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- POLICY DEPARTMENT -**

**NOTE  
ON THE POLITICAL AND ECONOMIC SITUATION  
IN MOLDOVA AND ITS RELATIONS  
WITH THE EUROPEAN UNION**

**Abstract:**

**This note is a summary presentation of the political and economic situation in Moldova as well as the current state of this country's relations with the European Union.**

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The opinions expressed in this document are the sole responsibility of the author and do not necessarily represent the official position of the European Parliament.

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## **I. POLITICAL SITUATION**

### **1. Introduction**

The Republic of Moldova lies in Eastern Europe between Romania to the west and Ukraine to the east and south. It covers an area of 33 670 km<sup>2</sup> (equal to Belgium) and has a population of 4.3 million inhabitants, of different ethnic origins (Romanians 64.5%, Ukrainians 14%, Russians 13%, Gagauzis 3.5% and Bulgarians 2%). Its capital is Chisinau. Although the Black Sea is not far away, the country is landlocked between its two large neighbours<sup>1</sup>. With low altitudes and open expanses to the east the country's climate is continental. The two major rivers bordering the country – the Prut in the west and the Dniester in the east – frequently flood their banks in spring and fall back to low levels in the summer.

### **2. Historical background**

Situated in a strategic area linking Europe and Asia, Moldova (which is Romanian-speaking and, in this sense, a Latin country) has been the object of territorial ambitions on the part of various outsiders, including the Ottomans and the Russians. The Principality of Moldavia (whose area extended much further than the present Moldova) was established in 1359 by Bogdan I, who broke away from the kingdom of Hungary. It fell under the suzerainty of Poland in the 15th century but in 1538, the Ottoman Empire took control of southern Bessarabia (the south of the present-day Moldova) and the Romanian principalities of Moldova and Wallachia became vassals of the Turks.

The Ottoman Empire's declining fortunes in the 18th century gave Moldova an opportunity to recover some of its autonomy even though it lost parts of its territory. In 1768, Austria took the Bukovina (in northern Moldavia) and in 1812, Russia took southern Bessarabia. Having been freed from Turkish domination, Moldova was then subjected to harsh Russian rule, during which the use of its national language, Romanian, was banned.

Following the defeat of the Tsarist empire in the Crimean War (1854-1855), Moldavia, together with its sister principality, Wallachia, claimed its autonomy and called for the merger of the two principalities into a single state. While this union took place in 1859, independence was only proclaimed in 1877. From this moment on, Moldova's history became intertwined with that of Romania.

The fall of the Habsburg and Romanov empires at the end of the First World War gave Romania an opportunity to recover the territories held by Austria-Hungary (Transylvania, Banat and Bukovina) and by Russia (Bessarabia). The USSR, which succeeded the Tsarist empire, did not recognise Romania's annexation of Bessarabia and in 1924 set up, on the right bank of the Dniester, an autonomous Moldavian Republic within the Ukraine.

Having supported the Axis powers, Romania once again lost Bessarabia which was returned to Russia in 1944. Three years later the Moldavian Soviet Socialist Republic was established. It

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<sup>1</sup> See Annex I, p. 16.

included Russian-speaking Transnistria, but not the Bukovina in the north nor the Bujak Steppes in the south, which were annexed to the Ukraine, thereby depriving Moldova of direct access to the Black Sea and splitting the Romanian nation. The Moscow-Bucharest dispute caused by the annexation of Moldova was, at the least on the surface, finally settled between Soviet Russia and newly Communist Romania.

Nationalist sentiments grew during the years of 'perestroika'. In 1990, the Popular Front of Moldova imposed the Latin alphabet and Romanian as the official language. A declaration of sovereignty was also adopted. In the wake of its success, the Popular Front then proposed outright unification with Romania. This proposal, fraught with consequences, threatened the unity of the republic even though it proclaimed its independence on 27 August 1991, following the anti-Gorbachev coup in Moscow.

Just as the new republic was facing the threat of breaking up, Moldovans elected Mircea Snegur President by universal suffrage, with a 98% majority, on 8 December 1991. He quickly distanced himself from those advocating union with Romania, with his motto 'one language, two states'. The 1994 parliamentary elections resulted in an overwhelming defeat for the 'unionists', who only obtained 7.5% of the vote, and victory for President Snegur's Agrarian Democratic Party (56 of the 101 seats).

In the presidential election held on 1 December 1996, Mircea Snegur was himself defeated by Mr Petru Lucinschi, President of the Parliament, who had the support of the centre-left Social Progress Party. However, given the difficult political context, the economic reforms introduced were too limited to bring about a rapid recovery and the parliamentary elections held in March 1998 reflected the country's political uncertainty. Although the Communist Party received the largest share of the votes, a centre-right coalition formed the new government, in a scenario reminiscent of the situation in neighbouring Ukraine.

The persistence of deadlock in Moldova, trapped by its geopolitical situation, contributed to the victory of the Moldovan Communist Party (PCM) in the parliamentary elections of February 2001. The PCM now controls parliament with 71 of the 101 seats. In April 2001, Mr Vladimir Voronin, the PCM's leader, won the presidential election, thus becoming the first Communist to lead a former Soviet republic. The Communist Party currently plays a dominant political role in Moldova.

Mr Voronin's attempts after his election to assure Moldova's numerous creditors and Western governments that the PCM had no intention of either reversing economic reforms or instituting a statist dictatorship were unsuccessful and the PCM's policy proved controversial.

Although the party avoided upheavals and ruled over a period of relative macroeconomic stability, it failed to resolve the stand-off with the separatist region of Transnistria and created further divisions within Gagauz Yeri, an autonomous part of the country populated by Turkic Christians.

The PCM embraced policies designed to raise the status of the Russian language and to de-emphasise the historic links with Romania, provoking public demonstrations which were settled thanks to intervention of the Parliamentary Assembly of the Council of Europe. The agreement reached provided for opening up the media, increasing the political space available to opposition

groups, and suspending long-standing policies concerning language and education; the restructuring of the local government organization was also achieved thanks to this intervention.

### 3. Domestic policy

#### 3.1 **Recent trends**

On 6 March 2005 new parliamentary elections were held. Despite the appearance of 23 political parties and blocs, only three of them entered the Parliament (obtaining at least 6% of the valid votes casted) - The Communist Party of Moldova (CPM), the Democratic Moldova Bloc (DMB) and the Christian Democratic Popular Party (CDPP).

According to the report of the Organisation for Security and Co-operation in Europe - Office for Democratic institutions and Human Rights - published on 7th March 2005, the Moldovan elections generally complied with international standards even though some criticisms were voiced. Major concerns were related to negative aspects of unequal campaign conditions, constrained media coverage, and pressure on public employees not to campaign in support of the opposition parties.

The CPM won 46% of the votes and a clear majority of the 101 seats in parliament, which was more than enough to re-elect Mr Voronin as the country's president (with the help of abstentions). The "constructive" opposition parties appear to have agreed to compromise with the CPM largely for pragmatic reasons, such as the approval of reforms to ensure the media's independence, the transparency of the Secret Services and the reform of the presidential election procedure.

#### 3.2 **Migratory pressures**

The major economic and social problems involved in the transition from a planned economy to a market economy led Moldovans to vote massively in favour of the Communist Party. The return to the values of the Soviet era, a policy encouraged by this party, simply caused the country's social, economic and political situation to worsen.

Moldova has now replaced Albania as Europe's poorest country. More than 80% of the Moldovan population are believed to live on less than one dollar a day. The country's per capita GDP is equal to US\$ 296 and 8% of the population are unemployed and wages remain low. Emigration is therefore a tempting prospect for Moldovans. The main migratory trend started in 1999 in the wake of the regional finance crisis, and accelerated in 2002/04.

Some 700 000 people have apparently left to work in European countries, generally illegally. The remittances that Moldova's migrants send home play a major role in supporting the local economy. However, Moldova's reliance on remittance is problematic as well. Most importantly, given Moldova's poor business environment, the majority of remittances continue to fuel consumption (boosting imports and inflation) more than production.

## **Institutional arrangements**

### *(a) Constitution*

The Constitution was adopted by the parliament on 28 July 1994, granting autonomous status to the secessionist regions of Gagauzia and Transnistria, although, in the latter case, the actual status still remains to be clarified.

Constitutional amendments in July 2000 diminished the role of the presidency and increased the power of the government and parliament.

### *(b) Parliament*

The Moldovan parliament consists of a single chamber 101 members are elected for four years *by proportional representation*. The PCM has an absolute majority in the Chamber<sup>2</sup>.

### *(c) President*

The President is elected for a term of 4 years. As a result of the constitutional changes introduced in July 2000, he is elected by the parliament. The current president is Vladimir Voronin who sworn in on April 7th 2005 for his second four-year term. Next presidential election will be held in 2009.

### *(d) Government*

The Prime Minister is appointed by the parliament. The Council of Ministers is appointed by the President, on a recommendation from the Prime Minister. There have been four Prime Ministers since 1999, reflecting the climate of recession and instability in Moldova. . The current Prime Minister, Mr Vasile Tarlev, has been re-appointed after 2005 elections for his second mandate. Observers hoped for a more dynamic and pro-European leadership. Mr Voronin opted instead for a prime minister who proved to be an obedient executor of the presidential administration's will.

## **3.1. Secessionist regions<sup>3</sup>**

### *(a) Gagauzia*

Gagauzia is a small territory (1 800 km<sup>2</sup>) whose population (200 000) is Turkish-speaking and Orthodox, and its main town is Komrat. Fearing Romanian-Moldovan unification, the Gagauzis founded the Soviet Socialist Republic of Gagauzia on 19 August 1990. Fortunately, it was possible to avoid an armed conflict. The 1994 Moldovan Constitution granted extensive cultural and political autonomy (three official languages – Gagauzi, Russian and Romanian; a local president with ministerial status directly elected; and a regional legislative assembly of 35 deputies) to an autonomous territorial unit called Gagauz Yeri, which in turn recognised Moldovan sovereignty.

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<sup>2</sup> See Annex III, p. 20.

<sup>3</sup> See Annex II, p. 17.

Gagauzia, however, reserved the right to opt for self-determination should Moldova decide to form a union with Romania.

*(b) Transnistria*

This once-Ukrainian region was incorporated by Stalin into the Soviet Republic of Moldova in return for relinquishing Bukovina and Bujak when they joined Ukraine. Transnistria has an area of 5000 km<sup>2</sup> and a population of 720 000. The Ukrainian (28%) and Russian (25%) populations of Transnistria, fearing assimilation to the pro-Romanian model, set up their own 'sovereign' and pro-Soviet republic in 1990<sup>4</sup>. The simultaneous establishment of these two secessionist republics at this juncture was largely due to Moscow's influence. The Soviet (and subsequently Russian) authorities were far from happy with the rapprochement between the two Romanian-speaking states, particularly in view of the fact that a major military base (the Fourteenth Army controls the south-west flank of the former USSR in the direction of the Balkans) is located in Tiraspol, which had been chosen as the capital by the Transnistrian secessionists. It was thanks to the support of this army, commanded by General Lebed, that the Tiraspol authorities were able to hold off the Moldovan army's attempt to regain control of the territory in June 1992.

Although it concerns a territory inhabited by a diverse population, the Transnistrian conflict is not an ethnic one; the real root of the problem is the corrupt economic management. Transnistria is a land of extensive smuggling and trafficking in drugs, weapons, human organs and women, which represents a significant source of income for the local leadership.

On 8 April 1997 the Moldovan President, Petru Lucinschi, and the secessionist leader of Transnistria, Igor Smirnov, signed a memorandum in Moscow aimed at 'normalising' their relations. This text, which reaffirms Moldova's territorial integrity 'within the January 1990 borders of the former Soviet Republic' is the most important step taken in the direction of a settlement of the conflict, which caused some 700 deaths in 1991 and 1992. However, the problem has not been entirely resolved. Another problem for Chisinau and Kiev is the future of the Russian Fourteenth Army, which is currently 2 600 strong, stationed in Transnistria. Contrary to the terms of an agreement signed by Moscow and Chisinau in 1995, the unit has not yet been dismantled.

At an OSCE meeting in Istanbul in November 1999, Russia again undertook to withdraw weapons it had brought to Transnistria and to repatriate its troops by the end of 2002, then extended to 2003. The Istanbul meeting in June 2004 regretted that this revised deadline had not been met. NATO Heads of Government stated that they would not ratify the 'Conventional Forces in Europe Treaty' until Russia had fulfilled its commitments to withdraw forces from Moldova and Georgia.

Although negotiations continue, a solution of the dispute over the status of the region of Transnistria still appears to be a long way off. However, a new seven-point plan proposed by the recently-elected Ukrainian government published in May 2005 has proved to be acceptable to both sides, even with some differences on the plan's interpretation. The proposal of holding internationally monitored elections in Transnistria, was contested as this would imply an implicit recognition of the region's status, as well as the assumption of a federalised Moldova.

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<sup>4</sup> See Annex II, p. 17.



In addition, the plan does not mention a timetable for accelerating the removal of Russian troops and weapons from the region.

In July 2005, following the plan put forward by the Ukrainian authorities, the Moldova's parliament passed a law that offered Transnistria a broad autonomy in exchange for demilitarisation and President Vladimir Voronin announced the lifting of trade sanctions imposed on the separatist region last year.

At the same time, Transnistrian leader Igor Smirnov said that, if the five-party talks on the separatist dispute resume, he would be prepared to accept EU and US participating as observers. Progress remains, nevertheless, slow and a final agreement is unlikely to be reached in 2005/06.

#### 4. Foreign policy

##### **4.1. Relations with international organisations**

Moldova is a member of the CIS, the UN, the OSCE, the Black Sea Economic Cooperation Area and the Council of Europe, and is a signatory to the NATO Partnership for Peace. It is also a member of the Francophone Community ('la Francophonie'). Finally, it is part of the GUUAM, an organisation set up in 1997 which groups together those former Soviet republics that are most wary of Moscow: Georgia, Ukraine, Uzbekistan<sup>5</sup>, Azerbaijan and Moldova.

Moldova's position within the Council of Europe has been delicate. There was special concern in regard to the Moldovan authorities' refusal to register the Bessarabian Church. In December 2001 the European Court of Human Rights (ECHR) ruled it as a violation of the Convention for the protection of Human Rights. In mid-2002 the government complied with the deadline imposed by the Council of Europe and granted official status to the Bessarabian Church<sup>6</sup>.

##### **4.2. Relations with neighbouring states**

###### *(a) Russia*

Moldova has sought to strengthen its relations with Russia and the CIS while also moving towards eventual EU membership. There have been conflicting initiatives and the priorities of the government in regard to the CIS are unclear. In November 2003 a special envoy from Moscow announced plans to turn Moldova into a loose federation under Russian military guarantee. However, a visit to Chisinau by Mr Putin planned at that time for signature of a memorandum on the Transnistria dispute did not take place.

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<sup>5</sup> Uzbekistan, however, has said that it does not wish to join the project for a free trade area which was expected to be launched by its partners at the GUUAM summit to be held on 19 and 20 July in Yalta.

<sup>6</sup> This subject was referred to in a resolution of the Council of Europe Parliamentary Assembly adopted on 24 April 2002.

According to a previous declaration made by Mr Voronin, Moldova cannot contemplate membership of the European Union so long as other CIS states do not join. Membership of NATO is ruled out by the fact that Moldova is a neutral state according to its constitution. Relations between Russia and Moldova are not only political, but also economic: 60% of Moldovan exports go to Russia, which for its part exports large quantities of gas to Moldova.

On 19 November 2001 the Russia-Moldova friendship treaty was ratified. This agreement provides for a special legal status for the Russian language. Following demonstrations by members of the Romanian-speaking (majority) community, the Moldovan Government decided on 22 February 2002 to abandon the plan to impose the compulsory teaching of Russian in schools. It also backtracked on the planned reform of the history curriculum, which, according to observers, would have promoted a 'Stalinist' interpretation of events.

However, since Mr Voronin rejected Russia's settlement proposal on Transnistria - the so called Kozak Memorandum- in late 2003, relations between Russia and Moldova have deteriorated markedly. The situation worsened during Moldova's election campaign in 2005, when the PCM accused the Russian authorities of interfering in the election process on behalf of the centrist opposition by threatening economic sanctions to scare Moldovan voters into backing the opposition. In fact, Russia has toughened its stance further after the elections, introducing more restrictions on Moldovan exports than previously expected and threatening to raise its gas price from 2006, in the attempt to steer Moldova away from its more pro-European policy direction.

#### *(b) Romania*

After 1918, all Romanian-speaking regions were incorporated into a single country, namely Romania. However, this unity did not last long. As early as 1939, the Ribbentrop-Molotov Pact provided for future annexation of Bessarabia by the USSR, and this occurred in 1944.

On 2 May 2000, following seven years of negotiations, a treaty was signed between Romania and Moldova. This Treaty is intended as a basis for a special partnership between the two countries. It recognises the principle of inviolability of borders. The treaty stipulates that 'one of the common strategic objectives will be to devote their efforts to mutual support in the process of European integration'.

In early 2001, though, the election of the CPM in Moldova brought a deterioration in bilateral relations, with Moldova's leadership accusing Romania of "expansionism" and financial sponsoring of the nationalist opposition's protest as part of a plan to fragment the country and reincorporate former Bessarabia.

However, the relations with Romania have improved since then. In 2003 Mr Voronin actively sought Romania's support for Moldova's EU accession bid, and secured a promise from Romania not to introduce a visa regime for Moldovan citizens until 2007.

#### *(c) Ukraine*

Relations between Moldova and Ukraine have been generally positive, despite the territorial disputes dating back to Stalin's unfortunate decision to incorporate Russian-speaking

Transnistria into Moldova and to transfer northern Bukovina and Bujak to Ukraine. An 'exchange' of these regions now seems unlikely since Romania and Ukraine signed an agreement in June 1997 guaranteeing their present borders.

The resolution of the Transnistria conflict depends largely on Ukraine, as most of the movements of goods, people, etc. takes place through the ports of Odessa and Ilychev in Ukraine (there are no land border between Transnistria and Russia). Ukraine was requested to implement the EU-OSCE proposal to make its border with Moldova more secure by constructing 3 trade control points and post 50 custom officials to these points. On 19 July 2005 the High Representative for the Common Foreign and security Policy Javier Solana said the EU will help Ukraine control its border with Moldova's separatist Transnistria region in order to crack down on smuggling, which has been vital for the survival of the separatist regime. In addition to funding, the EU might also provide customs officers to conduct training.

A greater commitment on Transnistria has been promised by Ukraine's new president, Viktor Yushchenko. However, his seven-point plan, despite being a good base for further negotiations, has not proved to be a possible solution.

## II. ECONOMIC SITUATION

### 1. Introduction

The Moldovan economy has no mineral resources. Agriculture forms its economic base, accounting for much of the country's gross domestic product (GDP). Before the break-up of the Soviet Union, Moldova was the sixth largest agricultural producer among the 15 republics. 35% of the working population is employed in agricultural activities, carried out on rich black earth. This work is directed primarily at ex-Soviet markets; the main crops are cereals, beet, sunflowers and tobacco. However, the most valuable resources are to be found in the country's vineyards and orchards: Moldova accounted for over 25% of the former Soviet Union's vines and 30% of its fruit.

The stand-off with Transnistria has further increased Moldova's dependence on agriculture-related export, as Transnistria is home to most of the country's heavy industry.

The industrial sector, dominated by food-processing, contributes for a smaller share to the GDP and the private sector is estimated to account for around four-fifth of the GDP.

This economic over-specialisation, together with the country's landlocked situation, its dependence on imported energy and the problems caused by the move from a planned economy to a market economy are substantial obstacles to national economic development.

### 2. Background

From 1993 to 1997, reforms introduced by successive governments with the support of the IMF led to financial stabilisation. The budget deficit was reduced from 7% of the GDP in 1990 to 3% in 1998-99, even if the economy contracted every year between 1992 and 1999.

A new currency – the leu – was put into circulation in 1993. The authorities implemented a stringent monetary and tax policy, bringing about a steady fall in inflation and a stable exchange rate for the leu. The National Bank of Moldova (NBM) played an important role in the late 1990s to ensure improved macroeconomic stability, seeking price stability, limiting real currency appreciation (due mainly to the large inflows of remittances from Moldovans working abroad) and keeping interest rate low.

The 1998 Russian financial crisis seriously destabilised the Moldovan economy, whose GDP fell by 8.6%. As Moldova is largely dependent on its CIS trade partners, exports fell by half, the currency fell to 50% of its previous value and the foreign debt rose to almost 100% of GDP.

Moldova's economy slowly recovered only since 2000, experiencing an expansion of average 7% in 2000-2003, with industrial production increasing intensely (due to the Russia's economic recovery and growing domestic demand as a result of significant inflow of remittances).

In 2000 the government eliminated a wide range of tax exemptions, improved tax collection, reduced wage arrears and eliminated pension arrears. The consolidated budget shrank further in

2000-02 as a result, and moved into surplus in 2003-04.

Even with a budget surplus, the government was still forced to build up arrears on its principal payment in light of lower than expected external borrowing possibilities and privatisation-related earnings. Delayed payment of salaries in the civil service (with the only exception of pensions, which, nevertheless, remain very low) led to a growing impoverishment of many sections of society.

The GDP grew by 7.3% in real terms in 2004. The economy's recovery was driven overwhelmingly by domestic consumption fuelled by large inflows of remittances from Moldovans working abroad and a favourable export environment (textile industry output towards Germany, Italy and Turkey and food products to Russia).

However, investments, which would provide a more sustainable basis for growth over the medium term, did not benefit from this recovery.

Moldova relied heavily on multilateral financing in the mid-1990 to boost its foreign-currency reserves, stabilise the leu and finance its budget deficit.

Slow political and economic reforms brought frequent interruptions to Moldova's multilateral lending programmes. In 1997, the IFM suspended lending with the World Bank following suit. After his first election in 2001, Mr Voronin promised to continue structural reforms and secured a newly agreed IFM poverty reduction and growth facility (PRFG). However, when the PRFG finally expired at the end of 2003, Moldova had received only one fifth of the US\$147m facility as a result of policy backtracking.

### 3. Economic objectives

In a speech given at the start of his second term in early April, the president Vladimir Voronin set an ambitious agenda for 2005-2009, ranging from economic liberalisation, deregulation and administrative reforms, to improving the education system and combating corruption.

In December 2004, the parliament approved the government's economic growth and poverty reduction strategy paper (EGPRSP), which provides the framework for World Bank lending under a new country assistance strategy (CAS).

The Moldovan government is committed to faster privatisation under the EGPRSP and is preparing an inventory of industrial assets to be sold. However, it is unlikely that Moldovan leadership will now speed up structural reform by much. The IFM, in particular, remain wary of the CPM's commitments to economic changes, given the lack of reform implementation that followed the Fund's last disbursement three years ago.

Therefore the IFM is unlikely to resume lending (interrupted in 2002) until it has had a chance to assess the government's economic policies and see some reform implemented.

#### 4. Economic forecasts<sup>7</sup>

##### *(a) Economic growth*

The preliminary data released for January-March 2005 showed a real GDP increase of 8.2% year on year, despite a sharp slowdown in the industrial sector. The continued inflow of remittances is having an impact, providing the economy with a large boost. However, some signs of weakening domestic demand are apparent and investment (little and mostly financed by remittances) is unlikely to be growing strong enough to sustain the GDP growth at this rate.

As the largest agricultural sector is likely to expand more slowly than in 2004, when it bounced back from a poor harvest in 2003, an increase in real GDP of around 6% for this year as a whole is expected.

Furthermore, without structural reforms and improvements in the business environment, the economy will remain consumption-driven in 2006 as well, with annual real GDP growth unlikely to rise above 5%.

##### *(b) Fiscal policy*

Due to limited privatisation earnings and multilateral inflows, the government fiscal stance will probably have to be tighter than forecast in the 2005 budget in order to ensure a smaller deficit for this year. The government intends to attract multilateral loans to finance its deficits as well as its net domestic debt repayments but its commitments to revitalising the privatisation process have proved contradictory, therefore it not certain that IFM credits will be secured.

In the absence of budget revisions, the government will probably have to increase its domestic borrowing and to call on the National Bank of Moldova for a credit, as in 2004.

##### *(c) Inflation*

Inflation has reached 12,5% in 2004. Despite rising further to 14% in the first months of 2005, it is expected to fall over the rest of the year. However, significant disinflation is precluded.

##### *(d) Exchange rates*

The leu has been rising because of large inflows of remittances and is 12% stronger in nominal terms against the euro at the beginning of August than at the start of 2005. Large inflows of remittances play a key role in supporting the leu; in the first half of 2005 remittances were up by roughly half compared with year-earlier period.

##### *(e) External trade*

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<sup>7</sup> See Annex IV, p. 19.

Moldova has acceded to the WTO in May 2001. Trade has been growing rapidly though the country has still a narrowly focused export base, which relies mainly on the Russian market and on agriculture and agro-processing industries (with wine being the single most important export, accounting for 40% of export revenue).

Although exports to the EU have risen in the recent years (the trade in processing of semi-finished textiles with Italy has made the latter country Moldova's second most important trading partner after Russia), Moldova's particular export offer is not well suited for a more rapid penetration of the EU market.

On the import side, Moldova has to import almost all its energy requirement, with Russia being the most important supplier. Demand for consumer imports is rising rapidly, as incomes are boosted by remittances.

The current-account deficit fell to 4.4% of GDP in 2004 (6.7% in 2003), with rising remittances offsetting the growing trade deficit (remittances being measured in the current account partly as income and partly as transfers). However, other capital inflows are small and Moldova has a poor record in attracting foreign investment. The lack of agreement with the IMF on a programme is a serious handicap in this regard.

The trade deficit is expected to increase to just fewer than 5% of GDP in 2005, pushed up by strong consumption growth.

### III. EU-MOLDOVA RELATIONS

#### 1. Historical background

Following the break-up of the USSR, the trade and cooperation agreement (concluded in 1989 between the European Community and the Soviet Union) was replaced by agreements with each of the new independent republics. These partnership and cooperation agreements do not mention the possibility of joining the European Union and include a suspension clause, like all new agreements concluded by the EU with third countries since 1992. They are basically 'mixed' agreements, covering matters falling within the sphere of competence of both the EU and its Member States. They also contain a future developments clause, which stipulates that free-trade agreements can be considered once the necessary conditions have been met.

#### 2. Content of the EU-Moldova Partnership Agreement

The Partnership and Cooperation Agreement (PCA) between the EU and Moldova was signed on 28 November 1994 and entered into force on 1 July 1998.<sup>8</sup> Its implementation has, nevertheless, been patchy and it is due to expire in 2008.

This agreement provides the necessary framework for closer relations with the EU based on democratic values, including political dialogue and respect for the rule of law. In economic terms, the Agreement promotes a market economy and forms the basis for a close partnership, establishing a new institutional framework and opening up new opportunities for cooperation in a whole range of areas.

The agreement thus includes the following aspects:

- establishment of a political dialogue with regular meetings at a high level and establishment of an institutional structure, including a Cooperation Council, a Cooperation Committee and a Parliamentary Cooperation Committee;
- provisions on: trade in goods; labour conditions; the establishment and operation of companies; crossborder supply of services; payments and capital; competition; intellectual, industrial and commercial property protection; legislative and economic cooperation; respect for democracy and human rights; cooperation in the field of prevention of illegal activities; cultural cooperation; and financial cooperation;
- a human rights conditionality clause making it possible to suspend the agreement, even unilaterally, in the event of violation of essential elements thereof, such as respect for democratic principles, human rights and the principles of the market economy.

#### 3. EU / Moldova Action Plan

In February 2005 Moldova and the EU signed an Action Plan for the next three years. It is part of European Neighbourhood Policy (ENP) which aims to provide the basis for increased political security as well as economic and cultural cooperation between the EU and its neighbourhood. Through the ENP, the neighbouring countries can participate in various EU programmes, deepen their political dialogue with the EU, and gradually be given a stake in the internal market.

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<sup>8</sup> OJ L 181, 24.6.1998, p. 3.



The Moldova's Action Plan focuses on three main areas: political dialogue, internal market access, Justice and Home Affairs. It sets out a comprehensive set of priorities to meet in areas within the scope of the Partnership and Cooperation Agreement:

- sustain efforts towards a viable solution to the Transnistria conflict.
- further strengthening of the stability and effectiveness of institutions guaranteeing democracy and the rule of law;
- ensuring respect for the freedom of the media and the freedom of expression;
- further reinforcing administrative and judicial capacity;
- resuming cooperation with IFIs; implementing actions aimed to poverty reduction, to strengthen private sector led growth and for fiscal sustainability;
- improving the investment climate through appropriate structural reforms aimed at ensuring non-discriminatory, transparent and predictable business conditions and by the fight against corruption;
- progress towards a system of efficient , comprehensive state border management on all sectors of the Moldovan border including the Transnistria;
- Working towards the EU granting Autonomous Trade Preference, by ensuring effective control of the origin of the goods from Moldova;
- stepping up the fight against organised crime, including trafficking in human beings;
- ensuring the efficient management of migratory flows, including initiating the process towards conclusion of a readmission agreement between the European Community and Moldova.

Despite having committed itself to working within the ENP framework, Moldova still sees the Balkans Stability Pact as more promising, as it provides a possibility for an eventual accession to the EU. The ENP, which the EU believes Moldova should concentrate on, is less open in this respect. In the last meeting of the European Parliament's delegation for the relations with the Moldovan parliament held on 24 May 2005, the EP's delegates confirmed this position.

#### 4. Financial assistance

Moldova received total aid amounting to €238 million for the period 1991-2003. Of this about €130 million was granted under the TACIS programme, with priority given to food production, processing and distribution; development of the private sector; training; and the social consequences of transition.

A national TACIS programme for Moldova was adopted in July 2003 for the period 2003-2004 which provides €25 million, in particular for institutional, legal and administrative reform.

Moldova has also benefited since 1994 from balance-of-payments support for a total of about €75 million. Humanitarian assistance under ECHO of €4 million was provided in 1999 and a grant of €5.5 million was provided in 2000 to promote reform in the agricultural and social sectors as part of the EU's Food Security Programme.

The EU has increased funding under its partnership and co-operation agreement (PCA) and the three-year Action Plan agreed with Moldova in 2004.

#### 5. Trade relations between the EU and Moldova

The importance of the EU as a trade partner for Moldova<sup>9</sup> has risen in the recent years and trade relations benefit from the EU's General Preferences System. Much of the increase in export to EU (by more than 20% year on year in Jan-May 2005) has arisen from textiles subcontracting work undertaken on behalf of German and Italian firm. Given the importance of textiles, there is a specific agreement in place. Other exports are agricultural products, which, nevertheless, face difficulties in penetrating EU markets. Much import from the EU consists of machinery, electrical products and agricultural products.

#### 6. Institutional relations

##### *(a) Council*

On 14 June 2004 the General Affairs and External Relations Council of the EU adopted conclusions on Moldova in which it confirmed the importance of Moldova as a partner.  
In the document the Council:

- reaffirmed the importance of the Republic of Moldova as a neighbour and partner with close links to the Union on the basis of common values of democracy, rule of law, human rights including freedom of media, as set out in the European Neighbourhood Policy (ENP);
- noted that the solution of the Transnistrian conflict is a key to develop a strong and stable Moldova. The Council reaffirmed the EU's commitments to support the conflict settlement;
- reaffirmed the importance of a efficient state border management, in particular the Transnistrian section, to eradicate the trafficking of human beings and illegal goods and the proliferation of weapons;
- expressed its concern about the lack of progress in the withdrawal of Russian troops from Transnistria;

In March 2005 the European Council appointed Ambassador Adriaan Jacobovits de Szeged as European Union Special representative (EUSR). The EUSR's nomination is a positive sign for the implementation of the EU policy objectives in this area which includes:

- The contribution to a peaceful settlement of the Transnistria conflict and the implementation of such a settlement as a viable solution, respecting the sovereignty and territorial integrity of the Republic of Moldova within its internationally recognised borders
- The strengthening of stability and cooperation in the region.
- The strengthening of democracy, the rule of law and the respect of human rights and fundamental freedoms, which includes the fight against trafficking in human beings and weapons.
- The promotion of good and close relations between the Republic of Moldova and the EU, as set in the ENP Action Plan, and the enhancement of the EU effectiveness and visibility in the region.

In early June 2005 Mr Voronin headed the Moldovan delegation at the Council of Europe summit, where he joined other heads of state in signing European conventions on the prevention of terrorism, on money-laundering and on human-trafficking.

(b) European Parliament

The European Parliament has consistently supported the Moldovan authorities' efforts to consolidate democracy<sup>10</sup> and respect for human rights and to introduce a market economy. In the last few years several resolutions have been adopted calling Moldova's government to respect democratic principles and fundamental rights and to intensify reform.

In February 2005 the EP adopted a resolution which "calls on Moldova and its breakaway region of Transnistria to restart settlement talks, urges the mediators to redouble their effort to assist in the process and reaffirms its continuing strong commitment to supporting settlement of the conflict, drawing on all instruments at its disposal in close consultation with the OSCE". It also expressed its support to this country's effort of establish a fully functioning democracy, the rule of the law and respect for human rights.

Moreover, the EP urged on the Moldovan authorities to ensure all necessary conditions for the 6 March parliamentary elections to be free and fair.

Seven members of the EP participated in an observation mission for these elections. The EP noted that the pluralistic party system in Moldova gave voters a genuine choice, which contributed to this country's successful democratic process.

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<sup>9</sup> See Annexes V-VII, pp. 22-25.

<sup>10</sup> Parliament welcomed the 'reappearance' of the opposition leader Vlad Cubreacov in May 2002.

(c) European Commission

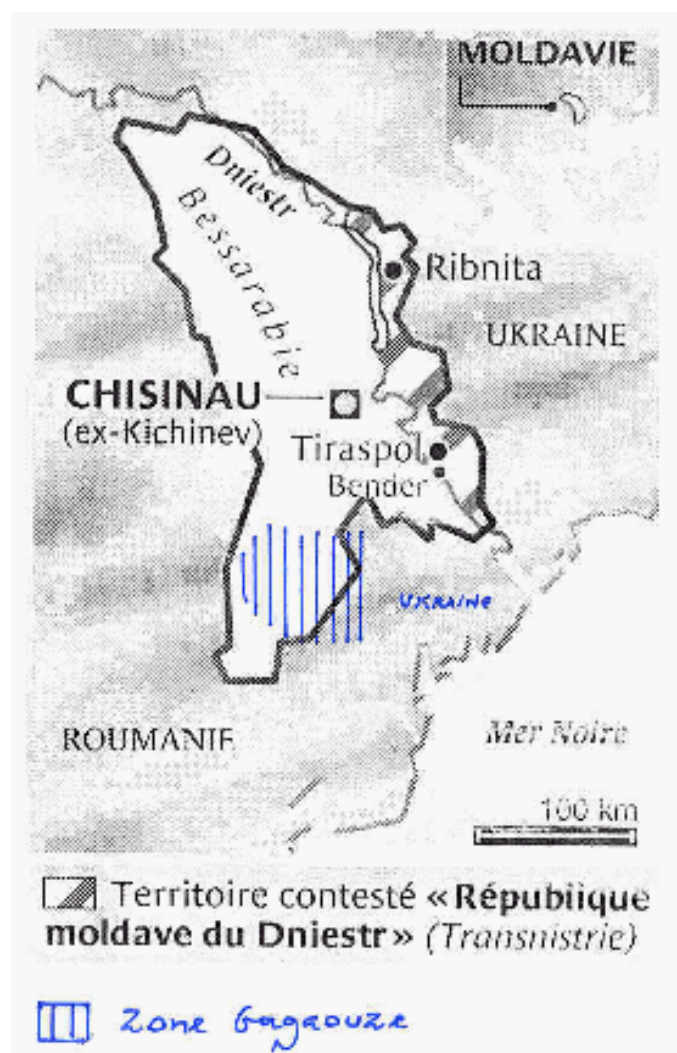
On June, 28, the European Commission and the government of the Republic of Moldova signed an Establishment agreement to open a Delegation of the Commission in Chisinau. The agreement was signed by the commissioner for External Relations and European Neighbourhood Policy, Benita Ferrero-Waldner, and Ambassador Eugen Carpov, on behalf of Moldova. This is an important step towards the implementation of the EU-Moldova European Neighbourhood Policy Action Plan, endorsed by the EU-Moldova Cooperation Council on 22 February 2005.

The opening of a Delegation will also contribute to a further development and strengthening of the EU-Moldova bilateral relations. The Commission Delegation Office will be formally opened by Mrs. Ferrero-Waldner on 6 and 7 October 2005.

# ANNEX I



## ANNEX II



### MOLDOVA - 2005 PARLIAMENTARY ELECTION

	% of no. of parliamentary	
	Vote	Seats
Communist Party of Moldova (CPM)	46.0	56
Democratic Moldova Bloc <sup>11</sup>	28.5	34
Christian Democratic Popular Party (CDPP)	9.1	11
Patria Rodina Electoral Bloc	5.0	0
Social Democratic Party of Moldova	2.9	0
Ravnopravie	2.8	0
Other	5.7	0

Source: Central Election Commission

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<sup>11</sup> Coalition of three centre's groups: Our Moldova Alliance (OMA, 23 seats), the Democratic Party (DP, 8 seats) and the Social Liberal Party (SLP, 3 seats).





## MOLDAVA - ECONOMIC DATA

## Annual indicators

	2000 <sup>a</sup>	2001 <sup>a</sup>	2002 <sup>a</sup>	2003 <sup>a</sup>	2004 <sup>a</sup>
GDP at market prices (Lei bn)	16.0	19.1	22.6	27.3	32.0
GDP (US\$bn)	1.3	1.5	1.7	2.0	2.6
Real GDP growth (%)	2.1	6.1	7.8	6.3	7.3
Consumer price inflation (av; %) <sup>b</sup>	31.2	9.6	5.2	11.6	12.4
Population (m) <sup>c</sup>	3.6	3.6	3.6	3.6 <sup>d</sup>	3.6 <sup>d</sup>
Exports of goods fob (US\$ m)	476.8	567.2	659.8	806.3	995.2
Imports of goods fob (US\$ m)	770.5	880.3	1,038.0	1,428.6	1,753.5
Current-account balance (US \$ m)	-125.3	-77.9	-56.4	-142.3	-112.9
Foreign-exchange reserves excl gold (US\$ m)	222.5	228.5	268.9	302.3	470.3
Total external debt (US\$ bn)	1.2	1.2	1.3	1.4 <sup>d</sup>	1.4 <sup>d</sup>
Debt-service ratio, paid (%)	14.1	14.9	16.8	9.4 <sup>d</sup>	11.2 <sup>d</sup>
Exchange rate (av) Lei:US\$	12.43	12.87	13.57	13.94	12.33

<sup>a</sup> Actual. <sup>b</sup> Annual and quarterly series from different sources. <sup>c</sup> Excludes Transdnistr. <sup>d</sup> Economist Intelligence Unit estimate.

Origins of gross domestic product 2004 <sup>1</sup> excl. Transnistria	% of total	Components of gross domestic product 2004	% of total
Agriculture	18.2	Private consumption	89.3
Industry	16.4	Public consumption	15.4
Services	50.9	Gross fixed investment	21.7
Construction	4.1	Increase in stocks	3.6
		Net exports	-31.1
<b>Principal exports 2004</b>	<b>% of total</b>	<b>Principal imports 2004</b>	<b>% of total</b>

Food products	35.1	Mineral products	21.7
Textiles	17.3	Machinery & equipment	13.5
Vegetable products	12.2	Chemicals	9.1
Machinery & equipment	4.0	Textiles	8.6
Live animals & animal products	3.1	Metal & metal products	6.3

<b>Main destinations of exports 2004</b>	<b>% of total</b>	<b>Main origins of imports 2004</b>	<b>% of total</b>
Russia	35.8	Ukraine	24.6
Italy	13.9	Russia	12.2
Romania	10.0	Romania	9.3
Germany	7.3	Germany	8.5
Ukraine	6.6	Italy	7.4

1) Source: TACIS, Moldovan Economic Trends.

Source: EIU

**TRADE RELATIONS EU / MOLDOVA: 2004**

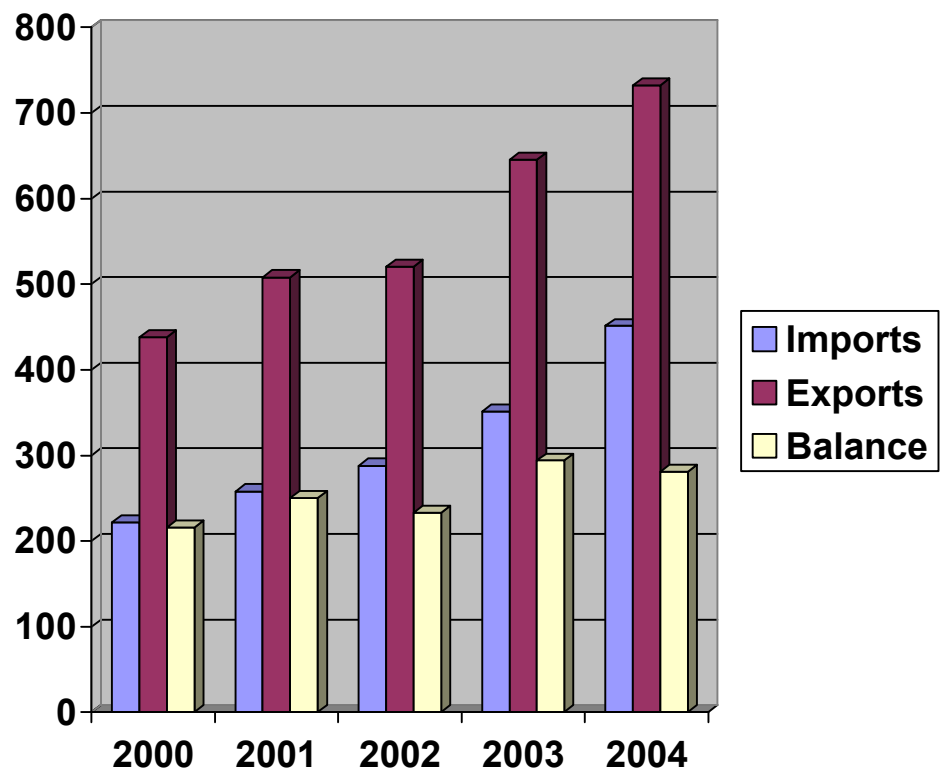
<b><u>EU Imports from Moldova</u></b>			
<b>Products (Sitc Sections) by order of importance</b>	<b>Mio euro</b>	<b>%</b>	<b>Share of total EU imports</b>
<b>TOTAL</b>	<b>451</b>	<b>100.0</b>	<b>0.0</b>
Manuf goods classif. chiefly by material	180	39.8	0.2
Miscell. manuf. Articles	128	28.4	0.1
Machinery and transport equipment	67	14.9	0.0
Food and live animals	37	8.3	0.1
Crude materials inedible, except fuels	23	5.1	0.1
Beverage and tobacco	6	1.3	0.1
Commodit. and transactions n.e.c.	4	0.8	0.0
Animal and vegetable oils, fats and waxes	2	0.4	0.0
Chemicals and related prod., n.e.s.	1	0.3	0.0
Mineral fuels, lubricants and rel. Materials	0	0.0	0.0

<b><u>EU Exports to Moldova</u></b>			
<b>Products (Sitc Sections) by order of importance</b>	<b>Mio euro</b>	<b>%</b>	<b>Share of total EU exports</b>
<b>TOTAL</b>	<b>732</b>	<b>100.0</b>	<b>0.1</b>

Machinery and transport equipment	316	43.1	0.1
Manuf. goods classif. chiefly by material	153	20.9	0.1
Miscell. manuf. Articles	86	11.8	0.1
Chemicals and related prod., n.e.s.	64	8.8	0.0
Food and live animals	54	7.4	0.2
Crude materials inedible, except fuels	19	2.6	0.1
Beverages and tobacco	11	1.5	0.1
Mineral fuels, lubricant and rel. Materials	10	1.3	0.0
Commodit. and transactions n.e.c.	5	0.6	0.0
Animal and vegetable oils, fats and waxes	2	0.2	0.1

Source: Eurostat (Comext, Statistical regime 4)

<b>EUROPEAN UNION'S TRADE WITH MOLDOVA</b>								
<b>Year</b>	<b>Imports</b>	<b>Yearly % change</b>	<b>Share of total EU imports</b>	<b>Exports</b>	<b>Yearly % change</b>	<b>Share of total EU exports</b>	<b>Balance</b>	<b>Imports + Exports</b>
<b>2000</b>	<b>222</b>		<b>0.02</b>	<b>438</b>	<b>16.1</b>	<b>0.05</b>	<b>216</b>	<b>660</b>
<b>2001</b>	<b>258</b>	<b>16.3</b>	<b>0.03</b>	<b>508</b>	<b>2.4</b>	<b>0.06</b>	<b>250</b>	<b>766</b>
<b>2002</b>	<b>288</b>	<b>11.5</b>	<b>0.03</b>	<b>520</b>	<b>23.9</b>	<b>0.06</b>	<b>233</b>	<b>808</b>
<b>2003</b>	<b>351</b>	<b>21.8</b>	<b>0.04</b>	<b>645</b>	<b>13.6</b>	<b>0.07</b>	<b>294</b>	<b>995</b>
<b>2004</b>	<b>451</b>	<b>28.7</b>	<b>0.04</b>	<b>732</b>		<b>0.08</b>	<b>281</b>	<b>1,184</b>
<b>Average annual growth</b>		<b>19.4</b>			<b>13.7</b>			<b>15.7</b>



Source: Eurostat (Comext, Statistical regime 4)

### Trade of the EU(15) with Moldova by Member States

#### EU-imports (cif)

	2003		January-May:		
	1000 €	- % -	2003	2004	% change
<b>Total</b>	323.905	100,0	98.132	181.702	85,2
<i>of which:</i>					
France	69.587	21,5	6.124	42.812	599,1
Netherlands	3.362	1,0	1.308	2.514	92,2
Germany	85.705	26,5	33.607	46.105	37,2
Italy	92.146	28,4	37.477	49.512	32,1
United Kingdom	7.532	2,3	3.258	1.317	-59,6
Ireland	3	0,0	1	0	-87,4
Denmark	192	0,1	51		
Greece	13.857	4,3	4.969	7.652	54,0
Portugal	12.731	3,9	1.540	16.637	980,2
Spain	20.763	6,4	4.752	8.569	80,3
Belgium	6.412	2,0	1.993	2.813	41,2
Luxembourg	50	0,0	0	1	
Sweden	2.574	0,8	807	915	13,4
Finland	126	0,0	98	11	-88,6
Austria	8.865	2,7	2.148	2.845	32,4

#### EU-exports (fob)

<b>Total</b>	508.935	100,0	148.735	235.813	58,5
<i>of which:</i>					
France	115.009	22,6	12.678	75.099	492,3
Netherlands	32.390	6,4	9.971	13.534	35,7
Germany	158.356	31,1	56.507	77.507	37,2
Italy	96.988	19,1	31.208	41.104	31,7
United Kingdom	8.700	1,7	3.844	3.014	-21,6

<b>Ireland</b>	406	0,1	177	68	-61,5
<b>Denmark</b>	3.275	0,6	1.371	1.235	-9,9
<b>Greece</b>	8.520	1,7	2.834	1.193	-57,9
<b>Portugal</b>	4.554	0,9	1.461	2.177	49,1
<b>Spain</b>	7.519	1,5	3.007	3.136	4,3
<b>Belgium</b>	21.026	4,1	6.566	9.443	43,8
<b>Luxembourg</b>	1.104	0,2	317	176	-44,4
<b>Sweden</b>	2.476	0,5	495	699	41,1
<b>Finland</b>	27.996	5,5	11.242	1.594	-85,8
<b>Austria</b>	20.616	4,1	7.057	5.835	-17,3

Source: COMEXT database, EUROSTAT *Production: JDa/DG4/European Parliament*



## Trade of the EU (15) with Moldova: 1995-2003

	<i>MIO ECU/€</i>		
	EU-imports (cif)	EU-exports (fob)	Balance
1995	95.207	148.059	52.852
1996	87.599	217.785	130.186
1997	100.953	289.554	188.601
1998	117.081	294.115	177.034
1999	141.825	255.597	113.772
2000	194.684	336.386	141.702
2001	232.195	380.319	148.124
2002	264.407	401.706	137.299
2003	323.905	508.935	185.030
Jan-May: 2003	98.132	148.735	50.603
Jan-May: 2004	181.702	235.813	54.111

Source: COMEXT  
database,

EUROSTAT

Production: JDa/DG4/European  
Parliament