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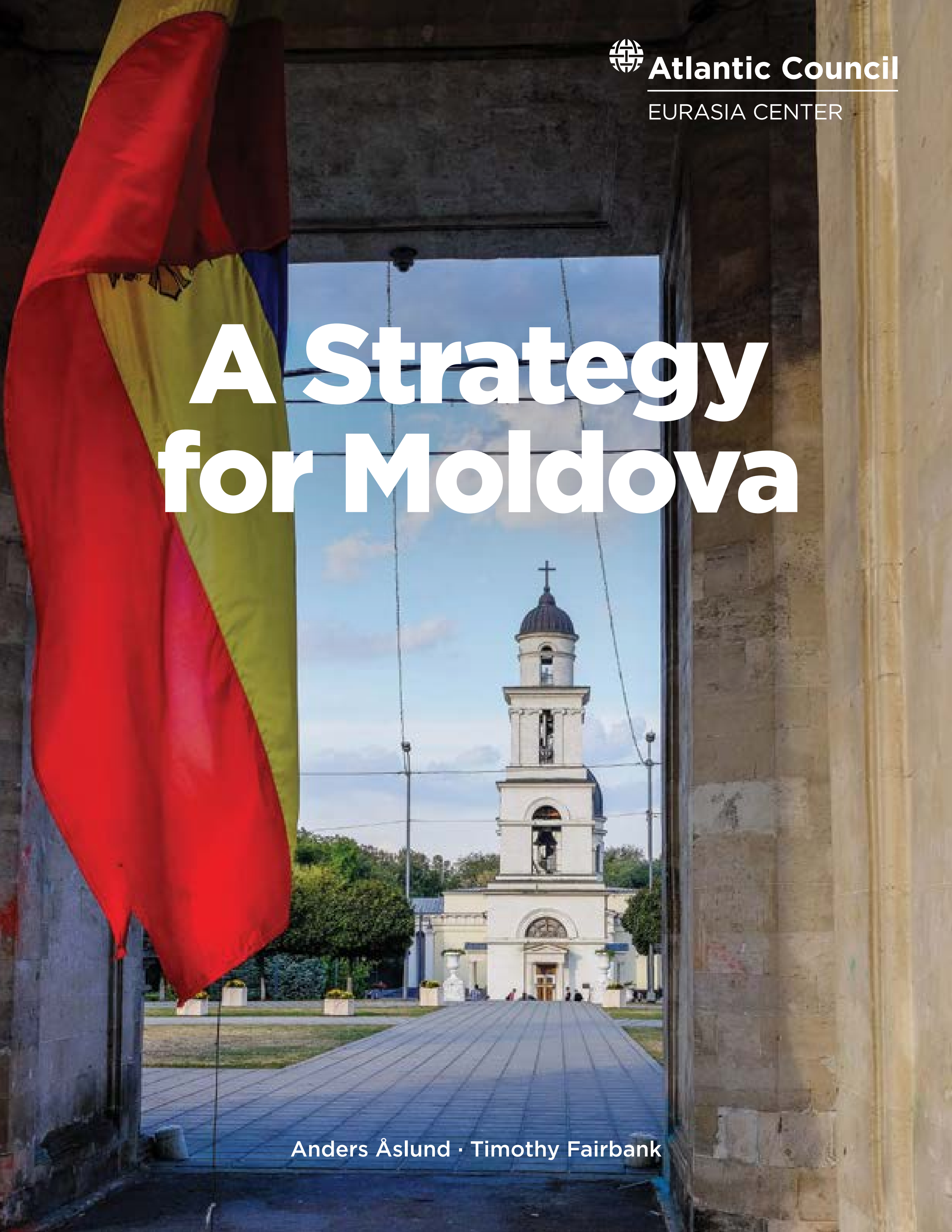
A Strategy for Moldova



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INTRODUCTION

The Republic of Moldova, a sliver of land bordering the European Union (EU) and NATO's eastern edge, finds itself at a critical crossroads twenty-seven years after gaining independence from the Soviet Union. Eager to forge closer ties with Brussels and Washington, the government has made concerted efforts to bring the country closer in line with the West's expectations and conditions required for a strong ally and partner. Genuine progress has been made over the past couple of years and the country has achieved financial and economic stability with the support of its development partners; it has reached over 4 percent economic growth, lowered inflation, fixed huge problems in the banking sector, and replaced Russia with the EU as its main trading partner.

However, at the same time, the country is backsliding in some key areas. Democracy appears to be on the decline; a legitimate election of mayor in the capital of Chisinau was recently voided; the judicial system remains controlled by powerful insiders; and independent media is almost nonexistent. This report will highlight some of the extensive progress made by Moldova's government and citizens as well as provide suggestions on how to ensure that democracy is not lost, and the rule of law is developed during a critical period in the country's political and economic development.

Moldova's progress can be seen in its active citizens and the government's strong engagement with the European Union and the United States. The country's civil society remains proactively engaged, and historically its elections have been more free and fair than those of its post-Soviet neighbors; administrative and economic reforms have been impressive and broad, and the banking sector has stabilized. Although the Russian-leaning Socialist Party is the most popular single political force in the country, the majority of Moldova's electorate and political entities are reform-minded and pro-Europe. Moldova's current coalition government, run primarily by the Democratic Party of Moldova, has strong ties to the West. Meanwhile, Moldova's pro-Europe opposition political parties, the Action and Solidarity Party and the Dignity and Truth Platform Party, are both healthy and thriving and should find strong representation in the next parliament.

The Moldovan government has been vocal about its ambitions to anchor its future with the West, and over the last few years strides have been made to link Moldova's political, economic, and security situation with Western institutions and allies.[1] In 2014, Moldova signed an EU-Moldova Association Agreement, including the Deep and Comprehensive Free Trade Agreement (DCFTA) that came into force in 2016. Trade and economic ties to Europe have increased significantly. Moldovan citizens now enjoy visa-free travel to the EU, and Moldova has expanded bilateral free trade agreements with major economic powers and has achieved modest economic growth and financial stability. The Moldovan government successfully lobbied to open a NATO Liaison Office in its capital, and has modestly increased defense spending.

While there is still a genuine affinity and urge from many citizens to maintain strong ties to Russia, a growing number in Moldova—indeed, now the majority, particularly among the younger generation—support deepening ties with European and Western institutions.[2] In fact, successive coalition governments have adopted pro-Western positions and have sought to move closer to Western ideals, institutions, and alliances. Since 2009, Moldova's government has been controlled by ostensibly pro-Western, democratic political parties, and genuine progress has been made in some reform areas meant to bring Moldova closer to European standards.

Nonetheless, in order to really benefit from Western integration and serve as a legitimate representative government, Moldova must initiate significant changes in its political and judicial sectors. Several major political corruption scandals in the past few years have left the stability of the state in question. In 2014, a banking fraud scandal saw $1 billion (equal to 13 percent of the country's gross domestic product—GDP) stolen from three Moldovan banks. In parallel, stakeholders in Moldova were complicit in facilitating the laundering of $20 billion from Russian banks through Moldovan banks. Senior political figures, including a former prime minister, have been jailed, but suspicions remain that several senior Moldovans involved in these two frauds have not been brought to justice.

1 Government of Moldova, "Government backs introduction of Moldova's European aspirations in Constitution," January 1, 2018, https://gov.md/en/content/government-backs-introduction-moldovas-european-aspirations-constitution.

2 International Republican Institute, Public Opinion Survey: Residents of Moldova, May-June 2018, http://www.iri.org/sites/default/files/2018-7-16_moldova_poll_presentation.pdf

The Democratic Party of Moldova, led by Vlad Plahotniuc, runs the current government coalition and has strong ties to the West, but suffers from a low approval rating. *Photo Credit: Wikimedia Commons*

At present, Moldova is in a political crisis. The government is increasingly losing credibility after the judiciary annulled the results of a free and fair mayoral election in Chisinau on June 3.[3] The winner of the election was opposition leader Andrei Nastase and the decision to annul the election was upheld by the Supreme Court. The country is now seeing the consequences of this decision. After the Supreme Court upheld the lower court's decision, the European Union announced on July 4 that it was suspending the disbursement of a €100 million tranche of macro-financial assistance.[4] Popular protests in Chisinau continue with regularity, while civil society organizations are actively denouncing troubling political developments and encouraging citizens to stand up for their rights. The approval rating for the government coalition, led by the Democratic Party of Moldova, is low.

The annulment of the seemingly free and fair election of mayor in Chisinau summarizes Moldova's two most pressing needs today: reform of the political and judicial systems. Though the country has carried out impressive administrative and economic reforms, economic growth is not likely to take off without reforms that secure property rights in the country. But the resolution of these two key problems is complicated by the electorate being divided over the country's future international orientation, and the ongoing frozen conflict in the separatist area of Transnistria. In addition to Moldova's domestic political problems, Russian interference and pressure—on both Moldova's territorial integrity and its political independence—has put a squeeze on Moldova's development, European ambitions, and democratization since independence, and it continues to do so today.

Moving Forward: Three Scenarios Facing Moldova

Given the political crisis currently facing the country, Moldova is likely to follow one of these three paths in the future:

1. an oligarch-led, quasi-authoritarian direction, with worsening democratic conditions and increasing isolation from Western institutions;
2. a Russian-leaning orientation led by the popular Socialist Party;[5] or
3. a genuine, democratic Western-aligned orientation.

In light of the events related to the recent election and the consolidation of power and near-universal control over the media, judiciary, and private businesses, the country is dangerously close to following an authoritarian path. This can only be in the interest of very few people.[6]

Another potential scenario is that Moldova slips under the increasing influence of Russia, since the Socialist Party—the new prominent left-wing party in the country, effectively replacing the Communist Party that led Moldova through its independence in 1991 and again during 2001–2009—has a stronghold on voters who are nostalgic for Soviet times. The Socialist Party receives the majority of its support from the older generation and from Slavic,

3 Ibid.

4 Moldpres, "EU suspends payment of first installment of macro-financial assistance programme for Moldova," July 4, 2018, https://www.moldpres.md/en/news/2018/07/04/18005763

5 The Socialist Party of the Republic of Moldova, of which President Igor Dodon is a member, consistently polls over 40 percent and will likely receive the largest amounts of votes in the next parliamentary election.

6 For analysis of Moldova's fit as a hybrid democratic-authoritarian regime and a look at the country's democratic backsliding, please see: Eleanor Knott, "Perpetually "partly free": lessons from post-soviet hybrid regimes on backsliding in Central and Eastern Europe," 2018, East European Politics, 34:3, 355-376, DOI: 10.1080/21599165.2018.1493993.

Igor Dodon, pictured above, leads the Socialist Party in Moldova. He and the party are increasingly aligned with Russia. *Photo Credit: ziarul de garda*

Russian-speaking citizens in the country. The Socialists, who have cooperated with the Democratic Party on numerous recent occasions, are already the most popular political party in the country and will likely win the highest number of seats in the next parliamentary election. However, this is not a viable option for the future.

Thus, the choice is not only between Russia and the West, as the discussion often runs, but the danger of isolation is all too real. It would inevitably imply national and economic weakness. In the short term, the danger of the first path appears greater than the second option, but all too easily the first option might lead to Moldova being ensnared by Russia, which is devoting great attention to Moldova.

The only sensible option for Moldova is option three, which would lean the country toward a Western-oriented and democratic future. Economically, Moldova appears to have chosen this option, but it requires significant political and judicial reforms involving changes to the governance structures, continued citizen engagement and pressure, and support from Western institutions and donors. The months leading up to and following the next parliamentary elections—slated to be held in February 2019—will be a critical time for the country.

Before reaching its democratic potential, Moldova will need to consider and remedy the following political, economic, and judicial issues facing the country.

The Great Moldovan Bank Robbery of 2014, and the Crisis that Followed

One major event four years ago set the stage both for Moldova's recent economic and administrative reforms and for the current political distrust. It was an extraordinary bank robbery, whose parallel is hard to find anywhere in the world. On one day in November 2014, $1 billion—one-eighth of Moldova's GDP—vanished from the country, leaving three Moldovan banks bankrupt.

Starting in 2012, those three banks—Banca de Economii, Banca Sociala, and Unibank—had been taken over by new owners, a multitude of anonymous offshore companies, none of which owned more than five percent of any bank (the threshold that would trigger greater scrutiny by the National Bank of Moldova—NBM). While initially these banks had appeared unrelated to each other, they were all simultaneously giving numerous large loans through a complex web of international transactions, transferring the money out of the country to shell companies with unknown owners. In this fashion, $1 billion just disappeared from Moldova without explanation.[7] After the $1 billion disappeared, the three banks were placed under special administration by the NBM and bailed out by the government.

This scandal rightly caused a major political and financial crisis. Instantly, the public's trust in government institutions fell to a new low. Popular protests erupted. The government was forced to resign. In 2015 alone, Moldova had no fewer than four different governments.

The International Monetary Fund (IMF), the World Bank, and the EU halted all financing to Moldova, significantly hurting the economy. In February 2015, the NBM hired the private due-diligence company Kroll to investigate. In April, Kroll presented its first report, which explained possible scenarios but pinpointed only two main culprits. One was the former Prime Minister Vlad Filat, who was arrested in parliament in October 2015. He was accused of having taken a bribe of $260 million from the politician and businessman Ilan Shor, the individual who was primarily blamed for the bank fraud. In June 2017, Filat was sentenced to nine years in prison and Shor to seven-and-a-half years. Filat currently sits in a Chisinau jail, while Shor spent only limited time under house arrest and was released the following month pending review by the Court of Appeals. Somehow escaping jail time, Shor resumed working as mayor of the city of Orhei and in June 2018 was re-elected. Furthermore, Shor did not have to return any of the money stolen from the three banks. Shor's preferential treatment raises many questions, and popular suspicions linger that major culprits are still free today.

7 Kroll, Project Tenor – Scoping Phase: Final Report, London: Kroll, April 2, 2015; Tim Whewell, "The Great Moldovan Bank Robbery," BBC, June 18, 2015.

Former Prime Minister Vlad Filat is still imprisoned for his connection to Ilan Shor and the bank fraud that resulted in the loss of one-eighth of Moldova's GDP in 2014. *Photo Credit: Wikimedia Commons*

In parallel, another major money laundering scandal involving Russia and Moldova erupted. It attracted the attention of many international agencies, and the IMF focused on stopping these practices. In August 2014, the international Organized Crime and Corruption Reporting Project (OCCRP) published a major investigative report titled "The Russian Laundromat," about how organized criminals and corrupt politicians in Russia had moved $20 billion in dirty funds through Moldova between 2010 and 2014. The transactions started in Russian banks and went through Moldovan banks, then passed on to Latvia and continued further. In Moldova, a score of judges certified that entities with bank accounts in Latvia held legitimate claims that had to be paid back.[8] Both the banking system and the courts needed profound reform.

These two scandals set the reform agenda for the international financial institutions with regard to Moldova. Not surprisingly, 2015 offered no good news for Moldova. GDP declined by 0.4 percent. The country had no fewer than four prime ministers that year. Little could be done because of the political instability. No international organization could conclude any significant agreement. Yet Moldova managed to avoid serious regression. Admittedly, inflation rose to 13.5 percent, but the budget deficit stopped at 2.3 percent of GDP and the exchange rate was reasonably stable.

New Economic Reforms from 2016

Moldova's economy is one of the weakest in Europe, and the country's population is in sharp decline as more and more people leave the country in search of better economic opportunities, mainly in EU countries. Many young Moldovans go to neighboring Romania for higher education, which they can get for free; at the same time, they may acquire a Romanian—that is, EU—passport. Of the three million citizens eligible to vote, approximately one-third live outside the country on a permanent or semi-permanent basis, working or studying. Of all the countries in the world, Moldova is one of the most dependent on remittances. The peak was reached in 2006, when remittances accounted for 35 percent of GDP;[9] they now hover at around one-fifth of GDP.

In January 2016, when domestic and international expectations were at a low, Pavel Filip became prime minister. His government has a technocratic character, with several ministers lacking prior party affiliation but with solid backgrounds in reputable international companies. Quietly, the Moldovan government has carried out substantial structural reforms. In March 2016, the government and parliament adopted a "roadmap" that included profound reforms such as fighting corruption, public administration reform, banking reform, and cleaning up the business environment.

As is usually the case, the new reform wave was based on an IMF program. After the big bank robbery, it took the Moldovan government considerable time to convince the IMF that it was serious about economic reform, and the government repeatedly changed hands. But two years later, on November 7, 2016, the IMF Executive Board approved a three-year stabilization program, an Extended Fund Facility, and an Extended Credit Facility to support Moldova's economic and financial reform program. The total IMF commitment was $17 million, or 75 percent of Moldova's IMF quota,

8 Organized Crime and Corruption Reporting Project, "Russian Laundromat," August 22, 2014.

9 World Bank, Remittance Inflows to GDP for Republic of Moldova, retrieved from FRED, Federal Reserve Bank of St. Louis, August 28, 2018, https://fred.stlouisfed.org/series/DDOI11MDA156NWDB.


The government of Pavel Filip, prime minister of Moldova since January 2016, has begun several reform programs, including reform of public administration. *Photo Credit: Wikimedia Commons*

which means that the IMF did not perceive the country's financial situation as critical. Its prime concerns were to fix Moldova's banking system and boost economic growth.[10]

Because of the shock from the banking scandal and the high level of political distrust, Moldova's considerable economic reforms have been little noticed. The government had to earn some trust to be able to govern.

However, the economic achievements have been palpable. Currently, all of the macroeconomic indicators are strong, and the IMF is generally positive in its reports. In 2016, GDP growth had already recovered to 4.3 percent, and in 2017 it reached 4.5 percent. Inflation has come down faster than expected, to 2.8 percent in May 2018. In 2017, the overall government budget deficit was only 1.0 percent of GDP, and the public debt had declined to 37 percent of GDP, partly because of the real effective exchange rate rising by 10.3 percent. The international currency reserves amounted to five months of imports. The only weakening indicator was the current account deficit, which increased to 7.9 percent, but that is a reflection of Moldova being able to borrow more from international creditors.[11]

Moldova's public finances are also in good order. Public revenues are steadily around 35 percent of GDP, which is about the right level for a country at Moldova's level of economic development; Romania and Lithuania have the same level. Revenue collection has improved somewhat because of major reforms in the tax administration and customs. Most tax rates were increased in 2016-17, but only marginally.[12] Public expenditures are insignificantly higher, but are supposed to rise to 39 percent of GDP in 2018. The intention is to raise public capital expenditures from 3.8 percent of GDP to 5.0 percent of GDP, which seems suitable, as Moldova needs to invest more in its infrastructure.[13]

The economic policy focus, however, has been to strengthen the banking sector after the colossal fraud in 2014. The first major step was to change the whole leadership of the NBM that appeared at best negligent in the bank fraud. In March 2016, the parliament approved a new governor of NBM, Sergiu Cioclea; he and his management team have extensive international experience. The new NBM leadership has elaborated a new banking policy that has been legislated, mainly in a new Law on Banking Activity. The two key IMF demands were to reveal the identity of all significant shareholders and to remove unfit shareholders.[14] The NBM now insists on knowing the identity of the beneficiary shareholders of more than 1.0 percent of any bank, since 5 percent turned out to be insufficient, and they claim to have achieved that.[15]

As a consequence, the banking system has gone through a profound structural change. Three of Moldova's fourteen banks have been liquidated. Needless to say, Moldovans

10 IMF, "IMF Executive Board Approves US$178.7 million. Arrangements under the Extended Fund Facility and the Extended Credit Facility for the Republic of Moldova," Press Release, November 7, 2016, https://www.imf.org/en/News/Articles/2016/11/07/PR16491-Republic-of-Moldova-IMF-Executive-Board-Approves-Arrangements-Under-EFF-ECF.

11 IMF, Republic of Moldova, IMF Country Report, no. 18/205, July 2018, pp. 4, 22.

12 German Economic Team Moldova/Berlin Economics, Moldova, January 2018.

13 IMF, Republic of Moldova, IMF Country Report, no. 18/205, July 2018, p. 25.

14 IMF, Republic of Moldova, IMF Country Report, no. 18/205, July 2018, pp. 6-9.

15 Interview with two deputy governors of the NBM in Chisinau on March 2, 2018.

The IMF, along with the EU and World Bank, resumed their financing of Moldova and approved a three-year stabilization program in 2016 to support Moldova's economic and financial reform program. *Photo Credit: Wikimedia Commons*

withdrew substantial deposits from the banks, and total banking assets declined from 84 percent of GDP in 2014 to 54 percent in 2016. The three biggest banks now have a share of 65 percent of total assets, compared with 50 percent in 2013. Of the remaining eleven banks, only four with about one-quarter of total banking assets are fully foreign owned.[16] As far as is known, none of the Moldovan banks has significant Russian ownership any longer. However, two of the three big banks now have substantial foreign minority shareholders.[17] Slowly, confidence in the banks is returning, and bank deposits both in leu and hard currency started growing again in the summer of 2016. Yet most international observers, including the IMF, remain greatly suspicious.

In parallel, the government has been trying to trace the funds stolen from the three banks. In 2016, the Anti-Corruption Prosecutor's Office and the National Anti-Corruption Centre established criminal responsibility for 59 percent of the stolen $1 billion and targeted seventeen people; several have been sentenced. Yet suspicions remain. A summary of a second Kroll report was released on December 21, 2017, but the whole report was not published, and the general view is that several of the main culprits are escaping scrutiny.[18]

The IMF has been remarkably satisfied with Moldova's performance since November 2016, and it has given Moldova no fewer than four disbursements on its three-year program. As a consequence of IMF approval, the EU and the World Bank resumed their funding of Moldova, which they had halted in the beginning of 2015. In November 2017, the Moldovan government and the EU concluded an agreement on €100 million in macro-financial assistance.[19] In addition, in 2016 Romania granted Moldova a $180 million loan on favorable conditions. Much of this international financing has gone to badly needed public infrastructure investment.

Major Administrative Reforms

One of the most impressive areas of reform by the Filip government is public administration, which has been carried out in several stages. The approach has been firmly top-down.

To begin, the state chancellery was slimmed down and given new and clearer functions. Then the number of ministries was radically cut from a fairly standard number of sixteen ministries to only nine. Also, the number of other state agencies has been reduced through mergers. As a result, nobody can argue that the Moldovan state administration is too top heavy. The next step is supposed to be a substantial decentralization of power to regional and local authorities, but their powers still need to be clearly defined.

A major aim of the administrative reforms has been to reduce the bureaucratic burden on business, which has been a persistent complaint. During the first half of 2016, the government imposed a moratorium on controls on businesses by state agencies, which it claims

16 German Economic Team Moldova/Berlin Economics, Moldova, January 2018.

17 IMF, Republic of Moldova, IMF Country Report, no. 18/205, July 2018, pp. 6.

18 "ECONOMY: Kroll 2 report: Summary and Reactions," last accessed August 28, 2018, http://www.moldova.org/en/kroll-2-report-summary-reactions/; and National Bank of Moldova, "NBM published a detailed summary of the second investigation report of the Kroll and Steptoe & Johnson companies," December 21, 2017, https://bnm.md/en/content/nbm-published-detailed-summary-second-investigation-report-kroll-and-steptoe-johnson.

19 The €100 million payment of macro-support was suspended by the European Union on July 4, 2018 following the Moldovan courts' invalidation of the Chisinau mayoral election.

led to a halving of the number of enterprise inspections in 2016. More important, the government slashed the number of state inspection agencies by two-thirds, from 58 to 16, as a part of the administrative reorganization. At the same time, the number of permits required was cut by 60 percent. Additionally, as a consequence of the merger of five state registries, a unified Public Service Agency for all of these registries was created.

As a result of these administrative simplifications, Moldova has risen in the World Bank's Doing Business ranking, from number 63 in 2015 to 44 in 2018; it has overtaken countries such as Romania, Italy, and Hungary. By contrast, Ukraine ranks 76th. Moreover, Doing Business has ten different measures and it is only with regard to dealing with construction permits that Moldova does not rank among the eighty best countries. Moldova has made the greatest progress in increasing the ease of registering property, starting a business, and paying taxes.[20] These are impressive improvements, even if more should be done.

Even so, Moldova has fallen on Transparency International's Corruption Perception Index, from 102 in 2015 to 122 in 2017.[21] This might appear contradictory, but it is a typical pattern in former Soviet republics. Their governments tend to improve the functioning of state administration, whose malfunctioning is a nuisance for all, while they retain executive control over prosecution and the judiciary—which means that property rights are uncertain. At present, corporate raiding, or more appropriately theft of private enterprises and other property, remains the bane of the whole region, including Moldova.

The conclusion for Moldova is that after having carried out quite successful economic and administrative reforms, the government needs to focus on judicial reform to secure private property rights.

Moldova Needs to Reform Its Prosecution and Judiciary

The lack of an independent judicial system is a major concern in Moldova. Anti-corruption bodies such as the National Anti-Corruption Centre have been ineffective and lack the public's trust. Even prior to the courts' recent decision to annul the free and fair mayoral elections in Chisinau, Freedom House noted, "even though the legal framework has improved over the years, the independence of judges and the application of legislation leave much to be desired."[22] In a study looking at the transparency and efficiency of the judicial process, Moldova ranked 132 out of 137 countries on judicial independence in the World Economic Forum's 2017-2018 Global Competitiveness report.[23] It is clear that a complete overhaul of the entire judicial system is required. As long as Moldovan political elites can personally interfere, guide, or determine judicial rulings, there will be no independent judiciary in Moldova.

Moldova would benefit from analyzing the judicial reforms that took place in other countries. Three post-communist jurisdictions—East Germany, Estonia, and Georgia—have carried out truly radical judicial reforms. In these three places, lawyers were the prominent reformers. They drew several fundamental conclusions: the judicial system must be not only reformed but also rebuilt from the bottom up; the reform must start from the top; and it must be driven and controlled by outside forces of verified integrity that cannot be captured by the old corrupt judicial elite.

All three of these jurisdictions abolished the old institutions, the courts, and the general prosecutors' offices, but they allowed everybody to reapply for the new jobs. This worked very well in all three places. The state administration improved greatly, and dismissed officials could come back without shame. East Germany allowed old officials to come back if they passed a test. Out of 1,780 judges at the end of communism, 38 percent were reappointed. And out of 1,238 prosecutors, 32 percent were reappointed. The reappointed officials were generally younger and better educated.[24]

Who will carry out judicial reform? The best option is to engage foreigners, which East Germany did to a large extent, allowing West German retired judges to play a major role.[25] The final question is who will replace the lustrated? The East German example offers three answers: young professionals as yet untainted by the

20 World Bank Group, *Doing Business 2018, Moldova*, Washington: World Bank, 2018, http://www.doingbusiness.org/~/media/WBG/DoingBusiness/Documents/Profiles/Country/MDA.pdf.

21 Transparency International, Corruption Perception Index, 2017, https://bit.ly/2N2gBUu

22 Freedom House, Moldova, Nations in Transit, 2018. https://freedomhouse.org/report/nations-transit/2018/moldova

23 European Commission, Association Implementation Report on Moldova, April 3, 2018. https://eeas.europa.eu/sites/eeas/files/association_implementation_report_on_moldova.pdf

24 Johann-Friedrich Staats, Lustration – oder die Ueberpruefung der Richter und Staatsanwaelte aus der DDR. In *Die Einheit: Juristische Hintergruende und Problems. Deutschland im Jahr 1990, ed. Klaus Baestlein. Berlin: Landesbeauftragter f. d. Unterlagen d. Staatssicherheitsdienstes d. ehemaligen DDR*, 2011, p. 98.

25 Ibid.

old regime, foreign professionals, and recovering and reeducated professionals. Moldova has a large number of young academics both at home and abroad who should be able to fill these posts with relative ease.

The Moldovan prosecution and courts have proven to be major hurdles in the country's development, and a complete judicial reform from top to bottom is urgently needed to render property rights tenable.

Moldova Needs to Develop Its Agriculture

Comprising 14 percent of Moldova's economy, agriculture remains a mainstay. However, as any visitor can see, agricultural land remains greatly underutilized. Much of the land is lying fallow; the machinery is ancient; and the undercapitalization is striking. This is a wonderful potential resource that needs to be used much more efficiently.

Moldova carried out a far-reaching agricultural land reform in 1991. The problem was that the land was distributed to everybody and the average land holding became as small as 1.5 hectares.[26] As a result, individual citizens had too little land. Much of the main growth of vineyards, for example, occurred on the 18 percent of agricultural land that remained in state hands after the reform. The situation is similar in several other countries in southeastern Europe, while Ukraine and Russia have become dominated by giant agro-holdings.

In order to develop its agriculture, Moldova needs to overcome its fragmentation. Formally, this should not be a problem—purchases of private agricultural land are allowed—but in practice it does not work. One problem is that land transfers remain too cumbersome, even if they have been simplified. A more serious problem is that few have the funds to invest in agriculture. It should be a major area of expansion of bank lending, which should work as long as agricultural land can be an effective collateral.

Moldova's Place in the World: European Integration

Politically, Moldova has always been a divided country. This political division has also resulted in a division in foreign policy. Roughly half of the population prefers integration with the West, notably the EU, and the other half prefers integration with Russia and its Eurasian Economic Union. Over time, the EU has won the upper hand.

After Moldova became independent, the EU showed minimal interest. In 1994, it concluded a Partnership and Cooperation Agreement of little significance that came into force only in 1998. In 2003, the EU started its European Neighborhood Policy, which may be described as a loose search for closer relationship. In 2009, the EU launched its Eastern Partnership, which involved Armenia, Azerbaijan, Belarus, Georgia, Moldova, and Ukraine. In practice, the focus lay on the three most democratic and Western-oriented countries—Georgia, Moldova, and Ukraine. Moldova followed in the wake of Ukraine, and did so quite effectively.

In 2010, Moldova and the EU started negotiating an Association Agreement (AA) with a Deep and Comprehensive Free Trade Agreement (DCFTA). The AA was initialed at the EU-Eastern Partnership summit in Vilnius in November 2013 (where Ukraine failed to do so), and it was signed in June 2014. It came into effect in July 2016.[27]

In parallel, Moldova started negotiations about visa-free travel to the EU, a major aspiration of Moldovans. Moldova complied quite efficiently with all of the EU's demands, such as biometric passports, and in April 2014 the European Parliament and the European Council agreed to visa-free travel for Moldovan citizens. This has greatly facilitated the travel of Moldovans to EU countries, though the drawback is that a vast number of Moldovans now live and work informally in EU countries. On the one hand, it results in large remittances for Moldova, but on the other hand it means that a large share of Moldova's best labor is working in EU countries.

The DCFTA has brought about quite a radical change in Moldova's economy. As late as 2000, only 20 percent of Moldova's exports went to EU countries. That share has steadily risen, and in 2017 it reached 64 percent of total exports. The Russian share has fallen correspondingly to 14 percent.[28]

This may appear natural given that countries' primary trade partners tend to be neighbors, but until 2005, Russia accounted for 40 percent of Moldova's exports, due to great complementarity and traditional

26 World Bank, Land Reform and Farm Restructuring in Moldova, World Bank, 1998, http://documents.worldbank.org/curated/en/596991468775526500/pdf/multi-page.pdf, p.3.

27 European Commission, Moldova, April 16, 2018, http://ec.europa.eu/trade/policy/countries-and-regions/countries/moldova/.

28 European Commission, Moldova Trade Statistics, April 16, 2018, http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113419.pdf.

A meeting of the EU Eastern Partnership, like that at which the Association Agreement between Moldova and the EU was initialed.
Photo Credit: Wikimedia Commons

similarities. Moldova exported wine and fruits to Russia, but in 2006, Russia suddenly prohibited the importation of wine from Moldova for political reasons, and that trade has never recovered. Similarly, Russia has tried to pressure Moldova through monopolistic practices in its gas sales, which has made Moldova pull away and begin building a pipeline to Romania.

The extensive money laundering from Russia through Moldovan banks has further damaged Russia's commercial reputation in Moldova. Western sanctions against Russia because of its military aggression in Ukraine further complicate Moldovan commercial links with Russia. The conclusion that the Moldovan government and businesses seem to draw is that Russia is not really an option because of its unequal business practices. Its Eurasian Economic Union does not seem to be a serious option, and any significant expansion of Moldovan trade with Russia does not seem likely. An analysis of Moldova's trade offers the clearest picture of which direction Moldova is really moving in.

Moldova's commercial Western orientation is further reinforced by international financing, which comes from the Western-dominated international financial institutions: the IMF, World Bank, European Union, European Bank for Reconstruction and Development, European Investment Bank, individual Western countries, and private enterprises.

In Soviet times, Moldova was a mono-supplier of wine and tropical fruit. A glance at its export structure shows that the diversification has already happened. The DCFTA offers Moldova real free trade with the EU for all manufactured goods, and as of 2016, the traditional mainstay of the Moldovan economy, agriculture, accounted for only 14 percent of GDP, while manufacturing contributed the same amount.[29] For such a small economy, some foreign direct investment in a new industry suffices to initiate a real takeoff. Moldova might be seeing such foreign investment in machine-building right now. At this stage, one should expect that Moldova will become increasingly connected to the European supply chain, which is likely to be the driver in Moldova's future economic development, as has been the case in Central Europe.

Moldova Should Carry out Electoral Reform

Compared to its neighbors and other post-Soviet countries, Moldova has had an admirable history of free and fair national elections. Previous elections to the 101-seat parliament were fully proportional and the country benefited from the gradual development and maturation of a representative multi-party system. Although electoral law was subject to minor changes in the past, Moldova's experience with a proportional system was well-established and accepted by the electorate. This electoral system, unfortunately, was changed in July 2017, after the

29 German Economic Team Moldova/Berlin Economics, Moldova, January 2018, p. 4.

Since 2006, Russia has targeted Moldova's wine industry, one of its major exports, in an effort to economically influence the country. *Photo Credit: Wikimedia Commons*

Democratic Party and the Socialist Party teamed up to adopt new legislation that changed the system from a fully proportional system to a mixed system. This includes fifty seats selected by party list proportional representation and fifty-one seats chosen by a single-mandate, first-past-the-post vote where voters choose candidates in individual, newly drawn up constituencies.[30]

Prior to the passage of the new electoral law, the Council of Europe's Venice Commission, the EU, the Organization for Security and Cooperation in Europe (OSCE), several Western diplomatic missions, and the broad spectrum of Moldovan civil society strongly advised against changing from a fully proportional system and commented extensively on the draft law.[31] Unfortunately, an overwhelming number of parliamentarians ignored the international experts' advice, and seventy-four parliamentarians voted for the new legislation.

The new electoral law arguably benefits the Democratic Party and Socialist Party and will allow for the election of many unaffiliated, single-mandate winners subject to influence and persuasion by political elites. Furthermore, the new law does not adequately account for—or provide a proper voice to—the large percentage of the country living abroad. According to the new electoral law, the diaspora's vote, which accounts for up to one-third of the electorate, will be funneled to only three individual-seat constituencies. This is not a fair or adequate way to account for the political preferences of such a huge portion of the electorate. In April 2018, an EU report on Moldova's reform progress again noted that the change in the electoral system occurred despite strong recommendations against such a move by the Council of Europe's Venice Commission and the OSCE's Office for Democratic Institutions and Human Rights.[32]

Moving forward, Moldova should seriously consider changing the electoral law back to a fully proportional system. Given the invalidation of the 2018 Chisinau mayoral election and the public's lack of trust in the current political and electoral process, steps must be made to win back the public's trust and offer a transparent and fair system.

Moldova Needs Energy Security

Like all former Soviet republics, Moldova formerly used too much energy. Long after the end of the Soviet Union, energy prices were far too low, and energy consumption was poorly measured if at all. These problems have abated. Energy consumption is still too high, but it has fallen sharply, primarily because of the collapse of its industry but also because of more efficient energy usage. The government has unified energy prices and adjusted them to the market level.

The remaining problem is a lack of energy security. Moldova has almost no energy production and relies on imports for almost 95 percent of its energy needs—and that energy comes almost completely from Russia. Two features stand out. The residential sector accounts for almost half of Moldova's energy consumption, which is inordinately high; also, natural gas accounts for more than half of Moldova's energy consumption. Virtually all of the natural gas comes through pipelines from the Russian gas monopoly Gazprom, and nearly all of its electricity comes from Transnistria. Oil and petroleum products are traded with multiple suppliers, including some from Romania as well as the major global oil companies.

Gas trade with Gazprom has been a major political concern ever since Moldova became independent. Initially, Gazprom did not really attempt to collect payments from Moldova, because it used large Moldovan arrears—first to take over half of the pipeline company, and then to take over the other half in debt-equity swaps. Gazprom claimed that would help Moldova get lower gas prices, but instead Gazprom hiked the prices so that Moldova has persistently paid one of the highest prices for gas. When Gazprom cut its supplies

30 "Moldova passes divisive election law amid street protests," Reuters, July 20, 2018, https://www.reuters.com/article/us-moldova-election-idUSKBN1A51G4.

31 "European Commission Says Will 'Closely Monitor' Moldova's New Electoral Law," Radio Free Europe, October 3, 2017, https://www.rferl.org/a/moldova-electoral-law-european-commission-closely-monitoring/28771778.html.

32 European Commission, Association Implementation Report on Moldova, April 3, 2018, https://eeas.europa.eu/sites/eeas/files/association_implementation_report_on_moldova.pdf.

The Romania-Moldova border is an important part of Moldova's energy security, as a pipeline connecting the EU and Moldova could reduce dependence on Russian gas monopoly Gazprom. *Photo Credit: Wikimedia Commons*

to Ukraine in January 2006 and January 2009, it also cut its deliveries to Moldova. To add insult to injury, Gazprom insists that Moldova should also pay for Gazprom's deliveries to Transnistria, which Moldova naturally refuses to accept. But since its gas supplies flow from that region and Gazprom controls the distribution, disputes continue.

Moldova's governments have long focused on its problematic gas supplies and have responded with four principled measures: adoption of a long-term energy plan, integration with the EU, reduction in energy consumption, and the construction of an alternative gas pipeline from Romania. In general, Moldovan governments have focused on the right issues and they have done so persistently, though as is often the case, they could have done so earlier and more forcefully.

Like many countries, Moldova has pursued long-term energy strategies. One was adopted in 2007 for the period up to 2030; in 2012, the government adopted a new energy strategy lasting until the year 2030.[33] The main feature of the new energy strategy is energy saving, but it is quite comprehensive.

Moldova has also joined the EU Energy Community, and in line with the EU energy packages, it adopted a 2009 Law on Electricity and a 2009 Law on Natural Gas, which aimed to establish markets for both electricity and gas in Moldova. Without alternative suppliers, however, the laws on marketization could have little effect.

The obvious resolution should be a gas pipeline from neighboring Romania. This short but long-planned project has repeatedly been delayed. At present, it seems that it will be finally completed at the end of 2019 or in early 2020. This pipeline would connect Moldova with the European gas transportation infrastructure, from the Romania/Moldova border (Iasi/Ungheni) to Chisinau, and offer it an alternative gas supply, which should force Gazprom to reduce its price.

Progress in Transnistria?

The separatist region of Transnistria, a narrow strip of land on the left (east) bank of the Nistru (Dniestr) River bordering both Moldova proper and southwest Ukraine, has long been thought of as an intractable conflict. Twenty-five years since the war of Transnistria concluded, Russia maintains about 1,500 troops in Transnistria that are remnants of the Soviet 14th Army, now called the Operational Group of Russian Troops (OGRT). Additionally, Russia has roughly 400 "peacekeepers" currently stationed in Transnistria under the terms of the 1992 ceasefire agreement. To this day, 20,000 tons of Russian munitions remain in Transnistria.[34]

Negotiations regarding Transnistria have long followed the "5+2" format, where the OSCE, Russia, Moldova, Transnistria, and Ukraine are equal negotiating partners joined by two observers, the EU and the United States. Although the 5+2 process stalled for many years, under the OSCE's guidance, considerable progress was reached in late 2017 and early 2018. In November 2017, authorities re-opened a bridge over the Nistru River that connected the villages of Gura Bicului and Bicioc, opening up vehicle traffic between the two sides and re-establishing an important international road corridor.[35] In late 2017, other breakthrough agreements were reached on several of the issues labeled the "package of eight": eight identified priorities considered long-standing disputes, including the apostilization of Transnistrian university diplomas, access to Dubasari farmland, and the functioning of the Moldovan Latin-script schools on the left bank.[36] The key sides have yet to make progress on the particular status

33 Government of the Republic of Moldova, Energy Strategy of the Republic of Moldova to the year 2030, Chisinau, 2012. http://komorasns.cz/assets/attachments/EnStrategy-MOLD-draft310512.pdf

34 Russia agreed to remove all of its munitions and troops from Moldova under the Adapted Conventional Armed Forces in Europe (CFE) Treaty signed in 1999, but has failed to make any withdrawal progress since 2003.

35 "Gura Bicului-Bicioc bridge over Nistru river opened for vehicles," Moldova.org, http://www.moldova.org/en/gura-bicului-bicioc-bridge-nistru-river-opened-vehicles/.

36 OSCE, "Progress in Transdniestrian settlement leads way for conflict resolution in OSCE area, says PA President in Moldova," Press Release, June 26, 2018, https://www.osce.org/parliamentary-assembly/385902

Peacekeeping forces remain in Transnistria to this day as a result of the 1992 ceasefire agreement. *Photo Credit: Wikimedia Commons*

of Transnistria should it be re-integrated with Moldova, but there is reason to be optimistic about the progress that has occurred over the past year.[37]

The benefits that Moldova receives from its DCFTA status with the EU, part of the EU-Moldova Association Agreement, also bring economic advantages to some firms in Transnistria. As many as 2,500 companies from Transnistria are registered with the Moldovan authorities and are thus considered Moldovan businesses, enabling their participation in the free trade agreement with the EU market. Official statistics from Transnistria are not always reliable or accurate; however, recent foreign trade numbers from Transnistria show a sharp increase in trade with the EU. Looking at the first six months of 2018, Transnistria is on track to easily surpass its export and import totals from 2017. The separatist region's share of trade with the EU is rising at the same time as trade with Russia—particularly its exports—is on the decline. The mid-year 2018 figures show Transnistria's exports to the EU at 36 percent, while exports to the Eurasian Economic Union are barely above 10 percent.[38]

It's not uncommon for people living in Transnistria to have multiple passports, and a significant percentage of people in Transnistria carry a Moldovan (or Ukrainian) passport, making them eligible for visa-free travel. Many in Transnistria have appreciated this key benefit of the EU-Moldova Association Agreement.

Until the status of Transnistria is resolved and the territory returns to Moldova proper, however, the region will remain a black hole, susceptible to Russian influence and control and a breeding ground for illegal trafficking and smuggling. In the long term, Moldova will have difficulty reaching the level of economic and political stability required to be a strong member of the wider, democratic Western Europe community of nations until it gains back full independence and territorial integrity.

A Strategy for Moldova

At present, Moldova has many pieces of its strategy together. It has a well-constituted state administration and a well-functioning economic policy maintaining macroeconomic stability and economic growth of 4 percent a year. Moldova's Association Agreement with the EU has become the base for its foreign relations. The vast European market has finally opened up to it. This has given an impetus not only to Moldova's traditional strength, agriculture, but also to manufacturing and services.

But this is far from sufficient, and Moldova remains the poorest country in Europe. It should aim for a long-term annual economic growth of 7-8 percent. The secret to achieve such a growth rate lies in raising the investment ratio to about one-tenth of GDP, from the current level of 22 percent of GDP to 30 percent of GDP.[39] The financing of greater investment can come from four sources. First, the steady capital outflow from Moldova needs to end; those funds should be invested at home. Second, the country should attract more foreign direct investment. Third, Moldova can attract more funding from international donors. Finally, with a rising standard of living, the domestic savings ratio should rise.

The precondition for all of these developments is the establishment of decent rule of law in Moldova. The prosecutors and courts need to gain real credibility. To facilitate that, Moldova needs to reinforce its democratic standards. Moldova has already ratified an eminent instrument to achieve these two targets, namely its Association Agreement. The EU knows how to build democratic institutions and the rule of law; together with the Moldovan government, it should apply its considerable skills with full force in Moldova.

As Moldova's economic welfare grows, the country will eventually need to focus on two other sectors, education and health care, that have been badly neglected because of minimal financing.

37 Thomas De Waal, Moldova's Conflict: Unfreezing, In a Good Way?, Carnegie Europe, March 6, 2018, http://carnegieeurope.eu/strategiceurope/75712.

38 "Внешняя Торговля Пмр По Основным Странам И Группам Стран За I-Е Полугодие 2018 Г.," http://customs.gospmr.org/2014-3.html.

39 IMF, Republic of Moldova, IMF Country Report, no. 18/205, July 2018, p. 22.

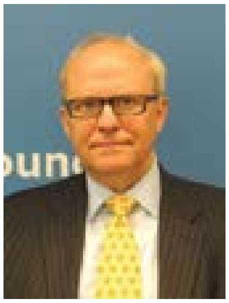
POLICY RECOMMENDATIONS

- Moldova should carry out a complete reform of the judicial system from top to bottom to render property rights tenable. This is the most critical step.
- Moldova should move to a fully proportional and transparent electoral system. A fully proportional system, which Moldova successfully used in the past, is essential if voters are to gain confidence in the integrity and transparency of the process.
- Moldova needs to complete its banking reform. It is critical to achieve full transparency of bank ownership. All beneficiary owners holding more than one percent of any bank should remain public, and anti-money laundering controls must be effective.
- Moldova needs to stick to its decision to aim for European integration. Russia does not have any positive alternative to offer. The EU can offer a vast open market, financing, and technical assistance in building democratic state institutions and the rule of law.
- The early completion of a gas pipeline between Moldova and Romania is the top energy priority. Discussion of this pipeline has occurred for years and has been promised by successive governments. To achieve greater energy independence, the pipeline should not be delayed any further.
- Moldova must carry out a real, genuine fight against corruption. Investigations of past crimes must be completed, particularly regarding the $1 billion stolen from Moldovan banks.
- Regarding Transnistria, Moldova should continue its earnest efforts as part of the 5+2 process and capitalize on the momentum and progress that has occurred since late 2017 to reach a settlement to the frozen conflict.

Recommendations for the United States and European Union

- The EU has a vast market and it should provide Moldova with full access, including for Moldovan agricultural products.
- Both the United States and the EU should offer Moldova ample financing and help the country to mobilize funds from international donors. The cost to the West to aid Moldova in its transition is too small to withhold.
- Both the United States and the EU should continue offering Moldova sizeable technical assistance for building democratic state institutions and the rule of law. Such technical assistance should include conditionality (like the current EU funds) tied to progress on the areas of democracy and rule of law.
- In advance of the February 2019 parliamentary elections, continued and increased assistance in the areas of civil society development, pre-election monitoring, independent mass media, government watchdog activities, and extensive election monitoring is critical.

ABOUT THE AUTHORS



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Prior to co-founding DT, Mr. Fairbank spent nearly a decade at the National Democratic Institute for International Affairs (NDI) where he worked on elections and provided technical assistance to civil society organizations and foreign governments. In addition to holding various positions at NDI's headquarters, he worked for several years in the field directing programs in Ukraine, Kazakhstan, Moldova, and Georgia. He served as NDI's first country director in Moldova, director of civil society programs in Ukraine, acting country director in Kazakhstan, and as an adviser to programs throughout the Eurasia region. Mr. Fairbank has conducted more than a dozen election-related assessments as a member of Organization for Security and Cooperation in Europe (OSCE) and NDI international delegations. He also worked as director for democracy and rule of law at L-3 Communications and as an adjunct at the RAND Corporation.

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