

MOLDOVA AND TRANSNISTRIA REINTEGRATION STUDY

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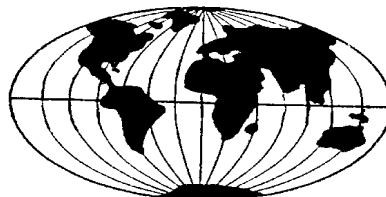
U.S. Agency for International Development

Under:

Evaluation IQC No. AEP-I-00-00-00023-00

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August 29, 2003

TABLE OF CONTENTS

	Page No.
Executive Summary.....	ii
I. Introduction	1
A. Purpose of The Study.....	1
B. Methodology	1
II. Background	1
III. Status of Negotiations Toward a Federal Structure	2
IV. Sectoral/Functional Areas to be Considered for Reintegration	4
A. Fiscal and Monetary Issues	4
1. Identification and Consolidation of Sovereign Debt.....	5
2. Currency Unification, Exchange Rate and Monetary Policy.....	7
3. Customs Unification	9
4. Banking	10
5. Fiscal Policy and Management.....	11
6. Tax Assessment and Collection	12
B. Government and Judicial Structures/Function	13
1. Government, Central and Local.....	13
2. Judicial.....	14
3. Military/Security/Police.....	15
C. Social Services and Civil Society	17
1. Health and Social Services	17
2. Education.....	21
3. Civil Society.....	24
D. Economy	27
1. Agriculture Efficiency and Utilization	27
2. Business and Industrial Development	28
3. Foreign Investment and Economic Growth.....	29
4. Privatization and Marketability of Transnistrian State Owned Enterprises and Land.....	29
V. Summary of Findings.....	30
A. Relative Importance of Issues	30
B. Summary of Costs.....	32
C. The Benefits of Reintegration.....	33
D. Policy Recommendations.....	34

EXECUTIVE SUMMARY

This study provides an early alert to USAID/Chisinau on the potential issues, costs and benefits associated with the proposed reintegration of Moldova and Transnistria within a federal structure, as outlined in the Kyiv Agreement.

The effort to end the unrecognized succession of Transnistria has been on-going for twelve years, but has become more intensive during the past several years. The current President of Moldova has made a political commitment to his electorate to reintegrate the country within his term of office. In addition, his government has instituted a number of policies that have affected Transnistria's trade, privatization program and the status of Transnistria's companies in an effort to regain partial economic control over the region and pressure the Transnistrian authorities to negotiate reintegration more seriously. In addition, the Organization for Security and Cooperation in Europe (OSCE) has increased its efforts to bring the two sides to an acceptable reintegration agreement.

Thus, it appears that today, both sides are preparing for a series of negotiations on constitutional issues and the reintegration of a number of functional areas of governance. This study analyzes the principal areas which are likely to be included in the reintegration agenda. The topics are grouped under fiscal and monetary issues, government and judicial structures/functions, social services and civil society, and the economy at large.

In the fiscal and monetary arena, the large external debt of Transnistria (\$1.2 billion) poses a serious difficulty for the financial future of a reintegrated Moldova. If it were treated as sovereign and added to the Republic of Moldova's (ROM) debt of \$1.3 billion, the total would be unserviceable by the united economy. This debt needs to be analyzed to determine the extent to which it should be considered sovereign debt. Most likely, some form of debt relief will also be needed so that the reintegration of debt does not negatively impact the per capita debt burden of either side.

Currency unification is a topic of immediate interest to the ROM. The ROM's willingness to permit a dual currency regime in Transnistria for a transitional period has merit. However, if mishandled, the ROM could import inflation or the Transnistrians could lose the value of their monetary assets. The unification of the currency under the Central Bank of Moldova will have far reaching economic consequences for the authorities in Transnistria. The Transnistrian budget will be denied central bank credits and the move will force a more disciplined and balanced budget. This is likely to result in reduced subsidies to industries and individuals.

Customs unification is essential but will likely be contentious because of the personalities involved and the corporate interests which may be affected. However, the reputation of both sides with respect to goods crossing borders is not good and has hurt the environment for foreign investment from the West.

The unification of banking is not an essential outcome of the reintegration process. However, there needs to be a mechanism for relations among the banks on both sides. Also, those who deal with Transnistrian banks need better assurances that these banks are sound and their funds

are secure. If unification is achieved, there is a need to determine the deposit insurance liability that is absorbed by the unified system.

As with customs, a common economic space within Moldova dictates that the Value Added Tax (VAT) is extended throughout the country replacing the turnover tax of Transnistria. Without such a move, a tax border would have to be erected between the two sides, imposing a significant impediment to commerce. The VAT, however, will raise the tax burden on Transnistrians and they are likely to object to its implementation. In addition, the authorities in Transnistria believe that the VAT will transfer resources from their territory to the ROM. This concern could be managed by an agreement between the two sides that temporarily precludes such transfers. Ultimately, however, intergovernmental transfers within the country will become necessary to ensure equal provision of (or access to) essential public services. In this regard, it is preferable that a new, federal level of government has the necessary taxing authority to carry out its functions, what ever they may be. Without independent taxing authority, this new government would be subordinate to the demands of whichever side chose to withhold its contribution to the federal level's financial requirements.

In the areas of government and judicial structures, little can be said about the costs involved until a clearer picture of the new structure emerges as reintegration negotiations proceed. Clearly the new federal level would have authority for foreign affairs, customs, central banking, the VAT and defense. However, the net cost for this new level may be quite small as it mainly represents a realignment of responsibilities rather than the creation of new bureaucracies.

The different judicial structures, for the most part, need not be unified except at the high court or constitutional court level. Unification is required for commercial and trade law and there has to be a countrywide standard for human rights protection. But these need not require a new and separate court system. Rather, they could be achieved by a body of law which is accepted and practiced by both sides.

There will be little need for a Moldovan military after reintegration as the OSCE and its member states are expected to ensure security. While a national army is not likely to disappear, a reintegrated military is likely to be smaller than the sum of the current levels on both sides. There may be considerable difficulty integrating the command structure and some costs associated with downsizing for severance pay and retraining of personnel for civilian jobs.

In the areas of social services and civil society, the health systems may be the easiest to reintegrate. There is already some cooperation between the two sides and there is room and willingness for more. Since health systems are often managed at the sub-national level, reintegration is not seen as a threat to either side's jurisdiction, but rather a means to cooperate more in the specialty areas and disease prevention.

Social protection on both sides is significantly under funded and lacks proper coverage. It is difficult to see how reintegration will change the circumstances in this area as undoubtedly there will continue to be "more pressing" problems that will capture public expenditures. There will, however, be a clear resource need, should pensions be harmonized across the territory, and there will be a need to compensate low income Transnistrians who will likely lose the subsidy hidden in the administered price structure.

Education will likely be a contentious area to reintegrate since an important element of schooling is to instill cultural values and national identity. The principal problem is the use of Cyrillic script for the Moldovan language in Transnistria. There are additional problems associated with nationalistic teaching materials which attempt to foster a separatist attitude in Transnistrian youth. However, the very sensitive language problem can be deferred until after political reintegration since the spoken language is the same throughout the ethnic Moldovan community. The Latin script could be taught to those who need to continue their education in the ROM.

At the higher education level, there are opportunities for greater cooperation and accreditation of degrees and certificates.

With respect to the economy at large, the most important outcome of reintegration will be an improved investment climate as the threat of social instability is reduced. There would be a renewed capacity to extend privatization to Transnistria. Not only will this be likely to produce needed revenues, but also it is essential for the promotion of greater efficiency in the use of resources.

The full costs of reintegration cannot be established at this time. There are too many unknowns since negotiations have just started. Further, as in the case of German unification, many of the costs did not appear immediately. For example, the continued high level of unemployment in the former East Germany was unforeseen and continues to burden the welfare system. However, it is fairly clear that some concessionality will have to be obtained to reduce the Transnistrian debt. Also, donors may wish to add resources to ongoing development programs in order to include Transnistria. Also, in a peaceful and open domestic society, there will be ample opportunities to initiate social service and civil society programs with NGO's. Finally, Moldova is a relatively poor country. While a number of the costs which specifically relate to the reintegration process or are essential to implement an agreement could be handled by domestic resources, donor assistance could be a useful addition to Moldova's limited resources. The provision of financial support to assist this process would appear far smaller than the cost to the donor countries if the status quo were maintained.

On the benefits side, the most important is the resolution of a conflict that has cost both sides dearly in terms of lost lives, lost opportunities and lost growth.

MOLDOVA AND TRANSNISTRIA REINTEGRATION STUDY

I. INTRODUCTION

A. PURPOSE OF THE STUDY

This study will identify issues, costs and benefits associated with the proposed reintegration of Moldova and Transnistria within a federal structure, as outlined in the Kyiv Agreement. In addition, the evaluation will identify the relative importance of major aspects of reintegration. Importance, in the context of this evaluation, relates to topics, functions and responsibilities which may be contentious or costly to resolve in the effort to form a mutually agreed upon federal structure. Finally, the study will also suggest policy recommendations which may be of assistance to the Government of Moldova (ROM) in dealing with the issues of reintegration.

B. METHODOLOGY

The study has been conducted in two stages. First, a review of the literature related to the integration of ethnic and linguistic minorities in a number of case study countries was undertaken in Washington D.C. The case study countries were Estonia, Latvia, Bulgaria and Macedonia. A review of the literature on the reunification of Germany was also undertaken with a focus on the economic and financial costs. A report entitled "Moldova Bibliography" was submitted to USAID on July 1, 2003.

The second stage was field research in Moldova and Transnistria from July 5 through July 25, 2003. For our team of four specialists, this involved interviews with a wide variety of officials from both sides, other local experts in academia and the private sector, representatives of international organizations, U.S. government officials and relevant U.S.A.I.D. technical assistance contractor personnel. In addition, locally published and unpublished materials including economic and social statistics were gathered and analyzed.

This final report primarily reflects the information gathered during the second stage of the evaluation, but conclusions concerning the relative importance of issues and suggestions related to policy also have been influenced by the results of the stage one literature search.

In this report, the Government of Moldova refers to the national governmental units located in Chisinau. For simplicity, this report uses the initials for its official name, i.e., ROM – The Republic of Moldova. The area east of the Dniester River and the "authorities" located in Tiraspol are referred to as Transnistria. In reviewing data produced by the ROM, it is often not clear if it contains or excludes Transnistria.

II. BACKGROUND

The history of the region as well as the political, economic and cultural forces responsible for the present division between Moldova and Transnistria are comprehensively discussed in Charles King's book entitled *The Moldovan's: Romania, Russia, and the Politics of Culture*, (Hoover Institution Press, 1999). King and other observers feel that the problem reflects Moldova's

historic position as a boundary state between the Western “Latin” culture and the Slavic Russian culture. Cultural and linguistic differences have been compounded by the purposeful differential industrial development of the two parts of the country during the Soviet period. Moldova, west of the Dniester River, is largely agricultural and dominated by a Romania oriented population. Transnistria, on the east side of the Dniester, was the site of the main Soviet industrialization in the Moldovan Soviet Socialist Republic and is dominated by a Russian elite who rose to power through Soviet institutions.

Transnistria declared its independence from Moldova even before Moldova finalized its separation from the Soviet Union on August 27, 1991. During this period, Transnistria, with the help of Russian troops in the area, began building its institutions of state and asserting control over its territory. Moldovan efforts to suppress this independence movement led to armed conflict in 1992 with more than 1,000 casualties on both sides. A cease-fire was reached in mid-1992 and, subsequently, efforts have been made to find a political solution acceptable to both sides. These efforts involve Russia, Ukraine, Moldova, Transnistria and the Organization for Security and Cooperation in Europe (OSCE). No country has recognized Transnistria’s independence.

During the mid-1990’s, little substantive progress was made. Transnistria continued its claim to independence and introduced its own currency (Transnistrian ruble) in 1994. Its language is principally Russian, but Ukrainian and Moldovan (written in the Cyrillic script) are also used for official purposes. The use of the Cyrillic script represented a significant affront to the Moldovan side since the adoption of the Latin script for the language was an important element of the country’s secession from the Soviet Union.

In 1996, as a confidence building measure, Moldova agreed to joint customs inspection with Transnistria, the granting of Transnistrian companies the right to use Moldova’s customs stamp, and the duty free passage of goods through Moldova to Transnistria. This agreement, however, likely prolonged the dispute since it conveyed a degree of recognition of Transnistria’s sovereignty and permitted Transnistria’s economy to obtain resources through trade.

The current effort to reintegrate the country began in May 1997. In a memorandum, both sides agreed that future negotiations would proceed on the basis of a “common state”. However, disagreement arose over the definition of a “common state”. Moldova understood it to mean that Transnistria would have some degree of autonomy under the current Moldovan governmental structure. Transnistria understood it to mean that a new, higher level federal government needed to be constructed.

Again, there was little visible progress until July 2002. As a result of discussions in Kyiv, a statement agreed to by all parties reiterated the principles of a common border, a common economic space and the mutual development of a federal system of government. In addition, international guarantees were to be provided to ensure the interests of both sides.

III. STATUS OF NEGOTIATIONS TOWARD A FEDERAL STRUCTURE

The dialogue and eventual negotiation of the terms of reintegration is taking place under the auspices of the OSCE. With offices in both parts of the country, the OSCE acts as a facilitator and provides a “neutral” location and a degree of confidentiality for the talks.

The President of Moldova and the “President” of Transnistria have not had face-to-face discussions since the Kyiv meetings. At present, the ROM is represented by the Minister for Reintegration. The Ministry is organizing small teams of appropriate government personnel relevant to each of the topics under discussion. (There are committees formed to work on the constitutional issues, currency unification, banking, pension, and tax systems). The Transnistrian side is led by its “Foreign Minister”.

From conversations with both sides, we believe the talks must be characterized as “introductory”. Teams have met and topics have been discussed, but no specific proposals have been formally put forth. In fact, there does not appear to be much agreement on the full contents of the agenda or the order of importance of issues. Moldova envisions what has been termed an “asymmetric” federal system. The federal level would have responsibility for all functions on the western side of the Dniester River (except for those authorities given to the autonomous region of Gagauzia), while some discretionary authority in a limited number of areas would be given to Transnistria. Transnistria envisions a “contractual” relationship between two equally empowered states with minimum responsibilities passed to the federal level. These differing ideas of the desired outcome are evident in the different approaches each side is beginning to formulate for the impending discussions. The Moldova side appears more focused on a series of stand-alone agreements covering specific issues or responsibilities. The Transnistrian side describes the need simultaneously to prepare a range of documents, which, in essence, constitutionalizes all of the details of reintegration, prior to their implementation. The ROM feels strongly that customs, central banking and social insurance must be central functions. Transnistria does not seem prepared to stipulate up front that any particular function must be centralized.

Planned Moldova Initiatives

The Ministry of Reintegration sees the future as a step-by-step process which ultimately provides for a new constitution, economic reintegration and external guarantees of security. It is preparing to initiate discussions on the unification of the currencies followed by unification of taxes and budgets. It will look for opportunities to carry out projects to reintegrate electricity, transportation infrastructure and industry. It will start looking for resources to finance the merger of pension funds and welfare systems and it will initiate NGO activities to get more popular participation in the process. In addition, it will continue to press for the further withdrawal of Russian troops and the demilitarization of the area in association with appropriate security guarantees.

The Ministry envisions currency unification as an early topic of negotiation and is prepared to agree to a period in which the two currencies are legal tender in Transnistria. This would be followed by a phase out of the Transnistrian Ruble and the unification of the currency management function in one central bank.

Transnistria Stance

The Transnistrian authorities appear to place a higher priority on reaching agreement on a new constitution compared to agreements on specific economic reintegration topics. In addition, they see less need to reintegrate in areas such as taxation, budgeting and customs as they describe their future to be an economic free zone. In the economic sphere, their most pressing interest is

to overturn a number of recent Moldovan and foreign actions that have seriously affected their economy.

Recent Moldovan and Foreign Actions

The ROM has taken a number of recent actions that partially extends its economic authority over Transnistria. Specifically, the 1996 agreement permitting Transnistrian companies to use Moldova's customs stamp has been withdrawn and an understanding was reached with Ukraine to stop goods from Transnistria entering its territory that do not have the official Moldovan customs stamp. This measure has had a significant adverse effect on Transnistrian exports and its economy at large. Furthermore, the ROM has informed Transnistrian companies that they must register with the Moldovan registry of companies in order to be able to use the new Moldovan export stamp. The ROM has stated that these measures are necessary as part of Moldova's responsibilities to comply with WTO requirements.

It is understood in Transnistria that starting in 2004, Transnistrian companies that register in Chisinau will be liable for ROM taxes. There appears to be some confusion over exactly what the tax liability will be. Some felt it was to be only the 0.18% levy on the value of the exports for the customs stamp. But most Transnistrian officials argued it meant the imposition of the ROM's VAT on Transnistrian companies. In either circumstance, the requirement was viewed as an attack on Transnistria's sovereignty. It has also introduced considerable uncertainty in the business community because the productive industries in Transnistria must export to both the ROM and other countries to survive.

A second significant action was the declaration by the ROM that Transnistria's privatization program was illegal. The ROM claims that it is the rightful owner of all state properties in accordance with the agreement that dissolved the Soviet Union. Transnistria, as an unrecognized and illegal entity, is not the legal owner of the public sector companies and land located in Transnistria. This measure has essentially stopped Transnistria's newly initiated privatization program and deprived the Transnistrian authorities of an anticipated important source of revenue.

In addition to the ROM actions, two international problems have affected Transnistria. One is the finding that Transnistria's large steel exporter violated U.S. anti-dumping laws and its products are now subject to a quota and a surcharge, which makes them less competitive in the important U.S. market. The second is a ban on travel to the U.S. and EU countries for senior Transnistrian authorities. This action has limited their ability to conduct business and lobby for their cause.

IV. SECTORAL/FUNCTIONAL AREAS TO BE CONSIDERED FOR REINTEGRATION

A. FISCAL AND MONETARY ISSUES

In assessing fiscal and monetary issues, it needs to be recognized that gaining accurate and comparable information on the ROM and Transnistria is difficult. However, for the purposes of considering reintegration issues, the information available appears sufficient to outline a useful analysis and commentary.

1. Identification and Consolidation of Sovereign Debt

The identification and consolidation of the sovereign debt of the ROM and Transnistria is one of the most significant economic issues facing the reintegration effort. This is a function of the absolute size of the debts involved, disparate views on what constitutes “sovereign” debt and arguments over the responsibilities of those who “benefited” to pay for their share.

The official sovereign debt of the ROM is set at over \$1.3 billion; total external ROM debt aggregates to just over \$1.6 billion when debts for energy resources are included. The official ROM debt is split mainly among debt to the IMF and international financial institutions, bilateral credits and other private entities including direct debt to Gazprom (the Russian company supplying natural gas), which is just over \$100 million. Tranches of this debt have been subject to rescheduling, particularly the commercial Eurodollar debt acquired in mid-1990s. ROM sovereign debt accounts have been carefully reviewed by international financial institutions and are accepted as accurate and real obligations of the ROM. The additional energy related external debt aggregates to just over \$300 million, split between Moldovagaz debts, principally to Gazprom, and debt for electricity to Ukraine.

The “sovereign debt” of Transnistria is estimated to be at \$1.2 billion, nearly all of which is due Gazprom based on the unpaid actual amounts and penalties accumulated to Gazprom across the last decade. The majority of the Transnistrian Gazprom debt appears to be penalties of over \$600 million on actual amounts of nearly \$500 million not paid by Transnistrian authorities. Transnistrian debt includes, in addition, state owned enterprise debt of over \$100 million and various other credits due Russia of under \$50 million. To include any of this debt in a consolidated sovereign debt account, the ROM would have to agree that an “illegal” and “non-sovereign” entity could legitimately accumulate sovereign debt. If this is stipulated in order to achieve reintegration, then a careful review of the components of the debt should be undertaken. Since Transnistrian “sovereign debt” accounts have not been reviewed by parties independent of the Transnistrian authorities, the legitimacy of any Transnistrian sovereign debt can be seriously queried. In particular, it is not clear what has been accrued by private users and state owned enterprises affiliated directly or indirectly with Transnistrian governmental structures, some of whom appear to have profited from the reduced payments or non-payments to Gazprom.

On a per capita basis, the current identified Transnistrian external debt exceeds the ROM external debt by nearly 400% and would therefore substantially increase the average debt burden on Moldovans who live on the Right Bank if it were to be assumed in reintegration. Currently, the Right Bank Moldovans face a \$533 per capita debt. The inclusion of Transnistria’s debt as now stated would increase this burden to almost \$800 per capita.

Transnistrian authorities make an effort to point out that the international institutional debt of the ROM has not benefited Transnistria and should not be assumed by Transnistria in any reintegration. However, debt related to transportation infrastructure improvements (roadways, Chisinau airport) certainly benefited Transnistria, as a percentage of Transnistria’s commerce transits through the Right Bank. Other benefits to the ROM will also benefit Transnistria, however indirectly, and the structural improvements including substantial legal frameworks allowing the ROM to take a respected position in the international community will also benefit Transnistria in any reintegration.

The Transnistrian authorities raise a number of issues with regard to Transnistrian debt. First, they point out that a considerable amount of the power consumed in Transnistria has been consumed by the Russian troops stationed in Transnistria. In addition, they feel Russia should make some payments for troop presence and the armaments that have been stored on Transnistrian soil. These amounts were not quantified, although a recent credit of \$100 million has been discussed and attributed by some to Russian military presence across the period. In addition, Transnistrian authorities point to agreements with Russia to forgive penalties on the debt, and reduce the debt based on the return to Russia of armaments under the OSCE accords. Indeed, Transnistrian authorities estimate the value of armaments in Transnistria at as high as \$4 billion. Based on accords where armaments left in the former states of the Soviet Union became the property of these states, Transnistrian authorities claim this value. If acknowledged, however, it seems appropriate that the value of this property should be shared on an agreed basis with the ROM in any reintegration.

It is significant that the Transnistrian debt derives largely from energy and is nearly all directly related to Russia, particularly as the real independence of Gazprom from Russian government influence has not yet been adequately established. Thus, Transnistrian debt is not viewed as free of political considerations arising from the unofficial support of the Russian government for the Transnistrian authorities.

Lastly, related third party privatizations should be considered in the determination and settlement of Transnistrian debts. During selected periods since 1992, up to 50% of the power supplied to Transnistria has been used by the Rybnitsa steel works which has supplied steel at favorable prices to purchasers based largely on the low cost of the power used by the steel works. Since the purchase of a controlling interest in the Rybnitsa plant by Itera (an energy brokerage firm), Transnistrian authorities indicated that power supplied to Rybnitsa has been generated from supplies of fuel gas provided by Itera. It is not clear how power was supplied to Rybnitsa and paid for prior to the Itera privatization. It is likely that additional amounts of power have been similarly “supplied” to state owned enterprises (SOEs) in Transnistria and not paid for although profits were made from the goods which were sold. Again, this points to the need to undertake an audit of the supply to and payment for power in Transnistria in order to evaluate the public vs. private nature of the Gazprom and other energy related debts.

Costs and Benefits: The cost of reintegrating sovereign debt could be as high as the Transnistrian debt of \$1.2 billion. When combined with the known sovereign debt of the ROM, there would be no capability in the foreseeable future to service this level of debt. Given the known but complex relationships between Gazprom, Itera, the Russian government and the Transnistrian authorities (which admittedly have shifted across time) any Transnistrian “sovereign debt” is certainly reasonably queried as to its amount and should not be assumed by the Transnistrian people and certainly not by the people of a reintegrated ROM without careful study. It seems that a negotiation among the Russian government, the Transnistrian government, Gazprom and Itera should be engaged in to minimize any “sovereign debt” to be assumed in a reintegrated ROM. If 85% of such current estimated debt were abated, the resulting per capita Transnistrian “sovereign debt” would approximate the current per capita ROM external debt, resulting in a per capita external debt burden that would be neutral in any reintegration. The resolution of the sovereign debt issue would clearly benefit the country in term of improving one of the essential measures for determining Moldova’s creditworthiness.

Conclusion: An audit should be carried out and a reduction of the Transnistrian “sovereign debt” needs to be negotiated among the Russian government, the Transnistrian government, Gazprom and Itera to reflect a settlement of this debt and the non-transparent economic activities of the past decade. The target of these negotiations should be set to create a debt burden on the Transnistrian population that would not negatively impact the per capita debt burden of any reintegrated ROM population.

2. *Currency Unification, Exchange Rate and Monetary Policy*

One of the first initiatives being proposed by the ROM in their reintegration efforts is a process designed to create currency unification across the next two to three years.

The current ROM approach is to negotiate an official acceptance of the Moldovan lei in Transnistria across a transition period during which Moldovan lei and Transnistrian rubles will circulate together in a dual currency regime. Currently, Moldovan lei unofficially circulate in Transnistria, and are more widely used in some parts of Transnistria (for example, Rybnitsa) than others. The ROM approach would allow the Moldovan lei to become a second official medium of payment in Transnistria but would not create a dual currency regime in the Right Bank ROM. This approach envisions having the National Bank of Moldova become the single central bank upon currency unification.

The approach of the Transnistrian authorities is very different. They fully expect to retain their independent currency and separate central bank structure implying their acceptance of a continuing responsibility to defend the Transnistrian ruble. However, the history to date indicates that the Transnistrian efforts to create monetary independence have not been successful and have worked very much to the detriment of the Transnistrian population. The Transnistrian ruble has suffered a much more substantial devaluation across time than the Moldovan lei. It has not been recognized as a real currency by any country, including the ROM. It is not used as a safe store of value by large segments of the Transnistrian population, as is made clear by the desire of the population for and acceptance of dollars and lei, and other currencies.

The current exchange rate (2 Moldovan: 1 Transnistrian Ruble) is an administered rate. It can be maintained in the short run because there appears to be little reason for people on either side of the boundary to buy each other’s currency as a store of value. Those holding significant monetary assets recognize that both currencies are relatively weak and they prefer to hold U.S. dollars, euros, Russian rubles or gryvna.

The rate does not reflect purchasing power parity between the two sides. Relative price levels for similar goods and services between Chisinau and Transnistria indicate that price levels in Transnistria are much lower, mainly as a result of hold-over Soviet policies to provide subsidies through administered prices in order to keep wage rates low. This may partly explain the to date not well-controlled transit of cigarettes, alcohol and other goods from Transnistria to the Right Bank.

The management of a dual currency regime is a very difficult undertaking if there is a desire to ensure that no one should suffer a severe loss due to the failure to keep the currencies in line. In the case of gold versus silver in the 19th century U.S. and the Dmark versus the Oste mark in German reunification, experience indicates that a weak currency quickly gets pushed aside by a

strong currency and, in an open market, the last sellers of the weak currency suffer a significant loss of monetary assets. To maintain the monetary assets of those who now hold Transnistrian rubles, there has to be a one-off conversion to lei with the Transnistrian ruble ceasing to be legal tender at the end of a specific conversion period. Alternatively, the Central Bank of Transnistria must be strong enough to maintain the Transnistrian ruble exchange rate through periods of widespread efforts by Transnistrians to shift to lei. In this regard, there is every reason to believe that the Central Bank of Transnistria is financially incapable of defending the Transnistrian ruble.

It should be noted that if a fixed exchange rate is agreed to for the period of dual currencies, the ROM could import a significant inflation if the authorities in Transnistria utilize Transnistrian central bank credits to finance their budget deficits. Consequently, if both the lei and the value of monetary assets denominated in Transnistrian rubles are to be maintained, the management of the Transnistrian ruble must be shifted to the central bank of the ROM, thus denying central bank credits for the finance of Transnistria's budget deficit.

Costs and Benefits: The implementation costs of currency unification could be minimal, if the process is carried out as the ROM envisions. The requirements are largely reaching a negotiated consensus and the implementation of the requisite conforming laws and regulations. Printing and distribution of additional currency should not be a material cost, as existing banking and postal facilities could be used in Transnistria. However, if the process moved quickly, there could be inflationary pressure on the lei as a result of monetary expansion, particularly if an unrealistic exchange rate was selected for the currency exchange. This could be managed with an appropriate monetary policy with minimum consequences on Moldova's investment environment and growth.

Currency unification as envisioned by the ROM will have far reaching consequences for the Transnistrian economy. In the first instance, it will limit Transnistria's ability to finance its budget. The authorities will then face the choice of increasing taxes or cutting programs. In most cases, the urgency for solving a budget problem requires immediate actions, which are primarily on the expenditure side. Investments get postponed and welfare/social services programs get their funding cut. In the case of Transnistria, the likely scenario is that the authorities will be unable to maintain a number of subsidies provided through the administered pricing structure. Furthermore, state owned companies that are kept operational through subsidies may no longer be affordable. In both cases, the average Transnistrian citizen will suffer a decline in income or purchasing power. The extent of the decline is not clear at this time and will depend on developments in other aspects of the reintegration process.

The benefits are that the Transnistrian population would no longer be forced to use a currency with no acceptance outside their region. They would benefit by using a currency which was a more meaningful store of value. The elimination of a symbol of Transnistria's sovereignty would also be a benefit. If Transnistria actually agrees to a single currency, this would signal a willingness to agree to a fairly comprehensive reintegration. However the most important benefit from an unified currency is the introduction of "reality" economics to a regime that has lived for the past 12 years in the unsustainable fantasy of Soviet economics.

Conclusion: The ROM should continue its efforts to unify the currencies. The reasonableness of the current exchange rate needs to be determined and an agreement reached on an exchange

rate to be used for conversion. Quotes should be obtained for printing currency required for conversion and a timetable set for conversion to be implemented through postal, banking and/or other Transnistrian institutions which will facilitate rapid and easy conversion by the Transnistrian population.

3. Customs Unification

Customs unification is another early initiative of the ROM designed to create a common economic space.

Currently, the ROM has reclaimed its sole rights to provide Moldova customs stamps. It has also prevailed upon Ukraine to begin better enforcement of customs procedures along the Moldova / Transnistria / Ukraine borders.

Customs unification is important for the ROM, particularly in light of the history of trading activities within and without Moldova which has created a poor reputation for the ROM, based both on Transnistrian activities and activities involving trading between Transnistria and the ROM. Until the ROM is viewed by the international community as fully complying with accepted customs requirements it will be difficult to encourage trading and investment activities from all potential participants.

An inevitable issue attached to the ROM's efforts to regain control over customs across the region is the requirement that Transnistrian companies register with the ROM and for goods shipped into the Right Bank, pay the ROM VAT tax. This disadvantages Transnistrian companies from a competitive point of view, as the Transnistrian turnover tax is not refunded for exports. Thus, these companies would effectively be double taxed. Clearly some reconciliation of taxation between the ROM and Transnistria is required in concert with customs reform and enforcement (see Tax Assessment and Collection, below).

Customs revenues and the VAT on imports finance more than 50% of the ROM budget. (In the ROM, the main source of revenue is the VAT. The VAT paid on imports is not, strictly speaking, a customs duty.) In Transnistria customs revenue finance about 10% of the budget and there is no VAT on imports. This low reliance on customs revenue reflects the authority's desire to make Transnistria a "free-zone." Whether total customs revenues increase or not with a unified structure, it is clear that some provision for sharing of customs revenues would be appropriate in any reintegrated ROM.

Costs and Benefits: The additional costs associated with customs enforcement should be small, as both the ROM and Transnistria have customs procedures and enforcement capabilities in place now. In addition, the ROM's recent agreement to pre-shipment customs clearance would apply to imports to the Transnistrian side and eases the unification burden. It is cooperation that is required. It is likely that some smuggled goods, often characterized as transit goods, will no longer flow to Transnistria and the ROM when the customs union is achieved. However, this trade has not been benefiting either the ROM or Transnistrian authorities (directly), or their respective general populations. Creating a common state operating within international rule of law procedures should create benefits for the ROM and both the Right Bank and Transnistrian populations. The short term profits which will disappear when illicit trading activities are ended have not been very beneficial to the general welfare.

Conclusion: The ROM should continue its program of regaining control over the country's customs borders, and continue its efforts to gain the needed cooperation of the Ukrainian authorities. The ROM should study and outline a proposal to conform the ROM VAT and Transnistrian turnover tax, perhaps considering a phasing in of collection of the ROM VAT tax as the Transnistrian turnover tax is reformed (see Tax Assessment and Collection, below).

4. Banking

The question of currency unification can be separated to some extent from banking issues. If currency unification were achieved, a single central bank approach is the only sensible one, at least as it relates to monetary supervision and policy. This would not preclude Transnistrian participation in the ROM central bank, and such participation could be agreed appropriate in any federal structure for reintegration. With regard to bank supervision, it is possible to conceive of some independence, even a branch of the ROM central bank being established in Transnistria as has been done previously. However, the practical purpose of any independence in a single currency regime is not clear. Prudent capitalization levels, reserve levels, bad debt supervision and other banking regulation practices should not diverge markedly under prudent governance, and if they did it would be disruptive for the development of a fairly competitive financial services sector.

Currently, the Central Bank of the ROM does not recognize Transnistrian banks because it has no ability to supervise them. However, this should not preclude the establishment of correspondence relationships which are not now occurring. However, if there is full integration of the banking system, there will probably be a difficulty in certifying Transnistrian banks. Most of these were founded as deposit windows of public sector companies since, with the collapse of the Soviet Union, their normal sources of capital disappeared. The record in Russia and Poland and elsewhere in the former communist states is that these banks are grossly undercapitalized and have a very risky loan portfolio. Despite the claim of the Transnistrian Central Bank that these banks meet Basle standards, it is quite likely that a truly independent assessment would find them bankrupt. If this is the case, there will be costs associated with the current deposit insurance commitment of the Transnistrian authorities. The ROM would find it politically difficult to not honor the deposit insurance commitment. The recapitalization of Transnistrian banks could become a very significant reintegration cost.

Costs and Benefits: The costs of fully bringing Transnistria's banks under the oversight of the federal level central bank relate to the audit and inspection of these banks and the commitment to honor the deposit insurance liability. Absent some compromise in the differing approaches of both sides, the financial reintegration of the two economic regions will be minimal and will provide minimal benefits to the economies of both sides. Just as any real political and economic reintegration in Moldova requires currency unification, the banking sector needs to be fundamentally congruent at least in its oversight regulations. If this is done, depositors' security will be enhanced and the costs of financial services between the two sides will be reduced.

Conclusion: An independent audit of Transnistria's banks need to be conducted and in light of its findings, determine the deposit insurance liability of a reintegrated banking system.

5. Fiscal Policy and Management

Fiscal policy management appears to offer the opportunity for as much flexibility as may be required to accommodate the political arrangements ultimately agreed to in any ROM reintegration.

Nevertheless, there are several issues to be considered with respect to fiscal policy. First is the critical need to put subsidies on-budget and target them to the intended recipients. While this is most important in Transnistria, the ROM also maintains hidden and poorly targeted subsidies. The amount of hidden subsidy on the ROM side has likely been well studied by the IMF. However, the administered pricing system and managed wage policy of Transnistria make estimation of the actual level of subsidy difficult to calculate for the conditions that will prevail in a more market based economy. Thus, if an economic objective of reintegration is to not adversely affect one population or the other, the required level of on-budget subsidy needed by Transnistria in order to maintain living standards should be known and included as a cost of reintegration. This cost could be large. For example, a \$10 per month increase in wages to the bottom 30% of the Transnistrian work force would require \$12 million plus per year.

The second issue is the incidence and allocation of the tax base. A general rule of fiscal policy is that taxpayers should see an understandable relationship between the taxes they pay and the services they received. Often this results in “earmarked” taxation such as taxes on gasoline for road construction. However, difficulties often arise when the “service” received by a taxpayer is a transfer payment to a welfare recipient or a transfer payment to a relatively poorer local jurisdiction. In Moldova, including Transnistria, there doesn’t appear to be taxpayer resistance to welfare transfers to widows, orphans, the disabled and other needy individuals, although these services are under funded for other reasons. However, there is strong concern in Transnistria that reintegration will result in transfers of tax revenue from their side to the ROM side. Unlike the advanced developed countries where intergovernmental transfers are a well established policy, Transnistria, and probably Moldova, have not fully embraced this concept as a social good.

At this stage, it is not entirely clear that with the VAT and Transnistria’s budgetary needs including on-budget subsidies, Transnistria’s tax base would produce a surplus which could be shared with the Right Bank. However, to achieve reintegration, it may be prudent for the ROM to agree that such transfers would not occur until some period has elapsed after political reintegration.

A third issue is the structure of intergovernmental fiscal relations among the levels of government. If Moldova is to be truly reintegrated, the federal level must have tax authority independent from the politics of each of the states. That is, the budget of the federal level must not depend on contributions from each of the “states”. Such an arrangement subordinates the federal level to the willingness of one side or the other to make its contribution. Such an arrangement enhances the separate sovereignty of each of the states.

Reintegration negotiations need to identify receipts and expenditures best administered at a federal level versus those at a local level. There are three tiers for fiscal policy consideration between the ROM and Transnistrian authorities: i) the activities that would be managed at a “federal” level; ii) the activities that would be managed at a Right Bank ROM government level and a Transnistrian government level; and iii) the activities that would be managed at a local

level in both the Right Bank ROM and in Transnistria. As examples from the discussion above, a “federal” activity clearly might be funding the National Bank of Moldova, a non-local activity handled by the two regions centrally might be future pensions, and a wholly local level activity might be funding local schools.

Conclusion: From a political point of view, it is essential for “federal” activities to be funded by federal level taxes and revenue. This may be handled by the earmarking of customs revenues to the federal level. If these funds insufficient, a percent of another nationally levied tax could be added. Non-federal and local programs in the immediate future would then be handled by the revenue bases in their respective regions. At some point after reintegration the concept of fiscal federalism should be established to avoid perpetuating material differences which might lead to significant resource shifts and/or population movements responding to differing education, pension, health and welfare regimes, among others.

6. Tax Assessment and Collection

An important consideration in every aspect of reintegration is the degree of difference between the two sides that is permitted by the agreement. In this regard, reintegration should ultimately create sufficiently comparable conditions on the Right and Left Banks so as to avoid a migration of population based solely on political governance decisions, or substantially different investment environments.

One of the most important and obvious areas to avoid substantial differences is in tax assessment and collection. Thus substantially different income taxes would likely lead to population migration. Currently, for example, the ROM’s determination to collect the VAT on Transnistrian goods will result in double taxation of such goods, as they will have already been subjected to Transnistrian turnover tax. This will clearly disadvantage Transnistrian companies competing in the Right Bank ROM. However, any refund of the Transnistrian turnover tax will deprive Transnistria of needed tax revenues. Clearly a compatible tax regime is needed.

The VAT and the turnover tax are the most important source of revenue for their respective governments. But the two can not exist side by side unless the Dneister becomes a permanent tax boarder. Reconciliation of the two structures would argue for the adoption of the VAT.

The VAT taxes only “value added” which encompasses just new value added by the firm working on the goods, whereas the turnover tax is a levy on all of the value of the goods when they change hands. This leads to “successive taxation” on the same value created early in the production chain, a non-neutral tax burden that tends to discriminate against multiple producers working in a supply chain to produce goods as opposed to a single manufacturer. This is a disincentive to the growth of smaller, more specialized manufacturers, and often frustrates the development of “just in time” manufacturing relationships and inventory management. The Transnistrian turnover tax is 5% as opposed to the ROM 20% VAT. It is likely but not certain that Transnistrian tax revenues would increase with a VAT similar to the ROM, and it would eliminate the double taxation of Transnistrian goods.

Costs and Benefits: The benefits of creating a unified market that can trade freely with tax fairness is clear as the larger economy should benefit its participants quickly. The relative costs of aligning the tax systems, should not be significant. However the hidden subsidies resulting

from Transnistria's non-payment of its Gazprom bill as well as the poor financial condition of many of its government provided services indicates that there is a substantially higher need for revenues than the Transnistrian authorities now collect. The introduction of the VAT in Transnistria would be seen by its residents as a significant increase in their tax burden. This would be true. Not only is the rate higher than the turnover tax rate but since the turnover tax is paid on exports a good share of Transnistria's earnings from this tax is paid by off-shore buyers. The shift to a VAT in Transnistria will likely more than triple the tax burden for consumers in that area.

Conclusion: The ROM and Transnistrian authorities should work to align the differing VAT and turnover tax regimes as soon as possible, with Transnistria adopting the VAT as the economically better and more accepted of the two. The VAT then arising in Transnistria could be budgeted for Transnistrian needs based on the sharing arrangements agreed in the "federal" discussions regarding fiscal policy.

B. GOVERNMENT AND JUDICIAL STRUCTURES/FUNCTION

1. Government, Central and Local

With no agreements made on the form and functions of the proposed federal government, nothing of substance can be said at this time with respect to the cost of its establishment and maintenance. But if a separate federal government were established for a very limited number of reintegrated functions, the structures of the current governments would remain largely unchanged in order to manage their respective areas. One would assume that the ROM would lose to the federal level the foreign affairs portfolio, the central bank, customs, VAT assessment and collection, and defense. The Transnistrian side would similarly lose these functions and their related organizations. But under this arrangement, each side would have substantial latitude in determining its executive, legislative and judicial structures and the differences in structure, which now exist between the two sides, could continue into the future.

Under an asymmetrical federal structure, the presumption is that the federal functions would be taken over by organizations now within the ROM. The non-federal functions would be managed under existing arrangements. Notwithstanding the costs of reintegration discussed elsewhere in this paper, the budgetary impact of the new arrangements under this form of federalism would be small. The shifts in responsibilities and functions should largely net out.

On the local level, the relationship of these governments to their respective capitals should not be affected by the creation of the federal system. That is, there is no discussion at this time to involve local governments in the process of reintegration. Consequently, while the current reorganization of local governments on the Right Bank has been fairly described as a mess, it will remain this way until the ROM, as a state government, corrects the problem. The process of reintegration via a federal structure will not correct the problem.

The important issue of governance that relates to the reintegration effort is transparency on the Transnistrian side. Reintegration has been undertaken to improve domestic tranquility and create a more attractive and productive common economic space. But it is also necessary for Moldova to make progress on its desire to eventually join the EU. To join this broader community, Moldova will have to show that its governing bodies at all levels operate under the liberal

principles of respect and safeguards for human rights, free and fair elections, modalities for citizen recourse against government actions and a broad degree of governmental transparency in the formation and execution of laws. In this regard, while the visible structure of the Transnistrian government could satisfy minimum EU requirements, it is generally believed that the real governing structure in Transnistria is the less visible political party and its associates who may not have any formal position in the Transnistrian government. This situation will need to change if reintegration is seen as part of the process of joining the EU. The current process of reintegration may be too fragile to include this issue at this time, but it will need to be on the top of the post-reintegration agenda.

Conclusion: A cost analysis should be undertaken after the current negotiations have produced at least the broad outline of the structure and functions of the proposed federal arrangement.

2. *Judicial*

The legal system in Moldova is based partly on Romanian law, thus giving it some European, or Napoleonic, flavor. Transnistria's system has been lifted from Russian and Ukrainian law. Since independence, the Moldovans have made some progress in developing an independent judiciary. Transnistria, however, has not yet had an opportunity to be exposed to outside influences. While the court structures of both Moldova and Transnistria resemble each other to some degree, their jurisdictions are quite different.

In 1945, Moldova adopted the Soviet regime's pattern for the legal profession, with the advocate, judge and prosecutor making up an examining team. They were bound not to the client, but to a common good. The adversarial principle was introduced only in 1995. Since then, 7 new private law schools have been formed to supplement the Chisinau Law faculty and the government has formed a new institution of higher judicial education to keep an up-to-date library, to train judges and to examine parliamentary draft laws.

The treatment of proposed legislation is quite different in both systems. Moldovan law is passed by the Parliament and the President has veto powers, which can be overridden. However, the main source of legislation in Transnistria is the presidential decree. While a law may be proposed by any branch or level of government, and opinions may come from a number of sources, by the time the law arrives in the parliament (now a single chamber since reform) its basic function is to simply pass it.

Moldova's reforms have permitted voluntary organizations to be influential in the process. There is a Judges Association, a Collegium of Advocates who look at commercial and finance law, an Association of Women Judges, a Union of Notaries and a Young Lawyers Association among others. While the system is still centralized and hierarchical, it has made some progress, though there is still some distance to go before it can be considered independent and transparent.

Transnistria's Minister of Justice stated that they were attempting reforms now, and wanted to have their system more closely resemble that in the US. They have begun work on a computerized system of registry for licenses, property, and business, and to facilitate a better system of civil registry. Their legal education and training, however, is still dependent on Russia for texts and teachers. Reform for the court system has only just begun, the prison system remains still to be put on the reform agenda, partly because it and the police are directly under

the control of the Ministry of Justice, whose staff appear overtaxed by the number of tasks they have been delegated.

Conclusions: For integration purposes, separate laws and civil court systems are not a problem on a local level. Transnistria could continue to work as it has with local jurisdictions for municipalities and for its 7 rayons. Moldova could maintain its district courts and rayon courts of appeal, as well as its system of traveling lawyers. Separate prisons could also be maintained, but some form of extradition needs to be agreed upon for what will be determined to be federal crimes. While legal training may remain separate, some form of bar examination or licensing system needs to be put in place to determine the jurisdictional competence for practicing law in Moldova and Transnistria. Once licensing is in place, the burden on Moldova's legal system would be lighter, if both the Russian and Moldovan language were given equal status in the judicial system for use in the courts and in official documents.

Commercial and trade law and legislation, however, must have a basis that is accepted by both parties. Human rights must also be common to the entire country. These are subjects that need to be governed by one constitution and consistency will be required for entry to the WTO and the EU. While it may be costly for business to maintain dual language documentation, it is certainly less expensive than having them try to maneuver between two separate sets of commercial laws.

The constitutional debate between the two sides is likely to be a more lengthy process than what has been predicted, given the very different perceptions and goals that are presently held on both sides of the river. However, if both parties understand that any future social and economic space for their development is dependent on that constitution, perhaps, at least a place to start the debate can be agreed upon.

3. *Military/Security/Police*

Currently the two sides have similarly sized formal military forces of approximately 5000 persons each. Within Transnistria, according to the OSCE, as of January 2003, there were only 1,288 Russian troops left of the 10,000 that were in Transnistria during the conflict with Moldova in 1992. Under OSCE supervision, the Russian forces are being withdrawn and are expected to be out of Transnistria by the end of 2003, with the exception of 340 Russian peacekeepers. In both territories, it was suggested by the OSCE, that militia and internal security police are available to supplement the basic military if need arose.

The Istanbul Agreement of 1999 and the later Porto Ministerial Meeting dictated the timing of planned demilitarization of Transnistria. Most of the equipment for conventional forces has either been removed by the Russians or destroyed. The OSCE provides a fund to help with the expenses of transport along with other bi-lateral Embassies aiding in weapons and munitions destruction. A question of what to do with 42,000 to 50,000 small arms and light weapons remains to be solved.

The 340 Russian peacekeepers remaining to work together with Transnistrians and Moldovans at 15 border crossings and river bridges, meet regularly through a Joint Control Commission including 10 Ukrainian military observers. The future of the peacekeeping forces is under discussion and is a component of the OSCE framework for negotiations. The fundamental

proposal is that an International Peacekeeping force be established under OSCE supervision, with forces from Russia, Ukraine and Romania.

While demilitarization is very much a concern of the OSCE, the question of whether or not to have a unified military will need to be part of the negotiations. Given the history of conflict and tensions between the two territories, the maintenance of two armed forces would be both costly and imprudent, although a senior ROM official did not rule out this possibility.

In approaching the development of a unified military, a key question will be its potential role and its modernization. This will be a particularly significant question since it is unlikely that the re-integrated state will wish to devote substantial financial or other resources to the development of a large military. The OSCE, however, has suggested that the unified military could be contracted to the UN or NATO, just as Serbian forces are being proposed to assist in Iraq, or Ukrainians were used in the Balkans. The income derived from such action could be used to reequip the force.

At the structural level, a major problem will be to develop a unified command structure which is able to work together, and which is committed to overcoming past tensions and to instilling confidence within its hierarchy and in the population that its existence serves some useful purpose.

Brief mention should be made here that while municipal police may continue in separate systems, the two national police forces need a Federal structure as much as the military does. A Strategic Task Force could be used to bring them together. Such a force will need extensive training, which could be supported by the international community.

A plan for demobilization will be desirable and necessary as a combined force of 10,000 troops is likely to be in excess of what could be supported by a reintegrated state. Reducing the number of military personnel from both sides will require retraining and the possibility of employment for the released personnel. Pensions and other social services will be required for those who retire. To be avoided at all costs is a large unemployed and unattached former military presence.

Associated with demobilization will be the need to provide training to enable military personnel to obtain employment or to establish businesses. Assuming that half of the military personnel who are demobilized, perhaps about 2500 individuals, would be eligible for and wish to receive training, at an estimated \$1000-\$2000 per person, the total could be anywhere from \$2,500,000 - \$5,000,000. In addition to this, credit should be arranged to permit the establishment of new businesses. Retraining and small business support, are excellent tasks for local NGOs, perhaps with help from international donors who have had experience in the field.

Regardless of whether the demobilized population intends to start businesses, or be retrained in some other profession, demobilization will certainly increase the civilian labor force, employed or unemployed. Without a massive retraining effort, the costs of unemployment benefits and an increase in the number of individuals utilizing but not contributing to social service would be costly in both the short and the long run.

A major cost will be that of providing military pensions for individuals from both sides. It is conceivable that the number of new pensioners could amount to half of the existing combined

military, about 5,000 people. Assuming a basic pension of approximately \$30/ month this would amount to \$150,000/ month or \$1,800,000/year. This figure does not include the value of subsidized housing, utilities, medical care and other entitlements and services that are typically provided to pensioners. It is not presently clear whether pensions paid by Russia for retired Russian military living in Transnistria will still come from Moscow or whether the burden of these pensions will fall on the reintegrated Moldovan government.

Conclusions: A starting place for reintegration could be confidence-building activities related to the military, encouraged by third parties and the international community. Foremost among these would be joint training exercises, voluntary transfers or exchanges from one army to the other on temporary or short-term basis.

C. SOCIAL SERVICES AND CIVIL SOCIETY

1. Health and Social Services

Moldova's Health System: Up until the May 2003 elections, the Central (or Republican) hospitals were run by the Ministry of Health, while the regional units were directed from the 11 local administrations of each district (judets). These latter managed the clinic and outpatient units situated in towns and villages.

With the reform begun in June 2003, the system is to be managed from the central Ministry. Rather than the 11 districts of the past, there are now 33 districts (raions), but the health system itself has been split into two units. One is the Republican system of 16 hospitals staffed with specialists, which serve the entire country (including critical cancer and cardiac patients from Transnistria). The other is the primary health care system based on the family doctor model. Each region will have a health center to link the family doctors at town and village levels to the Republican system, as well as to the emergency units and blood bank. The major difference after May 2003 is that the central Ministry now closely manages the entire system. Presently, space is left for local autonomy only through a lack of specific directions coming from the center.

The Health Ministry in Chisinau has 28 national programs that they will run throughout the country, such as TB, HIV/AIDS and drug abuse prevention. The Ministry stated that the World Bank and WHO health management systems have guided the reform and will be used to assure performance measurements using performance centers placed strategically in the country. The Ministry said that, besides the number of beds being reduced, the hospital reorganization has reduced the duplication of services that each regional hospital used to control. Now, for instance, laboratory, pharmacy and emergency services are shared. An earlier reform in 1993 and 1994, however, basically destroyed the pharmacy system in the hospitals. Approximately 98% of Moldovan pharmacies are now privately owned and run, so the hospitals are left with virtually no functioning pharmacies, and supplies procured from abroad go first to the private sector.

While about 400 employees, most of them doctors, were taken off the payroll of public employees, the Ministry said they had been rehired as private contract doctors. During the transition, the Ministry said that there might be a gap between pay periods, but that it would not be for as many months as had been experienced in the past. Health care workers understand that their salaries will be cut in order to economize and staff the new 33 rayon-based system. The Ministry did not confirm this.

A national health insurance will be put into action as of January 1, 2004. Management will be government-run, but through a separate organizational structure that will make use of field offices, approximately one for each 3 or 4 regions. The Ministry expects the population to pay 2% of their salaries, the employers a matching 2%. It is hoped that this will ensure universal health care and allow the Health Ministry to gain further financial assistance from world organizations. They expect the compulsory insurance system to increase their budget by 30 or 40%. In the past however, the total health budget was only 40% of what it should have been to run the system at its optimum, and presently most of the population pays for every medical service beyond a cursory examination.

The Republican level of the Health Ministry includes oversight of Moldovan medical education institutions. While their faculties include general medicine, pediatrics, epidemiology and hygiene, hematology, and pharmacology, they must look outside the country for training in radiology and other post-graduate specializations. Every five years, doctors must take an exam to maintain or upgrade their status.

Up until 1990 all texts were in Russian and while there is still an excellent relationship with Russia and Ukraine for study, some of the courses also use Moldovan and Romanian, but the predominant language of study is still Russian. The Ministry is required to put all documents in “the Language of State” (They would not say whether this was Moldovan or Romanian), but a Russian “translation” accompanies each one.

Social Protection System: The system is little changed since 1990. Its focus is on benefits for retirees, most of whom were state employees, and services for the elderly. Some benefits are allocated according to income, such as educational services and books, food, and heating fuel. Since 1999, many of these are given as cash subsidies. However, much of a family’s income may be from undeclared sources, so there is no guarantee that assistance will go to the genuinely needy. (World Bank Poverty Assessment, Republic of Moldova, 2000).

On the other hand, state services and subsidies are granted to victims of Chernobyl whether they are pensioners, students or professionals, and whether or not they need them. Large families and disabled children can get basic medical services, but care services are only offered for the elderly. In the past, the Fund of Social Support has provided social assistance in the home, with local offices in the districts. Many of these social workers are to be cut in the June 2003 reform, and the remaining few will be spread even more thinly among the population. While the total budgetary allocation for all benefits in 1999 was 1.85 times less than in 1998, only half the total allocated was actually paid out in benefits. (Ministry of Labor, Social Protection and Family, Republic of Moldova.)

Cuts are being made in the social service budget to finance other parts of the recent reform. With no comprehensive structure, it is difficult for NGOs to find a way to compliment the services offered, though the need is obviously there. There is no child or youth protection policy, and protection is, at best, done through “inadequate legislation and standards of procedure.” Chisinau’s Municipal Division for the Protection of Children’s Rights is a bright light in this sector, as are the youth programs run by the UNICEF sponsored NGOs. Most orphans and handicapped live in state boarding schools. The Small Group Homes program (with an average of 6 children in each) was found to operate more efficiently than the bigger state sponsored

homes, but they may not survive budget cuts. (The situation of Children and the Family in the Republic of Moldova 2000-2001, UNICEF.)

In 1991 public expenditures on health in Moldova were 3.9% of the GDP. In 2001 they were only 2.9%. The elderly dependency ratio was 21.2 in 1989 and in 2001 was 21.6 (ratio of 60+ population to the 15 to 59 year-olds.) Net external migration was 16.8% of the population in 1990 and is finally down to 3.9% in 2001. This is a demographic picture of an aging society. The growing proportion of the elderly, however, is not because people are living longer. Instead, the young working population, who could support increases in pensions, is emigrating and little of the money they send home is getting into the public funds. (Social Monitor 2003, UNICEF)

While the Health Ministry may be running national programs to prevent substance abuse and HIV/AIDS, the majority of social protection is carried out in response to critical situations rather than preventive programs. The administrative procedures are complex, but there is little experience in long-term or strategic planning. For instance there is no program to prevent abandonment of children or juvenile delinquency, and only a seminal admission that Moldova is a source and transit country for trafficking of women and children. The lack of social workers, much less those with recent training, also hinders recovery programs. In the present state of Moldova's increasing poverty and inequality, the cost of reforming the entire social protection system should be considered a priority.

Transnistria's Health System: The Ministries for Health and Social Services were united in the reform of 2000 and were also given responsibility for pensions and the various forms of social security. Medical Assistance includes stationary and mobile medical units as well as an emergency network. It also encompasses pharmaceuticals, certification and control of medications and the licensing of medical personnel. Under the Ministry of Health and Social Protection now are also the pension fund and other services to pensioners, the disabled, pre- and post-natal care, plus other services.

Before the 2000 reform, the district branches controlled their own expenses and were reimbursed by the local authorities. Now the central administration controls and funds all levels. The advantage, according to the Transnistrian "Minister," is that at least everyone is paid and not dependent on the local budget. When it is again economically feasible, the system could be decentralized again. According to the Minister, during the reform, hospitals were rationalized to permit measures of economy and to allow big expenditures to be targeted rather than having the regions compete with each other for resources.

Probably there is more cooperation between the Transnistrian and Moldovan Ministries of Health than between any other institutions on both sides. There are meetings between specialists of pediatrics, gynecology, neurology, and dermatology. The difficult cases in cardiology and oncology are frequently referred to Chisinau. Extensive cooperation also exists with Moscow, St Petersburg, Kyiv and Odessa in epidemiology, working on immunization, TB and HIV/AIDS and to improve doctor's training.

The Republican, or central, hospitals in Tiraspol are multi-purpose or are specialized for children, maternity, or veterans, or are designated as teaching institutions. In other towns there are hospitals for TB, psychiatric cases, and for the care of disabled veterans. Each of the seven regions has a hospital and each town has its own polyclinic that includes dentistry. Villages, even the smallest, have first aid centers. Each school and factory has a health care worker who is

specialized in preventative medicine. The entire system is connected by emergency services and a blood bank.

There are approximately 3000 specialists prepared at different times and in a variety of schools. The group that graduated before the break up of the USSR form the basic teaching faculty and the senior staff. During the last six years, preparation of young specialists has become increasingly difficult. Training in St. Petersburg or Kyiv is expensive, and extremely competitive. Moldovan schools do not accept the Transnistrian diploma. However, there is a licensing group working with Chisinau to make the process easier. In the past, doctors could only take the exam necessary to be upgraded in Chisinau and they were only eligible to apply if they had studied in Chisinau before. Without access to the qualifying exams every five years, young doctors have no opportunity to advance beyond a junior level.

Another possibility for training is in the new resident program in Chisinau that lasts 2 or 3 years for specialties such as pediatrics or surgery and the school of family medicine. In Tiraspol, young doctors can become interns for a year or two, but there is little opportunity for specialization. Tiraspol would like to have 30% of their doctors trained in family medicine, but this is only in the planning stage. Also, with young doctors making only 20 or 30 dollars a month, they are frustrated by lack of opportunity for further training and advancement. They know they are not as well prepared as their Chisinau counterparts.

A plan for medical insurance was put forward some years ago, and while the documents are ready and the system clearly explained, the system has not been implemented because the bill was not voted into law last year. Implementation has also been shelved simply because most people are unable to pay the premiums. While everyone expects basic medical care to be free, everyone also seems to expect to have to pay extra for anything beyond a cursory examination.

The "Minister" discussed the rational use of funds for medical equipment, but admits that what they have is behind the times and in disrepair. He said he had been to Chisinau as part of a committee to distribute assistance, but claimed that after many requests, he had gotten no response, and had given up trying. Each ministry mentioned the lack of assistance received by them, while Moldova gets aid of all sorts. This is a source of anger and resentment toward Moldova, which does not share, and toward the international community. Having a minimum of humanitarian assistance coming through the international organizations through Moldova could be an important early point to negotiate.

Transnistria's Social Services: The only area of social protection with available figures was that of pensions. Special areas of care for children and the handicapped come under the educational system and the Ministry of Enlightenment.

Besides the pensions given to regular retirees and former government employees, others are also eligible: invalids "of common diseases"(the handicapped, blind, etc.), invalids of the Defense Department, and invalids of the Second World War. The average pension is 124 rubles per month, or 31 dollars. The Ministry of Health and Social Protection lists 135,380 pensioners as of January 1, 2003.

Pensioners are the major supporters of the Smirnov administration. The payments are small, but three times as large for those serving in politically appointed positions such as district school

managers or local administrations. Ideally the sums should be increased every 3 months, but in actuality, they have been increased only once in the last twelve months

Conclusions: While the Health systems closely resemble each other structurally, the Moldovan system has relatively more resources to work with than do the Transnistrians. However, a major issue on both sides of the river is resources. While Moldova is receiving some humanitarian assistance, it appears that Transnistria is not, with the exception of some aid from WHO to assist with the growing problems of TB (In Moldova newly reported cases in 2001 were at 83 per 100,000 of population from 45 in 1989. It is understood that Transnistria's problem is similar.) and HIV/AIDS. A more proportional distribution of Moldova's assistance from abroad is likely to help rather than hinder negotiations of integration.

While the two Ministries are working together on a number of issues, the accreditation of degrees and post-graduate education for specialties, as well as admission to qualifying exams, should be considered a priority in negotiations for reintegration. Moldova should also offer to train a group of doctors in family medicine and to offer more internships and residencies. Having more well trained doctors in Transnistria is likely to reduce the number of patients requiring care in Moldovan hospitals, thus being an economical move rather than a costly addition to the budget. In turn, Transnistria could allocate some of its health care budget for those chronic patients who do need care in Chisinau.

It would not be too difficult to equalize pensions, as they are more or less equal now but the cost of living is quite different in Chisinau and Tiraspol. The cost of equalization, taking into consideration the variable cost of living, is likely to be offset by the savings gained when pensions, entitlements and subsidies are removed for those who do not need them. In order to do this, however, it is recommended that an assessment of need be carried out as the basis for the formation of a common social policy and strategy. Politically, this is a difficult move to make, but during the integration process, it might be possible.

From the sample information gathered during the assessment, it appears that both sides of the river are subsidizing a large number of pensioners, such as the Victims of Chernobyl or politically appointed directors who both work and receive a pension, who are not necessarily among the needy. Working without a coherent social policy or strategy on either side is extremely costly for the future of any society, integrated or not.

2. Education

Education in Moldova: The educational system in Moldova resembles a European model: primary education is 4 years; the gymnasium is 5 years and provides a certificate. At this point, a student competes for 3-year a lyceum or enters a secondary vocational program for 5 years or less. A student may also go to a vocational program after the lyceum and study for 3 years or less. Special art and sport education is available in Lyceums from grade 1 to 12.

Enrollment in Higher education can take place at 2 to 3-year colleges, 4 to 6-year universities, or institutes, all of which require competitive entrance exams. Correspondence courses are also available, but require more time to finish a degree. Specialized training is offered for students with "mental, physical, sensorial, socio-affective and behavioral or with mixed disabilities into

society” through special boarding schools, homes and orphanages comprising about 63 institutions.

At the republican, or federal level, a Board of the Ministry of Education and headed by the Minister directs the system. At the local level there has been a Management Council and a Consulting Council of the district or municipality, chaired by a Director appointed by the Central Ministry governing the judet, now the rayon network of schools. Each school has been run by a teaching Council and a School Management Council. It is not clear in the new local reorganization what will happen at the district level, or within the schools, and what functions will remain with local authorities, or if all will be directed from the center.

In 1998, education was 21.7% of the total budget for approximately 320,000 students in primary education and 420,000 students enrolled in secondary institutions. However, expenditures on education as a percent of the GDP were at a high of 9% in 1996 and have dropped to only 4.6% as of 2001. As of 2001, 200 private education institutions had been added to the overall choices in education. While the lower schools are still free (except for those that are private), fees have been imposed for universities. Due to insufficient space, about 1 in 10 students goes to school in a second shift. Resources are lacking for on-going training of teachers, and due to low salaries (about 200 lei per month in 2000 when over 2000 teachers left their jobs) many teachers have found outside employment or are working abroad.

Changes in enrollment are also significant. In 1990 enrollment in preprimary schools was at a high of 61.6% of the 3 to 6 year-old population. In 2001 it has dropped to 40.8%. While basic education and general secondary education enrollments have remained fairly stable (at around 94% for the 7 to 15 year-olds and 24% for the 15 to 18 year-old group), vocational and higher education have varied. In 1989, vocational schools enrolled 39.7% of the 15 to 18 year-olds, and in 2001 the figure had dropped to 13.6%, while higher education went from 16.2% to 22.6% of the same group by 2001.

Obviously, reform is much needed so that the education system responds more closely to the labor market and in the organization of its financing. At the root of the reform should be a redefinition of the state’s role in education. Assessment and accreditation systems for all educational institutions should be a priority for Moldova, but also for reintegration purposes. The World Bank project on new texts has just been completed for lower schools. The Ministry of Education has just received about 2 million dollars to create a curriculum in “life skills” for the school, but little other assistance seems to be planned.

Education in Transnistria: According to Moldovans, the difference between the systems is that Transnistria uses a Russian model, while the Transnistrians say they use a system that resembles that in the US, or a system that is “close to European standards.” Their schools are 11-year programs and are taught in Russian, Ukrainian, and Moldovan using the Cyrillic alphabet. Of the 200 schools with 90,000 pupils, 50 schools use Russian and Moldavian, 35 Moldavian only, 2 are taught in Ukrainian. Some schools offer a few classes using Ukrainian, while the pre-schools use all three languages. There are 16 technical schools, 9 professional lyceums, 3 state and 4 non-state institutions, plus one that is an affiliate of a Ukrainian school and another that is linked to a Russian school. 22,000 students are receiving professional training and 12,000 have gone on to university in Tiraspol or to Ukrainian or Russian universities. Moldavia has reserved 10% of their places in university in Chisinau for Transnistria students. The system also includes

continuing education in sports, dance, music, arts and crafts and other leisure activities for students and for adults.

Planning is done by the Central Ministry, depending on the needs of each technical or professional field. A ministry orders the number of students that need to be prepared, for industry or law, for instance, and that number of places will be supported by the state budget. Other students are welcome to enroll in those faculties, but will have to pay to attend. Of about 5,500 students who attend university, about 1000 who can afford to, go to Ukraine, Moldova or Russia for university.

Professional education and schools for the handicapped are financed by the central budget, while 60% of regular schools get local financing through business and industry. Data is not available for a clearer picture of costs and enrollment over time in the Transnistrian system. However, the main issue, according to the Ministry, for Transnistria at present is a lack of funds with the economy in crisis. With 30% of the population ethnic Ukrainian, there is a need to develop more schools for them. Also, they must write and print Moldavian texts themselves, which are expensive to print in small numbers. The entire system needs reform to bring it up to European standards, but at present the economic system does not permit the necessary investment.

In the lyceum and gymnasium schools, the students have 15 different subjects of study, now considered to be too many, but the teachers resist change for fear they will lose their jobs. Over the next few years about 40% of the teachers are due for retirement. In the meantime, the younger ones need retraining. However, the teachers make about 20 to 23 dollars per month and their pensions are only about 18, so it is no wonder that after retirement they look for jobs in education again, further restricting the possibilities for reform.

School integration is an important issue for both administrations. The Moldovans feel strongly that the systems must be more alike, while the Transnistrians would resist any integration at all. Both administrations admit to needing considerable reform. An in depth study would be needed to see exactly how the two systems could be made more compatible in the process of reforming to comply with EU standards. This could be done with a small team of experts from EU countries. In the meantime, however, neither Ministry is involved in Stabilization and Accession discussions. They should be brought into the process as soon as possible.

According to Mr. Braghis, the Moldovan opposition leader, the two different systems can continue side by side, but using the Moldovan language in Cyrillic script is not acceptable. The alphabet has been the main object of conflict since the Russian Revolution and language is embedded in the interpretations of history, also an important part of the dispute.

Both the systems and the content of the curriculum will be issues between Moldova and Transnistria. At present there is almost no contact between the two systems because Moldova does not recognize Transnistria degrees, also because the two administrations are planning reforms that promote what they consider to be two very separate systems, with different histories and languages.

Conclusions: If the systems remain separate, Transnistria and Moldova will both require funds to reform the curricula and teacher training. While it would be ideal for Transnistria to consider teaching Moldavian using the Latin alphabet, it is unlikely that this can be part of an early

agenda. However, costs for reform would be reduced in Transnistria if they were to teach in Russian instead of the expensive tri-lingual system. In turn, if Moldova were to legitimize their already bi-lingual system, it could be a basis for educational cooperation. Ultimately, it will be necessary in both systems to teach more European languages if they are to eventually join the EU and English if they are to communicate with the rest of the world.

A place to start, however, would be with the uneven system of accreditation. Some Russian universities accept degrees from both sides of the river, but Moldova does not accept most high school certificates from Transnistria, nor do they accept many university degrees. A first step would be to convene an accreditation committee that would concentrate on a system for recognizing degrees in such fields as medicine, chemistry, physics, mathematics and information technology. The cost of offering courses in Moldavian language using the Roman alphabet during summer months before students enter university in Chisinau would be nominal.

While avoiding conflict by both sides working toward European Integration standards, the question of history and thus, curricula will remain. However, over time with freer communication between the two populations, historical interpretations are likely to be discussed and questioned more openly by both, and the period of separation is likely to be debated and rewritten. Texts are revised with regularity in most countries, and there is no reason not to think that the process will take place over time in Moldova also. The costs in the long run, will be nominal compared to the benefits.

3. *Civil Society*

Moldova: There is no official information about the number of NGOs in Moldova, though many new organizations have appeared since the early 90s. In 2001, the Ministry of Justice had registered around 2000, but according to “The Needs Assessment Survey of Moldovan NGOs” of December of 2001, only 200 to 300 organizations were active. Most of these are located in Chisinau, with 14 to 20% located in the countryside, up from only 4.7% in 1997.

Over time, Moldovan NGOs have remained predominantly focused on cultural, educational, sports and tourism activities, but more now choose areas of human rights, health and economic activity. Organizations for youth tend to be the most active, while ethnic and cultural NGOs have the most influence. There is still a lack of community participation elicited by the NGOs, but volunteerism is on the rise. A small number of NGOs work in the social sector with disadvantaged children, the handicapped, or low-income groups. (The Situation of Children and Family in the Republic of Moldova 2000-2001, UNICEF)

NGOs are working under difficult circumstances with very little in the way of help for capacity building, training or technical assistance, but the legal structure is fairly positive. NGOs are allowed tax deductions for public benefit and statute-related activity and Moldovan businesses that support these activities are allowed a 7% tax deduction on an annual basis for charitable and public benefit purposes. Few know of these options, or the law which permits contracting for social services between the NGOs and government, so they are rarely used.

A lack of resources for the NGOs sector is probably the most severe restraint of all. Only about 3% receive help from government. A few NGOs are given reduced rents in public buildings or part-time use of school or sports facilities. A few have membership dues and even fewer receive

contributions from their communities. Only about 2% of the NGOs receive help from business (usually the international ones such as Coca-Cola, McDonalds and Xerox). The others rely on international donors and the competition is fierce. As those donors, by in large, fund projects in human rights, economic activity, health and youth, their targeted funds have helped determine the sectors in which there is a recent growth in the number of organizations with related missions and project proposals.

Service-providing NGOs are of two types. The first category includes NGOs that were operating before independence, such as the Children's Fund, the Society of the Disabled and the Association of the Deaf. These have maintained relations with the government and have broad recognition from the community at large. The second group has emerged since the early 90s as the result of a demand for social services. These are the organizations supported largely by the donor community, and while their leaders are open to educational opportunities and new ways of thinking, they tend to have a negative attitude towards cooperation with the government and with each other. Neither group of NGOs has done a scientific assessment of needs, and services are usually provided because of personal involvement in, or their own perception of the vulnerable group they serve. The government is just beginning to recognize the assistance that NGOs can offer in the provision of social services, though at present, only the Ministry of Sport and Tourism provides financial resources on a competitive basis to NGOs offering a service.

Many NGOs understand what a coalition is and believe that forming coalitions around a specific issue could be effective, but they rarely do so. This is probably a result of the intense competition for funds, compounded by a long ingrained reluctance to share ideas and take the responsibility for initiating changes.

Another constraint is the widespread distrust of NGOs that is unlikely to change as long as the government maintains control over the two daily newspapers and the state owned TV station. Other publications are mostly linked to one political party or another. The written media (40% fewer publications than in 1999) has been a victim of budget cuts and recession. Recently, electronic media has experienced a significant growth. Satellite TV has become widespread in the large cities, but undependable power supply limits the access in rural areas.

It is unlikely that NGOs will adopt transparent management and adopt ethical codes as long as the NGO environment remains so competitive and the donors continue to limit their funding to a few targeted sectors. There is also no tradition as yet of publishing annual reports or holding public hearings on issues and problems. The situation is likely to remain stagnant until technical assistance, more training and ultimately a competent training cadre can be developed within Moldova.

Transnistria: There are about 550 registered NGOs in Transnistria, but only about 10% are active, a few of these in the social sector. While the number of NGOs is growing, due to the administration's realization that NGOs are eligible to receive help from international donors, their growth is still severely regulated. NGO legislation resembles that of Moldova, but the registration procedures in Transnistria are complex and lengthy, and very few civil employees have any idea how to carry them out, resulting in more "initiative groups" than registered NGOs.

There are three basic groups of Transnistrian NGOs: one group, based in Tiraspol has some support through Chisinau; another group in Dubassay is also working with international

organizations in Chisinau; and the third group is supported by the Tiraspol administration. The first largely consist of “initiative groups”. They are tolerated by the administration as long as they do not go beyond prescribed limits. The second group is more independent because Chisinau-based donors largely support its organizations. These organizations are closely watched. The third group is supported by the leadership, and consists of mostly military and patriotic organizations.

If the situation for NGO organizational development is difficult in Moldova, it is much worse in Transnistria, as there are no donor organizations based in Tiraspol. Very few NGOs have their own offices and even fewer have office equipment. Only 5 of 35 organizations surveyed in Transnistria have access to Internet. There are few publications produced by the NGO community and only the military and patriotic organizations have relations with the administration. There are only two examples on NGOs partnering with business. (Needs Assessment Report on Moldovan NGOs, Counterpart Center and Alliance for Partnerships, December 2001)

For Transnistrian NGOs, there appears to be little possibility of either organizational or financial sustainability at the present time. While the laws are not restrictive, the administration’s oversight is. There is a strong demand among Transnistrian NGOs for relationships outside their region, but there is little literature available to them in Russian and the difficulties of crossing the border only compound the problems for their natural growth.

While a few organizations provide social services in education and health care, a great many new youth groups have been formed that have chosen democracy activities. As a whole, those surveyed said that neither the government nor their communities were much interested in supporting them. While Transnistrian youth are increasingly aware of the world outside their boundaries they also express extreme resentment of the blockade of information from the Moldovan side of the river. They need the information and assistance, they say, to get the message to people about the plans for federalization. As NGOs, they are also aware that they would be an ideal channel for humanitarian assistance. However, as long as they are reluctant to appeal to media they cannot have a very broad impact.

While the patriotic NGOs are mostly against negotiations on integration, the other two groups feel they could serve as barometers of public opinion that should be monitored during integration process, and that they could assist in pointing out the benefits of integration while working in various social sectors.

Conclusions: Lowering the information barrier as much as possible would benefit the nascent growth of civil society on the Transnistrian side of the river. Helping the NGOs in training, capacity building would permit them to use the information to broaden popular support. Teaching them to monitor public opinion during negotiations could only benefit both sides.

Programs such as youth parliaments and other joint NGO activities would help to bring, not just the youth together, but others working in a variety of areas. Networking activities for social workers, conferences for those with disabilities, and newsletters, all of which are low cost, would help to prepare NGOs and their members for a more integrated society. Such support should be committed for at least two to five years in order to guarantee lasting impact. No matter how well the negotiations for reintegration proceed at a government level; they cannot succeed if the two

populations are not brought into the process. The NGO sector is the best possible avenue for this to happen.

D. ECONOMY

1. Agriculture Efficiency and Utilization

The political collapse of the Soviet Union was preceded by the collapse of the state managed systems underpinning agriculture production and distribution. For Moldova's highly productive agricultural sector, this meant essential inputs such as fertilizers and pesticides became scarce and expensive. Furthermore, products had no organization to which they could be delivered for onward distribution within the Soviet Union. Consequently, agricultural production, which was heavily dependent on a functioning Soviet Union, shrank dramatically, essentially supplying the limited Moldovan domestic market. Private sector activity is beginning to replace the Soviet era institutions, but Moldova is still not attracting much interest from western agro-industry investors.

The data show that since 1990, Gross Agricultural Product fell by more than 50 percent. Perishables were especially hard hit with vegetables down by more than 66 percent, fruits by 65 percent, milk by 60 percent and meat by 75 percent. The scarcity of fertilizers and pesticides is apparent from the drop in yield per hectare by 30 to 50 percent. On the Transnistrian side, where good data are not readily available, the "Minister" of Agriculture estimates that agricultural production has dropped by 90 percent.

The segmentation of the domestic market due to Transnistria's self-proclaimed independence has had a negligible effect on agriculture compared to the loss of supplies from and markets in the rest of the former Soviet Union. The two sides are not particularly complementary and the removal of all barriers to trade along the Dniester River would not significantly open new markets for either side. Furthermore, the boundary is not particularly significant now as some commercial amounts of milk and vegetable seedlings are moved across the boundary. There also appears to be routine informal movement of agricultural products across the boundary.

The reintegration of Moldova and Transnistria need not necessitate the infusion of external assistance resources if Transnistria is given autonomy in the management of its agricultural affairs. In this regard, extension and inspection services and agricultural research, the principal government sponsored functions in market economies, are often delegated to sub-national levels of government. Even if there is a more comprehensive reintegration of the agricultural authorities, there is not likely to be a need to finance the downsizing of Transnistria's organizations due to the departure in recent years of agricultural personnel to jobs outside Transnistria.

From our limited exposure to Transnistria's agricultural personnel and facilities, it appears that this sector has been a relatively low priority in the Transnistrian budget. Therefore, from development and equity perspectives, after reintegration, Transnistria would benefit from external assistance to help dismantle its state farms, privatize its state ordering organizations, privatize food-processing industries (where possible) and up-grade the skill level of "ministry" staff. The cost of this effort depends on the desired pace and level of effort of the undertaking

but would not likely cost more than 15 percent of the level of assistance to agriculture carried out in Moldova during the past 10 years.

Again, after reintegration, on both sides of the boundary, agricultural development projects are also justified to help support the emerging private sector with credit, marketing, technology and improved quality standards. Furthermore, on the Transnistrian side, there is a need to reconstruct its irrigation facilities, when market conditions so warrant, to support its comparative advantage in vegetable production. In addition, on the post-reintegration development agenda, there is a need on both sides to expand irrigation systems to counter the effects of periodic drought conditions that have seriously hurt Moldova's agriculture sector in the past.

2. *Business and Industrial Development*

There is little question that the general economic, business and industrial development of Moldova and Transnistria have been negatively impacted by the conflict and separation of the regions. Moldova has become a country not well understood by international investors who are concerned about the heretofore uncontrolled customs and trading, as well as the reputation that has arisen of corruption being a major problem. There is no question that when the Transnistria issue is settled and customs procedures and trading activities become controlled by the rule of law that a larger legally functioning market will become more attractive for both domestic and international investors.

From a reintegration point of view, the issues most clearly presented are the differences that have now arisen between the ROM and Transnistria as the ROM has moved more towards a market economy with significant privatization while Transnistria remains a largely state owned economy. While not a requirement for reintegration, there is little question that Transnistria and the whole of the ROM would benefit from a transparent privatization program and a shift towards a market economy in Transnistria. The costs of this shift may be minimal, if the process can be largely self funded from privatization proceeds. The benefits should be realized in increased domestic and international investment in both regions.

The power supply issues in the ROM also present a severe deterrent to business and industrial development. The constant concern over availability and cost of supplies and the political issues that affect these considerations inevitably deter significant investment. The Transnistrian authorities are moving rapidly towards the privatization of the Transnistrian power plant. This process clearly needs coordination by both sides, as the issue of the uncertainty of power supplies in Moldova needs resolution. The ROM and commercial entities on the Right Bank need reliable long term requirements contracts for power, and any purchaser of the plant needs some customer assurances, as well as assurances of continued access to transit rights for power across the ROM.

Conclusions: The ROM and Transnistrian authorities should agree on a process for privatization in Transnistria. The ROM should accept the prior privatization activity despite its likely lack of transparency in the interests of moving forward. Future privatization activities should be reviewed by both sides to ensure transparency, with some of the proceeds going to the ROM to compensate for the value of the ROM's participation and defray the time and costs of their activities. In addition the ROM and Transnistria should reach clear agreements and settlement of power supply arrangements so that this uncertainty and the possibility of economic

blackmail become issues of the past. Agreements and guarantees with Gazprom may be required, as well as agreements with any new owner of the Transnistrian power plant.

3. *Foreign Investment and Economic Growth*

It is quite possible that the highest cost associated to date with low foreign investment in the ROM and Transnistria has been to the Right Bank, as the ROM has suffered from a poor investment climate based on a perception of a lack of transparency in privatization and investment activities and from a perception of a poor business environment for day to day business activities as well. These perceptions have been based in significant part on the issues associated with the economic difficulties presented by the Transnistrian situation, including the power supply uncertainties noted above. In addition, the lack of success in ROM privatizations such as Moldtelecom, and issues which threaten to reverse privatization agreements, certainly also contribute to the poor investment climate.

Transnistria, has offered few privatization and investment opportunities, and the opportunities offered have often been taken by groups close to Transnistrian authorities (i.e. Itera) or by groups with a view towards profiting from the unregulated environment that has prevailed across the past decade. As in the case of Itera, some investors have been able to control their own power supply arrangements. This has made participation in the Transnistrian economy an “insiders” game.

It is clear that the most significant investors in Transnistria, and yet also in the ROM, are of Russian origin. This need not be discouraged per se, but there needs to be an effort to ensure the investments are made, and perceived to be made, transparently. Russian capital, particularly in the energy sector, will likely be important to a reintegrated ROM. The issue would seem to be creating circumstances to encourage significant investment sooner rather than later, Russian or otherwise.

There can be no question that settlement of the Transnistrian question through reintegration will improve the investment environment, and consequently foreign investment, as the uncertainties of doing business in the ROM will diminish. Larger investment flows, a better and more transparent competitive environment and a larger internal market should all contribute to greater economic growth.

Conclusions: After some of the initial needed agreements are reached in the reintegration process, a concerted effort should be made by the new ROM to make the case for foreign investment in the ROM. Reintegration offers this new opportunity, and creates a reason for a “fresh look” at the ROM.

4. *Privatization and Marketability of Transnistrian State owned Enterprises (SOEs) and Land*

As noted above, rapid privatization of Transnistrian SOEs and land would be beneficial, as in the case of the former it should lead to more investment sooner thus benefiting the economy and its participants. Benefits that flow to one part of the ROM will almost always spill over to the remainder of the ROM, so privatization in Transnistria should be encouraged on both banks of the Dniester.

With regard to land, it appears that the agricultural land privatization process in the Right Bank ROM took considerable amounts of time, was costly and remains controversial in its ownership results and effective economic management. Certainly a similar program should be considered for Transnistria if only to avoid very different ownership structures. However, if the view taken is that the land privatization measures in the Right Bank ROM should not be replicated for one or more reasons, there are certainly alternative structures that can be considered. It is likely that land privatization of some sort will lead to a faster resurgence in agricultural production than maintaining the present circumstances which have only lead to a continuing poor level of production in Transnistria.

The cost of land privatization cannot be estimated until an approach is agreed upon. However, if the Right Bank ROM approach is adopted they will not be inconsiderable. Estimates of the cost of the Right Bank approach are up to \$30 million across several years, with continuing production support programs. Benefits are yet to be seen, but projections for increased production levels can be made that are very favorable, assuming a market for increased production is secured. Whether this increased production will be coming more quickly with one form of privatization and production approach or another remains an active debate in Moldova.

It should be pointed out, however, that the concept that Transnistria is “industrialized” is somewhat of a myth. One factory (the Rybnitsa steel works) produces 50 percent of Transnistria’s industrial output and it has already been “privatized”. Out of the remaining 100 plus industrial operations in the area, knowledgeable sources estimate that as few as 10 to 15 are economically viable in today’s market economy. According to the Transnistrian “Minister” of Industry, most of the remaining factories are operating at a fraction of their rated capacity or are not operating at all. If the conditions at the large electric power plant are illustrative of other industrial plants, most investors would find it better to make a greenfield investment, than to buy an existing public sector industry.

Conclusion: The ROM and Transnistrian authorities should commit themselves to privatization at the earliest opportunity. A decision to replicate the Right Bank procedures or adopt another approach should be agreed.

V. SUMMARY OF FINDINGS

A. RELATIVE IMPORTANCE OF ISSUES

Clearly, establishing the overall form for the “federal” level, its authorities and checks and balances will be a difficult and lengthy process of negotiation. To a large degree, however, its form and its authorities will be determined by the ability of both sides to agree on the reintegration of the sectoral/functional areas discussed above. It is difficult to predict which of these will be more troublesome to reintegrate, given the preliminary state of negotiations. However, those areas that Transnistria sees as its symbols of sovereignty will most likely be the most contentious. These include the currency and central bank function, customs and the use of Cyrillic for the Moldovan language. Because of the past fighting and the high degree of mutual distrust, the military and security establishments could also be difficult to merge. Finally, there is likely to be considerable resistance to replacing the turnover tax with the VAT

Clearly, one of the principal objectives of reintegration is the creation of a common economic space. While a common currency and a single central bank are not essential, (witness NAFTA and the EU before the introduction of the euro), the existence of two currencies and two central banks in Moldova is an unnecessary source of inefficiency and risk. Transnistria has, however, pointed to its currency and central bank as clear evidence of its national sovereignty and will likely fight for their continuation for symbolic reasons. From a process point of view, Moldova's willingness to permit a dual currency regime in Transnistria appears politically sound in that it provides an opportunity for the Transnistrian ruble to wither away. The approach avoids the confrontational challenge to Transnistria's self image that would be conveyed by a one-off conversion and the removal of the Transnistrian ruble as legal tender.

To avoid losses in the monetary assets of those who hold Transnistrian rubles and to minimize inflation, the management of both currencies needs to be in one central bank. This would essentially make the Transnistrian ruble a variant of the lei and the single central bank could carry out a program of gradually withdrawing the Transnistrian ruble over time. Some face-saving measures may be needed with respect to Transnistria's central bank to win agreement to this approach.

Immediately important to the creation of a single economic space is the unification of customs. The establishment of its separate customs agency has been pointed to by Transnistria as a symbol of sovereignty. Moreover, given the particular personalities managing the Transnistrian customs department, reintegration may be especially difficult. It has been suggested that the customs function has been a source of economic rent for those who control it. If true, it may be as hard to merge the function as it was to convince Moldova to agree to pre-shipment customs inspection and payment. Furthermore, the management of Transnistria's customs department has made a substantial investment in a state-of-the-art inspection and tracking system. They are likely to be most reluctant to lose control of this system.

Further to the creation of a common economic space is the need to harmonize the tax system. In essence this means adopting the VAT on the Transnistrian side. The turnover tax used in Transnistria has been severely criticized by virtually every knowledgeable tax economist as having deleterious effects on production and investment incentives. Furthermore, virtually all countries surrounding Moldova have replaced the turnover tax with a VAT. There is no practical way for the two fundamentally different systems to co-exist unless a tax border is maintained along the river. Such a situation would contradict the intent of reintegration and introduce an unnecessarily high internal barrier to trade.

However, Transnistrians object to the VAT because of its high rate. They feel that their revenue needs can be met with the substantially lower turnover tax that they now use. They believe that the main benefit of introducing the VAT on their side of the river would be to transfer resources to the Right Bank. They may not be wrong in this belief. But it was clear to us in our discussions with the Transnistrians on this subject that they do not have a full understanding of the VAT or the long run consequences of the turnover tax. Specifically, they did not seem to understand that the VAT is levied only on production for the domestic market while the turnover tax is levied on all production. VAT payments on goods that are exported are refunded to the exporting company. Thus, Transnistrian companies who primarily export may, in fact, face a lower total tax liability under the VAT than they now face under the turnover tax. If this and other aspects of the VAT compared to the turnover tax were better explained to Transnistrian

corporate leaders, they may be more favorably disposed to accept the VAT. On the popular level, the VAT, as a tax on consumption, will raise prices for Transnistrians and could be politically quite unpopular.

The script used for the Moldovan language has been a long-standing policy instrument of ruling elites to promote a particular cultural identity. The emotional investment of both sides in preserving their respective scripts may make agreement on this issue impossible in the near term. Therefore, it may be useful to defer the discussion of this issue until later in the reintegration process. This particular language issue is not at the core of why Transnistria continues to assert its independence. Negotiating it at this time will most likely lead to an unproductive distraction from the more important issues that need to be resolved. As a practical matter, Moldovans who live in Transnistria already speak the same language as Moldovans on the Right Bank. Given the relatively small size of the population learning to read in the Cyrillic script, it would be more efficient for the ROM to offer a short course on the Latin script to anyone who needed it in order to advance his or her education on the Right Bank. Ultimately, if the unified Moldova is to join the EU, both educational systems should begin to promote the study of European languages, which would help to put their own into a wider perspective of importance.

It was pointed out to us that Moldova's and Transnistria's only enemies are each other. With reintegration and OSCE supervised peace-keeping forces in place, the need for an army on either side is somewhat moot. Nevertheless, vested interest and cultural differences may make the creation of a unified defense force difficult. On the Transnistria side, NGO's of veterans may be the only real source of popular interest in the outcome of the reintegration process.

B. SUMMARY OF COSTS

There are three rationales that justify the provision of financial resource in support of reintegration. First, specific resources (financial, material and technical expertise) may be required to inform or facilitate the negotiations on reintegration. Examples of this would be the provision of an independent audit firm to assess the financial strength of Transnistrian banks or the finance of an audit of Transnistrian debt to help determine how much of it can fairly be accepted as "sovereign".

The second rationale is resources needed in direct support of the implementation of elements of the reintegration. For example, selected government personnel on both sides of the Dneister may need retraining to perform duties which may have been redefined by the terms of the reintegration agreement. New texts books for schools may be required. In addition, real, but more difficult to predict needs arise from dislocating individuals, groups and institutions through downsizing or other economizing actions associated with reintegration. In some cases, this type of cost may be immediately obvious (e.g., severance pay to reduce redundant personnel). However, in other cases, the need may not appear until sometime after political reintegration has occurred (e.g., costs associated with the inability of dislocated personnel to find new employment). Finally, the terms of the reintegration may require specific transfer payments such as an increase in pension payments to achieve equity in the unified system or to compensate for the loss of current indirect subsidies.

The third rationale follows from the political imperative to improve particular services in order to obtain political agreement for reintegration or to reduce unacceptable disparities between the two sides after reintegration. In these cases, the costs will be determined by the level of effort that

the body politic decides is necessary. Moldova's desire to join the EU may significantly influence these costs as a result of the EU's concern with minority rights and poverty alleviation.

The table at the end of this report summarizes potential activity under each of the three rationales. There is no presumption that this list is in any way comprehensive or that it implies any need for additional assistance from the foreign donor community. Many, if not most of activities identified could be financed from locally derived resources or ongoing donor programs. The largest item is some form of debt relief for Transnistria from its Russian Gazprom debt.

C. THE BENEFITS OF REINTEGRATION

Supporters of reintegration operate under the presumption that the long term benefits of reintegration are positive. Some even argue that there will be noticeable benefits in the short run. It is hard to take issue with the first presumption. Elimination of duplication, internal barriers to trade, and most of all, the removal of the political conditions that have deterred investor interest in Moldova should produce positive results in terms of sustainable economic growth. Obtaining these results presumes that the ROM does not pursue reversals of previously implemented market reforms related to privatization and the regulation of public utilities. Such an endeavor would further alienate potential investors.

Certain groups of people could realize immediate benefits from reintegration. For example, the ROM's recognition of Transnistria's school diplomas would open immediate opportunities for Transnistrian students to study in the ROM. Cooperation in health would reduce the spread of infectious diseases. And, recognition of Transnistria's banks would reduce transaction costs for conducting business in both sides.

In the short run, however, most Moldovan's on the Right Bank will probably see no effects from reintegration, except for possibly higher prices for some "smuggled" commodities which get brought into the tax net. The economy on their side of the river does not depend on Transnistria's industries except for power. In the case of power, the Right Bank has been paying closer to market prices than the Left Bank and this is not likely to change as a result of reintegration. In addition, the Right Bank may not see the anticipated increase in the tax base as a result of reintegrating the "industrialized" Left Bank into the VAT.

In Transnistria, however, reintegration should cause a shift from a Soviet styled economy to a more modern market economy. This will likely raise prices before it raises opportunities. Without some immediate adjustments in wages, pensions or other transfers, the benefits of reintegration may be negative. However, with or without reintegration, the current economy of Transnistria is not sustainable as it is heavily dependent on highly subsidized energy. The lack of sustainability is clearly evident from the fact that during the period when Transnistria had free access to Moldova's customs stamp, it still accumulated a 1 billion dollar debt for unpaid gas. This subsidy permitted the inefficiencies within the economy to still produce products which were competitive in export markets.

Thus, perhaps the greatest benefit of reintegration, despite its short-term costs to Transnistrians, is the removal of the economic regime that wasted resources, underemployed workers' potentials and closed off opportunities for entrepreneurship. Closely associated with this outcome is the benefit from the reduced potential for renewed armed conflict.

D. POLICY RECOMMENDATIONS

This study was undertaken in part to provide USAID/Chisinau with an early alert on the potential costs of reintegration. It was presumed that if there are substantial financial costs associated with this process, the ROM and Transnistria may approach the wealthier donor countries for help both during and after the process. But donors have influence beyond the financial resources that they provide. Through contacts and dialogue, opinions and positions of the negotiating parties can be formed or changed. With this in mind, the team offers the following thoughts.

There is clear interest in reintegration at the senior level of the ROM. This is evident by the recent measures taken by the ROM regarding the customs stamp, Transnistria's attempt to undertake a privatization effort and the newly required registration of Transnistrian companies under the ROM. These measures make it urgent for Transnistria to more seriously participate in negotiations since, after twelve years, it still is an unrecognized state and necessary support and subsidies from Russia may be nearing an end. The "stick" which the ROM is wielding would appear necessary at this time. But so too are confidence building measures which offer the "carrots". One such "carrot" would be to defer the very sensitive language issue until the two sides have reach some partial agreements and feel more comfortable moving together along the road to reintegration. The cost of training Transnistrian applicants in the Latin script for higher education in Moldova would be slight compared to the cost of delays in reintegration.

In health, there is an interest and opportunity to actually implement various cooperative programs. There are opportunities in education related to the recognition of Transnistrian diplomas. There are opportunities in banking in terms of establishing correspondence relationships. The ROM should be urged to pursue these and identify additional areas where increased contact and cooperation could be achieved without conceding any degree of sovereignty as was the case in 1996 with the dual management of customs and the granting to Transnistrian companies the right to use the ROM customs stamp.

In the area of electricity, there is a need and an opportunity for an agreement which will allow appropriate commercialization and privatization of the power sector. The ROM has already privatized three of its five distribution companies. Transnistria wants to privatize its generating capacity. This combination of interests could be incorporated in an agreement that commercializes the entire electrical generation and distribution system, thus removing it from the political arena where threats of power description have been heard. The agreement would contain a specific formula for allocating the taxes and privatization proceeds between the two sides. This would integrate the power sector, like the railroad, into a common facility. Since the purchasers of the power generating plant are likely to be Russian, proceeds from the sale could also help reduce Transnistria's debt to Gazprom, thus reducing an important obstacle to reintegration.

The example of "carrots" noted above were the ones that became quickly identifiable during our short stay in Chisinau and Transnistria. We would expect to find more opportunities if a deeper probing of the attitudes and interests of those involved had been possible. Moreover, if negotiations proceed in a positive direction, opportunities for contact and cooperation in areas which now seem difficult may become possible.

Summary Table of Potential Costs

Activity	Reintegration Assumptions	Rationale 1 Facilitate Negotiations	Rationale 2 Support Implementation	Rationale 3 Post-reintegration Development
Sovereign debt	Some amount of Transnistrian debt must be treated as sovereign debt	An independent audit of Transnistria's debt. \$0.5 million	Debt forgiveness reduces Transnistria's debt to a manageable level. \$900 million	
Currency unification	A single central bank is agreed to.		Additional currency is printed. \$ 0.25 million	
Customs	Customs departments are merged into one organization.		Some retraining of personnel is required. \$ 0.25 million	
Banking	Transnistrian banks become eligible to obtain a license from the central bank.	An independent audit of Transnistria's banks. Assessment of deposit insurance exposure. \$1.5 million	Severance pay for redundant personnel at the central bank level. Deposit insurance guarantees.	
Fiscal Policy	Transnistria retains some degree of budget and taxation authority.			

Activity	Reintegration Assumptions	Rationale 1 Facilitate Negotiations	Rationale 2 Support Implementation	Rationale 3 Post-reintegration Development
Taxation	The turnover tax is replaced by the VAT	Analysis of the revenue effect of switching to the VAT. Needs assessment of the tax department. \$0.25 million	Training or retraining to expand the tax department	
Government administration	Asymmetric Federation			
Public services	Regulatory bodies are unified by function with the provision of services ultimately privatized.			Rail and road infrastructure is improved. Further privatization in power generation and transmission. Privatization of the phone system.
Judicial	Unified high court		Licensing legislation and procedures improved.	Greater press freedom throughout the country Passage of strengthened civil liberties legislation in Transnistria.

Activity	Reintegration Assumptions	Rationale 1 Facilitate Negotiations	Rationale 2 Support Implementation	Rationale 3 Post-reintegration Development
Education	Schools remain locally managed and the Moldovan language is shifted to Latin script in Transnistria's schools after reintegration.		New textbooks Latin script training for Transnistrian students continuing their education in the ROM. \$0.5 million	Teacher salaries are increased. Additional teacher training is provided. Curriculum reform. Teacher training in the Latin script.
Health	Reintegration is primarily greater cooperation			Various health improvement programs.
Civil society				Increased resources to NGO's
Military	The military is unified under a single command.		Severance pay for redundant personnel. \$ 5 million	Modern equipment and training provided.
Police	Under local authority		Training to familiarize police with new laws.	Training to implement new civil liberties legislation.
Agriculture	Transnistria will retain some degree of autonomy for agricultural extension, inspection and research.	Identification of activities that require cooperation between the two agricultural units.		Transnistria's state farms are privatized. Agro-businesses are privatized. The farm store program is expanded to Transnistria. Ag research facilities are improved.

Activity	Reintegration Assumptions	Rationale 1 Facilitate Negotiations	Rationale 2 Support Implementation	Rationale 3 Post-reintegration Development
Business development				
Foreign investment				Publicity program to attract Western investor interest.
Privatization				Renewed privatization effort throughout the country.