

EXECUTIVE SUMMARY

The present study relies on two complementary approaches: first it thoroughly analyzes the commercial exchanges between the Republic of Moldova and all EU Member States, and then it focuses on the accomplishments of the Republic of Moldova and the further steps it has to undertake in order to achieve a free trade agreement with the EU in a reasonable timeframe.

The European Union uses its trade policy as part of the Europeanization process, especially in its immediate vicinity. Thus the Republic of Moldova was offered the possibility to negotiate an agreement on establishing a *Deep and Comprehensive Free Trade Area – DCFTA*. The difference between a free trade agreement and a deep and comprehensive one is that the latter requires that the partner state should include a multitude of elements of the European *acquis communautaire* into its own legislation. The targeted legislative areas are: competition, public procurement, business, product standardization, statistics, customs, intellectual property, etc. In addition, the partner state has to solve specific matters – in the case of the Republic of Moldova it comes to the issues regarding the situation in Transnistria.

The *first chapter* points out the internal and international context in which the Republic of Moldova wishes to sign a DCFTA agreement with the EU. This consists of the participation of the RM in the Eastern Partnership and the fact that the DCFTA agreement would be a part of the Association Agreement between Republic of Moldova and the EU, meaning that the Association Agreement would not be signed before the completion of DCFTA negotiation (which is itself a complex process).

Signing the free trade agreement is important for Republic of Moldova from two main viewpoints:

1) *the political dimension* – the date when the Association Agreement will be signed depends on the progress of the negotiations. The DCFTA Agreement will be regarded as an important indicator regarding the determination of the Chisinau Government when it comes to structural reforms which, over time, could bring the Republic of Moldova to the much desired area of the discussions on EU enlargement. In other words, the Republic of Moldova would have already implemented much of the EU *acquis* even before it passed, the Europeanization process taking place even without a clear perspective regarding the accession.

2) *the economic dimension* – the EU is already the main trading partner of the Republic of Moldova. The DCFTA Agreement will favour a greater integration of the country into the European economic area, providing direct access to the Single Market and leading to economic growth and competitiveness. Thus, the main economic benefits translate into: access to a huge market (the EU common market) for the Moldovan goods, the attraction of new investments (by increasing investors' confidence), the optimization of

both institutional and legislative framework, the business environment's improvement, a real increase of the overall economic competitiveness of the country's economy.

The context in which the Republic of Moldova wishes for a DCFTA Agreement is also determined by the agreements the country has at the moment. The Republic of Moldova has been a full member of The World Trade Organization (WTO) since 2001, and also a member of The Commonwealth of the Independent States (CIS) since 1994. Although CIS does not hold supranational competences its members' agreements may influence the free trade agreement. In this respect, Republic of Moldova and the other CIS states established a free trade area. The Republic of Moldova holds a total of 16 agreements, counting those with the CIS states and the countries from the Stability Pact of the Southeastern Europe. Also, together with Albania, Bosnia and Herzegovina, Macedonia, Montenegro, Croatia, Serbia and UNMIK Kosovo, the Republic of Moldova has been a member of the Central European Free Trade Agreement (CEFTA) since 2007.

We cannot speak about the current political and economic context of the Republic of Moldova without briefly mentioning the situation of Transnistria. Transnistria is an impediment in Moldova's European integration path, and the delay in solving this frozen conflict has direct implications on the DCFTA: Transnistria pertains territorially to the Republic of Moldova, while not being controlled by its state authorities, which equates with a high degree of risk for external partners. One of the disadvantages imposed by the situation in Transnistria (breakaway territory for the last 20 years) is that this political entity has had time to develop specific state elements: government, borders, an army, police force, its own judiciary, monetary system and so on.

Thus, for the DCFTA negotiations, Transnistria represents a vulnerable spot for the Republic of Moldova because it is an uncontrolled territory. All these considered, the Moldavian authorities are not entirely discouraged, trying to learn from the experience of Cyprus, even though the two situations are not quite identical.

The present study pinpoints the actual stage of the Republic of Moldova on its way to the DCFTA Agreement. The authorities have already begun to implement many of the European Commission's recommendations, according to the commonly agreed timetable. In July (at the date of our study) the Moldovan Ministry of Economy had already reported the actions undertaken in the first two quarters of 2011. The first round of negotiations is expected to start in September – October 2011. Although the Republic of Moldova started to implement the EU trade acquis, the negotiations cannot start in the absence of a thorough assessment, which will be conducted by the European Commission. The start of negotiations will be recommended/ decided on this basis. It is worth pointing out that in many respects (including *opening of borders*, which is one of the most important aspects regarding a free trade agreement) the Republic of Moldova shows a good situation. According to our estimations, a standard free trade agreement could have been obtained in less than a year. Instead, achieving a DCFTA agreement brings up some difficulties, but it countervails by bringing the country on the European path, closer to the European Club.

The *second chapter* presents an in-depth analysis of imports and exports of Republic of Moldova with the EU and with each Member State. On this basis we can conclude that:

- The commercial exchanges with the EU countries experienced a sharp increase (about 400%) over the last decade (except for the “crisis” time in 2009). Thus, the EU has become the main trading partner of the Republic of Moldova since 2005;
- Since 2006 the EU has also become the main trading partner of the Republic of Moldova in terms of exports, with a share of 51-52% between 2006-2009 and 47% in 2010. Although this cannot be entirely credited to the introduction, starting January 1st 2006, of the Generalized Preferences System (GSP+), it is obvious that this scheme has made significant contributions to the Moldovan exports’ (to EU) increase. In this respect, the logical conclusion is that the more liberalized exports system within the DCFTA could only continue to increase the Moldovan exports to the EU. However, it is expected that the exports’ growth rate would not be as great after signing the DCFTA agreement (21-26%) as it was after adopting GSP+ and PCA, because most of the goods with potential for export already benefit from the liberalized scheme within GSP+ and PCA;
- The Moldovan products with the highest share of exports to the EU are from the following groups: “textile materials and products”, “vegetable products”, “machinery, electrical equipment and parts”, “food and beverages, except alcohol, vinegar, tobacco”, “fats and vegetal and animal oils”, “furniture”, “medical and surgical furniture”, “lighting appliances and similar”, “prefabricated buildings”. These held about 80% of the overall Moldovan exports to the EU in 2010. Except for “vegetable products” and “food and beverages, except alcohol, vinegar, tobacco” groups, the rest will be more or less immune to the liberalization within the DCFTA. Instead, they will benefit from the abolition of the pricing quotas and the pricing and non-pricing barriers. This applies especially to those items using 100% granted tariff quotas;
- The first ten countries in the overall Moldovan exports to the EU are: Romania (33,8%), Italy (20,2%), Great Britain (11,3%), Germany (10,4%), Poland (6,4%), France (3,2%), Bulgaria (2,6%), Greece (2,4%), Lithuania (1,6%), Austria (1,5%). Once the DCFTA agreement will come into force the share of exports to “non-traditional” countries will increase, especially at the expense of foreign investments that come along with removing the international trade barriers. However, in the short term the main export destinations and goods will remain the traditional ones;
- The main product groups imported from the EU are those of: “machinery, electrical equipment and parts”, “mineral products”, “products of the chemical industry and its related industries”, “textile materials and products”, “vehicles, aircrafts, vessels and transport equipment”, “plastic materials and products, rubber and rubber products”, “food and beverages, except alcohol, vinegar, tobacco”, “common metals and articles of common metal”. Removing tariff and non-tariff barriers within the DCFTA will

not dramatically affect the import of goods from most of these categories, because they are not produced in the Republic of Moldova and will still be imported, no matter if the tariff barriers are kept or not;

- The most susceptible goods when it comes to the liberalization of imports from the EU will be the ones from the “food and beverages, except alcohol, vinegar, tobacco” group (especially beverages, sugar and food) which come with competitive advantages in price and quality compared to the local products. In the short term, their import will increase following the DCFTA agreement’s adoption. However, the impact will not be dramatic, as the food and alcoholic beverages already hold a high and continuously growing share in the domestic consumption (their import has increased with 78% for the last 4 years, while the export has decreased with 23%). In the long term this will bring many benefits, as a result of enhancing the Moldovan goods’ competitiveness and the inflow of FDI;
- The main trade partners of the Republic of Moldova, relative to the total imports from the EU in 2010, are: Romania (22,7%), Germany (17,3%), Italy (15,9%), Poland (6,2%), Greece (5,5%), France (4,0%), Hungary (3,8%), Austria (3,5%), Great Britain (3,1%), Bulgaria (2,9%). Following the signing of the DCFTA Agreement the imports are expected to increase, especially the ones from the neighbouring countries: Romania, Bulgaria, Hungary, and Poland. This means the increasing imports of alcoholic beverages and food from these countries will substitute the ones from the further away countries (especially Russia and CIS states), which, at the moment, hold free trade agreements with the Republic of Moldova.

The *third chapter* looks at the performance of the Republic of Moldova regarding the Autonomous Trade Preferences (ATP) over the last three years. In this respect, the main conclusion is that the Republic of Moldova has been increasingly capitalizing on the ATP, marching to 100% in 2010.

Chapter four deals with the institutional arrangement for preparing the DCFTA, institutional responsibilities and capacity building for the administration in order to implement this type of agreement. It also evaluates the progress and actions on each of the 13 points recommended in the Action Plan, coordinated by the Minister of Economy and Trade.

The actions within the plan differ from each other in terms of nature, complexity, difficulty and impact. Therefore, in order to achieve an overview of the preparations carried on by the Republic of Moldova in terms of harmonizing legislation with the EU acquis, we chose a quantitative approach of the answers, instead of a qualitative one. Given the wide range of areas which could be evaluated – as each field could get a comprehensive assessment of its own – a qualitative approach would have scaled the present study beyond its goals and proportions. This does not mean that we did not look carefully to each area in order to make relevant assessments. Information of a qualitative nature can be found within the findings regarding each of the analyzed fields, and are detailed in this chapter.

The most important findings of the qualitative analysis (on the negotiation topics set by the Action Plan) are the following:

1. Overall coordination and administrative capacity building

- The institutional framework required in order to start negotiations has been set up.
- The Ministry of Economy has created a Working Group for the technical coordination of the DCFTA negotiations. The group is comprehensive (including representatives of all relevant institutions in terms of the DCFTA acquis adoption) and is divided into four working groups, according to the negotiation process: (1) Market access and customs management, (2) Actions and trade barriers, (3) Financial services and the competitive environment, (4) Private sector and NGOs consultations.
- The Ministry of Economy (as coordinator), has been benefiting from technical assistance programs aimed at increasing the administrative capacity. These are mainly funded by UNDP. However, these support programs had no real impact within the Ministry, especially at the technical level, where specific expertise is essential. This is due to the burdensome bureaucratic procedures that delay engaging relevant experts. The role of these experts (local consultants) is to assist in developing feasibility studies in the field of: market access, technical barriers hindering trade, sanitary and phytosanitary actions, customs and law.
- The Ministry of Economy needs mainly local experts (or international experts with a good knowledge of Moldovan law and the national context). In terms of human resources, the Ministry of Economy does not have enough staff – compared to the workload – available to exclusively pursue the DCFTA negotiations. The General Directorate for Trade Policy has duties and competencies in implementing many other agreements, such as CEFTA, CIS, Turkey, etc.
- In the absence of local feasibility studies to support the negotiations with the EC, the Republic of Moldova sets its position based on several existing macroeconomic indicators and on the (mainly theoretical) experience of the working groups' members.
- In the following period it is recommended to institutionally strengthen the General Directorate for Trade Policy, by increasing the number of people responsible with DCFTA negotiations coordination. Currently there are only two people in charge with this vast agreement, covering many topics.

2. Market access for goods/Trade statistics

- In this respect, one can notice the vague character of the EU's first recommendation. However, the Moldovan authorities translated it into equally vague measures within the Action Plan: "Harmonization of legislation with the EU acquis on statistics". Such wordings favour the party with the greater negotiation power (in this case the EC), allowing it to make additional requirements.

3. Tariff and non-tariff barriers (NTBs)

- In order to meet the EU recommendation, the Republic of Moldova carried out an assessment on tariff and non-tariff trade barriers (as it arises from the WTO commitments on market access). The study identified tariff and non-tariff barriers of legislative, institutional and procedural nature. Several regulations impeding the development of import transactions were identified and specific review recommendations were made accordingly.
- The Republic of Moldova's commitment within the WTO helps keeping the custom tariffs very low – amongst the lowest in the world. This is already an advantage for the country: it doesn't have much to lose, given the low impact on the state budget.
- In 2010, the tariff quotas were used at full capacity (100%) in the case of goods eligible for export in the EU. Currently, animal origin products cannot be exported to EU Member States because of sanitary and phytosanitary requirements (SPS).

4. Technical barriers hindering trade (TBT)

- Overall, the Republic of Moldova fulfilled the EU recommendations in this regard. Moreover, it recorded further progress, expected at the level of 2012.
- The Republic of Moldova adopted a significant number of Romanian standards (over 2000), which were considered European standards and applied as such. The disadvantage is that the standards were developed and are owned by The Romanian Standardization Association (ASRO), which charges high annual fees. So far the standards have been purchased with the World Bank support.
- The legal framework for this area is emerging and the process of transposing EU directives into the Moldovan law is in progress. Unfortunately, they fail to be implemented at the level of economic agents because many fields where standards are adopted lack economic agents to put them into practice.

5. Sanitary and phytosanitary measures (SPS)

- As far as this chapter is concerned, most recommendations have deadlines which stretch beyond the current reporting period. Nevertheless (according to the second Progress Report), the Republic of Moldova has already undertaken measures aimed at meeting the recommendation on time or even before the deadline.
- The main problem concerning this chapter is the lack of technically well equipped laboratories, to ensure an efficient sanitary and phytosanitary control. The State Inspectorate for Market Supervision, Metrology and Consumer Protection functions as a sole inspectorate for the supervision of economic agents. It doesn't have sufficient technical capacities and human resources to perform an efficient

control of a significant number of economic agents (in May, there were only 8 staff members with attributions in this respect).

- As for metrology, the Metrology Inspectorate has been included into the customer protection sphere. While Republic of Moldova is fairly good at testing foodstuff products (thanks to several projects financed by the World Bank), there is a completely different situation when it comes to industrial products. There are no technical capacities for the re-evaluation of medical and pharmaceutical products.

6. Commerce and border administration facilitation

- The Government has been permanently trying to ensure a homogenous implementation of commercial and border administration throughout the territory of Republic of Moldova. Nevertheless, no substantial progress has been recorded so far, as concerning the amendment and implementation of the legal framework regulating import taxes on transactions with Transnistria economic agents.
- An essential aspect is the implementation of the ethics policy, as a first step towards better border security. Still, these measures don't fully cater for the need to effectively and efficiently tackle customs corruption, a phenomenon plaguing not only Moldova, but all the states in the region. A more efficient measure has been revising and perfecting the customs clerks' alternation system, for those occupying sensitive positions.

7. Rules of Origin

- Both the European Commission recommendations, as well as the actions proposed by the Republic of Moldova are rather vague and unquantifiable. Over time, the border between the Republic of Moldova and Transnistria has proven quite permeable. There have been documented cases of goods coming from outside the Republic of Moldova and afterwards receiving local certificates of origin, only to be sent further on to the European market.
- The measures comprised by the Action Plan primarily aim at developing the administrative capacity and strengthening the Customs Audit function, which verifies the rules of origin. Without minimizing their importance, they must be doubled by large scale anticorruption measures, an attribute of the judiciary police.

8. Competition

- The Republic of Moldova's internal market is very small, making monopolies very hard to justify. A distinction must be made between the „de facto” monopolies, imposed by certain economic agents, and cartels, which were formed over time. (In the Republic of Moldova cartels were established in several economic fields, such as, for example, the meat industry and oil products trade).
- The National Agency for the Protection of Competition (ANPC) is a new

institution (it was established two years ago), which currently does not have the capacity to effectively protect competition. Moreover, ANPC is undergoing an administrative capacity development process.

It is interesting that the Chisinau authorities chose to boost the acquis adoption process from the very beginning. However, this approach has two edges: the implementation process is difficult and expensive (for the business environment as well) and, at the same time, the various barriers cannot be broken in the short time available, mainly because the Republic of Moldova has the same governance problem as the other countries in the region, namely a poor capacity of inter-ministerial coordination. On the other hand, if the issues related to the implementation are tackled quickly, the political rewards will come earlier. This is very important for the ruling European Integration Alliance. Although we are in the second quarter of 2011, and the last deadline for implementation is 2014, most of the recommendations (63%) reached term in the first part of the first year of adopting the acquis. This does not automatically mean that the acquis benefited from measures which led to the fulfilment of its 63%, but only that they were early programmed.

As far as the implementation - according to the action plan - is concerned, we noticed that in the second quarter of 2011 there were completed or almost completed actions on the vast majority of the European Commission's recommendations. Thus, our conclusion supports the official statement of the Moldovan Minister of the Economy who claimed that *"the Republic of Moldova has, in general terms, met the commitments for the second quarter"*.

Overall, the findings of the present report state that:

- A great part of the European Commission's recommendations are very vaguely formulated, comprising phrases such as: "adequate consolidation"/appropriate strengthening, "continued efforts to...", "to give greater priority". These phrases do not include clearly-worded indicators and leave room for a subjective interpretation, up to the more powerful entity – in this case the European Commission. In the event of redefining the Action Plan (perhaps with the beginning of the negotiations), the recommendations (the EU requests) should be expressed more clearly.
- By comparing the EU GDP (9422 billion EUR) with the GDP of the Republic of Moldova (3,6 billion EUR), one can clearly see the unbalance between the two trading partners – in favour of the larger one, the EU. Since the Union uses DCFTA as a tool within the Neighbourhood Policy in order to help the smaller, underdeveloped countries to grow both economically and institutionally, the Commission should not negotiate measures which harm the economic growth of the Republic of Moldova, but to aim at protecting it. The Union will not be truly affected by signing a free trade agreement with the Republic of Moldova. In fact, the agreement has a rather political ground, namely to encourage (and reward) the State for carrying out reforms.