

# BTI 2008 | Moldova Country Report

<b>Status Index</b>	1-10	<b>5.93</b>	# 60 of 125	
Democracy	1-10	6.85	# 42 of 125	↑
Market Economy	1-10	5.00	# 78 of 125	→
<b>Management Index</b>	1-10	<b>4.46</b>	# 88 of 125	

scale: 1 (lowest) to 10 (highest)    score    rank    trend

This report is part of the Bertelsmann Transformation Index (BTI) 2008. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 125 transformation and developing countries are evaluated.

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## Key Indicators

Population	mn.	4.2	HDI	0.69	GDP p.c.	\$	1,868
Pop. growth <sup>1</sup>	% p.a.	-0.3	HDI rank of 177	114	Gini Index		33.2
Life expectancy	years	68	UN Education Index	0.89	Poverty <sup>3</sup>	%	20.8
Urban population	%	46.7	Gender equality <sup>2</sup>	0.54	Aid per capita	\$	45.6

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

## Executive Summary

Throughout 2005 and 2006, Moldova's reform process continued to be hampered substantially by the unresolved conflict concerning the Dnjestr Republic, the secessionist entity on the left bank of the Dnjestr River, as well as by Russia's direct interference (e.g., using energy resources for political leverage) and indirect interference (subsidizing and backing the Dnjestr Republic's regime). As sovereignty of the Moldovan authorities in Chisinau over the left bank territories presently exists in name only, this report refers to Moldova's right bank, unless explicitly indicated otherwise. Although the EU Border Monitoring Mission has increased international pressure on the secessionist regime in Tiraspol, indications in early 2007 are that political agitation has increased in the Dnjestr Republic, but any hopes of a reunified Moldova and the sovereignty of Chisinau seem far-fetched.

Domestically, the reform process has profited from a weakened ruling Communist Party after the parliamentary elections on 6 March 2005. At least in some policy fields, greater political commitment and coherence have led to improved reform legislation and its implementation. The rationale behind the regime's improved track record of reforms, however, is not political pressure by the weak and discordant opposition, but rather the regime's quest for acceptance by and partnership with the international community, the United States and the European Union specifically. The Communist Party has learned that a foreign policy agenda of Euro-Atlantic integration guarantees domestic popularity and makes it hard for the political opposition to define an alternative stance. The genuine drive and conviction behind the domestic reform agenda, however, are still rather limited. The rapid economic slide of the 1990s has produced dire social circumstances that no 6% growth rate can reverse: glaring social disparities between an impoverished majority of the population and a small, criminalized economic elite with strong, but intransparent connections to and overlaps

with a corrupted political nomenclature. Substantial remittances from hundreds of thousands of Moldovan legal or illegal migrants keep Moldova's economy afloat. In 2006, an estimated 30% of the working-age population worked abroad and their cash remittances of one billion U.S. dollars amounted to 30% of Moldova's GDP. Moldova's social fabric has been severely damaged, particularly in the villages. Economic despair has led countless Moldovans, especially women, to fall victim to human trafficking. Many have ended up in prostitution and other forms of quasi-slave labor.

## History and Characteristics of Transformation

Two interlinked, key developments set Moldova's transformation process apart from otherwise comparable countries in the western CIS. In the early phase of mobilization and transformation, the future of a Moldovan state and/or the existence of an ethnic or civic Moldovan nation were hotly disputed. Initially, the dominant elite factions favored "reunification" with Romania and denied the existence of a separate Moldovan nation. From their perspective, a political and economic transformation process beyond the dismantling of communist institutions would have been only a transitional phase until full reunification with the Romanian state had been completely accomplished. Overall, the issues of forming a nation-state absorbed almost all political energies until early 1994, which resulted in considerable polarization during the first few years of independent statehood and in the postponement of economic reforms. In the following years, however, Moldova was often praised by international organizations for its quick and courageous economic reforms compared to other post-Soviet states (other than the Baltic states). The delay and partial derailing of the transformation process due to the lack of management skills on the part of the Moldovan elites was seriously aggravated by the territorial secession of Transnistria and Russia's overt support of the regime in Tiraspol. Two separate custom and tax regimes were established.

Since bouts of violence in 1991 and 1992, the territory on the left bank of the Dnjestr River has been, de facto, a non-recognized state beyond the sovereign authority of the Moldovan government institutions in Chisinau. Since then, unproductive negotiations on the future status of this so-called Dnjestr Republic (PMR) within a Moldovan (con)federation have induced successive Moldovan governments to bend over backwards to accommodate Moscow as the key backer of the PMR-regime in Tiraspol, thus adding to Moldova's political and economic dependency, while putting constraints on any pro-European reform endeavors. Russian support provided to the separatist regime aims strategically to derail the pro-EU standing of the elites and economy in Moldova, thus postponing essential demands for societal reforms. The ongoing debate over reorganizing the state structure to accommodate the PMR is by now a far more serious threat to Moldova's stateness than any debates concerning the Romanian-ness

of the Moldovan nation and the idea of state reintegration. Over the past ten years, the existence of the Dnjestr Republic and the burden of the stalemate have contributed substantially to the fragile legitimacy of the Moldovan state and the weakness of the state institutions' authority. Over the years, moreover, the Dnjestr Republic has become a black hole of the global economy, a hotspot of organized crime, trafficking and bootlegging. Originally couched in terms of ethnic tensions, the conflict became propelled by economic fears of comparatively well-off industrial standing coupled with strong militaristic underpinnings. This rhetoric has been substituted by Soviet nostalgia, anti-reformism and economic interests in the Dnjestr Republic and in neighboring countries. On top of that, Soviet-era militaristic attitudes have been replaced with newly emerging Russian imperialism and exclusivist politics.

Economic transformation in Moldova had a relatively promising start in the early 1990s thanks to the country's economic and trade potential, its basic legal foundations for new democratic and economic institutions, and the innovative governance practices and foreign relations. The controversies over state- and nationhood soon put reforms on the backburner. By the time the electorate made economic considerations a top priority in the 1998 parliamentary elections, the window of opportunity had closed. Moldova's total dependency on Russian markets and energy resources as well as the absence of natural resources or competitive agricultural and industrial products for Western markets resulted in a structural socioeconomic crisis, aggravated by the 1998 ruble crisis in Russia. The absence of a strong pro-reform elite, general socioeconomic malaise (even without the hardships of actual reform), and the erosion of public trust in economic reforms resulted in a conservative backlash. In 2001, the Communist Party led by President Vladimir Voronin was voted back into power with a constitutional majority in parliament (71 out of 101 seats). In 2005, the Communists won a moderate victory, large enough for an absolute majority in parliament, but small enough to force the ruling party to make a deal with the oppositional right-wing Christian Democrat Party for Voronin's second term as president. Over the past few years, hundreds of thousands of Moldovan workers have left the country as legal or illegal migrants or victims of human trafficking, signifying the end of reform prospects. The economy has been increasingly reduced to derelict state-owned industrial enterprises, organized crime and subsistence farming. Most families rely on remittances from migrants to survive, whereas the state's power in directing economic processes is seriously handicapped by illegal flows of labor and capital as well as by state capture.

# Transformation Status

## I. Democracy

### 1 | Stateness

The state's monopoly on the use of force remains firmly established on the right bank of the Dnjestr, with the exception of the city of Bendery, which is controlled by the Dnjestr Republic (PMR) regime. On the left bank of Dnjestr, Moldova still preserves its de facto control over a strip of some small villages inhabited by Moldo-Romanian speakers around the Dubasari district. No progress has been made in restoring Chisinau's sovereignty over the rest of the left bank territories. The PMR, established in 1990, however, is a de facto unrecognized statelet with its own monopoly on the use of force on the left bank. In sum, guerrillas, civil war and anarchy have never emerged in Moldova. The series of armed – often erroneously defined as “civil war” – clashes from 1991 to 1992 have produced two strong states and created no niches for the mafia, clans or warlords that are beyond state control. Arguably, the state has been captured by shadowy economic interests, but the state has not lost its control over the territory and the populace per se.

Monopoly on the use of force

Again with the caveat of the PMR regime that does not accept the Moldovan constitution, the civic concept of the Moldovan nation is widely accepted by the populace and political parties. The PMR itself champions a civic concept of the nation, albeit with a preference for the Russian language and occasional campaigns against Romanian-language schools and intelligentsia. The trend in recent years among Moldovans to apply for a Romanian passport is no longer related to a rejection of the very concept of a Moldovan state and nation, but has a pragmatic rationale linked to Romania's EU accession. Even parties such as the Christian Democratic People's Party (CDPP), which used to be adamant in their rejection of Moldova's “separateness” as a nation seem to have come around to accepting the permanence of the Moldovan state, despite their insistence on the Romanian-ness of the Moldovan language and nation. Both in the PMR and Moldova, a certain amount of propaganda for an ethnic concept of the nation (Russian patriotism and ethnic Moldovan respectively) demonstrates the current strained political situation.

State identity

The state is largely secular and religious dogmas play no role whatsoever in the legislative, executive or judiciary branches. The constitution provides for freedom of religion, yet the Moldovan Orthodox Church receives favored treatment from the government, although there is no state religion. The conflict between the Moldovan Orthodox Mitropoly, which is a tributary to the Moscow Patriarchate, and the Bessarabian Orthodox Mitropoly, which declares its historical link with the pre-war Church of the Romanian Orthodox Patriarchate, continues to occupy the courts, but remains unsolved. A European Court of Human Rights (ECHR) decision made in 2004 forced the Moldovan Government to register the Bessarabian Mitropoly, although there are many other issues, including ownership issues, that remain unresolved to date.

No interference of religious dogmas

The state has a differentiated administrative structure throughout the country (again with the exception of the left bank territories, where the PMR regime has produced its own full-fledged administrative system). Institutions exist for the full range of policy fields, which is largely a legacy from the Soviet administrative system. The actual extractive and allocative power of the Moldovan state, however, is rather weak.

Basic administration

## 2 | Political Participation

Parliament has been electing the president since 2001. The latest general parliamentary elections of March 2005 were held in the presence of several hundreds of international observers and were rated “free and fair” by the OSCE/ODHIR, despite a number of reported unsystematic minor violations on election day. Though there has been a positive trend in free and fair general elections and the democratic determination of rulers has never been questioned since independence, the ruling Communist Party continues to exploit its privileged access to the voters via print and other media. After the March 2005 elections, the government gave up ownership of two major newspapers, although it continues to receive (overly) positive coverage in these and many other media, particularly in the electronic media (Public TV Company), which is trusted by a majority of the population (82%).

Free and fair elections

Elected rulers have the power to govern in principle. Democratic rule, however, is qualified by a high degree of “state capture.” In the Moldovan case, state capture typically implies that the political elite has “captured” the main economic activities in the country. This indicates a strong state, but certainly also the tradition of individual (ruling) power groups protecting their domains with special-interest policies that run counter to the general interests of the state and its citizens. Typically, many current and former key politicians are at the same time heavily involved in international business.

Effective power to govern

As a rule, there are no inhibitions on the founding or functioning of political and civil-society organizations, even for those outspokenly critical of the government, such as (until recently) Iurie Rosca and the CDPP. There are reports of some informal incidents of state repression and obstruction against, for example, demonstrators protesting the rewriting of history textbooks and the reintroduction of Russian in the curriculum. Journalists have also been subject to repression. Ghenadie Braghis of the Romanian television station Pro-TV was arrested and interned in September 2006 by officials of the Ministry of Interior after Pro-TV had reported on the maltreatment of detainees in Interior Ministry custody. Political parties cannot act freely in Transnistria, where political rights and censorship are critically infringed by the separatist region's Ministry of Security.

Association /  
assembly rights

Though outright prohibition and obstruction of the press and media outlets are limited to specific incidents, the constitutionally guaranteed freedom of the press is qualified by various factors in Moldovan reality: the financial dependence of media outlets on state subsidies, the use of state secrets, libel charges and other law suits to stimulate auto-censorship. Although many parties have their own newspapers, the incumbent government is clearly favored by the largest in circulation. Government influence on the press has decreased markedly due to the 2005 post-election accord with the opposition in which the government gave up ownership of the official *Nezavisimaya Moldova* and *Moldova Suverana*. In 2006, the Municipality of Chisinau decided to privatize two of its own media: Antena C Radio and Euro TV stations. Nevertheless, over 30 local newspapers are financed with public money. The reformation of the main TV broadcaster Teleradio-Moldova Public Company was impeded by the governing elite's strong opposition. Since April 2006, a new Broadcasting Code has been adopted by Moldova's parliament, providing a new legislative platform to guarantee the independence of the electronic mass media. A new audiovisual council, as well as the National Council of Observers have been established, and voted by the end of 2006. Despite the positive signs of progress, Moldova still ranks 74th out of 167 in the Worldwide Press Freedom Index.

Freedom of  
expression

### 3 | Rule of Law

Moldova's track record concerning the separation of powers for the reporting period is mixed. The March 2005 elections resulted in a new arrangement with the political opposition and, to some degree, a restoration of the legislature's representative political role, which had been severely eroded by the Communists' constitutional majority in combination with the other parties' principled opposition in the previous legislature. Political decision-making has partially returned to its legitimate place where it can serve as a check on the Communists' power monopoly. By all appearances, however, the Communist Party made a

Separation of  
powers

tactical decision to share responsibility for Moldova's dire political and socioeconomic situation generously with other parties. Some of the opposition parties gladly accepted to play into the constructive opposition. Typical of the low profile of the dominant political force that may be read positively as "checks and balances" is the fact that most ministers in the current Tarlev cabinet are perceived more as "technocrats" rather than high-profile members of the Communist Party.

Moldova has maintained an elaborate, institutionally and functionally differentiated judiciary that was present during the Soviet period. Moldova's 2005 judicial reform generally rates as a substantial improvement to the system's functioning and architecture, although certain deficits such as corruption and an enormous backlog of cases continue to hamper the judiciary and public trust in the courts. Judiciary reform in Moldova was slowed down by partial political reform and by the near lack of key steps taken to depoliticize Supreme Court membership. Confidence in the judiciary is quite low; there are few judges whose names are associated with independent justice by the public and mass media. The process for appointing and dismissing judges was reorganized in 2005 in an attempt to improve the judiciary's independence from political pressure. In view of the general state of checks and balances in Moldova, political penetration of the judiciary is a given, although in some cases the courts, and especially the Constitutional Court, have demonstrated a remarkable degree of independence and professionalism, for example by waylaying the government's decision in the dispute concerning the Bessarabian Orthodox Church.

Independent  
judiciary

Since January 2005, Moldova has a national anti-corruption strategy, signaling that the political authorities are beginning to take the problem of grand and petty corruption seriously. In Transparency International's CPI 2006, Moldova was ranked as the least corrupt CIS state. Ranking 79th out of 163 (up 14th from 2005), however, was linked to a score of 2.9 on a 1 to 10 scale. The anti-corruption strategy is comprised of a mixed (governmental and civil society) monitoring group and the Center for the Fight against Economic Crime and Corruption, although most attention tends to concentrate on inhibitive penalties for petty corruption and some high-profile cases with, reportedly, a political bias, such as the January 2006 trial of former Defense Minister Valeriu Pasat for selling MIG-29s below market price.

Prosecution of  
office abuse

Civil rights are violated partially and incidentally by individual state authorities, but not systematically. Nevertheless, the Moldovan state continues to regularly lose several human rights cases in the European Court of Human Rights (ECHR), largely because of the mistakes intentionally made by biased judges.

Civil rights



#### 4 | Stability of Democratic Institutions

Moldova's democratic and administrative institutions' performance is limited not so much by instability, but rather by a lack of resources, state capture by vested interests, and consequently the lack of political will to tackle society's key problems. The course of centralization and the installation of a strong vertical power that began with the Communists' return to power in 2001 has apparently been halted, as a significant effort towards decentralization was launched in early 2006. By the end of 2006, parliament adopted new laws on administrative decentralization, regional development and local public administration, excepting the law on local finances, which is to be adopted in 2007. A new minister for local public administration was established in May 2006 to advance further the above mentioned reforms, and to facilitate decentralization as a long-term process of domestic and territorial development.

Performance of democratic institutions

State capture and monopoly of power, not veto powers, constitute key problems in the acceptance of democratic institutions in Moldova. The risk of a reversal of institutional democratization seems remote in Moldova. This is in itself a major achievement, considering the adverse domestic and regional environmental conditions, which include a contested national identity, the Dnjestr conflict and an ongoing socioeconomic crisis. The encroaching of dominant political players and their undermining of the actual functioning of democratic institutions is a political reality. In the framework of the EU European Neighborhood Policy, Moldovan authorities committed themselves to adapting their legal system to EU norms and values, that is, the rule of law, public participation and good governance standards, but the results of the past two years have been mixed at best. Neither the range of political parties nor the community of civil society organizations contains any significant extremist leanings.

Commitment to democratic institutions

#### 5 | Political and Social Integration

Prior to the March 2005 elections, national and international analysts had criticized a number of the Moldovan electoral system's rules and regulations for the unfair advantages given the incumbent, the Communist Party. Quite a number of these issues have since been resolved, but only since the elections. Criticism focused on the 6% hurdle for a political party, 9% for two-party alliances and an inhibiting 12% for multiparty alliances, all of which clearly favors the established and unified Communist Party. These hurdles resulted in a 101-seat unicameral parliament with only three parties represented in 2001, and in a parliament with no independent candidates elected in the last general elections, although 18 parties entered the electoral contest, leaving over 16% of the actual voters without representation. Moldova thus has a low Laakso/Taagepera index value (1.79).

Party system

Considering Moldova's existing social and rural-urban disparities, ethnic polarization and reform controversies, this index value signifies clientelism and serious deficits in the representation of social groupings rather than the curbing of political fragmentation. The party landscape as such is highly detached from the socioeconomic interests of the populace at large and rather represents the vested interests of privileged groups.

Social, non-political self-organization and self-help are mainly concentrated on communal and family structures of economic subsistence. A small elite, almost exclusively in the capital of Chisinau, has produced social capital by teaming up with relevant international organizations. Typical for a USSR successor state, attitudes and concepts concerning social organization are focused on the state, irrespective of the ability and willingness of the state to live up to expectations of state protectionism. The issue here is not a low level of trust among the population, but rather, a fragmentation of society and the state's monopoly on several aspects of social and economic life. More far-reaching forms of social organization are limited to a rudimentary elite and mobilize the populace on an ad-hoc basis. According to 2006 statistics, there are over 4,500 NGOs registered in Moldova, but few would claim to have a strong impact in rural areas. Civil society has been invited to assist governmental agencies in implementing the action plan process, and many government officials have praised local NGOs for their quality and timely expertise in helping the government meet the international community's conditions for assistance and reform recognition. Broader, bottom-up civil-society initiatives that function as an additional check on government policies and a lobbyist for group interests are correspondingly rare. Access to decision makers is basically limited to NGOs providing much-needed expertise and a small circle of major legal and illegal business interests. NGOs advocating vital interests of social groups generally depend on funding by their international partners and rely on the international community to influence policy-making.

Interest groups

The most recent opinion survey of the Institute for Public Policy (IPP) indicates that support for democracy is high. As noted in 5.1, except for some marginal groupings, no political party has advocated a return to an authoritarian regime or massively violated fundamental democratic principles in the contest for political power. Dictatorship is mentioned by some 7% of the respondents as one of their top three current concerns. Overall, no more than 14% of the interviewees identified with being "(very) much interested in politics," three quarters "somewhat," "hardly," or "not at all." To the key question of political trust, whether the republic was ruled in accordance with the popular will, 18% had no answer, 27% said "yes" and 55% "no." The question concerning free and fair elections produced very similar percentages. Overall trust in political institutions is generally low, ranging from (-70%/+22) for political parties to (-53%/+44%)

Consent to  
democratic  
norms

for the president and (-36/+58) for the mass media. From the February 2005 to the November 2006 survey, however, the trend is negative for almost all of the 13 institutions listed.

Rural Moldova in particular has maintained strong traditions of communal self-help, which is a key asset in the hardships of transition and subsistence, as demonstrated by the mass influx of cash remittances from Moldovans working abroad. The widening gap between rural and urban Moldova, the resulting migration flows to the cities, and most of all the out-migration of up to one-third of the working age population has seriously damaged the social fabric and voluntary associations of self-help in the villages beyond consumptive support for family members at home.

Associational  
activities

## II. Market Economy

### 6 | Level of Socioeconomic Development

Social exclusion is extensive and in the process of becoming socially ingrained. The relative advantages of the egalitarian Soviet system, such as access to education and health care, are rapidly eroding and a new underclass is in the making. The official unemployment rate of 7% is largely fictional with close to one-third of the working-age population working abroad and substantial hidden unemployment in subsistence farming. At the end of 2005, 33,600 workers were on “unpaid leave,” in addition to the 21,700 officially unemployed. Over 80% of Moldovans live below the nationally defined poverty line. Thus, social exclusion is largely driven by poverty and a sharp increase in economic inequality. A large share of the population depends on subsistence farming and migrant remittances. Gender and ethnicity are no strong determinants of social exclusion, with the possible exception of the Roma community as a victim of popular discrimination. The GDI for Moldova in 2006 is 0.732 and is strongly pre-determined by the ratio of female to male wages in non-agricultural activities of 0.685. The growing rural-urban disparities in terms of socioeconomic quality of life may be illustrated by the 2005 infant mortality rate: 1.24% for Moldova, 0.97% for the capital city of Chisinau and 2.5% in the district of Soldanesti. The Gini Index of 0.54 (2004) also indicates growing socioeconomic disparities. Typically, the city of Chisinau accounts for 20% of Moldova’s population, but over 60% of collected income tax (2005).

Socioeconomic  
barriers

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	1,662	1,981	2,595	<b>2,917</b>
Growth of GDP	%	7.8	6.6	7.4	<b>7.1</b>
Inflation (CPI)	%	5.3	11.7	12.5	<b>13.1</b>
Unemployment	%	6.8	7.9	8.1	-
Foreign direct investment	% of GDP	5.1	3.7	3.3	<b>6.8</b>
Export growth	%	20.1	19	8.3	<b>20.2</b>
Import growth	%	18	28.6	0.3	<b>21.2</b>
Current account balance	\$ mn.	-20.0	-134.8	-53.1	<b>-241.8</b>
Public debt	\$ mn.	825.8	848.2	754.3	<b>699.7</b>
External debt	\$ mn.	1,804.8	1,941.5	1,945.7	<b>2,052.9</b>
External debt service	% of GNI	13.8	7.2	10.4	<b>7.6</b>
Cash surplus or deficit	% of GDP	-	2.0	0.4	<b>1.9</b>
Tax Revenue	% of GDP	12.9	14.7	16.4	<b>18.9</b>
Government consumption	% of GDP	20.2	19.7	15.4	<b>15.5</b>
Public expnd. on edu.	% of GDP	4.9	4.9	-	<b>4.3</b>
Public expnd. on health	% of GDP	3.3	3.5	4.2	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	0.4	0.4	0.4	<b>0.3</b>

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

## 7 | Organization of the Market and Competition

Moldova's market economy suffers from a weak institutional framework and thus lacks a level playing field for market competition. The "wild capitalism" of the transition period typically implies that certain major economic players have privileged access to political decision-makers, and because of the entanglements between politics and business, rules are not applied consistently. There are substantial gray zones beyond state regulation: corruption, the informal sector, criminal activities, migrant cash remittances, etc. An estimated 12% (UNDP,

Market-based  
competition

2005) of the labor force is employed in the informal sector in Moldova itself, apart from the third of the labor force working abroad, often illegally and also in the informal sector.

Due to its small market, Moldova has not witnessed the emergence of oligarchic monopolists like those in Russia or Ukraine. Nevertheless, the formation of monopolies is regulated inconsistently in practice because of the entanglements between politics and big business as well as by the large informal economy. The Moldovan government has established an autonomous regulatory agency on competition three times, only to dissolve it later each time, albeit against OECD encouragement and domestic demands.

Anti-monopoly  
policy

Having become a WTO member in 2001, Moldova's economy is export-oriented, with exports making up about 50% of GDP. The state's monopoly on trade was abolished early on and most prices were also liberalized early on. In 2005, the average tariff on imports was at 5.7%, but almost half of the product categories have zero tariffs. State regulation, illegal trade flows and administrative non-tariff barriers mean that Moldova is selectively integrated into the world market. Prohibitive Russian customs tariffs and excises on most Moldovan agricultural products – particularly the ban from March to December 2006 on the import of Moldovan wines – seriously limited Moldova's access to world markets and the traditionally important Russian market in particular (the Russian market accounts for 80% of Moldova's wine exports). In 2005, prior to the ban, the CIS accounted for half of Moldova's exports and 40% of imports, whereas for Germany and many other EU countries, Moldovan imports were twice as high as exports. The main exportable agro-industrial products originate from sub-sectors dominated by state-owned companies.

Liberalization of  
foreign trade

Moldova's financial sector is fairly stable, but the reformed banking industry is more advanced than the country's capital markets. After a short phase of explosive growth around the year 2000, the number of banking institutions has stabilized. The capital market, however, is strongly oriented toward short-term credits to large enterprises. Long-term credits and SME credits are mainly financed by international financial institutions. Migrant workers' massive cash remittances largely bypass domestic banking institutions. Meanwhile, competition among banks has intensified. Due to the current tax legislation, the banks monopolizing the financial market are inclined to strongly prefer consumptive, short-term non-investment loans over riskier investment credits. Thus, interest rates remain prohibitively high: ca. 20% on average for the years 2003-2005 for credits in Moldovan lei and 11% for credits in U.S. dollars. Commercial banks' assets rose from 37% to 49% of GDP from 2003 to 2005, while the share of unfavorable credits declined from 6.4% to 4.3%. In sum, the banking sector prospers commercially, but has serious difficulty in fulfilling its macroeconomic functions. 2006 was the year of considerable mergers in the

Banking system

banking sector, with Societe Generale and Veneto Bank purchasing two of the most important local banks (out of 16): Exim Bank and Mobias Bank.

## 8 | Currency and Price Stability

In recent years, the Moldovan government – in part thanks to its improved budgetary discipline – has been successful in controlling inflation, albeit at a relatively high level. Government policies have contributed to bringing the (end of year) inflation down from 43.8% in 1999 and 15.7% in 2003 to 12.5% in 2004 and 10.0 in 2005. As foodstuff prices tend to be more inflationary than other prices, the public perception of subjective inflation is stronger than actual overall price increases. The foreign exchange rate of the Moldovan lei has improved from 13.5 lei to the U.S. dollar to 12.6 (2002 – 2005).

Anti-inflation /  
forex policy

Governmental debt policy has contributed to macroeconomic stability. External debt has dropped from a disastrous 111.2% of GDP (2002) to 69.1% (2005), and correspondingly, the external debt service expenditures for a share of the state budget dropped from 24.5% to 8.5% over the same period.

Macrostability

## 9 | Private Property

Private property is safeguarded formally in law and state intervention is no longer a major concern in Moldova. The serious qualifications concerning an impartial and independent judiciary, however, imply that the protection of property rights is structurally assured. The protection of intellectual property, too, is a matter of ongoing (international) concern.

Property rights

Private companies constitute the backbone of the market economy, although non-profitable state-owned companies continue to be protected from market forces, for example, by preferential fiscal treatment. From 2002 to 2004, the private sector's share in employment, however, has declined slightly, from 72.3% to 69.4%, and the same applies to its share in GDP (76% and 68.6% respectively). The position and sustainability of SMEs in Moldova remains highly uncertain: three quarters of all SMEs fold in less than two years. Small enterprises (i.e., up to 50 employees) make up the lion's share of enterprises (92.2% in 2005), but employ a mere 39.6% of the workforce. In agriculture, less than 30% of the arable area is state-owned, but 40% of the private sector consists of peasant farms and household plots.

Private  
enterprise

## 10 | Welfare Regime

There are social assistance and welfare programs in Moldova, but they are too weak financially and too ineffective in terms of compensating for social risks. Consequently, 82% of the population lives below the official poverty line, despite the 2004 IMF and World Bank-initiated Economic Growth and Poverty Reduction Strategy. Social assistance and welfare are distributed extremely unevenly and based on categories rather than needs. The Moldovan state concentrates assistance to specific categories of relevant citizens. In the absence of a single database comprising all social assistance beneficiaries, and a household-based system, categories matter more than actual need. With a declining labor force and the disproportionate share of migrants cash remittances for subsistence to GDP, the role of state-regulated social assistance is declining significantly. In 2005, out of 21,700 registered unemployed, only 1,400 received social benefits.

Social safety nets

There are no formal hindrances in access to education, social assistance and health care for women and ethnic or religious minorities. Increasingly, however, social status and economic resources become a factor in access to (private) education and jobs. Because financial resources are lacking, the state's role in providing public services is diminishing.

Equal opportunity

## 11 | Economic Performance

Considering the estimated size of the gray market and cash remittances, any macroeconomic data for Moldova are at best indicative. For example, the country's relatively moderate unemployment rates fail to take into account the (often illegal and/or seasonal) out-migration of up to one-third of the workforce. Thus, the substantial and continuous annual growth rate of 6-7% by now indicates sustainable development or a national regulative and institutional infrastructure conducive to competitive modernization. Foreign direct investment in 2005 amounted to only 7% of GDP. The structure of growth remains lopsided. Restructuring the national economy is slow and industrial as well as agricultural growth rates are declining. Conversely, import growth is accelerating and augments the share of net production and import duties in GDP, but the share of gross value added in GDP is decreasing, making the Moldovan economy consumptive rather than productive. The IMF and World Bank continue to admonish Moldova for its lack of diversification in exports, which are based on a handful of (low added-value) products, such as wine, tobacco and textiles. Similarly, over the past two to three years, the ratio of dependent persons to employed persons has increased drastically from 1,413 in 2002 to 1,733 in 2005 (per 1,000).

Output strength

## 12 | Sustainability

Thanks to international norms and pressure, environmental concerns have made it onto Moldova's policy agenda. However, in 2005, only half of the 100 million Moldovan lei earmarked for environmental protection under the EGPRS was actually allocated. More than half of the Moldovan population has no sustainable access to potable water. Major legacies of industrial and agricultural pollution remain unaccounted for and unresolved in Moldova, with serious consequences for public health.

Environmental  
policy

Considering Moldova's dire socioeconomic situation, government budgetary investment in research, development and innovation (RDI) is improving significantly, from 0.17% of GDP in 2001 to 0.21% in 2005. The HDI index of education reached an all-time low of 0.503 in 1999, but has been growing steadily since, reaching 0.587 in 2005. The mushrooming of unaccredited institutions of (higher) education and brain drain are detrimental to the Moldovan educational system in the medium-term. So far, enrollment rates are close to 100% in primary and secondary education, irrespective of gender.

Education policy  
/ R&D



## Transformation Management

### I. Level of Difficulty

A decade has been lost in the transition period, and the current structural constraints on the government are massive. Moldova's management faces a number of serious structural constraints with origins or root causes that reach far beyond the responsibility of the current government and cannot be remedied easily in the short- or medium-term. Three key constraints are directly or indirectly linked to the end of the Soviet Union. Firstly, there is the loss of the traditional Soviet markets for Moldovan exports and difficulties in reorienting the economy to other markets. Secondly, the intractable Dnjestr conflict has turned from a regional and ethnic conflict to a consolidated failed state and a source of organized crime. Thirdly, the suppressed issue of the separate nation and statehood of Moldova vis-à-vis Romania has re-emerged. The predominance of issues of nation- and state-building in the crucial first phase of post-communist transition resulted in much valuable time lost and a delay in democratic and economic transformation. Lack of critical support from the European Union and the West can equally be seen as a source of the state's weakness. Each of these "perennial issues" absorbs enormous political energy, undermines the legitimacy and strength of state authorities and can easily be used as an excuse not to tackle key reform issues. As part of the above chain reaction, the best-educated younger generations have left the country in unknown numbers to go to the other post-communist states, thus depriving the state of crucial human capital for governance and reform.

Structural  
constraints

As in most post-communist societies, traditions of civil society are weak and expectations of the state and government are high. Lack of trust in political parties complements a high degree of trust in charismatic leaders and massive parties. The number of effective NGOs is small, and most of them are fully dependent on international support and funding. Trust in political institutions is low. Civil society traditions are generally weak in the European post-Soviet republics, and reforming essential state structures has only recently been made a government priority (civil service reform, decentralization, strategy of reforming central government). Because of the Moldova-Romania nexus and the corresponding concern among Soviet authorities in Moscow, state repression of

Civil society  
traditions

non-state organizations and reducing the scope of civil activities has been pronounced. Since independence, a substantial portion of civil mobilization has been directed toward exclusivist ethnic issues, which hardly increases trust in institutions or generates moderation in society. There have been efforts in recent years to crystallize a sense of the nation-state. Overall, NGOs in Moldova are not of a grassroots nature; the international community more often than not serves as both NGO sponsor and main client or addressee. Typically, most of the current politically relevant NGOs are highly dependent on international funding, particularly the Soros Foundation. Juridical and bureaucratic obstruction of NGO activities as well as their substitution and undermining by GoNGOs are recent phenomena. The combination of Soviet and Moldovan traditions with NGO-unfriendly governments has resulted in a particularly weak civil society. Also, Moldova's political and societal elite is minute in size, which makes it extremely difficult to develop a civil society independent of party politics. However, the positive example of the Civic Coalition for Free and Fair Elections, which acted as a pressure group in monitoring the 2005 elections, marked a watershed for civil society participation. Together with the Concept of Cooperation, which was passed by parliament in 2006 to formalize its relations with NGOs and to promote open and ongoing consultations with NGO representatives, this positive development in the political culture could lead to more productive and less adversarial relations between the government and NGO sector.

Moldovan society has a substantial share of ethnic minorities. According to the most recent national census in October 2004, the total share of ethnic minorities has declined from 35% to 26%. The statistics do not include data on the population on the left bank, where a parallel, separate census has been conducted. The decline of ethnic minorities in Moldova is dictated by the low birth rate of the urban population, where most of the Russian-speakers live, and to a certain degree, by the emigration of some of the minorities to their original homelands, such as Russia, Bulgaria and Ukraine. Ethnic cleavages are only one dimension of the Dnjestr conflict. In a way, one might also refer to a Romanian-Moldovan ethnic split within Moldovan society. The communist leaders see Romanian and Moldovan identities as conflicting and diverging identities, which reflects the Soviet nationalities policy legacy. In general, in the villages the issue is contained by customary structures of segregation, and in the cities there is little ethnic tension in daily life. Not unlike in the Baltic States, ethnic conflict is a political meta-issue of nation- and state-building rather than a source of everyday tension and discrimination. Ethnic cleavages are largely unrelated to socioeconomic disparities. Nevertheless, the impoverishment of the population – that has thus far not translated into mobilized violence – and the legacy of the violent potential of the once-ethnic Dnjestr conflict have placed serious constraints on the government's strategic options. External pressures exercised by more powerful neighbors (Russia, Ukraine) often channel these options to

Conflict intensity

unbearable costs. Religious tensions are marginal in a secular state with a 90% Orthodox majority, although the Russian Orthodox Church receives some preferential treatment. State bureaucracy obstructs the operation of minor churches and sects. During the period under review, the ruling party twice attempted to redefine the policy on nation- and state-building by making Russian language instruction mandatory in schools and by replacing the history curricula. Ethnic conflicts are potential and instrumental rather than real. Social differences define the main cleavages in society; social polarization, income-fragmentation, urban-rural divides, huge variations in education, access to primary services and job opportunities are key factors in Moldovan society's weakness. Nevertheless, an eruption and escalation of violent conflict would undoubtedly result in ethnic mobilization and confrontation, and endanger the cohesion of the state. Currently, the level of violence is not exceptionally high, as the well-entrenched Communist Party dominates politics with a large constituency. Most key representatives of the current Smirnov separatist regime are people who never lived in the region before 1991; they are Russian citizens who previously served in the various secret services, counter-espionage or military units of the Russian Federation. No mobilized group or protest movement has a major impact on politics at the moment. Society is not even polarized along socioeconomic lines. The regime has been successful thus far in integrating various ethnic groups and social classes.

## II. Management Performance

### 14 | Steering Capability

The reform strategies of the communist government are to a limited extent defined by short-term electoral consideration. To a much more substantial degree, reform efforts are predetermined by the objective of finding recognition as a partner of the international community and the European Union in particular. Consequently, doubts concerning the genuine reform commitment of the government remain, and the unrealistic priorities and reform objectives set by the government are obvious. The targets defined by the EU Neighborhood Policy's Action Plan are way beyond Moldova's managerial capacities and resources, but have nevertheless been accepted, at least rhetorically. Political strategies are, for instance, not on par with the crucial problems of human trafficking, out-migration and rural deprivation.

Prioritization

The communist government has improved its reform agenda and reform commitment, but bureaucratic inefficiencies and lack of resources are certainly not the only reasons for deficits in the reform process. In both democratic and market economic reforms, particularistic elite interests tend to undermine reform agendas, and the government more readily concedes to the opposition and the international community on issues of secondary importance, while dragging its feet on pivotal issues such as media privatization or poverty reduction.

Implementation

The weight of the anti-reform faction in the Communist Party seems to be diminishing. Consequently, the political leadership's responsiveness and learning processes have improved somewhat, but so have strategies of simulated reform and public propaganda. In some policy fields, enhanced flexibility may also be read as erratic policy-making. In a number of fields, the government has demonstrated more readiness to accept and implement reform programs proposed by international organizations and international financial institutions, such as budgetary discipline, poverty reduction and judiciary reform.

Policy learning

## 15 | Resource Efficiency

In terms of financial resources, the government's room for maneuver is strictly limited. Budgetary discipline, however, has improved in recent years. Since 2002, the budget balance has shifted from -2.0% to +3.2%. Due to the cash remittances and the volume of illicit market economics, much of Moldova's financial flows continue to bypass the treasurer's coffers, often with the tacit consent of the political elite. The main deficit in terms of resource management, however, concerns human resources. The institutionalized dominance of the Communist Party has resulted in well-entrenched politicians whose appointments were more often than not based on the party book rather than expertise or competencies in the respective field. This traditional phenomenon has been partly remedied by the recent trend toward inclusion of the non-communists in governmental and administrative responsibilities. Typically, the average minister in the Tarlev cabinet is almost 50 years of age. The qualification of the younger generation with a relevant post-Soviet education and international experience has not (yet) brought them to positions of political responsibility in Moldova – an evident waste of human resources, with the exception of the Ministers of Local Public Administration (43 years), Justice (32) and Economy (36).

Efficient use of assets

Policy coordination in Moldova used to be hierarchical rather than horizontal, with the president in the position of guarantor of policy coherence. In a number of policy fields, horizontal coordination is gaining ground such as in the fight against corruption, without prejudicing, however, the dominant position of the president and his advisors. Key dilemmas of policy prioritization and resource

Policy coordination

allocation remain unresolved. These include balancing economic liberalization and social cohesion for the rural and urban poor as well as matching policy initiatives with the required human and financial resources. For the rich, a de facto laissez-faire economy has been created, whereas social policies are oriented toward a bare subsistence minimum rather than breaking the circle of impoverishment. The mismatch between policy initiatives and resource allocation is often handed down to regional or local levels of government.

A full set of anti-corruption mechanisms is in place. Since the introduction of new anti-corruption legislation and monitoring in early 2005, Moldova has seen a steady increase in harsh sentences for cases of petty corruption by officeholders and others, as well as a small number of grand corruption cases, usually with accusations of setup charges and the political abuse of anti-corruption legislation, as seen in the case of Alexandru Tanasa, president of the Victoria Bank. All indications point to the political establishment being itself involved in grand corruption, making the absence of high-profile political corruption as court cases indicative of the selective nature of Moldova's anti-corruption campaign.

Anti-corruption  
policy

## 16 | Consensus-Building

The political consensus on a market economy as a long-term objective has improved in recent years with the gradual sidelining of the orthodox communist faction in the Communist Party. Neither democracy nor a market economy are disputed in principle as goals by any major political player in Moldova, except for the current regime in the Dnjestr Republic, which is still prone to bouts of Soviet nostalgia. Balancing economic liberalization and transformation costs, on the one hand, and social sustainability for the populace, on the other hand, remains a controversial issue. In terms of adopting formal transformation-related legislation, the degree of consensus among the major political parties is relatively high.

Consensus on goals

In the absence of anti-reform or principally anti-democratic veto players in Moldova, reforms in the opposition and the reform-wing of the ruling party have been quite successful in co-opting the orthodox communist wing and in eroding its resistance to market economic principles. The implicit subversion of reform objectives such as the rule of law or the state's redistributive function by political and economic entrepreneurs (without them being formal veto actors) are largely beyond the control of committed reform actors in Chisinau, not the least because the power elite is deeply involved in economic activities. The absence of visible and outspoken veto powers may be read as an indication of the superficial nature of many reforms and the virtually unlimited scope for illicit activities subverting or bypassing the state's regulative and penal powers.

Anti-democratic veto  
actors

The political leadership has further improved its capability in managing and de-escalating political cleavages. Since the 2005 elections and the subsequent arrangement with Iurie Rosca and his PPCD, which used to be adamantly anti-communist, escalating public confrontation between the government and opposition has been reduced to a minimum (e.g., on issues of national identity and history textbooks). Whereas governmental leadership has made the PPCD give up its principled anti-communism, the eroding popular mandate and the external factors of relations with the European Union as well as Voronin's falling out with Russia in late 2003 have made the communist regime backtrack on its anti-European and anti-reform stances. A cross-party reform coalition of sorts has emerged. The crucial caveat, however, concerns the virtual absence of political representation for Moldova's silent majority of the poor. National identity issues are well-managed, but Moldova's real socioeconomic problems find a weak political echo and lack fundamental political contentiousness. The populace, however, is beginning to question the regime's "stagnation," which can be seen as an important incentive to domestic reforms.

Cleavage / conflict  
management

The government's move to draw on civil society and think tank expertise in addressing social issues or European integration as well as parliament's Concept on Cooperation both point to a restored viability of political dialogue and compromise that enhances the role of non-partisan expertise and opinions. It remains doubtful, however, whether civil society will have any meaningful influence on core policy decisions, both in domestic and international issues, as long as the Communist Party can rely on an absolute majority in parliament.

Civil society  
participation

Unlike nearly all other post-communist states, Moldova has not seen any serious management of or public confrontation with the dictatorial (fascist and communist) pasts and their respective injustices. With an only partially reformed Communist Party in power, the public discourse (e.g., in history textbooks) concerning collectivization, deportations and purges is scant and largely euphemistic. Conversely, pro-Romanian textbooks boycotted by the government tend to expand on communist injustices, while, until recently, passing over the existence of fascist concentration camps in Romanian/German occupied Moldova in WWII in silence. A recent documentary by the historian Nataria on the Holocaust in Moldova was not only the object of serious controversy because of its accusatory stance toward the Romanian occupational regime of that time, but also because the topic itself had been largely taboo in the Moldovan media for decades. Formally, Moldovan law provides for the property confiscated from the politically repressed or exiled persons by the fascist and communist regimes, but no general statute on restitution exists. A hazardous process of de-collectivization and an incomplete restitution process wrought with uncertainties have produced a highly fragmented rural economy rather than historical justice. Restitution and historical justice, however, are not significant public issues in Moldova today.

Reconciliation

## 17 | International Cooperation

Arguably, the Moldovan regime inverts the dynamics of this relationship and uses its domestic reform policies to support its relations with international partners. Overall, Moldova has become more compliant with European Union, IMF and World Bank recommendations and policy guidelines, making an effort to present itself as a dependable and reform-committed international partner. Political tactics and a substantial gap between strategic promises and policy implementation, however, are detrimental to Moldova's international standing. Overall, Moldova's track record with Western organization seems to have improved (from a very low starting point) recently.

Effective use of support

The Moldovan government has definitely improved on its international standing in recent years by being more amenable to policy advice from Brussels or Washington (WB/IMF). Moldova's compliance with at least the letter of the ENP Action Plan over the years 2005 and 2006 has been a positive surprise. A closer scrutiny of the realities of policy implementation, however, reveals glaring deficiencies and international trust in Moldova thus remains guarded. Moldova's decision to abolish visas for EU citizens unilaterally as of 1 January 2007 has been a positive sign of international outreach. On 15 January 2007, Moldova initiated discussions with the European Commission on a Visa Facilitated Regime for Moldovan citizens.

Credibility

In the Stability Pact for Southeastern Europe, Moldova's politicking concerning its alleged Southeast European status and corresponding claim to EU association still outweighs its active commitment in regional cooperation initiatives under the Stability Pact and the South East European Cooperation Process (SEECF), though less glaringly. Moldova's lack of active and tangible participation beyond the political forums is an often-heard point of criticism. The Orange Revolution in Ukraine in late 2004 has resulted in a marked improvement in relations, exemplified by the introduction of the EU Border Mission Assistance Mission one year later to curb illegal exports from the Dnjestr Republic.

Regional cooperation

## Strategic Outlook

Since 2001, Moldova's main macroeconomic indicators, propelled by a continuous annual GDP growth of near 7%, have suggested a turn for the better. Considering the size of the gray economy and international trafficking emanating from Moldovan territory as well as the weight of the cash remittances from Moldovan workers abroad in the national economy, growth figures and other indicators can hardly be taken to reflect the sustainability and development of the Moldovan economy. In socioeconomic terms, the main threat for Moldova in the medium-term is neither corruption and illicit economic activities, nor the lack of economic diversification. Advocates of reform will find their main adversaries in the uncertainties and political strings attached to both access to the crucial Russian market and dependable imports of natural resources, and most of all, energy from Russia.

Without a strategic redistributive policy (poor-rich, urban-rural), the agricultural hinterland of Chisinau and Balti will continue to suffer the consequences of losing its better-qualified and its younger generation to ongoing out-migration and brain drain.

The strategic priority is thus to provide better prospects in terms of education and employment for the younger generation, and most of all, to upgrade the socioeconomic infrastructure outside the cities to create a basis for modest betterment and an alternative to out-migration. Micro-credits for local entrepreneurs ought to be a spearhead of such a strategic policy of rural development. Currently, better, modern living conditions are not spreading from the urban centers to the small municipalities and the countryside. Quite the opposite, the destitute living circumstances of rural areas are spreading to the suburbs.

Politically, reform should not invest in the Dnjestr separatist conflict that cannot be resolved in the current regional power constellation, but rather in persistently working toward a European reform policy. The strategic orientation and financial incentives provided by the European Neighborhood Policy and the accompanying Action Plan may be insufficient, but a prospect for European reforms exists, even with the Communist Party in power. Thus far, catch-all conditionality from Brussels and the weakness of the domestic opposition have let the ruling party get away with paying lip service to Europeanization and European reforms. The 10-point list of demands of the united opposition after the March 2005 elections has demonstrated that the ruling party is responsive to strong conditionalities and willing to compromise. In a number of policy fields,



strategic reforms have been initiated and implemented with more commitment since. Therefore, critical cooperation with the Communists' reform-oriented wing should be the political strategy for a unified political opposition in Moldova. Petitioning the European Union for more reform assistance is a corollary to tangible reform efforts and should not be sidelined by fruitless expectations of EU accession or a more constructive economic and geopolitical Russian position vis-à-vis Moldova.