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NEWSLETTER

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Synthesis and Foreign Policy Debates

The materials are realized by Lina Grau, foreign policy expert and programme coordinator with APE.

TOPICS OF THE EDITION:

1. **MACRO Conference 2014** at its second edition. The director of the Expert-Grup, **Adrian Lupușor**: The state of the country report reveals a slowdown in the economic growth in 2014.
2. The macroeconomist **David Dalton** from The Economist Intelligence Unit states that the standard of living of the countries which joined the EU is way above that of the countries which remained under the influence zone of Russia.
3. The director of CRPE, **Cristian Ghinea**: The barriers of access to the EU market of the agricultural products have to do with standards, sanitary conditions and the capacity of signing contracts.
4. **Mircea Geoană**: I am anticipating that in 10 years we will witness an absolutely spectacular development of the Republic of Moldova.

The last period has been marked by a series of important events for the Republic of Moldova.



More than 70% of the Ukrainian voters who took part in the early parliamentary elections from October 26, 2014, have voted for the pro-European parties. The voters from Crimea which was annexed by Russia, and the Eastern regions controlled by the pro-Russian separatists, did not take part in the elections.



The Governor for the Luhansk region appointed by Kiev, Ghenadie Moskal, has stated during a TV programme that all the former Transnistrian leadership have now key positions in the pro-Russian separatist regions on Donbas. "The entire Transnistrian brigade is now in Luhansk who are all collaborators of the 5th Intelligence Division of the Russian Federal Security Service (FSB), called also Division for Operational Information and International Cooperation", said Ghenadie Moskal.



The Russian foreign minister Serghei Lavrov has accused during a public lecture, the EU of wishing to apply in the Republic of Moldova the so-called "Ukrainian scenario". Lavrov added that the Transnistrian region should be able to decide by itself its future in case Moldova renounced the neutrality. The Russian official has criticised the decision of the Constitutional Court from Chisinau calling it "shocking", which denied the challenge of the opposition Communist Party regarding the non-constitutionality of the Association Agreement of the Republic of Moldova with the European Union.



Russia has imposed new restrictions on the meat imports from the Republic of Moldova and banned the unlabelled vegetable and fruit imports from Belarus suspecting its partner from the Customs Union of re-exporting products from other countries, especially from the Republic of Moldova.



The new European Commission led by Jean Claude Juncker was approved by the European Parliament on October 22, 2014, and its 5-year mandate started on November 1st.



In a letter addressed to Nicolae Timofti at the end of his mandate, the European Commissioner for Enlargement, Stefan Füle, has appreciated highly the contribution and the ideas of the Republic of Moldova to the consolidation of the Eastern Partnership, highlighting that during his mandate, the Republic of Moldova had consolidated significantly its relations with the European Union, while the signing on June 27th, 2014, of the Association Agreement as well as of the visa liberalisation regime with the EU in April 2014, were historic steps in the development of these relations.

The successor of Stefan Füle, the European Commissioner for Neighbourhood Policy and Enlargement, Johannes Hahn, paid his first visit abroad in his new capacity, the destination being Chisinau. The symbolic gesture has highlighted the importance which the new Commission will attach to the relations with the Republic of Moldova. Johannes Hahn has signed with the Prime-Minister Iurie Leancă a memorandum based on which the EU will provide to the Republic of Moldova financial support in the amount of 410 mln Euro in the period of 2014 – 2017. The financial assistance is earmarked for the administrative reform, reform of the police, tightening of border security, agricultural and rural development. The money will be disbursed depending on the quality and speed of reforms.



MACRO 2014: European Integration for Citizens



Adrian Lupușor:
The state of the country report reveals a slowdown in the economic growth in 2014

The impressive economic growth of the Republic of Moldova in 2013 which accounted for 8.9 percent, as well as that from the first half of 2014, is temporary and it is expected to decelerate in the near future. The growth is expected to decrease to 3-4%, although in order to reach the average of the region Moldova needs

an increase of 7-10%. The factors which determine this situation are the regional and external context such as the decrease in the demand, contraction of investments, and restrictions applied by Russia, as well as internal factors such as the slow modernization of the infrastructure, lack of support and financial motivations by the state for the companies implementing these standards. These are the conclusions of the State of the Country Report developed by the Analytical Centre Expert-Grup in partnership with the Friedrich-Ebert-Stiftung and presented at the MACRO Annual Conference in Chisinau on October 21st.

The executive director of the Expert-Grup, Adrian Lupușor, is explaining these conclusions and what Moldova should do in order to reduce the gap between the level in the standard of living of its citizens and that of the European countries.

■ **Adrian Lupușor:** The economic growth in 2013 was atypical for Moldova and, respectively, it will be difficult to maintain. The growth was driven by a good agricultural year, but also by the depreciation of the national currency, which boost the exports and discouraged the imports. These factors are temporary by definition and will dissipate. The structural factors that the natural economic growth depends on remain quite frail. In the next years we anticipate a modest growth of circa 3-4 percent. There is a series of internal and external barriers which will influence this economic growth.

Internally, we have a shortage of skilled labor, a problem attested by the business sector practically every year that affects the businesses productivity.

Another problem is that most public institutions are very inefficient and the institutional framework is rather



weak, especially when it comes to the protection of property rights, efficiency of the justice system and of the rule of law.

Another problem is the excessive share of the state in the economy - the state has assumed a number of inappropriate responsibilities, which is inefficient for the economy. We have a large number of state enterprises which are either ineffective or on the verge of bankruptcy and the maintenance of these companies at all costs hampers the economic progress and modernization.

Another problem is the small market, coupled with an imperfect competitive framework which is rather inefficient. And namely, this is about the financial and banking sector, the agricultural agents' market, the oil market, where the competition is not beneficial for the development of these sectors.

What is different about the current situation is the presence of **external barriers** which will put additional pressure on the economic growth in the following years. It's about certain problems and a decline in the demand for the Moldovan industrial production

on the EU markets, such as Italy and Romania, but also about economic problems in Ukraine, coupled with worsening of trade relations with the Russian Federation.

■ **Lina Grâu:** How big is the impact on Moldova of the Russian embargo and of the economic problems of the Russian Federation following the depreciation of the ruble, decrease in the oil price and the Western sanctions?

■ **Adrian Lupușor:** The impact of the trade restrictions imposed by the Russian Federation is mixed. On the one hand, the Russian Federation is an important trading partner for Moldova - in 2013 we exported about a quarter of products to this market. It is true that in 2014 this share dropped to 20 percent. Given these barriers it is clear that certain sectors, especially the agribusiness, are affected and this puts additional pressure on the economic growth, attraction of investments, and on the income of the population employed by these enterprises. So, there are several obvious negative effects.

However, there is a number of less negative effects as these restrictions

motivate the businesses to diversify their production and look for other outlets and thus avoid relations with such an unpredictable trading partner as the Russian Federation. Since 2006, Russia has been promoting towards Moldova an unstable, unpredictable and geopolitical commercial policy. As a result, already in 2014 we have seen an increase in the exports to other markets such as the EU market, even Belarus and Kazakhstan markets, and these exports have offset the loss of the Russian market. So we see that the worsening of relations with the Russian Federation correlated positively with the diversification of exports. And the diversification of exports is one of the essential conditions for increasing competitiveness of Moldova and ensuring a sustainable economic growth.

■ **Lina Grâu:** You said that the basic principles of the Moldovan economy are not very healthy and do not allow for rapid economic growth. What should be changed in this regard?

■ **Adrian Lupușor:** Internally, first of all, we need a more favorable business climate, especially when it comes to the issue of permissive documents and the relations between the civil servants responsible for issuing these documents and the economic agents. This interaction between the state and businesses should be automated in order to reduce the incentives for corruption. Also, the protection of property rights should be strengthened, in particular the intellectual property rights. Here I refer to the reform of the judiciary as the protection of property rights is crucial for the attraction of foreign direct investments.

Another constraint is related to the quality of the workforce. In this context, we need at least two reforms. The first would be the

reform of the education system by making available the necessary resources to invest in the quality and ensure a better correlation between the supply of the education sector and the demand of the businesses sector. A closer dialogue between the educational institutions and businesses is needed. The second is the health sector reform - we need the necessary resources to invest in the quality. Both sectors consume about 12 percent of GDP and are managed extremely inefficiently.

Other reforms should aim at increasing the efficiency of the production factors in the economy. Moldova has few resources and it is extremely important that these resources be managed very effectively. This is impossible to do with so large a share of the state in the economy - so we need to resize the role of the state, increase the efficiency of the state enterprises and enhance competition. We need a more targeted and effective competition policy, particularly in the banking sector, agricultural intermediaries and petroleum products.

These measures should be complemented by a series of efforts aimed at reducing external risks. First, it's about the modernization of the quality infrastructure and implementation of European standards, which would allow for the local companies to diversify their markets and be less dependent on the CIS market.

Additionally, the national security should be strengthened as the investment attractiveness of the country depends very much on this. In this sense, we recommend to make the party financing and the banking and financial system more transparent.

■ **Lina Grâu:** When you were talking in the State of the Country Report about

the reforms being copied in Moldova, what did you mean?

■ **Adrian Lupușor:** We have referred to the fact that the Government has so far mainly perceived the European integration as foreign policy objective rather than a domestic policy objective. There have been neglected certain internal reforms without which it will be impossible to benefit from the Association Agreement with the EU.

The pension system reform, the central public administration reform, adjustment of the quality infrastructure to the European standards (currently only one third of standards have been harmonized) the party financing reform, reform of the judiciary - all these reforms have dragged on for years. It has probably been a major blunder of the pro-European government.

■ **Lina Grâu:** When do you estimate that the ordinary people, producers, and farmers will start feeling the benefits of the Association Agreement and Free Trade Zone with the EU? Theoretically, we can already freely export to the EU but in fact this is not happening. When will we be able to fully benefit from the above-mentioned agreements?

■ **Adrian Lupușor:** In fact, this is already happening – over the first two months of the implementation of the Association Agreement (it entered into force provisionally on September 1st) there has been an increase in the exports of certain products, especially food production. We are talking primarily about companies that have managed to implement European standards and now are enjoying tax-free access to this market.

These companies which have started exporting more can serve as inspiration for other businesses which can see the tangible benefits of this Agreement

if the quality requirements are met. Now, obviously, the companies which are exporting are the large and most competitive ones which had relations with the EU before the Association Agreement - they had put in place a European quality system long ago. As I've mentioned above, they are a source of inspiration for other companies.

■ **Lina Grâu:** To what extent the political situation in Moldova, in particular the results of the parliamentary elections from November 30th, will have an impact on the economic development of the country?

■ **Adrian Lupușor:** Implementation of the roadmap envisaged by the Association Agreement implied lack of political crisis and was based on the assumption that there would be no political deadlocks. The problem is that the process of forming the next government will most likely be quite difficult and this will translate into a slowdown in the implementation of the Association Agreement. So there is a high probability that we will be late with the achievement of certain measures of the Association Agreement.

In addition, we will benefit greatly from this Agreement provided there is an increase in investments. And the investments, as we know very well, like stability and predictability. In the context of the current political situation and the rhetoric of certain political parties of denouncing the Association Agreement there is high uncertainty which will most likely persist until after the elections when the next government is formed. This situation will have an impact on the investment attractiveness. So there is a high probability that in 2015 the Association Agreement will still not bring the expected results.

David Dalton: The standard of living of the countries that joined the EU is way above that of the countries which remained under the Russian sphere of influence



The macroeconomist of The Economist Intelligence Unit, David Dalton, drew attention at the MACRO Conference 2014 to the fact that the standard of living in the post-socialist countries that have chosen to get closer to the EU and to develop their economies in connection with the European markets is superior to that of the countries which chose to remain in the sphere of influence of the Russian Federation. David Dalton gave the example of Poland and Ukraine which in the early 1990s were almost at the same level of development. But now Poland has a much better economic situation than Ukraine.

David Dalton mentioned that the post-socialist countries which joined the EU have had a significant increase in the human development index, while in the Republic of Moldova and Ukraine this index has decreased. Moreover,

the social inequality in the post-soviet countries which did not align to the EU, including Moldova, has increased.

The problem for Moldova is that at the moment the benefits promised by the Association Agreement - the creation of institutions and the removal of trade barriers which will lead to better standards of living - are medium and long term tasks, while the costs have to be paid immediately. This is exactly what Russia counts on, which is trying to focus on costs, in order to discourage the Moldovan citizens.

The biggest threat for Moldova at present, says the economist, is related to the political and economic destabilization of the country and to the character of the investments coming into the country. David Dalton recommends to Moldova to attract investments "which are not destabilizing," the key element in this respect being the banking sector. The remittances should be channelled through the banking sector so that it becomes stronger and provides loans to small and medium enterprises, while the direct investments should be directed towards the export-oriented sectors.

Another extremely important aspect for Moldova related to the free trade and economic growth is the peoples' education. This leads not only to the formation of a valuable human capital, but also to long-term development of the society, says the macroeconomist from the Economist Intelligence Unit. According to him, the Association Agreement will also envisage retraining programs to help people to cope during the transition period.

Cristian Ghinea: The barriers of access to the EU market, the sanitary conditions and the capacity of signing contracts

The director of the Romanian Centre for Foreign Policy (CRPE), Cristian Ghinea, is saying that in order to be able to export in the EU, the Moldovan producers which most of them are of small scale, should put in place an efficient post-harvest system as it is unlikely that small producers farming only a couple of hectares of orchard will have the capacity to deliver alone to the big western commercial chains.

■ **Cristian Ghinea:** The Association Agreement is opening an immense market, a market which is ready to pay a good price for the agricultural and food products and especially it is a market which is not subject to political pressure and caprices. On the other hand, in the short term, there are various kinds of barriers which have to do with standards, sanitary conditions as well as with the capacity of the Moldovan producers to sign contracts. CRPE has conducted a study recently which has analysed three sectors- fruit, wine and meat- and identified the problems which are mainly the temporary barriers and the blockages mentioned above.

As far as fruit is concerned the problem is the lack of a post-harvest infrastructure. This means that after the harvest, the apples should be packed, graded after which a contract should be signed with someone who should sell them in the EU. This part of post-harvest infrastructure is rather weak in the Republic of Moldova.

When it comes to the vineyards, there is a problem with the age of the plantations and productivity. A quality Moldovan wine is still expensive compare to the wines from



South Africa, Chile, Australia and other countries. In order to increase productivity, there is need for serious investments. In turn, the latter generates other problems as even if the “Moldovan vineyards” Programme or other European funds provide money for the vineyard plantations, there is a problem with co-financing. In Romania we had the same problem when we had a similar programme for the vineyards renewal. Only big farmers will have access to this money, at least in the short-term.

There is also a marketing problem with the vineyards- the European consumers should know what they buy and have confidence in the brand. There are discussions as whether the “Wine of Moldova” brand is a good idea or not. On one hand, it is a good idea to have a country brand, but on the other hand, in the case of wine, the country brand

does not make it easier to sell. So, if you say “French wine” this does not necessarily mean it is good. So, I would recommend to invest in brands apart from the “Wine of Moldova” general brand, as Moldova has very good and strong brands such as Purcari.

Regarding the meat, the blockage here is the biggest. The phyto-sanitary conditions are very strict in the EU. From our interviews with the producer associations and the officials, we have seen that actually, there are two opinions and that the two sides blame each other. Some say that the producers are not ready for this change and that they are hostages of the internal and the CIS market which have less constraints and that the producers have indulged themselves in this delay, having not done anything as there is need for big investments for the reengineering. On the other hand, the Agency for Food Safety is not accredited by the EU yet. This agency was set up at the beginning of 2013 and made some steps but it will take some time until it gets accreditation. If the Agency is not accredited, it cannot accredit in its turn the meat products. So here there is a situation when the hot potato is thrown from the producer to the state and vice versa.

The fact is that there are these sorts of blockages which make the agricultural exports lag behind other exports when it comes to the orientation towards the EU.

We think they should be given priority so as the money given by the EU to the Republic of Moldova for the agriculture and rural development is directed towards creating special measures in order to remove these blockages.

■ **Lina Grău:** One of the ideas discussed at the MACRO 2014 was that the benefits offered by the Association Agreement are of medium and long

term, while the problems that appear with alignment to certain standards are short-term challenges which affect directly the producers. Agriculture is the most sensitive area in this sense as there is need for more time to be able to align to certain standards and have qualitative products. Where and how should specifically be the agricultural producers supported in order to really be able to benefit from the Association Agreement?

■ **Cristian Ghinea:** I think we should have sectorial policies for each sphere and I think that this has been the problem until now- the way the national subsidies were spent- as the objectives were of global nature and no attention has been paid to the details.

We have to say that the wine sector finds itself in a paradoxical situation: in 2005-2006 it was the first to be hit by the Russian embargo. The big Moldovan wine producers made investments then which allowed them to reorient towards the EU market.

■ **Lina Grâu:** The embargo could have been the factor which allowed them to be in a better situation now...

■ **Cristian Ghinea:** Exactly. The wine story teaches us that there is need for several years of investment and effort to reach a new market. For this reason, the wine producers are way ahead the fruit and meat producers. It is because they were hit by Russia much earlier. That is why I think we should learn from their experience.

On the other hand, even in the wine sector I can see two industries – one which is still hostage to the CIS market and the other which oriented towards higher standards. In this case, we should help the second one to be able to export more and get a better position on the market.

So, now there is this story with the exports to Belarus which is very interesting and we see that Belarus has become a big market for the Republic of Moldova. But this is a short-term situation as I don't know if Russia does not counteract it as what Belarus does is to import wine from the Republic of Moldova and export it to Russia. This infringes the principle of the origin of goods and I don't know if Russia has political interest to react to it. This is not a long-term solution. It is only a short-term trick of Moldova and Belarus. A long-term solution would be to have a niche on the European market.

■ **Lina Grâu:** As far as the Moldovan fruit and vegetables are concerned, how do you see the export capacity of the Republic of Moldova and the absorption capacity of the EU?

■ **Cristian Ghinea:** In our study we gave an example with the wall nuts. The price of nuts is very high in the EU and even if the share of nuts is rather small in the total agricultural exports, the money value is rather high. The problem with the wall nuts is that it takes long to create wall nut plantations. The situation is that if the Republic of Moldova panned more wall nut trees, it would take minimum five years to have a first yield. So, if Moldova is intending to occupy the wall nut niche, the state should provide assistance as nobody can afford to block the land for five years. However, the recompense is very high and the annual deficit of wall nuts in the EU is estimated at about 100 thou tons. So there would be a market for that.

There is one more thing which could be done. We don't think this reorientation towards exporting fresh fruit will happen overnight. What Moldova can do though is to get integrated into the fruit production chain – like the

fruit juice. I would attract investors to process the fruits at European standards- we speak here about fruit juice, jams etc. I think there might be foreign investors interested to come here as the fruit is cheap. Initially they will export under their own brands- this is the first stage when you get integrated into the big production chains. In the beginning Moldova can provide the raw material and then it can develop its own brands. If you set too high objectives at the beginning, I don't think you will manage.

■ **Lina Grâu:** You were speaking about investments. What is the connection between the investments and the political situation of the Republic of Moldova?

■ **Cristian Ghinea:** I think that the foreign investors do not necessarily look at the elections, but rather at the rule of law. From the discussions I had with the investors here, what they say is: "I'm not sure that tomorrow I won't be deprived of my business". It is slightly better than during Voronin times when the people were deprived over night of their businesses by people from Voronin's entourage, but this problem has not been solved by the pro-European Alliance either. The problems is that the investors have no confidence. And all the stories with the raider attacks of banks make the situation even worse.

Unfortunately, Moldova is still a territory where only the adventurous ones dare to do something. And I don't have in mind big investments with future plans for business development, but individual businessmen who hope for rapid and big profits as only in this case it is worth the risk. There is need for several years of stability and serious measures of ensuring the rule of law to remove this perception.



Mircea Geoană: I am anticipating that in 10 years we will witness an absolutely spectacular development leap in the Republic of Moldova

Speaking at the MACRO 2014 conference, the Romanian ex-foreign minister, Mircea Geoană, has mentioned that the EU commercial border had definitively moved towards East and there it will stay. "I see no possibility for the EU and the West to rebound from the point of view of the free trade area, an aspect which Moldova should develop in partnership with Romania or within big regional projects with Romania and Ukraine", stated Mircea Geoana at MACRO 2014.

■ **Mircea Geoană:** If it is to make a geo-economic observation, from my point of view and according to the evaluation of conscious people from Europe and USA, the commercial border of the European Union has moved hundreds of km towards east and there it will remain. I see in no any variant of competition over the influence between Russia and the West the possibility that the EU and the West rebound from the point

of view of the economic dimension and free trade.

Otherwise, we can discuss about the timing of Moldova's integration into Europe, other elements, as many things can happen. Romania will remain highly consistent with our national interest and regional interest – that of having our neighbours part of the European project as soon as possible. It is a natural thing and Romania here enjoys a national and politically remarkable consensus which makes Romania a little more robust in conditions of vulnerability that we also have.

So let's start from the working hypothesis, which I think is a rational and lucid assumption, that in the future we will actually have a co-existence of two economic and trade areas with interpenetrations as a result of sovereign decision of the governments of the ex-CIS countries. The fact that

Armenia has decided to go into a different direction, as well as Belarus and Kazakhstan, while Moldova, Ukraine, and Georgia decided in a sovereign and already legally way to go towards an Association Agreement with the European Union, will be a reality of the coming decades. We will do our best so that in the end the integration into the EU is genuine, deep, and legally for Moldova, Georgia and Ukraine. This is a vital interest for Romania and we will continue to do our utmost to support it.

So what can be done given this reality? First, we should find out together the elements that can best capitalize the positive aspects of the Association and Free Trade Agreement. But we should have a strategic goal in mind. I feel that the discussion in Chisinau is rather whether it is good or bad to be close to Europe, whether it is good or bad to turn away from Russia. That's not the type of conversation you should have. The question is how the Republic of Moldova can change its economic structure to be more competitive and move from its current poor position within the human development index



ranking to and towards the high-value chain of the world economy. This is what it is all about. And it is non-ideological what I'm saying to you. It is non-political, non-geopolitical, it is simply the obligation of any state and any government: to try to go as far as possible during their mandate towards the food chain of the world economy.

So if at the East-West and North-South intersections we –Romania, Moldova, and Ukraine came together, and had a minimal coordination of infrastructure projects - from energy to border crossing, from ports to intermodal transport- and we worked a little more strategically and in a more practical way, I think we could do miraculous things in which the discussion between the Kremlin and the White House, between Chancellor Merkel and the Prime Minister, will be important, but will not be the dominant topic any longer.

This idea of Danube - Black Sea cluster between Romania, Moldova and Ukraine - is an area where we have the potential together to become multi-regional platforms and to transform the current geopolitical handicap – which is important for Moldova and Ukraine at least for now – into a geo-economic advantage. This is possible given that no matter how much someone would struggle in Moscow or elsewhere, the commercial border in Europe moved for a long time beyond the eastern border of Georgia and the border, whatever it is, between Ukraine and Eastern space. From this standpoint Moldova is



in a commercial area that can breathe together with Europe. It's a huge advantage, which does not prevent it from diversifying its supplies and continuing having trade and partnership relations in all directions. It would be a shame to not use your geography as a gateway to Europe. Together with Romania, together with Romania and Ukraine, individually, this geo-economic advantage should be exploited.

I'm expecting that in 10 years we will see an absolutely spectacular development leap in Moldova. I do not know how quickly reforms will be implemented and I do not know what will happen with politics, but I think that the economic structure of the Republic of Moldova will change inevitably and the food chain of the

European economy will expand here as well. I think it is only a matter of time, of policy coherence and strategic direction of the country, for the Republic of Moldova to climb rapidly within in the ranking of the world economy and of the value added chain. Do not lose hope! Even if it is hard, this road is one that will bring success. And we want very much in Bucharest to see the entire neighbouring region developing as this way we are helping ourselves- to have prosperous neighbours with whom we can have business relations.



Foreign Policy Association (APE) is a non-governmental organization committed to supporting the integration of the Republic of Moldova into the European Union and facilitating the settlement of the Transnistrian conflict in the context of the country Europeanization. APE was established in fall 2003 by a group of well-known experts, public personalities and former senior officials and diplomats, all of them reunited by their commitment to contribute with their expertise and experience to formulating and promoting by the Republic of Moldova of a coherent, credible and efficient foreign policy.



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