

An aided economy The characteristics of the Transnistrian economic model

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The economy of breakaway Transnistria is a peculiar combination of the command-and-distribution model inherited from the USSR with elements of a free-market economy which is heavily dependent on Russian energy and financial subsidies. The main pillars of the region's economy are several large industrial plants, built in the Soviet era, which generate more than half of its GDP (in 2012, Transnistria's GDP reached around US\$1 billion). As a consequence, the condition of each of these companies, whose production is almost exclusively export-oriented, has a huge impact on the economic situation in Transnistria. This makes the region extremely sensitive to any changes in the economic situation of its key trade partners. This problem is additionally aggravated by the extremely low diversification of Transnistrian exports. The only major economic entity in Transnistria which regularly yields profits and is not so heavily dependent on the external situation is Sheriff. This corporation controls the greater part of the local wholesale and retail trade, as well as a major part of the services sector on the domestic market.

In its present form the Transnistrian economic model is extremely unstable and inefficient. As a result, this unrecognised republic suffers from an unceasing budget deficit, and its economy needs external funds to keep going. The key role here is played by funds generated through sale of Russian gas, cash remittances from expatriate workers, and funds received from Moscow. Given its very low demographic potential, extremely small domestic market and the lack of raw material resources, the region seems unable to function by itself. Moreover Russia, which has a key influence on Transnistria's fate, is not interested in the region's economy becoming self-sufficient. Since Moscow subsidises the inefficient Transnistrian system, it is able to control this breakaway republic and to deepen the divide between Transnistria and Moldova.

The structure of the economy

A permanent deficit is one characteristic of the Transnistrian economic model. This negative trend has been worsening since 2008. Recently, expenses have been running from one to almost three times higher than income¹. According to official declarations, Transnistria's budget expenses in 2013 will reach approximately US\$294 million, and will thus be double the level of the planned income.

The region's economy is based on four giant industrial plants: the JSC Moldova Steel Works in Ribnita (MSW Ribnita), Tirotext, the Ribnita Cement Plant and the Moldavskaya GRES power plant. 95% of these firms production is exported.

¹ Budget expenses were almost triple the level of income in 2009, and double the level of the 2010 income. The year 2012 was an exception, since severe cuts were introduced to reduce the deficit, and it was thus possible to meet 70% of the budget using Transnistria's own funds.

The **MSW Ribnita** steelworks was privatised in 2003². Its products are exported predominantly to the USA, Germany and Italy. The steelworks is the second largest tax contributor, but it is also exposed to fluctuations on global markets and energy price rises. The company's situation has been gradually deteriorating since the economic crisis in 2007. The plant is often forced to stop production due to the lack of orders.

Tirotex is among Europe's largest textile producers. The company's main stockholder is the Transnistrian group Sheriff. According to data from the Transnistrian customs service, in 2011 this plant sold products worth US\$163 million to external markets. Given the fact that, according to the firm's declarations, it exports 70% of its production, its income for 2011 can be estimated at around US\$230 million (it sells its products mainly to Austria, Germany, Italy and Greece).

The **Ribnita Cement Plant** was privatised in 2004. At present, its majority shareholder is Metalloinvest, as is the case with the Ribnita steelworks. The plant's products are sold both at home and on international markets. Most of its output is exported to Russia. Like MSW Ribnita, the plant currently has to face serious problems due to the slowdown on the construction market linked to the global economic crisis and rising gas prices.

The **Moldavskaya GRES power plant** was privatised in 2004–2005. Currently, its controlling stake is held by Inter RAO UES, an energy group owned by the Russian state. The plant meets the region's energy needs, although only a small part (around 20%) of its output is used for this purpose. 80% goes to right-bank Moldova, where it meets 50% of the demand for energy. Until March this year, the plant also exported a small proportion of its output to Romania.

The Sheriff group, established by the Transnistrian entrepreneurs and former militia officers

Viktor Gushan and Ilya Kazmaly, plays a special role in the region's economy. Now it is owned by Gushan alone. It is the largest employer in Transnistria (with 12,000 employees); the holding consists of more than ten firms and production plants representing various industries. For example, it owns supermarket chains, filling stations and a mobile telephone network operator. It has managed to effectively monopolise many branches of the regional economy. According to unofficial data, the holding controls approximately 50% of the construction

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market and around 90% of the fuel market. It is the only major Transnistrian enterprise to operate on principles close to those of a free market. It does not receive state subsidies, although it enjoyed some customs privileges until the end of 2012. Sheriff's annual contribution to the state budget is approximately US\$30 million, which is almost 30% of all taxes paid by Transnistrian business, and 17% of total annual budget income. The holding has extensive foreign contacts and a well-developed network of partners, especially in Russia, Ukraine and Belarus, and also in the Baltic states, Turkey, the USA and Poland.

Sheriff enjoyed special privileges under the government of Igor Smirnov (1991–2011), and built up its power for this reason. The holding was able to trade in the republic in both Transnistrian roubles and foreign currencies. Foreign currency was mainly obtained via wholesale business and chain filling stations owned by Sheriff. The holding could thus take abroad the foreign currency they earned without any limits or customs duties being imposed. Some of the cash was spent on purchasing goods, and some was

² The controlling stake is held by Metalloinvest, a holding owned by the Russian oligarch Alisher Usmanov.

siphoned off to tax havens. The business preferences offered to Sheriff changed when Yevgeny Shevchuk took power at the end of 2011. Earlier (in 2006–2010), he had led the Renewal party, which is the holding's political wing. However,

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he came into conflict with Sheriff in 2010. When he assumed the presidency, he embarked on a policy of restricting the holding's influence, with the aim of subordinating it to himself. On 29 December 2012, Shevchuk passed a decree cancelling Sheriff's privileges³. As a result, the company was forced to pay customs duty for foreign currency exports, or to use the services of the Transnistrian Republican Bank (TRB) and pay a 25% commission.

Sources of income in the region's economy

The major sources of income in Transnistria's economy are from exports and cash remittances from expatriate workers. These are essential, since they provide the only opportunities for gaining foreign currency reserves. The local market, given its small size and limited demand, offers marginal profits and has no major impact on the condition of the economy. Furthermore, the profits generated on the domestic market are in Transnistrian roubles, which cannot be exchanged on the international currency market, a fact which reduces the local market's share of the income structure.

³ Shevchuk explained that this decision was motivated by the desire to stop cash flowing out of Transnistria to tax havens. However, it was obvious that the new regulations will primarily strike at Sheriff. See <http://www.kommersant.md/node/12298>

Exports are the main source of income for the region's economy. In 2012, the value of products exported from Transnistrian companies was almost US\$700 million, equivalent to approximately 70% of the breakaway republic's GDP. However, the foreign trade structure lacks differentiation. Sales by the metallurgical and textile industries and electric energy generates almost 75% of the export revenues. Furthermore, each of these branches (as shown above) is represented by only one plant. The most important trade partners and recipients of 88% of the region's production in 2012 were: right-bank Moldova (US\$250 million), Russia (US\$154.7 million), Romania (US\$103.1 million), Ukraine (US\$59.6 million) and Italy (US\$46.8 million)⁴. The significance in Transnistria's overall trade balance of EU member states is increasing, while that of the CIS countries is falling; total exports to the EU in 2012 reached US\$203.5 million, and to post-Soviet countries US\$223.2 million⁵. This information has been confirmed by data from Moldovan customs services, according to which between January and October 2012 EU member states received 45.9% of Transnistrian production exports, while 44.9% of the exports went to the CIS area within the same timeframe. Since 2006, Transnistrian firms wishing to do exports legally have been obliged to register their businesses at a Chisinau court, from which they receive certificates of origin for their products. As a result, goods sold by Transnistria abroad are labelled as made in Moldova⁶. The second major source of foreign currency inflow to the Transnistrian economy is **cash remit-**

⁴ All data is for the period between January and December 2012. Source: State Customs Committee Dniester Moldavian Republic, <http://customs.tiraspol.net/content/view/689/148/>

⁵ According to Transnistrian data, total exports to CIS countries are higher, reaching US\$473.3 million. This is because trade with Moldova is taken into account in these calculations, since from Transnistria's point of view it is seen as an independent trade entity, being a member of the CIS.

⁶ Additional information that Transnistria is the place of origin is often provided on the packaging.

tances from expatriate workers. According to TRB's estimates, in 2012 these reached approximately US\$198.5 million⁷. An upward trend has been observed here; in 2011 the amount was US\$184.5 million. Between 66% and 86% of this amount is sent by residents of Transnistria working in Russia.

The role of Russian assistance

Financial assistance received from Russia – both indirectly (so-called gas subsidies) and directly (humanitarian aid) – is, along with the incomes from exports and expatriate workers' remittances, a key element which makes it possible for the Transnistrian economy to function.

Gas subsidies are the incomes earned by Tiraspol on the domestic sale of Russian gas supplied to the Transnistrian company Tiraspol-TransGaz-Pridnestrovye by the Moldovan operator MoldovaGaz. Transnistria consumes over two-thirds of the gas supplied by Gazprom to Moldova, which amounts to around 2 billion m³ annually. The right-bank part of the country uses one billion m³ of gas annually on average. This business generates very high income, because Transnistria has not paid anything at all since 2009 to the Moldovan company and keeps 100% of the profits for itself⁸. It is noteworthy that Tiraspol-TransGaz-Pridnestrovye sells gas on the domestic market at prices which are several times lower than the contracted value. The current gas price set for Moldova (including Transnistria) under the contract with Gazprom is US\$391 per 1000 m³. However, the rate for individual recipients in Transnistria ranges between US\$75 and US\$90 per 1000 m³, and for corporate recipients is approximately US\$163 per 1000 m³ (until the end of 2012, the rate was even lower, at US\$137). MoldovaGaz tolerates

⁷ This amount includes only remittances sent by bank transfer.

⁸ Before 2009, Transnistria used to pay only part of its dues. As a result, its gas debt had already reached US\$1.5 billion in 2006.

Transnistria's growing debt because Gazprom holds its controlling stake. The existence of the debt is convenient for Russia because this offers it an instrument for putting political pressure on Moldova. Since Moscow has not officially recognised Transnistria, it can burden Chisinau with Transnistria's debts⁹. The estimated present value of Transnistria's debt to Gazprom is approximately US\$3.7 billion.

Exports are the main source of income for Transnistria. In 2012, the value of products exported from the region companies was almost US\$700 million, equivalent to approximately 70% of the GDP.

Although no official data is available concerning the value of the income generated by Transnistria this way, it can be estimated that they reached approximately US\$272 million in 2012¹⁰. These amounts are not taken into account in the budget, and are at the disposal of Transnistria's government. This money is deposited in a special account with one of Transnistria's banks, and is used, for example, to fill in gaps in the budget.

In 2008–2010, Tiraspol used the excuse that it could not pay off the debt because Transnistrian roubles could not be converted into dollars (the contract requires any settlements be made in US\$). However, in 2011, Transnistria's leader, Igor Smirnov, officially disclaimed the debt, insisting that there was no bilateral agreement to impose any obligation on Tiraspol to pay for

⁹ Dmitry Rogozin, Russia's deputy prime minister and special presidential envoy for Transnistria, announced in April 2012 that "unless Chisinau recognises Transnistria, the debt for gas used by Transnistria will become Moldova's debt." Source: <http://www.rbc.ru/rbcfreenews/20120418060404.shtml>

¹⁰ This estimated result was received by multiplying the annual average gas consumption in Transnistria by the price set in 2012 for firms and individual entrepreneurs (US\$137 and US\$80 respectively). It was assumed that the industry consumes 85% of the gas purchased.

the gas supplied to it¹¹. The system of gas subsidies also needs to be viewed in political terms. Companies which are loyal to the government can count on lower gas prices, while other firms may be forced to pay for energy bills with their shares.

Funds offered to Transnistria as part of so-called Russian humanitarian aid are the second pillar of budget financing. Moscow has consistently backed the region financially since the very beginning of its separation from right-bank Moldova. However, this aid has been significantly increased since 2008. From then until the end of 2012, Russia offered around US\$110 million to the government in Tiraspol (approximately US\$27 million annually), to be spent on increasing pensions and financing food

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supplies for those most in need. In addition to fixed transfers, Russia also offers Transnistria certain *ad hoc* subsidies; in 2011, it gave US\$10 million for supporting and developing small business, and in 2012 Moscow offered US\$30 million to stabilise the Transnistrian currency. Russia probably also subsidises Transnistria's law enforcement agencies, especially the army and the KGB. However, the scale of such aid is undisclosed, and thus difficult to assess.

¹¹ Transnistria's present leader, Yevgeny Shevchuk, recognised the existence of the gas debt in January 2012. In turn, several months later in September 2012, he claimed that "only cowards pay back their debts." Source: <http://news.point.md/ru/politika/shevchuk-na-vstreche-s-filatov-suschestvuet-shutka-cto-dolgi-otdayut-toljko-trusi>

The major economic problems

The Transnistrian economy is facing numerous problems typical of small economies undergoing systematic transformation. However, in the case of this region, the problems are chronic, and nothing seems to indicate that it will be possible to overcome them.

Transnistria is almost completely devoid of any of the internal prerequisites necessary for economic growth. Small- and medium-size businesses have a marginal impact on the local economy. Therefore, a middle class (as understood in Western terms), which could have become a stable factor for GDP growth owing to investments and increasing consumption, cannot coalesce. Increasing imports of foreign goods further affects the domestic production, thus making the development of local entrepreneurship more difficult. Furthermore, Transnistrian firms depend on decisions passed by the government in Tiraspol, which are usually politically and not economically oriented.

The scale of foreign direct investments is very small. The lack of clarity as to the ownership of assets and privatised companies is a serious barrier. There are no stable conditions for economic development or the growth of innovation. Transnistria educates young specialists who are unable to find work suitable for their qualifications, and therefore emigrate.

One of the key problems is the **demographic bust** resulting primarily from mass emigration of residents (approximately 2000 people leave the region for good every year) and a very low birth rate (-0.4% in 2012). Since the proclamation of independence in 1990, the region's population has shrunk by one-third, from approximately 750,000 to only 508,500 in 2013¹². At present, almost 30% of the region's residents are pensioners, and this ratio is constant-

¹² The data provided here and below originates from the State Statistical Service of Transnistria as of April 2013.

ly growing. The number of retired people has already exceeded the number of people working in the Transnistrian economy; in December 2012, these numbers were respectively 138,000 and 104,000 (0.75 workers per one pensioner). This is a serious burden for both the economy and the **complex system of welfare privileges**. Welfare expenses consumed US\$172 million in 2012 alone (and were higher by around US\$12.5 million than in 2011), accounting for 61% of all budget expenses and as much as 98.5% of total budget revenues. Maintaining such an expensive welfare system would not have been possible if not for support from Russia, which pays an extra US\$15 to each old-age pension paid out in Transnistria. From the very beginning Transnistria has had an **unfavourable trade balance**. A constant preponderance of imports over exports has been observed. In 2012, the value of goods imported by the region was 2.5 times higher than that of those it exported. This difference is especially evident in agriculture. Food imports rose from US\$70 million in 2003 to US\$198.5 million in 2011. The rapid growth in food imports is also proof of the inefficiency of Transnistrian agriculture. Another problem is **the economy's reliance on exports**, which generate an essential part of the region's incomes. Should this source of budget financing be lost or dramatically reduced in significance, it will not be possible to compensate for this by aid and subsidies from Russia, not to mention domestic demand. If foreign trade became impossible (for example, as a consequence of a customs border being introduced between Transnistria and Moldova)¹³ and no additional external aid were received, the Transnistrian economy would collapse. The dependence on exports is of a dual nature. On the one hand, the

¹³ For more information on the possible establishment of a customs border between Moldova and Transnistria see: W. Konończuk and W. Rodkiewicz, 'Could Transnistria block Moldova's integration with the EU?', *OSW Commentary*, <http://www.osw.waw.pl/en/publikacje/osw-commentary/2012-10-23/could-transnistria-block-moldovas-integration-eu>

scale of exports from the region is conditioned by demand on those markets which are the traditional recipients of Transnistrian production. On the other hand, given the lack of raw material resources, Transnistria must import raw materials from other countries, which makes the competitiveness of the region's products dependent on the prices imposed by the suppliers.

Forecasts for the Transnistrian economy

Nothing seems to indicate that the economy of Transnistria can become independent or efficient. For the time being, the region's government is showing none of the political will necessary to make any legislative changes. Such changes would have facilitated the operation of small- and medium-sized businesses, without the development of which any normalisation of economic relations in the region is impossible.

The economic model operating in Transnistria is inefficient and can survive only thanks to support from Russia.

Furthermore, despite invitations from Chisinau, for political reasons the Transnistrian government does not wish to participate in the currently very advanced Moldova-EU talks on signing an Association Agreement (AA) and a Deep and Comprehensive Free Trade Area (DCFTA) agreement, which is an integral part of the AA. The government in Tiraspol's behaviour is due to political pressure from Russia, which by preventing Transnistria from joining the free trade agreement with the EU also makes it difficult for right-bank Moldova to integrate politically and economically with the European Community. This also curbs opportunities for local businesses to develop. Although the political and business lobby which own the large industrial plants favour the development of multilateral foreign trade co-operation (they would very likely also sup-

port Transnistria being covered by the DCFTA), they are at the same time among the fiercest opponents of any possible reform of this para-state's economic system. If such changes were introduced, they would be forced to operate in an economic system based on free-market principles, with no subsidies, cheap raw materials and legal privileges. Despite their openness to co-operation with Western partners, this lobby also opposes any possible reintegration of Transnistria with right-bank Moldova. If this happened, the results of the privatisations carried out in the breakaway republic could be revised, and they could be deprived of the property they have acquired in Transnistria.

The economic model operating in Transnistria is inefficient and can survive only thanks to support from Russia. We may expect Moscow to continue backing the region financially as long as it sees this as politically convenient. It is very unlikely that such assistance could be withheld in the immediate future. To many residents of right-bank Moldova, the Transnistrian economic model may seem attractive, given the low energy and gas prices and the complex welfare system. From the Russian point of view, this makes Transnistria a kind of propaganda bait, intended to show Moldovans the benefits of co-operation and closer integration with Russia.

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