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Options for a Deep and Comprehensive Free Trade Agreement between Moldova and the EU

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The German Economic Team Moldova (GET Moldova) advises the Moldovan government and other Moldovan state authorities such as the National Bank on a wide range of economic policy issues. Our analytical work is presented and discussed during regular meetings with high-level decision makers. GET Moldova is financed by the German Federal Ministry of Economics and Technology under the TRANSFORM programme and its successor. Our publications are publicly available at our website (www.get-moldova.de).

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Options for a Deep and Comprehensive Free Trade Agreement between Moldova and the EU

Executive Summary

A deep and comprehensive free trade agreement (DCFTA) is the logical next step in developing Moldova's economic integration with the EU. In line with the WTO rules for preferential trade agreements, the planned DCFTA will establish free trade in goods between Moldova and the EU. Furthermore, to make the agreement deep and comprehensive, Moldova and the EU agree in principle that they will harmonize trade-related policies in additional, often "non-traditional" areas, such as technical barriers to trade, trade in services, or state aid to enterprises. Such harmonization of trade-related policies will generate most of the economic benefits of the planned DCFTA because most import tariffs on trade in goods between Moldova and the EU are already low.

It is up to Moldova and the EU to decide which policies to include or exclude. For Moldova's economic integration with the EU, the choice will have far-reaching implications. Under a vigorous approach, Moldova would adopt large parts of the EU's Acquis Communautaire as part of the DCFTA. Successful, wide-ranging approximation of legislation and administrative practices to EU standards would enable Moldova in the medium term to apply for EU membership and obtain candidate status.

By contrast, under a "minimalist" approach, Moldova would seek to limit the scope of a future DCFTA to a small number of trade-related policies beyond abolishing import tariffs. A minimalist approach could be justified by the limited administrative capacity of government institutions in Moldova and the high cost of technically complex policy reforms. However, by lowering its ambitions even while donors stand ready to enhance its administrative capacity and alleviate resource constraints, the Government of Moldova would signal a lack of confidence in its ability to pursue successful institutional reforms. EU accession would become a distant prospect.

The negotiation and implementation of a DCFTA, whatever its scope, will raise questions about the role of Transnistria. So far, Transnistrian exporters have benefitted from the EU's trade preferences for Moldova while the Transnistrian region has charged import tariffs on imports from the EU. The logic of a free trade agreement would require Transnistria to abolish such import tariffs. Furthermore, harmonizing trade-related policies with the EU beyond import tariffs would in practice require the assent of the Transnistrian authorities if harmonized policies were to be applied in Transnistria. Such assent may be difficult to obtain without involving the Transnistrian authorities in Moldova-EU negotiations, which, however, might be viewed as incompatible with the legal status (or lack thereof) of the Transnistrian regime.

A pragmatic approach to the role of Transnistria would involve an understanding that the DCFTA will not apply to Transnistria until the legal status of the region is resolved. In the meantime, practical solutions need to be found to develop Transnistria's commercial links with the rest of Moldova and with the EU. The fact that Transnistrian exporters are keen to enhance their EU market access may provide useful leverage to ensure the Transnistrian authorities' acceptance of measures that (i) affect the Transnistrian region and (ii) are necessary to ensure that the DCFTA functions effectively, even while it is not applied to Transnistria. Such measures include customs control of trade flows across Moldova's Eastern border (i.e. between the Transnistrian region and Ukraine) and *in situ* checks of production establishments in Transnistria by Moldovan customs officials when these firms apply for Moldovan certificates of origin.

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1 Introduction

This policy paper discusses the challenges and choices faced by the Government of Moldova as it approaches negotiations with the European Union about a Free Trade Agreement (FTA). A "deep and comprehensive" FTA is the next logical step for Moldova on its path towards closer political and economic integration with the EU and its member countries. "Deep and comprehensive" means in this context that an agreement would not only eliminate tariffs on bilateral trade in goods (the basic requirement according to WTO rules), but would also provide for market integration or harmonization of regulations in additional selected areas, such as specific service sectors, energy, competition policy, state aid, etc.

Even implementing the most basic elements of an FTA – the full liberalization of trade between Moldova and the EU – will result in significant economic restructuring in Moldova. Most Moldovan exports to the EU are already exempt from EU import tariffs and EU import quotas for certain sensitive products including wine have recently been increased. At the same time, Moldova still charges relatively high import tariffs, particularly on certain agricultural imports. Since all tariffs on Moldovan imports from the EU will have to be eliminated in an FTA, we discuss the possible effects on Moldovan producers and on government revenue (Section 2).

Another issue related to basic FTA rules is how the Government of Moldova can control its customs territory. Currently, firms based in Transnistria may export to the EU under EU trade preferences for Moldova if they are registered with the Government of Moldova and allow Moldovan authorities to conduct all local inspections necessary for the issuance of certificates of origin. At the same time, the Transnistrian authorities conduct their own trade policy, mainly through import tariffs charged on all imports to the region. When the EU's existing Autonomous Trade Preferences for Moldova are replaced by a full bilateral free trade agreement, it would be logical for the EU to expect its exports to the whole of Moldova – including the Transnistrian region – to be exempt from import tariffs. It is difficult to see how the necessary permanent changes in Transnistrian trade policy practices could be implemented without involving the Transnistrian authorities in the negotiation process. However, any involvement will quickly raise questions about the broader legal status of Transnistria. We clarify the issues and possible options (Section 3).

Finally, the EU's emphasis on concluding "deep and comprehensive" (rather than WTO-only) FTAs raises the question of which areas the Government of Moldova should strive to include or exclude. One way of looking at the Government's choices is to ask which chapter of the Acquis Communautaire Moldova and the EU might find advantageous to include. We examine several options that seem particularly relevant because these areas have been covered extensively by recent Action Plans under the existing Moldova-EU Partnership and Cooperation Agreement (Section 4).

While this policy paper takes a fresh look at the issues raised by a possible Moldova-EU FTA, we draw on several earlier, more extensive studies. In particular, Prohnitchi et al. (2009) present a more detailed analysis of many issues covered by this paper. Prohnitchi (2011) provides an updated simulation analysis of the trade effects of a Moldova-EU FTA. Oprunenco (2010) places the planned DCFTA in the wider context of economic reform and development in Moldova.

2 Implications of an FTA on Moldova's merchandise trade with the EU

The basic rules of a WTO-compatible free trade agreement require tariffs and other trade barriers to be abolished on substantially all bilateral trade within a pre-determined transition period (Art. 24 of GATT1994). Moldova's exports to the EU already benefit from "autonomous trade preferences" by the EU whereby the EU has eliminated import tariffs on imports from Moldova except on a few sensitive agricultural products. For these, the EU either grants tariff quotas (imports within the quota are exempt from tariffs) or a reduced tariff rate. These special protections for sensitive products can be expected to be phased out as part of an FTA. Against this background, Section 2.1 takes a closer look at recent trends in Moldova's exports and considers the possible effects of abolishing the remaining EU tariffs.

Moldova's imports from the EU are currently still subject to normal ("MFN") import tariffs. Although Moldova's tariff rates are generally low, some sensitive products are subject to higher rates whose elimination may put some pressure on the affected industries. Furthermore, the governments will receive less tariff revenue when tariffs are eliminated on imports from the EU. Section 2.2 takes a closer look at both these issues.

2.1 Moldova's exports to the EU

Since 2008, the EU has received approximately one half of Moldova's total exports (Table 1). Most of the rest went to CIS countries with which Moldova already has functioning bilateral free trade agreements.

The relative weight of these two partner regions differs across commodities. In particular, agricultural exports (S3-0: food and live animals; S3-1: beverages and tobacco) to the EU are much smaller than to CIS countries. While this discrepancy broadly suggests opportunities for increasing agricultural exports to the EU, the obstacles to be overcome are well known and concentrated on certain product groups. For animal products (meat and dairy products), sanitary standards in the EU are demanding and Moldovan producers so far have not been able to meet them. No animal products are currently exported to the EU, although Moldova's meat exports to Romania were significant until Romania acceded to the EU. For wine and other alcoholic beverages, EU markets are highly contested and Moldovan exporters struggle to become competitive in terms of price and quality.

In this context, it will be helpful if the remaining EU tariffs on certain agricultural exports from Moldova are eliminated by the proposed FTA. While only a few product categories are subject to tariffs (either reduced or mitigated by a tariff quota), these products nevertheless accounted for approximately 45% of the value of Moldova's agricultural exports to the EU in 2009 and 2010. The same products accounted for 61% of Moldova's non-EU agricultural exports – suggesting a significant potential for higher exports to the EU.

More formally, Prohnitchi (2011) simulates the effects of fully liberalized exports to the EU through a general equilibrium model of the Moldovan economy, combined with estimates of the ad-valorem equivalent effects of existing trade barriers. He finds that the full elimination of tariff quotas and remaining tariffs by the EU would raise Moldova's exports of agricultural and food products to the EU by between one third and one half for the various product groups, with only minor reduction in exports to non-EU countries. While this increase in exports would provide important benefits for Moldova, it would be so small relative to the size of the EU market that it would hardly be noticed by competing EU producers. On this account, it should be politically feasible for the EU to abolish remaining tariffs on imports from Moldova in the near future.

Table 1

Exports of Moldova by major commodity groups (SITC, 1-digit) and partner regions, 2008-2010 (USD m)

SITC code	Description	EU-27			CIS			World		
		2008	**2009**	**2010**	**2008**	**2009**	**2010**	**2008**	**2009**	**2010**
S3-0	Food and live animals	91	114	140	111	154	207	248	317	417
S3-1	Beverages and tobacco	29	26	23	173	141	164	215	174	205
S3-2	Crude materials, inedible, except fuels	73	52	67	63	19	25	155	88	156
S3-3	Mineral fuels, lubricants and related materials	3	5	7	0	1	0	3	5	8
S3-4	Animal and vegetable oils, fats and waxes	34	23	34	27	24	12	63	51	48
S3-5	Chemicals and related products, n.e.s.	9	10	10	32	53	69	41	63	79
S3-6	Manufactured goods classified chiefly by material	105	49	45	112	44	65	236	99	117
S3-7	Machinery and transport equipment	118	120	128	49	29	57	177	154	193
S3-8	Miscellaneous manufactured articles	348	270	292	57	35	38	442	335	359
S3-9	Commodities and transactions not classified elsewhere in the SITC	10	0	0	0	0	0	11	0	0
Total		**820**	**668**	**747**	**623**	**499**	**637**	**1591**	**1288**	**1582**

Source: UN COMTRADE (extracted May 4, 2011); own calculations

2.2 Moldova's imports from EU

The EU accounted for 44% of Moldova's imports in 2009 and 2010, compared with 34% for CIS countries (already covered by bilateral free trade agreements) and 23% for the rest of the world. These shares have remained remarkably stable even while total imports dropped by one third from 2008 and 2009 due to the financial crisis, recovering only partly in 2010 (Table 2).

Moldova's MFN tariff rates are relatively low at 5% overall (unweighted average of tariff lines, with estimated ad-valorem equivalents for specific and combined rates; World Bank WITS database, TRAINS data for 2008). The rates for agricultural and food products (HS chapters 1 to 24) are higher on average at 9.4% than for non-agricultural imports at 3.6%.

Since the EU is already Moldova's largest trading partner and Moldova's MFN tariffs are relatively low, it is unlikely that eliminating Moldova's tariffs on imports from the EU would lead to negative welfare effects by diverting Moldovan import demand from more efficient third-country suppliers to the EU. Prohnitchi (2011) estimates, based on his CGE model for Moldova, that eliminating duties on imports from the EU, together with the ensuing restructuring, will increase Moldova's GDP by 1.5%. This estimate describes a medium-run effect, allowing for factors of production to shift to different sectors of the economy. However, it does not include likely dynamic effects that may arise when the proposed FTA helps to lock in the process of European integration in Moldova, contributes to a more favorable business environment, and thereby creates incentives for additional investment from both domestic and foreign sources.

When import duties are eliminated on imports from the EU, the government will lose most of its revenue from foreign trade taxes which amounted to 1.5% of GDP in 2009 and 2010 (IMF 2011, Table 3). MFN tariffs would still be charged on imports from most of the rest of the world (there are free trade agreements with several South-East European trading partners), but these amount to little more than one fifth of total imports. Prohnitchi (2011) estimates the loss in government revenue at approximately 1% of GDP. As long as Moldova is going through a fiscal consolidation (IMF 2011), it will be useful to phase in tariff cuts gradually so that lost government revenue can be replaced from other sources.

Table 2

Imports of Moldova by major commodity groups (SITC, 1-digit) and partner regions, 2008-2010 (USD m)

SITC code	Description	EU-27			CIS			World		
		2008	2009	2010	2008	2009	2010	2008	2009	2010
S3-0	Food and live animals	115	113	149	191	139	152	429	346	410
S3-1	Beverages and tobacco	36	25	35	111	107	93	153	136	136
S3-2	Crude materials, inedible, except fuels	34	24	30	45	32	35	96	66	87
S3-3	Mineral fuels, lubricants and related materials	345	213	269	758	481	221	1105	702	492
S3-4	Animal and vegetable oils, fats and waxes	6	2	3	4	2	2	13	7	9
S3-5	Chemicals and related products, n.e.s.	295	276	298	115	73	90	565	462	521
S3-6	Manufactured goods classified chiefly by material	418	281	348	278	172	197	907	599	738
S3-7	Machinery and transport equipment	597	337	414	156	84	112	1101	626	807
S3-8	Miscellaneous manufactured articles	217	151	156	69	49	54	447	334	355
S3-9	Commodities and transactions not classified elsewhere in the SITC	42	1	1	11	1	300	84	2	301
Total		**2105**	**1423**	**1704**	**1737**	**1141**	**1258**	**4899**	**3278**	**3855**

Source: UN COMTRADE (extraded May 4, 2011); own calculations

A gradual phase-in of tariff cuts will also reduce adjustment pressures on those agricultural producers and food processors that benefit from relatively high tariffs. The average rate of 9.4% for agricultural and food products includes a fairly wide range of products (especially meat and dairy products, but also various fruits and vegetables) that are covered by specific or combined tariffs or ad-valorem rates above 15% (Prohnitchi 2011, Table 5). Given Moldova's favorable natural conditions for agriculture as well as the ongoing modernization of the sector and improved export opportunities in the EU market, Moldovan producers by and large should be able to withstand additional import competition. This view is supported by the CGE-based simulation analysis by Prohnitchi

(2011) that implies a modest increase in overall agricultural and food output in line with the increase in GDP.

3 Transnistrian firms and a Moldova-EU FTA

The Transnistrian region and its authorities have so far played an ambiguous role in the economic integration process between Moldova and the EU. On the one hand, Transnistrian firms have been keen to benefit from the trade preferences that the EU has granted to Moldova. On the other hand, the unrecognized international status of the Transnistrian region has precluded any formal involvement in trade negotiations with the EU. While this ambiguity has not been a serious barrier to Moldova-EU trade integration in the past (including the EU's granting of Autonomous Trade Preferences), it is difficult to see how a full bilateral free trade agreement could avoid placing obligations on the Transnistrian authorities that they would somehow have to assent to (such as exempting imports from the EU from any import duties, in return for similar treatment of Transnistrian exports to the EU). In this section, we discuss Transnistria's trade policy, the commodity structure and regional composition of its international trade, and the incentives faced by the Transnistrian authorities to cooperate with the Government of Moldova and the EU in moving towards a full free trade agreement.

While not recognized internationally, the Transnistrian administration has put in place a foreign trade policy enforced through its Customs State Committee. The main instrument of trade policy is the customs tariff, consisting of mainly ad-valorem rates that vary between 0 and 20%. However, specific and combined import duties are also applied for transport equipment, alcoholic beverages, and others. Imports from Moldova are subject to a 'countervailing' duty of 100% ad-valorem. Combined ad-valorem and specific duties are levied on "luxury" goods such as alcoholic beverages, tobacco, jewelry, fuel, furs, coffee, and some electronic equipment. No value added tax is levied as the region uses a turnover tax. Because of its unrecognized international status, the region is not part of any formal free trade agreements.

Transnistria is a small, very open economy; as such, it is even more dependent on foreign trade than right-bank Moldova. (Some part of this trade is probably illegal transit, but due to data limitations it was impossible to estimate its share). With an average trade-to-GDP ratio of 220% for the period 2005-2010, foreign trade plays a critical role in the Transnistrian economy (Table 3). Reflecting political and economic shocks, Transnistria's foreign trade has followed an erratic evolution since 2005. For exports, the region is significantly dependent on the right-bank Moldova, which receives more than 30% of the total, consisting mainly of electricity (Table 4). For imports, the region is heavily dependent on Russia, mostly for energy materials. More than three quarters of Transnistria's output and exports are accounted for by only four companies: Moldova Steel Works, Moldovan Regional Power Plant, Tirotex, and Rybnitsa Cement Factory. All these companies desperately need access to foreign, mostly Western markets.

Table 3

Transnistria's „foreign" trade in goods, 2005-2010 (USD m)

	2005	2006	2007	2008	2009	2010
Export, total	579.7	422.1	727.0	928.5	576.8	584.9
Import, total	855.6	738.4	1131.6	1641.1	1111.9	1294.6
Memo: GDP	517.5	585.6	808.4	1000.2	960.9	992.5

Source: „Ministry of Economy of the Transnistrian Moldovan Republic", Expert-Grup estimates for 2010 based on the „Customs Office of the Transnistrian Moldovan Republic"

Furthermore, a significant, and apparently increasing share of Transnistria's external trade is with the EU. No aggregate data are available for the entire EU, but the trade statistics for the main destination countries suggest that more than 25% of exports go to the EU, while imports from the EU represent only about one tenth of total imports. Among the EU member states, the top destinations of Transnistrian goods are Italy (10%), Romania, and Germany (both at 7%; Table 4). Poland, Slovakia and France are other important destinations. Metal articles, textiles and clothes represented the main exports to the EU in 2010.

Following the 2005 agreement between Moldova and Ukraine and the launch of the European Union Border Assistance Mission (EUBAM) to Moldova and Ukraine, all Transnistrian companies willing to export have had to register with the State Chamber of Registration of Republic of Moldova starting January 2006. This move by the Moldovan government was first labeled an economic blockade by the Transnistrian authorities, while Transnistrian businessmen were concerned about possible double taxation. However, legislative measures have since been taken to avoid double taxation and Transnistrian companies have started to register with official Moldovan authorities. According to the most recent information available, by the end of 2009 as many as 414 Transnistria-based companies had registered provisionally with Moldovan authorities (328 at end-2008), while 160 had registered permanently (135 at end-2008)[1].

Table 4

Transnistria's „foreign" trade in goods by major trading partners, 2009-2010

	2009			**2010**		
	Total trade	**Exports**	**Imports**	**Total trade**	**Exports**	**Imports**
Total, USD m	1690.6	577.5	1113.2	1879.4	584.9	1294.6
Russia	37.6	20.2	46.7	35.7	17.8	43.8
Moldova	12.8	33.3	2.2	13.1	34.7	3.4
Ukraine	13.5	3.1	19.0	11.9	5.3	14.9
Germany	4.4	4.6	4.3	5.3	6.5	4.8
Italy	4.6	8.8	2.4	4.3	10.0	1.8
Belarus	3.3	0.4	4.8	3.4	0.4	4.7
Romania	3.2	7.3	1.0	3.0	7.0	1.2
Brazil	2.6	3.3	2.3	2.5	4.8	1.5
China	1.3	0.0	2.0	2.1	0.0	3.1
Poland	1.9	2.6	1.6	2.0	2.5	1.8
Turkey	0.7	0.6	0.8	1.3	1.5	1.2
USA	1.7	0.1	2.5	1.2	0.3	1.7
Kazakhstan	1.4	0.2	2.0	0.7	0.1	1.0
France	1.1	1.7	0.7	0.7	0.6	0.8
Slovakia	0.9	0.8	0.9	0.6	0.8	0.5
Other countries	8.9	13.1	6.7	12.0	7.7	13.9

Source: „Customs Office of the Transnistrian Moldovan Republic"; Expert-Grup calculations

[1] Report on the activity of the State Chamber of Registration for 2009, available in Romanian language at http://cis.gov.md/content/774.

The documents necessary for provisional registration and issuance of an Individual Registration Number are copies of the company's registration certificates and other legal documents based its registration in Transnistria. Based on the provisional registration certificate, the company may obtain the documents necessary for international trade, including certificates of origin. For the latter, however, the company has to provide access to its production sites to Moldovan customs officers and allow them access to all necessary documentation as well as the company's information system. While unimaginable a few years ago, such customs controls are now taking place and Moldovan customs officers are allowed to enter the region (even though not in uniform). These episodes demonstrate that questions of legal status may take a back seat to economic considerations when the possible gains to the Transnistrian economy are large enough.

In the context of a future FTA with Moldova, the EU is likely to be guided by two objectives with respect to Transnistria. First, it may be concerned about the region acting as a grey area for smuggled goods that could enter the EU through Moldova. Considering the porous Eastern border of Moldova (currently controlled by EUBAM), the EU is likely to insist that Moldovan customs authorities be able to control the entire territory and that Transnistria's international trade be consistently reflected in the official Moldovan trade statistics. Second, the EU will probably want to see Transnistrian-based companies benefit from the proposed FTA (as they currently benefit from the EU's Autonomous Trade Preferences for Moldova). Such benefits would be viewed as a soft power tool helping to bring the breakaway region closer to Moldova and contributing to conflict solution.

For this approach to work, Moldovan official bodies will need to consider the interests of the Transnistrian-based companies in negotiations with the EU. At some future point, the EU may also need to clarify what assurances it will seek that Transnistrian authorities will bring their trade policies into line with the proposed Moldova-EU free trade agreement (e.g. exempt imports from the EU from any import duties, in return for similar treatment of Transnistrian exports by the EU). The stronger the desired assurances, the closer the contacts with the Transnistrian regional authorities may have to be.

4 Making a Moldova-EU FTA deep and comprehensive

The Government of Moldova and the EU Commission agree broadly that any bilateral FTA should not only meet the basic WTO requirements (cf. Section 2), but should extend formal economic integration to additional significant policy areas. The economic rationale for this approach is that import tariffs on Moldova-EU trade are mostly low. The most important trade barriers are now non-tariff measures such as trade-related transaction costs (e.g. customs procedures), different national regulations that increase the cost of market entry, etc. For an FTA to generate significant economic benefits, it has to reduce such non-traditional trade barriers.

Potentially, a deep and comprehensive FTA could provide for economic integration across a wide range of policy areas. To delineate the possible choices, one may ask which of the 35+ "chapters" of the EU's Acquis Communautaire would be beneficial for Moldova to adopt. In practice, the existing Plan of Actions for Preparation for the Negotiations on the FTA (hereafter, Plan of Actions) as well as similar FTAs concluded or under negotiation by the EU can serve as guideposts. In the following sub-sections, we briefly discuss six areas in which the Government of Moldova and the European Commission have previously expressed an interest. While some areas have long been part of of EU-Moldova cooperation (especially, technical barriers to trade and sanitary and phyto-sanitary standards), other areas played only a small role in the EU-Moldova Action Plan (2005-2008) or as preconditions for the EU's Autonomous Trade Preferences for Moldova (March 2007).

4.1 Technical Barriers to Trade (TBTs)

TBTs refer to mandatory technical regulations and voluntary standards that define specific characteristics that a product should have, such as its size, shape, design, labeling / marking / packaging, functionality or performance. The specific procedures used to check whether a product is in compliance with these requirements are also covered by the definition of TBT. These so-called "conformity assessment procedures" can include, for example, product testing, inspection and certification activities[2]. Such regulations act as trade barriers if they oblige producers to make costly adjustments to their products in order to abide by different national standards in different markets.

The WTO TBT Agreement includes various procedural rules on how domestic regulations are to be drawn up, published, and enforced. Moldova still has to implements some of its obligations under this TBT agreement, not least as a precondition to negotiating further commitments under a future Moldova-EU FTA.

With respect to technical regulations and standards, the EU has adopted the „mutual recognition principle" (based on the „Cassis de Dijon" ruling by the European Court of Justice): Goods legally marketed in one member state must be accepted in any other. Furthermore, the EU's „Global approach" supports mutual recognition of Conformity Assessment Bodies and their results as part of economic integration agreements. This means that (i) Moldovan standards should be harmonized with European standards and (ii) the recognition of Moldovan conformity certificates by the EU should be ensured. In this case, EU products will be able to freely enter Moldovan market (as the EU standards and conformity assessments will be recognized by Moldova), while Moldovan products produced under the same EU standards and certified as conforming to the EU rules will be able to access the EU market.

So far Moldova has implemented 2,500 EU standards out of approximately 20,000. At the same time, there are important differences between European (developed via CEN and CENELEC) and International Standards (ISO). Thus, out of CEN's 13,300 European Standards, only 27% (2500+) are identical to ISO's International Standards (Gonciarz 2011). It is clear that the complete modernization of Moldova's technical standards, which are often still based on the former Soviet GOS-STANARD norms, will be technically demanding and time-consuming.

Coverage of TBTs in a future Moldova-EU DCFTA will require Moldova to make commitments related to all pillars of the "quality infrastructure": technical regulation; market surveillance; standardization; conformity assessment; accreditation; metrology (Gonciarz 2011). The main issues to be confronted include:

- The need for coordination between multiple agencies in Moldova
- The lack of qualified personnel and equipment to ensure implementation of thousands of norms and conformity certification
- Possible high costs for the public budget, companies, and consumers when European standards are unnecessarily complex or demanding for domestic production for the Moldovan domestic market

The Government of Moldova may want to consider the following steps to address these risks:

- Conduct a rigorous study of past and current obstacles to the harmonization of regulations with a view to dismantling these obstacles
- Strengthen the Ministry of Economy as the lead agency in this field

[2] European Commission: http://ec.europa.eu/trade/creating-opportunities/trade-topics/european-competitiveness/non-tariff-barriers/

- Adapt any future harmonization and implementation schedule to Moldova's needs; e.g. focus initially on sectors that account for a large share of output and exports to the EU
- Allow Moldovan producers to obtain conformity certification from EU member states' certification bodies if the corresponding Moldovan bodies take longer to develop
- Ask the EU for hands-on technical assistance to train and equip the relevant Moldovan agencies and technical facilities

4.2 Sanitary and phyto-sanitary standards (SPS)

This area of the Acquis Communautaire is one of the most complicated and even the new EU member states have found it difficult to implement. For instance, only 52 out of 700 Romanian food companies were allowed to trade with the EU in 2010, while other new member states experienced a dramatic decrease in the number of domestic agri-food companies (Messerlin et al. 2011). Nevertheless, SPS will play a critical role in DCFTA negotiations with Moldova as SPS were included in the EU-Moldova Action Plan as well as in the Action Plan for Preparation for Negotiations on the DCFTA.

Implementing the EU's SPS would allow Moldovan exporters to tap the EU market and to eventually attract more investment to the domestic agri-food sector, promoting rural development. Consumers would benefit from higher quality and safety standards for domestically available food.

Moldova's agricultural sector accounts for just over 10% of GDP and 27% of employment. Despite some consolidation, most agricultural land is still owned by small farmers that practice subsistence agriculture. Obviously, they will not be able to implement the full body of the SPS acquis. Furthermore, implementing the SPS acquis will be technically difficult and costly not only for producers, but also for public authorities and the government budget. More complex regulations could also lead to more corruption. Last but not least, sector-wide implementation could lead to higher food prices and thus hurt consumers, especially the poor.

In response to these challenges, the Government may consider the following steps:

- Assess the competitiveness of agri-food subsectors and negotiate transition periods for those deemed competitive
- Negotiate exemptions or a transition period for the implementation of the SPS acquis by small- and medium-scaled farmers selling only on the domestic market
- Request hands-on assistance, both technical and financial, for the implementation of the SPS acquis via staffing and equipping relevant public agencies
- Establish a safety net for small farmers and poor consumers
- Ensure transparency and maximum use of digital technologies in the process of certification

4.3 Customs administration and trade facilitation

Despite some progress, Moldova's custom system still shows considerable weaknesses such as perceived wide-spread corruption and lack of accountability.[3] International rankings demonstrate that customs procedures remain a huge burden[4] and the cost of

[3] Transparency International Moldova, Measuring corruption: from survey to survery, 2008 and The Petition System: Monitoring and Enhancing, 2010.

[4] World Economic Forum ranks Moldova 118th of 139 countries, see WEF, Global Competitiveness Report 2010-2011.

trading across borders is amongst the highest in the region[5]. There are important gaps between the Moldovan and European legal frameworks related to customs administration, while certain regulations adopted by the Customs Service even contravene Moldova's WTO obligations.[6]

Further reforms in in this area will be key to promoting trade integration between Moldova and the EU. Commitments under the DCFTA will need to focus on further harmonization of Moldova's customs procedures and documentation with the EU. Moldova will have to ensure timely publication of the relevant laws, rules and regulations, establish a framework for discussion with the involved stakeholders, ensure standardization of customs data and documentation, etc. These measures will hugely benefit Moldovan companies (both importers and exporters) and consumers by reducing the "administrative" costs that act like a tax paid by both companies and consumers. As a result, Moldovan producers will find it easier to participate in regional production networks and international supply chains.

When planning the necessary reforms, strategies need to be developed to deal with certain risks:

- Vested interests and those who benefit from corruption may seek to undermine reforms.
- Technical and personnel needs for adequate implementation of EU procedures may increase.
- Control over transactions through Transnistria will be crucial (cf. Section 3).

While improvements will inevitable take time, the Government of Moldova can help by making customs procedures more transparent:

- Implement one stop shop procedures at customs
- Publish all regulatory decisions by the Customs service
- Streamline legislation, including to minimize room for interpretation

4.4 Trade in services

Provisions for trade in services in a future DCFTA will rest on two pillars: first, the harmonization of Moldova's regulatory framework with the European one and, second, the effective opening of the Moldovan markets for particular services (Gonciarz et al. 2011). Service sectors differ substantially from one another in terms of the international tradability of services as well as the objectives and extent of domestic regulation. Therefore, the parties will need to decide on a case-by-case basis which individual service sectors are to be covered by a future DCFTA and what commitments Moldova and the EU will make. The Government of Moldova will also need to determine its priorities for sectors where it wishes to push for market opening by the EU vs. those where it seeks to maintain protection from import competition.

Moldova's balance of payments statistics do not provide geographically disaggregated information on services trade between Moldova and the EU. However, the available information for Germany and Romania suggests that Moldova runs a trade deficit for most service sectors (trade in communication services with Romania is the main exception). Hence it is difficult to identify any promising services exporters that would benefit from market opening by the EU. Regarding service imports by Moldova, the EU has expressed an interest in Moldova liberalizing its air transport market, essentially allowing more foreign companies to compete with Air Moldova. From a development standpoint, Moldova may be interested in improving the quality of education and medical services available in Moldova by permitting more supply by foreign service providers.

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[5] 19th out of 25 economies of Eastern Europe and Central Asia, see Doing Business Survey 2010, IFC and World Bank.

[6] http://www.conventia.md/recomand%C4%83ri-de-politici/

The benefits of service trade liberalization include the improvement of the business climate for manufactured exports and all other producers which require access to high-quality business services at competitive prices. The Government may wish to take the following steps:

- Conduct diagnostic studies of the competitiveness of individual service sectors to identify potential exporters and to determine why the competitiveness of some sectors has apparently fallen recently (e.g. road transport)
- Sequence internal reforms aimed at eliminating constraints to competitiveness and regulatory approximation reforms
- Be willing to confront vested interests in those sectors whose inefficiency and high level of protection impede economic development and modernization

4.5 State Aid

In recent years, the EU has insisted that its bilateral economic integration agreements include restrictions on state aid equivalent to those that apply within the EU (pre-accession agreements with recent new members and Western Balkans candidate countries; members of the European Economic Area). From the EU's perspective, these provisions ensure that trade is fair and that partner-country companies do not obtain unwarranted advantages.

In the case of Moldova, the Partnership and Cooperation Agreement includes a reference to state aid whereas more detailed commitments are included in the EU-Moldova Actions Plan. The latter specifically requires Moldova to undertake three key actions: (i) establish a binding and uniform definition of state aid in national legislation; (ii) draw up a complete list of institutions that grant state aid; and (iii) put in place a system of centralized data collection on state aid in Moldova.

So far, little has been done to fulfill these commitments, except for a draft law on state aid in 2008 which was approved by the Government, but not passed by the Parliament. In the absence of a proper monitoring system, Moldova cannot even provide information on the total amount and types of state aid granted to Moldovan enterprises – failing not only in its commitments to the EU, but also to WTO members.

Tying state aid to restrictive conditions (as in the EU) through an international agreement such as a future DCFTA will benefit Moldova because it makes it more difficult to introduce wasteful subsidies. The Government may wish to consider the following steps for rapid progress in this important area, especially now that the stalemate in Parliament has led to state aid being provided with minimal public scrutiny:

- Designate a government body to be responsible for Moldova's international commitments regarding state aid. The National Agency for Competition Promotion authored the draft Law on State Aid, but is not legally entitled to supervise state aid in Moldova. The Ministry of Finance would be a possible candidate, provided that strict rules can be enforced on the transparency of the fiscal accounts.
- Confront vested interests with political connections that seek to undermine the introduction of more sober fiscal rules that would prohibit write-offs of debt to the government and intransparent debt rescheduling
- Speed up privatization to enhance transparency in the fiscal relations between these enterprises and the Government

Under EU rules, most state aid currently granted by Moldova could be continued under the *de minimis* rule (200000 euros over a 3 year period). Therefore, there would be little need for immediate cuts in state aid, while good practices in this important area would be locked in.

4.6 Competition policy

The legislative framework for competition policy in Moldova is outdated and prone to significant misinterpretations and misuses. The 1992 Law on the Limitation of Monopolistic Activity and Development of Competition is still in force although a Law on Competition Promotion was adopted in 2000. The provisions of the two laws are not consistent; even the Law of 2000 has significant deficiencies and is not in line with relevant EU legislation. A new Law on competition promotion has been drafted by the National Agency for Competition Promotion (NACP), but has not yet been released for public discussion. The NACP has also been slow to develop relevant methodologies and implementing regulations. Even when the legal base is in place, there will still be shortcomings in the judicial system and a shortage of judges and lawyers with training in this field.

This weak state of competition policy sows doubts on whether Moldova can be considered a fully functional market economy. Among other consequences, such doubts weaken the position of Moldovan exporters that may be accused of dumping and threatened with anti-dumping duties by trading partners. To move ahead in this field, the Government may wish to consider the following steps:

- Consolidate the institutional capacities of the NACP; among other measures, the NACP should hire more operational specialists and pay higher wages to retain qualified staff.
- Repeal the 1992 Law on Limitation of Monopolistic Activity and Development of Competition and ensure that all relevant provisions are incorporated in the draft Law on Competition Promotion
- Ensure a public and transparent discussion of the new draft Law on Competition Promotion

5 Conclusions

A deep and comprehensive free trade agreement is the logical next step in Moldova's economic integration with the EU. Just how comprehensive it will be, and how fast it will be negotiated and implemented, will determine for many years to come the pace of Moldova's European integration, including ultimately the timing of Moldova's possible accession to the European Union.

On the one hand, Moldova could commit itself in the planned DCFTA to vigorously implementing many important areas ("chapters") of the EU's Acquis Communautaire, in addition to free trade in goods as required by WTO rules. Thereby Moldova would not only promote trade in goods and services with the EU, but would also set itself on a path of continuing institutional reform. Doing so within an international agreement rather than unilaterally will help to lock in reforms by making it costlier for any future government to abandon them. Donor assistance could help to accomplish the technically demanding and resource-intensive task of creating the necessary legislation and reforming government institutions and the court system to ensure that the new rules are effectively implemented on the ground. By adopting and effectively applying a large number of provisions from the Acquis at an early stage, Moldova would demonstrate its ability to satisfy the preconditions for EU membership.

On the other hand, Moldova could aim for an agreement that goes beyond WTO rules (free trade in goods) only in a few selected areas. Such a "minimalist" approach might be compatible with the EU's policy of concluding (only) "WTO plus" agreements with regional trading partners. However, progress in approximating Moldova's legislation and practices to EU standards would remain piecemeal. Such caution could be justified by the limited administrative capacity available in Moldova and the large personnel and financial requirements of more thorough-going reforms. At the same time, a "minimalist" approach would signal to the EU and the international community as well as to domestic and international investors that the Government of Moldova has only limited confidence in its ability to reform and to pursue the European integration of Moldova vigorously. This would likely postpone EU accession indefinitely.

One big unknown in planning for a DCFTA is the role of Transnistria. If the DCFTA were to apply uniformly to the whole of Moldova, the Transnistrian authorities would have to implement its provisions in the Transnistrian region. Realistically, they could hardly be expected to do so unless they had previously been involved in some substantial way in Moldova-EU negotiations. At the same time, such involvement would need to be designed to not prejudice the future status of the Transnistrian region in relation to the rest of Moldova.

If that sounds like squaring the circle, one alternative approach might be to to treat Transnistria as a separate customs area, without any implications for the issue of state sovereignty. This would allow the Government of Moldova to negotiate a DCFTA only for that territory that it effectively controls. However, day-to-day relations between Transnistria and the rest of Moldova would suffer. Transnistrian enterprises would lose their preferential access to the EU market and a customs border would have to be enforced between Transnistria and the rest of Moldova.

Maybe a realistic approach would be to negotiate a DCFTA that applies in principle to the whole of Moldova in the same way in which the Government of Moldova is the legitimate government of the country under international law. However, it would be understood by both parties that the DCFTA will not be applied in Transnistria until the status of the region is resolved. In the meantime, practical solutions would be found to develop Transnistria's economic links with the rest of Moldova and with the EU. Thus Moldova could move ahead with its economic integration with the EU while keeping the door open to Transnistria to join the process at a later stage.

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