102.8	120	113.1	108.7	111.5
Non-Food Price Index	135.6	112.5	107.9	108.2	111.5	111.9	114.9	112.0
Service Price Index	155.6	111.6	104.5	104.4	112.6	111.6	106.6	118.0
<b>Labor Market</b>								
Population, thousand	3646	3639	3631	3623	3612	3386	3,383	3,379
Employed people, thousand	1,495	1,515	1,499	1,505	1,356	1316	1,312	1,301
Unemployment rate, ILO methodology	11,1	8,5	7,3	6,8	7,9	7.8	7.3	7.8
Monthly average salary, MDL	304.6	407.9	544	692	891	1104	1320	1545
Real salaries, agr	-12.5	2.2	21.2	21.1	15.0	10.2	6.9	4.5

## The Main Indices (continued)

	1999	2000	2001	2002	2003	2004	2005	2006p
<b>Foreign Trade and Balance of Payments</b>								
Export of goods and services, agr	-23,5	5,5	14,5	18,3	21,1	24,8	22,0	18,0
Import of goods and services, agr	-36,1	22,3	11,2	18,1	34,6	26,5	30,0	20,0
Volume of foreign trade in goods and services, million USD	1035,4	1248,9	1467,4	1813,2	2193,0	2760,5	3 480	4800
Current account, % of GDP	-4,0	-9,4	-7,3	-6,2	-7,4	-3,2	-3,0	-3,5
FDI, million USD	38,8	127,5	148,5	110,4	39,4	50,0	75,0	60,0
Remittances from abroad, million USD	90,1	126,2	183,7	239,1	258	450	600	600
<b>Public Finance</b>								
Revenues in the consolidated budget, % of GDP	25,2	25,6	22,7	22,5	24,3	23,5	26,2	26,7
Budget balance, % of GDP	-3,2	-1,0	0,0	-0,5	1,6	0,2	1,9	2,2
Internal public debt, % of GDP	15,5	12,6	12,6	12,5	10,7	11,6	11,1	11,0
Foreign public debt, guaranteed by the Government, % of GDP	65,9	79,3	64,5	59,4	51,5	29,2	24,9	25,0
Arrears on electricity, % of GDP	35,5	24,6	19,4	18,1	15,9	11,1	9,1	9,1
<b>Financial indices</b>								
Monetary base, agr	41,3	29,8	27,9	31,1	17,0	38	31,8	26,5
Currency reserves, million USD, end of the year	180,5	222,5	228,5	269,6	302,3	470	597,4	650,0
Official exchange rate, annual average MDL/USD	10,52	12,43	12,87	13,57	13,92	12,3	12,6	13,0
Interest rate on credits in MDL, %, aa	35,5	33,3	28,5	23,1	19,2	21	18,9	18,5
<b>International economy</b>								
World GDP, agr	3,7	4,7	2,4	3,0	3,9	4,8	4,5	4,0
Weighted average of GDP growth in the main partner countries (2/3 of the Moldovan exports)	2,5	5,3	4,0	2,8	3,8	3,5	3,2	4,1

Source: DSS, NBM, EM Forecasts

## Transistria, Selected Indices

	1999	2000	2001	2002	2003	2004	2005e
Regional GDP, million USD	332	281	199	250	309	405	486
Regional GDP, agr	-30,1	-20,9	10,0	-2,7	18,1	16,2	18,0
Industrial output, agr	-3,8	16,5	9,0	-18,7	21,4	47,0	5,0
Population, thousand (estimations)	658,0	651,8	633,6	630,1	621,8	616,5	600
Retail trade and services, agr	-18,3	11,9	23,1	18,4	7,6	7,3	16
Investments in fixed capital, agr	34,6	3,8	15,6	-32,7	-14,7	70,0	10
Exports, million USD	258	328	378	243	433	535	560
Imports, million USD	417	489	541	450	530	758	790
Consumer Price Index	240	190	127	111	133	120	116

Source: "CBDMR", CSIR, ME estimations

# SUMMARY

**Russia increased the media influence on the political life of Moldova, with the goal to create guided missiles and block the economic relations**

---

*Nobody will accept neither the plebiscite planned by the Smirnov regime for September 2006 nor the official inclusion of this enclave into the Russian Federation, because these events only aim at setting up a cabal in the relationship with USA and EU rather than getting a new headache in South-Eastern Europe (the Kaliningrad model).*

---

**The increase in the agricultural output will be very modest, not exceeding 2%**

---

*During the first quarter of 2006 the animal production increased by only 0,7% as compared to the same semester of 2006.*

---

**In 2006 the industrial increase will not exceed 2.5% and there is a high likelihood to have a industrial decrease**

**POLITICS.** In the context of the first signs of economic crisis, the Republic of Moldova faces a shortage of capacities to manage the administrative crisis. The parallel actions (PAUERM and IPAP) call for an essential change in the paradigm of executive structures managements, implementation of structural reforms, management of its foreign debts and a new approach in the relationships with the EU. The preparation for the 2007 local elections will defrost the political life and, at the same time, will test the paradigm of democratic consensus, set via negotiations and "cooperation without reciprocity".

The Transnistria plebiscite planned by Moscow for 17 September will be held under a high political tension, even accompanied by eventual local provocations, with a wide coverage in the mass-media of Russian influence. The pressure exerted on Kiev to suspend the Moldo-Ukrainian customs control regime will place Ukraine in a very difficult situation. Though nobody will accept neither the re-plebiscite on Transnistrian "sovereignty" nor the official inclusion of the break-away enclave into the Russian Federation (the ultimate role of these actions is to hinder the UE-NATO accession to the ex-soviet area and for Russia to receive various material or political "compensations"), the Russian diplomacy, saying ditto to President Putin, has launched a large media campaign to test the international reaction to an eventual unilateral recognition of the break-away enclave. The West will not recognize such unilateral actions and seems reluctant to admit the existing status-quo in this region of Euro-Atlantic limes. Anyway, the Russian media factor will increase its impact on the political life of the Republic of Moldova, aimed at creating guided missiles in the political and economic area in order to complement the shortages of its ideological and political attractiveness with economic obstructions.

**AGRICULTURE.** During the first half of 2006 there haven't been registered any positive changes in the agricultural sector. On the contrary, a number of flaws have been identified in the state agricultural policy during this period. The Court of Accounts reports reveal plenty of disorders in the management of Agricultural Sector Support Fund during 2005 and in the management of public assets by "Moldova-Tutun" Agri-Industrial Department and in some tobacco processing companies during 2003-2004. In 2006 the agricultural output growth will not exceed 2 percent, i.e. there will be only a slight increase as compared to 2005. The harvest of cereals of the first group will be lower that last year, amounting at about 900 thousand tons. This autumn the areas under these cultures will increase significantly because of the liquidation of the cereal stocks, increase in prices and cancellation of export restrictions. There will be a similar situation with other agricultural cultures, including the multi-annual cultures. It is very unlikely to have any positive developments in the zootechnical sector, similar to those registered in 2005. On January 1, 2006 the livestock of households of all categories decreased as compared to the same period of 2005, while in the first quarter of 2006, the animal production increased by only 0,7% as compared to the same semester of 2006.

**BUSINESS.** The negative predictions formulated in late 2005 came true. We can talk now about a crisis in the national industry. The lack of serious economic and social development policies, concentration of exports on certain market, dubious sale of some assets of the wine-making industry in 2002-2003, the inappropriate or abusive state interference in the economy, underdeveloped financial market, low investments, including foreign direct investments - all these started the industrial crisis.

Our pessimistic predictions turned out to be optimistic, if reported to the latest trends. Based on the latest analyses we can conclude that in 2006 the industrial output increased by 2.5%, and not by 5% as we have predicted earlier. At the same time, there aren't any reasonable premises for improvement of these negative trends and it is possible that this year the industrial output will decrease.

**FOREIGN TRADE.** The negative trends registered in 2005 got worse in the first of 2006. Thus, the slight increase in exports was accompanied by an exponential increase in imports. The trade balance deficit will reach over 1.3 billion MDL by late this year, while the coverage rate of imports by exports will decrease: from the current 46.8% down to 42% by late this year.

In spite of the attempts to diversify the sales markets, the current trends reveal a stable increase and intensification in the trade relations with the Eastern partners: Russia, Romania, Italy and Ukraine. The diminution of exports to the Russian Federation was not compensated by an increase in exports to other markets and economic directions. The current trend of export diminution to all economic partners of the Republic of Moldova is alarming. As a result, in 2006 the exports might drop by 3.5% as compared to 2005.

The imports are increasing continuously, mainly from the same geographical areas. Given the increase in the price for energy resources, mainly imported from Russia, the volume of imports from this country increased two-folds, and these commercial flows will reach 32% by late 2006.

**MONETARY POLICIES.** The negative trends of the economy and foreign trade increased the people's mistrust in the national currency and stirred a "currency fever" since May. This, in turn, diminished the deposits in MDL by 3% - something that hasn't occurred over the past few years except for October 2005.

The diminution in the currency revenues from the wine export to the Russian market will not impact the exchange rate, as it will be further supported by the remittances transferred into the Moldovan economy. In August-September the currency market turnover will increase because of the high currency offer, that will lead to the traditional, but insignificant appreciation of the MDL. However, we believe that by the end of the year the Moldovan leu will depreciate by 5% against the US dollar, reaching 13.4 MDL/USD.

**PUBLIC FINANCE.** Following a 55-percent increase in the budgetary revenues in 2005 we expect a stagnation in 2006, thus proving the depletion of the base for budgetary revenues increase. The main revenues of the state budget will amount at about 8.8 billion MDL, i.e. by 5% more than planned.

The cessation of the budgetary revenues growth diminishes widely the Government possibilities to make public investments and endangers the implementation of the law on remuneration of budgetary employees, approved in 2005.

Given the weak capacity of public bodies, the international financial institutions took a reserved and prudential approach towards Moldova. As a result, the Government will fail to attract into the state budget the 218 million MDL planned as loans. The first credits will not be granted earlier than at the beginning of 2007 and will be targeted at strictly determined investment projects of relatively small volume, much under the real needs of Moldova.

***At the end of the year the trade balance deficit will exceed 1.3 billion MDL***

***In 2006 the export volume will be by 3.5% lower than in 2005***

***The "currency fever" made people convert their MDL deposits into deposits in foreign currencies***

***Late this year the exchange rate will reach 13.4 MDL/USD***

***In 2006 there will be registered a stagnation in the increase in budgetary revenues, thus proving the depletion of the economic growth base***

***This wrong anti-inflation policy will not stop the price growth, which will reach 13.2% by the end of the year***

**Late this year the number of people working abroad will reach the share of 30% of the total labor force.**

**PRICES.** The prices keep going up in spite of the joint efforts of the Central Government and the National Bank management to control the monetary inflation. They fail to do so mainly because they use monetarist methods to fight an inflation of strict non-monetarist origins: imports and low efficiency of the national economy. Under these conditions, the current measures and decisions help stabilize the exchange rate, but they fail to settle the problem of rapid inflation, that might exceed 13% by the end of the year. The inflationary pressures will be worsened by the inevitable increases in the prices for gas, oil, electricity and, last but not least, the chronic inefficiency of most economic branches of this country.

**SOCIAL AREA.** The existing imbalances on the labor market caused an aberrant situation, when employment is not necessarily a guarantee against poverty. This situation exerts high emigrational pressures on able-bodied people, and reduces the motivation of those who are just entering the labor market. At the same time, the number of people who are planning a social emigration is growing, amounting at 30% of the able-bodied people by the end of the year.

The number of employed people diminishes in the context of a critical shortage of qualified labor force. This paradox is caused by the low competitiveness of the salaries paid in the national economy, employment instability and low efficiency of local enterprises. In spite of the economic growth, registered during the past 6 years, it is for the first time since 1999 when the poverty rate increased repeatedly, a risk which we warned about in the previous issues of the Economic Monitor.

**TRANSNISTRIA.** The Eastern region continues its role of seasonal "tension factor", according to its political mission. After the attempt to initially block and then dramatize the Moldo-Ukrainian agreement on securing the Eastern border, the break-away administration closed unilaterally several key enterprises, prejudicing thus a number of other enterprises of this region; as a consequence, the regional GDP increased by 1.1% only during the first half of 2006. Most of the economic units that form the basis of the regional economy got registered in the Republic of Moldova and have resumed their activity. During the first half of this year the regional budget was executed in proportion of 85%, which led to increased tax pressure, especially in industry.

## ● IN THIS ISSUE

Can the European integration be separated from the Euro-Atlantic integration? What lessons must Moldova learn from the "wine war"?

Has the big privatization started?

The impact of the wine industry over the exchange rate

External funding in terms of governing quality.

# POLITICS

This April – May we have observed some revival on the political arena of Chisinau. This trend will become more intense towards autumn, as a result of the preparatory works for the 2007 local elections. The political parties will be also affected by the election fever, thinned down by seasonal intermittent discords in the context of political cooperation lacking reciprocity. Meanwhile, the national economy will experience the first signs of a cyclic crisis, apparently provoked by the trade embargo imposed by Russia, the real reason being the stagnation of structural internal reforms and the low quality of the decision making process. The slow down of economic growth coincides with the effects of the export restrictions, but is not determined exclusively by this factor. The Government decisions are vegetative; they just react to the crises produced on a regular basis and all this due to the fact that state administration modernization process is carried out only on papers. Even though no big changes are loomed within the regulation process of Transnistrian conflict, today it is already evident that the first EU monitoring mission at the Moldovan - Ukrainian border has created on the regional level a new paradigm of Western involvement in the regulation of frozen conflicts. Except for Russia, no other stakeholder involved in the territory tolerates the current status quo of the secessionist regime through which Smirnov's administration became the official recipient of Russian financial transfers, - a fact that confirms once again the annexionist character of Putin's policy towards Moldova. Neither EU nor USA can admit the maintenance of the break-away regime even for the sake of diplomatic reverences towards Russia. The G8 summit from Sankt Petersburg revealed a new stage within the relationship between Russia and the West: from the stage of platonic love towards pragmatic realism of the integration of the Russian energy system into the world economy.

## The Internal Political Context

The past 3 months were marked by the searches for security options in common with the Western partners. The Chisinau authorities have actively participated in the meetings in Vilnius (3 May), Kiev (22-23 May), and Bucharest (4-6 June), striving a lot to place the RM problems on the agenda of the Western partners, as well as within the bilateral relations with the neighboring countries. The export bans imposed on wine and agricultural products by Russians, increase in gas price and separatists' open support explain, in this very moment, the reasons of the crisis between RM and Russia and do not leave any other options then energy resources diversification, economy modernization and an assumed partnership with the Western institutions (EU and NATO).

Just as Georgia, RM would like to compensate the loss of the Eastern markets with new opportunities on the European markets, but does not make sufficient efforts in this direction. A key problem refers to the current ownership structure within the viticulture sector, owned by Russian capitals, mainly oriented to massive imports of doubtful quality wines towards the Russian market, bustled by diverse political interests in disadvantageous conditions for Moldovan producers. The exports' crisis has induced significant losses among wines distributors that should be encouraged by the state to sell their properties to some western investors, obtaining thus access to new sales markets, new marketing and processing technologies. But, RM will not be able to achieve this goal without an efficient strategy of artificial barriers elimination and creation of an attractive image in 2-3 sectors, which have already been penetrated by foreign Western investments. Hence, the internal political stability is determined by the quick augmentation of Western investments, enhancement of the business environment quality and modernization of the distribution industry.

Another essential factor for the Moldovan internal stability is the security regional cooperation. After the failure to obtain unilateral security guarantees

**Meanwhile, the national economy will experience the first signs of a cyclic crisis, apparently provoked by the trade embargo imposed by Russia.**

**Except for Russia, no other stakeholder involved in the territory tolerates the current status quo of the secessionist regime through which Smirnov's administration became the official recipient of Russian financial transfers.**

**Hence, the internal political stability is determined by the quick augmentation of Western investments, enhancement of the business environment quality and modernization of the distribution industry.**

***There is a need not only for a simple change of its approach but also for efficient reinforcement and re-generation of security structures at national level.***

(2003), Chisinau should give up on the utopian projects and contribute by itself to the success of regional initiatives set up with Western assistance. Joining GUAM, COD and Black Sea Extended Region projects, the Chisinau officials start to realize that there is a need not only for a simple change of its approach but also for efficient reinforcement and re-generation of security structures at national level, search for non-patterned solutions and last but not least for new people for the Moldovan missions, needed in order to strengthen its presence within these initiatives. These missions are totally different from the ones with the help of which a party can win electors, but nevertheless the political stability and approximation of the Republic of Moldova to the Euro-Atlantic trajectory depend essentially on its security approach seriousness. The plenty of advisors who urge us to follow pro-EU trend as a "NEP"<sup>1</sup> are more harmful presently than the declared enemies of the Moldovan sovereignty.

For this very reason, the CPRM "staff reserve" is not enough for the modernization of the Moldovan state and external policy. The impossibility to join now the EU forces the Moldovan political elite and diplomacy to search for a new approach. Thus, it is recommended that RM challenges itself to join voluntarily certain EU thematic blocks, as the benefits of this kind of approach overpass a lot the eventual costs. In this context, several desirable options should be noted: the approximation of the Moldovan external policy to the EU external policy line, enforcement of the EU aquis on Home Affairs and Justice, i.e. regarding public order organization and Europeanization, monitoring of illegal migration and state border regime, acceleration of the reform initiated in the security sector and development of compatibilities at the level of local governments.

***On the external arena it is necessary to wholly assume the Euro-Atlantic project in the RM.***

On the external arena it is necessary to wholly assume the Euro-Atlantic project in the RM, i.e. through the efforts of Moldovan militaries in Iraq, enhancement of cooperation forms within the bilateral relations with Poland, Romania, Ukraine, Georgia and the Baltic Countries. This approach should give rise to serious debates in the public opinion regarding the goals and the outputs of Moldovan integration process: either with NATO or CIS, either towards decorative neutrality maintenance or assumption of an efficient commitment that will provide the needed security guarantees on the external arena. Finally, RM should give up on the "neutralist" ideological tone, while the civil community should operate with measurable figures and arguments regarding the costs of a neutrality that does not present any advantages to its sovereignty. The authorities should concern themselves with the establishment of a favorable opinion rather than with the management of some residual opinions within the nostalgic electorate.

On May 19, the North Atlantic Council approved the Actions Plan on the Partnership with RM, after its internal approval in March by the Supreme Security Council and in April by NATO political-military committee in "26+1" format<sup>2</sup>. RM hopes to strengthen its relationship with the Alliance under IPAP and to use its support in order to reinforce the internal reforms in the security sector. Except for Belarus, we note that RM is among the last post-soviet countries that approved individual plans (IPAP) with the North Atlantic Alliance (much later than Georgia, Azerbaijan, Armenia and Kazakhstan, as long as NATO relations with Ukraine and Russia are framed within a special format of dialogue and cooperation (NATO-Ukraine and NATO-Russia Councils). Since June 2005, Vladimir Voronin has requested a special plan to intensify RM-NATO dialogue, pointing out that this very step does not mean "giving up on neutrality" or accession to NATO, unlike Ukraine and Georgia that want to officially join this structure. Apparently, Moldovan officials treat IPAP in a tandem with RM-EU Actions Plan, expressing the opinion that country's integration into the EU can be accelerated through the support of NATO, but in the same time "joining NATO is not a compulsory condition for the pan-European integration".

<sup>1</sup> NEP – "new economic policy", adopted in 1920 by the Communist Party (b) of Russia as a result of internal economic difficulties when bolsheviks have admitted the "co-existence" of diverse ownership forms in parallel with the proletariat dictatorship and police stations.

<sup>2</sup> Chisinau, May 22 (INFOTAG)

There are just a few officials who risk supporting openly an accelerated NATO integration, this is because the current head of the state, President Voronin, is still allergic to an eventual project of institutionalized integration of RM into NATO Alliance. Though few officials question the need to search for some external security guarantees, in reality they have delayed or even ambiguous reactions. They just do not see the logic and inseparable chain between the accession to NATO and integration into the EU, and when they even admit that there are some links, they appear to be overwhelmed by the span of risks this step could provoke. The only exception seems to be the civil leadership of the National Defense Ministry that pronounced itself publicly in favor of a future step to the benefit of PAP-DIB<sup>3</sup>. Article 11 of the Constitution is an anti-NATO reason, but the same article is also invoked by the ones who regard the current RM neutrality as “background-free form”, which holds back the external guarantees without protecting the state’s sovereignty from the Transnistria separatism incited and financed by the Russian Federation. Unlike Ukraine and Georgia, which have established their Euro-Atlantic courses through laws adopted by Parliament, which led in the first case to the establishment of the Ukraine – NATO Council, and in the second case – to an intensified post-IPAP dialogue framework (seen as an advanced cooperation stage with Georgia), RM encounters opposition even with respect to the proposed project.

***Unlike Ukraine and Georgia, which have established their Euro-Atlantic courses through laws adopted by Parliament, RM encounters opposition even with respect to the proposed project.***

Yet, by canceling from the very beginning any possibility to join NATO, Chisinau narrows voluntarily its tactical exercise field. Chisinau needs a new wave to impel the internal reform and effective security guarantees. No public official of RM could deny this. Nevertheless, a lot of CPRM-related politicians sincerely believe that these security guarantees could be granted to the RM for free, unconditioned and without efficiently assumed costs, just as the grants offered by foreign donors. From this point of view, there is a bigger and bigger differentiation between the “successful” integration paradigm followed by the Baltic countries and the inherent limitations of the integration model followed by the Chisinau authorities: accession to EU – yes, accession to NATO – never!<sup>4</sup> These awkward “pirouettes” on the tactical level are watched with a lot of skepticism by Western partners of Moldova; they are treated as “superficial approaches lacking real commitment”, being compared frequently in Brussels not to the Baltic option but to Magrebian countries volatility – countries which wish to obtain EU economic and politic support without sharing an European identity-cultural project and without demanding any integration into the security structures. This is actually the big trial rock for the Chisinau political elite for the future period. The top officials of Chisinau delude themselves when affirming that issue of EU accession does not correlate to NATO accession issue, although it is expected that the individual Actions Plan with NATO (IPAP) will contribute to RM armed forces modernization according NATO standards. These ambiguities have created a visible dissonance between the appeals of the civil society and the political class affiliated to the state power.

***There is a bigger and bigger differentiation between the “successful” integration paradigm followed by the Baltic countries and the inherent limitations of the integration model followed by the Chisinau authorities: accession to EU – yes, accession to NATO – never!***

While the Kiev political elites have committed themselves to join NATO institutionally, the Chisinau officials remain undecided regarding the opportunity of this effort. About 46% of respondents told in late 2005 that “RM should follow the example of those 10 states which joined EU by joining firstly NATO”, and 37% did not have a clear opinion (Gallup, November 2005). Even when analyzing superficially the attitudes expressed by Moldovan and Ukrainian citizens, there can be observed a strong recoil of “against accession” in Kiev<sup>5</sup> and a “pro-accession” trend in RM among ordinary people. A more recent survey<sup>6</sup> reveals the existence of a number of respondents (about 30-35%) with clear “pro- NATO integration” options, ready to support un-conditionally

***While the Kiev political elites have committed themselves to join NATO institutionally, the Chisinau officials remain undecided regarding the opportunity of this effort.***

3 PAP-DIB (Partnership Action Plan for Defense Institutions Building) – a form of institutional conditionalities, similar to the EU Neighborhood Policy, launched by NATO.

4 Infotag, July 11, 2006, President Voronin has rebuffed the possibility of Moldova to join NATO, pointing out that Moldovan authorities pronounce themselves for minimizing and liquidating any military presence in Moldova to ensure the neutral status of the country as security strategic pillar, reasoning that the „neutral status” of Moldova is established by the Constitution and it can be changed only through a referendum.

5 The recent surveys show that only 15-20% of Ukrainians support categorically accession to NATO, as compared to 55-60% which are categorically against this trend.

6 Opinion Poll , IPP, April 2006

this trend, as against another conservative segment of the population (estimated at approximately 20-25%, who do not see any use in this accession) and a third segment of the "non-decided" (15-25% - who do not hide the fact that they lack the necessary information or just are confused regarding the optimal trend which would ensure national security to RM).

It can be assumed that if Ukraine is included on NATO agenda for integration-related issued at the Summit of October 2006 in Riga, Chisinau will also change its political behavior. It seems that the only factor that could hinder this process is the failure to settle the "clientele-related dispute" between the elites from Kiev and Donetsk, that could lead to the early elections in autumn and/or overtake of the power by the pro-Russian political group lead by Ianucovici/Ahmetov oligarchy. The eruption of anti-NATO protests in Feodosia (Crimea) could block Ukraine's plans to receive already in 2006 the official invitation to join NATO, delaying thus the objective process of the Euro-Atlantic extension. In this situation, it is expected that NATO integration process will branch out to the Pontic line of the South Caucasus and the Black Sea, thus outlining some very attractive tactical options for the Republic of Moldova, as well.

***The regional trend describes the completion of a regional economic growth cycle.***

***Corruption is traditionally, a powerful accusation against the most inspired pro-EU measures of the RM authorities.***

The regional trend describes the completion of a regional economic growth cycle. Unfortunately, RM did not succeed to obtain a lot from this relative growth, and the additional resources accumulated to the state budget have been wasted during the past years, frequently for irresponsible and populist goals. Though the privatization and industrial production have decreased, the Gross Domestic Product (GDP) increased by 7.3% in 2004, by 6.5% in 2005 and it is expected that the GDP growth rate will reach 5.5% in 2006, simultaneously with consumption rate growth and national currency appreciation. Only in early 2006 IMF has announced that it would resume the external financing for RM, thus helping Moldova in its efforts to restructure or annul the debts owed to the Paris Club. The fiscal debt score of the Moldovan government is by 0.1 points better this year, but comparatively lower than the regional average. In this context "the vertical power" established by the CPRM is a hindrance to the market reforms and individual initiatives development. Corruption is traditionally, a powerful accusation against the most inspired pro-EU measures of the RM authorities. The EU and USA officials have, either insistently or discreetly, attracted many times, especially during the past months, the attention of the Chisinau officials to the low efficiency of anti-corruption national programs, i.e. the state bodies authorized to fight against economic crimes and abuses. Even the speech of the former US Ambassador, Heather Hodges at the end of her mandate in RM points out the disappointments she had in RM regarding the activity of the institutions intended to control and fight against corruption. Unfortunately, the RM access to one of the most generous non-reimbursable US programs for external assistance (Millennium Challenge Account) is presently blocked by the lack of efficiency and bureaucracy of the state administrative structures.

***The Index of Economic Freedom, published by the Heritage Foundation, is rather low in 2006 as well.***

The Index of Economic Freedom, published by the Heritage Foundation, is rather low in 2006 as well. This index reaches the rate of 3.10, and represents a 0.01 percentage deviation as compared to 2005, which decreases sensibly the "self-pride" of Moldovan authorities regarding the economic attractiveness of the country. This situation is explained both through the inertia of international ratings and drowsiness of local changes. As for corruption, the formulas give up diplomatic reserves, warning on the generalized character of the "chain effects", "decrease in the efficiency and legitimacy of institutions and delay in economic development". If the European integration can be seen as substitute for politics, it can be assessed only depending on the effective political actions, in other words – on the capacity to implement policies in the place where group interest and improvisation were promoted instead of strategies and goals. Resistance to changes, bureaucracy and corruption in RM is well-known – a fact that actually discourages foreign investors and decreases the ranking of Moldova in international ratings.

Many of these obstacles derive from individual indecisions and administrative gaucheries. Only on the June 8, 2006 the Parliament passed a law on visas suspension for EU, US, Canadian, Swiss, and Japanese citizens, but this regime will be enter into force on 1.01.07. It should be mentioned that Ukraine suspended the visa regime for EU citizens over 16 months ago, which allowed it to initiate discussions regarding a simpler visa regime for its citizens. As for Chisinau, the decision to suspend visas for EU citizens raised awkward dissatisfactions within the Government, because visas were bringing annually about 50 million USD into the state budget. But no one has calculated the losses for RM image as a result of feeble-mindedness actions carried out by certain "consular staff" of the Ministry of Foreign Affairs and European Integration. At the same time, no one has yet calculated the prejudices for maintaining the visa-free regime with the Russian Federation and its effects on the "sustainability" of Smirnov's regime in Tiraspol.

The EU-RM Actions Plan is implemented with big difficulties as well, thus Chisinau losses precious credibility points. The relations with EU are characterized by a general wave of "tiredness" in the majority of EU member states, and by its effects at the EU political level. The Chisinau authorities fail to enhance their trustworthiness within the bilateral relation with the most important EU countries, and this is not because of the slow course of internal reforms, Chisinau just cannot build an "irresistible" integration offer by spreading the PEV differentiation principle, as most of planned actions have remained just good intentions. The Central Government is criticized by the head of the state, but this criticism only raises regrets, without inciting them to real corrective actions. The quick alignment to the President's "single course" plays, in these conditions, the role of a "Papal Bull" against any serious crime committed during the daily service. Obviously, the Moldovan authorities make efforts to popularize the EU-RM actions, but the management of several branch strategies is sabotaged by the lack of some staff "dedicated" to the objectives of this process and by the ambiguities of morose nomenclature reluctant to the idea of country's "Europeanization". The lack of qualified public servants explains and diminishes the coherence of administrative and economic reforms, exuberantly dependent on the "omnipotence and omniscience myth", which is enjoyed by a single person in this state.

The reform of central public administration and the decentralization process are steps in the right direction, but it is very unlikely that the current government will give up voluntarily the symbols and the tools of its power while the opposition is inexistent and weak, and the West is apparently satisfied with the internal political stability. Nevertheless, the relationship between the current power and the opposition are still tensioned. The law suits filed against some leaders of "Moldova Noastra" Alliance are still the headlines of the local press, the opposition having a limited access to mass-media means, which are under the direct censorship of the CPRM. Opposition weaknesses don't refer only to the "unjust treatment" by the political power, as some people pretend, but also to a surprising lack of socially attractive ideas, as would say others. Due to lack of political objectives based on an immediate public support, the issues that could anchor the political elite to a social agenda under extreme pressure in RM, the European integration, as a project under development and as the assumed accession to NATO, has become the main goal of the public policy. Limiting the Parliament's capacities to the function of "issuing new laws" without effectively following up on their enforcement, the dubious quality of some recent Government decisions or the use by some ministers of their competence to issue autonomous decisions and to administrate their reserve funds in a discretionary way, leave a lot of room for bureaucratic anarchy, which is the main reason for low credibility of the Government in the eyes of the development partners of the Republic of Moldova: UNDP, SIDA, DFID, and IFM, not mentioning the citizens. The appeal to urgent ordnances or simple ordnances are viewed as the major cause of legislative instability, and

***But no one has calculated the losses for RM image as a result of feeble-mindedness actions carried out by certain "consular staff" of the Ministry of Foreign Affairs and European Integration.***

---

*The relationship between the current power and the opposition are still tensioned*

---

***The EU-RM Actions Plan is implemented with big difficulties as well, thus Chisinau losses precious credibility points.***

***The quick alignment to the President's "single course" plays, in these conditions, the role of a "Papal Bull" against any serious crime committed during the daily service. Obviously.***

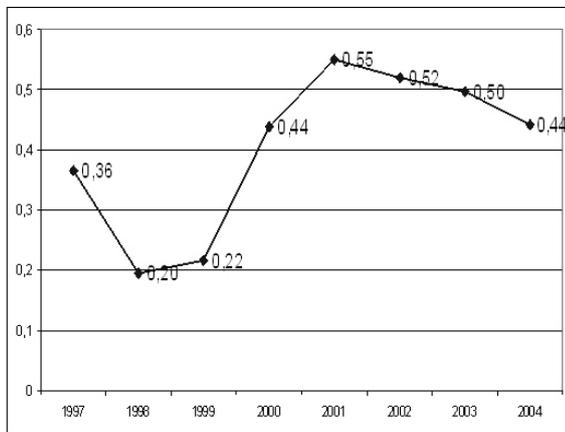
***The reform of central public administration and the decentralization process are steps in the right direction, but it is very unlikely that the current government will give up voluntarily the symbols and the tools of its power while the opposition is inexistent and weak.***

the absence of transparency and public consultancy are also generated by the voluntarily and non-transparent policies in the Government functioning.

Many conditions formulated by the opposition in April 2005 have remained at the level of "frozen project ideas", and the adopted or planned laws did not produce the expected changes. Thus, neither the Courts of Accounts, nor the Central Electoral Commission and nor the Public Television became more militant or more reasonable in relation to the public interest after a year of political and legislative efforts, external encouragements and diplomatic counseling. Both the Security and Intelligence Service (SIS) and the Ministry of Home Affairs have an extremely politicized agenda. Apparently, both institutions are basically over-financed and, at the same time, their contribution to the settlement of RM security problems is extremely modest, if any at all. An independent study<sup>7</sup>, launched in February 2006 submits in an eloquent way and with a lot of details the existent contrasts between the financing of these "force" institutions as compared to the main democracy

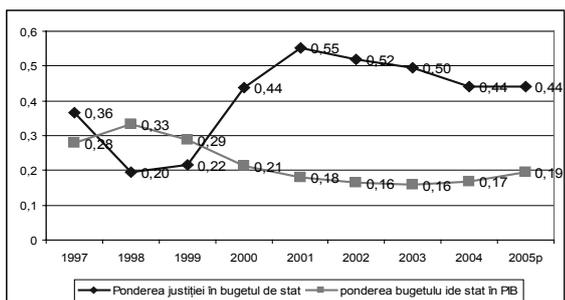
institutions: independent justice administration, free press and local government autonomy. As for the justice case, this system is funded disproportionately to the role and functions attributed to it by law and to the reforms launched during the last decade in this sector as a political option of the country. The variation of the ratio of state budget expenditures to GDP shows the actual interference of the state in the society's life. The higher the indicator, the larger are society's resources consumed by the state and respectively the higher is the share of utilities provided by the state in the total volume of utilities provided to the society. It is very interesting to analyze the change of the ratio of expenditures for justice to the state budget as compared to the ratio of the state budget expenditures to GDP. In the case of local governments, due to chronic lack of financial resources, the local authorities have been transformed into central government's appendixes and/or certain local oligarchy groups.

**Figure 1. The ratio of expenditures for justice to state budget (%)**



Source: 1997-2004 State Budget Law and IDIS calculation

**Figure 2. Correlation of expenditures for justice with state budget expenditures**



Source: 1997-2004 State Budget Law and our own calculations

The share of expenditures for justice ranged from 0.2% to 0.55% from the total of state budget expenditures. The draft state budget development process is based on a number of negotiations between ministries and the Ministry of Finance, with Parliament and Government involvement. As a result of these negotiations, depending on the Government policy priorities, each activity department receives the financing for justice, which can be interpreted as follows: the share of expenditures for justice indicates indirectly the importance of justice for the Government.

The opposition feels humiliated, firstly, because of effective lack of capacity to oppose to this regime, reinstalled after 2005, either "as a result of a collusion"<sup>8</sup>, or "as a result of some implacable circumstances" without having sufficient force to offer its own alternative, at least, before settling its complicated internal struggles. The partial local elections of 2005 in Chisinau have not helped the opposition to free itself from the "defeated" complex and even if as a result of some new election tours the CPRM candidates have not won either, the

<sup>7</sup> Justice Financing in RM, September 2005 – January 2006, IDIS/CSPJ

<sup>8</sup> April 4, www.azi.md, PSL: „Democracy in Moldova is in danger”

final result of those 4 successive elections have only extended both the public confusion and CPRM trend to co-opt the municipal administration authorities to serve its own electoral interests. It is very difficult to explain the legal reasons for which the Central Electoral Commission did not rush to repeat the local partial elections during the first half of 2006, though the Electoral Code stipulates expressively the obligation to organize new elections if the general mayor position is vacant. It is true, during December – January there was carried out a public survey, but its results cannot compensate or substitute the obligations of the electoral legislation to have “an elected mayor”. The failures of the “little elections” of July - November 2005 have set the leaders of political parties of RM wondering. Many have understood correctly that the local election picture undermines the position of political parties, and implicitly of the Government power. Recently, the idea to modify the Electoral Code, so as for mayors to be elected from counselors has become a popular refrain among certain political forces, even if such a step would be criticized under all aspects. Russia also intends to abolish mayors’ direct election, just as it has proceeded in 2005 with the governors’ direct elections<sup>9</sup>. It would be very difficult to believe that such a model would be benefic for RM - a country with European ambitions. The failure to adjust the national law to the European Charter stipulations on local autonomy requires not only a legislative effort but also a competent policy to accelerate the state decentralization.

***The partial local elections of 2005 in Chisinau have not helped the opposition to free itself from the “defeated” complex.***

## ● FORECASTS FOR 2006

It is expected that the monotone political life of the past 1,5 years will be challenged this autumn by a multitude of relatively new political groups, recently set up parties and diverse adrift fractions, decided to re-launch themselves into the big politics using the future local elections as a lifebelt (2007). Nevertheless, the competition for obtaining the political control over Chisinau municipality will mean more than just a new series of administrative elections. The recent amendments to the administrative structure of Chisinau municipality (5 mayors instead of 5 praetors), and the decrease of elections validity threshold actually proves a concern for the electoral absenteeism. On the background of a “kulturkampf”, which was not completed yet, serious divergences will loom between the governing party (CPRM) and the leaders of the “constructive opposition”. The first autumn months will be critical for establishment of a new liberal pole, derived from withered trunk of “Moldova Noastra” Alliance, as well for the enhancement of the democratic trend, based on a centrist orientation. These political re-grouping movements lack the vitality of some charismatic leaders capable to unite the opposition at national

level. Moreover, the media resources of these forces are insignificant as compared to their direct competitors. Their only advantage is that unlike the authorities, these groups are less affected by government abrading and are less hesitant.

The big deficiencies of RM economy will loom only in autumn 2006. Unlike the previous years when the remittances ensured an high increase rate on the account of excises collection, the ceiling of the indirect extensive increase was hit in 2006. The attraction of foreign Western capitals is still at the stage of good intentions, and unlike Ukraine, RM is not regarded as a functional market economy - a fact that represents a serious default of image and attractiveness. Far from being a simple courtesy phrase, the “functional market economy” term has to be a means for achieving other political goals: citizens’ prosperity and freedom, national or individual security. The effects of export ban to Russia should be used with ability to diversify the range of products to be exported to EU and to restructure the ownership structure of the economy.

<sup>9</sup> “The Moscow Times” reported on June 1 (see “RFE/RL News line,” April 6 and May 31, 2006).

## External Politics

***During the last months, the Russian pressures have intensified a lot in a galloping rate in the ex-soviet space.***

During the last months, the Russian pressures have intensified a lot in a galloping rate in the ex-soviet space. Today, Russia is ready to sacrifice even its privileged relations with Lukašenko for the sake of its project to regain the imperial force through abusive use of energy resources (Gasprom). This risky policy is alarming the West by touching the sore points in Brussels, Washington, and in a range of Central Europe capital cities, which perceive these actions as an evident dystopia of the Euro-Atlantic security system that should protect them from the Russian neo-imperialist policies. These regional frustrations will bring up intense debates within EU and NATO Alliance regarding the goal and the means through which the members of these two interrelated organizations could safeguard themselves from the pressure of the big Eastern neighbor. The key factor referring to the contradictions emergent on Russia subject is placed again in Kiev. Ukraine's detachment from the bad habit of political "small compromises" sanctions today the political class of Kiev and makes it radical. Russia cannot be attractive anymore when compared to its immediate neighbors, a fact that strengthens their frustration related to the Russian state geo-policy, searching to ensure their sovereignty within the Western alliances. Russians will hardly accept this orientation within the space they regard as "vital" for their geo-political interests, and will try to maintain their hegemony through the distribution networks of hydrocarbon, gas and direct political influence.

The spectacular overthrow of the political life from Kiev strengthens the feeling of Russia's "second return"<sup>10</sup> into the Ukrainian political process. But, Russian factor's central bid in political life from Kiev is not limited to the general identity-related debates: East-West, but follows pragmatically to take the control over energy distribution networks, "joint" management of gas pipes which pass through RM and control over the strategic Ukrainian enterprises. The conflict in Rada will probably lead to early elections. It would had not occurred if President Iușcenco would have been more decided or if would not have been surrounded by a suite, which profited from the orange coalition and have actually denied it, without caring a bit about the principles launched by the revolution from 2004. The second factor that determined the political crisis in post-electoral Ukraine is linked to the comparative advantage of Party of Regions patterned according to "Putin's vertical authority"<sup>11</sup>, animated by a brutal appetite for power and a campaign exacerbated by the unlimited access to economic and media resources. Ukraine's officials (Boris Tarasiuc) have explained that the deep crisis occurred after the elections from Ukraine, and the scenario according to which the main orange coalition ally "has migrated voluntarily" towards the Party of Regions were Kremlin's opera from the very start, which did all its possible for this thing to coincide with the G8 Summit. Western analysts regard this situation as an extremely difficult for the western interests in Ukraine, which can be described as follows:

- The risk of a big civil conflict between the 2 electoral Ukraines, marked by visible borders of legitimacy and ambiguous enforcement of the Constitution;
- The risk of an oppressive and non-democratic regime installment via free elections. This danger comes as a result of Party of Regions' anti-western and unreformed behavior, which continue to deny the legitimacy of 2004 elections and implicitly of President Iushcenco;
- The risk of the revival of the Russian factor direct influence in the Ukrainian politics, which would pass through a profoundly negative message within the extended space of the Black Sea, i.e. through the resistance of the "anti-orange" coalition leaders (Ianucovici and Moroz) to the Euro-Atlantic integration course, announce previously in Kiev;

<sup>10</sup> ANALYSIS & COMMENTARY: By James Sherr CSRC, UK Defense Academy, United Kingdom  
Published by the Action Ukraine Report (AUR) #733, Article 1 Washington, D.C., Sunday, 16 July 2006

<sup>11</sup> Yulia Mostovaya, 'Curtain Drops on the Maidan Stage', Week Mirror', No 26 (605), 8-14 July 2006

- The risk to diminish the benefic effect of the regional strategic partnership in regards to Georgia, Azerbaijan and Moldova, so as the regional initiatives –Community of Democratic Choice and GUAM – could loose their vitality and evolution direction (affecting thus the current control regime over Moldovan – Ukrainian border, a fact which would also cancel EU monitoring mission in the territory);
- Eminent multiplication of risks related to energy security and diversification of distribution sources, which mainly depend on the Ukrainian ownership of gas and oil piping passing through the territory of Ukraine<sup>12</sup>;

For RM these evolutions could have deep implications. First of all, within the eventual control taking over the executive power from Kiev, the “anti-orange” leaders could suspend immediately and without any regrets the commitments assumed previously by President Iushchenko, which would give a negative signal to the western support (EU), as well as to the population from the region. Secondly, the regional solidarity copied by EU/NATO to the Eastern-Pontic area would loose the coherence of the original project. Since May, the Kremlin started to support openly the Tiraspol’s actions for preparing a referendum in the region, scheduled for September 17, though which the separatist regime would like to manufacture itself a new legality of formal separation from the Republic of Moldova, according to the Montenegro and Kosovo pattern.

In discord with USA and EU statements, Russia would like to use the last convulsions of the former federal Yugoslavian state with the declared goal to extend its sovereignty upon some enclaves “cultivated” and “nourished” after the USSR disband to states which it considers to be “not loyal”: Georgia and Moldova, Ukraine. This trend perfectly matches with the new paradigm of the Russian external politics, which does not whisper any more about its annexionist plans, but moves already to open actions of contesting the legitimacy of independent states’ creation: Georgia, Moldova, Ukraine, because of their virtual orientation to the West. This trend is encouraged also by the timidity of some Western institutions regarding Kremlin’s claims as to a right to be the “big global power”, which does not promise any award to separatist actions but also does not frozen the games initiated recently by Russia.

The so-called “Kosovo model” has been invoked insistently during the past years as a precedent for settling the conflicts from the ex-soviet area. Since March 2005, the Russian diplomacy, saying ditto to President Putin, has launched a large media campaign to test the international reactions to an eventual unilateral recognition of the ex-soviet space enclaves by Russia. There have followed several categorical statements from EU (having the role to moderate the Russian initiatives), OSCE and USA, which have opposed themselves categorically to such a scenario. Apparently, these messages had a benefic effect. Nobody will accept neither the re-plebiscite on Transnistrian “sovereignty” nor the official inclusion of the break-away enclave into the Russian Federation, as the ultimate role of these actions is to hinder the UE-NATO accession to the ex-soviet area and for Russia to receive various material or political “compensations”, in the case when this enclave’s destiny would be sealed through a political effort supported by Ukraine and the West. Nevertheless, the Russian media factor has increased its influence upon political life of RM. This influence can embezzle public opinion, in conditions when Government’s policies remain at the level of warm cabin phraseology, failing to find solutions for people’s main concerns: lack of working places, corruption.

During the past months diverse signal were launched indicating the possibility of

<sup>12</sup> In spite of repeated insurances sent to the West from President Iushchenko and Prime-minister Yekhanurov that the gas and oil piping will remain in Ukraine’s ownership, on July 13, 2006, the President of ‘Naftohaz Ukrainiyi’, Oleksandr Bolkisev, said that in conditions when Moscow would price the gas at 95 USD for 1,000 metric cubes, Ukraine would be able to transfer its networks to a joint management team. (TV5, July 13, cited in SWB).

***The “anti-orange” leaders could suspend immediately and without any regrets the commitments assumed previously by President Iushchenko.***

***the regional solidarity copied by EU/NATO to the Eastern-Pontic area would loose the coherence of the original project.***

***The so-called “Kosovo model” has been invoked insistently during the past years as a precedent for settling the conflicts from the ex-soviet area.***

***Nobody will accept neither the re-plebiscite on Transnistrian “sovereignty” nor the official inclusion of the break-away enclave into the Russian Federation.***

**The official ban of Moldovan exports was recently complemented by the declarations of Russian officials and an ostentatious campaign of Moldovan wines destruction in several Russian cities.**

**Under these conditions, the Republic of Moldova resistance towards Russia's accession to the WTO is very predictable.**

---

*UCTE was established 50 years ago and aims at supporting the cooperation between the energy transportation system operators so as to ensure European energy security and development of energetic systems interconnection. UCTE systems supply electrical energy for about 450 million persons.*

---

**Thus, we assist to a "Kaliningradization" of the break-away region.**

**Thus, we can conclude that Russia tries to avoid a frontal contradiction with the position of the West in this matter (the eventual unilateral recognition of separatist enclaves), counting exclusively on its energy resources as a natural "adhesive" to its geo-political projects.**

some attempts to destabilize the situation in RM. Starting with the anti-blocking media campaign launched in March and up till the generalized psychosis in May-June regarding local currency depreciation, or even its decrease of its nominal value as a result of exports interdiction to Russia; all these rumors suggest a multi-faze diversion plan. The official ban of Moldovan exports was recently complemented by the declarations of Russian officials and an ostentatious campaign of Moldovan wines destruction in several Russian cities. These actions of vandalizing the "made in Moldova" products' image have been presented to the entire world, although up till the present moment the federal bodies that ordered the destruction of wines could not submit any evidence to prove the low quality of Moldovan wines. Meanwhile, the big distribution networks of Russia import massive lots of Russian wines through Bulgaria, exporting them immediately under other brands, in spite of the fact that the same wines exported directly from RM are presently destroyed openly by the authorities.

Under these conditions, the Republic of Moldova resistance towards Russia's accession to the WTO is very predictable. Nevertheless, when Georgia tries to approach openly this crucial issue, Chisinau is blocked by lack of character or by the ambiguities of its "matrimonial" relationship with diverse circles of Russian influence. The political shock within the bilateral Moldo-Russian trade relation would not be completed without mentioning the doubling of the price for the gas delivered to RM since the July 1 to 160 USD/m<sup>3</sup> (record cost within CIS) and the official meeting of Smirnov in Moscow with ostentatious – presidential honors at the beginning of May<sup>13</sup>. Meanwhile, the Transnistrian break-away enclave is helped to avoid an inevitable collapse by its financial connection to the Russian federal government resources. Immediately, the break-away regime's leaders have declared in Suhumi, the capital city of Abkhazian secessionist enclave, about their intention to establish the Community of Democracy and Freed Nations, as well as establishment of some mixed military troops, which will substitute, if needed, the Russian pacifiers' troops that are not welcomed any more in Moldova and Georgia.

This message was made in less than one month after the GUAM Summit, thus trying to ridicule the cooperation projects of the 4 GUAM states, once again proving the manipulation power and these enclaves' direct dependence on Moscow. Thus, we assist to a "Kaliningradization" of the break-away region, provided that Chisinau postpones again and again the enforcement of some leverages at its disposal, such as: withdraw the license for the military airport of Tiraspol, not insist on a sever control of the passports of the Transnistrian population when passing the border, rigorous control of all militaries that enter or leave the region (conscripted employees or pacifiers that do not have yet mandates from RM), supervise the current flows between diverse commercial banks from the region with other foreign banks (especially from the Russian Federation), rigorous inspection of any enterprises suspected of arms and munitions manufacturing, adjust the property owners of that region, which are not registered in the Republic of Moldova, to the Moldovan legislation, etc. It is worth mentioning that in late May the Russian President pronounced himself reluctantly in favor of territorial integrity of some CIS states, pointing out in his presentation on the external policy, that only in this way "the international community can avoid the chaos that would appear if states' sovereignty is not respected any more", but this message is not conclusive with Russia's "real neighboring" policy.

Thus, we can conclude that Russia tries to avoid a frontal contradiction with the position of the West in this matter (the eventual unilateral recognition of separatist enclaves), counting exclusively on its energy resources as a natural "adhesive" to its geo-political projects to rule over EU and its close neighbors though galloping prices for gas, petrol and electricity. Announcing its course towards the establishment of a world energetic super-power, Russia has fully

---

<sup>13</sup> It is worth mentioning that in spite of President Voronin's insistences to meet in a private meeting with his counterpart, Putin, the Kremlin declined categorically any possibility for the nearest time.

used the EU dependence on cheap gas which it can supply, thus trying to take its revenge for the losses incurred during the past decade. But the initiation of the new Russian strategy coincided with the adverse reaction of the states, which play presently the role of an interface between the EU and Russia and which felt themselves seriously affected by the new geo-political plans of Moscow.

The breakdowns occurred in energy supply system have determined EU not to hurry with this issue. EU has requested Russia (1) to ratify the Energetic Charter and (2) the permission to invest in energy exploring and transition sector, presently administrated by Gasprom. The requests expressed during the EU – Russia Cooperation Council have been blocked by Moscow's categorical refuse to accept more foreign players on its internal market; nevertheless they have been left on the stand-by list of unsettled strategic issues. Playing tough in regards to EU, through the "secondary effects" Putin's regime generates today, Russia becomes vulnerable in several chapters: worsening of the human rights issues, aggressive use of the secret services against the business community, continuation of Caucuses wars, and last but not least, augmentation of the expenditures for armament up till rates of the former USSR. On the background of these visible deviations from the "logics" of the partnership Russia wishes to have with the West, especially with USA, during the last months of 2006 Russia was the target of some intense external critics because "it does not deserve to be among the members of the G8 Club (or better said "G7+1") due to the worsening of the democratic climate<sup>14</sup>. It is worth mentioning especially the reactions of the US officials, who qualified Russia's actions as "unjust and non-proportional"<sup>15</sup>.

The conflict with Ukraine and cessation of gas supply in winter 2006 have increased EU concern even more, especially of Central Europeans (thus stimulating the development of an European Strategy for Energy Supply), who were extremely disturbed by the effects of the Russian politics. The US Vice-President, Richard Cheney accused Russia of using the energy resources for purposes of blackmail<sup>16</sup>. Moscow tries to put to silence its critics through an aggressive diplomacy using its special relations with Germany, Italy and France so as to diminish the EU powerful positions, trying to block its neighbors through economic pressures and even through direct interferences. The Chisinau position is ambivalent here. On one hand, Chisinau actively participates in diverse regional meetings, especially GUAM, signs urged statements and talks about the "need to recognize the culpability of some parties involved in the conflict", but on the other hand, it tries to maintain good relations with the ones "who could commit a big mistake at the moment".

Unlike Georgia, which uses the economic and political crisis with Russia in order to promote its integrity and sovereignty ideas, the RM officials seem to remain at the "late regrets" stage and appear to be unable to change essentially the ownership structure of wineries, previously acquired by the Russian capital. Georgia is an example also due to the fact that it succeeded to obtain a Special Agreement for its wines export to the EU<sup>17</sup>, unlike the competent Moldovan authorities, which only complain continuously about the lack of ideas. At the regional level, Georgia is visibly favored by an innovative and multi-dimensional diplomacy. However, the activation of the cooperation process under GUAM strengthens not only a common anti-Moscow position, as the Russian press states, but also helps to create a regional bridge of joint actions and interactions between the West and Ukraine, Moldova, Georgia and Azerbaijan, which obtain thus possibilities to get out of the Russian gravitational trajectory.

14 Interview with the expert from Political Conjuncture Center, Mrs. Galina Saalego.

15 РИА "Новости", April 5, USA State Secretary, Condolisa Rise, has regretted that certain countries use their energy potential for political goals, in the detriment of international system stability.

16 RFE/RL News line," May 4, 2006

17 Civil Georgia, June 13, 2006

***The conflict with Ukraine and cessation of gas supply in winter 2006 have increased EU concern even more.***

***Georgia is an example also due to the fact that it succeeded to obtain a Special Agreement for its wines export to the EU.***

On May 4, 2006, President Voronin again requested EU and USA to help re-establish the territorial integrity of the Republic of Moldova, in conditions when certain countries support the enclave auto-isolation and secessionism<sup>18</sup>. He used as occasion for this request the Vilnius Conference, which was attended by the state leaders from Poland, Ukraine, Moldova, Romania, Bulgaria, the all 3 Baltic countries, Georgia and the US Vice-President, Richard Cheney. Confirming a tradition launched in Lithuania in 1997, through the establishment of "the Group of 10", the 2006 Conference affirms a process pleading for complete integration of European South-East (Ukraine, Moldova, Georgia, and Azerbaijan) through sustainable institutions and links. Contrary to the general pessimism regarding PEW and other new integration waves, the USA supported the effort of these countries in emancipating themselves out of Russia's guardianship. And it is not unusual that Russia did not like at all the Vilnius event, especially the speech of USA emissary<sup>19</sup>, which was qualified as "non-official and non-objective".

At the GUAM summit in Kiev the presidency was passed to Ukraine and the organization's name was changed into an organization "for democracy and economic development". The energetic crisis started by Russians dominated the agenda of GUAM summit in Kiev. Ukraine and Moldova has requested the Union for the Coordination of Transmission of Electricity (UCTE), at the end of May, to join their energetic systems to UCTE synchronized zone as a single regulation block. It is worth mentioning that these requests were supported unconditionally by all similar system operators of Romania, Poland, Slovakia, Hungary, but also woke up Russia's frenzied reaction. RAO EES president, A.Ciubais stated during the meeting of CIS Electro-energetic Council that the synchronization of CIS and Europe energetic systems and the synchronization of Ukraine and Moldova energy systems excluded each other and if the "small project" is implemented" (that is, Ukrainian and Moldovan energy systems join the European one), Ukraine and Moldova must accept a regime isolated from Russia and Belarus, which would lead to serious consequences for Russia and Belarus, as well as for Latvia, Lithuania, Estonia, Georgia, and Azerbaijan.

***The declaration of those 4 states stipulates explicitly that "it is the duty of any state not to involve itself in other country's affairs, not to make military, political or economic pressures".***

The issue of "frozen" conflicts was discussed intensely at the official level, adopting even a declaration on the regulation of conflicts on the territory of GUAM states which "can be carried out only on the basis of respect for territorial integrity and sovereignty and in-destructibility of internationally recognized borders<sup>20</sup>". The declaration of those 4 states stipulates explicitly that "it is the duty of any state not to involve itself in other country's affairs, not to make military, political or economic pressures". At the same GUAM Summit there was announced the establishment of some special military units with diverse "pacifying functions". According to the press, the announcement regarding the establishment of these pacifying troops will be discussed at the nearest Ukraine – NATO Council, launched immediately after the declaration of Ukrainian Minister of Defense, A.Grițenco, regarding Ukraine's full exit from all cooperation and political-military structures of CIS<sup>21</sup>. The recent initiatives of GUAM states to set up and operate common pacifiers forces represent a very strong signal for EU, USA and Russia, which within the remained little space for manipulation, could take the course towards progressive escalation of conflicts generated by itself at the end of 90s. Substitution of Russian pacifiers in the Transnistrian region is a

<sup>18</sup> RFE/RL May 5, 2006

<sup>19</sup> Vice-President Cheney declared in Vilnius that: "The Russian Government has limited the rights of its people in an inappropriate and non-loyal manner. The attempts to transform the gas and oil into monopolization instruments for energy supply or attempts to monopolize its transportation are of no legal interest. Nobody could justify the activities that undermine the territorial integrity of a neighboring country or interfere in its democratic development."

<sup>20</sup> May 3, MOLDPRES. The declaration of GUAM heads of states as "the territory of a state cannot be the object of military occupation, which constitutes the result of some force threatening or use of force with the purpose to break the international law."

<sup>21</sup> A.Grițenco "Ukraine is interested in the Euro-Atlantic structures, and this cannot be framed within the CIS defense coordination policies".

matter of maximum priority in 2006 for RM. Such an action is supported now by all Western partners (OSCE, EU and Ukraine). A number of impediments make EU support unlikely, the reasons being that GUAM is perceived by Europeans as a “too” American initiative. Nevertheless, the idea of pacifying mission under European responsibility is very much alive in a number of European Commission offices, and the establishment of an irresistible offer at regional level could rush up this decision. Analyzing GUAM evolutions in an ironic manner, Russian analysts consider that the states of this club will not be able to fulfill any serious role within active conflict zones where the situation is controlled by Russia.

## ● FORECASTS FOR 2006

**T**he current difficulties of the orange coalition from Kiev have degenerated into a new stage of debates regarding the course pursued by Ukraine: either towards a plenary integration in EU, or a pro-Russian politics, which fully enrolls in Kremlin's politics to re-establish the circles concentrated around Russia's present borders.

**A**fter the “successful” ending of the G8 Summit, the Russian Federation has free hand to support a scenario of making keen the Ukrainian elites, as (1) just before the elections from March 2006, it has recognized that the Party of Regions cannot come to power through free election (its popularity rate is decreasing), (2) Moscow is determined to block through any means Ukraine's integration to NATO (discussion regarding the eventual invitation to join could be officially launched during the NATO Summit in Riga); (3) the possibility to terminate the gas supply contract by the Iulia Timoshenko's Block could cancel a number of plans recently agreed and ratified between Russia and gas consumers from Western Europe – the strategic platform

on which the entire change of the Russian external politics paradigm of the last 2 years is focused.

**T**he fluidity of the Ukrainian political situation will orient automatically the Western attention to Moldova, Georgia and Azerbaijan, which unlike Kiev are examples of “coherence and stability”. It is presumed that under these conditions USA and EU will come back to the approach they had before the 2004 “orange revolution”, supporting thus the democratic course and the non-permission of other stakeholders' to get involved in the Ukrainian political life. It is crucially important under these conditions for RM to remain loyal to its partners from Kiev (President Iushchenko, ex-Prime-Minister Timoshenko), affirming at the same time its interest for applying the principle of differentiation and integration of the basis of “individual merit” regarding EU. The differentiation of energy imports, settlement of the transit tariff problem, gas control at the entrance into the distribution system of RM have to be the main priorities of Tarlev Government for the next months, which actually forecast a new energy conflict.

## The Transnistrian Conflict

***No one doubts the role this border monitoring regime has for changing the "frozen conflict of Moldova" paradigm.***

The new customs regime at the Moldo–Ukrainian border has recently turned 4 months since its implementation under the international monitoring (EU Mission). Although the international press continues to comment sarcastically on the tens of tons of smuggled chicken, which were passed illegally to and from Ukraine through the Iliichevsk port (without the tons of cocaine expected since the very first weeks!)<sup>22</sup>, no one doubts the role this border monitoring regime has for changing the "frozen conflict of Moldova" paradigm. The instrumental value of the Mission consists in transforming the conflict approach paradigm: from the so-called "parity of parties involved in the conflict" (Russian approach through the terms used in the 1997 Memorandum) towards a new approach within which the key-words refer to: "Russia's international obligations confirmed through the 1999 OSCE Declaration of Istanbul", "the unconditional withdrawal of the Russian troops", the territorial integration of Transnistria within "the indivisible and sovereign state of the Republic of Moldova", in conditions when those 3 principles formulated by the civil society – "democratization, demilitarization and decriminalization" – are the priorities operated by Chisinau within the regulation process.

***The official course of Republic of Moldova, encouraged by EU and USA, changes the reference frame for regulation.***

It is obvious that these elements are crucial for the democratic settlement of the conflict before adopting any "special statutes" or "recognition of the existent reality", as dreamt by the Kremlin administration. The official course of Republic of Moldova, encouraged by EU and USA, changes the reference frame for regulation<sup>23</sup>, and implicitly determines the behavior of the stakeholders involved in the regulation process (Ukraine, EU, USA, and Russia). As long as Ukraine will hope and will be called to fulfill "pro-EU" options, Kiev will honor its duties at the Moldo–Ukrainian border, being in line with the position of its Western partners (EU and USA), together with Republic of Moldova, which wishes to accelerate the territorial re-integration "without Smirnov", without paying with its sovereignty for this integration. "The new Europeans", the Baltic countries, Poland and Romania support as well through cumulative efforts the integral re-establishment of the Moldovan sovereignty over Transnistria, using the regional initiatives (COD, GUAM and Extended Black Sea) as reference institutions in favor of this approach. It is presumed that these initiatives will point out the process of a dual neighboring regionalization of EU and NATO for the ex-soviet space, eventually as an waiting room for their ulterior integration.

***The separatist enclave resists, especially through the generous transfers obtained from Moscow, which Chisinau cannot control or stop now.***

On the other hand, the separatist enclave resists, especially through the generous transfers obtained from Moscow, which Chisinau cannot control or stop now. Or maybe it does not want to control them, stimulating thus a full indifference towards the way the sovereignty is openly challenged by the Russian officials! In less than 2 weeks after these declarations the Republican Bank of Tiraspol received from Russia a stabilization credit of 15 million USD, the first tranche of the help estimated at about 200 million US dollars. It is known that the money allocated to the separatist regime are pledged through local industrial objects, i.e., machinery constructing industry, electro-technical industry and military industry, which will be transferred in this way under Russian ownership, in spite of all the warnings made previously by Chisinau regarding the non-recognition of the acts issued by the separatist leaders. At the same time, many banks of Chisinau have offered with suspicious generosity credits to

<sup>22</sup> Moldova-Ukraine anti-smuggling operation acclaimed by EUBAM, 05.06.2006. „The fact that during one week the Mission has found out more than in 3 months of monitoring proves the real results that can be obtained following the intense cooperation between the agencies involved in control maintenance between Ukraine and Moldova” states Gral Banfi, the Chief of Border Monitoring Mission. Thus, about 322 persons who passed illegally the border were retained; there were confiscated 52 tons of meat, 63 tones of vegetables, 11.30 kg of drugs, 5520 packs of cigarettes and 2555 liters of alcohol.

<sup>23</sup> The Law on the Statute of Eastern Regions of RM is framed within the Moldovan constitution, an element protected from the improvisations of some projects influenced by mediators and adjusted to international law rules.

the owners of Moldovan wineries, especially to the ones oriented to the Russian sales markets, and economic analysts assess very pessimistically the chances for these credits to be reimbursed and actually forecast an important banking crisis in Autumn 2006. It is to be mentioned that the Central Bank of the Russian Federation prohibits to foreign banks to open subsidiaries on the territory of the Russian state – an argument which no one from Chisinau has yet used "to seize" the functioning of Transnistrian financial-banking regime, one of the main tool for this regime survival.

**At the same time, many banks of Chisinau have offered with suspicious generosity credits to the owners of Moldovan wineries**

The course followed by the separatist part towards the organization of a referendum regarding the matter of independence proclamation has not obtained public support either, being qualified as "non-productive" and "absurd"<sup>24</sup>. Nevertheless, it is clear that Tiraspol will mobilize all its propaganda and military resources to strengthen its positions from which to request the maintenance of its current status quo as these positions have been weakened due to the recent economic pressures. In a report issued on May 22 by Modest Colerov, Head of the Department for regional and cultural relations with the neighboring countries from the Russian President's administration, it is stated that "conflicts' defrost could produce their new escalation, as not all the countries which can be disbanded have actually disbanded", thus making a hint to Moldova, Ukraine, Georgia, Kosovo and Curdistan, as zones with a potential to disband. Moscow leaders claim that Abkhazia, South Osetia and Transnistria should also make the necessary steps for obtaining international recognition of there secessions, based on the "right to self-determination" of these territories.

The "territorial identity" and "territorial self-determination" concepts try to substitute the "national self-determination" concept, which cannot be applied in these situations because of the demographical complexity and continuous ethnic "cleaning". It is worth mentioning that as a reply to the opposition of the West and GUAM countries towards these annexionist projects, Russia has initiated in Moscow the establishment of a counter-alliance – the Community for Nations' Democracy and Rights (June 12-14), consisting of Abkhazia, South – Osetia and Transnistria separatist leaders.<sup>25</sup> It is to be mentioned that the project of this alliance was conceived in December 2005 in Moscow through which the Kremlin leaders tried to repel the pressures of USA, EU and their partners from Central and Eastern Europe. Affirming its opposition regarding any change in the format of the Russian pacifying troop from the region, the separatist leaders have established some individual pacifying forces, which will substitute them in case "they will be forced to evacuate"<sup>26</sup>. It is obvious that these actions will raise Tiraspol's radical reactions during the presidential elections of this autumn. Though Moscow does not express officially its support, the Smirnov's recent visits to Kremlin, to Sokhumi, eloquently proves whom Russia will favor. This is also evident from the excessive coverage of the Transnistrian leader in official press of Moscow, and also from the financial help delivered regularly by Russia since March 2006 with the goal to diminish the economic losses of the separatist regime. Both OSCE and the Chisinau authorities have declared that they will not recognize the results of the referendum regardless to its results<sup>27</sup>. However, there are little chances for this referendum to be canceled.

Another unclear moment refers, especially after the establishment of the "anti-crises" coalition in Kiev, to the post-electoral configuration in Ukraine. Tiraspol's intention is to use the recent example of Montenegro and Kosovo, through which

24 RFE/RL, News line," June 8, 2006

25 Separatist leaders from Abkhazia, South Osetia and Transnistria announced the establishment of a CIS-2, affirming that the goal of this formation is "to stop the political-judicial disband of the USSR through affirming the legal continuity of separatist entities". <http://www.kommersant.ru/doc.html?docId=682234>

26 The foreign observers mention that in June 2004, armed groups of volunteers from the very same enclave reached, from the Russian territory, into South Osetia with full military equipment and with a huge media coverage. *Interfax, Apsnypress, Regnum, NTV Mir*, June 12-14) – *Vladimir Socor*.

27 The Times, 02/06/06

**Moscow will try to use the results of the referendum as a reason for absorbing the separatist enclave into the Russian Federation, or as a reason to request some solid compensation from the West in order to stop the support granted to Smirnov's regime.**

Tiraspol would be able to obtain state independence as a result of an open and recognized voting. Answering to this, President Voronin has stated that he will try to make order in the ownership origin in the region, as well as in the functioning of some foreign banks on the territory which Chisinau cannot control. We can presume that the future election will be dominated by the competition of the 2 rivalry movements – on one hand Smirnov's administration supported by the military component and Russian special services (assisted by the "Proriv" Party), and on the other hand the "Obovlenie" movement, linked to business interest from the region and certain leaders who would like to negotiated an armistice, including with Chisinau. The preparatory works for the referendum from September regarding the independence of the Moldovan Dnistrean republic from the Republic of Moldova have been launched, at Moscow's initiative, so as to diminish the asperities between the Antiufeev-Smirnov clan and the Sherrif-Shevciuc oligarchy-financial group. In diplomatic terms, Moscow will try to use the results of the referendum as a reason for absorbing the separatist enclave into the Russian Federation, or as a reason to request some solid compensation from the West in order to stop the support granted to Smirnov's regime. Under these conditions, Chisinau should not wait for presents but just to challenge itself the achievement of some realistic, measurable, technical objectives, which will separate the industrial-financial elite from Smirnov's political regime stimulating thus, at the external level, increased critics towards the subsidies allocated by Russia to this enclave.

## ● FORECASTS FOR 2006

The acceptance of the customs regime at the Moldo-Ukrainian border segment will play a major role in the monitoring of border traffic and exports control in the region. Nevertheless, the procedure of temporary registration of the economic units from that region does not yet offer a guarantee for the economic, customs and commercial re-integration. The conduct of a new referendum in Transnistria close to the elections from Moldova require new tactics in this field. These tactics should support the creation of a pro-Moldovan platform in the region, the message pointing out that territorial reintegration of RM is inevitable and that this obligation will be hold upon any person who will win the official leader position in the region.

The Chisinau authorities should create a Regional Fund for accumulating the excise duties collected from the Transnistrian economic agents registered temporarily according to their legislation, thus offering the possibility to direct these resources towards the development of some projects necessary for the

infrastructure of the transversal communication between the region and the rest of the RM territory: reparation of roads, bridges, interrupted communication between the localities, social projects for local needs. First of all, this course should determine Chisinau to give up the voluntary on the Transnistrian exporters' excise duties. Secondly, the Moldovan authorities should administrate its external debt for gas separately from the money pumped by Gasprom, in the support of Transnistrian non-profitable industries, or by regime's direct subsidies provision.

As it is not a magic wand, this tool should be used carefully and with responsibility, for the Western and Ukrainian partners to reveal the real reasons for ensuring an efficient, transparent and reliable control. Moreover, this customs regime should be completed urgently with other measures and policies, which will link the central economic actors from the region with the national economic system of RM.

# AGRICULTURE

In the first half of 2006, no changes occurred in the agricultural sector that could impact positively this economic field. The increase of agricultural production by 0,8% in the first quarter of 2006, is the first sign in this regard. This year the harvest of cereals and vegetables - beans from the first group will be much lower than last year. The same situation will be in the case of other agricultural cultures, among which multi-annual cultures. (See ME no. 5, 2006). In the zootechnical sector it is unlikely to have positive developments, similar to the ones of 2005. On January 1, 2006, the livestock of households of all categories decreased as compared to the same period of 2005, while in the first quarter of 2006, the animal production increased by only 0,7% as compared to the same semester of 2006. In our opinion, in 2006, the increase in agricultural production will not exceed two percentage points, which represents an insignificant increase, if compared to 2005.

***In the first half of 2006, no changes occurred in the agricultural sector that could impact positively this economic field.***

***In 2006, the increase in agricultural production will not exceed two percentage points.***

## The use of agricultural lands

According to the land cadastre on the situation as of November 1 2005<sup>1</sup>, the area of lands with agricultural destination that are in private property amounted at 1688592.29 ha, out of which: 921.02 ha – built-up area lands, 1450302.55 ha – arable lands, 11621.73 ha – fallow ground, 97407.64 ha – orchards and 118959.53 ha - vineyards. In January-November 2005, the area of agricultural lands, leased and owned by cooperatives and of joint-stock companies increased, and the area of agricultural lands owned by limited liability companies, of individual enterprises and of farms diminished. According to the land cadastre on the situation prior to November 1, 2005, the area of agricultural lands owned by farms (by farmers) has significantly reduced. Thus, the area of agricultural lands owned and leased by farms decreased by 119000 thousand ha or by 17,5% as compared to the beginning of 2005. At the same time, the number of land owners who owned these lands also decreased to 378070, which represents their reduction of 125002 as compared to the beginning of 2005<sup>2</sup>. These changes did not take place as a result of some important improvements on the land market, but they reflect only the changes made in the Land Centralizing Cadastre Form, on the situation prior to November 1, 2005. As for the chapter „Other Lands in Private Property” of this document, we can learn the number of

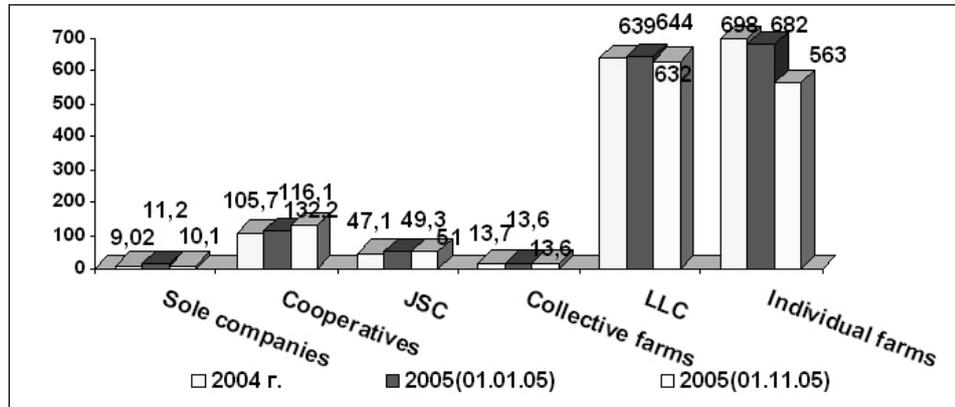
***In January-November 2005, the area of agricultural lands owned by farms diminished by 119000 thousand ha or by 17.5%, as compared to the beginning of 2005.***

1 Government Decision no. 422 dated 25.04.2006 on the Approval of the Land Cadastre on November 1, 2005. Monitorul Oficial of the R. Moldova no. 70-72/465 dated 05.05.2006.

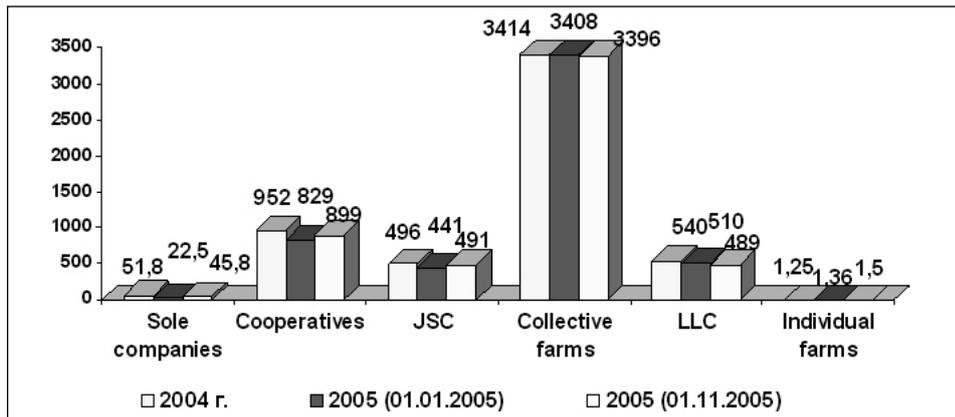
2 According to article 4 of the Land Code, *land owners* are the holders of the right to property, possession, land benefit. The owners of land with title of private property can be citizens of the Republic of Moldova and foreign investors, according to Moldovan laws. The land owners with any title are protected by the state. It is not allowed to return the lands to the former owners and to their successors. The latter can be assigned lands in property under the conditions stipulated by the Land Code.

land owners and of the lands that are in their possession, surplus over the total number of farms and of the lands that are in their possession, registered before January 1, 2005.

**Diagram 3. Structure of agricultural lands in private property by to the organizational-legal form, thousand ha**



**Diagram 4. The average surface of agricultural entities according to the organizational-legal form (including leased lands), ha.**



The agricultural entities included in this table of the cadastre form ranks the fourth in the structure of private agricultural lands (by the organizational-legal form), according to the owned agricultural lands, and the second by the number of land owners. In our opinion, these changes in the land cadastre have been caused by the deficiencies with land monitoring<sup>3</sup> and of the information system of land monitoring<sup>4</sup>.

3 The land fund monitoring, as part of the general nature monitoring, represents a permanent supervision system of the changes in land resources, their analysis and prediction of these changes. The monitoring works are carried out on the whole area of the land fund and involve: 1) permanent supervision of quantitative changes within the borders of land owners from villages (communes), cities (municipalities), rayons of the republic, on the whole, calculation based on aerophotogeodetical and cartographic researches of land areas, whose destination has been changed; 2) permanent supervision of qualitative changes in the structure of land resources and of soils, calculation of changed areas, periodical paedologic, agrochemical, geobotanical, geomorphologic, landscape, climate and other research, which is needed for the correct and timely assessment of the carried out changes.

4 The information system of land monitoring is carried out according to a unique method and includes data on the quantitative qualitative changes in the republic, rayon, city (municipality), village (commune), and household. The information content and terms for presentation to the appropriate bodies are approved by the Government. The access to information on the situation of land resources is ensured, as established, to all the interested physical and legal persons.

The approval of the Land Cadastre on November 1, 2005, and not on January 1, 2006 represents another reason in favor of our statement<sup>5</sup>. According to the same Land Cadastre, during January-November 2005, some important changes occurred. These changes impacted the size of agricultural entities<sup>6</sup>. In the same period, the average area of agricultural lands that are run by cooperatives, sole companies, joint-stock companies and farms has significantly increased. The exceptions are limited liability companies and the collective farms (kolkhozes).

<sup>5</sup> Traditionally, the land cadastre is approved on January 1. From 1995 until 2006, this tradition was not broken.

<sup>6</sup> According to the average area of the owned agricultural lands.

## ● THE AGRICULTURAL LAND CONSOLIDATION PROGRAM

By the Government Decision no. 554 dated 22.05.2006 the Agricultural Land Consolidation program was approved for the years 2006-2012. According to the program, „the main criterion for land consolidation is the stability of the compact sector in space and in time, according to which the land sector shall maintain its form and size as long as possible“. The consolidation program has to be accomplished in three stages. The first stage shall include the development and implementation of pilot-projects, pursuant to the legislation in force. The second stage shall include the development of the legislative-normative framework, methodic-scientific basis, raising population awareness, creation of commission for coordination of works at the local level. The third stage shall include the establishment of favorable technical-material and financial conditions for the consolidation of lands on the whole

territory of the republic. The consolidation program aims at correcting the errors committed during the privatization of over 1.6 million hectares of agricultural lands and the implementation of a concept that is to be finalized after the end of the first stage of this program. It would be good that this consolidation concept does not contravene to the new concept of European agriculture that involves complex economic development of rural areas, which means the support of all the economic organization forms in agriculture and the provision of special facilities for the small agricultural units in the surrounding areas. Moreover, it is good that such a program is supported by several actions crucially important for the creation of a third sector in the rural areas, which will assimilate a large part of farmers that will leave agricultural activities.

## Zootechnical sector

The zootechnical sector suffered traumatizing changes during the process of agriculture reform. During the period of socialist-type agricultural system, the zootechnical sector had important production capacities that were ignored completely in the further agricultural reform. Nowadays, this sector is characterized by inefficient production structures and by the non-qualitative growing of animal production. Despite this, in 2005, the zootechnical sector registered the bigger increase of agricultural production over the past five years, amounting at 8.6%.

***The zootechnical sector is characterized by inefficient production structures and by the non-qualitative growing of animal production.***

	2001	2002	2003	2004	2005	2006	2007
Bovines, total	405	410	373	331	311	311	
of them cows	272	279	256	231	217	218	
Swine	449	508	446	398	462	464	
Sheep and goats	946	956	938	942	938	948	
Poultry	14119	14995	15765	17522	22235	-	-

**Source: The National Bureau of Statistics of the Republic of Moldova.**

**In the first quarter of 2006, the growing of animal production represented only 0.7%, in comparison with the same period of 2005.**

The results obtained by the farmers in the zootechnical sector are important, but they do not reflect constant medium and long-term increase trends. Thus, on January 1, 2006, the livestock from farms of all types diminished, as compared to the same period of 2005, and in the first quarter of 2006, the growth in animal production amounted at only 0.7%, in comparison with 2005.

	On April 1, 2006		Share (in %, against the total)
	Thousand heads	In %, as compared to April 1, 2005.	
Bovines; total	311	93	100
Of which: farming enterprises	21	101	7
Individual and farming households	290	93	93
Swine; total	464	116	100
Of which: farming enterprises	51	133	11
Individual and farming households	413	114	89
Sheep and goats; total	948	100	100
Of which: farming enterprises	47	102	5
Individual and farming households	901	99.9	95
Poultry (farming enterprises)	3057	127	×

**Source: The National Bureau of Statistics of the Republic of Moldova.**

**The zootechnical households have become monopolist, which involves certain short- and medium-term risks.**

The slow development rate of this sector is influenced by several factors, such as:

- Over 90% of the livestock is owned by individual and farming households;
- The fodder cultures have an insignificant share in the structure of agricultural settlements (4.3%);
- The state passes poor and inconsistent support policies in the zootechnical sector.

The zootechnical households have become monopolist, which involves certain short- and medium-term risks. The low exports of agricultural zootechnical production in last year (only 0.7 thousand tons) is one of the consequences of these structural changes.

Besides, in aviculture, the most stable sector of the zootechnical field there are some risks that should not be ignored: the complicated epizootic situation in the region and the possibility of cease of poultry products exports.

**The share of fodder cultures in the structure of agricultural settlements is insignificant (4.3%).**

## Plant growing

This year the spring agricultural campaign started with big delay, because of unfavorable climate conditions. At the same time, the farmers had to rehabilitate or to complete a part of the cereal agricultural settlements from the previous autumn with spring cereals. As a result, the predictions for the harvest of cereals of the first group are not optimistic. This year the harvest of cereals of the first group will be much lower than last year and will be about 900 thousand tons. In our opinion, this autumn the areas under these cultures shall increase significantly, due to the liquidation of the cereal reserve, increase in prices for these products and the elimination of restriction on the export of cereals and cereal products<sup>7</sup>.

**The areas under sunflower increased by 42 thousand ha, if compared to 2005.**

**The harvest of cereals of the first group shall be much lower than last year and shall represent about 900 thousand tons.**

On 4.07.2006, according to MAFI data, the following agricultural settlements were registered: cereal – 481394 ha, technical cultures - 358127 ha, fodder cultures - 30857 ha. As for agricultural cultures, the autumn wheat has the biggest share in the structure of agricultural settlements (246.9 thousand ha), followed by grain corn(354.4 thousand ha) and sunflower (291 thousand ha). In addition, the areas under sunflower are growing. They extended by 42 thousand ha, as compared to 2005, despite the intentions of MAFA to diminish the share of this culture in the structure of agricultural settlements.

**In the autumn of 2006 the areas of settlements with autumn cereals will increase significantly.**

<sup>7</sup> In the autumn of 2006 the Government will cancel the restriction on the export of cereals that were imposed by Government Decision no. 834 dated 26.07.2004 on regulation measures regarding the procurement and export of cereals and cereal products. According to the decision, the list of goods that are exported through the Universal Commodity Exchange of Moldova includes the following items: 1001 - wheat and meslin (mixture of wheat with rye in a two-to-one ratio); 1003 00 - barley; 1101 00 – wheat or meslin flour.

## ● THE RESULT OF THE COURT OF ACCOUNTS CONTROL ON THE USE OF ASSETS FROM THE AGRICULTURAL SECTOR SUPPORT FUND IN 2005

The Court of Accounts has examined the results of the control on the use of assets from the Agricultural Sector Support Fund in 2005. According to Parliament Decision no. 19-XV dated 17.02.2005, the assets of the agricultural sector support fund, amounting to 180 million lei<sup>8</sup> have been distributed for administration and management in the following way:

- 1) To the Ministry of Agriculture and Food Industry 41 million lei, including:
  - a) 29 million lei for funding and stimulation of crediting economic entities producing agricultural production from the internal resources of commercial banks, savings and loan associations of the citizens and from the Rural Funding Corporation;
  - b) 10 million lei for the stimulation of creation of fruit plantations;
  - c) 2 million lei for equipping zoo veterinary offices with technological equipment;
- 2) 18 million lei to the state owned enterprise "Moldresurse" as to encourage the establishment of machine technological stations;
- 3) 121 million lei to the 2-level local public authorities as to subsidize agricultural works.

The Court of Accounts control over the use of assets from the Agricultural Sector Support Fund in 2005 revealed several breaches in the management and the use of these assets:

- The working group responsible for the management of fund assets aimed at subsidizing and stimulating the crediting of economic entities producing agricultural production has decreased the maximum share of subventions down to 10% and the maximum amount – down to 43.0 thousand lei<sup>9</sup>. They credited some economic entities that haven't used the loans received in the previous years for production of the agricultural products. In 2005 these entities were granted subventions in the order of 114.26 thousand lei. Some Savings and Loan Associations of Orhei rayon have granted loans to the agricultural producers at the interest of 30%, in Ialoveni rayon – at the interest of 28%, Telenesti and Causeni – 27%, pe while the commercial banks were providing loans at the interest of 20-24%.
- During the management of financial means granted for the stimulation of fruit plantations there were cases when subsidies were calculated without taking into account the expenses borne by beneficiaries for the procurement of planting material and its planting on the newly-established useful area.
- The financial means granted for provision of zoo veterinary offices with technological equipment were used to pay the salary tax of 123.25 thousand lei (via the incaso order dated 16.09.2005 of the State Tax Inspectorate (STI) for Anenii Noi rayon).
- The money intended for the creation of machine technological stations was distributed without establishing any principles for the selection of subsidy beneficiaries,

as requested by point 27 of the Regulations approved by Parliament Decision no.19-XV<sup>12</sup>. Even if the regulations approved by Parliament Decision no.19-XV provided for subsidizing the machine technological stations created in 2005, 6 machine technological stations created in 2004 received subsidies in the order of 660.8 thousand lei. On 01.01.2006, the machine stations created in 2004 had to reimburse 2927.7 thousand lei, but in reality 764.6 thousand lei were reimbursed, i.e. 2163.1 thousand lei less. On the same date, the overdue debts of subsidy beneficiaries to the state amounted at 25799.9 thousand lei, including for 2004 – 9000.0 million lei and for 2005 – 16799.9 thousand lei.

- The money distributed for subsidizing the agricultural works have been transferred to economic entities and individuals for partial compensation of the agricultural producers' expenses that are generated by the increase of prices for diesel oil. Despite point 32 of the Regulations approved by Parliament Decision no.19-XV, funds for the unprocessed land areas, for pastures, lands that exceed the ones registered in the Land Cadastre<sup>13</sup>. The 2-level local public authorities transferred subsidies for agricultural works in the order of 292.2 thousand lei to the owners and users (lesers) who did not register the right to the agricultural lands as requested by the law. The 1-level local public authorities failed to follow the procedure stipulated in point 40 of the Regulations approved by Parliament Decision no.19-XV,<sup>14</sup> while providing subsidies of 420.4 thousand lei to individual beneficiaries. The 2-level local public authorities from 3 rayons reimbursed the unused assets amounting at 650.0 thousand lei with delay, while in 13 rayons the unused subventions amounting to 1434.6 thousand lei were transferred to the budget during the control. Some mayoralties from the rayons of Donduseni, Drochia, Criuleni, Briceni, Leova and Cahul, used 27.7 million lei from the account of the Agricultural Sector Support Fund to pay the debts for the land tax both with and without the consent of subvention beneficiaries. 200.0 thousand lei were withdrawn from the subsidies account based on an incaso order of the State Tax Inspectorate for the payment of debts to the land tax. Based on incaso orders BC "Moldindconbank" JSC, BC "Moldova Agroindbank" JSC and BC "Businessbank" JSC received 42.2 thousand lei, 23.1 thousand lei and 11.3 thousand lei (overall – 76.6 thousand lei) from some customers from the rayons of Riscani, Briceni and Donduseni as repayment of loans and bank interest; this money was withdrawn from the subsidies account. At the same time, certain beneficiaries of subsidies from the rayons of Briceni, Drochia, Donduseni, Edinet and Floresti transferred 992.2 thousand lei, received as subsidies, for the repayment of debts owed to the state for different goods and services (75.6 thousand lei, 52.9 thousand lei, 46.0 thousand lei, 54.6 thousand lei and 763.1 thousand lei).

<sup>8</sup> The Decision of the Court of Audit no. 15 dated 17.04.2006 on the report concerning the use of the assets from the agricultural sector support fund in 2005. Monitorul Oficial no. 98-101/22 dated 30.06.2006.

<sup>9</sup> Parliament Decision no. 19-XV dated 17.02.2005 on the approval of the Regulations concerning the use of assets from the agricultural sector support fund. Monitorul Oficial of the R. of Moldova no. 30-33/107 dated 25.02.2005.

<sup>10</sup> Aprobat prin Legea bugetului de stat pe anul 2005.

<sup>11</sup> Conform regulamentului din Hotărârea Parlamentului nr. 19-XV din 17.02.2005, cota maximă a subvenției (20% și 30%) și valoarea maximă a subvenției (85 mii lei și 125 mii lei) vor fi determinate de volumul creditelor acordate producătorilor de producție agricolă supuse subvenționării și de sursele fondului prevăzute la pct.1.

<sup>12</sup> The principles of selection of subvention beneficiaries, the way of use and reimbursement of subventions are established in regulations developed by the Ministry of Agriculture and Food Industry and approved by the Government.

<sup>13</sup> The total area of agricultural lands calculated for granting the subvention mentioned at point 30 cannot exceed the area of agricultural lands stipulated in the Land Cadastre, according to the situation as of January 1, 2005.

<sup>14</sup> The authority of the 1-level local public administration shall issue the subvention received on its account to the beneficiaries – physical bodies according to the lists, under their personal signature, in which they mention the data of their ID card, and shall produce an authenticated copy of the lists of the 2-level special commissions so that it is attached to the transfer documents.

# BUSINESS

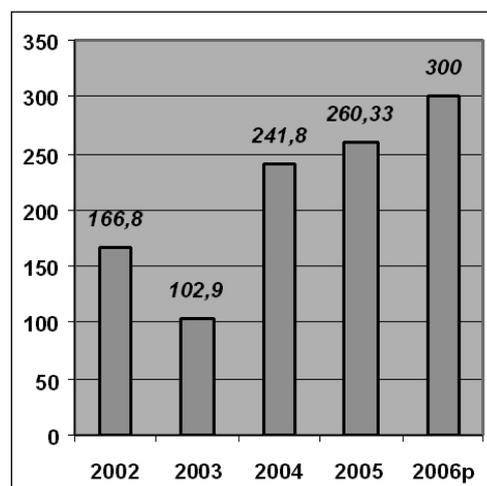
The decline of the national industrial output, incapacity of the Government to conclude a truce in the “wine war”, desperate attempts to impede the imminent aggravation of price on natural gas and missing a sustainable progress in improving the business environment, are several general characteristics of the Q II of 2006.

The CEP experts consider that by the end of the year the level of industrial output will continue to decrease, compared to previous year. The crisis of the industrial sector deepens, and as consequence of the above, the CEP experts have revised their forecasts regarding the industrial growth, thus reducing the industrial growth index from 5% to 2,5%, which is an obvious fact, and even mandatory, in conditions when this sector is so volatile in the overall picture of the national economy. With regard to service sector, an increase is expected of 10% by the year end.

## Investments level

The volume of foreign direct investments in the economy of the country are still at a low level, compared to the FDI rate registered at both regional level and in the neighboring countries. In 2005 the Republic of Moldova attracted **foreign direct investments** worth USD 260 mln, this indicators being a display of reduced investment attractiveness of the RM. Although geographical position of the country and qualified labor force are among the factors that should encourage foreign direct investments, nevertheless, a sharp lack is perceived of economic stability factors, of transparency, of rules of game to be equal for all the economic entities, of law observance, and of independent justice. In line with all of that, the high level of corruption, disinterest of public servants in supporting the economic initiatives, poorly developed infrastructure, combined with an impulsive government, who misses decisive actions and clear vision, discourages foreign investors.

Diagram 5. Foreign Direct Investments, USD mln.



The recent declarations of the Ministry of Economy and Trade, where unsatisfactory level is recognized of foreign direct investments attraction per capita – the lowest rate on European arena – unveils the lack of an effective policy and the urgent need to look for untraditional solutions. A simple statement on this issue does not resolve the problem and does not offer any perspective, concerning the steps needed to be undertaken in this field. The precarious legal framework, arbitrary execution of laws, as well as general disinterest of the state office holders’ „cast”, who take care of only their private affairs, regardless of anti-corruption programs, or “guillotine” legislation, unveil, in fact, the reasons why the investment process in the RM is in dead-lock.

For this year, the Export Promotion Organization of Moldova has forecasted foreign direct investments worth USD 300 mln, and the CEP experts have qualified it as “excessively optimistic”. The Republic of Moldova has a unique chance to use at maximum the time remained by the end of the year only in conditions of initiating some more form and more consistent policies, or even radical, ones in terms of considerably improving the investment climate and using the opportunities of EU neighbor country, an incontestable advantage, whose effects will ascend once with Romania’s joining in the EU.

**Investments in fixed assets** at the domestic companies are at a low level. Thus, in the first quarter of 2006, this level has reached a modest level of USD 54.4 mln.

Most Moldovan companies are in a vicious circle. The low level of investments is caused not only by lack of finance but also of low demand of Moldovan products, which discourages the growth of production capacities. At the same time, the lack of investments in the research and development activities, and in raising staff qualifications, entail production of uncompetitive products on foreign markets.

On the one side, investing in these conditions seems to be risky, and on the other hand, the companies hesitate to increase the output capacities in conditions when products are completely missing, that could "conquer" not only domestic market but also foreign ones.

Thus, we do not have competitive products because there are no new ideas and professionals of high standards, and consequently we neither have what to produce. Once we do not have what to produce, the risk to invest is ungrounded, because the existent products on the market are not competitive. As a result, the foreign creditors or investors do not see perspectives to invest in project without any clear future.

***Moldovan enterprises are in a vicious circle. Lack of competitive products discourage investments, and competitive products are missing because the investments are not made...***

## **The growth tempo in constructions**

The level of enterprise works performed by the constructions & assembling companies in the first four months of the year are at the level of 111%, compared to 2005; in the same period of 2005 a growth rate was registered of 121% versus the same period of 2004.

Although at present over 50%, of the total investments in the fixed capital have been made in constructing several production units (in conditions of a low level of investments and of significant growth of constructions cost), the volume of investments in the production units will decrease.

Over 70% of the overall construction works have been performed in the mun. of Chişinău, which unveils a significant geographical polarization of the economy.

The volume of living space construction will be determined by raising prices for construction works and declining purchasing capacity of the population (including of the population living abroad). The raising demand for living space will be possibly stimulated by developing accessible schemes of mortgage lending, which will make possible that individuals with incomes generated within the country get encompassed in the potential buyers category.

***The performance tempo of constructions will slow down...***

***...the volume of new flats construction will diminish.***

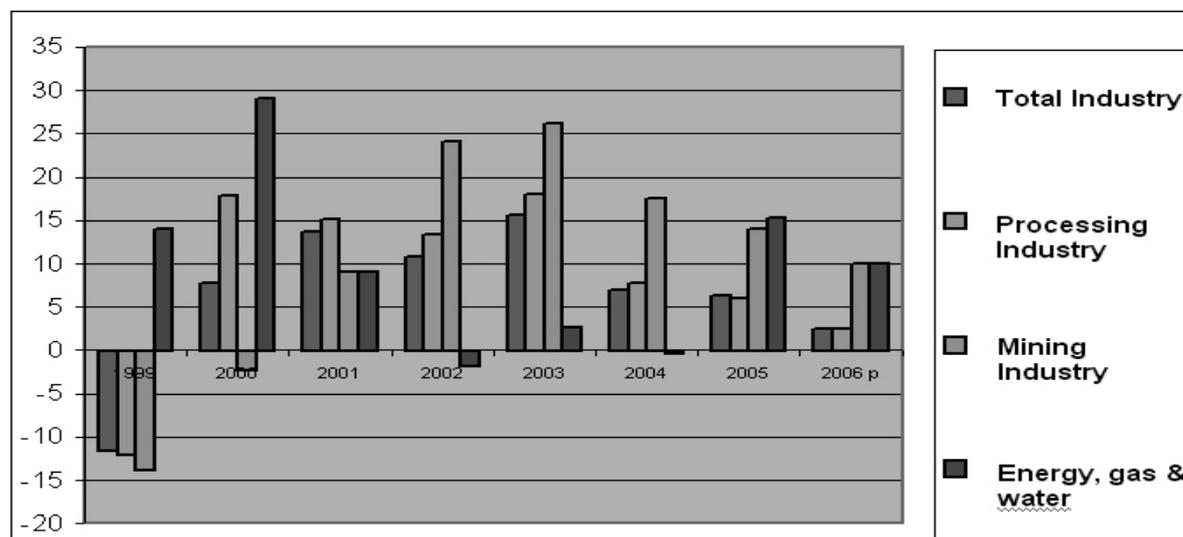
***Changing the forecast of the industrial growth from 5% to 4%, as a result of deepening crisis in the industrial sector.***

## **Crisis of the National Industry**

The level of industrial output has reached the minimal amount in 2006, in May. The decrease of industrial output volume by 6.9% is caused by the crisis the enterprises of the traditional branches are going through: wine

making and distilled alcoholic drinks industry, tobacco processing and oils and fats production. The decrease of the forecasted industrial output indicator, from 5% to 2.5% level, reflects the fact that the national industry will not manage to recover by the end of the current year.

**Diagram 6. Growth tempo of national industrial sectors**



**Source: NSB, CEP**

## Processing Industry

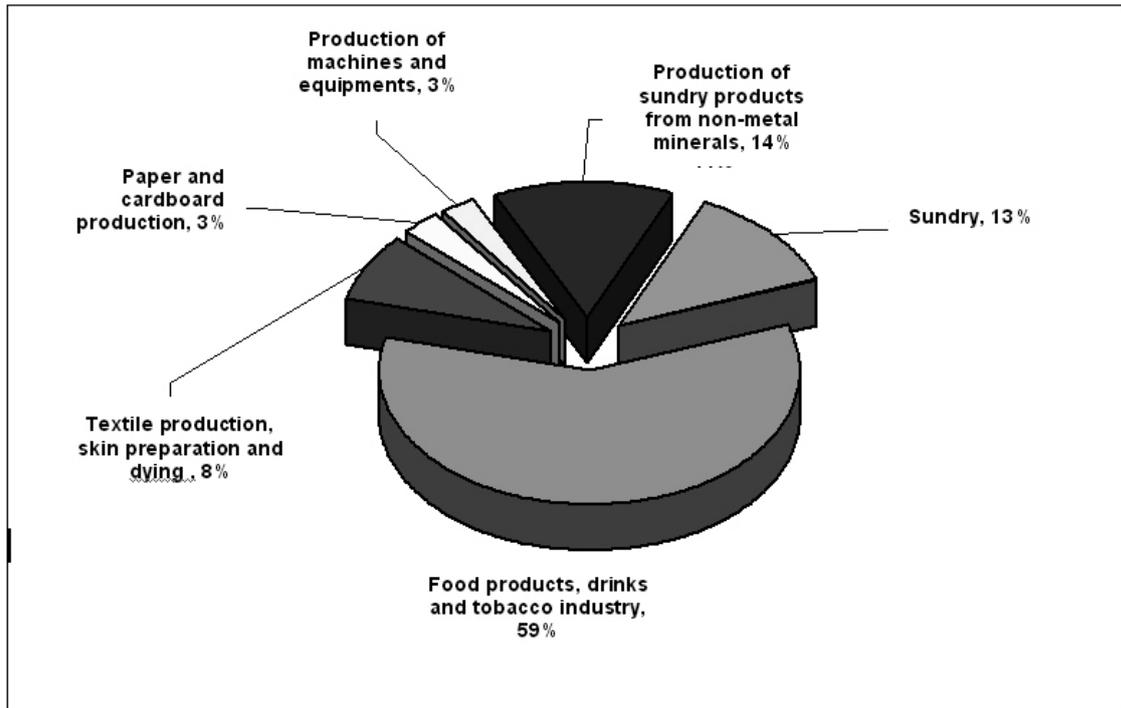
The crisis in the industrial sector, in general, is caused by the decline of the processing industry.

As a result of decreasing volume in the processing industry by 9% in the period of Jan.-May 2006, the experts team of the CEP have adjusted the forecast of the growth rate from 5%, as initially announced, to 2.5%.

The decrease of the production volume in the processing industry has been determined by the significant reduction of the production volume in the foods and drinks industry (by 18%) which accounts for over 50% of the processing industry.

The decline of the *tobacco products* volume by 21% has had a negative impact on the processing industry; in this situation the privatization of the „Tutun-CTC“ S.A. must be a priority for the government. This fact implies, however some negative results too; the experts of the CEP consider that the protectionist measures of the Government will have no economic support, will be of discriminatory nature versus the other players on the tobacco products market (increased rate of import license tax, for instance) and this is why will be, most probably, harmful. We consider that the state should discourage smoking, following the example of the economically advanced countries, and should have a “protectionist” attitude towards the citizens and health state of the whole society, rather than towards the company whose owner it is.

Diagram 7. Processing Industry Structure; %



Source: NSB

The food and drinks industry has been affected mostly by the decrease of 18% of the wine output, which accounts for a share of 37% of this industry, as well as diminution of beer output, dairy products, oils and fats.

*Will there be any restrictions for the preserved fruits and vegetables?* The Economic Statewatch team consider that the restrictive measures of the Russian Federation are of political nature and seek to determine the Republic of Moldova give up several political desiderata. The persuasion method, chosen by the Moscow power, is being manifested by economic pressures imposed upon the authorities from Chişinău: raising price of natural gas, ban on imports of several products that account for a significant share in the Moldovan agricultural industry. Russian authorities have rejected the political nature of these actions by stating several arguments. Moscow states that it accepts the imports of other products from the Republic of Moldova, such as, *inter alia*, canned fruits and vegetables, given that they „comply to the sanitation norms of Russia”. This *pro domo* evidence, is, euphemistically speaking, infantile; the import of such products will not be banned because such actions will have no significant destructive economic effects for the economy of the Republic of Moldova, thus, will not contribute to reaching political objectives sought by Russian Federation.

*Wine making* has decreased by 38% in the first 5 months of the current year as a result of cease by Russian Federation of wine imports from the RM.

## **What lessons can be made by the RM from the “wine war”?**

1. This “war” was predictable, it was just a matter of time. The restrictive actions of the Russian Federation ever since the spring of 2005 were suggesting a potential scenario, yet, the authorities from Chişinău did undertake almost nothing to diminish the impact of this “war”.
2. The reaction of the Moldovan wine makers to the actions of the Russian Federation was anemic, short of seriousness. The respective branch managers seem to have been too sure of the Moldovan authorities’ capacities in anticipating this economic war. Thus, most of domestic companies have proved to be totally unprepared to face this dramatic situation.
3. The panic that grasped both the government officials and wine makers, has deprived them of the capacity to make any weighted and well-thought decisions in strategic terms. A series of chaotic and desperate measures have been made in terms of promotion and merchandising Moldovan wines on the other markets. Romania, Ukraine, Belarus, Poland and other markets have been assaulted by offers and „wine festivals”. These actions have not implied the expected results, because not any country is a potential market for wine sales. We think that febrile moves of our government officials have been aimed at creating the opinion that much is being done in crisis solution.
4. The negotiations with the Russian Federation may be successful only in case when the RM gives up its firm stance on political issues that have determined Russia unleash this war. The situation would be resolved shouldn’t Moldova be so insistent on evacuation of Russian troops from Transnistria, should it give up the new customs regime for this region and should it forget of its aspirations to integrate into the European Union.
5. Republic of Moldova has been “late for the train” that might have transported its wine to Europe. Should it have been displayed a firm attachment to the European democratic values and displayed its political option in actions, it might have been more actively supported by the European community in the process of sales markets diversification. In these conditions, however, “conquering” new markets will take considerable sustainable efforts.
6. The tough reality for the wine makers can be mirrored by the statement: „Producing and selling are two different jobs”. Thus, the Moldovan wine makers have two possibilities: to either learn to sell (which might take years and considerable investigations) – or trust this job to certain companies specialized in competitive exports, which might promote consequently and efficiently the Moldovan wines on other markets. Some managers have rapidly perceived this thing and have oriented and found such experts in the field, others however, are still looking for specialized marketing agents, whose task will be to searching and developing wine distribution channels.

7. The "wine war" with the Russian Federation must be regarded as a little battle, which we should lose for the sake of victory in a big battle. The efforts of the government officials and wine makers should be targeted towards: raising wine quality and maintaining it, regardless of the country exports are made to; re-acquiring Russian market with high quality products (superior to those exported previously), penetrating on some other market "niches"; joining efforts of all producers and promoting abroad of the country of products and using foreign companies for this; and not least, working out marketing strategies that would change for the longer term the image about Moldovan wines as being cheaper and of less quality.

Most of wine making companies have been specialized, first of all, in producing bulk wines, which was delivered and then processed and bottled in other soviet republics. Due to this, in the respective sector companies skills are missing of both promoting some brands, and marketing ones. After the privatization of the enterprises, the Russian Federation was the first sales market for the Moldovan wines. Selling wines was done via Russian distribution markets, without any intense marketing efforts.

In these conditions, when the skills are missing of wine promotion, and the reduced capacities of the companies are limited, the Moldovan wine brands must be created urgently and promoted on all foreign markets; this is why emergence of some virtual producers is required who might substantially contribute to remedying this situation. The virtual producers might be some specialized agencies in creating brands and promoting products on new markets, acting on behalf of the producers. For the Republic of Moldova two scenarios might be possible: 1) A number of enterprises of this sector create such an agency (a virtual producer), which will be funded commonly and which will be staffed with marketing specialists from both Moldova and abroad, the latter having to promote several brands, of these producers. 2) A virtual producer should be recruited from abroad, by one or several domestic companies. In both cases the role of the virtual producer will be to create the brand, promote it and develop distribution channels for the domestic wines.

## Services

The paid services offered to the population have reached during the 4 months of the year a growth of 7.7%, versus the same period of the previous year. The volume of services offered will slow down its tempo during 2006. The growth in this sector is supported continuously by the high volume of remittances and higher demand for services.

The investments channeled in developing both fixed and mobile telephony will continue to grow in this sector, as well as the increasing number of subscribers.

Passenger transportation branch will continue to grow. Particularly, the passenger air transportation will grow, due to raising number of citizens working abroad and their preferences to travel by air.

The volume of goods transported by railway has registered a decline in the first five months of the year. This trend will continue until the end of 2006, due to diminishing both industrial output tempo and declining volume of the exports volume. An increase is registered of goods transportation by air, this trend seemingly being up-kept until the end of the year.

## **Trade**

Retail sales will continue to grow due to consumerist nature of the economy, the latter being stimulated, at the same time, by remittances. At the same time, the organized nature is being stressed of the trade activities. Thus, the growing rate of the retail sales volume in the trade units outpaces the volume of sales on the markets. This trend will be developed also in the next several years, due to both withdrawing patents for retail trade activity and reorientation of consumers' preferences and behaviors. The total growth of sales accounted for 10.1% in the first four months of the year, versus the respective period of the previous year.

## **Small Business**

Regulatory reform intended to review and optimize regulations in the fields of entrepreneurship at all state administration levels of the Republic of Moldova, with the view to avoid eliminate inefficient regulations who used to impede the business development and investment flow.

The first legislative initiative who ought to support this initiative was enforced on the 7<sup>th</sup> of February 2005. Being implemented in several stages, this initiative is only the first step in normalizing business environment – by simplifying the procedures, curtailing the number of regulatory acts, raising transparency and stability in the regulatory business framework.

Certainly, the regulatory reform has been unleashed, and actions of the state are necessary, which it should have done. The small business needs to further simplify all procedures, starting from both registration of businesses with the Registration Chamber and other state bodies and accounting norms and standards and fiscal policy of the state. In order to create the legal framework, veritably favorable for the development of the small business, the fiscal legislation needs to be revised and create a simplified legal framework, stable and less costly for small business agents.

# FOREIGN TRADE

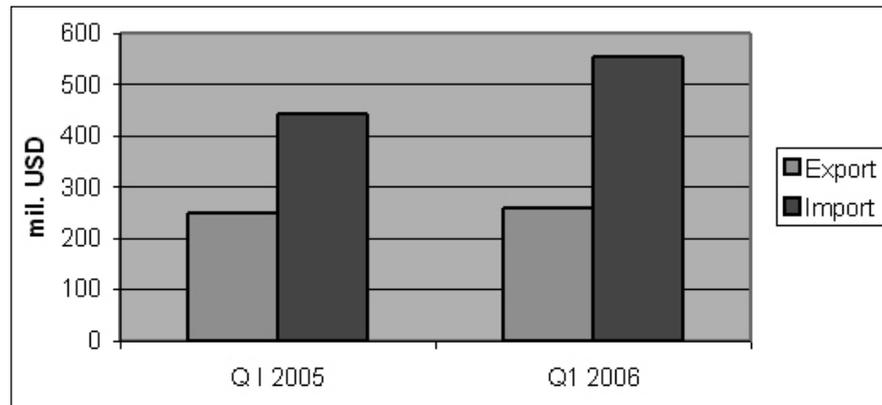
**The foreign trade trend in Moldova is characterized, at most, by raising and diversification of exports.**

It was believed that 2005 was not the best year in terms of developing the Foreign Trade of Moldova; neither could we imagine that in the Q I of 2006 there were profiled only its basic trends. The fact of imports out-passing by exports, at the end of the Q I, 2006 reached the level of 46,8%, and by the year end this indicator was expected to be 42%.

## General trends

The trade balance deficit registered incredible trends on the background of the insignificant growth of exports in the first quarter of the year, which will have very hard consequences for the economy of Moldova. The emerged situation in the relations with Russia have proved that as of today, the political factor can prevail easily upon the rationalization of the economic decisions for the political regimes existing in the post-soviet area, to make possible (or even inherent!) tools of the market for geopolitical aims. The problem of unilateral barring of both Moldovan and Georgian exports by a country which claims as if "has entered the WTO" reflects a disproportionate intervention of the state in the real economy sector. Despite all the efforts made in the last several months by the authorities of the RM to resume the access of the domestic exporters to new markets (China, USA, EU), the situation has not been improved substantially and sufficiently fast for the domestic producers. The phenomenon that saves the RM from the current economic situation is mostly linked by the remittances of the Moldovan laborers abroad, a life buoy of the Moldovan economy, and not of miraculous solution of state bodies. Their rates are painfully felt by producers, and the lack of visionary strategy by exporting sectors engender lack of trust among the authorities and business.

**Diagram 8. Moldovan Foreign Trade Evolution**



Source: National Statistics Bureau of the RM

## Exports

**Re-exports – a solution for getting out of the current economic situation.**

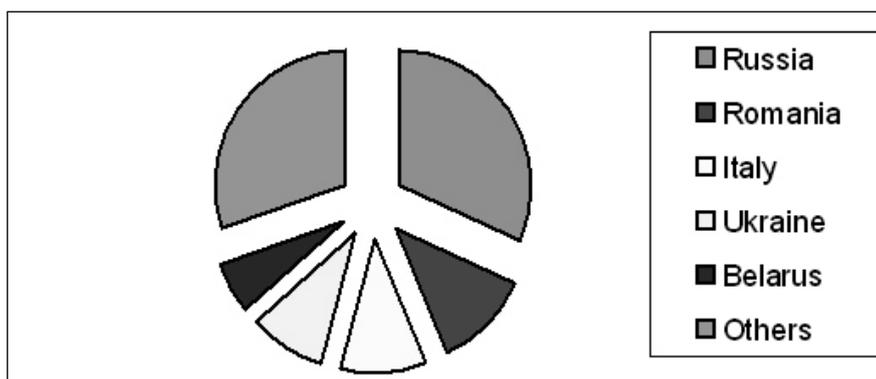
Despite of the initiatives to diversify the sales markets, the current trends profile a stable growth and even an intensification of the commercial relations with the traditional partners.

In the first quarter of 2006, the main partners of Moldova (main export markets of Moldovan goods) have remained Russia, Romania, Italy and Ukraine. There are many predictions with regard to re-orientation of the

Moldovan exports to other markets, we consider, however, that this process will last several years, rather than several months, as somebody may think. We support the idea that both political and economic relations with Russia will resolve in the following several months and, to some extent, this fact will allow to cover the incurred losses.

One could speak of introducing the notion of „re-export” of Moldovan goods to CIS countries, given that the exports to Belarus and Ukraine can be re-oriented from these countries to the Russian market.

**Diagram 9. Moldovan Export Partners Q1, 2006**



Source: National Statistical Bureau of the RM

**EXPORTS OF CEREALS.** Lastly, the negotiations with the Universal Commodity Exchange (UCE) has reached a logical final – starting since September 2006 export operations are allowed of cereals without UCE as intermediary. This fact will make possible to raise flexibility of exports and will simplify the procedure of document preparation.

**EXPORT OF FOOD STUFFS.** This branch of the national economy has increased the export volume; this trend will be maintained, seemingly in the next several years too.

**EXPORT OF CATTLE-BREEDING PRODUCTS.** The Ukrainian authorities have affirmed that it is possible to introduce restrictions on Moldovan exports of cattle-breeding products. To mention is that the export of cattle breeding exports to the neighboring country is an insignificant part of the overall exports and an eventual cease of this kind of exports will not impact substantially the foreign trade of Moldova.

**EXPORT OF TEXTILES.** Recently, positive trends are seen in the export of textiles – cheap and qualified labor force, and stable political environment, have implied its positives: the foreign companies started to use more frequently the production capacities of Moldova.

***Attitude of the authorities towards the export promotion engenders positive results.***

## Imports

**Raising imports constitute most stable trend in trade evolution.**

The imports continue to grow, without any changes in geographical area. Meanwhile, the imports originated from Russia have almost doubled in volume, accounting for almost 30,8% of the overall imports of the national economy. The positive side in this context is that the main categories of imports continue to be mineral products, which are vital for the economic development of Moldova in the region.

An increase is noticed of imports in the constructions industry too (construction materials and complementary products), imports of these categories of products having raised in some periods of the year. It is true that the imports have made possible for our state to execute the budget, but in no way have contributed to the economic development. The negative trends in this sphere are pertinent, in this sense; a constant growth has been registered of imports of the cattle-breeding products – by approximately 1/3 a year.

To mention is that several companies, oriented to exports, ignore the existence of the domestic market, a fact which has provoked the following situation – export-import ratio has remained almost unchanged. Following the behavior of the Moldovan producers in the “wine war”, one could state that only the shock therapy will force the domestic producers understand the importance of the domestic market.

## Foreign investments

Moldova becomes more and more attractive for foreign investors, this fact can be observed in its recent development trends. The foreign investors are not interested only in short-term foreign investments, which might allow them pay-off the invested funds. The intensification is obvious of the activity of potential investors in the strategic branches of the national economy: energy sector, banking, and wine making industry. It is expected that in the near future several important acquisitions will take place of large companies; strategic investors are ready to enter the Moldovan market. In line with that, the Government has declared to continue in 2006 the privatization process, although „most demanded” assets have not been exposed to privatization yet.

### ● DOES BIG PRIVATIZATION START?

Recently an intensification has been noticed of the foreign investors in the banking sector. The shares of the Moldova Agroindbank have been purchased by Slovenian companies, 100% of the Eximbank have been purchased by an Italian bank. Privatization is expected of Banca de Economii (Savings Bank), the biggest bank with state capital (over 50% of shares), with the largest network of subsidiaries. It is obvious that no local company will be able to purchase such an asset. Thus, one should state with all certainty that the international financial institutions are ready to start expansion on the financial market of Moldova.

The Government has initiated already to look for an international company for evaluation of the Banca de Economii. We consider appropriate the fact that the Government does not rush to sell the bank, hoping that this hesitation is not of bureaucratic nature, but rather an attempt to try to find a better offer. There is a negative precedent to enter the Moldovan market by purchasing a local bank by a larger foreign bank (the authorities have reacted respectively, at that moment), an eventual inadequate decision might impact negatively the image of Moldova on international scale.

# FINANCIAL MARKET

In May, last year, the monetary system of the Republic of Moldova has been subjected to trial by the fluctuations of the exchange rate of the MDL versus foreign currencies. The predictions launched in media with regard to imminent devaluation of the national currency generated a wave of panic among the clients of several important banks, whereas the activity of the currency exchange offices has increased progressively. The absence of several objective factors which might trigger these fluctuations in the exchange rate and the short time-span of this occurrence have determined us to name this phenomenon as – May „currency rush”. Compared to the US\$, the MDL has not been devalued in the first half of the current year, because the US\$ itself has recorded a devaluation in the respective period, on the international market. The MDL has registered a devaluation versus Euro, having reached up to MDL 16.90 per 1 Euro in the recent weeks.

## ***Influence of the currency market fluctuations upon the bank deposits***

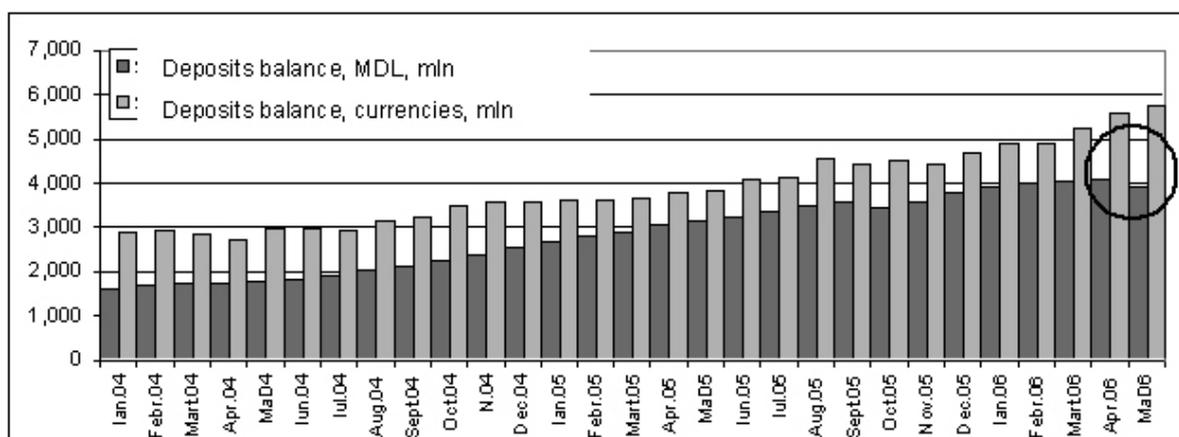
The “currency rush” has impacted, undoubtedly, the currency flows in the banking system of the RM. Despite of that, the effect on deposit structure in MDL have not changed significantly.

In May 2006, the balance of the MDL bank deposits have diminished by 3% versus April 2006. This phenomenon (diminishing balance of MDL deposits) is faced very rarely. During the recent years, the MDL deposits were, usually, more gainful as the bank deposits in foreign currencies. Consequently, the monthly balance of the bank deposits have been continuously growing. In the last 3 years, the decline of the bank deposits’ balance has been eyed only in October 2005 and, obviously, in May 2006.

At the same time, the bank deposit balance in foreign currencies has increased by 3% when, usually, the balance of deposits in currency is almost stable in May-July. This demonstrates us once again that a small part of bank deposits in MDL have been changed in foreign currency and deposited in foreign currency.

***“Currency rush” has stimulated conversion of MDL deposits into foreign currencies deposits***

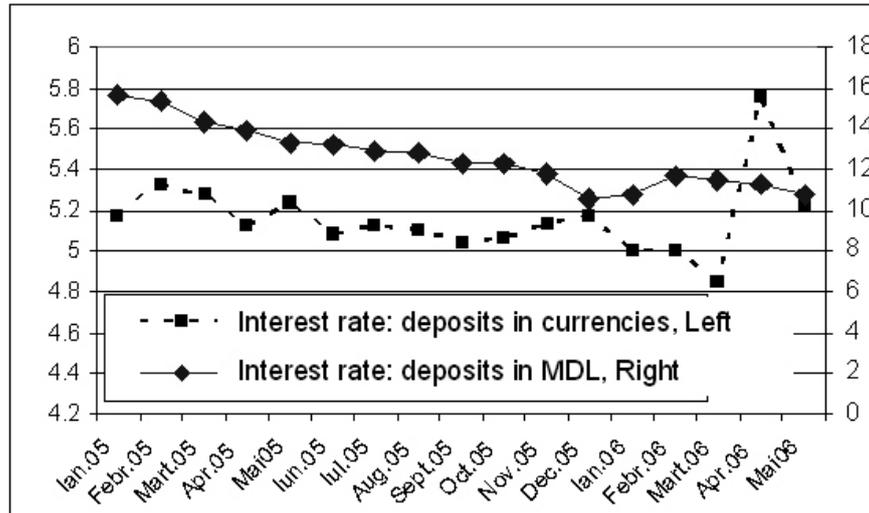
***Diagram 10. Evolution of bank deposits in MDL and in foreign currencies***



***Source: Calculations of the CEP based on data from NBM.***

At the same time, the higher demand for currency deposits made possible for the commercial banks diminish the interest rate thereof and to increase, at the same time, the interest rate for currency loans. The phenomenon is very obvious, given that on the international markets the interest rate for both US\$ (LIBOR), and Euro (EURIBOR) has been increasing during May of the current year.

**Diagram 11. Average interest rates for MDL and foreign currencies**



Source: Calculations of the CEP based on data from the NBM

## ● THE IMPACT OF THE SITUATION IN THE WINE-MAKING INDUSTRY ON THE EXCHANGE RATE. FORECASTS

In April-May of the current year, on the currency market of the RM an opinion has been wide-spreading that the difficult situation of the wine-making industry exports might imply, in autumn, a depreciation of the MDL. It is this why we have set our goal in this issue to analyze these forecasts which have created panic on the currency market.

The opinions with regard to MDL depreciation are based to a great extent, on the assumption that the cease of wine-products exports to Russia could reduce considerably the cash collections from exports, which are necessary for up-keeping the balance between the supply and demand of the foreign currency market in the RM.

The statistical data show something else. In 2005 the wine-making industry has exported produce worth US\$ 208,3 mln. At the same time, we estimate that the wine-making industry has imported from Russia primary goods worth at least US\$ 23 mln for production needs and some other US\$ 15 mln (estimated) have not been repatriated. Thus we consider that the exports of the wine-making industry to Russia have generated net collections of approximately US\$ 170 mln.

Cash collections' missing in the current year will not trigger devaluation of MDL, due to also many other forces that might compensate for these losses of currency; namely:

1. An important factor will make up the remittances from abroad. The months of August-September are characterized by a higher consumption. This fact implies higher remittances from abroad in this period. Should we analyze the evolution of the turnover of the currency inter-bank market (which comprises the most currency operations of the individuals)<sup>1</sup> one can notice a high turnover rate in Dec.-Jan. (winter holidays period) and in Aug.-Sep. In these periods the supply of the foreign currencies in the RM increases suddenly, thus, triggering the trend of MDL appreciation.

2. The NBM avails of an excess of currency reserve. The NBM will not allow a significant devaluation of the MDL. Currently, the currency reserves of the NBM make up US\$ 650 mln and the NBM avails an excess of currency reserve of approximately US\$ 60-70 mln. In case of need, the NBM will be able to intervene on the currency market to meet the temporary demand of foreign currency.

If in Aug.-Sep. one could eye, typically, a pressure on the MDL on appreciation, this year the forces will get compensated. The most pessimistic scenario of ours assumes that the national currency will depreciate at most by 3-5% versus the US\$, and in no way will ever register a dramatic devaluation. On the longer-run, however, the rate of import coverage by exports will diminish and this factor might imply a devaluation of the national currency<sup>2</sup>.

1 Currency transactions of the companies are re-included in the category of inter-bank currency operations.

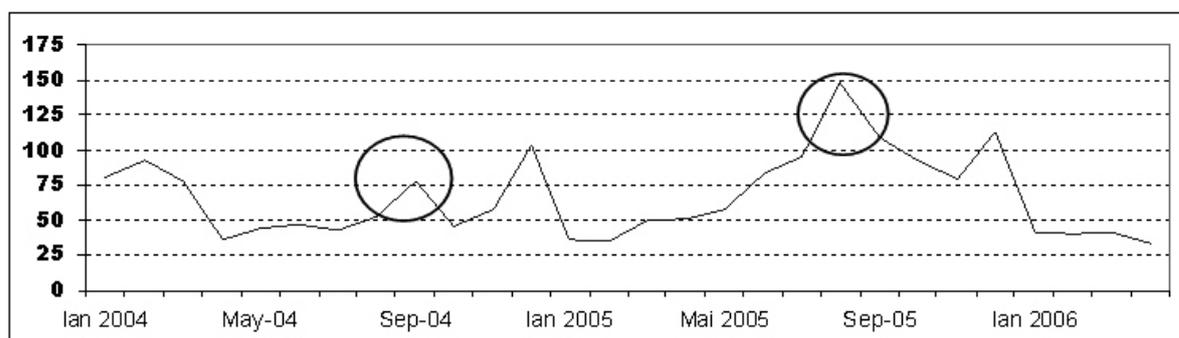
2. This factor has persisted since the introduction of MDL into circulation.

**Table no 3. Net export of the wine-making industry to Russia, 2004-2005**

US\$ mln	2005
Grapes wine, embattled	176.9
Sparkling wines	9.0
Wine – as raw material	22.4
Total export, wine-making industry	208.3
Imports of the wine-making industry (estimate)	23
Non-repatriated currency	15
Net export, wine-making industry (estimate)	170.3

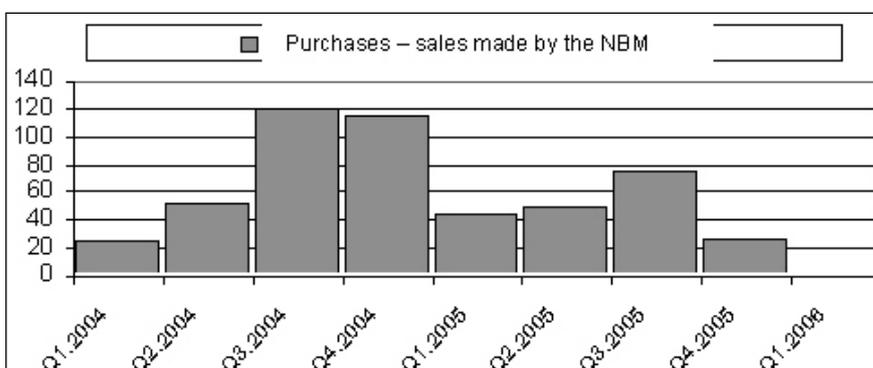
Source: Moldova-Vin

**Diagram 12. Monthly turnover of the inter-bank currency market; US\$ mln, Jan. 2004-Apr. 2006**



Source: Calculations of the CEP based on data from the NBM

**Diagram 13: Balance of Net Acquisitions Made by the NBM, USD mln, Q1. 2004 - Q1. 2006**



**On the longer-run, decreasing import-export ratio might trigger a devaluation of the national currency.**

Source: Calculations of the CEP based on data from the NBM

## **On global arena, one can notice a rise of credit cost.**

In the period of 1 to 15 June 2006, 12 central banks of the world (most of them being of the G8) have increased the discount rates. These increases have been justified by the inflationist pressures which have been occurring at global level, as a result of raising price of energy resources and of construction materials. The interest rate has been increased for US\$ including, and Euro. The event will impact, undoubtedly, upon the increase of the interest rate on deposits in foreign currency raised by the commercial banks of the RM, which will make the foreign currency deposits be more advantageous in the second half of the current year. In the first half of the current year, interest rates started to grow on deposits mobilized in foreign currency, from the yearly average of 5% in Jan. 2006, to 5,23% in May 2006.

## **Conclusions and forecasts**

***The MDL devaluation will reach at worst 5% in 2006.***

We insist on our forecasts with regard to interest rates on the Moldovan market, considering that by the end of the current year, the NBM will raise the discount rate. This raise will be determined to a great extent by the inflationist effects emerged during the first two quarters which will condition the change of trend, because the discount rate has been being decreased during the last two years. In case the NBM will decide to raise the discount rate, partially the problem will be resolved of liquidity excess in the economy, and, at the same time, loan marking-up will be triggered.

We consider that the situation implied by the "wine war" will not imply a significant devaluation of the MDL. The MDL devaluation will reach in 2005, at worst - 5% versus the US\$.

As a result of the situation on the currency market, which implied modifications in the MDL bank deposits' evolution, our forecast with regard to the final balance of bank deposits for 2006, have implied some changes. We foresee that the bank deposits in MDL will grow by only 32% versus December 2005, much below the increase of 47% registered in 2005. The monetary aggregate M2 seems to evolve in tandem with the our previous forecasts, in the last 12 months having increased by only 20%, which is a positive manifestation, given that the liquidity excess seems to get balanced.

# PUBLIC FINANCE

## General trends

After a spectacular growth of the budget incomes in 2005 the year 2006 seems mostly as a worrisome stagnation. The basic state budget incomes will make up about MDL 8,8 mlrd. And will outpass the volume planned by about 5%.

Although the Moldovan economy registers negative growth, nevertheless the poor trend has not impacted the state budget essentially, which denotes a weak link between the state budget and the national economy.

While a clear strategy is missing on country development attraction of foreign resources becomes a more difficult objective to be realized. Attraction of foreign funding will be possible only by means of investment projects, which curtails the actions of the Government and essentially reduces the volume of raised financial resources. The most probably the first funding will take place only at the beginning of 2007.

***In 2006 a stagnation will be eyed of budget incomes growth***

## In 2006 the state budget will deplete its growth basis

As anticipated also in the previous numbers it is already obvious our forecast with regard to growth rate of incomes to the state budget.

Without a radical change of the economic development paradigm of the country one cannot ensure the development and respectively, in the following years, the Government will face problems related to accumulation of incomes to the state budget.

The year of 2006 is the last year when the VAT will serve as driving force for the incomes growth to the state budget. However, unfortunately, other forms of income have not become yet a real source of growth.

The negative symptoms from the national economy, have been seen in the first half of 2006, when the growing rate in most economic sectors has become negative. However, the negative processes in the economy, as expected, did not impact the budget incomes. They are at least executed in compliance with the forecasts of the Ministry of Finance, the difference being that the "sur"-incomes of this year will be much less than in 2005. This fact denotes once again that the state budget does not have any link with the economy of the country, which makes it very vulnerable in terms of incomes, because the Government does not have any leverage to impact on its execution. The economic basis, which ensures the state budget execution is beyond the competence area of the Government.

***The VAT in 2006 will lose the driving force role in growing budget incomes.***

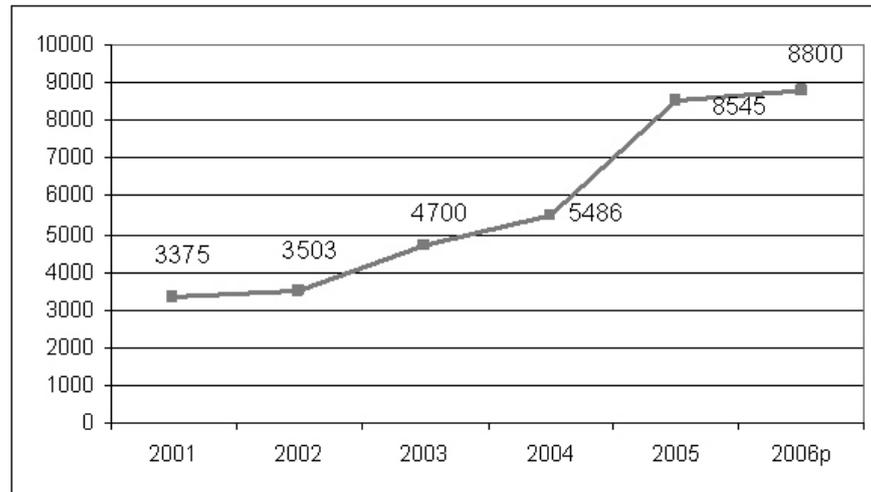
The tensed economic relations with the Russian Federation and the „wine crisis” did not impact negatively on the state budget, yet, it showed in detail how fragile and dependent is the most important branch of the national economy. Over and above, this crisis showed a well known fact for us, that the decision making center in the priority sector for us is not in the Republic of Moldova, and both Government and economic agents, cannot undertake anything to save the situation.

**After spectacular growth of 2005 currently we eye a worrisome stagnation of the budget incomes**

Evolutions of the Q II, have proven our forecasts concerning the declining tempo of remittances from abroad, which declined almost 2-fold versus 2005, which confirms our hypothesis with regard to diminishing in the future of the VAT role in raising the budget incomes.

We continue to believe that the state budget in terms of incomes will be executed at an excessive rate versus the forecasted incomes of at least +5% and the total collections will make up over MDL 8,8 mlrd. We want to just mention that the state budget for 2006 in terms of current incomes has been approved in a very pessimistic scenario, with incomes of MDL 8,18 mlrd., in situation when it was already clear that in 2005 it will be executed in this regard not less than MDL 8,4 mlrd., which was proved (see the Chart below).

**Diagram 14. The trend of the state budget incomes**



**Source: The State Budget Law 2000-2006, forecast of CEP experts**

**Missing a clear strategy of country development, is the main impediment in raising foreign grants**

As we anticipated in the previous issue the Government signed successfully the Memorandum with the International Monetary Fund, yet, missing a vision with regard to further development of the country, the defective mechanisms of public money allocation in the investment projects, reduces considerably the capacity of the Government to fund-raise foreign resources. We consider that by the end of the year in terms of foreign grants will occur nothing significant and with no improvement of the public finance system, and a clear delimitation between the local budgets and local budgets, is difficult to attract financial resources from abroad.

## ● FOREIGN FUNDING THROUGH THE ANGLE OF QUALITY OF GOVERNANCE

After many years, the Republic of Moldova in 2006 has unfrozen its relationships with the international financial institutions. In conditions of an insufficiency of domestic financial resources, it is impossible to develop the national infrastructure without foreign financial support.

However, the form which can be taken by the relations between the Republic of Moldova and main donors and international financial institutions depends by the quality of governance and ability of the public authorities to form clearly the agenda of the Governance.

Foreign financial resources can come to Moldova by two ways:

1. Structural reform fund
2. Funding by means of projects

The first form of funding is promoted when all international actors are sure in the capacity of the national authorities to form adequate strategies of development and when the state institutions have a due preparation and competence level to realize the established objectives.

The second form of funding is typical to weak states, with no clear vision and with weak state institutions, and particularly corrupted. In this case the funding fields are usually established by the funding entity.

One could affirm, with a high degree of certainty, that for the RM the second way of funding will be

chosen. Which means that:

1. The foreign loans will be offered only for specific investment projects and not as grants of general destination.
2. The European funds, starting from 2007, will not be offered for structural reforms to public institutions, but in form of projects to the NGOs.

This newly profiled relation between the RM and the International Financial Institutions have two negative effects:

First of all the allocation procedures of the financial resources take very much time, given that the Government has not formulated a clear-cut strategy of development which might be supported financially, and any time needs to be subjected to acceptance procedure for each project activated by it.

Secondly, the amounts that can be raised are much smaller than in case of existence of an acceptable strategy of country development.

This state of affairs denotes the low level of trust on behalf of the donors, in capacities of the national public institutions.

Without an increase of the credibility in the public institutions and without formulation of a clear agenda of country development, it is impossible to get financial resources, either in form of grants or loans, so much necessary for development.

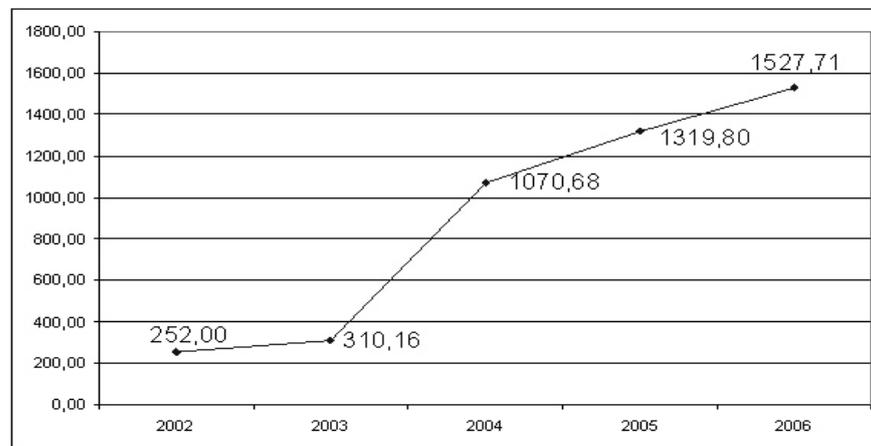
## In the last five years the expenditures for health care have increased 6-fold

**Expenditures for health care have increased 3-fold faster as the other public expenditures**

In 2006 the basic costs of the state budget will grow 2-fold compared to 2002 and will make up about MDL 8 mlrd., versus MDL 3,9 mlrd. In 2002. If in most fields of activity a uniform growth was observed, then, due to reforms commenced in 2003-2004 the costs for health care in the respective period have grown 6-fold, from MDL 252 mln. in 2002 to over MDL 1,5 mlrd. In 2006.

The most tangible growth was registered in 2004 once with the creation of the Health Care Mandatory Insurance Fund. Once with the implementation of the new system of health care insurance for each employee 4% are paid from the salary (2% by the employer and 2% by the employee), and those who do not have a job, can buy the insurance police, whose price is established on yearly basis.

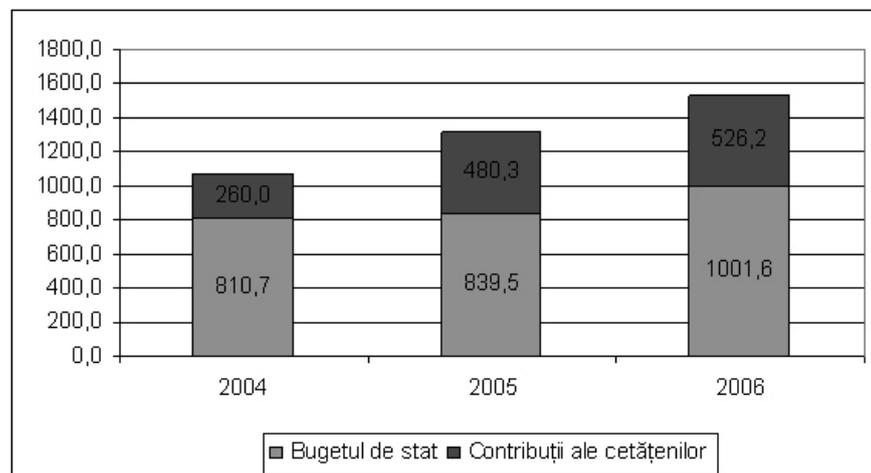
**Diagram 15. Trend of costs for health care**



**Source: State Budget Law on 2002-2006, the Mandatory Health Care Insurance Fund 2004-2006**

The state budget remains the largest contributor for formation of the Health Care Fund. In 2004 the share of transfers from the state budget accounted for 75% of the overall health care fund incomes. In 2006 the contribution of the state budget to formation of health care fund will diminish to 65%, mostly due to raising the health care insurance polices paid by the employers and employees.

**Diagram 16. Formation of Health Care Insurance Fund**



**Source: Law on Mandatory Health Care Insurance Fund 2004-2006**

However, of the total adult population able to work are employed, and respectively pay the Health Care Insurance Premiums only 25%. Beside them there are some more 25% who perform a certain economic activity and, according to law are obligated to purchase Health Care Insurance policies. Should all the people employed in the national economy buy Health Care Insurance policies then the Health Care Insurance budget would collect additionally MDL 450 mln. to those 28 mln. as are collected de facto. This amount could be collected besides the other 50% of the population who are not employed in the national economy.

***Improving the system of health care insurance premium collection would collect additionally some MDL 450 mln.***

This is why the state, as best payer, is also the biggest payee to the Health Care Insurance Fund. Normally, the share of transfers from the state budget should not exceed 25-35% of the overall incomes of the Health Care Insurance Fund. In other words, the reserve of the Health Care Insurance Fund growth reserve is of minimum MDL 500 mln. as on 2006.

In most European countries it is considered that a normal functioning of the health care system can be insured only should the contributions to the Health Care Insurance Fund be of minimum 7% of the salary.

We consider that during the next several years, in order to improve the Health Care Insurance System the following actions should be undertaken:

1. Increase one a 2 years, by one percentage point, the contributions to the Health Care Insurance Fund, so that this grows from 4% to 7%. This would make possible to increase the incomes of the fund by 75%.
2. Improve the system of premiums collection from non-waged individuals, which would make possible raising collections to the health care fund by 30-50%.

Should we extrapolate the suggested actions, for 2006 the total incomes of the mandatory Health Care Insurance Fund would make up at least MDL 3,5 mlrd.

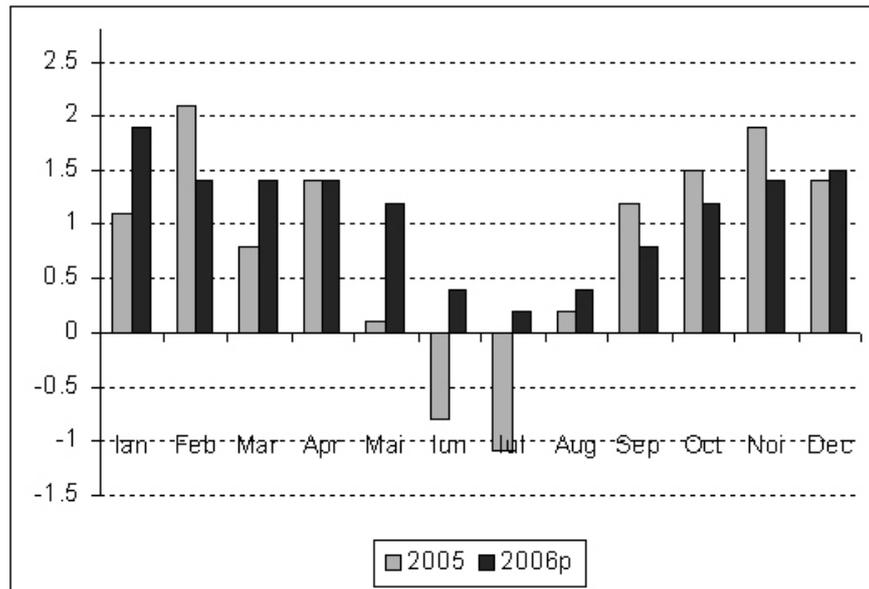
# PRICES

## Prices continue to raise

In the first quarter of 2006, the price level increased by more than 7.5%, which accounts for over half of the forecasts made by the National Bank for this year. The high increase rate of inflation is mainly determined by the increase in prices for food and energetic products.

### Diagram no. 17. Monthly inflation rates for 2005 and the forecasts for 2006

**For 2006, we foresee an annual inflation rate of 13%.**



Source: DSS, ME estimations

For 2006 we keep our forecasts of an annual increase in the price level by 13%, which is mainly determined by the following factors:

1. The inevitable increase in the price for gas by the end of 2006;
2. The high oil prices will not go down and stay at the level of 65-70 USD per barrel in 2006.
3. The ban on exports to Russia can increase the unemployment rate, the external trade balance deficit, and the budget deficit.
4. Inefficiency of the national economy that risks to collapse at any time.

## The gas price will reach 160 USD for one thousand m<sup>3</sup> by the end of this year.

The increase in the gas price up to 110 USD was not fully reflected yet in the consumer price index that is why the CPI will continue to increase under the influence of the new price for gas. Even if the Government manages to

obtain the price of 110 USD for one thousand m<sup>3</sup> of gas in the third quarter of 2006, in the fourth quarter we have the certainty that the price will be increased up to 160 USD. Moreover, Russian mass-media claims an initial price of 180 USD for one thousand m<sup>3</sup> of gas, calculated on the basis of a specific methodology adjusted to the evolution of the world prices for oil.

The Government does not have the necessary leverages to negotiate an advantageous price for gas. Under these conditions, Russia will decide when and to what extent to increase the price. On the other hand, the uncertainty regarding the gas price must not be maintained for ever, because business entities are not able to plan correctly their business. The incapacity of the Government to sign a long-term contract on gas supply determines further speculations concerning the level of inflation.

***The incapacity of the Government to sign a long-term contract on gas supply determines further speculations concerning the level of inflation.***

In this context, the government strategy on local tariffs for natural gas is not clear. Even if the increase of tariffs is imminent, they have not been restructured for better seasonal tariff balancing. The prices will presumably increase in the fourth quarter and the Government, unfortunately, doesn't have an additional plan for the unfavorable situation that will emerge, aimed at diminishing the dissatisfaction of the population.

On the other hand, the structure of tariffs for the end consumers makes us think that households pay for a part of the gas consumed by electric-thermal plants. The tariffs paid by electric-thermal plants are under 110 USD for one thousand m<sup>3</sup> of gas. Thus, we have a feeling that households (mostly rural population) sponsor the heating of urban population during the winter. Statistical data show that, in fact, urban population has a higher living level than that of rural population.

***The structure of tariffs for the final consumers makes us think that households pay for a part of the gas consumed by electric-thermal plants***

Another important consequence of the increase in gas prices will be the imminent increase in price for electricity. The possibility of Cuciurgan Thermal Electrical Plant to cease its activity is not advantageous for RAO EAS (hence to the Russian Government), consequently the imports of electricity at 2.5 cents for a kW/h will not last for a long period of time. Russia is not exporting electricity to Moldova any more. Ukraine, like Moldova, has problems in maintaining the gas price. An eventual increase in the gas price in Ukraine will, in turn, increase the price for the electricity supplied to Moldova.

Obviously, the increase in energy prices will mainly affect the households and will raise people's dissatisfaction. The National Economy will be less affected, because basically there is no national economy in Moldova. Even if a threatening situation is foreseen, the Government doesn't seem to be prepared to prevent the negative effects generated by an eventual increase of gas prices.

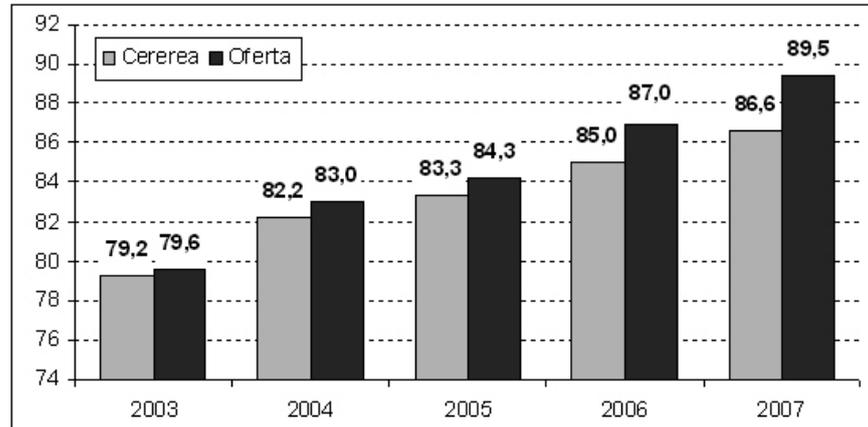
## **The prices for oil will stay at the level of 65-70 USD/barrel in 2006**

The uncertainty on the world prices for oil is still maintained by Iran's nuclear program, by the high economic growth in Asian and Eastern European countries, as well as by the political instability in the region of the Persian Gulf. The world demand and supply of oil is in an almost perfect balance; that is why, an insignificant reduction of the oil supply could generate disequilibrium, and as a result, the prices could blow up.

Nowadays, any speculation on the initiation of military actions or of economic sanctions against Iran will lead inevitably to the destabilization of the world market and to the increase in the oil price.

According to the estimates of *Economist Intelligence Unit*, Iran supplies about 2.6 mln. barrels per day on the world market, while the oil supply exceeds the demand only by 2.0 mln. barrels per day.

**Diagram no. 18. Oil demand and supply, million of barrels/day**



Source: [http://www.viewswire.com/index.asp?layout=IWArticleVW3&article\\_id=240200209%20&refm=iwIndustry&industry\\_id=280000028](http://www.viewswire.com/index.asp?layout=IWArticleVW3&article_id=240200209%20&refm=iwIndustry&industry_id=280000028)

According to the estimates of *Economist Intelligence Unit*, the oil production capacities will increase insignificantly in 2007, thus diminishing the danger of disequilibrium on the world market. The average price for oil in 2007 is expected to be lower than in 2006 and will amount to 60-65 USD for one barrel.

## The ban on wine exports to Russia can pose additional inflation pressures

The ban on wine exports to Russia will increase the commercial balance deficit. In the first quarter of 2006 the wine exports decreased significantly, at the same time, the efforts to enter other markets are not successful yet.

Most wine factories and raw material suppliers have reduced their activity sending many employees in forced vacation. Thus, the wine-making industry will pay fewer taxes to the state budget, causing an increase in the budgetary deficit.

As a result, a bigger budgetary deficit will generate additional inflation pressures, and the dissatisfaction of the employees caused by the loss of income will cause a new wave of emigrations.

The problem gets more serious because of the commitments assumed by the Government towards the employees of the state sector concerning the rapid increase of salaries.

In our view, the issue of resuming the wine exports to Russia is related to the establishment of the macroeconomic balance. The settlement of this

**The only destination of financial reserves of Moldovan population is the consumption, given the lack of attractive investment projects.**

**The maintenance of the crisis of wine exports to Russia can generate the increase of the budgetary deficit.**

problem is also beneficial for the reduction of inflation pressures.

## **The inefficiency of national economy favors inflation**

Massive currency transfers have stimulated consumption, and, consequently, contributed to the increase of inflation pressures. During the last three years, consumption increased by an annual average rate of 20%. In fact, most of the funds that came from abroad were oriented towards end consumption, while investments represent less than 20% of the total consumption. The lack of attractive investment projects, poor functionality of capital markets have determined the population to consume its reserves or to keep them out of the banking system, ignoring the investment variant.

After having remarked the population's tendency for consumption, the businesses have increased the prices, thus we are in the situation when Moldovan consumers have to pay bigger prices for some products than the Romanian and Ukrainian consumers.

On the other hand, unprofessional management and unwillingness to risk also determine bigger prices for products and services on the market.

The lack of intermediaries that affect adversely the prices, the withdrawal of profits from the country via off-shore zones, the misunderstanding between managers and company owners, etc. make our economy sensible to eventual external crises, and impact indirectly the exchange rate, increasing thus the inflation rate.

## **The separation of enterprises into smaller units generates inflation and inefficiency**

In terms of the turnover, the Moldovan enterprises can be classified as small business (with 3-4 exceptions) according to the international classification. Small enterprises have certain advantages related to the specialization, oriented towards a specific client segment, but they cannot form the basis of the national economy. On the contrary, they are oriented towards serving big enterprises, often being inefficient without the big enterprises. The main problem of small enterprises is the high production cost, as they cannot benefit from economies of scale. Big enterprises can develop trade marks and promote them on bigger markets, are less vulnerable to environment factors and have lower unit costs.

In the Republic of Moldova there are plenty enterprises. However, being inefficient, they are forced to constantly raise the prices in order not to go bankrupt and have some profits. The Government is trying to support these enterprises by imposing barriers to imports, but the efficiency cannot be achieved in such a way. For example, in the construction sector the excessive fragmentation of enterprises has generated costs by over 50% bigger than they should be, in the banking system the interests are 2.5-fold bigger than those offered by EU banks, within the insurance system, the companies impose the payment of exaggerated and unjustified payments, etc. Moldovan enterprises solve the internal problems, which are related to profitability, by simply increasing the prices, without trying to increase the efficiency using the internal reserves.

Some paradox situations are known when individuals build houses on their own, because the construction companies request extremely high prices.

Lately, a more active presence of foreign companies is reported in the fields that were recently regarded as "local": there are fewer local food products in supermarkets, the foreign commercial banks try to enter the local market, foreign construction companies declare more and more frequently their presence, and the retail trade belongs to a big extent to foreign capital companies.

If the past strategies approached export promotion, now the focus needs to be turned first of all on the maintenance of the local market by local enterprises because we risk losing what we still have.

# SOCIAL SPHERE

## Labor force disequilibrium confuses the business and investors

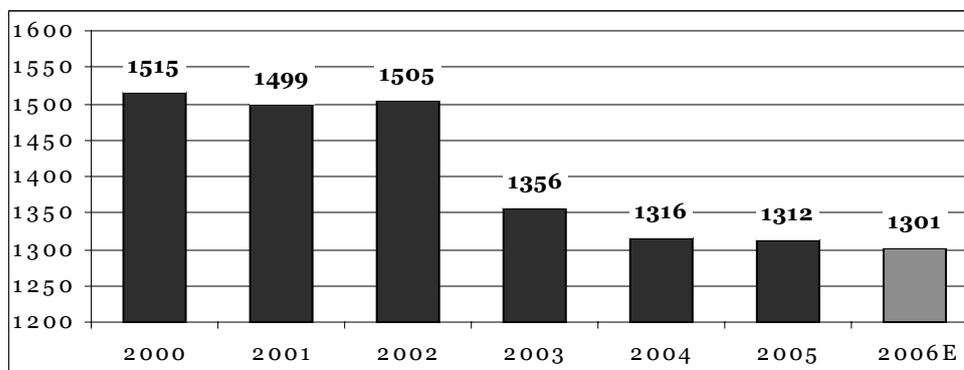
The situation on the labor market, in the first semester of 2006 continues to be rigid triggering structural and territorial disequilibria in the national economy.

The problem of labor force disequilibrium in Moldova is so poignant, that the fact of having a job does not account for a guarantee against poverty. Paradoxically, according to recent data of the Ministry of Economy, the poverty rates are higher among the people who work, than among disabled, the ill, or students. This situation makes more and more Moldovans look for jobs abroad. In 2005 the number of emigrants has increased by 14.3%, versus the previous year (or by 85.9%, versus 2000). The forecasts of the CEP for 2006 are similarly pessimistic. We consider that the number of Moldovan emigrants will grow by 15%, respectively the share will raise up; 30% of individuals declared as left abroad from the overall number of the economically active population (in 2005 this share accounted for 27.7%).

At the same time, on the labor market another alarming situation is being profiled – **labor force deficit**. In several sectors of the national economy signals are frequently received in this sense. This fact creates real risks for GDP growth.

**Poverty rates are higher among people who work, than among the disabled, the ill, or students**

**Diagram no 19. Evolution of the employed population, thou people**



**Source: DSS, CEP estimates**

The data for the first semester of 2006 and CEP estimates for the same period show the population employed in the industrial sector will diminish by about 5% in 2006. The decline of the industrial gross output since the beginning of the year confirm our prediction. Moreover, slowing down tempo of economic growth forecasted for 2006 can contribute, to bigger extent, to diminishing the degree of employment of the population in the economy.

We should mention that the IMF pointed attention of the Government, repeatedly, that the labor force statistics is inadequate for macroeconomic analysis. This has been confirmed by the fact that data is missing on unemployment based on WLO methodology, whereas the data on salaries do not include additional bonuses, which for an important part of remuneration<sup>1</sup>.

<sup>1</sup> IMF Report on consulting on the Article IV of 2006.

**Manner and level of wage-earners labor motivation does not stimulate the labor force.**

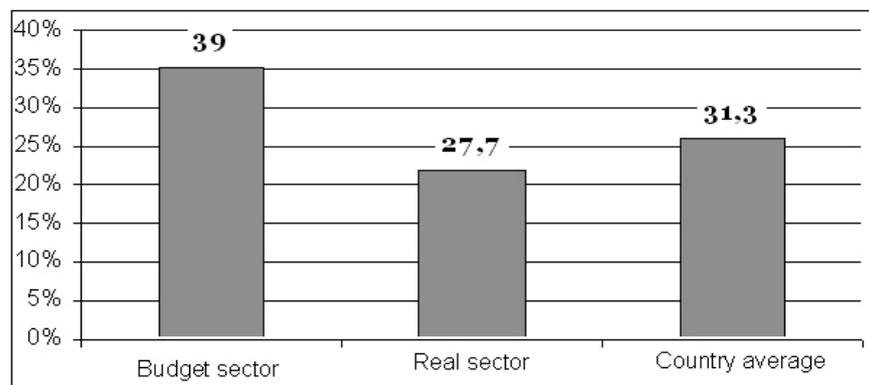
The poverty in Moldova is impacted not only by the employment rate, but also by the source of main income of the population. It has been mentioned frequently that the manner and level of motivation of wage-earners does not stimulate currently the labor force of this country, which contributes to up-keeping an additional factor of pauperization. According to forecasts of the Government, in the period of 2005-2008, the average nominal salary, in the economy as a whole, will raise 2,5-fold, versus 2004, and will get in 2008 the amount of MDL 2765 (USD 216), and the labor payment fund will increase 2,3-fold, to get the amount of MDL 19,3 mlrd., or 33,4% versus the GDP, compared to 26,7% in 2004<sup>2</sup>. On the other hand, according to the Mid-term Expenditures Framework (CCTM)<sup>3</sup>, it is expected that the real growth rate of the monthly average salary in the economy will make up 12% in 2005 and 2006, reaching 17-18% in 2007-2008.

Taking into account that the Government of the Republic of Moldova has made already expenditures worth approximately 40% of GDP (which is too much compared to other countries with a similar level of incomes per capita), "the high raise of salaries from the public sector reached in 2006 is regrettable and the authorities have been advised by the IMF to provide for mid-term the conformity of the salaries with the CCTM and, thus, with the growth objectives as established"<sup>4</sup>. In other words, the Government has the obligation to change the policy priorities on the labor market, by focusing on the stimulation of the evolution in the real sector, by improving the business environment and creating an attractive investment climate (with the view to raise the tax basis of the national budget and to create more well-paid jobs).

At the same time, the official data of the NSB show that in the first semester of 2006, the average monthly salary has increased by 26%, due to, a large extent, raising salaries of budget paid wage-earners, and the real salary has increased by only 13,5%. Also, the monthly average pension has increased, actually, by 22,5%, versus April 1, 2005.

Taking into account these key-factors (which in the following three years will continue to profile the situation on the domestic labor market), depending on the anti-inflationist aims of the NBM and of the Government (See the Chapter Monetary Policies), the CEP forecasts a slow-down of the salary raising tempo in the public sector in 2006-2007 by about 12%-13%.

**Diagram no. 20. Salary growth in the 1-st semester of 2006**



**Source: DSS, CEP estimates.**

<sup>2</sup> Macroeconomic indicator parameters for the years 2006-2008, adjusted to the stipulation of the Government Action Plan for 2005-2009 "Modernization of the country – welfare of the nation" (updated in Aug. 2005, the Law on salary establishing system based on budget sector and of salaries for individuals holding offices in the public sector, 355-XVI 23.12.2005

<sup>3</sup> Government Resolution no. 1079 dated 19.10.2005

<sup>4</sup> IMF Report on consulting on the Article IV dated 2006.

**Non-financial incomes, including the ones from the land-ownership, do not contribute to raising incomes from savings.**

Once with the raising retribution for the public sector employees, the rapid growth of salaries, first of all in the financial sector and constructions, will continue to impact on the salary dimension in modifying the incomes of the population in the next two years. According to estimates of the CEP, the share of salary incomes in 2006 will contribute to raising incomes of the households by 56,5%.

On the short and middle terms, the share will continue to grow of the social services in the incomes of the households, first of all, of pensions, whose increase will make up at the end of 2006 about 15.7%.

**Conclusion:** In 2006-2007, the emigration and flow of remittances from abroad will continue to make pressures on the size of salaries and provoke significant macroeconomic consequences, implying both raising consumption level of the households, and diminishing demand of labor force.

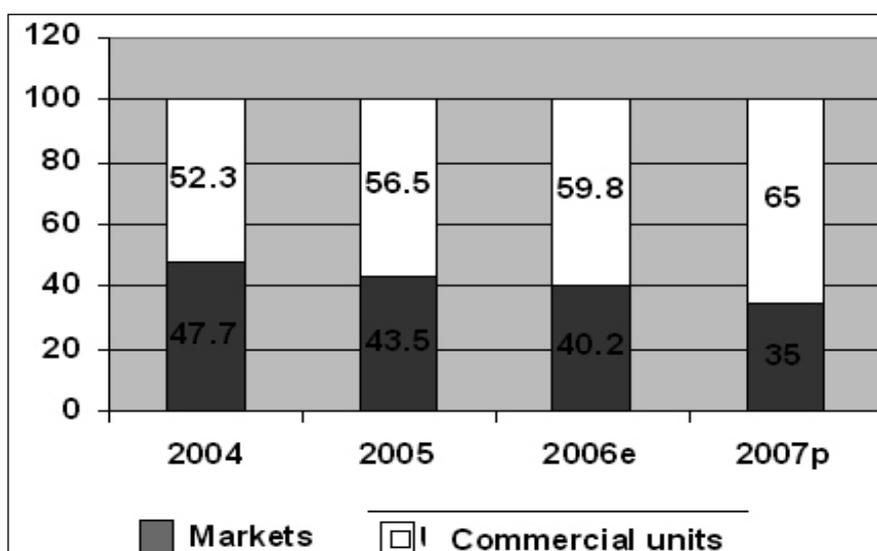
## The current model of economic growth is not based on sustainable potential

In the Q I of 2006, the GDP increased in real terms by 6,2%, versus 8,2% in the same period of 2005; the tempo of net added value has made up 3,5%, in real terms, versus 6,4% in 2005 (see the chapter *Industry*). The picture of economic growth has not changed versus the previous year, given that the final consumption increased, exceeding the consumption of the same period of 2005 by 13%, which triggered also the raising inflationist potential of the consumption demand. (see Chapter *Prices*).

The increase of the aggregate demand continues to stimulate, subsequently the increase of imports which in 2006 rose by 15% (versus 8,6% in 2005), being funded, to a great extent, by massive remittances from abroad. In line with that, in 2006-2007 the share will continue to grow of the retail sales and of services supplied to the population via commercial units.

***In 2006 the economic growth picture did not change versus the last year, due to rapid growth of final consumption; this way the inflationist pressure was stimulated.***

**Diagram no. 21. Retail Sales Structure**



Source: BSS, CEP estimates

**Excessive tempo of final consumption growth, compared to GDP growth is explained by the trend of legalizing the undeclared incomes.**

In the expenditures of the emigrant families, as in the previous years, domestic consumption preferences keep being structured as follows: basic consumption needs, housing and children education. This fact stimulates a rapid growth of services offered to the population (by 8% in Jan.–Apr. 2006) and of retail trade (by over 11% in the Q1, 2006). In 2006, the CEP envisions a growth of the retail trade by about 12% and of services offered to the population by about 10%.

The volume of investments in business by the households will continue to be insignificant, thus revealing the trend of currency means as a stable and non-cyclical source, of short term.

In 2006, as in the previous year, the tempo excess has been observed of final consumption growth, versus the GDP growth, this fact being explained by legalization of the unofficial economy, whose share in the national economy is over 45%, according to NBM estimates.

#### **Consumption versus GDP; MDL thou, current prices**

	2001	2002	2003	2004	2005	2006e
<b>GDP</b>	19052	22556	27619	31992	36200	40226
<b>Final consumption</b>	19263	23289	30450	33832	40700	48026
<b>Households</b>	16385	18493	24711	28576	34500	41698

*Source: DSS, CEP forecasts*

Of the mentioned above, one can easily eye the focus in the next several years of the trend on formalizing the incomes, by consumption, which might mean to exceed the growth tempo of the final consumption versus the growth of GDP, whose main share accounts for the household consumption.

## **Growth without development**

**Despite the economic growth of the last six years, in 2005 for the first time since 1999, a growth was registered of poverty rate.**

Despite the economic growth of the last six years, in 2005, for the first time after 1999, a **growth was registered of the poverty rate**; of that risk the experts of the CEP have been warning during the whole year of 2005 (see ES, 2005). This phenomenon has been caused, to a great extent, by growing poverty rate in the rural area, where the number of employees in farming means nothing but lack of employment opportunities in industrial and service sectors, *i.e.* poverty deepening.

During 2000-2004, the economic growth has been accompanied by constant and significant reduction of the poverty rate and inequality. At the same time, in 2003-2004, some more worrisome signals have been registered concerning incoherent policies and inefficient policy of resources usage which implied failure to reach the previously declared aims. Consequently, once with the GDP growth, during several years, the poverty level increased (by about 3% in 2005, versus 2004). In 2005, 1/3 of the citizens of Moldova (29%) live in a deep poverty<sup>5</sup>, and 16% are on the verge of total poverty<sup>6</sup>; in the rural area, the poverty risk has been 6-fold more than in Chişinău and

<sup>5</sup> Estimated by comparing the consumption costs per adult person, equivalent with the absolute poverty line – MDL 353,87.

<sup>6</sup> Estimated by comparing the consumption costs per adult person, equivalent with the poverty line, based on the food products consumption –MDL 278.52.

Bălți and increased by 2% versus the small towns. During 1998-2004, the level of poverty has been continuously declining, whereas the last year a growth was noticed of the income deficit of the poor individuals, compared to the poverty line.

In 2005, inequality rose of material status: 20% of the most better-off households used 45% of the total consumption (versus 43,9% in 2004 and by 45% in 2005), and 40% of the poorest families have consumed less than 20% (versus 7,2% in 2004 and 6,7% in 2005).

It is important to mention the fact that virtually all the poor house-holds from the rural area avail of, smaller or larger, land plots, but this fact did not contribute to improving the material status of these families.

### **Human development indicators**

	2000	2002	2004	2006p
Share of population with daily income less than 2\$, %	64.5	39.8	27.8	28
Gini Coefficient	0.34	034	...	
Life expectancy; years	67.8	67.0	...	
Child mortality rate (per 1,000 of live delivered)	23.3	18.2	15.3	15
Maternal mortality rate (per 100,000 deliveries)	27.1	28.0	23.5	23
Mortality rate associated with tuberculosis (deaths) per 100,000 individuals	16.9	15.8	16.8	13.9
Share of population with sure access to water resources; %	37.8	38.5	44.5	47.7
Share of population with access to certain sanitation services, %	41.1	41.7	43.6	56.0

*Source:* Ministry of Economy and Trade; Data base of the NBM: Development indicators; 1/Inequality of available incomes distribution.

We finally conclude, that the current model of economic growth, based on consumption, does not comply with the Millennium Development Objectives (which Moldova has committed to fulfill). While in several fields, such as: child birth decline and assuring access to safe drinking water sources, some tangible results have been reached, up-keeping the Human Development Indicators represent a more difficult test for the authorities of the RM. According to recent data of the UNFPA, the Population of Moldova has declined by almost one million due to emigration of the last years, dramatic decline of birth rate, whereas the ageing of the population has impacted considerably the scale economy of the country.

***Population of Moldova has diminished by about one million due to emigration, radical decline of birth rate and population ageing.***

# TRANSNISTRIA

## General Trends

**Lately Transnistria has continued to exercise its role of „tension factor“**

Lately, Transnistria has continued to exercise its role of „tension factor“<sup>1</sup>, according to its political mission it was vested by Russia since the eve of the transnistrian armed conflict of 1992. The administration from Tiraspol displays total „fidelity“ towards any moves made by Russia in order to destabilize the situation, maintain the Republic of Moldova vulnerable and „under eastern influence“, even in terms of the banal problem of wine exports (RBC, 2006)<sup>2</sup>.

In the region, more and more aggressive measures are resorted to in order to intimidate any social initiative of the population from that territory, a behavior typical to any ultra-centralized regime; as an example can be the ban laid by the local „authorities“ to get financial support, in any form and any kind of activity, by NGOs<sup>3, 4</sup>. The behavior and attitude of Tiraspol unveil its designation and the true aim<sup>5</sup>, which before the reaching the bi-lateral Agreement between the Republic of Moldova and Ukraine, on border securitization between the two, could be „disguised“ by various speculations. Anyway, those 196<sup>6</sup> economic units from Transnistria registered for getting the official customs documents to legalize foreign trade transactions, for exporting produce on the European markets, are some results worthy of attention, but which do not cancel the problems to a great extent.

## Industry

In Mar.-Apr. 2006, the industrial sector of the transnistrian zone registered a decline of production output, which was qualified by the „transnistrian central bank“ as lowest level of growth during the last three years (101,1%). In 2005 the nominal GDP of the region reached the amount of trr<sup>7</sup> 4 198,6 mln or USD 517,5 mln, which in real terms exceeds the respective indicator for the last year by 11,8%. In the last year, the GDP per capita increased by 25,0%, having reached the amount of USD 844,0.

This situation can be considerably impacted also by the fact of pushing in this „game“ economic entities with „considerable weight“, such as the Metallurgical Plant from Rybnitsa (town of), one of the 5 largest of its kind in Europe. Due to pretended „economic blockade“ established by the Republic of Moldova and the Ukraine, after a standstill period of 3 months, the same plant resumed exports (after its decision to register provisionally in the RM<sup>8</sup>) of produce from its storehouses (over 33,5 thou tons of mill work, in about three weeks, of them 10 thou tons – to Russia. The 3 months standstill of the company occurred despite of free trade facilities, provided in the agreements signed by the Republic of Moldova with the CIS countries, as well as facilities granted to Moldova in the trade relations with the countries of the EU and Stability Pact for South-Eastern Europe, with whom our country has signed free trade agreements.

1 A recent example is the demand on behalf of the Bender town authorities, to urgently evacuate the Moldovan police from the city, on the grounds that this way a military conflict will be avoided. INFOTAG, 9 June, 2006. „Authorities of the town of Bender demand evacuation of Moldovan police from the city“, at: <http://www.conflict.md/stiri.php?ID=890>

2 RBC. 2006. Transnistria tightens control over Moldovan wine quality. At: <http://www.rbc-news.com/free/20060530111303.shtml>, on May 31, 2006.

3 INFOTAG. Chişinău, 18 May, 2006.

4 INFOTAG. Chişinău, 21 June 2006. Members of Helsinki Committee for Human Rights in Moldova have been threatened by the transnistrian security.

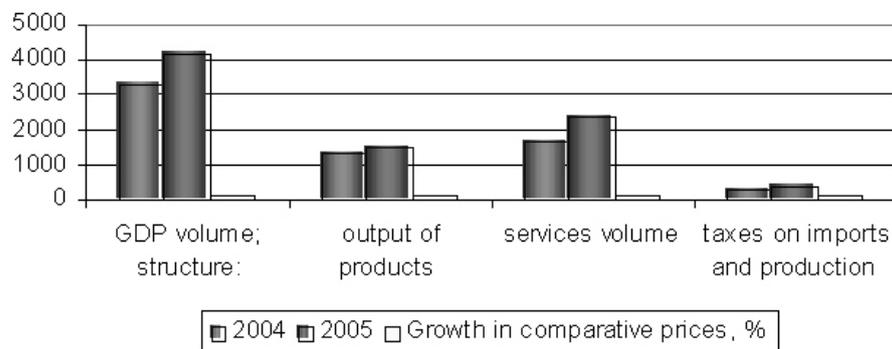
5 INFOTAG. Chişinău, 20 June 2006. Moldovan policemen have been tortured in Tiraspol.

6 „Novosti-Moldova“. CHIŞINĂU, 30 June 2006. Until 29 June 2006, 196 economic units of the transnistrian region were registered with the State Chamber of Industry and Trade of the Republic of Moldova.

7 trr - transnistrian ruble

8 INFOTAG. Chişinău, 19 June 2006. The metallurgical plant from Rybnitsa intensifies exports of mill work.

**Diagram no. 22. Dynamics and structure of Transnistrian Region GDP, 2004-2005**



During 1995 the contribution of the industrial output to GDP has been of 65,4%, and of services – of 55,5%, which unveils that the service sector in the region becomes a considerable component of the economic activities.

On the other hand, in 1995 a decline was registered of the share of the added value: in the Q II it had made up 98,6%, versus the level of the Q I, whereas in the Q IV it declined to 95,8%. These realities show that on the background of the economic situation, in general, the consumption has risen, in the second half of 2005, by 2,0 percentage points in the Q III and by 1,4 percentage points in the Q IV.

In 2005 in the region a growth was registered of the budget costs which exceeded much the tempo of economic development, in general (150,6% versus 110,8% in the last year). These trends unveil the fact that the “state” structures of Transnistria have assumed excessive social commitments, which do not have economic grounds in the activity of the industrial sector, which would create real material values. In the situation when potential sources are missing of long-term investments, the regional budget of Transnistria is threatened by a considerable misbalance for the mid- and longer-term. Usually, in such situations, without considerable financial “injections” from other sources, the stagnation phase entails and/or economic depression. These, however, did not have to wait too long, and now we see that „Russia makes monthly injections in the budget of the transnistrian region, worth \$15 mln, via a bank from Crasnodar”<sup>9</sup>.

Another indicator of the problems emerged in the region is under-funding some economic spheres such as industry, energy sector and constructions (by 39,0%); we can eye that less „capital investments” were made, versus the volume planned of 20,1%. This decline has been registered only during one year; in the last year, 2004, these funding commitments have been met almost entirely. Thus, the populist policy promoted in the region seems to resort more on emotions rather than on administrative and economic potential based on real viability.

The major share of the budget incomes of the transnistrian region accounted for fiscal collections, which in 2005 were of trr. 390,2 mln (\$46,95 mln)<sup>10</sup> or, by 29,2% more than in the same period of the previous year, and by 2,5% less versus the planned percentage. One of the factors of tax collection under the expected level was failure to reach the expected results by several privatized companies which did not manage to respect their assumed commitments in finalizing some projects.

<sup>9</sup> Press conference supported by the president of the Republic of Moldova, Vladimir Voronin: the head of the state is dissatisfied by the level of relations with Russia.... Excerpt from Internet on July 17, 2006, at: <http://www.conflict.md/stiri.php?ID=1018>

<sup>10</sup> Exchange rate as on July 15, 2006.

In 2005 the consolidated budget of Transnistria made up trr. 1 243,1 mln (\$ 149,6 mln), and was executed in amount of 98,2%. The expenditures side made up trr. 1 347,3 mln (\$ 162,1 mln). Due to the big budget deficit (trr. 104,2 mln/\$ 12,5 mln), commitments were considerably reduced of the state administration structures up to 89,1% versus the planned expenditures (compared to 2004 – 95,3%). The situation emerged imposed the regional authorities resort to applying a fiscal burden based on "extremes": the least fiscal burden having been laid of trade and public nutrition – of 2,8% (in 2004 – 3,8%), and the heaviest – on industrial sector – of 44,7% (respectively, in 2004 – of 43,5%).

In the structure of the fiscal contributions, the major share was generated by the income tax of the companies – 53,7%, exceeding the planned volume by 2,5%. The main tax payers to the regional budget were the ferrous metallurgy companies, electro-energy, retail and wholesale trade, public nutrition enterprises and cognac and wine making industries.

## Farming

In the second half of 2005, the agrarian sector registered a positive result, compared to the first half year, and an excess of 20,8%, versus 2004; also, in the region a decline was registered of the Gross Agricultural Product by 3,0% and consumption increased by 9,3%.

The negative trend of the agrarian sector growth implied the decline by 2,2 percentage points of the share of this sector in the GDP structure, compared to 2004. The increased fiscal burden upon agriculture of the region from 10,3% to 26,9% has been registered on the background of up-keeping in the region of negative profitability: according to the results of 2005 the losses registered in this sector made up 36,8% versus the gross revenue.

These trends involve also large salary arrears, which as on January 1, 2006 were trr. 82,2 mln (\$ 9,9 mln), registering an annual raise rate of 22,5%; this indicator has become already a tradition in the agrarian sector and makes up the largest level of arrears in the economy.

The social burden, due to small incomes of the economic activity (possible to attain at a permanent job), have stirred up the private entrepreneurship; in 2005 in this segment of farming have been registered incomes worth trr. 509,3 mln (\$ 61,3 mln), or by 38,8% more than in the previous year.

## Financial sector

The local budgets of the region, have made up in terms of expenditures trr. 421,3 mln (\$ 50,7 mln), having registered a decline by 15,8% versus the planned level. On the other side, compared with 2004, the expenditures of the local budgets increased by 39,0%.

Execution of the local budgets commitments have been mostly un-reached per all expenditure items. From the cash collected for education were allocated trr. 236,6 mln (\$ 28,5 mln), or 91,6% versus the planned volume, for communal services – trr. 29,5 mln (\$ 3,5 mln) or 79,3%, social "state" services sector – trr. 26,5 mln (\$ 3,2 mln) or 86,6% of the planned volume. Under-funded were also such spheres as: health care (28,9%), capital investments (64,5%), transports and communications (33,9%), and "national" defense (30,8% of the planned volume). On the other side, an increase of 22,5% occurred of the volume targeted to paying-off internal debts and interest.

The major sources of the financial flow have been the collections from the commercial activity, in the vaults of the banks and lending institutions from the region,

worth – trr. 362,5 mln, (\$ 43,6 mln) as well as from the sales by physical entities of the foreign currency – trr. 181,3 mln (\$ 21,8 mln), which made up respectively 48,6% and 24,3% of the total volume of collections (for comparison, in the Q I of 2005 – 46,4% and 32,4% respectively).

In 2005 in Transnistria and its main commercial-partner countries, the transnistrian ruble has valued in real terms: by 4,0% versus USD, by 3,8% versus Euro, versus MDL – by 3,0%, versus the Ukrainian Grivna – by 2,2%, and versus Russian Ruble it has declined by 2,7%.

## Trade

In the accounting period the trade and public nutrition sectors have contributed by 43,5% to the overall volume of the gross added value, created in the market service sector, which made up more than the contribution of transports, communications and communal companies (34,0%).

The general unfavorable trend from the regional industry will impact, undoubtedly, the consumption, which, subsequently, will impact on the development of services on the market (trade, communications and transports); to mention is, that one of those 5 spheres that contribute mostly to budget formation<sup>11</sup> is the trade.

The taxes of the external trade and foreign economic operations make up the second source, as a share, in fiscal revenues formation of the regional budget. These sources have made up trr. 67,1 mln (\$ 8,07 mln), which means an excess of 20,3% of the planned level, including the imports tax – trr. 64,6 mln (\$7,8 mln) or 128,4% versus the planned level. The major effects, in this sense, have been produced by the change in the early 2005 of the methods of customs tax collection on imports.

The sales volume in 2005 on the sales markets of CIS countries, on all channels, have increased by 13,0%, which makes up a growth rate similar with that of 2004. The commercial volume, performed in CIS countries by the commercial companies, accounted for 57-79%.

Despite the general decline of the growth rate decline of the Ukrainian economy, the raise of domestic consumption in this country has implied an increase of the trade volume of Transnistria with the neighboring country, this (the largest versus the realized one with other CIS countries) having reached 121,8%, with Belarus – 119,4%, with Russia – 112,0%, with the R. Moldova the sales volume turned out to be the least – 4,7%.

According to the Eurostat data, in 2005 the retail sales in the Eurozone have increased by 0,8%, versus 2004, in the first half year their volume registered a sustainable evolution, versus the second half year, respectively by 2,1%, compared to the same period of the last year, and in the period of the first 9 months of 2005 - by 0,9%.

In the respective period, the foreign trade of the region increased by 9,2%, exports having registered a growth of 16,8%, and imports of 2,5%. The foreign trade balance was positive, in amount of \$ 164,6 mln.

The commercial relations are also characterized by a “dynamization” of the foreign trade transactions, mostly with the CIS countries, and also with the further countries, except for the EU ones. Compared to 2004, the exports of goods with the CIS countries have increased by 34,3%, and imports from these countries – by 31,4%. The exports to further countries have curtailed by 11,2%, and imports from this category of countries - by 22,3%. The share of CIS countries in the commercial trade, of both exports and imports, made up, respectively 53,2% and 63,4%.

<sup>11</sup> The other four are as follows: ferrous metallurgy, electrical power, public nutrition and wine-making and cognac industry.

**Table 1.** *Gross Domestic Product, millions Moldovan Lei, current prices*

	1999	2000	2001	2002	2003	2004	2005	2006p
GDP	12322	16020	19052	22556	27619	32032	36755	40285
Final consumption	11090	16503	19263	23289	29706	33298	39846	49135
households	9137	14031	16385	18493	24417	28125	33650	42000
public administration	1888	2348	2736	4600	5072	5504	5951	6850
private administration	65	124	142	196	216	235	245	285
Gross investment	2820	3836	4436	4886	5916	8443	10951	14650
gross fixed capital formation	2272	2472	3190	3682	4668	6787	8954	12800
changes in stocks	548	1364	1246	1204	1248	1141	1997	1850
Net exports of goods and services	-1588	-4319	-4647	-5619	-8325	-9936	-14042	-23500
exports of goods and services	6446	7946	9536	11834	14487	16398	19526	21000
imports of goods and services	8035	12265	14183	17453	22812	25107	33568	44500.0
Memo: GDP mill USD	1171	1288	1481	1663	2007	2520	2895	2919.2

Source: Department of Statistics and Sociology of Moldova, estimates by Moldova Quarterly Forecasting

**Table 2.** *Structure of Gross Domestic Product, %*

	1999	2000	2001	2002	2003	2004	2005	2006p
GDP	100	100	100	100	100	100	100	100
Final consumption	90.0	103.0	101.1	103.3	108.8	103.9	108.4	122.0
households	74.2	87.6	86.0	82.0	89.5	87.8	91.6	104.3
public administration	15.3	14.7	14.4	20.3	18.4	17.2	16.4	17.0
private administration	0.5	0.8	0.7	1.0	1.0	0.7	0.7	0.7
Gross investment	22.9	23.9	23.3	21.7	21.7	26.4	29.8	36.4
gross fixed capital formation	18.4	15.4	16.7	16.3	17.1	21.2	24.4	31.8
changes in stocks	4.4	8.5	6.5	5.3	4.6	5.2	5.4	4.6
Net exports of goods and services	-12.9	-27.0	-24.4	-24.9	-30.5	-30.3	-38.2	-58.3
exports of goods and services	52.3	49.6	50.1	52.4	53.1	51.2	53.1	52.1
imports of goods and services	65.2	76.6	74.4	77.3	83.6	81.5	91.3	110.5

Source: Department of Statistics and Sociology of Moldova, estimates and computations by MQF

**Table 3.** *Annual real change of GDP components, %*

	1999	2000	2001	2002	2003	2004	2005	2006p
Final consumption	-15.8	17.2	4.4	9.7	15.4	2.0	9.5	18.0
Private consumption	-8.2	20.7	6.1	5.9	18.5	6.2	10.1	20.1
Public consumption	-38.3	-1.2	-6.2	30.3	-0.5	1.5	8.1	8.4
Gross investment	-37.9	48.4	1.5	52.4	-4.6	1.0	6.38	14.0
Gross fixed capital formation	-19.8	11.9	5.2	1.1	13.5	10.5	11.0	15.0
Changes in stocks	-23.1	-8.7	17.3	5.7	18.6	8.2	10.2	22.4
Net exports of goods and services	-0.7	97.6	-16.8	-10.9	-5.3	-7.0	13.9	3.8
Export of goods and services	-65.9	124.6	-1.5	9.1	37.7	32.2	43.9	33.3
Import of goods and services	3.1	9.5	17.2	19.0	18.9	11.0	17.6	10.0
Final consumption	-22.6	32.3	10.6	15.7	25.0	3.6	18.1	20.0

Source: Department of Statistics and Sociology of Moldova, estimates and computations by MQF

**Table 4.** *Factoral contribution to real GDP change, %*

	1999	2000	2001	2002	2003	2004	2005	2006p
Final consumption	-15.9	15.4	4.5	9.8	13.8	16.4	13.3	13.0
households	-6.1	15.4	5.4	5.1	13.9	16.1	11.6	13.43
public administration	-9.4	-0.2	-0.9	4.4	-0.1	0.3	0.31	0.55
private administration	-0.3	0.2	0.0	0.4	0.0	0.0	0.01	0.05
Gross investment	-5.1	2.7	1.2	0.2	1.9	1.4	3.36	2.44
gross fixed capital formation	-5.1	-1.6	2.7	1.0	2.2	1.7	3.11	3.63
changes in stocks	0.0	4.3	-1.4	-0.7	-0.3	-0.3	0.25	-0.02
Net exports of goods and services	17.6	-16.1	0.4	-2.2	-9.4	-9.8	-10.4	-9.8
exports of goods and services	1.4	5.0	8.5	9.5	9.9	12.1	6.93	2.49
imports of goods and services	-16.2	21.1	8.1	11.7	19.3	21.9	-17.3	-12.3
Real GDP change	-3.4	2.1	6.1	7.8	6.3	8.0	6.3	5.7

Source: Department of Statistics and Sociology of Moldova, estimates and computations by MQF

**Table 5.** *Table 7. GDP by sector, current prices, millions MDL*

	1999	2000	2001	2002	2003	2004	2005
Value-added	10999	14022	16773	19689	23523	27353	30745
Agriculture, hunting, forestry and fishing	3062	4066	4261	4730	5062	5633	5241
Mining and quarrying	1637	2307	3041	3402	4859	5469	6244
Manufacturing industry	456	308	523	499	504	566	570
Electricity, gas and water supply	409	433	584	665	812	1102	1284
Construction	1885	2003	2287	2488	2967	3384	3895
Wholesale and retail trade	1013	1528	1974	2255	2977	3780	4441
Transport, storage and communications	2537	3379	4103	5651	7493	8880	10362
Other activities	1323	1998	2278	2867	4096	4514	6010
Net tax on products and imports	12322	16020	19052	22566	27619	32032	36755
GDP	1999	2000	2001	2002	2003	2004	2005

Source: Department of Statistics and Sociology of Moldova, estimates by Moldova Quarterly Forecasting

**Table 6.** *Industrial output, current prices, millions MDL*

	1999	2000	2001	2002	2003	2004	2005	2006p
Total industry	7191	8168	10428	12624	15963	17591	21124	25063
Mining and quarrying	56	62	74	101	128	211	273	287
Manufacturing industry	5002	6755	8452	10550	13776	15234	18430	16944
Electricity, gas and water supply	2133	1351	1902	1973	2059	2146	2421	2663

Source: Department of Statistics and Sociology of Moldova, estimates by Moldova Quarterly Forecasting

**Table 7.** *Gross agricultural output*

	Total, millions MDL	Annual real change, %	Crop production, millions MDL	Annual real change, %	Livestock production, millions MDL	Annual real change, %
1999	8184	-8.4	5401*	-11.7	2783	-3.5
2000	8268	-3.3	5790	-1.0	2202	-7.8
2001	8646	6.4	5727	8.8	2655	1.2
2002	9474	3.4	6298	2.5	2870	5.7
2003	10354	-3.6	7086	-7.3	2937	-4.9
2004	11819	20.8	7900	29.3	3524	4.0
2005	11937	1.0	7321	-2.1	4216	8.6
2006p	12176	2.0	7431	1.5	4325	2.6
2007p	12770	4.9	7830	5.4	4500	4.1

Source: Department of Statistics and Sociology of Moldova, estimates by Moldova Quarterly Forecasting

**Table 8.** *Major agricultural commodities*

	Grains, th. tons	Grapes, th. tons	Fruits, th. tons	Vegetables, th. tons	Meet (livestock), th. tons	Eggs, mil.	Milk, th. tons
1999	2200	465	136	489	147	555	589
2000	1935	704	255	364	123	575	574
2001	2628	505	317	448	115	618	579
2002	2587	641	327	397	120	671	604
2003	1613	677	617	361	118	620	593
2004	2994	686	430	315	119	668	628
2005	2828	517	384	389	126	759	658
2006p	2200	520	460	420	118	770	680
2007p	2700	650	520	430	130	750	690

Source: Department of Statistics and Sociology of Moldova, estimates by Moldova Quarterly Forecasting

**Table 9. Public Expenditures, Revenues and Debt**

	2000	2001	2002	2003	2004	2005	2006p
Total revenues	25.6	22.7	22.5	24.3	24.2	26.2	26.7
Tax revenues	19.3	18.0	19.0	21.0	21.9	25.0	24.7
Corporate profit tax	1.7	1.8	1.9	1.7	1.8	1.8	1.9
Personal income tax	1.7	1.8	2.1	1.7	2.1	2.1	2.0
Land tax	1.0	0.9	0.8	0.0	0.5	0.6	0.5
Real estate tax	0.2	0.1	0.1	0.0	0.1	0.1	0.1
VAT	8.4	7.9	9.0	10.2	9.6	12.8	13.9
Excises	4.1	3.6	2.9	3.3	3.2	2.9	2.8
Taxes on foreign trade	1.4	1.2	1.5	1.7	1.7	1.8	1.5
other tax revenues	0.8	0.7	0.6	2.4	2.9	2.5	2.0
Non-tax revenues	5.5	3.9	3.2	2.9	2.3	2.1	2.0
NBM profits	2.4	1.2	0.6	0.5	-	0.1	0.3
Proceeds from privatization	0.9	0.5	0.5	0.4	0.2	0.2	0.2
other non-tax revenues	2.2	2.2	2.1	2.0	-	1.8	1.5
Total spending	26.6	22.7	23.0	22.6	23.1	24.3	24.5
Economic activities	2.3	1.7	1.8	1.9	2.1	2.3	2.3
External trade activity	0.4	0.4	0.4	0.0	0.5	0.4	0.5
Education	4.5	4.8	5.5	4.8	4.7	5.4	5.4
Health	2.9	2.8	3.5	2.6	2.4	3.0	2.9
Social assistance	3.8	2.6	2.9	2.7	3.4	3.1	3.2
Public administration	4.1	4.0	4.7	3.8	4.3	4.2	4.3
Debt servicing	6.4	4.2	2.2	2.1	2.1	1.8	1.8
Capital investment	1.1	1.1	1.1	0.3	0.9	1.8	1.7
Other	1.0	1.1	0.9	4.3	3.5	2.3	2.4
Budget balance	-1.0	0.0	-0.5	1.6	1.1	1.9	2.2
Domestic debt	12.6	12.6	12.5	10.7	11.2	11.1	11.0
Foreign debt (millions USD)	79.3	64.5	59.4	51.5	42.9	24.9	25.0
Energy payment arrears (millions USD)	24.6	19.4	18.1	15.9	10.9	9.1	9.1

Source: Department of Statistics and Sociology of Moldova, estimates by Moldova Quarterly Forecasting

**Table 10. Monetary indicators**

	Currency in circulation		Reserves of banks		Monetary base		M2		M3		Multiplier		Foreign reserves of NBM, millions USD	USD/MDL period average
	millions MDL	growth %	millions MDL	growth %	millions MDL	growth %	millions MDL	growth %	millions MDL	growth %	M2	M3		
Q1'01	1406.3	-4.3	477.8	0.3	1884.1	-3.2	2526.2	0.5	3574.0	1.8	1.34	1.90	222.7	12.69
Q2'01	1475.7	4.9	477.6	0.0	1953.3	3.7	2691.3	6.5	3886.1	8.7	1.38	1.99	210.2	12.95
Q3'01	1698.0	15.1	525.3	10.0	2223.3	13.8	3189.7	18.5	4423.5	13.8	1.43	1.99	227.1	12.88
Q4'01	1834.2	8.0	654.7	24.6	2488.9	11.9	3464.5	8.6	4787.4	8.2	1.39	1.92	228.5	12.94
Q1'02	1751.4	-4.5	776.1	18.5	2527.4	1.5	3450.9	-0.4	4852.7	1.4	1.37	1.92	225.0	13.21
Q2'02	1826.7	4.3	690.4	-11.0	2517.0	-0.4	3560.7	3.2	5187.0	6.9	1.41	2.06	220.0	13.62
Q3'02	2246.7	23.0	755.0	9.4	3001.7	19.3	4346.0	22.1	6126.7	18.1	1.45	2.04	279.3	13.64
Q4'02	2288.5	1.9	974.2	29.0	3262.7	8.7	4517.6	3.9	6511.5	6.3	1.38	2.00	269.6	13.81
Q1'03	2193.1	-4.2	944.0	-3.1	3137.1	-3.8	4455.1	-1.4	6885.7	5.7	1.42	2.19	250.4	14.18
Q2'03	2364.1	7.8	915.3	-3.0	3279.4	4.5	4749.5	6.6	7300.7	6.0	1.45	2.23	260.1	14.36
Q3'03	2907.5	23.0	797.3	-12.9	3704.9	13.0	5384.6	13.4	8199.0	12.3	1.45	2.21	285.9	13.92
Q4'03	2740.5	-5.7	1078.4	35.3	3818.9	3.1	5621.9	4.4	8509.2	3.8	1.47	2.23	302.3	13.32
Q1'04	2632.8	-3.9	1233.6	14.4	3866.5	1.2	5800.9	3.2	8659.2	1.8	1.5	2.2	309.6	12.92
Q2'04	2853.4	8.4	1350.5	9.5	4203.8	8.7	6130.1	5.7	9099.1	5.1	1.5	2.3	295.7	11.95
Q3'04	3320.9	16.4	1675.5	24.1	5000.4	18.9	7140.9	16.5	10384.9	14.1	1.5	2.3	391.6	12.03
Q4'04	3699.9	11.4	1611.4	-3.8	5313.1	6.3	8137.0	13.9	11719.6	12.9	1.5	2.3	470.3	12.42
Q1'05	3656.1	-1.2	1969.7	22.2	5626.4	5.9	8432.9	3.6	12103.3	3.3	1.5	2.2	461.2	12.52
Q2'05	3895.2	6.5	2102.0	6.7	5997.2	6.6	9692.0	14.9	13345.7	10.3	1.6	2.2	482.6	12.60
Q3'05	4350.0	11.7	2559.6	21.8	6320.6	5.4	10505.9	8.4	14932.7	11.9	1.5	2.2	582.1	12.58
Q4'05	4571.2	5.1	2761.9	7.9	7002.9	10.8	11125.5	5.9	15826.8	6.0	1.5	2.2	597.4	12.70
Q1'06	4541.2	-0.7	2451.1	-11.3	6992.3	-4.6	11050.5	-0.7	16299.6	3.0	1.6	2.3	587.7	12.9
Q2'06p	4850.0	6.8	2830.0	15.5	7680.0	9.8	12800.0	15.8	17400.0	6.8	1.7	2.3	613.0	13.1
Q3'06p	5280.0	8.9	3210.0	13.4	8490.0	10.5	13900.0	8.6	19300.0	10.9	1.6	2.3	660.0	13.0
Q4'06p	5500.0	4.2	3360.0	4.7	8860.0	4.4	14250.0	2.5	19900.0	3.1	1.6	2.2	670.0	12.9

Source: National Bank of Moldova, computations by MQF

**Table 11.** Money market indicators, millions MDL, end of period, if not other mentioned

	Deposits				Credits					
	Current in MDL	interest rate, %	Foreign Deposits	interest rate, %	NBM to Gov-ernment.	NBM to banks	NBM base rate, %	Banks to Economy	interest rate (for MDL), %	interest rate (for foreign), %
Q3'00	463.7	24.6	424.4	4.9	1675.9	103.7	28.7	1984.3	33.7	15.8
Q4'00	493.8	23.8	368.1	5.1	1675.9	62.3	27.0	2291.2	32.4	15.1
Q1'01	484.4	23.8	396.0	4.9	1660.8	102.8	20.0	2374.2	29.9	14.7
Q2'01	479.2	21.3	416.6	4.4	1645.8	104.2	19.0	2543.8	29.6	14.1
Q3'01	845.1	20.2	486.3	3.9	1750.9	96.7	16.0	2827.0	26.6	13.3
Q4'01	1028.4	18.4	809.6	3.0	1888.5	75.6	13.5	3101.3	26.2	11.9
Q1'02	1038.3	16.5	958.2	3.3	1984.0	178.1	13.0	3202.5	24.9	12.8
Q2'02	1058.2	14.1	1089.9	3.0	2007.1	86.8	12.0	3392.1	24.5	12.6
Q3'02	1211.6	14.3	1177.4	3.3	2007.1	84.8	10.0	3782.2	22.5	11.9
Q4'02	1172.1	12.6	1306.6	3.3	2144.0	81.4	9.5	4165.7	19.3	11.9
Q1'03	1211.9	12.3	1544.1	3.0	2144.0	79.6	10.5	4675.2	19.5	11.0
Q2'03	1280.1	11.9	1654.7	2.9	2144.0	76.7	10.5	4878.9	19.6	10.8
Q3'03	1330.4	12.2	1741.6	2.8	2144.0	92.4	12.0	5615.5	18.7	10.2
Q4'03	1469.6	13.8	1813.0	3.7	2144.0	72.3	14.0	5999.7	19.4	11.2
Q1'04	1725.9	15.0	1806.0	4.5	2143.6	67.96	14.0	6168.1	20.8	11.5
Q2'04	1856.3	14.8	1909.0	4.9	2635.8	67.96	14.0	6290.0	21.1	11.3
Q3'04	2145.9	15.8	2051.8	5.1	2472.2	65.41	14.5	6846.7	21.0	11.3
Q4'04	2572.3	15.5	2393.6	5.4	2741.0	62.29	14.5	7399.3	21.0	11.5
Q1'05	2901.5	15.4	2538.0	5.3	2821.7	61.6	14.0	7619.3	20.9	11.3
Q2'05	3260.7	13.5	2614.0	5.2	2728.0	61.5	13.0	8117.9	19.6	11.2
Q3'05	3596.2	12.7	2709.5	5.1	2800.0	54.2	12.5	8976.9	18.7	11.0
Q4'05	3792.3	11.5	2800.0	5.1	2800.0	62.5	12.5	9990.5	17.8	10.9
Q1'06	4057.8	11.3	3463.7	5.0	2611.0	65	12.5	10761.6	18.3	11.0
Q2'06p	4250.0	11.5	3400.0	5.2	2700.0	65	12.5	11205.0	18.5	10.8
Q3'06p	4680.0	11.8	3550.0	5.4	2700.0	65	13.0	12100.0	18.8	11.1
Q4'06p	5020.0	12.5	3620.0	5.3	2700.0	70	13.5	12900.0	19.1	11.2

Source: National Bank of Moldova, computations by MQF

**Table 12. Wages**

	Nominal monthly wage, MDL (average per quarter)	Real change, quarter on quarter, %	Real change, year on year, %	Minimum Monthly Consumption Budget, MDL, average per quarter	Ratio of nominal average monthly wage to minimum consumption basket, %
Q3'00	416.9	6.9	-6.3	954	43.7
Q4'00	530.7	-4.9	15.8	965	55.0
Q1'01	447.3	11.7	-4.6	1047	42.7
Q2'01	500.9	3.7	4.7	1085	46.2
Q3'01	531.0	4.5	13.2	1011	52.5
Q4'01	641.4	4.7	32.6	1007	63.7
Q1'02	579.0	8.4	16.4	1023	56.6
Q2'02	646.8	8.6	27.3	1068	60.6
Q3'02	705.5	4.5	43.8	1114	63.3
Q4'02	885.3	2.0	75.2	1136	77.9
Q1'03	775.7	11.0	46.0	1259	61.6
Q2'03	864.2	0.7	57.3	1279	67.6
Q3'03	921.3	3.4	62.9	1312	70.2
Q4'03	1088.7	6.8	78.9	1349	75.7
Q1'04	976.0	-2.1	55.7	1386	70.4
Q2'04	1087.7	4.7	70.9	1423	76.4
Q3'04	1123.3	4.1	73.4	1460	76.9
Q4'04	1282.3	2.9	87.2	1497	85.7
Q1'05	1148.0	-13.5	62.0	1545	74.7
Q2'05	1296.0	12.0	76.1	1590	81.3
Q3'05	1335.3	2.7	76.0	1646	81.2
Q4'05	1532.7	10.8	91.3	1736	88.3
Q1'06	1454.3	-9.5	73.2	1806	80.3
Q2'06p	1485.8	-0.9	74.0	1842	80.7
Q3'06p	1530.1	1.6	75.7	1879	81.5
Q4'06p	1716.2	9.1	77.7	1909	89.9
Q1'07p	1811.5	1.8	-	1934	93.7
Q2'07p	1896.7	2.5	-	1964	96.6
Q3'07p	1965.3	2.2	-	1999	98.3
Q4'07p	2025.2	0.1	-	1999	101.3

Source: Department of Statistics and Sociology of Republic of Moldova, computations by MQF

**Table 13. Unemployment, %**

	2000	2001	2002	2003	2004e	2005	2006p	2007p
Total people	3639	3631	3623	3612	3386	3383	3379	3350
People over 15 years	2778	2807	2840	2868	2881	2899	2910	2915
People employed in the economy	1515	1499	1505	1356	1316	1312	1301	1390
Unemployed people	140	118	110	117	116	104	102	104
Non-active people	1123	1190	1225	1395	1449	1483	1507	1600
Employment rate	0.55	0.53	0.53	0.47	0.46	0.45	0.45	0.47
Economic dependency rate	1.40	1.42	1.41	1.66	1.57	1.58	1.60	1.66

Source: Department of Statistics and Sociology of Republic of Moldova, computations by MQF

**Table 14.** Average consumer prices changes, %

	Jan	Feb	Mar	Apr	Mai	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Compared to December, previous year	Yearly average
1997	1.9	1.4	1.0	0.8	0.6	2.0	-1.0	-0.8	1.2	0.9	1.1	1.5	11.2	12.0
1998	1.3	0.4	-0.1	0.7	0.2	-1.1	-1.4	-0.6	0.2	1.4	8.6	7.8	18.3	8.0
1999	5.4	1.5	0.6	2.0	4.1	7.2	2.5	0.7	1.7	2.1	4.3	5.0	43.7	39.0
2000	2.9	1.3	0.1	1.6	1.4	4.4	0.7	0.8	1.4	1.0	0.8	0.8	18.4	31.0
2001	1.2	0.3	0.3	1.5	0.5	-3.5	-1.7	-0.5	0.9	1.3	1.1	1.9	6.3	10.0
2002	1.3	-3.4	0.5	1.9	1.6	-3.4	-1.5	-0.6	0.8	1.2	1.2	1.9	4.4	5.2
2003	1.9	1.8	0.9	1.5	0.5	1	1.3	0.4	1.6	2.1	1.1	0.7	15.7	11.6
2004	1.5	0.9	0.6	0.9	0.5	0.1	0.3	0.5	1	2.2	1.8	1.6	12.5	12.4
2005	1.1	2.1	0.8	1.4	0.1	-0.8	-1.1	0.2	1.2	1.5	1.9	1.4	10.0	11.9
2006p	1.9	1.4	1.4	1.4	1.2	0.4	0.2	0.4	0.8	1.2	1.4	1.5	13.2	13.2
2007p	1.5	1.2	1.1	1.0	0.9	0.3	0.2	0.4	0.5	0.9	1.0	1.1	10.1	10.1

Source: Department of Statistics and Sociology of Republic of Moldova, NBM, computations by MQF

**Table 15.** Balance of payments, millions USD

	1999	2000	2001	2002	2003	2004	2005	2006p	2007p
Current account balance	-46.99	-120.92	-108.05	-103.14	-142.09	-113	-285.0	-448.7	-473.9
Trade balance in goods	-134.7	-306.62	-312.92	-378.25	-622.3	-758.3	-1190.8	-1486.7	-1656.9
Exports FOB	474.84	476.58	569.43	659.8	806.3	995.2	1104.4	1058.5	1270.2
Imports of goods	-609.54	-783.2	-882.35	-1038.1	-1428.6	-1753.5	-2295.2	-2545.2	-2927.1
Balance of services	-32.05	-43.13	-48.75	-38.8	-39.47	-54.8	-20.2	-12.0	-2.2
Income, including	33.99	72.25	100.78	159.27	215.04	336.5	358.8	395.0	445.0
Remittances from work	90.05	126.24	183.67	239.05	278	480	476.8	570.0	630.0
Current transfers	85.77	156.58	152.84	154.64	304.64	363.6	567.3	655.0	740.0
Capital and financial account (excluding changes in reserves), including	121.27	169.46	80.32	86.35	67.29	143.45	172.9	264.1	313.0
Capital account	116.61	-11.97	-20.66	-15.32	-12.81	-5.35	-3.8	3.0	-2.0
Direct investments	37.83	135.99	146.05	116.18	58.37	147.92	225.5	240.5	280.0
Portfolio investments	-140.06	117.03	-32	-27.48	-21.21	-10.41	-7.0	5.0	8.0
Other investments	106.89	-71.59	-13.07	12.97	42.94	11.29	8.4	15.6	35.0
Net change in NBU reserves	-48.7	-47.42	-9.47	-26.96	-14.07	-147.99	-80	72.6	-26.0
Errors/omissions	-25.58	-1.12	37.2	43.75	88.87	117.54	192.1	-112.0	-186.9
Net Investment Position	-1364.41	-1473.31	-1535.8	-1649.66	-1694.5	-1637	-1665.7	-1645.0	-1620.0

Source: NBM, computations by MQF

**Table 16.** Real GDP in major trade partners of Moldova

	1998	1999	2000	2001	2002	2003	2004	2005	2006p	2007p	Share in Moldovan exports, % 2004	Share in world output, % 2004
Russia	-4.9	5.4	9.0	5.0	4.3	7.3	6.1	6.4	5.8	5.5	35.8	2.7
Euro zone:	2.9	2.8	3.5	1.5	0.9	0.5	1.9	1.3	1.5	1.6	30.1	15.7
Italy	1.8	1.7	3.1	1.8	0.4	0.4	1.2	0.1	0.8	0.8	13.9	3.0
Germany	2.0	2.0	2.9	0.8	0.2	-0.1	1.7	0.9	1.2	1.3	7.3	4.4
France	3.5	3.2	4.2	2.1	1.2	0.5	2.4	1.4	1.6	1.5	1.1	3.2
Romania	-4.8	-1.2	2.1	5.7	4.9	4.5	8.0	4.1	4.6	4.8	10.0	0
Ukraine	-1.9	-0.2	5.9	9.2	5.2	9.4	12.0	2.8	3.8	4.1	6.6	0
Belarus	8.4	3.4	5.8	4.7	4.7	6.8	11.0	9.2	7.8	8.2	6.0	0
USA	4.3	4.1	3.8	0.3	2.4	3.0	4.4	3.5	3.2	3.4	4.3	21.1

Source: NBM, computations by MQF

**Table 17.** Breakdown of Moldovan Imports by Country, millions USD

	1998	1999	2000	2001	2002	2003	2004	2005	2006p	2007p
CIS	440.2	221.9	252.7	334.5	434.8	593.4	764.8	915.9	1070.9	1172.9
Russia	233.0	118.8	104.6	136.3	168.6	183	212.3	273.6		
Ukraine	151.6	78	112.4	164.2	225.3	309.3	436.3	491.4	-	-
Belarus	50.6	21.3	32.7	38.7	39.1	50.6	64.3	84.5	-	-
Other	5.0	3.8	3.0	4.7	1.8	50.5	51.9	66.4	-	-
UE	281.2	156.6	209.3	249.0	290.6	505.8	581.1	752.3	764.9	909.0
Germany	91.9	66.2	85.4	93.6	101.3	135.6	150.2	190.9	-	-
Italy	65.1	34.2	45.1	61.1	82.8	118.7	131.6	152.3	-	-
Other	124.2	56.2	78.8	94.3	106.6	252.5	299.3	409.1	-	-
SEE	214.8	143.1	205.2	190.6	256.1	133.5	199.1	292.4	280.5	410.5
Romania	112.9	90.1	129.3	107.1	126.2	98.2	164.1	257.4	-	-
Bulgaria	29.3	9.7	14.4	23.5	28.9	30.1	29.6	29.0	-	-
Other	72.6	43.3	61.6	60.0	101.0	20.0	5.4	6.0	-	-
Other	87.5	51.5	107.8	123.1	121.7	4.8	223.5	351.2	433.5	439.8
Total	1023.7	573.1	777.4	897.2	1103.1	1402.8	1768.5	2311.8	2549.8	2932.2

Source: Department of Statistics and Sociology of Republic of Moldova, NBM, computations by MQF

**Table 18.** Breakdown of Moldovan Exports by Country, millions USD

	1998	1999	2000	2001	2002	2003	2004	2005	2006p	2007p
CIS	429.1	256.3	279.7	348.0	368.8	423.8	502.4	551.2	473.4	530.2
Russia	336.8	191.8	212.5	249.9	251.7	308.4	353.3	347.5	-	-
Ukraine	48.7	35.2	36.5	62.0	64.9	56.2	64.8	99.7	-	-
Belarus	31.8	21.7	21.8	30.2	39.6	41.1	58.7	71.2	-	-
Other	11.8	7.6	8.9	5.9	12.6	18.1	25.6	32.8	-	-
UE	82.9	98.4	103.3	122.3	172.9	211.0	296.3	324.3	326.1	378.7
Germany	23.9	36.9	36.3	41.1	52.6	56.2	71.3	47.4	-	-
Italy	22.3	25.9	36.6	47.7	64.4	82.4	136.4	133.6	-	-
Other	36.7	35.6	30.4	33.6	56.0	72.4	88.6	143.3	-	-
SEE	80.5	82.8	65.1	62.0	96.1	98.1	105.7	121.4	136.8	202.0
Romania	60.8	42.1	39.1	40.2	59.7	90.2	98.9	111.7	-	-
Bulgaria	2.8	5.4	3.2	3.8	3.5	6.2	5.5	7.6	-	-
Other	16.9	35.3	22.9	18.0	33.0	1.7	1.3	2.1	-	-
Other	39.6	24.8	25.9	37.8	72.8	57.1	80.8	94.4	115.7	151.5
Total	632.1	462.3	471.5	570.2	710.6	790.0	985.2	1091.3	1052.0	1262.4

Source: Department of Statistics and Sociology of Republic of Moldova, NBM, computations by MQF

**Table 19.** Retail turnover and private housing starts

	Retail turnover, quarterly, millions MDL	Year-on-year or quarter- on-quarter real change, %	Services rendered to population	Annual growth rate, real, %	Investment in commercial and residential real estate
1996	3840	12.3	820	-21.9	105
1997	3971	-7.7	1237	10.2	122
1998	3679	-14.2	1299	-11.7	114
1999	3602	-29.6	1897	-10.2	94
2000	6012	27.4	2600	0.1	67
2001	7612	15.1	3404	21.2	92
2002	10753	34.3	4222	11.8	105
2003	14537	18.2	5229	13.3	114
2004	16575.8	5.6	6970.4	5.3	150
2005	19368.2	4.7	8194.2	9.3	180
2006p	21082	10	8919	10	-

Source: Department of Statistics and Sociology of Republic of Moldova, computations by MQF

**Table 20.** *Nominal disposable income and consumption spending of households, million MDL*

Year	1999	2000	2001	2002	2003	2004	2005	2006p	2007p
Disposable income, average per month per one household member, MDL, including, %	5833	8105	10492	13961	18285	23838	28913	33249	3989.9
wages	2065	3023	3966	5166	6820	9003	12237	15908	17816.9
proceeds from agricultural activities	2246	2796	3347	4174	5284	6510	6945	7300	7800
proceeds from individual activity	193	243	283	363	713	1098	1320	1550	1900
revenues from propriety	23	16	31	14	110	157	210	230	280
social payments	484	778	1144	1969	2560	3379	4075	4686.3	5249
other current allowances	23	32	42	42	18	22	38	45	51
other current transfers	799	1216	1679	2234	2779	3669	4088	4880	2010
Consumption	6144	8380	10831	14144	18610	24156	30150	34672	35088

Source: Department of Statistics and Sociology of Republic of Moldova, computations by MQF