



German Economic Team Moldova

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**Impact assessment of Moldova's participation in
the extended WTO Information Technology
Agreement (ITA)**

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Updated version

About the German Economic Team Moldova

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 Energy. Our publications are publicly available at our website (www.get-moldova.de).

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Executive Summary

The Republic of Moldova participates in the Information Technology Agreement (ITA) Moldova. As a signatory of the agreement Moldova has abolished import duties on a range of IT products imported from WTO member countries. At the same time Moldova can export the IT products covered in the agreement duty-free to those countries that also signed the ITA.

In 2016 an extension of the ITA was proposed which covers an additional 201 IT products reflecting the technological changes which took place since the original agreement came into force. In this study we assess the impact resulting from Moldova's participation in the ITA extension. As part of this assessment we analyse the expected increase in imports of IT products, the effect on budget revenues, the risk for domestic production, and the impact on Moldova's exports of IT products to ITA signatory countries.

Import demand: In 2015 Moldova imported USD 174 m of those goods covered by the ITA which reflect 4.4% of total imports. We estimate that the ITA extension would lead to an increase of this number by USD 4.3 m per annum (based on 2015 trade data). This is equivalent to a 2.5% increase of imports of IT products covered in the extension. This rather small increase reflects that Moldova had already largely liberalised trade for those goods. Still the USD 4.3 m increase reflects a substantial benefit for consumers and companies which are able to afford more IT products and will have increased choice.

Fiscal impact: In the short term, the ITA extension will cause a net loss of USD 1.4 m p.a. to the Moldovan budget. This is due to a loss in revenues from import duties of USD 2.3 m per year which can only be partly compensated through rising VAT revenues (USD 0.87 m p.a.) from increased imports. Overall, the net fiscal loss is small as it equals only 0.1% of total revenues and does not require any compensating measures.

Risk for domestic production: The risks for domestic producers are limited, too. As mentioned above, the overall increase of imports is rather small in absolute terms. The import increase is only about 2.9% when compared to the value of domestic IT equipment production. Looking at export statistics suggest that the main IT products manufactured in Moldova are already tariff-free and therefore do not face increased competition. However, there are four product categories with significant domestic production which are still protected by tariffs. Here a phased tariff reduction schedule is proposed which gives the relevant companies time to adjust.

Export impact: Finally, we do not expect a significant increase of IT products exported by Moldova as the bulk of Moldova's IT exports are already sold in countries with which Moldova has a free trade regime.

We conclude that participation in the ITA extension is a logical continuation of Moldova's successful liberal trade policy and we assess that it will be beneficial for the Moldovan economy.

Overview: Impact of the ITA extension

| Impact | USD m (per year) |
|-------------------------------|------------------|
| Import increase | 4.3 |
| Loss of import duties | 2.3 |
| Increased import VAT revenues | 0.87 |
| Export increase | Negligible |

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1 Introduction

The objective of this paper is to describe the impact that can be expected in the case of Moldova becoming a participant of the extended Information Technology Agreement (ITA). The extension of the ITA envisages the liberalisation of trade for another 201 information technology product groups (see chapter 2.1 below).

This paper consists of three sections. In section 2 we describe the current trade regime of the concerned products describing tariff levels and already existing trade preferences prior to the ITA extension. In the second part of section 2 we describe the current trade in IT goods identifying the most important IT imports and the largest trading partners for the relevant goods.

In section 3 we describe the impact on import demand, fiscal revenues and IT exports for Moldova following the additional liberalisation of IT trade. Section 4 concludes with a summary of the findings.

In our analysis we assume a complete abolition of all existing tariffs for the relevant product groups. However, it is important to note that such a full trade liberalisation for all products will only occur after 2023 as the extended ITA foresees adjustment periods of up to five years for some products.

The analysis was conducted at the HS 6-digit level using trade data from 2015¹. We estimate the expected increase in imports, which will take place after the price decrease following complete tariff elimination. The change in demand takes into account the import demand elasticity and the change of the price for each product category. In addition, we also calculate the loss in revenues from import duties and increased VAT revenues. We also consider the wider economic impact of the planned trade liberalisation, especially the question whether the import increase following the ITA extension can threaten domestic production and employment in the concerned sectors. Finally, we consider Moldovan exports to find out, whether they will benefit from the extension of the ITA.

¹ The last available year for detailed trade data by products and geography.

2 Current trade and trade regime of goods covered by the ITA extension agreement

2.1 The ITA extension agreement

The original Information Technology Agreement (ITA) was signed by 29 WTO members in 1996. In order to liberalise their mutual trade of IT goods, the participants agreed to eliminate import tariffs for a range of information technology products. Due to the considerable technological developments in the IT sphere, the member countries decided to extend the original list of products in 2015 including an additional 201 product categories into the agreement.

It is important to highlight, that the ITA only foresees tariff elimination and does not include any non-tariff measures (NTM). However, ITA participants are encouraged to discuss alignment of product standards. The ITA covers trade in goods only.

Being a participant of the original ITA, the Republic of Moldova now considers participating in the ITA extension. While the extended ITA foresees eventual tariff elimination for all 201 products, for some products adjustment periods are foreseen. It is important to note that the ITA is a plurilateral agreement, which means that liberalisation occurs asymmetrically: Moldova abolishes import duties for its imports of goods covered by the ITA for *all* WTO members, as the principle of Most Favoured Nation does not allow for discrimination. On the other hand, it can export relevant goods tariff-free only to those countries participating in the ITA. Among today's participating countries of the extended ITA are also Moldova's main trading partners for IT products.

2.2 Current trade regime for products covered by the ITA extension

In order to understand the impact that the ITA extension will have on Moldova's imports of IT goods, we first describe the existing trade regime. Currently, there are two different main trade regimes in place for IT goods (see Table 1): The Deep and Comprehensive Free Trade Agreement (DCFTA) between Moldova and the EU which is in force since 2014, means Moldova does not levy import tariffs for IT imports from the EU. For imports from other countries, the import tariff is between 0% and 10%.

Out of the 201 products affected by the ITA extension, only 163 are relevant for our analysis as the others have not been imported in 2015. Additionally, 61 products of the relevant products were already tariff-free prior to the ITA extension. Those 61 tariff-free products account for 56% of Moldova's imports of products covered by the ITA extension. Thus, less than half of the total import value of products covered by the ITA extension will be affected by the elimination of tariffs following the ITA extension.

Due to the fact that imports from the EU are already zero-rated and Moldova also does not levy an import tariff on a large range of IT products means that the average trade weighted import tariff on all products covered by the ITA extension is currently only 1.3%.

The share of imports from the EU in the relevant product group amounts to 42%. If we look at imports only from non-EU countries, which still have to pay import tariffs on many products, the average trade weighted tariff is 2.6%, which is still not very high.

However, to get a better understanding of the current tariff regime, it is useful also to look at the average weighted tariff of only those products which are imported from non-EU countries and for which

a tariff is still in place. In this case, the average trade weighted tariff is 6.9%, which is fairly high in comparison to Moldova’s average tariff level. Thus, for those goods from non-EU countries, on which still a tariff is levied, a significant change in import demand can be expected following the ITA extension.

Table 1: Current average trade weighted tariff for IT products

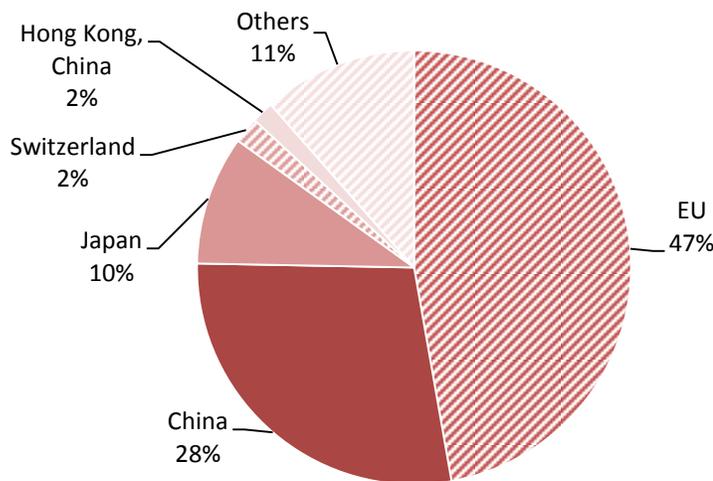
| | including EU trade | excluding EU trade |
|---------------------------------------|--------------------|--------------------|
| including zero-tariff products | 1.32 | 2.57 |
| excluding zero-tariff products | | 6.91 |

Source: World Bank, own analysis

2.3 Current trade in goods covered by the ITA extension

Moldova is a net importer of IT products covered by the ITA extension. In 2015, the import volume of these products was USD 174 m. This is a nominal decrease compared to 2014 when imports of those goods reached USD 200 m. In 2015, IT imports and total imports had decreased in general due to the strong devaluation of the Moldovan Leu and the economic slowdown. However, the share of IT products in total imports has increased and amounted to 4.4% in 2015 – up from 3.7% in 2014.

Figure 1: Countries of origin of Moldova's IT product imports, 2015



Source: World Bank

Figure 1 shows that the EU, China and Japan were the main origin countries of Moldova's imports of the relevant IT products covered under the ITA extension. Importantly, with the EU countries – from where 47% of IT imports originate – Moldova already has a free trade agreement and thus goods are already imported without tariff.

The analysis of origin countries also shows that countries shipping the largest share of IT imports to Moldova are members of the ITA agreement.

The most imported product categories (see Table 2) were parts for electrical circuits (including prefabricated elements for electrical circuits, connections and contact elements for wires and cables and wafer probers), TVs and receivers, static converters, office equipment, cameras, switches, heat exchange units and fans. Together the top 10 import products account for 69% of imports covered by the ITA extension. The share of imports from EU countries and non-EU countries in the top-10 product group is quite balanced with the EU share slightly smaller: 47% of the top-10 products were imported from the EU, 53% from non-EU countries. Parts for electrical circuits are by far the most important category making up one third of the relevant imports. 91% of this product category is imported from the EU.

Currently, none of the top 10 products is zero-rated for all countries and in some cases (for example TV receivers, electrical machines with translation or dictionary function, amplifiers for antennas and demarcation apparatus) import tariffs amount to up to considerable 9%. Still, the trade weighted average tariff is rather low with 2.4%, as products with the highest tariff are predominantly imported from the EU.

Table 2: Top-10 imported products covered by ITA extension and their tariff rates

| Product description | HS Code | Import value 2015, USD m | % of IT imports | Current simple MFN tariff, in % | EU import share | non-EU import share |
|---|---------|--------------------------|-----------------|---------------------------------|-----------------|---------------------|
| Electrical apparatus for switching/protecting electrical circuits | 853690 | 25.4 | 33.2% | 4.0 | 91% | 9% |
| TV receivers | 852871 | 5.4 | 7.1% | 9.0 | 10% | 90% |
| Electrical machines and apparatus with individual functions | 854370 | 3.7 | 4.9% | 8.8 | 21% | 79% |
| Static converters | 850440 | 3.7 | 4.9% | 5.6 | 23% | 77% |
| Other office equipment | 847290 | 3.5 | 4.6% | 1.7 | 82% | 18% |
| Cameras | 852580 | 3.3 | 4.3% | 6.1 | 14% | 86% |
| Parts of static converters | 850490 | 2.5 | 3.3% | 4.1 | 62% | 38% |
| Switches other than isolating switches | 853650 | 1.8 | 2.4% | 4.1 | 33% | 67% |
| Heat exchange units | 841950 | 1.8 | 2.3% | 4.5 | 81% | 19% |
| Fans | 841459 | 1.4 | 1.9% | 4.0 | 56% | 44% |
| Average | | | | 5.2% | 47% | 53% |

Source: World Bank (WITS)

3 Impact assessment

In this section we describe the impact that the ITA extension agreement is expected to have on import demand, the state budget, domestic production and Moldovan exports. Higher demand for the affected IT products will lead to higher VAT revenues, which may partially off-set the loss in revenues due to eliminated tariffs. Additionally to these primary effects, tariff liberalisation can also have adverse effects on domestic production if imported products become increasingly competitive by lower prices. Therefore we also analyse the extent of domestic production in order to identify possible threats for the Moldovan economy. Finally we will turn to the question whether Moldovan exports will profit from abolishing import duties on those IT products imported from Moldova by other ITA signatory countries.

3.1 Impact on import demand

As consumers will react to a price decrease by increased consumption, imports of the relevant product group are expected to increase. In order to estimate the change in imports that the tariff elimination will bring about, it is necessary to find out how strongly consumers will react to the price decrease. This demand reaction is quantified by the import demand elasticity².

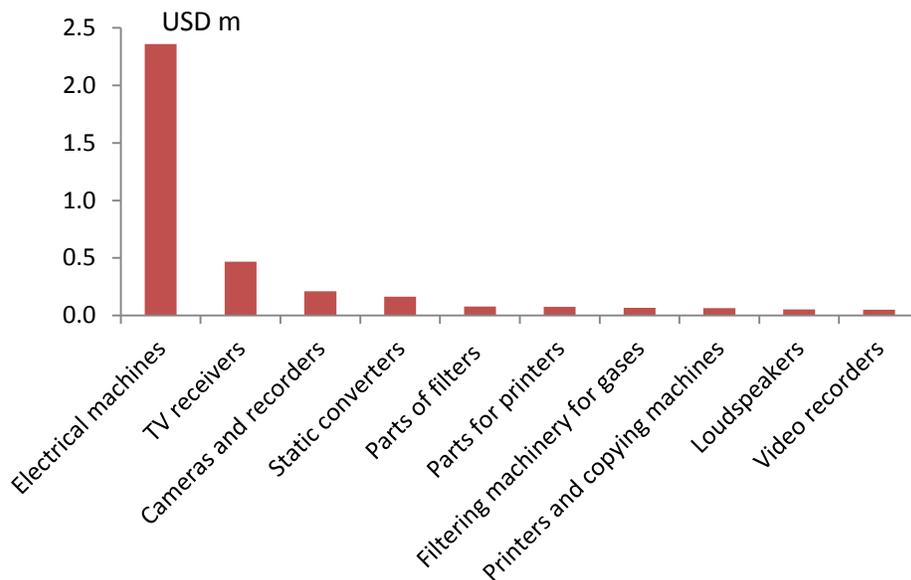
Our analysis suggests that the weighted average import demand elasticity for the relevant product group is 1.2. This implies that a 1% decrease in price will lead to 1.2% increase in demand. This is based on import demand elasticities estimated by World Bank WITS for individual goods at the HS-6-digit level. Based on the import demand elasticity and tariff change resulting from the ITA extension, the expected additional annual import value can be estimated.

We estimate imports of the affected goods to increase by USD 4.3 m compared to 2015 once tariffs are fully abolished. This represents an increase of imported goods affected by the ITA of 2.5% compared to the actual value of 2015. This equals a 0.1% increase of total imports.

Electrical machines and apparatus, TV receivers, cameras and recorders will be the goods which show the highest absolute increase in import demand. The chart below (Figure 2) shows the top 10 products with the highest absolute import increase. As could be expected, most of these products are currently imported from non-EU countries and have a high tariff rate: 80-90% of the top-3 products are imported not from the EU. Their average weighted tariff rate lies between 6.0% and 10.0%.

² We use import demand elasticity estimates provided in the [WITS World Bank database](#).

Figure 2: Products with the highest absolute import increase (based on data from 2015)



Source: World Bank (WITS)

To sum up, as expected the increase in import demand following the ITA extension is rather modest reflecting that average tariffs were low to start with.

3.2 Fiscal impact

If imports increase, Value Added Tax (VAT) revenues will also increase as imports are liable for import VAT. We estimate that the additional imports of USD 4.3 m will lead to additional VAT revenues of USD 0.87 m annually. The additional VAT revenues equal 0.2% of total VAT revenues in 2016.

On the other hand, the Moldovan budget faces losses due to reduced import duties after the elimination of tariffs. We expect the loss in revenues from import duties on the affected products to amount to USD 2.3 m in 2015 equal to 0.6% of total revenues from excises in 2016.

Thus, the Moldovan budget faces a net revenue loss of USD 1.4 m. This does not pose a heavy burden for the state budget, as the net revenue loss equals only a negligible 0.1% of total revenues in 2016. Given the size of the expected revenue loss, we do not see a need for any compensation measures.

Compared to increased welfare of consumers and cost reductions for companies marked by increased import demand, the fiscal losses are significantly smaller. What is more, in the medium to long-term it is likely that the economic stimulus resulting tax revenue increase due to the ITA extension is likely to reduce the fiscal loss even further.

3.3 Impact on domestic production and employment

In this section we investigate whether the planned trade liberalisation in the context of the ITA extension could potentially have an adverse effect on the Moldovan manufacturers of IT products. This could be the case if the influx of IT products following the ITA extension is large in comparison to the size of sectors producing those goods in Moldova. More precisely, we will provide answers to the following questions:

1. How important is IT equipment manufacturing for the Moldovan economy?
2. Does the increase of imports pose a threat to the domestic IT production?
3. Are producers of selected IT products threatened?

In order to quantify the importance of the IT manufacturing sector for the Moldovan economy, we use the following three subcategories of the manufacturing industry as an approximation for IT equipment production:

- manufacturing of computer, electronic and optical products
- manufacturing of electrical equipment
- manufacturing of machinery and equipment not specified elsewhere

Based on this sector definition output of the IT equipment production sector amounted to approximately MDL 2.8 bn in 2015 (about USD 149 m). This equals 7.4% of total output of the manufacturing industry and 1.2% of total output in 2015. These figures indicate that the economic importance of IT manufacturing is relatively small. The value of MDL 2.8 bn is probably even overestimated, as it can be assumed that the selected categories also include products other than those covered by the ITA extension.

Employment in the relevant sector is equally modest. We estimate that about 8,700 people are employed in the IT manufacturing sector which accounts for 0.7% of the total labour force. Again, this value is probably somewhat overestimated.

Table 3: Output and employment in the IT equipment sector in 2015

| | Output, MDL m | % of output of manufacturing industry | Employed people, annual average | % of total labour force |
|---|---------------|---------------------------------------|---------------------------------|-------------------------|
| Manufacture of computer, electronic and optical products | 557.1 | 1.5% | 2,810 | 0.2% |
| Manufacture of electrical equipment | 1,677.8 | 4.5% | 3,653 | 0.3% |
| Manufacture of machinery and equipment n. e. s. | 573.7 | 1.5% | 2,212 | 0.2% |
| Total IT manufacturing | 2,808.6 | 7.4% | 8,675 | 0.7% |

Source: National Statistics Office

We can now compare the expected increase in IT imports, which we estimated at USD 4.3 m, to the output of the IT manufacturing industry, which amounted to USD 149 m in 2015. The resulting share of 2.9% indicates that domestic production of goods covered by the extended ITA is not seriously threatened by additional imports.

Still, it might be worth to take a more detailed look on the product level and analyse whether producers of selected products might be negatively affected. To do so we analyse which of the IT products covered by the extended ITA are currently exported by Moldovan companies in significant numbers. Indeed, products that are exported in large quantities are also likely to be manufactured for the domestic market.

The export of goods covered by the ITA extension amounted to USD 37.2 m in 2015. They are dominated by two products – electricity meters and switches. Together these two products account for 75.5% of IT product exports (see Table 4). Still, the amount of those IT exports is not large in relation to total exports – making up a share of 1.4%.

Six out of the top-10 export products are already zero-rated. They account for 61% of IT exports. Thus, the domestic production of the larger share of relevant IT product will not be affected by the tariff elimination and there is no risk for domestic producers.

The four product groups for which import duties still existed prior to the ITA extension are:

1. Switches
2. Parts of static converters
3. Electrical apparatus for switching/protecting electrical circuits
4. Parts of electrical machines & apparatus

Switches are the second most important export product among the relevant product range. Closer inspection shows that the tariff rate differs according to the product's subcategories. Three out of seven subcategories are already tariff-free. For the remaining four subcategories the implementation schedule for Moldova envisages a staged liberalisation, such that tariffs for all subcategories of switches will be abolished only by 2021. With switches already covered by a phased tariff liberalisation, domestic production of switches is sufficiently sheltered from a potential increase in imports.

Parts of static converters currently have an MFN tariff of 5.0%. This tariff will also be abolished in a stepwise manner, such that it will be zero only in 2015. However, no significant change in imports can be expected, as this product group is currently imported entirely from the EU.

Two subcategories of electrical apparatus for switching/protecting electrical circuits can currently already be imported tariff-free, for another two the initial import tariff was 10%. Again, complete tariff abolition will be staged, such that only by 2021 tariffs for this product group will be completely abolished. The expected increase in imports amounts to about USD 40,000 per year, not placing this product group among those with the highest import increase. Additionally, its share in IT exports is very small with only 1.5%.

Parts of electrical machines & apparatus are the product category with the highest initial average trade weighted import tariff of 8.8%. However, making up less than 1% of IT exports the importance to domestic production is rather small.

This detailed analysis of IT sector output, employment and its current exports allows for the conclusion that, overall, domestic production will not be adversely affected by increased imports of products covered by the extended ITA. For those products with a notable domestic production, staged tariff reductions are foreseen providing ample time for adjustment.

Table 4: Moldova's top-10 export products covered by ITA extension

| Product description | HS Code | Export value in 2015, USD m | % of IT exports | % of total exports | Current MFN tariff, in % |
|--|---------|-----------------------------|-----------------|--------------------|--------------------------|
| Electricity meters | 902830 | 12.8 | 47.3% | 0.65% | 0 |
| Switches | 853650 | 7.7 | 28.3% | 0.39% | 4.1 |
| Machines for the reception, conversion & transmission/regeneration of voice, images/other data | 851762 | 1.5 | 5.6% | 0.08% | 0 |
| Other machines & mechanical appliances | 847989 | 1.0 | 3.6% | 0.05% | 0 |
| Parts of static converters | 902490 | 0.8 | 3.1% | 0.04% | 5 |
| Parts of telephone sets | 851770 | 0.7 | 2.4% | 0.03% | 0 |
| Electrical apparatus for switching/protecting electrical circuits | 853690 | 0.4 | 1.5% | 0.02% | 4.0 |
| Parts & accessories for machines machine tools | 846693 | 0.4 | 1.4% | 0.02% | 0 |
| Parts of electrical machines & apparatus | 854370 | 0.3 | 1.0% | 0.01% | 8.8 |
| Instruments & appliances used in medical/surgical/veterinary sciences | 901890 | 0.2 | 0.9% | 0.01% | 0 |
| Total | | 25.8 | | 1.31% | |

Source: World Bank (WITS)

3.4 Impact on Moldovan exports

Another effect of the ITA extension is that Moldova can also export tariff-free to countries that participate in the ITA extension. Thus it is worth to investigate whether Moldovan exports may profit from this liberalisation.

A look at the top destinations for Moldovan exports (Table 5) reveals that out of the 10 most important export destinations, eight countries are EU member states which already have abolished import duties on Moldovan IT products as part of the DCFTA.

The other two countries left in the top 10 export destination, Russia and Turkey, are not participants of the ITA extension agreement. That means they are not obliged to abolish import duties on IT goods imported from Moldova which fall under the ITA extension.

Exports to Russia account for 17% of the relevant Moldovan exports. In 2015, IT goods worth around USD 6.2 m were exported to Russia. As Moldova can currently export tariff-free to Russia in the context of the CIS Free Trade Area, Russia not being a member of the ITA extension has no impact on Moldovan IT exports to that country.

The second country not participating in the ITA extension is Turkey. However, Turkey is part of the European Union Customs Union and is therefore obliged to mirror EU tariff policy including the EU-Moldova DCFTA. Thus there are already no import duties levied by Turkey on IT products imported from Moldova.

As the top ten export destinations already have abolished import duties on IT products imported from Moldova, there will be no noticeable impact from the ITA extension on Moldova's IT exports.

Table 5: Top destinations for Moldovan IT exports in 2015

| | Country | DCFTA country | Participant of ITA extension | Value of IT exports in 2015, USD m | % of IT exports |
|----|--------------------|----------------|------------------------------|------------------------------------|-----------------|
| 1 | Romania | ✓ | ✓ | 9.0 | 24% |
| 2 | Bulgaria | ✓ | ✓ | 6.7 | 18% |
| 3 | Russian Federation | ✗ | ✗ | 6.2 | 17% |
| 4 | Latvia | ✓ | ✓ | 4.2 | 11% |
| 5 | Slovak Republic | ✓ | ✓ | 1.8 | 5% |
| 6 | Turkey | ✓ ³ | ✗ | 1.7 | 4% |
| 7 | Germany | ✓ | ✓ | 1.1 | 3% |
| 8 | Greece | ✓ | ✓ | 0.9 | 2% |
| 9 | Sweden | ✓ | ✓ | 0.7 | 2% |
| 10 | Estonia | ✓ | ✓ | 0.7 | 2% |

Source: World Bank (WITS)

³ Turkey is member of the European Union Customs Union and is therefore bound to European customs policy.

4 Conclusions

Overall we find that the ITA extension is advantageous for Moldova.

The products covered by the extension of the ITA are, to a large extent, imported from outside the country. The government is therefore rightly using the extension of the ITA to reduce the cost of those imports for consumers and companies.

The expected price decrease for a range of consumer products will directly improve the situation of Moldovan consumers as they can afford to buy more of those products covered by the agreement. Additionally, there should be more choice as additional imports enter the Moldovan market.

The expected decline in the cost of the IT products will also improve the competitiveness of Moldovan companies which need to spend less money on vital IT equipment.

Those positive effects for consumers and companies obviously come at the price of losing some revenues for the state budget. Indeed, the loss in revenues after import duty elimination will be larger than the expected increase in VAT revenues due to increased sales. However, as the expected revenue loss amount is not a significant fiscal burden, it is a price worth paying when comparing it to the substantial welfare increase of Moldovan consumers and companies.

At the same time, Moldova does not have to fear a massive influx of cheap IT products threatening the domestic production for two reasons. Firstly, a large share of imports covered by the ITA extension will not be affected by tariff elimination as they had been liberalised already prior to the ITA extension or are covered by the DCFTA. Only imports from Asian countries (China, Japan, Hong Kong), which are the next most important importers to Moldova after the EU, remain to be liberalised. This means that the expected increase in imports is small compared to the size of the IT production sector in Moldova.

Secondly, while Moldova has a number of relevant domestic manufacturers of IT hardware, in an overall perspective the sector does not play a key role in the Moldovan economy. Those few products currently protected by import duties have been correctly identified by the Ministry of Economy. For them tariffs will be eliminated in a phased process over several years allowing them to adjust to the new situation.

As far as Moldovan exports are concerned, no significant changes can be expected. The bulk of Moldovan exports of IT products already profit from free trade in the DCFTA framework.

To conclude, Moldovan consumers and companies are the main profiteer from the trade liberalisation. Increased economic welfare for consumers and companies is considerably larger than the burden for the state budget caused by tariff elimination. The extension of the ITA will be beneficial and marks a continuation of Moldova's sensible trade policy.