

ECONOMY AND FINANCE

FISCAL AND BUDGETARY ASPECTS OF THE REINTEGRATION OF THE REPUBLIC OF MOLDOVA

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This paper presents the main results of an independent analysis of the fiscal-budgetary implications of the reintegration of the Transnistrian region with the Republic of Moldova, essential constraints that will mark the reintegration process.



The analysis shows that the Transnistrian region will be facing insurmountable structural difficulties in the case of extending the "independence" scenario, which is not recognized internationally.



On the one hand, it is clear that reintegration involves very high costs, especially in the early stages. On the other hand, reintegration entails enormous long-term economic benefits both for the right and left banks of the Dniester.

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INTRODUCTION

The purpose of this document is to present the main results of an independent assessment of the fiscal-budgetary implications of the reintegration of the Transnistrian region with the Republic of Moldova. The results could be used directly in the process of developing a reintegration plan. Such a plan will obviously consider other aspects than strictly fiscal and budgetary ones, but the latter could be the essential constraints that will mark the reintegration process.

The document begins with the economic diagnosis of the Transnistrian region. The first chapter focuses on the socio-economic risks and macroeconomic imbalances that impact the region sustainability.

Chapter two analyses the economic prospects of the Transnistrian region in the status-quo scenario, the one in which the region chooses the continuation of internationally unrecognized "independence". As the chapter shows, a possible crisis triggered by the rising price of gas in the year 2025 could be a defining factor for the evolution of the region in the foreseeable future.

Chapter three models the adoption by the regional authorities of the Moldovan tax and customs policy and assesses the impact on the Transnistrian economy. The analysis is carried out on the basis of a Computable General Equilibrium model of the region, which allows consideration of the complex ways in which the effects of fiscal adjustments propagate in the economy.

Chapter four makes a time projection (up to the horizon of 2040) of the most significant budget costs involved in the reintegration of the region. The projections are based on the assumption that the Government of the Republic of Moldova aims for a rapid socioeconomic convergence of the two banks. The convergence of the income level of the Transnistrian region to the level already reached and continuously growing of

the right bank, as well as the expansion in the region of public services financed at the level of the right bank, are two indispensable conditions for the sustainability of reintegration. In the absence of socioeconomic convergence, the reasons for reintegration will always be contested by the left bank.

Chapter five presents the main conclusions that can be drawn from the analysis. The chapter addresses a series of recommendations to the Government in order to minimize and manage the risks related to the reintegration process.

The methodological approach is based on a combination of the general equilibrium analysis with macro-financial projections. The author used statistical data published by the de facto authorities of the region. The use of this data does not imply a recognition or appreciation of the "statehood" of the Transnistrian region. The names of the respective authorities ("central bank", "ministry of economic development") are used only to easily identify the entity producing the statistical data. The phrases "The Transnistrian region", "left bank" are used interchangeably with reference to the same entity. The phrase "Republic of Moldova" refers to the space controlled by the constitutional authorities.

The author did not set out to evaluate the quality of the statistical data, but the analysis process revealed serious problems related to their consistency, coherence, coverage and temporal relevance of the data. The datasets produced and used in the analysis – such as the input-output table and the social accounting matrix of the region – should be viewed as approximate representations of the regional economy. Therefore, the results of the analysis should be considered as indicating the magnitude rather than the certain values of the costs of eventual reintegration. As higher-quality and more comprehensive data are obtained, the instruments, results and conclusions could be revised, adapted and clarified.

1

ECONOMIC DIAGNOSIS OF THE TRANSNISTRIAN REGION

Population

The official number of the stable population of the Transnistrian region at the beginning of 2023 was 456.1 thousand people¹. Heavy emigration is a strong reason to suspect that the population with usual residence is lower. Starting from the 2015 census data and those regarding the enrolment of children in education, and applying demographic balance equations, a more realistic estimate is that the region's population ranges between 405.0–425.0 thousand people. The post-2015 evolution of population correlate indicators – the number of marriages, the household water consumption and total deaths – validates these estimates. The level of 415 thousand can be referred as to the most probable number of the usual residence population in 2023. Although some estimates circulate in the public sphere according to which the population of the region would be around 300-350 thousand people, the author doubts their substantiation. In particular, such a small population would strongly dissonate with the

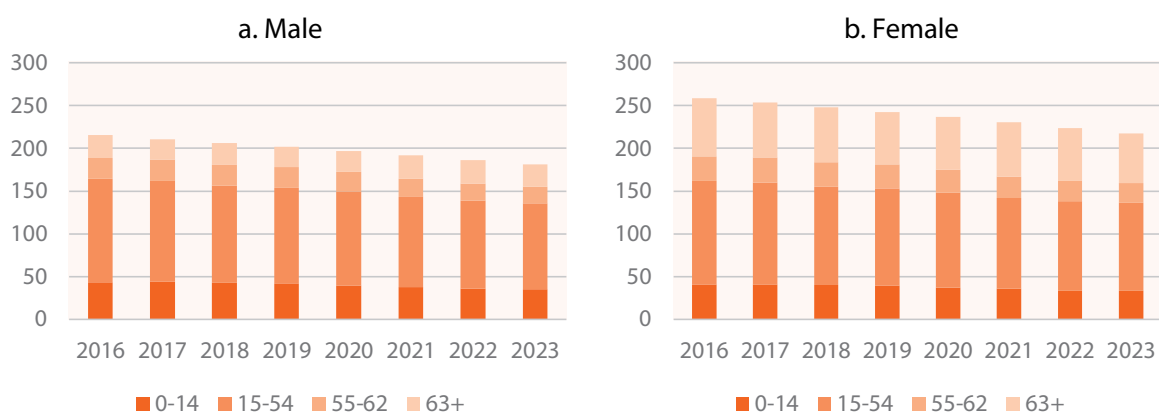
number and age profile of deaths reported in the region².

Out of 415 thousand population, 181 thousand are men (45 percent of the total) and 227 thousand are women (55 percent), an imbalance that reflects a more intense emigration of young men and a higher death rate among elderly men. The population under working age (0-14 years) estimated for 2023 is 61 thousand (15 percent of the total), compared to 65.5 thousand in 2016 (14 percent). The working-age population (between 15-54 years for women and 15-59 years for men) is about 223 thousand people (53 percent), compared to 275 thousand (58 percent) in 2016. The population over the working age is 129,7 thousand (31 percent of the total), compared to 134 thousand (28 percent) in 2016.

Thus, starting from an already high level of demographic aging in 2016, the region continued to age rapidly. Figure 1 shows the evolution of the young, adult, pre-retirement and retirement population (according to the 63-year retirement

Figure 1.

Evolution of the population with usual residence of the Transnistrian region by gender and by standard age groups, in the period 2016-2023, persons

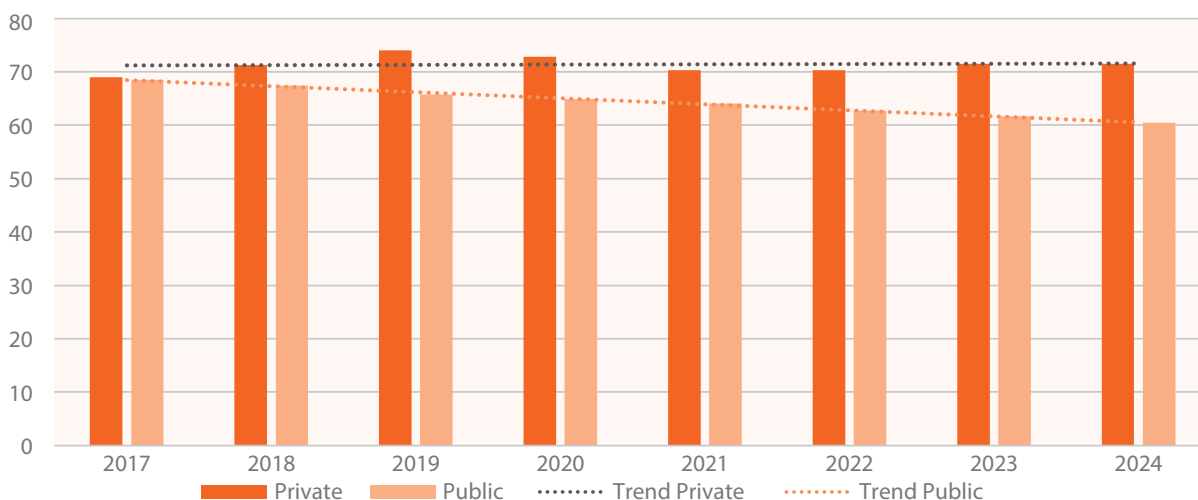


Source: The author's estimates

¹ <http://mer.gospmr.org/deyatelnost/gosudarstvennaya-sluzhba-statistiki-gosstat.html>.

² КРИВЕНКО, Андрей. „Динамика смертности в Приднестровье в 2014-2021 гг.“ в „Creșterea economică în condițiile globalizării”, Ed. 16, 12-13 octombrie 2022, Chișinău. Moldova: INCE, 2022, Ediția 16, Vol.3, pp. 39-47. ISBN 978-9975-3385-7-8; doi: <https://doi.org/10.36004/nier.cdr.2022.16.4>.

Figure 2.
The evolution and trends of the employed population in the period 2017-2024, by the forms of ownership of the employing organizations, thousands of people, beginning of the year



Sources: cited in footnotes 2-4, author's estimates for 2023-2024

threshold applied in the Republic of Moldova) for the period 2016-2023.

Labour force

According to statistical yearbooks³ and the last available publication on socioeconomic situation⁴, the labour force of the Transnistrian region has contracted from 132.3 thousand at the beginning of 2017 to 127.8 thousand in 2022. The author's estimates suggest that at the beginning of 2024 the official number of employees has accounted for about 126.8 thousand people (this is without taking into account the refugee population from Ukraine).

The official figures do not include people employed in the security and customs bodies. For the 2022, their number is around 12.5 thousand, estimated by the author by corroborating data on budget expenditures and wage data, and by triangulating with open data on the number of employees in some law enforcement structures of the region⁵. The population wage employment rate for 2023 can be estimated at around 36 percent, more than on the right bank of the Dniester (30 percent). Total employment rates (wage-earning employees plus other forms of employment) are probably closer. The official number of un-

employed is 3.5-3.7 thousand people, corresponding to an unemployment rate of 2.5-2.7 percent, which is practically at the level of the unemployment rate on the right bank of the Dniester.

About 46-48 percent of the population of the Transnistrian region is employed in the public sector, which is in a slight decrease compared to the beginning of 2017 (50 percent). The employment in the public sector offers the population a safety cushion in the short term, but represents a long-term vulnerability as the region's public sector itself is financially fragile. It is noteworthy that the absolute decline in employment in the public sector was not accompanied by a compensatory increase in employment in the private sector (Figure 2) – the region's private sector simply cannot create enough jobs.

At the beginning of 2024, approximately 19 percent of the population was employed in the industrial sector, down compared to the beginning of 2017 (21 percent). The trade and food services sectors have overtaken the industrial sector, becoming the main employer of the population (from 18 percent in 2017 to 20 percent in 2024). Agriculture increased its employment, both as an absolute indicator (from 9 thousand to almost 11 thousand in 2024) and relative one (from 7 percent to 8 percent). Apparently minor, this evolution could reflect the existence of some competitive advantages of the agricultural sector which traditionally has not been seen as a privileged one in the economy of the region. Employment in the education and health care service sectors declined continuously over the period, following the decline in the population. Employment in the utilities and energy service sectors has been relatively stable, which is no accident, as the sector is one of the main beneficiaries of public subsidies and a creditor of "government". The construction sector has maintained the employment thanks to some infrastructure investment programmes.

3 <http://mer.gospmr.org/deyatelnost/gosudarstvennaya-sluzhba-statistiki-gosstat/informacziya/ezhegodnik-gosudarstvennoj-sluzhby-statistiki.html>.

4 <http://mer.gospmr.org/wp-content/uploads/2022/07/doklad-okonch.-2021-g.doc>.

5 Appendix No. 56 to the report on the execution of the republican and local budgets, special budget accounts (funds) for 2022 <https://minfin.gospmr.org/wp-content/uploads/2023/03/komplekt-2022-god.rar>.

Table 1.

The evolution of employment by economic sector in the period 2017-2024, thousands of people, beginning of the year

Sector	2017	2018	2019	2020	2021	2022	2023e	2024e
Industry	27,4	27,3	27,0	26,2	25,5	24,8	24,5	24,0
Agriculture and forestry	9,0	9,3	9,7	10,1	9,7	10,2	10,4	10,6
Constructions	2,4	2,4	2,4	2,5	2,4	2,5	2,5	2,6
Transport, telecommunications, IT	9,0	9,1	9,5	9,7	9,2	9,2	9,4	9,4
Trade and food services	23,9	25,0	26,3	24,9	24,9	24,7	25,2	25,0
Communal household services	8,4	8,7	9,0	8,9	8,4	8,3	8,5	8,3
Health, social insurance	13,8	13,8	13,8	13,4	13,5	13,0	13,0	12,9
Education	21,2	20,8	20,3	20,0	19,3	18,9	18,4	18,1
Culture, art, science	4,0	4,0	4,0	3,9	3,7	3,7	3,7	3,6
Financial and real estate services	4,6	4,3	4,2	4,3	4,1	4,2	4,1	4,1
Public administration	6,9	6,7	6,2	6,2	6,2	6,1	5,9	5,8
Other sectors	1,9	2,0	2,0	2,3	2,1	2,2	2,3	2,3
Total	132,3	133,5	134,5	132,5	129,1	127,8	127,9	126,8

Sources: cited in footnotes 2-4, author's estimates for 2023-2024

Income and standards of living of the population

The general income structure of the population of the Transnistrian region shows a very high dependence of the well-being of its people on social transfers (Table 2). Almost 28 percent of their income derive from various social benefits (in particular, old-age pensions), while on the right bank this income accounts for about 19 percent of total income. On the right bank, the income from autonomous economic sources (wages and entrepreneurial income) accounts for 50.8 percent and 15.5 percent, respectively, while in the Transnistrian region – 41.4 percent and 5.2 percent, respectively. It is possible, however, that “other income” (10 percent of the total) partially includes wages and informal entrepreneurial income. The income from remittances has a slightly higher share in the Transnistrian region (15.5 percent) than in the Republic of Moldova (12.5 percent).

The two most important sources of income – the salary and the old-age pension – were higher in the Transnistrian region than in the Republic of Moldova until 2016, both in nominal terms (at the “ruble”/MDL “official” exchange rate) and in terms of purchasing power (Figure 3). More recently, the situation reversed, with the region showing an increasingly pronounced divergence from the right bank. In 2023, the average salary in the region, recalculated in Moldovan lei, was about 7.3 thou-

Table 2.

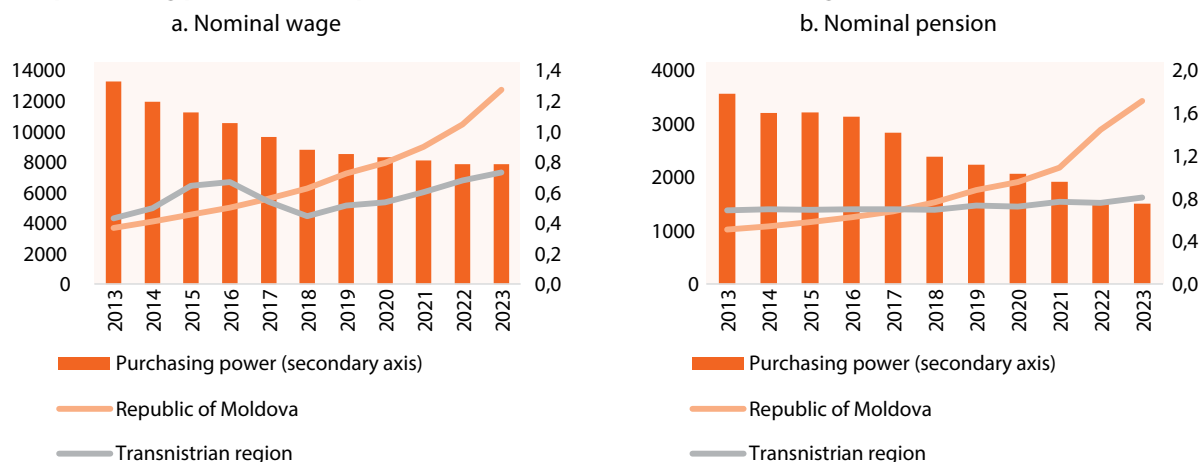
The comparative structure of the population's income in 2021, percent of the total

income	Republic of Moldova	Transnistrian region
Salaries	50,8	41,4
Entrepreneurial income	15,5	5,2
Social benefits	18,5	27,6
Remittances	12,5	15,5
Other incomes	2,7	10,3
Total	100,0	100,0

Source: NBS for the Republic of Moldova, “central bank” for the Transnistrian region on the left bank

sand MDL, compared to 12.7 thousand MDL on the right bank. In the case of the pension, the gap has grown even more, the average level being 1.6 thousand MDL in The Transnistrian region and 3.4 thousand MDL in the Republic of Moldova. Using the subsistence minimum established on the two banks of the Dniester for adjustments to the absolute price levels, it can be estimated that the purchasing power of the salary in the Republic of Moldova is 20 percent higher than in the Transnistrian region, and that of the pension – 25 percent

Figure 3.

The comparative evolution of the average nominal salary and the average nominal pension (Moldovan lei), and their purchasing power in the Republic of Moldova and the Transnistrian region


Note: The purchasing power is expressed in relative terms, as a ratio between the basket of products and services that can be purchased by a monetary unit in the Republic of Moldova and the basket purchased by the same unit in the region.

Sources: NBS for the Republic of Moldova, "statistical yearbooks" of the Transnistrian region for the Transnistrian region, author's estimates for purchasing power

higher. For comparison, in 2016 the purchasing power of the salary in the Transnistrian region was 33 percent higher than in the Republic of Moldova, and that of the pension – by 78 percent higher.

Prices for food products on both banks of the Dniester are broadly aligned (Table 3). In 2022, the food basket included in the table was 2.5 percent more expensive in the Transnistrian region, and in 2023 – 5 percent cheaper. The price convergence is favoured by the intense cross-river trade.

The comparison of prices for non-food products and services is more difficult, because opposite to the foodstuffs, data on the standard prices of some non-food products and services

for both banks are not available. However, a comparison based on open sources shows that the major differences are attested, in particular, for services (Table 4). The price for natural gas paid by the households in the Transnistrian region in December 2023 was 12 (!) times lower than in the Republic of Moldova, and if the compensations received by households from the Moldovan Government were eliminated, the price would be 17(!) times lower. Gas is also cheaper for industrial producers (about 6 times), which translates into lower prices for other products and services. For example, electricity in the Transnistrian region is 3 times cheaper, while the urban electric transport – 1.7 times cheaper than on the right bank.

Table 3.

The average consumer prices for several socially important food products in the Transnistrian region, percent of the average prices in the Republic of Moldova

The product	Dec 2022	Dec 2023
Fruit juice for children	55,2	58,4
Wheat flour bread, quality 1	55,9	59,3
Beef (muscle)	72,6	64,4
Sausage, made of beef, pork or a mixture	79,9	68,9
Bread made from wheat flour, superior quality	71,6	73,0
Minced meat, mix (pork and beef)	80,7	74,6
Spaghetti	87,9	77,1
Cream, with a fat content of 20 percent	98,2	77,2
Bread made from wheat and rye flour in a mixture	82,0	80,0
Beef, on the bone, fresh	85,4	80,8
Food product for babies' type "Malis" or "Maliutca"	80,6	83,0
Boneless pork (lean)	94,5	83,7
Unrefined sunflower oil, sold in bulk	102,1	84,2
Dried garlic	124,6	84,9
Fresh water carp, whole, 25-30 cm long	110,1	88,3

Pork ribs, fresh/chilled	104,1	89,4
Chicken carcass, fresh/chilled/frozen	94,5	89,6
Kefir, fat 1 percent	97,0	90,1
Chicken legs	96,2	90,4
Argentina, headless	125,1	91,6
Apples, other varieties	86,8	92,2
Cow's cheese, with a fat content of 5 percent	99,7	93,5
Wheat groats, packaged by the manufacturer	81,2	93,7
Wheat flour, superior quality, packaged by the manufacturer	89,2	95,7
Homemade butter "taranesc", with a fat content of 72.5 percent, packaged by the manufacturer	104,6	96,1
White round grain rice packaged by the manufacturer	116,6	96,8
Pariser "Milk"	107,5	96,9
Carrot	107,3	97,6
Frozen hake, whole, headless	113,1	97,9
Cottage cheese, homemade, in bulk	109,7	98,9
Potatoes	94,1	100,0
Flour pasta (different forms) domestic product, excluding Spaghetti	99,0	101,6
Crystal sugar, packaged by the manufacturer	104,3	102,2
Beet	102,8	102,8
Chicken eggs, widely consumed	117,0	103,9
Fresh water crucian carp, fresh, whole 15-20 cm long	115,4	104,5
Dry onion	105,6	111,3
Fresh pasteurized milk, 2.5 percent fat, local producer	115,4	113,8
Good quality dry white beans sold in bulk or bagged	124,7	114,5
Dried peas, sold in bulk or packaged by the manufacturer	121,4	114,9
Fresh pasteurized milk, 1.5 percent fat, local producer	127,9	118,9
Buckwheat groats, packaged by the manufacturer	101,6	121,9
Oatmeal, packaged by the manufacturer	122,5	122,9
Semolina groats, packaged by the manufacturer	126,2	123,0
Sunflower oil, refined, packaged by the manufacturer	140,6	133,2
Cabbage	146,1	133,6
Cream, with a fat content of 10 percent	137,9	136,7

Sources: Author's calculations based on „Average Consumer Prices”

https://statistica.gov.md/files/files/serii_de_timp/preturi/IPC/Preturi_medii_produce_social_importante.xlsx și „ЭКСПРЕСС – ИНФОРМАЦИЯ «О СРЕДНИХ ЦЕНАХ И ТАРИФАХ НА ТОВАРЫ И УСЛУГИ В ПМР ЗА ДЕКАБРЬ 2023 ГОДА», „ministerul dezvoltării economice” a regiunii transnistrene <http://mer.gospmr.org/deyatelnost/gosudarstvennaya-služhba-statistiki-gosstat/informacziya/czeny/o-srednih-czenah-i-tarifah-na-tovary-i-uslugi-v-pmr.html>.

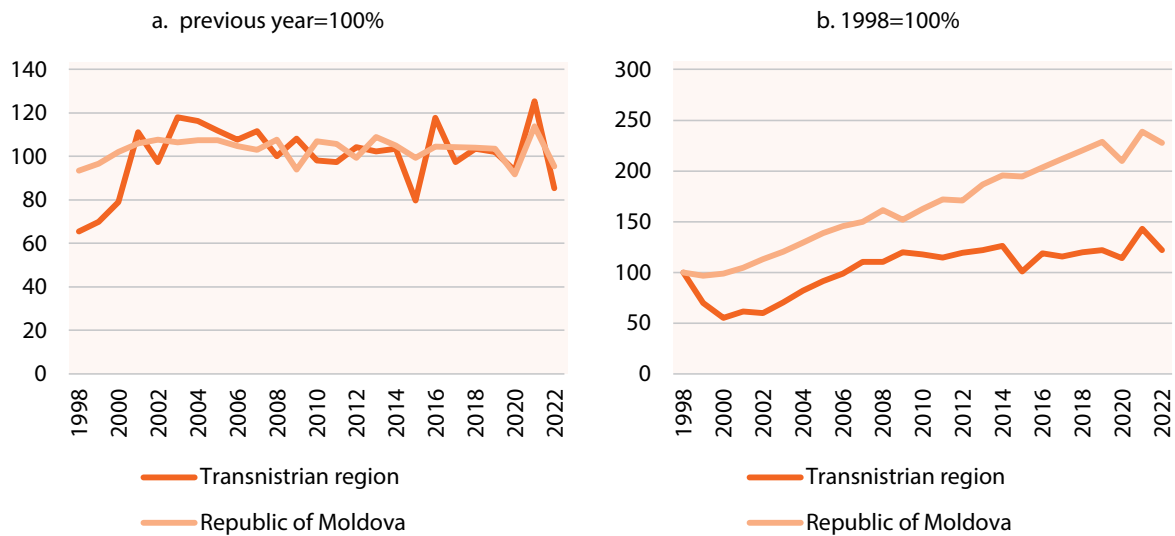
Table 4.

The price level for fuel and some services in the Republic of Moldova and the Transnistrian region, MDL equivalent, December 2023

Products and services	Republic of Moldova	Transnistrian region
Diesel fuel	21,0	22,0
Gasoline	23,0	23,4
Natural gas	0,8	0,8
Electricity	13,1	1,1
Intercity transport	2,4	0,7
Urban electric transport	6,0	3,4

Sources: author's calculations based on „ЭКСПРЕСС – ИНФОРМАЦИЯ «О СРЕДНИХ ЦЕНАХ И ТАРИФАХ НА ТОВАРЫ И УСЛУГИ В ПМР ЗА ДЕКАБРЬ 2023 ГОДА” (EXPRESS INFORMATION “ON AVERAGE PRICES AND TARIFFS FOR GOODS AND SERVICES IN THE PMR FOR DECEMBER 2023).

Figure 4. GDP indices in the Transnistrian region and the Republic of Moldova, percent



Sources: National Bureau of Statistics for the Republic of Moldova, “Ministry of Economic Development” for the Transnistrian region, and author’s calculations.

Aggregate supply

A defining feature of the long-term economic evolution of the Transnistrian region is the remarkable volatility. The episodes of significant recession were followed by spectacular growth (Figure 3, panel a.). Compared to the economy on the right side of the Dniester, the economic volatility in the Transnistrian region, in the period 1998-2022, was 3 times higher⁶. The average growth rate of the region’s GDP (0.3 percent) was considerably lower than on the right bank of the Dniester (3.2 percent), causing a clearly defined economic divergence (Figure 3, panel b.). In 1998, GDP/capita in the Transnistrian region was about 5 percent higher than on the

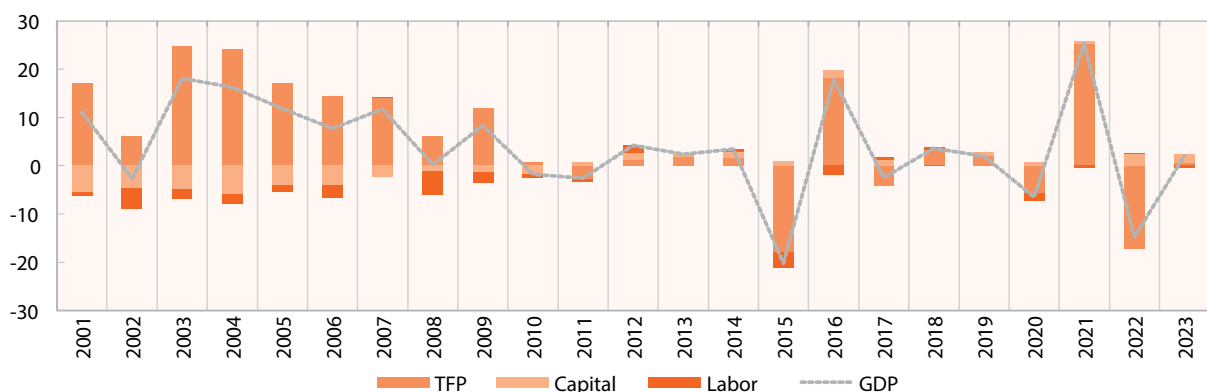
right bank of the Dniester (492 USD versus 465 USD). By 2022, GDP/capita in the region was around USD 2,720, half the level of USD 5,719 achieved on the right bank.

A *Cobb-Douglas* decomposition of the regional economic growth by main sources shows that total factor productivity (TFP) had the main contribution to GDP variation, both in the case of isolated recession-recovery cycles, and throughout the entire period (Figure 4). The strong and relatively stable economic growth in 2001-2008 driven by total productivity growth was followed by a period of much slower and more volatile growth, also determined by a slower TFP dynamic.

Table 5 presents quantitative benchmarks regarding the contribution of production factors to economic growth by period. The 4.1 percent annual average economic growth achieved in 2001-2023 can be fully attributed to major gains in economic

6 Volatility is define as the ratio of the standar deviation of the GDP annual growth rates over the average growth rates.

Figure 5. Factor contributions to GDP growth, percent and percentage points



Sources: Author’s estimates and calculations based on sources cited in footnotes 2-4.

Table 5.

The sources of economic growth of the Transnistrian region by periods

Indicator	2001-2009	2010-2016	2017-2023	2001-2023
Average GDP growth rate, percent	9,2	0,5	1,3	4,1
Contributing factors:				
TFP growth, p.p.	15,1	0,4	0,6	6,2
Capital growth, p.p.	-3,7	0,7	1,1	-0,9
Labour growth, p.p.	-2,2	-0,6	-0,3	-1,1
Average growth of GDP/ employee, percent	13,2	1,3	1,9	6,1
Average increase in capital/ employee, percent	-4,2	3,0	2,9	0,2
Indicators of capital investments				
Net investment / capital stock, percent	1,5	7,3	1,6	3,3
Gross investment / GDP, percent	15,4	17,6	12,1	15,1

Sources: Author's estimates and calculations based on sources cited in footnotes 2-4.

efficiency (6.2 percentage points). But these efficiency gains occurred only in the years 2001-2009, associated with some initial reforms in the region, after which virtually no substantial productivity increases followed.

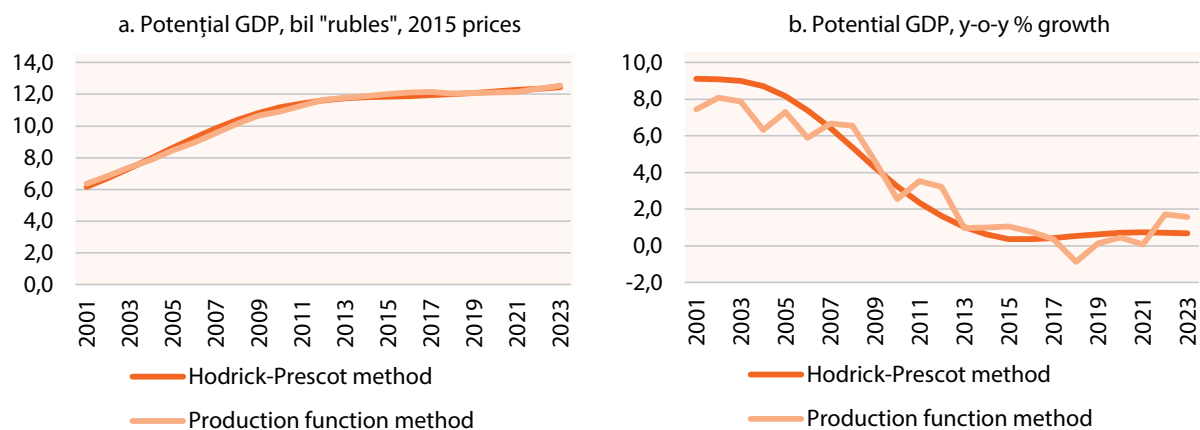
The stagnation of TFP over the last decade reflects the absence of improvements in the institutional framework, the underdevelopment of the private sector, the inappropriate economic policies that created major macroeconomic imbalances and the impact of the multiple shocks endured by the region's economy, including those related to the evolution of metal prices on the global market, of the gas supply and the access to markets.

A major risk to TFP and economic growth is related to rising natural gas prices. This is an essential input in the region's energy, metallurgical, and construction materials industries. The region practically does not pay the price for the gas delivered by the "Moldovagaz" company, which ensures economic

competitiveness for the producers in the region, including compared to economic agents on the right bank. As an example, the bricks produced on the right bank of the Dniester are twice as expensive as those produced on the left bank, while cement – 20-25 percent more expensive. On the other hand, this arrangement provides certain advantages to the Republic of Moldova as well – cheaper electricity than the one imported from other suppliers.

Capital had a negative contribution to the growth achieved in 2000-2023 (-0.9 percentage points). In the 2001-2009 period, investment rates only marginally exceeded capital depreciation, resulting in a contribution of -3.7 percentage points to growth. After the more accelerated growth of investments in 2010-2016, the contribution of capital to GDP growth turned into a moderately positive one (0.7-1.1 points). But the pace of investments significantly decreased in the years 2017-2023. It can be stated with a high degree of certainty that the feeble growth of investment in 2017-2023 will result in a smaller,

Figure 6.

The evolution of the potential GDP of the Transnistrian region in the period 2001-2023

Sources: Author's estimates and calculations

possibly even negative, contribution of capital to economic growth over the next 5-10 years.

As for the labour factor, its contribution has been constantly negative both for the entire period 2001-2023, and for each of the three sub-periods analysed. The unfavourable demographic perspectives of the region in the following two decades practically guarantee a negative contribution of labour to the economic growth that could be achieved in the medium and long term.

Altogether, the data clearly show to the stagnation of the region's potential output. The potential GDP, an indicator that smooths out cyclical variations in real GDP, reflects best the evolution of economic capacities over the long term. Estimated by two alternative methods (*the Hodrick-Prescott method and the Cobb-Douglas production function method*), the potential GDP of the region shows a clear slowdown after 2010 compared to the frenzied growth period of 2001-2009 (Figure 6 panel a. for the level potential output and panel b. for growth rate). It can be stated that the potential level of the region's production is currently about 12 billion rubles (in constant 2015 prices) and that this potential is growing very slowly, by about 1-2 percent annually, held back by anemic increases in efficiency and capital stock, and negatively impacted by the decline in available labour.

Aggregate demand

Analysis of GDP on aggregate demand components shows major problems related to unobserved economic flows to/from the region. The principles of national accounts statistics require that the sum of total resources (GDP at market prices + imports) be identically equal to that of total uses (private consumption + public consumption + gross fixed capital formation + stock variation + exports).

The data published by the authorities of the Transnistrian region do not even broadly verify this basic identity. Statistical discrepancies in the period 2011-2021 accounted for 41 percent of the official GDP on average, even if a downward trend of the unexplained discrepancy is attested (Table 6). In absolute terms, in 2020 the discrepancy was USD 112 million, while in 2021 – USD 463 million.

The discrepancy could be explained by the fact that the “statistical authorities” of the region underestimate private consumption and/or gross fixed capital formation. However, the time series of large positive values on the “errors and omissions” line in the region's annual balances of payments and the unusually large imports of some products offers a more plausible explanation – the statistical discrepancy is caused by unobserved exports (i.e., smuggling).

Even these distorted figures reflect the critical dependence of the region's prosperity on access to foreign markets. Net exports have been the main contributor to GDP change over the past decade, far greater than the public and private consumption combined. In the 2012-2021 period, for which more reliable data is available, the average annual GDP growth accounted for 2.9 percent. Net exports account for 4.1 percentage points of this growth, while private consumption – +1.5 points, and public consumption – +0.42 points. The gross fixed capital formation (GFCF) and the statistical gap component were the main obstacles of growth, with -1.7 percentage points each.

Public consumption represents a substantial share of the region's GDP, accounting for about 20 percent. Gross fixed capital formation (GFCF) accounts, according to the author's estimates, for 13 percent of GDP, continuously decreasing in the last decade. At the same time, GFCF is extremely volatile, due to the very high share (85 percent) of companies' own

Table 6.

Breakdown of GDP by expenditure items, billions of “Transnistrian rubles”, current prices, unless another unit of measure is indicated

Year	GDP	Private consumption	Public consumption	Gross fixed capital formation	Stock variation	Export	Import	Statistical gap	Statistical gap, percent GDP	Statistical discrepancy, USD mln
2011	10.4	8.3	2.0	3.4	0.6	7.1	18.9	7.8	75	750.0
2012	11.2	9.7	2.3	2.8	0.7	7.9	21.0	8.8	78	786.1
2013	12.3	10.7	2.4	3.4	0.9	6.9	18.8	6.9	56	621.9
2014	13.0	10.6	2.5	3.2	-0.1	8.2	20.2	8.7	67	786.8
2015	9.9	8.5	2.1	2.8	-0.4	6.9	12.9	3.0	30	266.6
2016	11.5	8.5	2.8	2.3	-0.7	6.0	10.2	2.8	24	245.8
2017	12.3	10.1	2.5	1.7	0.9	8.5	13.9	2.5	20	184.0
2018	14.2	11.0	2.7	2.9	1.2	12.3	21.2	5.2	37	324.0
2019	14.9	15.0	3.0	3.7	0.6	11.2	20.9	2.2	15	139.3
2020	14.4	13.8	3.3	3.0	-0.1	10.6	18.0	1.8	13	112.0
2021	19.2	15.7	3.8	3.8	0.8	15.9	28.3	7.5	39	463.0

Sources: author's estimates based on “statistical yearbooks”

sources in financing investments. The own sources, in turn, varied enormously depending on internal external trade conditions. The financial sector finances only 5-10 percent of gross fixed capital formation. At the same time, from the perspective of forms of ownership, the public sector has a disproportionately large share (about 35 percent) in the total investment.

Private consumption in the last decade has been extremely unstable, reflecting the general economic uncertainty of the region, emigration and the underdevelopment of small and medium-sized businesses. Accounting for 85 percent of GDP on average, private consumption has a share comparable to that of exports. Structurally, private demand is dominated by goods (about 75 percent), unusually high for the region's income level. This is determined by low tariffs for public utilities and quasi-free gas. Therefore, not only the production but also the private consumption of the region is extremely vulnerable to the gas price.

Inflation and monetary policy

The stated objectives of monetary policy in the Transnistrian region include: supporting economic growth, ensuring financial stability and cushioning the socioeconomic impact of external shocks⁷. The declared monetary regime is targeting of the region's "ruble" exchange rate against the US dollar.

This choice could seem rational considering the acute dependence of the region on foreign markets. Under this regime, if there is control over capital flows, then a certain autonomy in monetary policy is possible. But the effective implementation of this regime is significantly limited by the absence

of control over capital flows (a consequence of the region not being recognized as a subject of international law and of border porosity), but also by increasingly more constrained access to foreign exchange resources for the formation of official reserve assets. Currently, these reserves are practically absent. The official exchange rate is set at 16.1 "rubles"/USD. It is hard to say how credible this level is, but it is telling that the market rate is higher. Previously, the region went through crises after which it had to devalue the "ruble", thus questioning the credibility of its monetary strategy.

Having a very small and open economy, the region is sensitive to supply and demand shocks. The policy of administrative control of tariffs for communal services allowed the partial amortization of these shocks but produced serious macroeconomic imbalances.

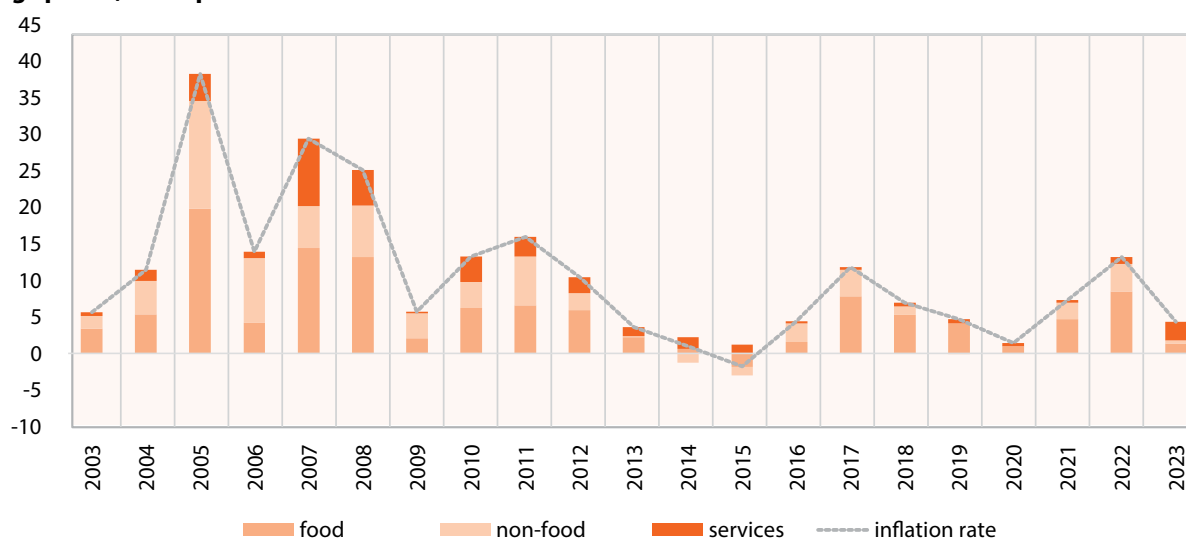
While in 2003-2013 the annual inflation rate was on average 15.7 percent, in 2014-2023 – 5.4 percent (Figure 7). Inflation in the region is largely determined by the increased price of food products (20.2 percent in the first period, 8.2 percent in the second). This is largely explained by the large share of food products in the consumption basket of households (estimated at around 40 percent). Prices for non-food products rose more slowly (16.2 percent and 3.1 percent, respectively), as did services (13.3 percent and 4.1 percent, respectively).

A substantial adjustment in prices for services, however, occurred in 2023 (+11 percent), largely due to higher prices in healthcare, rent, telecommunications, and transportation.

Despite the substantial increase in the price of natural gas on the global markets in the last years, this has not yet translated into the level of the price paid by the households and companies on the left bank (Table 4). Although it cushions short-term shocks, the subsidized gas price motivates irrational economic

⁷ https://cbpmr.net/data/onegdkp_2024.pdf.

Figure 7.
The end-of year inflation rate (percent) and the contributions of the main consumption categories (percentage points) in the period 2003-2023



Sources: According to the "central bank" data and author's estimates for contributions

behaviours in both the manufacturing and household sectors – excessive consumption, lack of investment in more advanced technologies and in energy efficiency improvements – and makes the region vulnerable to the adjustment of these prices.

The increase in the price of natural gas remains a major risk factor for inflation, because, coupled with the very high energy intensity of the economy, it can cause a dramatic decrease in domestic supply and a general increase in consumer prices. Very limited competition in the region’s commercial sector magnifies the consequences of this risk for inflation.

Financial sector

In the period 2018-2023, the average net return on assets (ROA) of commercial banks in the region accounted for about 1.5 percent, while the net return on capital employed (ROE) – 8.5 percent. Both indicators are within reasonable limits.

As of 2021, the bank liquidity ratios have improved, with liquid assets exceeding the sum of demand deposits and term deposits up to 1 year. The simulations carried out show that in the absence of other shocks, the banking system would not face major liquidity problems in the event of a withdrawal of deposits of the magnitude seen in 2015-2016. However, it is uncertain that the sector would cope with a somewhat more complex crisis, for example, a withdrawal of deposits, combined with a moderate increase in non-performing loans and the devaluation of the “ruble”.

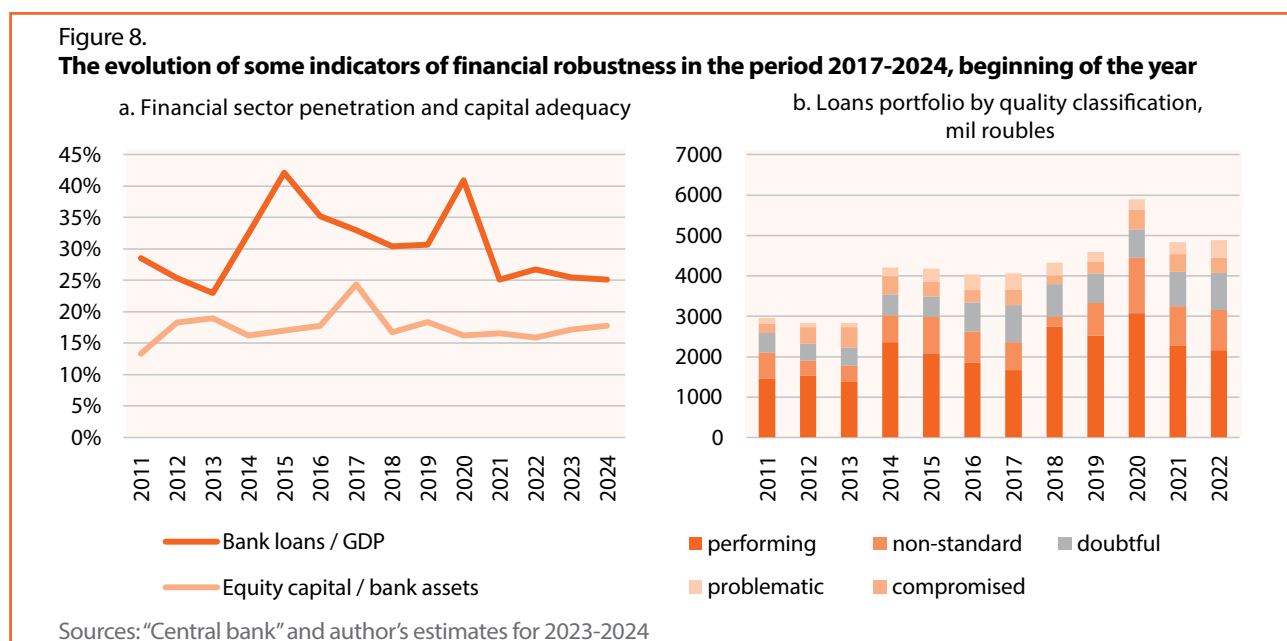
Following an exuberant and uncontrolled credit growth (from 25 percent of GDP in 2012 to 42 percent of GDP in 2015, Figure 8.a.), the region’s financial sector went through a major crisis, with the number of authorized banks falling from 6 in 2015 to 3 entities in 2018. The financial rehabilitation interventions improved the capitalization of banks,

with the ratio between share capital and assets increasing from 16.1 percent in 2014 to 24.3 percent in 2017. Even though later on it started to decrease again, the estimated shareholder capital adequacy level for 2024 of around 17-18 percent seems quite reasonable. Under normal conditions, at such a level of capitalization, the probability of insolvency of the financial sector is very small.

However, big unknowns are related to the real evolution of the capitalization level after 2021 and the quality of assets declared by commercial banks (Figure 8.b). At the beginning of 2014, the non-performing loans (NPL), i.e. problematic, doubtful or compromised loans, accounted for 28 percent of gross loans. By any modern standards of financial prudence, this indicator shows already a very high level of risk. After 4 years, in 2017 their share reached 42 percent. After the rehabilitation of several banking institutions, the NPL ratio dropped to 25 percent at the beginning of 2020, but then again increased sharply. At the beginning of 2022, their stock represented 35 percent of the gross portfolio and, according to the author’s estimates, this level persisted at the beginning of 2024. In the event of a shock in the real sector of the economy – such as an increase in the price of gas to the level paid on the right bank – the NPL share would quickly reach 55-60 percent of the portfolio, setting in motion a vicious mechanism of bank decapitalization and insolvency.

It should be mentioned that the more decapitalized the region’s banks will become, the more difficult, in the case of the reintegration scenario, will be the enforcement of the prudential norms accepted by the NBM. This may also have implications on the budgetary costs of reintegration – these costs may increase significantly if the Government of the Republic of Moldova will have to allocate resources to save the Transnistrian banks.

Another major risk is related to the currency structure of



the banks' balance sheets. In the event of a depreciation of the regional ruble, the position of banks seems favourable since the foreign currency denominated portion of banking assets (62 percent) exceeds the share of foreign currency liabilities (57 percent). But looking strictly at the priority balance sheet items – loans and deposits of the non-financial sector – it can be seen that the banks' net currency position is strongly negative – the term currency deposits exceed the foreign currency loans by about 35-40 percent. In the event of a currency crisis associated with a 50 percent devaluation of the "Transnistrian ruble," the capital of banks in the region may fall below 10 percent of their assets.

Budgetary sector

In the last decade, the tax revenues of the region varied between 75 percent and 83 percent of the total revenues of the "public budget" (consolidated by including the "republican" budget, local budgets and the social insurance budget). The budget fiscal base shows a clear erosion tendency (Figure 9), being replaced by revenues from non-fiscal sources, in particular, from various administrative services provided, as well as ad-hoc quasi-fiscal payments (various payments and deductions to a series of special funds).

Social insurance contributions are the main tax revenue in the region's public budget, with an average share of 42 percent of total tax revenues in the indicated period. Next is the turnover tax, with a share of about 22 percent, seconded by the personal income tax, with about 12 percent. The share of the import customs tariff accounts for about 7 percent of total incomes. The budget grants account for about 1.8 percent of total revenues.

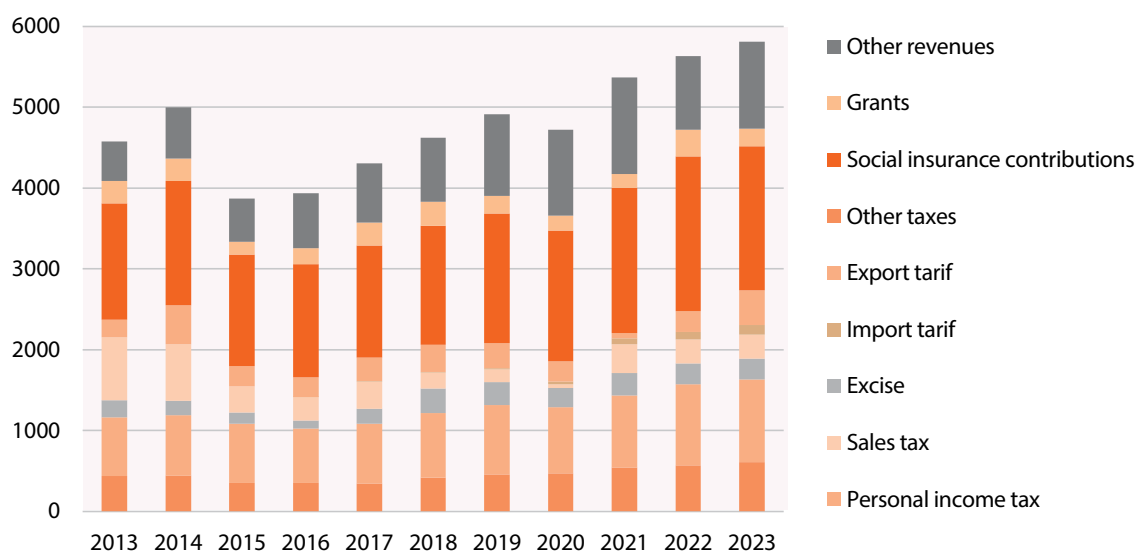
While the budget revenues relative to GDP on the two banks are at comparable levels, this cannot be said about the budget expenditures. In the Transnistrian region, expenditures in 2022 were at an extraordinarily high level compared to budget revenues, about 44 percent of GDP. Even if on a negative trend in recent years, the exorbitant expenditures are a rule rather than an exception, the average for 2016-2022 being 48 percent of GDP. In the Republic of Moldova, the budget expenditures in 2022 stood at 37 percent of GDP, for a general average of 33 percent in 2016-2022 (Figure 10).

In 2022, social protection accounted for almost 37 percent of total spending (39 percent in the Republic of Moldova), in sharp decline compared to 46-48 percent in 2016-2018. This decrease is fully explained by the decrease in the number of beneficiaries of the "single state social insurance fund", following the transition of Transnistrian pensioners from the regional public pension system to pensions received from the Russian Federation. In this way, although the pensioner-age population in the region was relatively stable, the number of pensioners registered in the insurance and social protection centres decreased from 126 thousand in 2016 to 95.5 thousand in 2022.

Education expenses have a relatively stable share of 15 percent of total expenses (17 percent in the Republic of Moldova). The COVID-19 pandemic forced the increase of health protection expenses from 8 percent of the total to 11.5 percent, especially from the "other expenses" account. Defense and public order spending increased from 10 percent in 2016-2017 to 12 percent in 2021-2022 (down from 8 percent to 7 percent in the Republic of Moldova). Expenditures for functioning of the central and local governments increased from 3 percent in 2016 to 5 percent in 2022.

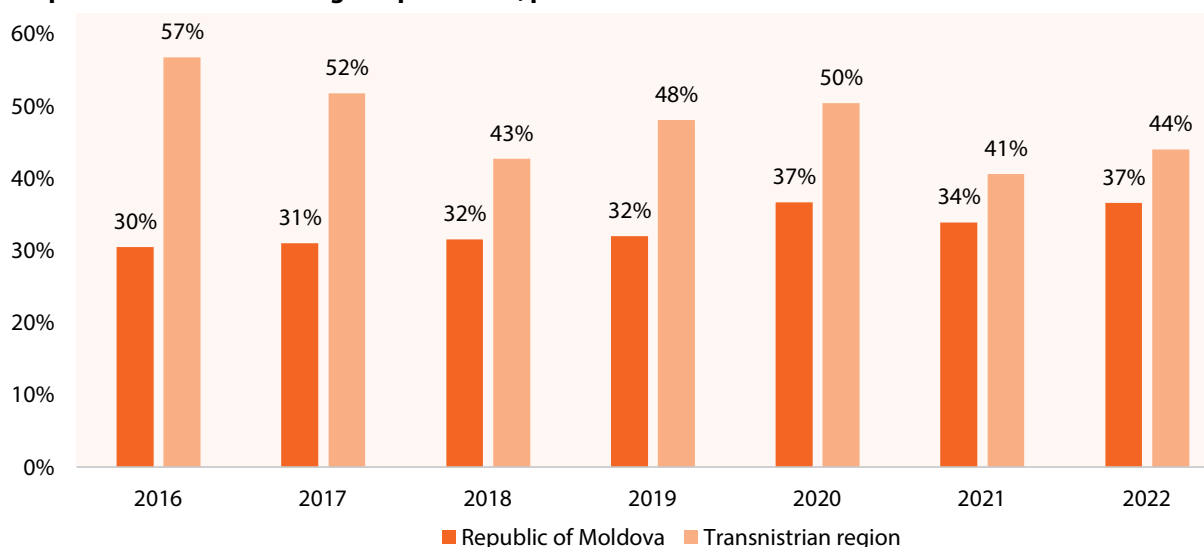
Figure 9.

The evolution of budget revenues of the Transnistrian region, millions of "roubles"



Sources: According to "statistical yearbooks", annual budget execution reports, and author's estimates for 2023

Figure 10.
Comparative evolution of budget expenditures, percent of GDP



Source: Budget execution reports and author's calculations

The comparison of the revenue and expenditure chapters clearly shows that the budget sector is the source of some of the biggest risks to the region's economic stability. These risks derive from the chronic deficits generated by the regional public budget, in the last decade their annual average accounting for 16 percent of GDP. Even if cyclically adjusted, by removing the effect of GDP variation, the deficit is enormous, around 11 percent over the period 2013-2024 (Figure 11).

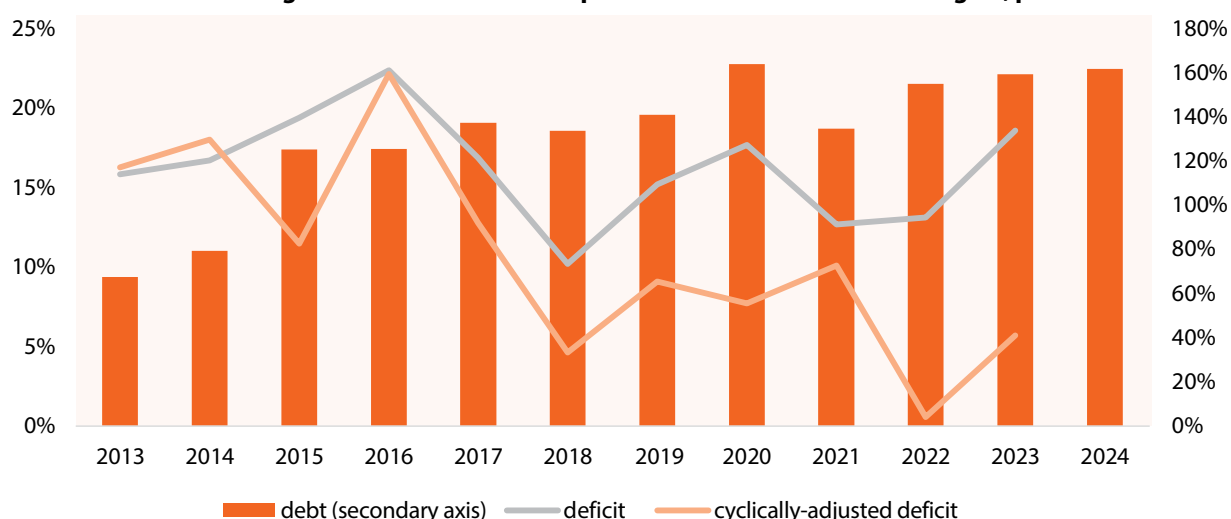
The practice of chronic deficits led to the exponential growth of public debt. The public debt of the region includes an external component of about 78 million USD (about 1.26 billion "rubles"), of which 30.3 million represents the principal of the debt received from the Russian

Federation in the period 1992-1994, while the rest – unpaid interest and calculated penalties.

But the main component of the public debt is the internal one. While in 2013 the internal debt was 8 billion rubles (66 percent of GDP), at the beginning of 2024 its absolute level reached an estimated level of 34 billion "rubles", i.e. around 160 percent of the region's GDP. The region's energy and utility companies are among the main creditors of the public budget.

A curious aspect is that practically no interest is calculated or paid on this debt, and the "repayment" of the debt is done by continuously contracting other debts. The maintenance of very high deficits, the continuous rolling of the

Figure 11.
The evolution of the budget deficit and the internal public debt of the Transnistrian region, percent of GDP



Sources: Author's estimates based on budget execution reports of the "Ministry of Finance"

debt and zero interest rates calculated on the debt clearly indicates that the strategy of the authorities probably does not even involve paying off the public debt in the foreseeable future. Under normal conditions, neither the fiscal policy nor the debt of the region is sustainable.

In the short term, the regional government is unable to repay its debt without renegotiating, restructuring and extending it forcefully. In the long term, the regional government is clearly insolvent. In only 3-4 years, the debt will exceed 200 percent of GDP. In the conditions of an unrecognized "sovereignty", the lack of access to international financing makes it impossible any restructuring strategy and repayment of this debt.

External sector

"Monetary authorities" have regularly published the balance of payments until 2021 (Table 8). The balance of payments underlines the very high level of trade dependence⁸, over 200 percent of GDP, even if in a slight decrease as a long-term trend.

Imports of goods dominate the payment balance, exceeding 2 times the exports of goods. About 50 percent of exports are directed to the Republic of Moldova, 35 percent – to the EU, both positions growing in the long term. The trade in services and primary income is insignificant, while the secondary income is very important. Secondary

income from the rest of the world (represented mostly by the private transfers, humanitarian financial aid and payments for pensions from the Russian Federation) ensures the financing of imports. The chronic dependence on the external environment, which the balance of payments attests, clearly represents a reflection of the economic impossibility of independence.

Balance of payments data show that up to 2018 inclusive, the region had an exorbitant current account deficit – minus 45 percent of GDP in 2018 and minus 60 percent on average for the entire 2007-2018 period. This series of chronic current account deficits must inevitably reflect in worsening net investment position of the region. Although the "monetary authorities" do not publish any more data on the international investment position since 2008, it is possible to estimate, starting from the initial debt level of USD 1.9 billion, that at the beginning of 2019 the total external debt of the public and private sectors reached USD 7.8 billion (Figure 12). Strictly from an accounting point of view, this represents, for the most part, a commercial private debt of the Transnistrian gas supplier to the "Moldovagaz" company. However, the legal aspects of this debt are not clear – in particular, whether or not Gazprom's agreed to continue gas deliveries despite the astronomical debt already accumulated by the region is documented.

Figure 12 and Table 7 show a significant structural break in the balance of payments in 2019. The current account deficit suddenly became very small (and in 2021 the current account balance was actually positive), the secondary income received almost tripled, and the financial account

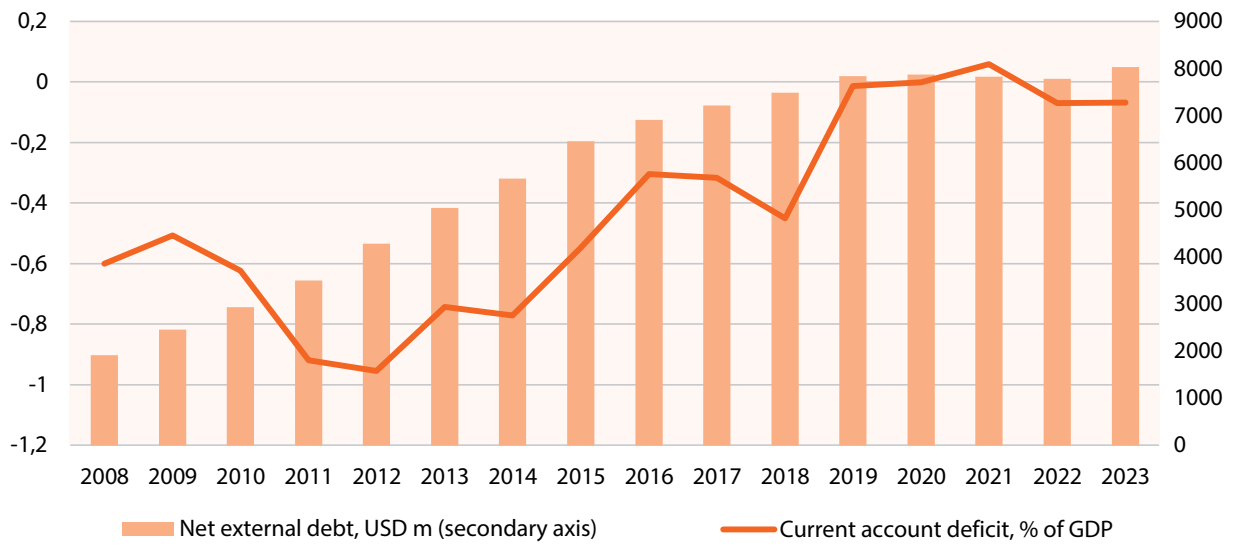
⁸ Defined as the ratio of foreign trade turnover to GDP.

Table 7.
The balance of payments of the Transnistrian region, million USD

Anul	Cont curent	Export bunuri	Import bunuri	Export servicii	Import servicii	Venituri prim., cred.	Venituri prim., deb.	Venituri secund., cred.	Venituri secund., deb.	Cont finan.	Variația rezerve oficiale	Erori / omisiuni
2007	-328.7	727.0	1131.6	56.7	114.6	6.2	22.0	173.6	24.0	300.9	-5.8	33.4
2008	-650.6	928.9	1642.6	54.4	155.4	6.2	52.4	242.6	32.3	543.8	-24.6	131.4
2009	-516.9	576.8	1111.9	44.1	136.7	7.6	46.2	175.6	26.2	483.9	2.7	30.3
2010	-649.1	528.4	1271.5	53.4	106.2	21.2	39.1	197.8	33.1	567.0	1.8	80.7
2011	-922.4	627.1	1725.9	61.8	100.2	29.9	36.6	259.6	38.1	775.0	50.7	96.8
2012	-961.7	653.3	1794.3	55.6	95.9	28.8	62.1	294.0	41.1	761.3	-77.2	277.7
2013	-827.2	556.4	1597.2	68.3	94.6	32.6	57.2	312.4	47.9	627.8	33.8	165.5
2014	-901.1	672.2	1675.5	65.9	144.7	45.4	51.5	277.5	90.4	783.5	20.3	97.4
2015	-490.2	566.2	1086.2	57.1	76.9	14.7	43.7	142.6	64.0	457.5	7.7	25.0
2016	-310.3	470.1	844.7	64.4	61.4	11.1	26.4	123.8	47.2	300.6	18.5	-8.6
2017	-292.3	573.0	971.7	63.9	64.2	10.6	37.9	178.2	44.2	276.2	11.0	5.2
2018	-399.7	705.2	1226.9	72.6	91.6	10.3	42.5	213.9	40.7	350.4	0.8	49.0
2019	-12.4	642.9	1203.4	55.8	92.9	10.9	52.8	677.1	50.0	31.0	-31.5	12.9
2020	-1.2	621.4	1031.4	39.0	83.9	10.5	51.8	553.3	58.3	-46.3	3.2	44.3
2021	69.6	938.7	1646.9	50.1	109.9	11.8	52.6	945.4	67.0	-40.0	-40.0	10.0

Source: According to the "central bank" of the Transnistrian region

Figure 12.
The evolution of the current account deficit and net indebtedness of the Transnistrian region



Sources: "Central bank" of the Transnistrian region and author's calculations

decreased almost 10 times. If this metamorphosis is not an error or an artifice of balance of payments accounting, then it can be interpreted unequivocally – the region has stopped accumulating gas debt and started receiving gas as a natural transfer from the Russian Federation (recorded in the balance of payments as secondary income). From an accounting and legal point of view, it is difficult

to understand how exactly these changes could occur, especially since the financial reports of the „Moldovagaz” company continue to reflect the increase in the debt to „Gazprom” even after 2019. Thus, contrary to what is reflected in the balance of payments, the net indebtedness of the Transnistrian region most likely continued to grow, reaching the level of USD 10.5 billion in early 2023.

2

RISKS OF THE STATUS-QUO SCENARIO FOR THE TRANSNISTRIAN REGION

Development challenges

The Transnistrian region tried to set up elements of statehood such as government, currency, army, fiscal policy, etc. But at least economically, the failure is quite obvious. The set of basic economic indicators shows that the region is unable to sustain itself at the level of the ambitions assumed by the authorities, and its geopolitical declarations and separatist options are in sharp contradiction with its own resources, the economic logic of trade interdependencies and the interests of the people.

In the long term, one of the main structural challenges is the decline and aging of Transnistrian region's population. The region has lost almost half of its population it had in 1991, and the retirement age population has reached 31 percent, continuing to grow rapidly. The savings of the elderly population are very small, making them to remain dependent on social transfers in the next decade.

The economic system represents an exotic mix of market economy and centralized planning elements, featuring the omnipresence of security structures and the pyramidal financing of public debt. This climate will make the emergence of a robust and competitive private sector extremely difficult.

Politically unaffiliated SMEs are fragile and only admitted to less profitable activities. The region's traditional industrial sectors are controlled either by the "state" or by local or foreign economic conglomerates. The functioning of the economic system will depend critically on access to foreign markets.

The economic base of the region will remain very little diversified, due to the chronic shortage of investment resources and the suppression of free private initiative. While at the beginning of the 2000s the production potential of the region increased by around 8-9 percent annually, currently the growth limits are at the level of 1-2 percent annually. More than 40 percent of the population depends on either modest pensions and social benefits, or humanitarian transfers, or foreign remittances. The fact that 30 percent of pensioners – practically all those eligible by work experience – opted for pensions paid by the Russian Federation instead of those paid from the local budget is eloquent.

Despite the transition of pensioners to the Russian pension system, social transfers still represent a third of total budget expenditures. In addition to social transfers, the region pays heavily for an unnecessarily large administration, defence, security and public order sector, and for subsidies to inefficient companies. In the last decade, the annual budget resulted in deficits of 14-18 percent. Due to fiscal policy disconnected from reality, the economy has accumulated critical macroeconomic imbalances. The public debt has reached the level of around 160 percent of the region's GDP and has no way to decrease in the foreseeable future in the status-quo scenario, limiting the fiscal space of authorities. Even if the cost of the debt is zero, the region does not have the resources even for reimbursement of the principal part of the debt. The external debt has reached the level of about USD 10 billion, with no prospect of repayment.

The region has been kept afloat thanks to the monetary and non-monetary injections from the Russian Federation (pensions, free gas, humanitarian aid, transfers of administrative know-how). In the event of their cessation, the accumulated imbalances could explode in forms that are difficult to predict and control. The main critical point in the economic construction of the region is the consumption of gas, the volumes and conditions of supply of which are uncertain. Thus, in the short term, the main challenge is specifically related to the increase in the price of gas and how the region will go through this crisis.

Gas and economic prospects

With an extensive and technologically depreciated industrial sector and an inadequate tariff policy, the Transnistrian region uses very large amounts of gas. The region receives this gas as an in-kind subsidy from the Russian Federation, in a volume equivalent to almost half of the region's GDP.

The maintenance of this subsidy is uncertain. First, the Russian Federation is facing increasingly severe budget constraints caused by the war against Ukraine and international sanctions. Second, the current gas transit agreement between the Russian Federation and Ukraine expires in December 2024 and there are high risks of its non-renewal. The Republic of Moldova already purchases gas at market

price from suppliers who have no interest in offering the Transnistrian region subsidized prices. Thus, the subsidy could disappear as early as 2025, and the region will have to transition to market prices. Thirdly, reunification under the conditions of a dual tariff is unacceptable, because it entails major competitiveness risks for the right bank, prompting migration of companies to the left bank.

A study by a team of German economists shows that the economic impact of the transition to market prices for gas would have dire consequences for the region⁹. The author's estimates based on a computable general equilibrium model applied to the Transnistrian region's economy confirm the conclusions of the quoted source (the model is described in chapter 3). Table 8 illustrates the results of some simulations of the impact of the gas price increase, starting from a mild scenario of a 20 percent increase in price up to a threefold increase of the price. The sharper the increase in the price of natural gas, the more negative the impact. To align with the price paid by households on the right bank, the price for households on the left bank would have to increase 15 times. Conventional economic models fail in simulating such extreme scenarios – an allegory for the region's economic collapse.

An increase in the gas price of even "only" 3 times means the dramatic worsening of the terms of trade (the ratio between

import and export prices). Unaccompanied by government compensatory responses and / or by technological adaptation measures by firms, this would compress the GDP by 10-11 percent. Almost 30 percent of jobs in the region could come under risk of liquidation, especially in the real sector (energy -52 percent, construction -48 percent, agriculture -32 percent, ICT -34 percent). In the budgetary sector, the immediate risks of job losses are lower (-1.6 percent in the education sector, -3.6 percent in the health care sector and -3.5 percent in the public administration sector), but these risks increase as the budget deficit deepens, and as prices rise and reduce the purchasing power of budget wages. The job loss scenario applies to the hypothetical case of maximum labour market flexibility, which is clearly not the case for the region. However, these figures show that the magnitude of the adjustments in the labour market in such a scenario is, in any case, dramatic.

While in the case of moderate price increases, the nominal budget revenues increase, in the case of the extreme scenario of tripling the gas price, the revenues would decrease by 5 percent compared to the base scenario, and population consumption – by almost 36 percent. The budget deficit, already astronomical, would worsen even more, estimated by 12 percent points. The worsening of the terms of trade and the co-evolution of real exports and imports would lead to the worsening of the trade deficit as

Table 8.

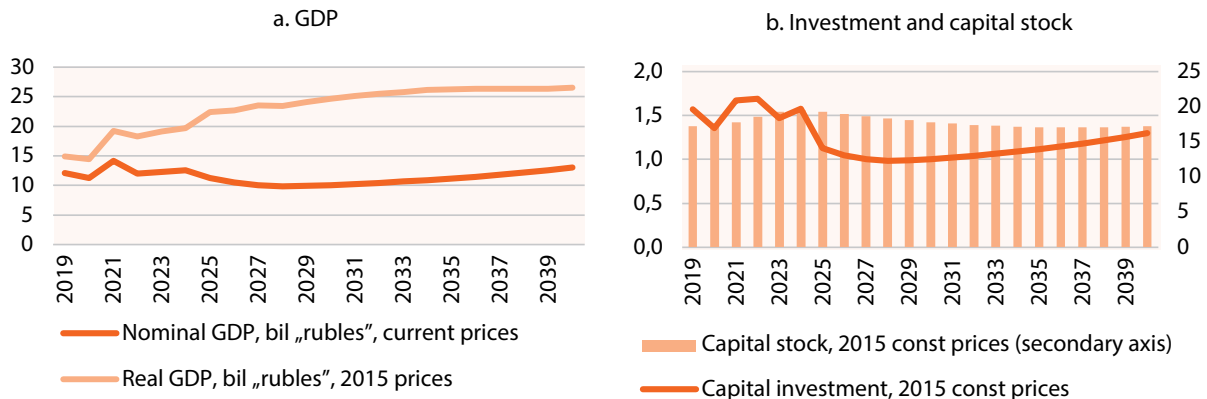
The impact of gas price scenarios on some key indicators of the region, percentage change (percent) or percentage points (p.p.) compared to the base scenario

Indicator	Gas price increase rate, percent compared to the base scenario						
	20	40	60	80	90	120	200
Gross domestic product, percent	-0,7	-1,5	-2,4	-3,3	-3,8	-5,3	-10,7
Jobs, percent	-3,2	-6,2	-9,3	-12,3	-13,8	-18,2	-34,7
Nominal budget revenues, percent	0,4	0,5	0,6	0,4	0,3	-0,3	-4,5
Internal absorption, percent	-1,7	-3,3	-4,9	-6,5	-7,2	-9,6	-16,5
Private consumption, percent	-4,3	-8,4	-12,2	-15,9	-17,7	-22,9	-35,7
Total investments, percent	-0,3	-0,6	-1,0	-1,5	-1,7	-2,6	-6,8
Exports, percent	-1,4	-3,0	-4,6	-6,3	-7,1	-9,6	-17,2
Imports, percent	-3,2	-6,2	-9,0	-11,7	-13	-16,8	-26,6
Effective exchange rate, percent	12,1	25,9	42,0	60,8	71,4	110,2	301,6
Trade conditions index, percent	-1,9	-3,8	-5,5	-7,2	-8,1	-10,5	-16,3
Investments/ GDP, p.p.	-0,6	-1,3	-2,1	-3,0	-3,4	-5,1	-11,7
Savings/ GDP, p.p.	-1,2	-2,5	-4,0	-5,7	-6,6	-9,7	-21,7
Current account / GDP, p.p.	-1,2	-2,5	-4,0	-5,7	-6,7	-9,9	-23,4
Trade deficit / GDP, p.p.	-2,1	-4,4	-7,1	-10,0	-11,6	-17,2	-40,6
Budget deficit / GDP, p.p.	-0,5	-1,1	-1,8	-2,5	-3,0	-4,6	-11,7

Source: Author's simulations

⁹ Ricardo Giucci et al, „End of gas subsidy in the Transnistrian region? Analysis of economic implications“, Berlin Economics, 2023.

Figure 13.

Evolution and projection of GDP, investments and capital stock, years 2019-2040.

Sources: Author's estimates

a share of GDP (-23 percentage points) and of the current account as a share of GDP (-40 points). Faced with an acute shortage of foreign currency, with binding constraints in accessing international loans and with the need to protect the competitiveness of exports, the authorities will have to devalue the regional currency by almost 300 percent in the first year of the crisis. Devaluation is unpopular in the region, but the alternative is the emergence of a “black” currency market.

In the hypothesis of a gradual convergence of the gas price at the international level during 3 years (3 times in the first year, 2.5 times the second year and 2 times the third year), the GDP of the region would compress by about 10 percent in the first year, by 7 percent in the second year and possibly by about 4-5 percent in the third year (Figure 13.a.). In the economic history of the region, episodes of acute recession have traditionally been followed by equally strong recoveries. After such an increase in the gas price, however, the economic growth would resume at low rates, around 1 percent annually, and depending on the investments for industrial modernization, it could increase to 2-3 percent in the long term. But after such a deep recession and massive population exodus, it is doubtful that the region will have the investment resources for rapid and sustained technological recovery. This transformational process would be similar to the one that the Republic of Moldova went through in the years 1991-1995. The difference would be that the recession in the region would be deeper and possibly more extended in time, and the region's authorities would have virtually no credible fiscal and budgetary policy options.

A major risk is related to the impact of the investment recession on the capital stock in the region (Figure 13.b). The depth and duration of the decline in capital investment could be of such magnitude that annual investment will not compensate for capital depreciation and the capital stock will degrade rapidly. It could take nearly a decade before positive capital accumulation resumes. The depreciation of the capital stock means the decrease of potential production, of exports, of incomes of the population and of budgetary revenues. The

region risks entering a vicious economic circle that will be self-perpetuating.

More expensive gas will also lead to higher prices. Although it has a share of only 2-3 percent in the consumption basket of households in the region, the gas price increase would translate into an increase in consumer prices by 27-30 percent in the first year, by 20-22 percent in the second year, and by 14-15 percent in the third year. Combined with the erosion of factors of production, the rising costs can ruin the region's competitiveness.

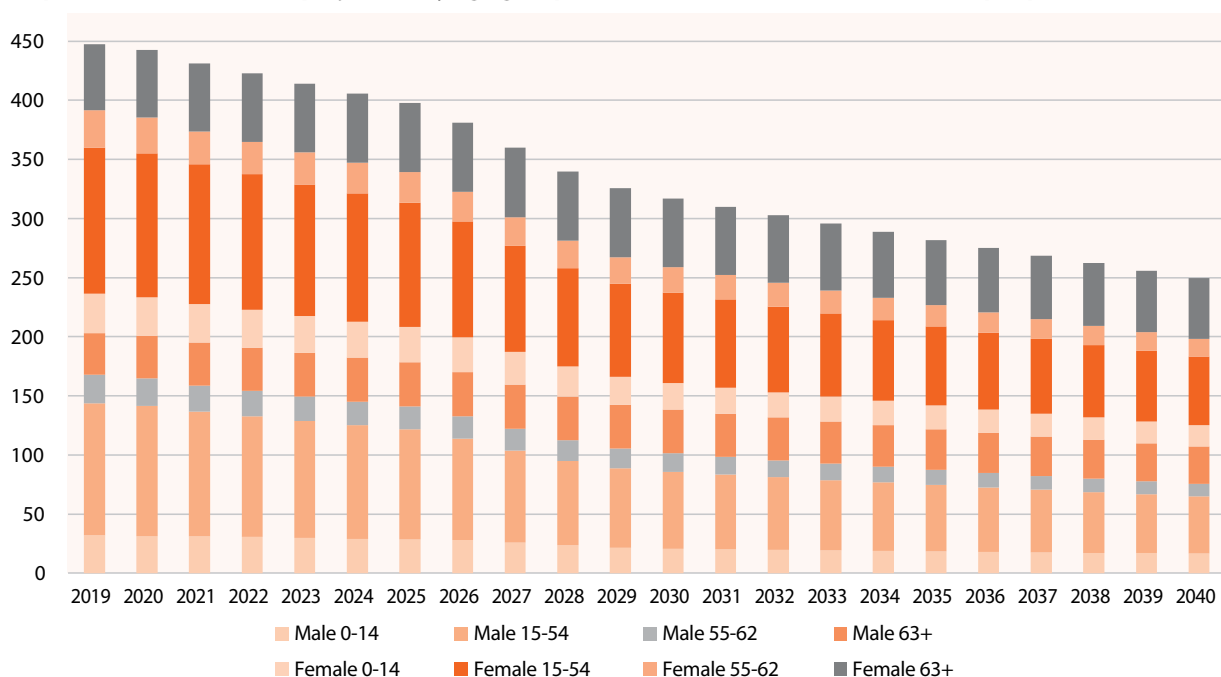
On the other hand, the increase in the gas price in the Transnistrian region will have a moderate negative impact on the economy on the right bank. A consequence of the gas price increase will be the decrease in the volume of electricity supplied by MGRES (in the most extreme situation, by 30-40 percent). The impact on the price will be more moderate, due to the devaluation of the “ruble”. However, the Republic of Moldova will have to compensate the deficit with more expensive energy procured from other sources. For the economy of the Republic of Moldova, the impact translates into the compression of GDP by about 0.25-0.50 percent compared to the base scenario. The electricity price shock is partially cushioned by the increase in the labour supply.

Demographic perspectives

If the main parameters of fertility, vitality and emigration do not change, by 2025 the Transnistrian region will have a population of 400 thousand people (Figure 14).

The anticipated economic crisis starting in 2025 can end, in the most extreme scenario, with the liquidation of almost half of the jobs in the region during 3-4 years. This number includes both the direct effects of the recession in the metallurgical, building materials and energy sectors, as well as the secondary and tertiary effects induced by the propagation of the initial shock to other sectors. Considering the very low level of personal savings and the persistence of the recession,

Figure 14.
Population evolution and projection by age groups and sexes, 2019-2040, thousands of people



Source: Author's estimates

the unemployed will have to emigrate. In the current regional security circumstances, they can only emigrate to the right bank. Assuming that at least half of the unemployed will emigrate, together with their families, the region may lose about 40 thousand people by 2030.

This wave of emigration will create a new breach in the demographic profile of the region, so that by 2030 the population will decrease to about 317 thousand people. By 2040, the total population of the region will be around 250 thousand people. Due to increased mortality and emigration, the share of men will decrease from the current 45 percent to 43 percent. The share of children aged 0-14 will go from 15 percent today to around 13 percent in 2040, while the share of adults aged 15-62 will decrease from 62 percent to 50 percent. The share of elderly (63+ years) will follow an upward evolution, from 22 percent at present to 37 percent towards the horizon of 2040.

In the short term, the population migrating to the right bank can have a positive economic impact on the economy of the Republic of Moldova, to the extent that it fills the vacant jobs. But in the most difficult scenario, the economy will not be able to create a sufficient number of jobs for all displaced people from the Transnistrian region, which will put an additional burden on the national public budget.

Budgetary-fiscal perspectives

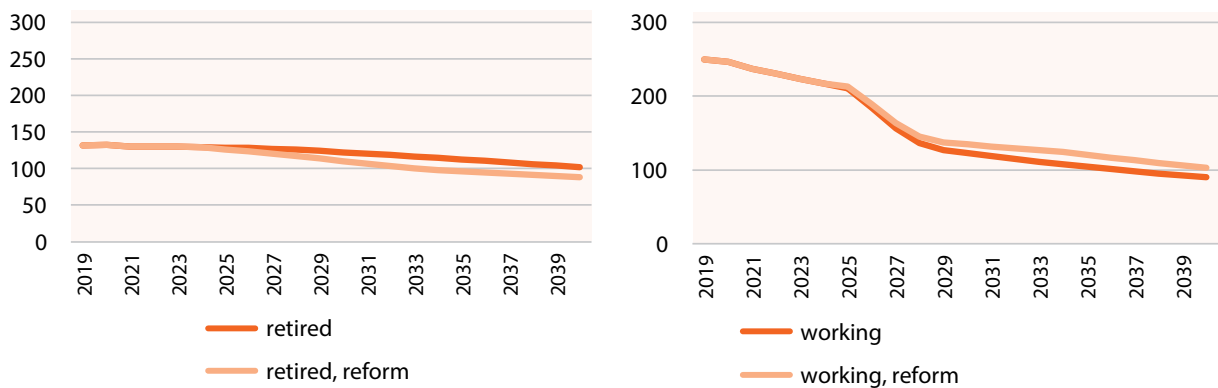
The economic and demographic evolution will increase the pressure on the budget of the Transnistrian region. On the one hand, due to the decrease in investment, productive

capital and the number of the working-age population, the potential output will decrease, and with it, the tax base of the region will also narrow.

On the other hand, in the next two decades, the ratio between the socially-assisted population and the productive population will worsen (Figure 15). In the status-quo scenario, the number of the working-age population (estimated at the retirement ages applied in the region) decreases by 127 thousand during the years 2024-2040 (including due to emigration caused by higher gas prices), while the number of pensioners decreases by 27 thousand. Even if the authorities of the region decide to reform the pension system by increasing the retirement age, the situation changes only marginally (Figure 15). For example, if the authorities set the retirement age at 63 for men and 60 for women and, starting from 2025, increase the retirement age for men by 4 months/year and for women by 6 months/year, the new thresholds of retirement will be reached in 2033 for men and in 2034 for women. Even in this case, the number of the retired population decreases by 41 thousand until 2040, while the number of the working population – by 113 thousand.

This will put increasing pressure on the region's social security budget. The strategy of moving pensioners to the Russian pension system has exhausted its potential, one of the eligibility criteria being the possession of work experience during the Soviet period. The men who are going to retire in 2024 have 5-7 years of work experience on average in the Soviet Union, while the women – a maximum of 3 years. If in 2023 the "local" pensioners accounted for about 75 percent of the total population of retirement age (compared to 96 percent

Figure 15.
Evolution and projection of the retired and working population under current retirement conditions and under the conditions of raising the retirement age



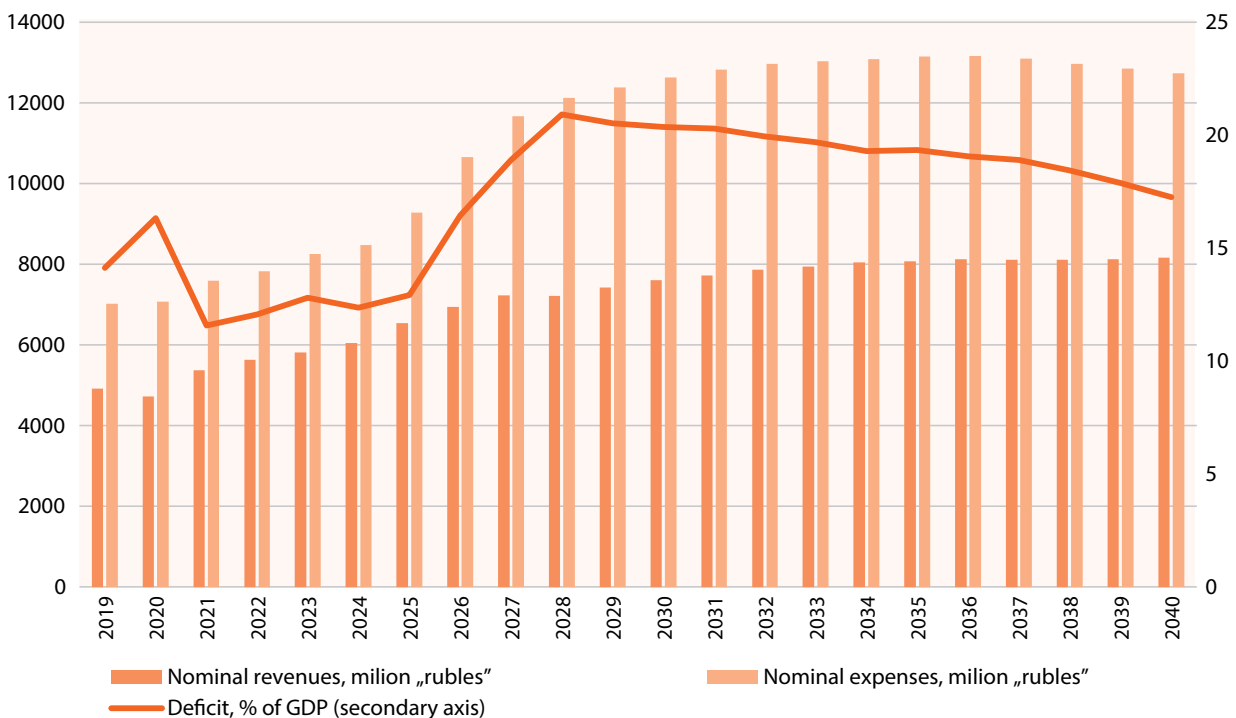
Sources: Author's estimates

in 2016), by 2030 their share will represent 81 percent, and by 2040 – 88 percent.

To get a general idea about the pressures to which the budget will be exposed in the medium and long term, the revenues can be modelled starting from the assumption of maintaining the current tax burden as a ratio of nominal GDP, although a crisis of the proportion anticipated with the increase in gas prices may erode not only the tax base, but also the effective tax rates. For the expenditure part, it can be assumed

that those for health, education and social protection will incorporate the evolution of the population and inflation, and the rest of the budget expenditures – only the evolution of the nominal GDP. Projections suggest the worsening of the fiscal situation during the anticipated economic crisis, with the budget deficit reaching hard to imagine levels – about 20 percent of GDP (Figure 16), while the public debt exceeds 200 percent of GDP already in 2027-2028. A slight “improvement” of the situation takes shape only after 2030, with the resumption of economic growth.

Figure 16.
Budget evolution and perspectives, years 2019-2040



Sources: Author's estimates



3

IMPACT OF THE TAX AND CUSTOMS POLICY HARMONIZATION ON THE TRANSNISTRIAN REGION

Tax and customs policy differences

Reintegration involves alignment of the fiscal policy in the Transnistrian region with that applied on the right bank. The economic and budgetary impact of this alignment derives from the actual differences between the policies currently applied on the two banks of Dniester river and the way the new fiscal policy will interact with the structure of the local economy and the monetary union (by eliminating the “ruble” and joining the leu zone).

Relative to GDP, total budget revenues are currently slightly higher in the Republic of Moldova (33.3 percent versus 31.0 percent, Table 9). This is largely determined by the greater role of tax revenues (30.0 percent versus 26.7 percent). The difference in tax burden suggests a negative impact of the transposition of Moldovan tax policy in the region, as any tax reduces economic efficiency, and increasing the tax burden under any circumstances results in lower output, at least in the short term. External grants represent about 1.7 percent of GDP in both cases, while non-tax revenues in Transnistria are more important, with a share of 2.5 percent of GDP, compared to 1.6 percent in the Republic of Moldova. The reduction in non-tax revenues provides the opportunity to slightly cushion the impact of the tax increase. Additionally, the reduction of non-tax revenues could be complemented by the transitory increase of some external grants addressed directly to the budget.

The two tax systems have certain similarities, but there are

also conceptual differences. Both sides apply the tax on the income of natural persons, its effective rate being slightly higher in the Transnistrian region (3.6 percent of household incomes) than in the Republic of Moldova (3.3 percent). (Here and further the effective rates of taxes and fees are presented according to the social accounting matrices of the two banks).

The region lacks corporate income tax, while in the Republic of Moldova it is a major source of budget revenues (at effective rates of 8.3 percent for non-financial companies and 4.2 percent for financial companies).

Compared to the wage fund, the share of mandatory social insurance contributions in the Transnistrian region (17.4 percent) is lower than in the Republic of Moldova (24.3 percent). But in the Republic of Moldova, the mandatory contributions include both social insurance (pensions, unemployment, etc.) and contributions for medical insurance, the latter being absent in the Transnistrian region.

The Transnistrian region does not apply VAT, but a sales tax, the average effective level of which is 1.1 percent of market sales. If product subsidies are taken into account, the effective sales tax rate ranges from -0.4 percent in agriculture to 9.8 percent in the region’s commercial sector. In the Republic of Moldova, the net VAT (without the amounts returned to economic agents) accounts for 4.2 percent of the value of market sales, varying from 0.6 percent in transport services to 8.5 percent in the case of industrial products.

Table 9.
Budget revenues in the Republic of Moldova and the Transnistrian region, percent of GDP

Category of budget income	Republic of Moldova	Transnistrian region
Total budget revenues	33,3	31,0
Total fiscal budget revenues	30,0	26,7
Budget grants	1,7	1,8
Non-fiscal budget revenues	1,6	2,5

Sources: Calculated by the author based on budget execution reports

The region applies a customs tariff for the export of goods, which in ad-valorem terms accounts for 0.8 percent of the value of the region's exports. The tax is applied to the export of some seeds, some cereals, hides, ores, scrap metal. This tax is absent in the Republic of Moldova.

The effective levels of import customs tariffs in ad-valorem equivalent are practically equal on both banks, about 1.9 percent of the value of goods imports. However, there are certain differences at the level of products: the effective quota of the customs tariff on agricultural products in the Republic of Moldova (about 5 percent) is almost 2 times higher than in the Transnistrian region (2.9 percent), on the other hand, the tariff on industrial products of import (1.9 percent) is lower than in the Transnistrian region (2.1 percent).

The effective level of excise duties on industrial products in the Republic of Moldova is higher, 5.3 percent of the value of sales, compared to 1.9 percent in Transnistria.

Taxes on production (which include local taxes and fees, environmental taxes and other taxes applicable directly to producers) are at comparable levels, around 0.5-0.6 percent of the value of production. In contrast, production subsidies are much more generous in the Transnistrian region, about 0.52 of the aggregate production value (the construction sector being the main beneficiary). Compared to the Transnistrian region, the production subsidies in the Republic of Moldova are practically zero.

Fiscal policy model and scenarios

To estimate the economic impact of the introduction of the fiscal and customs policy of the Republic of Moldova in the region, the author used a computable general equilibrium model applied to the Transnistrian economy. The author used a static neoclassical model analogous to the IFPRI standard model¹⁰. The uncertainty about the quality of primary data makes it appropriate using a dynamic type model. For simplicity, but also taking into account data constraints, the model is based on a one-to-one relationship between activity sectors and markets for goods and services (each activity produces only one good and each good is produced by only one activity).

The applied closure rules are as follows: The resources available for investment are assumed to be determined by the savings accumulated in the region. The exchange rate is supposed to be flexible. The government deficit is flexible, adjusting according to budget revenues, while government consumption is considered fixed. The capital factor is assumed to be fixed and specific to each activity (ie, it cannot migrate from an unproductive sector to another more productive

one). The labour factor is assumed to be flexible and mobile between sectors.

The model was compiled based on a social accounting matrix developed by the author for the year 2021.

A similar matrix was developed for the Republic of Moldova in order to calculate the effective rates of taxes and fees with which the current taxes and fees in the region are to be replaced.

The model includes the following elements:

- Sectors of activity / goods and services:
 - Agriculture, fish farming and forestry;
 - Mining industry;
 - Manufacturing industry;
 - Energy industry, delivery of gas, water and other public utilities;
 - Constructions;
 - Trade, hotels, restaurants, cafes;
 - Transportation and related services;
 - Telecommunications and information technology services;
 - Financial services;
 - Other market services;
 - Educational services;
 - Health and social care services;
 - Public administration and defence services.
- Transaction costs:
 - Domestic supplies;
 - Export supplies;
 - Import supplies.
- Factors of production:
 - Capital;
 - Labour.
- Taxes and subsidies:
 - Mandatory social security contributions;
 - Production taxes;
 - Production subsidies;
 - Direct income taxes;
 - Sales tax/ value added tax (net);
 - Excise duties and other indirect taxes;
 - Import customs tariff;
 - Export customs tariff.
- Institutions:
 - Non-financial companies;
 - Financial companies;
 - Public administration;
 - Households;
 - The rest of the world.
- Capital accounts:
 - Investment-savings account;
 - Inventory changes.

¹⁰ The standard model is fully documented and described in Lofgren et al., „A standard Computable General Equilibrium (CGE) model in GAMS”, IFPRI – International Food Policy Research Institute, 2002.

The available data did not allow the explicit modelling of transaction costs applicable to deliveries to/from the Republic of Moldova, although their decrease after full reintegration could be the source of important efficiency gains for economic agents on both banks.

Several scenarios were defined and simulated based on the model.

- **Baseline scenario** – it does not imply any change in the fiscal policy of the region;
- **Alternative scenario “VAT”** – the relatively moderate sales tax in the region is replaced by the value added tax at relatively higher effective rates observed in the social accounting matrix of the Republic of Moldova for the corresponding groups of goods and services; the author models the net VAT, which as general effect is similar to a sales tax;
- **Alternative scenario “Production taxes and subsidies”** – for each production activity in the region, production taxes and subsidies are adjusted to the levels corresponding to the Republic of Moldova; in this scenario, the overall level of production taxes is virtually unchanged, while the very high subsidies paid by the region to the construction sector are reduced to zero;
- **Alternative scenario “Social insurance”** – the effective share of social insurance in the region (17 percent) is increased up to the level corresponding to the Republic of Moldova (24.3 percent);
- **Alternative scenario “Income tax”** – the effective rate of physical entities’ income tax in the region (3.6 percent) is slightly reduced, to the corresponding level of the Republic of Moldova (3.3 percent); the corporate income tax is also introduced, at the level of 8.4 percent for non-financial companies and 4.2 percent for financial companies;
- **Alternative scenario “Import customs tariff”** – for each category of imported goods, the customs tariff rate is added up to the level corresponding to the Republic of Moldova; in the case of agricultural products, the tariff increases from 2.9 percent to 5 percent, in the case of industrial products – it decreases from 2.1 percent to 1.9 percent; since in the model it was not possible to explicitly model the Transnistrian region’s commercial partners, this scenario ignores the fact that the import customs tariff is to be completely cancelled for deliveries from the Republic of Moldova;
- **Alternative scenario “Export customs tariff”** – the customs tariff applied to exports of goods from the region is cancelled;
- **Alternative scenario “Excise duty”** – the region introduces the effective excise duty rates at the level of those

in the Republic of Moldova, which are higher; the excise duties have the main incidence on the industrial products sector, where their level increases from 1.8 percent to 5.3 percent;

- **Alternative scenario “Other income”** – the region reduces non-tax revenues (dividends, ad hoc transfers, etc.) collected from non-financial and financial companies by 50 percent;
- **Alternative scenario “Total”** – this scenario combines the alternative scenarios presented above.

The Results of fiscal policy simulations

Table 10 shows the main results of the simulations of the alternative scenarios discussed in the previous subsection. The results are consistent with the theoretical predictions and economic intuition.

Thus, in all cases involving increase in fiscal pressure, the economy responds with a reduction in jobs and GDP. The introduction of VAT in the region is expected to have the biggest impact. GDP shrinks by 2.2 percent compared to the baseline scenario, while the number of jobs by 8.2 percent, especially in industry (-20 percent). It is expected that the industry will bear the biggest consequences of the introduction of VAT, because it is precisely in this sector that the highest effective VAT rates are; in addition, the transition will be made from relatively low rates involved by the current sales tax.

At the same time, the elimination of the export customs duty has a positive, albeit minor, impact on GDP (+0.2 percent) and employment (+0.6 percent), while nominal budget revenues decrease by 2.5 percent, and the budget deficit increases by 1 percentage point. Except for a 0.2 percent drop in nominal budget revenues, the adjustment of the Transnistrian import customs duties to the Moldovan grid has no significant economic effect. This disproves recent claims by regional authorities that the introduction of Moldovan customs tariffs creates a blockade of the region.

The unusually strong impact of the “Production Taxes” scenario on budget revenues (+174 percent) is noteworthy. This is not so much because of the increase in production taxes (in fact, they are decreasing, being slightly higher in the Transnistrian region than in the Republic of Moldova in the baseline scenario), but because of the cancellation of the generous system of production subsidies used in the Transnistrian region.

It is also worth noting that the introduction of corporate income tax does not have the anticipated negative effect on investments. The explanation lies in the dominant economic role of the “government” and the fact that the “government” is one of the largest investors, financing, directly from the budget or through public companies, almost 1/3 of regional investments. The increase in budget revenues hence allows a greater volume of public resources to be channelled into

Table 10.

Impact of fiscal policy scenarios, percentage variation (percent) or percentage points (p.p.) compared to the base scenario

Indicator	The alternative scenario								
	VAT	Production taxes	Social security	Income tax	Import tariff	Export tariff	Excise duties	Other	Total
Gross Domestic Product real, %	-2,2	-0,5	-0,1	0,0	0,0	0,2	-0,7	0,0	-3,7
Jobs, %	-8,2	-1,8	-0,3	0,0	0,1	0,6	-2,8	0,0	-12,7
Nominal budget revenues, %	60,3	174,7	17,7	90,0	-0,2	-2,5	16,8	0,2	361,9
Internal absorption, %	-1,9	-0,4	-0,1	0,0	0,0	0,1	-0,6	0,0	-3,1
Private consumption, %	-5,8	-1,2	-1,0	-0,1	0,1	0,4	-1,9	0,0	-10,2
Total investments, %	0,3	0,1	0,4	0,1	0,0	0,0	0,1	0,0	0,9
Exports, %	-10,3	-1,9	-1,5	-0,2	0,1	0,8	-3,3	0,0	-17,5
Imports, %	-6,5	-1,2	-1,0	-0,1	0,0	0,5	-2,1	0,0	-11,0
Real exchange rate, %	-3,2	-13,3	-9,6	-1,4	0,0	-0,5	-1,4	0,2	-24,6
Investments/GDP, p.p.	0,8	2,9	2,2	0,3	0,0	-0,1	0,2	-0,1	5,8
Savings/GDP, p.p.	-2,3	-6,0	1,5	-4,8	0,0	0,1	-0,6	0,5	-11,4
Current account/GDP, p.p.	-0,5	-1,1	-0,8	-0,1	0,0	-0,1	-0,2	0,0	-2,4
Trade deficit/GDP, p.p.	-1,4	-2,2	-1,6	-0,2	0,0	-0,3	-0,4	0,0	-5,2
Budget deficit/GDP, p.p.	-3,5	-9,9	-1,3	-5,2	0,0	0,1	-1,0	0,5	-19,2

Sources: Author's simulations

investments, which more than compensates for the decrease in private companies' own sources available for investments as a result of more burdensome taxation. Precisely this structural peculiarity of the Transnistrian economy explains the apparent paradox why in the scenarios of cancelling export customs tariffs and revenues from non-fiscal sources, the economy grows, while investments, on the contrary, decrease moderately (about -0.1 percent). In these two cases, budget revenues decrease, which also reflects in the decrease in savings available to the economy for investment.

Looking at these results in their entirety, it can be said that the adoption of the Moldovan fiscal policy in the Transnistrian region will have the anticipated negative effect on the regional economy and the well-being of the population. This is natural and well within theoretical predictions. Especially since the given scenarios did not model any compensatory measures from the Government of the Republic of Moldova.

At the same time, it is clear that the economic effect of the adoption of the Moldovan tax and customs policy is not nearly as dramatic as one might think at first glance. Moreover, in a realistic reintegration scenario, the transposition of some taxes and fees can be achieved gradually, over a reasonable time horizon (2-3 years) and taking necessary precautions to prevent labour and capital migration. As for the trade policy

(import and export customs tariffs), it can be implemented without transition periods, as the harmonization will have a positive effect on the region's economy.

It is worth pointing out that the transition from sales tax to VAT could even be quite simple in administrative terms, despite the negative impact on the region's budget and production. Conceptually, the VAT mechanism is built in such a way that this tax is self-enforced – producers are advantaged by the possibility of deducting VAT on the inputs used, therefore, they are interested in showing all transactions "in white". The fiscal impact of VAT is ultimately on final consumers and has a transitory effect.

In the new tax system, the region should have the right to autonomously define only its local taxes and fees. Shares from general state revenues and transfers from the state budget will have to be made to balance revenues and expenditures. In order to avoid distortions and artificial fiscal advantages in favour of companies on either side, the fiscal union must be established as soon as possible together with the monetary union, without too long transition periods that would allow the coexistence of parallel systems. Tolerated for too long, parallel tax systems in a reintegrated country will favour the migration of firms and households from one bank to the other.

4

THE BUDGETARY COSTS OF THE REINTEGRATION OF THE REPUBLIC OF MOLDOVA

Sources of main costs

The reintegration of the Transnistrian region of the Republic of Moldova involves the introduction of policies and standards applicable on the right bank in a series of essential aspects for the convergence of living standards (productivity, wage level, salaries), for fair competition between the companies on the two banks and for the proper functioning of the reintegrated economy. This will inevitably have an impact on the economy and budget of the Republic of Moldova.

A (non-exhaustive) list of the most expensive measures includes the following:

Costs at the pre-reintegration stage:

- **Transitional subsidies to offset the increase in gas prices.** It was shown above that a sudden elimination of the current gas subsidy the region receives from the Russian Federation could economically ruin the Transnistrian region and substantially increase the long-term budgetary costs of reintegration. Our hypothesis is that the Republic of Moldova will assume responsibility for granting transitional subsidies paid directly to households and companies in the region, which will cushion the shock of the gas price increases. In the situation when gas for the region will have to be procured from sources other than the Russian Federation, the allocation of this subsidy to the region will result in an increase in the foreign public debt of the Republic of Moldova. Bearing this in mind, it is clear that the granting of these subsidies must be closely linked to the actual progress of negotiations and reintegration in the early stages. A scenario where the Republic of Moldova grants subsidies AFTER reintegration is achieved may not be possible, as the gas crisis could hit much sooner. This obviously represents a source of political risk for the Republic of Moldova – the payment of compensatory subsidies without any subsequent real progress in the reintegration process.
- **Dismantling illegal structures and securing the new economic regime.** Civil law, competition protection, fiscal and trade legislation, other essential economic institutions will not be possible to be fully imposed in the region until completely dismantling illegal paramilitary, security and legal structures and until their replacement with constitutional or foreign structures. Moreover, dismantling the system is imperative for the referendum to take place in democratic conditions on both banks to validate the conditions of reintegration. De-commissioning the exponents of the current administrative, justice and security system means eliminating a large number of jobs. Eliminating these jobs will generate, on the one hand, major savings. On the other hand, a significant number of the current holders of these jobs will end up in unemployment and will require budgetary support measures for retraining and professional reintegration as part of a special program. Such a programme should be established before the actual reintegration is carried out. In this process, political complications are possible, since granting such payments from the budget of the Republic of Moldova may generate protests from the war veterans on the right bank, who currently receive very modest social allowances. The only solution that could ensure reconciliation will be a substantial increase in allowances for Moldovan veterans as well.
- **Costs to reset the regional justice system.** Without a reset justice system of the region, effective economic reintegration will not be possible. The reset is only possible on the basis of judges, prosecutors, lawyers, notaries and bailiffs trained in the professional training system of the Republic of Moldova. Considering the demographic proportions, for the proper functioning of the justice system, around 100-120 judges, 100-120 prosecutors, 300-320 lawyers, 30-40 bailiffs and 50-60 notaries should be deployed in the region, without considering a series of auxiliary professions. The financially most expensive is the training of judges and prosecutors, also because it takes a lot of time. Even if specialists who are already trained are to be delegated to the region, they are to be replaced on the right bank by other specialists, i.e. the costs related to the professional training of a large number of legal specialists are inevitable anyway.
- **Conducting the region's population census.** Even under normal conditions, the census is not a very cheap process, especially in the situation when there are no credible statistical structures in the region. However, carrying out a general census of the population in the region as early as possible is indispensable for the integration of the region in the annual and medium-term budgetary planning mecha-

nism applicable in the Republic of Moldova. Completing the census must be a precondition for the integration of pensioners from the region into the Moldovan pension system. It is essential that the census is carried out or supervised by the National Bureau of Statistics.

- **Costs of holding a referendum to validate reintegration.** The referendum must take place on both sides simultaneously, costs are determined both by normal unit costs and by the need to ensure the highest possible presence of international observers.

Costs at the post-reintegration stage:

- **Funding of regional pensions.** According to the applicable legislation, the vast majority of current pensioners in the region, even if they are citizens of the Republic of Moldova, would not be entitled to old-age pensions because they have not completed the minimum contribution period of 15 years. Their direct integration into the Moldovan pension system collides with a series of legal problems. Among others, this would be in collision with the principle of equity and that of contributivity. Transnistrian pensioners have not contributed to the national pension system, therefore, they do not have the right to benefit from pensions at the same level with those who have made contributions. Under the current national legislation, the pensioners from Transnistria could maximum claim a social allowance from the state, i.e. approximately 50 percent of the minimum pension, 1300 MDL/month according to the data for the year 2023. An allowance of such size would not ensure the necessary convergence of living standards, being even lower than the current modest pension that pensioners already receive in the region. For the sustainability of the reintegration, substantial changes, even if transitory, will be needed in the national pension legislation, in order to pay the beneficiaries pensions at least at the level of the minimum pension on the right bank (2600 MDL/month according to the data for 2023). In parallel, the gradual increase of the retirement age to 63+ for women and men is indispensable. A realistic transition calendar could be to increase, starting from 2025, the retirement age by 6 months/year for both sexes, so that the minimum retirement age of 63 is reached in 2033 for men and in 2038 for women. In parallel, the minimum contribution periods are to be gradually increased – from 25 years for men and 20 years for women, currently applicable for the population of the region, to 34 years for both sexes applicable in the Republic of Moldova¹¹.
- **Payment of salaries in the public administration.** In order to ensure the good functioning of all state services (but, obviously, also for the loyalty of local elites), it is indis-

pensable to establish salaries in the public administration sector of the region at the level applicable in the Republic of Moldova right from the beginning of the reintegration process, without transition periods.

- **Funding schools and hospitals.** School and health care facilities in the region must be included in the national financing system at the normative unit costs in force in the Republic of Moldova. At the same time, a good number of schools and hospitals may require major capital investments for equipment provision, energy efficiency, etc. In the absence of data, it is difficult to assess these investment needs.
- **Social assistance of the population.** This domain involves the unconditional integration of all social assistance applicants in the region into the national system of social assistance and services. Unlike the social insurance system, the social assistance and services system must respond unconditionally to all those who need assistance and protection. The most expensive elements will be related to the extension of social help (“ajutorul social”) and compensations for the cold period of the year, even after the anticipated increase in gas prices.
- **Subsidies and prices.** Currently the region practices an extensive, incoherent and non-transparent system of budget subsidies for companies in the region. In order to prevent negative effects on free competition between companies on the two banks, this system is to be liquidated as soon as possible. The left bank resident organizations, as they re-register with the constitutional administrative bodies, must be given access to all state aid programmes, including the programmes administered by the Organization for the Development of Entrepreneurship, the National Fund for the Environment, the Agency for Interventions and Payments in Agriculture, the National Agency for Research and Development, etc.
- **Public investment programmes.** The region requires sustained investment in public infrastructure, in particular, road transport infrastructure, utilities, community infrastructure and energy efficiency projects. In some areas, such as local economic development, local communities from the left bank of the Dniester should be given access to national programmes (such as the “European Village”) immediately. Access to funding from European sources should be provided rapidly after local elections are held according to democratic standards.

Significant but uncertain costs:

- **Verification, validation and unification of administrative registers.** These measures refer to the registers of the population, legal entities, means of transport, vehicle drivers, real estate, farm enterprises, etc. and to a host of automated information systems to be populated with data relating to the region. Although the relevance of this overly technical measure may seem doubtful, it should be noted that

¹¹ Even if the reintegration will not be achieved, increasing the retirement age is the only solution available to the regional authorities to delay the implosion of the pension system in the region.

without it will be impossible to expand public services in the region, neither in classic form nor in digital form, it will be impossible to check SMEs' eligibility in public financing programmes, farm's eligibility in the support funds for agricultural producers, etc. The costs of this action are difficult to estimate with precision, also because the author does not know the state and conditions of the corresponding registers on the left bank of the Dniester, but it is certainly significant amounts, possibly about 100 million MDL.

- **The costs related to a possible deployment of an international security mission in the region.** If the negotiations will lead to an agreement on a policing mission to ensure the reconciliation of the two banks, the assumption is that the related costs will be largely borne by the organizations that will carry out the international mission. Assuming that the security mission will be of similar proportions to the UN peacekeeping mission in Cyprus or Lebanon, the annual costs could be between USD 50 and USD 60 million. However, the international practices show that the Republic of Moldova will have to bear part of these costs.
- **Evacuation or controlled liquidation of ammunition from the deposit in Cobasna.** The presence of these munitions represents a major risk to military, economic, ecological and human security. An estimate of the disposing costs of these munitions from year 2000 was USD 40 million¹². In today's security conditions, these estimates may no longer be realistic, and the only option available is on-site controlled liquidation and not their evacuation through the territory of Ukraine. Taking into account the importance of the subject, the author's assumption is that the Republic of Moldova will get international help to solve this problem. However, the liquidation of such a large volume of munitions will involve a series of costs related to the displacement of the population in the region, the granting of compensations, environmental protection measures, etc.
- **The costs of a possible systemic banking crisis.** As shown in Chapter 1, the soundness of the region's banking sector is far from certain. It is imperative to conduct the earliest possible independent external audit of all banking institutions in the region and, depending on the outcome, to enforce the imposition of special supervision/administration. If one or more banking institutions become insolvent during or following a possible economic crisis related to the rise in gas prices, this may cause the risks of a systemic banking collapse to which the Government of the Republic of Moldova and the National Bank of Moldova will have to respond with financially expensive measures. The bud-

getary impact of these measures is clearly very high – as much as MDL 2.0-2.5 billion, depending on the negotiated exchange rate, in an extreme scenario requiring the withdrawal of 50 percent of the funds held in the current accounts of the population and companies. However, the probability of this risk materializing cannot be assessed at this stage.

- **Evacuation of the armed forces of the Russian Federation.** The very process of the evacuation of the armed forces might not entail major direct costs, but the perpetuation of their presence on the territory of the region will represent a major country risk factor that will diminish the investment attractiveness of the region and limit economic growth well below potential. At the same time, in the conditions of the war, it seems hardly feasible to evacuate these troops through the transit of the Ukrainian territory. Identifying and using an alternative route for the controlled evacuation of these forces could involve higher costs than the conventional route.
- **The costs of a possible recognition of the gas debt of the region as part of the foreign debt of the Republic of Moldova.** Our hypothesis is that before the official reintegration, the de facto authorities of the region will default on their public debt, that the Republic of Moldova will not include the gas debt of the region in its external debt, and the "Gazprom" company will write off this debt. However, since the legal commitments of the "Moldovagaz" company in relation to this debt are not clear, it is not clear how feasible this strategy is. Clearly, the debt represents one of the biggest risks regarding the costs of reintegration and the sustainability of the external debt of the Republic of Moldova.

Reintegration scenario and key parameters

To assess the budgetary impact of reintegration, the author considered the following scenario:

At the pre-reintegration stage:

- In 2025, the region accepts the general conditions of autonomy that the current status of UTA Gagauzia implies.
- After the agreement of the political solution, the preparation of the reintegration takes 3 years, a process that involves bilateral and multilateral negotiations on specific topics. The bilateral negotiations concern the conditions offered by the Republic of Moldova to pensioners, the former administration, the de-commissioned military personnel, the ways and conditions of recognition of property rights, the exchange rate at which the assets of the population, companies and banks of the region are to be re-nominated, etc. The multilateral negotiations refer to the evacuation of Russian ammunition and troops, the establishment of an external fund to support reintegration, the preparation of the international security mission, etc.

¹² Dumitru Burduja, „The Cobasna deposit – danger for the ecological security of the Republic of Moldova”, publication appearing in the proceedings of the Conference “Ensuring the right to a healthy environment and the challenges of the transition to the EU”, national scientific conference, pp. 278-283, Chisinau, Republic of Moldova, May 12, 2023, State University of Moldova, https://ibn.idsi.md/sites/default/files/imag_file/278-284_5.pdf.

- In 2024, the training of future judges, prosecutors, lawyers, notaries and bailiffs necessary to reset the justice system in the region begins. The need to start as early as possible is determined by the rather long training period for judges and prosecutors (3 years of bachelor studies + 2 years of master's studies + 1.5 years of initial professional training at the National Institute for Justice).
- The gas prices on global markets remains unchanged for the foreseeable future, which means that in 2025 the gas price in the region will be on average 8 times lower than the gas price on the right bank of the Dniester. The Transnistrian region bears the gas price increase, but the impact of the crisis is mitigated by the financial aid granted by the Republic of Moldova. Instead of a brutal 8-fold increase in the gas price delivered to the region to the market level, the price increases according to a milder schedule: 1.9 times in each of the years 2025, 2026 and 2027 and 20 percent in 2028 for completion of convergence.
- The Government of the Republic of Moldova covers the difference between the price paid by the region and the market price in the form of a transitional subsidy that is eliminated once the process of aligning the gas price to the market price is completed. Reflecting the above transition schedule to market prices, the subsidy value is USD 290 million in 2025, USD 180 million in 2026 and USD 40 million in 2027, for a total of approximately USD 510 million. It should be noted that the duration of the transition period has major implications for the subsidy costs. For example, if the transition lasts 4 years instead of 3, the total amount of the subsidy increases to USD 900 million. Obviously, the global gas price is also of major importance: if Moldova buys gas 50 percent cheaper than at present, the value of the transitional subsidy for the Transnistrian region drops to USD 230 million for the entire transition period.
- The subsidy received by the region cushions the gas price shock on GDP, which falls by 4 percent in 2025, 3.8 percent in 2026, 3.6 percent in 2027 and 0.7 percent in 2028 (compared to the baseline scenario, where the decline is much harder and with disastrous long-term effects). Two other effects of the subsidy are: 1) preserving jobs in the region and thus reducing the number of people displaced on the right bank, from 42 thousand in the baseline scenario to 26 thousand and 2) better preserving the productive potential of the region.
- In 2026, a general population census is conducted in the region.
- In 2027, a referendum is held on both banks to legislate the conditions for reintegration.
- By 2027 all juridical and security structures in the region are liquidated. As a result, 12.5 thousand people become unemployed. For their professional reconversion, the Republic of Moldova is launching a program of monthly payments in the amount of 2 thousand MDL/beneficiary.

The program is transitory, the number of beneficiaries decreasing progressively with their reintegration into civilian occupations. In parallel, a permanent program of monthly allowances for veterans on the right side of the Dniester is being implemented, in the amount of 2 thousand MDL/beneficiary, for a total number of beneficiaries of 19 thousand people.

At the post-reintegration stage:

- On January 1, 2028, the Moldovan leu becomes the only official currency in circulation in the region. Joining the leu zone marks the actual reintegration moment. The assets of the population and economic agents in the region are re-nominated at the rate of 2 "rubles"/ MDL. The Moldovan leu suffers a slight depreciation (about 10 percent) determined by the expansion of the monetary zone with a much less productive region.
- On 1 January 2028, the region adheres to the fiscal policy of the Republic of Moldova. The fiscal convergence occurs gradually and is completed on 31 December 2030. This allows for the significant mitigation of the negative economic impact of the increase in the tax burden.
- Starting from 2028, the Republic of Moldova reduces its defence spending by 20 percent, thanks to the disappearance of military risks from the Transnistrian region.
- Starting from 2028, the responsibility for public order and security of the region is assumed by an international mission under the auspices of the UN or the EU. The Republic of Moldova takes over this function starting from 2038.
- In order to support the accelerated development of public infrastructure in the region, starting from 2028, the Republic of Moldova shares with the Transnistrian region the resources for financing public investments. The share is established proportionately to the populations on the two banks. In 2028, the amount allocated to the region is about USD 55 million, but it grows progressively with the economy of the reunified country, reaching USD 82 million in 2040.
- Starting from 2031, after the Russian Federation's troops and ammunition are evacuated, the Transnistrian region begins to receive foreign direct investments. In 2031 their value is USD 20 million USD/year, an annual growth rate of 10 percent is assumed, so that in 2040 the annual investment inflow reaches USD 47 million USD. Such a growth rate is plausible to the extent that the property problem is effectively resolved and the region opens to the world.
- The combination of public investments shared by the Republic of Moldova and foreign direct investments initially ensures the preservation, and later the growth of the productive capital, despite the economic decline caused by the gas crisis and the transition to the new

fiscal policy. Thanks to the increased capital stock, as well as efficiency gains, starting from 2031, the region returns to growth rates of around 7 percent, which gradually converge to 6 percent in the horizon of 2040.

- Starting from 2028, the public administration, school and public health institutions in the region begin to be financed at the normative costs applied on the right bank.
- The Republic of Moldova assumes the financing of pensions at the level of the minimum pension in the Republic of Moldova, and the retirement age begins to gradually increasing to reach 63 years in 2033 for men and in 2038 for women.
- The Russian Federation maintains pensions funding for persons retired as part of its pensions system.

the reintegration also entails a series of positive consequences for the Republic of Moldova, including:

- The increase in the overall efficiency of the factors of production on both banks, determined by the removal of transaction costs involved in controls along the security zone, exchange rate costs, etc.
- Eliminating a source of enormous fiscal losses caused by illicit international trade in/from the region.
- The reduction of country risks as a result of the resolution of the Transnistrian conflict, the costs of accessing international financing by the reintegrated Republic of Moldova, both under market and concessional conditions, as well as improving the attractiveness of the country as a destination for foreign direct investments.

Estimating the net budgetary costs of reintegration

At the pre-reintegration stage, the estimated value of the total costs is MDL 11.2 billion (about USD 596 million), of which the overwhelming share comes from the transitional subsidy granted to the region to cope with the increase in gas prices (Table 11). As a share of GDP, the costs at the pre-reintegration stage will decrease from 1.7 percent of GDP in 2025 to 0.5 percent of GDP in 2027, as a result of the progressive adjustment of gas tariffs. The costs are very sensitive to the gas price on global markets – a 20 percent decrease in them leads to a decrease in the transitional subsidy to USD 334 million, and the transition period can be shortened to 2 years.

Table 12 reproduces the main results of the net cost calculations at the post-reintegration stage. It is worth emphasizing here that the assessment given refers specifically to the net costs of the reintegration and not to the gross ones. However,

In the simulation of net costs, it was possible to take into account only the first element. According to Table 12, health care and social protection have the largest share of the costs associated with reintegration, about 58 percent at the beginning, although their share will most likely decrease below 50 percent by 2040. Such a high share is determined by the very large percentage of the elderly population, where the main beneficiaries of both spending sectors come from. The expenditures on education will decline in both absolute and relative terms, reflecting the decline in the number of children in the education system as the population declines.

In absolute terms, the net costs start in 2028 at MDL 11.2 billion (about USD 511 million), but decrease to MDL 5.4 billion (USD 174.5 million) by 2040. As the economy grows on both banks, the share of these costs in the GDP of the Republic of Moldova decreases from 2.7 percent in the first year after reintegration to 0.9 percent in 2037, after which there is a slight increase together with the taking over by the Republic

Table 11. **The costs of the pre-reintegration stage under the assumption of constant gas prices, billion MDL unless otherwise stated**

Funded measure	2024	2025	2026	2027	Total stage
Population census of the region	-	-	0.069	-	0.069
Organization and running of the referendum	-	-	-	0.128	0.128
Training of justice specialists	0.015	0.016	0.018	0.010	0.059
Subsidy for increasing gas prices	-	5.663	3.626	0.884	10.172
The decommissioning programme of paramilitaries	-	-	-	0.312	0.318
Veterans Allowance Programme	-	-	-	0.476	0.476
Total costs	0.015	5.679	3.712	1.816	11.222
Total costs, % of GDP of the Republic of Moldova	0.0	1.7	1.1	0.5	
Total reintegration costs, USD million	0.8	295.3	210.8	89.2	596.1

Sources: Author’s calculations and estimate

Table 12.

Costs of the post-reintegration stage, billion MDL unless otherwise stated

Funded measure and sector	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040
Population census of the region	0.00	0.00	0.00	0.00	0.00	0.00	0.28	0.00	0.00	0.00	0.00	0.00	0.00
Training of justice specialists	0.011	0.040	0.021	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
The decommissioning programme of paramilitaries	0.33	0.32	0.29	0.25	0.20	0.17	0.13	0.11	0.09	0.07	0.06	0.05	0.04
Veterans Benefit Programme	0.49	0.51	0.52	0.52	0.53	0.54	0.55	0.56	0.56	0.57	0.57	0.58	0.58
General purpose services	2.40	2.46	2.52	2.58	2.65	2.72	2.79	2.87	2.91	2.96	3.01	3.06	3.12
Defence, security and public order	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	1.63	1.66	1.69
Services in the economic field	0.52	0.61	0.68	0.77	0.87	0.97	1.08	1.19	1.29	1.39	1.48	1.58	1.67
Health care protection	4.30	4.41	4.47	4.52	4.58	4.63	4.68	4.73	4.73	4.73	4.73	4.73	4.73
Education	2.95	2.91	2.89	2.90	2.91	2.92	2.94	2.95	2.93	2.91	2.90	2.88	2.86
Social protection	4.21	4.28	4.31	4.34	4.36	4.37	4.43	4.49	4.50	4.51	4.54	4.64	4.73
Other expenses	0.27	0.31	0.35	0.40	0.45	0.50	0.55	0.61	0.66	0.71	0.76	0.81	0.86
Nominal budget revenues of the region	4.24	5.17	6.08	6.88	7.74	8.64	9.58	10.55	11.43	12.31	13.18	14.04	14.86
Total net costs	11.2	10.7	10.0	9.4	8.8	8.2	7.9	7.0	6.3	5.5	6.5	5.9	5.4
Total net costs, % of GDP Republic of Moldova	2.7	2.4	2.1	1.9	1.7	1.5	1.4	1.2	1.0	0.9	1.0	0.9	0.7
Total net costs, USD million	511.0	471.7	427.9	392.6	357.3	322.6	301.3	258.9	226.1	194.9	222.3	197.4	174.5
The deficit of the region	10.4	9.8	9.1	8.6	8.1	7.5	6.9	6.3	5.6	4.9	5.9	5.3	4.8
The region's deficit, % of regional GDP	76.9	62.1	51.2	42.8	35.5	29.5	24.5	20.3	16.7	13.6	15.2	12.9	11.0

Sources: Author's calculations and estimate.

of Moldova of the defense and public order mission in the region.

Thus, even if the initial costs are quite high, they are not insurmountable and as time passes, the growth of the economy of the Republic of Moldova and the exit from the crisis of the Transnistrian economy, their burden is becoming smaller. These costs are more than justified considering the long-term effects and the importance of the country's reintegration mission. The correctness of the proposed fiscal-budgetary

strategy is demonstrated by the gradual decrease of the own budget deficit of the Transnistrian region. The region suffers several major shocks caused by the gas crisis, the abolition of the "ruble", the introduction of the new fiscal policy, the adoption of higher public sector financing norms – all of which lead to a very high deficit of almost 80 percent of the regional GDP (but the deficit drops to 11 percent by 2040). The deficit could fall even faster, as in the projections the author adopted very cautious assumptions regarding the region's post-crisis economic growth.

5

CONCLUSIONS AND RECOMMENDATIONS

The diagnosis carried out shows that the Transnistrian region is facing insurmountable structural difficulties in the case of extending the scenario of the “independence” not recognized internationally. Demographic changes – declining fertility, increased emigration, demographic aging – are advancing at such a pace that the internal market is becoming increasingly irrelevant, while the fiscal pressure on the workforce is reaching unsustainable levels. In an extremely harmful geopolitical context, the region is becoming increasingly vulnerable to external shocks. The eventual increase in the natural gas price, which could occur as early as 2025, is the main challenge for the region in the short term. In the absence of external support, the region will suffer enormous losses of labour and productive capacity even in the case of a gradual adjustment of prices – although it is not certain that the authorities of the region could ensure such a gradual adjustment.

The economic logic and existing trade interdependencies – such as the region’s dependence on the Republic of Moldova as a market for electricity, dependence on the EU as a market for metallurgical products, textiles and other goods, and soon also total dependence on the Republic of Moldova in the supply of gas, the provision of humanitarian support and investment resources – all this suggests that the best scenario for the well-being of the people in the region is to return to and become part of the Republic of Moldova. Only in this coordinate system will the region be able to freely access foreign markets – its main source of sustainable economic growth in the medium and long term – and ensure access to investments and technologies for the technological modernization of the economy and the capitalization of its economic potential. It should be mentioned that the role of the domestic market is already secondary compare to the role of exports as the engine of the region’s economic growth. Together with the decline, emigration and aging of the population, this imbalance will only increase.

The budgetary-fiscal implications related to the reintegration of the Republic of Moldova should be viewed on two levels. In terms of fiscal policy, the region will have to transition to the fiscal system applicable in the Republic of Moldova. The tax revenues in the Republic of Moldova are slightly higher than in the Transnistrian region (30 percent of GDP, compared to 27 percent), therefore the adaptation of a more burdensome tax policy will naturally have a cer-

tain negative effect on the regional economy. But even if negative, the estimated impact is rather moderate, of about 3-4 percent of GDP and can be relatively easily managed through a schedule of gradual adjustment of some taxes or, more appropriately, through compensatory subsidies from the Government of the Republic of Moldova. The biggest shock is expected from the replacement of the turnover tax with the value added tax. The impact of the introduction of the Moldovan import customs tariff will be practically zero, the effects of the tariff decrease for industrial products being offset by those of the tariff increase for agricultural products. The cancellation of the export customs tariff will have positive effects for the regional economy, as well as reducing the burden of non-tax revenues on companies.

In terms of budget expenditures, in the pre-reintegration phase, the main burden for the Republic of Moldova will derive from the need to grant subsidies so that the Transnistrian region can face a possible crisis of the gas price with minimal losses for its productive capacity. If the global prices for gas remain unchanged, and the tariff adjustment in the region occurs gradually over the course of 3 years, the highest costs will be in the first year, just under USD 300 million (1.7 percent of the GDP of the Republic of Moldova), after which they decrease to USD 210 million in the second year (1.1 percent of GDP) and just under 90 million in the third year (0.5 percent of GDP).

After reintegration, the budget costs will be determined by the gap between the own budget revenues and the budget expenses needed on the left bank of the Dniester to achieve socioeconomic convergence with the right bank. The main burden for the budget will be the need to finance the health and social protection system of the region at the unitary norms applicable on the right bank. In 2028 – the year of the supposed reintegration – the Government will have to transfer about USD 511 million (2.7 percent of GDP) to the region. Along with the economic growth achieved by the Republic of Moldova, with the more thorough establishment of the new tax system and with the resumption of the regional economic growth, these costs decrease. The macro-financial projections carried out show that the equalization transfers to the region in 2035 will be around USD 260 million (1.2 percent of GDP of the Republic of Moldova), and by 2040 – USD 175 million (0.7 percent of GDP).

On the one hand, it is clear that reintegration involves costs, especially very high ones in the early stages. These, however, could decrease – or increase – dramatically depending on the evolution of global gas prices. The level of prices determines not only the costs at the pre-reintegration stage, but also the speed of economic recovery and growth of the region in the long term, therefore also the costs borne by the budget of the Republic of Moldova, in the long term.

On the other hand, reintegration has enormous long-term economic benefits, some of which cannot be quantified at this stage. For the Republic of Moldova, the main argument in favor of reintegration is the elimination of a major source of risks and threats to the country's security – implicitly, this also allows the reduction of defense and security expenses. But there are also a number of purely economic arguments in favour of reintegration, including access to cheaper credit resources on international markets following the reduction of country risks, the elimination of sources of unfair competition for the economic agents on the right bank, the elimination of the source of contraband exports flooding the right bank, restoring some natural inter-industrial links that functioned normally until 1992 and significantly increasing the economic potential of the reintegrated country (more than the simple sum of the two economies).

For Transnistria, the main arguments in favour of reintegration are precisely the economic ones. Returning to the Moldovan economic system, the region will be able to fully capitalize on its competitive advantages and overcome chronic structural problems (the decrease in the productive population and the chronic deficit of investment resources). The syndrome of survival in a "city under siege" will be replaced by an honourable goal of sustainable economic and human development. The Moldovan economic system, although very small compared to other Eastern European countries, is nevertheless large enough to significantly cushion the shocks to which the region is sensitive. Most importantly, only reintegration with the Republic of Moldova can guarantee the region access to foreign markets. In the unrecognized "independence" scenario, the potential economic growth is capped at around 1-2 percent annually in the best-case scenario. In the case of reintegration, growth returns to 6-7 percent starting in the 2030s.

The analysis carried out allows the formulation of several strategic recommendations for the Government of the Republic of Moldova:

- Regardless of the specific year when the reintegration occurs, the Republic of Moldova must prepare to provide humanitarian support to the region in the event it is hit by a crisis determined by the impossibility of procuring subsidized gas from the Russian Federation. Also, plans must be prepared for the socioeconomic integration of a fairly large number of people who may want to move from the region to the right bank.
- Although in the short term, it might be tempting for the Government to find a solution to extend – directly or indirectly – the gas supply from the Russian Federation at subsidized prices for the region, in the long term this strategy is a losing one, because it will perpetuate the main factor of unfair competitiveness of producers on the left bank compared to those on the right bank. However, an integrated economic system will not be able to function on the basis of a dual tariff. A possible alternative could be the situation where the reduced-rate gas is delivered only to MGRES, subject to a single electricity tariff for both banks.
- The economic effect of the adoption of the Moldovan tax and customs policy is nowhere near as dramatic as one might think or as circulated in some sources from the left bank. This must be clearly communicated to the authorities and companies in the region. Moreover, in a realistic reintegration scenario, the transposition of some taxes and fees can be achieved gradually, over a reasonable time horizon (2-3 years) and taking necessary precautions to prevent labour and capital migration. A better alternative is to provide another set of transitional fiscal adjustment subsidies. The import customs tariffs can be adjusted immediately, while the export tariffs – canceled immediately, with a positive effect on the region's economy.
- The reintegration of the Transnistrian region, including in the national public budget, must be strictly conditional on the complete and irreversible dismantling of all illegal military, paramilitary and security structures. If this does not happen, it will be impossible to implement the fundamental institutions necessary in the region for the functioning of the economy – including commercial, fiscal, corporate and banking law, free competition. Chronic fiscal imbalances will not be able to be brought under control. Moreover, it will not be possible to establish an effective monetary union. On the one hand, the region will benefit from the lower interest rates at which the Government of the Republic of Moldova will be able to borrow internationally and locally, and on the other hand, it will not share the country risks that will make borrowing more expensive than in the alternative scenario. The region will continue to be avoided by "clean" foreign investment due to security risks. Thus, its economy will operate below its potential, and the budget costs for the Republic of Moldova will increase more than in the above scenario.
- For similar reasons, the evacuation of Russian troops stationed illegally in the region is imperative. But in order to prevent the costs related to a possible humanitarian, economic and environmental catastrophe in the region, which will result in a much higher cost level of reintegration, even more important is the controlled evacuation or destruction of the ammunition and weaponry stored in the military warehouses in the village of Cobasna.
- It is necessary to remove the regional currency from circulation and establish banking supervision rules as early as possible. It would be optimal to establish the supervision and/ or special administration by the NBM in all banks of the region, to prevent the materialization of the risks of a

systemic banking crisis. If the banks fail, the costs of reintegration for the budget of the Republic of Moldova will increase substantially. For the same reasons, the degree of exposure of Moldovan banks to possible placements – direct or intermediated – from the regional banks must be carefully analyzed.

- It is optimal for the Republic of Moldova that, before reintegration, the regional authorities, in one form or another, recognize their inability to pay the public debt, and the Government of the Republic of Moldova does not recognize this debt as part of the external public or private debt of Republic of Moldova. The solid argument of the Government could be the need for compensation for the illegal stationing of Russian troops on the territory of the Republic of Moldova for more than three decades.
- In the long term, an absolute priority for the national economic policy should be the development of the region's private sector, with an emphasis on the SMEs founded at the post-reintegration stage. This will allow the strengthening of the role of autonomous economic sources in the formation of the population's income (salaries, interest, profit), the mitigation of dependence on social transfers will provide outlets for the employment of a part of those who currently hold jobs in the public sector and, very importantly, the erosion of financial-economic conglomerates that suppress the emergence of new players.
- Reintegration has a number of legal, fiscal and budgetary implications that are difficult to communicate publicly. An example is the need to provide social support measures for the decommissioning and reintegration into the labor market of exponents of the region's security and military system. This could be followed by protests from right bank veterans who fought for independence. Another example is the need to integrate into the pension system pensioners from the Transnistrian region – who did not contribute to the state social insurance budget of the Republic of Moldova. This will require the development of transitional legal solutions. On the other hand, the equity criterion, which is the basis of the public social insurance system, requires raising the retirement age of the population in the region up to the retirement census applied in the Republic of Moldova.
- Some reintegration measures should start immediately, already in 2024. This refers, for example, to the need to train new judges, prosecutors, lawyers, notaries, bailiffs who will have to work in the region according to the national legislation applicable on the right bank.
- It is clear that the reintegration costs are quite high, but not insurmountable, and the Republic of Moldova must have the firm support of the external partners, including financial support. The differences between the two banks are not yet very large, so the convergence should not take very long either. However, it is clear that it will be necessary to establish a "standby" fund that can finance the most expensive elements of the process, including the costs of projects that are currently unknown. For example, it may be necessary to build new bridges, electrical interconnection lines and other projects in order to connect the region as closely as possible with the Republic of Moldova. All this will require a volume of easily accessible financial resources.

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FISCAL AND BUDGETARY ASPECTS OF THE REINTEGRATION OF THE REPUBLIC OF MOLDOVA



The diagnosis shows that the Transnistrian region is facing insurmountable structural difficulties in the case of extending the “independence” scenario, which is not recognized internationally. The demographic changes - declining fertility, increased emigration, demographic aging - are advancing at such a pace that the internal market is becoming increasingly irrelevant, while the fiscal pressure on the workforce is reaching unsustainable levels. In an extremely harmful geopolitical context, the region is becoming increasingly vulnerable to external shocks. The eventual increase in the natural gas price, which could occur as early as 2025, is the main challenge for the region in the short term. In the absence of external support, the region will suffer enormous losses of labour and productive capacity even in the case of a gradual adjustment of prices – although it is not certain that the authorities of the region could ensure such a gradual adjustment.



On the one hand, it is clear that reintegration involves very high costs, especially in the early stages. On the other hand, reintegration has enormous long-term economic benefits, some of which cannot be quantified at this stage. For the Republic of Moldova, the main argument in favour of reintegration is the elimination of a major source of risks and threats to the country's security. But there are also a number of purely economic arguments in favour of reintegration, including access to cheaper credit resources on international markets following the reduction of country risks, the elimination of sources of unfair competition for the economic agents on the right bank, the elimination of the source of contraband exports flooding the right bank, restoring some natural inter-industrial links that functioned normally until 1992 and significantly increasing the economic potential of the reintegrated country (more than the simple sum of the two economies).



For the Transnistrian region, the main arguments in favour of reintegration are precisely the economic ones. Returning to the Moldovan economic system, the region will be able to fully capitalize on its competitive advantages and overcome chronic structural problems (the decrease in the productive population and the chronic deficit of investment resources). The syndrome of survival in a “city under siege” will be replaced by an honourable goal of sustainable economic and human development. The Moldovan economic system, although very small compared to other Eastern European countries, is nevertheless large enough to significantly cushion the shocks to which the region is sensitive. Most importantly, only reintegration with the Republic of Moldova can guarantee the region access to foreign markets. In the unrecognized “independence” scenario, the potential economic growth is capped at around 1-2 percent annually, in the best-case scenario. In the case of reintegration, growth returns to 6-7 percent starting in the 2030s.

Further information on the topic can be found here:

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