



BULLETIN

No. 92 (687), 27 June 2014 © PISM

Editors: Marcin Zaborowski (Editor-in-Chief) • Katarzyna Staniewska (Managing Editor)
Jarosław Cwiek-Karpowicz • Aleksandra Gawlikowska-Fyk • Artur Gradziuk • Piotr Kościński
Łukasz Kulesa • Roderick Parkes • Patrycja Sasnal • Marcin Terlikowski

Three Stress Tests for Moldova's Association Agreement with the EU

Stanislav Secieru, Anita Sobják

On 27 June, Moldova signed an Association Agreement (AA) with the European Union. Yet its implementation might be thwarted in numerous ways: first, by pressure from Russia, second, by the results of the parliamentary elections in November, and third, if Tiraspol declines to comply with the provisions of the AA. To help Chişinău overcome these challenges, the EU should maintain intense political support in the run-up to the elections and assist the Moldovan economy to adapt swiftly to the requirements of the Deep and Comprehensive Free Trade Agreement (DCFTA). Brussels and Chişinău also need to work out a patient and flexible formula for Transnistria's participation in the DCFTA.

Russia's Allergy to the AA. Russian officials warned of punitive measures against Moldova in the aftermath of the AA signature ceremony. If adopted, the aims of these measures could be threefold: to raise the costs of AA implementation, to slow down Moldova's economic growth (the prognosis for 2014 was revised by the government in May, from 4% to 3.5%), and to shape the outcome of the parliamentary elections scheduled for 30 November.

To this end, Russia could introduce a wide ban or tariff barriers on Moldovan fruit and vegetables. For instance, the biggest share (approximately 90%) of Moldovan exports of apples, plums and grapes goes to Russia. This might have significant social and economic repercussions, as agriculture and the agricultural processing industry employ around 27% of the work force, accounting for 18% of Moldova's GDP.

Russia might also introduce travel restrictions against Moldovan workers (around 300,000). In 2013, more than 21,000 Moldovans were blacklisted and thus prohibited from entering Russia. Since January, a further 6,000 have been added to the list, according to representatives of the Moldovan diaspora in Moscow. Russia can also disrupt passenger traffic, creating more problems for Moldovans who travel to the country. Since May, Russian aviation authorities have, without explanation, refused to permit large Air Moldova aircraft to land in Moscow and St. Petersburg. Russia might also try to disrupt wire transfers to Moldova. In 2013, remittances represented 24% of Moldova's GDP, and 68% of money transfers originated from Russia.

The combined immediate effect of these economic measures directed against Moldova would have the potential to fuel social discontent, and undermine both Moldova's economic growth and the pro-European coalition ahead of the elections. In addition to economic tools, Russia could make use of provocations in Transnistria or encourage separatism in autonomous Gagauzia,¹ to destabilise the political situation in Moldova in an attempt to shift government focus away from the European integration agenda.

Shaping Political Will for the Next Four Years. While the AA is expected to come into force provisionally in October, the outcome of the parliamentary elections in Moldova will be decisive for the pace of AA implementation. Depending on the configuration of power, Moldova could speed up European integration or drag feet on it. Public opinion polls predict that members of four political parties will be elected to parliament: the Communist Party (CP), the Liberal Democratic Party (LDP), the Democratic Party (DP) and the Liberal Party (LP). The latest public surveys are favourable for pro-European coalition. An opinion poll released by the Institute for Public Policy in Chişinău reveals a sharp decline in support for the Communist Party (which until recently campaigned for accession to the

¹ A. Sobják, "Is Transnistria the Next Crimea?," *PISM Bulletin*, no. 49 (644), 11 April 2014.

Russian-led Customs Union) from 34.3% in November 2013 to 24.3% in April. At the same time, combined pro-European forces together (the LDP, the DP and the LP) are estimated to have the support of 30.3% of citizens.

However, the advantage of a potential pro-European coalition could melt away under the impact of Russian economic measures, the opposition's efficient "blame the government" policy, and intra-coalition squabbles. Despite the potential for good electoral scores, it is by no means certain that the pro-European alliance will be re-established after the elections. There are growing signs of discontent within the Communist Party, which lately scaled down critical discourse towards European integration and moved slightly to the centre of the left of the political spectrum. Weaker internally, and with slightly moderate discourse, the Communist Party might turn out to be a more attractive post-election coalition partner for the smaller, centre-left, DP. In these circumstances, a centre-left coalition of the kind that Russia tried to foster in Moldova in 2010 cannot be totally ruled out in 2014. Thus, whether Moldova will have a strong political will to implement the AA after the elections is an open question.

Applying the DCFTA to a Divided Country. In principle, the DCFTA could bring significant benefits for Transnistria. It would allow sales on European markets to be maintained, and even increased, due to the removal of trade barriers. This is vital for an economy as dependent on external trade as that of the breakaway region, especially as almost half of Transnistria's exports go to EU markets (primarily to Romania, Italy, Germany and Poland), and some 30% to the rest of Moldova (defined in Transnistrian statistics as foreign trade). These are products that could not easily be reoriented to the much saturated Russian market. The DCFTA would also help diversify the region's exports, 80% of which are from just three sectors (metal products, energy products, and light industry goods, mainly textiles) produced by only a few large industrial companies. Moreover, increased incomes from tariff-free exports would also pave the way for investments, thus making the economy more sustainable.

Yet in practice, even if the DCFTA is economically beneficial for Transnistria, politically it will remain unaffordable, because Russia opposes it. Besides, applying the DCFTA would also bring some costs for Tiraspol. Apart from legal approximation costs, which the EU is ready to cover, it would need to renounce indirect aid provided by Russia to Transnistrian companies through subsidised prices for natural gas. In fact, it is partially this cheap energy that makes Transnistrian exports competitive abroad.

The lack of consensus in the political elite, the split between business and political interests, and pressure from Russia, are three factors that make it extremely difficult to predict what Tiraspol will do. Yet the region will probably stick to its current defiant position. Tiraspol might also advocate privately for an extension of the Autonomous Trade Preferences (ATP) regime beyond 2015. The main question is, what will the EU response be? One possibility is that, instead of the ATP, the EU will apply the principle of "most favoured nation" to the breakaway region from 2016 (for example, by re-introducing customs tariffs) if Transnistria does not start DCFTA implementation. This would mean an estimated 5.2% drop in the region's GDP. Another scenario is that the EU will tolerate selective application of the DCFTA by Transnistria, meaning that companies will continue to benefit from the preferences on exports to EU markets by registering and being certified in Chişinău.

Recommendations. To help the pro-European coalition face challenges after signing the AA, the EU has to continue to provide political and diplomatic support reflected in high-level visits to Moldova. It should also join the Moldovan government's efforts to advertise how funds provided to Moldova have already had a positive impact on people's lives. Large, long-term international observation missions will be instrumental for objective assessment of the elections and international legitimisation of the outcome. This is particularly important if there are orchestrated protests to challenge the results. International observers should pay special attention to autonomous Gagauzia, where several politicians have threatened to boycott the elections as a pre-emptive challenge to the legitimacy of the eventual parliament.

Although the EU has pledged to increase import quotas for Moldovan fruit in order to partially mitigate the effects of Russia's restrictive economic measures, in the short run, Moldovan farmers will not be able to extract the maximum benefits of greater access to EU markets without substantial investments in equipment (for instance, calibration and sorting facilities). The EU, via its financial institutions (such as the European Investment Bank), can play an important role in increasing the competitiveness of Moldovan farmers. EU Member States, such as Poland, which have successfully reformed their agricultural sectors, could provide expertise and necessary know-how. Moldova's structural dependence on remittances cannot be offset in the short run. Nevertheless, the EU should boost and extend its financial support beyond 2015 for the "PARE I+I" programme, aimed at attracting and converting remittances into investments in small and medium-sized businesses. The programme offers new economic opportunities at home for Moldovans who have previously migrated to Russia or the EU.

If stripped of the continued benefits of the ATP, Transnistria would become even more dependent on Russian financial help. The least harmful from the EU perspective would be temporary acceptance of a partial implementation of the DCFTA by Transnistria. Letting businesses profit from more advantageous trade with the EU could, in time, exert leverage on the political elite. For such a compromise, however, it will be necessary to create a system of incentives for Transnistrian companies, so that they can achieve EU requirements. Rigorous control of all goods traded with Transnistria also needs to be enhanced along the Transnistrian section of the Moldovan-Ukraine border so that the rules of origin can be properly applied.