

Dismantling the myths about Moldova's trade failures after implementing the Association Agreement

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Introduction

The following comment aims to clarify some aspects reflected in the analysis "Republica Moldova. Doi ani de la semnarea Acordului de Asociere cu UE" [eng. "Republic of Moldova. Two years after signing the Association Agreement with the EU"], published on the personal blog of the President of the Republic of Moldova, Igor Dodon, and to present the Expert-Grup's counterarguments. We will only give our opinion on the statistical interpretations related to the development of the foreign trade after signing the DCFTA (EU-Republic of Moldova Deep and Comprehensive Free Trade Agreement), avoiding biased geopolitical speculations and visions.

Expert-Grup arguments on the published analysis and its original text are submitted below, paragraph by paragraph. The comment sometimes includes refutations and myths debunking, using official statistical data without any biased interpretations.

Note: the text in red represents excerpts of the analysis "Republic of Moldova. Two years after signing the Association Agreement with the EU", published on the personal blog of the President of the Republic of Moldova, Igor Dodon, followed by the comments of Expert-Grup.

Main Expectations from the EU Association Agreement

"Before signing the Association Agreement, many active PR campaigns had been organised to persuade the Moldovan society of the benefits and advantages of such an agreement. These campaigns were based on economic forecasts, according to which, after implementing the EU agreement, Moldova's GDP will increase by 3.2%, exports - by 14.8%, imports - by 6.4%, salaries - by 3.1% and consumption prices - by 1.0% in the short run (Source: Trade Sustainability Impact Assessment in support of negotiations of a DCFTA between the EU and Georgia and the Republic of Moldova. Final report (Client: European Commission – DG Trade)/ ECORYS. – Rotterdam, 27 October 2012.).

The signing of the EU Association Agreement and establishment of the free trade area were expected to open up the European market, increase the export of Moldovan goods, enhance the investment attractiveness of Moldova, expand the foreign investment flow, and ensure a sustainable external financial support for reforms. But, most of the expectations were not met."

Note that these estimations, which related to the economic impact of the DCFTA, rather than the whole Association Agreement, were made in 2012 on the basis of the most recent available data at that stage (2010 as the baseline year).

Thus, none of the shortcomings that occurred in the next years and that left their mark on the country's economic performances, such as the regional geopolitical crisis (the war in Eastern Ukraine and the annexation of Crimea, mutual economic sanctions between the Russian Federation and the EU), the internal political crisis, the foreign exchange crisis, the banking crisis (including the stolen billion), the drought from 2015 and even less the Russian intentions to impose restrictions on import of Moldovan goods despite existing international commitments (about 80% of exported products being affected) could be anticipated at that time.

Thus, attributing all the governance failures and the latest external shocks to the EU Association Agreement is wrong. On the contrary, despite the unprecedented domestic and external constraints, Moldova's economy has not collapsed, the trade with the EU and its support being as an airbag that cushioned these shocks (see next section).

Foreign Trade

Starting with 1 September 2014, the customs duties to most of the Moldovan exports to the EU (about 90% of deliveries) were cancelled, which should boost exports to the EU. Nonetheless, a fast increase in exports to the EU did not occur. During 1 September – December 2014, exports decreased by 0.4%, in 2015 - by 2.3%, in January-August 2016 - by 1.3%.

During 1 September 2014 - August 2016, under the free trade with the EU, exports to the EU countries decreased by USD 41 million. As mentioned above, a growth occurred during the fall of 2016 only due to the good harvest and seasonal factors. Therefore, the increase in exports to the EU market cannot be deemed a trend, yet."

Exports to the EU countries

	September - December 2014	2015	8 months 2016	11 months 2016
Export				
% reported to the corresponding previous period	-0.4	-2.3	-1.3	+7.2
+/-, million USD	-2	-28	-11	+81

Source: National Bureau of Statistics of RM"

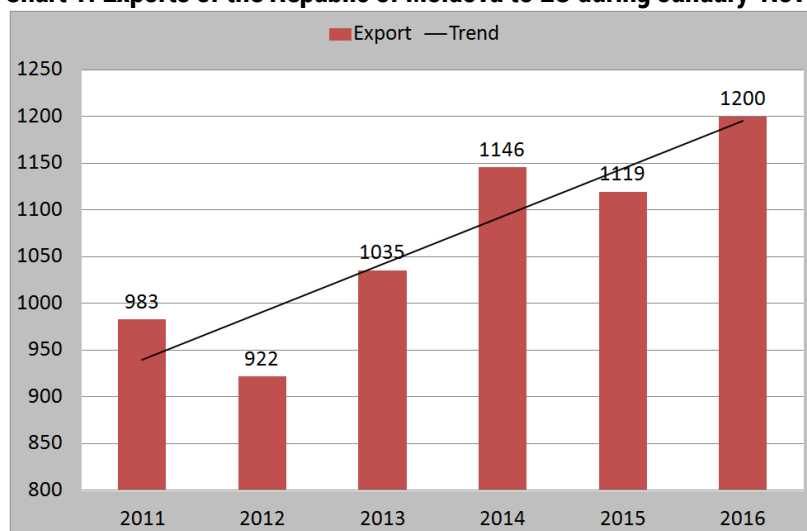
In a system dominated by free market relations (such as EU), the fact that the bilateral trade with the EU did not "explode" during the first day after signing such a document is not surprising. Given that most of the tariff benefits existed under the previous unilateral tariff regime ATP (Autonomous Trade Preferences), naturally the tariffs did not decrease dramatically (except for products falling under entry price and the anti-circumvention mechanisms). On the other hand, all trade benefits, obtained over time, could be fully harnessed with the expansion of commitments, not only in terms of tariffs (but also of all non-tariff components of the DCFTA), but adapting to new circumstances requires a longer period of time.

As for the data presented by the author, we draw attention to the inconsistency of comparing different time series (such as 4 months, 12 months, 8 months, 11 months). Especially for the reason that exports can "migrate" throughout a calendar year, such as the agrifood products that depend on the weather and seasonal factors.

Therefore, the evolution presented by the President Igor Dodon (from the point of view of comparability) is misleading and does not allow drawing meaningful conclusions. Thus, it would be fairer to present the data on exports to EU by equal series of time (thus comparable), where a light and natural decrease (-2.3%) for 2015 can be noticed, in the light of shocks mentioned above. In addition, we note that in 2016, after constraints of 2015 receded, Moldova's exports to EU recorded a new increase, exceeding by 5% the level

from 2014. Last but not least, we also note the increasing general trend of Moldovan exports to EU during the past years (Chart 1).

Chart 1. Exports of the Republic of Moldova to EU during January-November, thousand USD

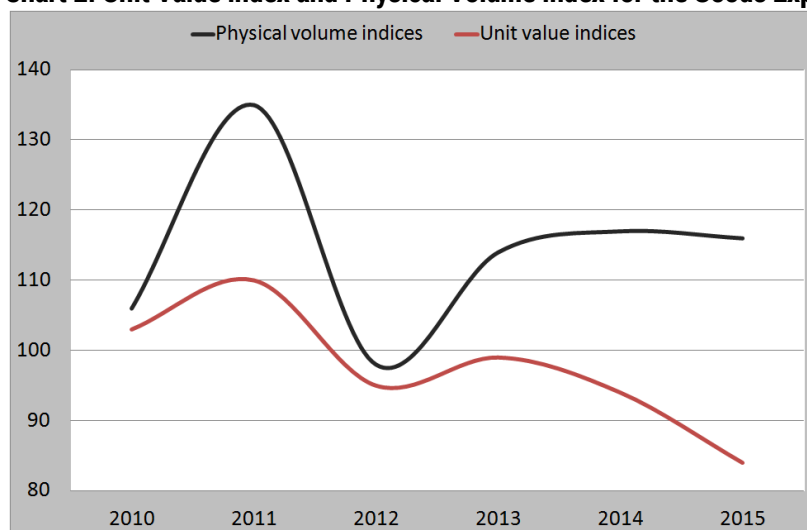


Source: Expert-Grup calculations based on NBS data

Nonetheless, the interpretation of data solely on the basis of value changes (in particular for different series of time, as the author proposes) becomes deficient under the influence of macroeconomic factors.

Besides, it would not make sense to exclude from the equation the influence of certain "events" that occurred during this period, such as the sharp devaluation of the national currency against major currencies, as well as the appreciation of the US dollar against euro (Chart 3). These factors determined thus, to a great extent, the decrease in the exports value, while the quantitative evolution indicated the growth of almost all exports. This is confirmed by the chart below, which shows the upward trend of the physical volume index, despite the constant reduction in the unit value index (Chart 2).

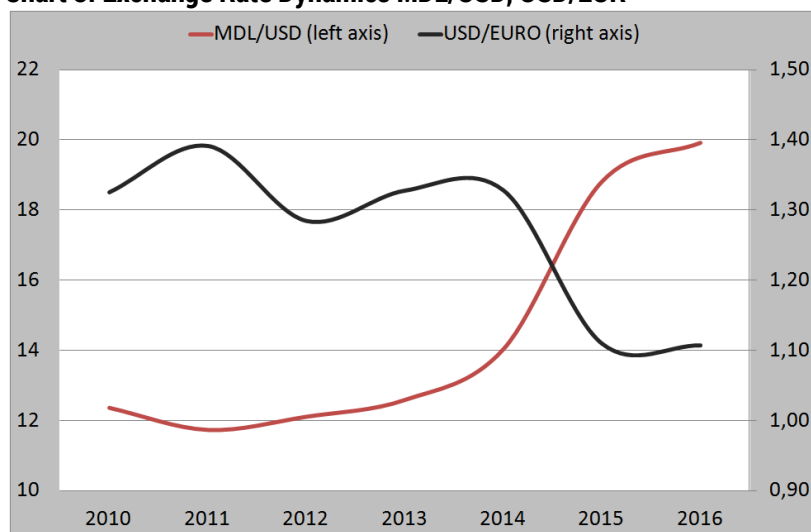
Chart 2. Unit Value Index and Physical Volume Index for the Goods Exported to EU, y-o-y change, %



Source: Expert-Grup calculations based on NBS data

In addition, though 65% of total exports go to the EU market, where transactions are performed in Euro, the country's official statistics is calculated in US dollars. Thus, the devaluation of EUR against the US dollar (from 1.33 in 2014 to 1.10 in 2016) (Chart 3) also contributed to the distortion of foreign trade data.

Chart 3. Exchange Rate Dynamics MDL/USD, USD/EUR



Source: Expert-Grup calculations based on NBS data

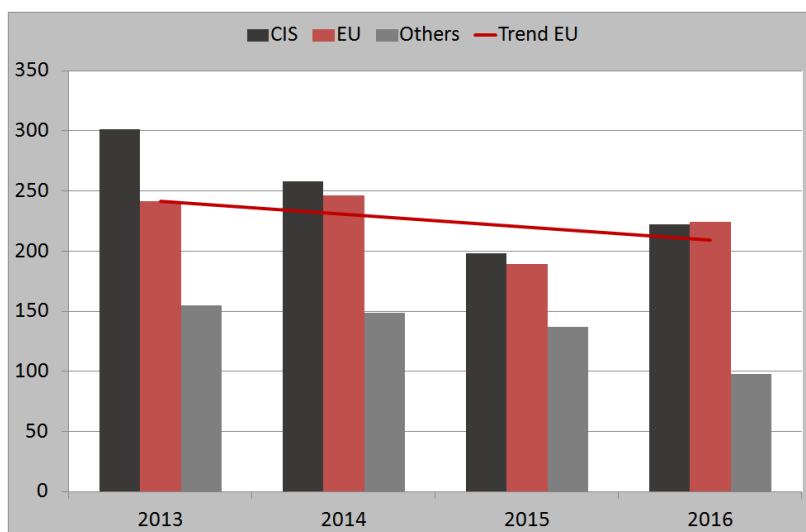
“At the same time, there is a tendency of increasing imports from the European countries of a range of agrifood products - which our country is able to produce in large quantities and at high quality - vegetables (tomato, onion, cabbage, lettuce, carrot etc.), apple, corn, sugar etc.

Thus, in 2015 compared to 2014, the imports of poultry' eggs rose from 11.0 million pieces to 20.9 million pieces (1.9 times); tomatoes - from 0.2 thousand tones to 0.9 thousand tones (4.5 times); apples - from 0.3 thousand tones to 1.1 thousand tones (3.7 times); sugar - from 6.3 thousand tones to 8.1 thousand tones (1.3 times).

In 2016, imports from EU of products like milk and sour cream, apples, corn, sugar increased.”

Besides reviewing the volume of imports from EU only (without making any reference to imports from CIS or other countries, as the data presented above), the evolution of Moldova's imports of agrifood products from EU indicates a decrease (Chart 4).

Chart 4. Republic of Moldova's Imports of Agrifood Products during January-November, million USD

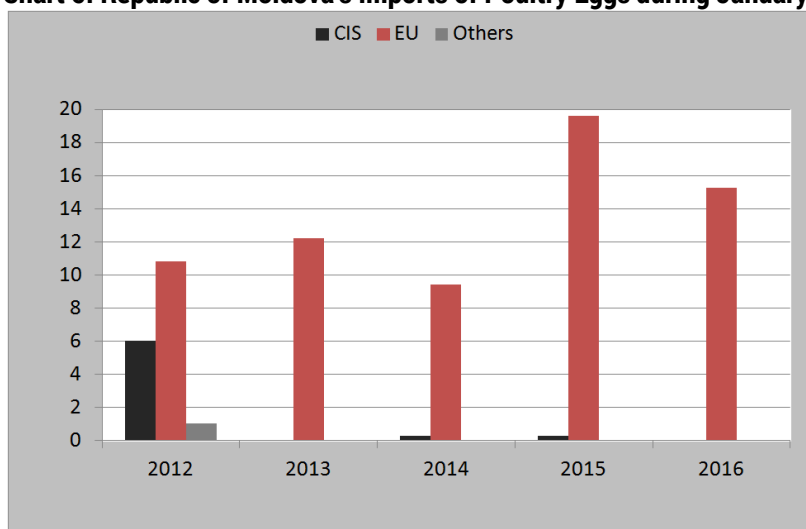


Source: Expert-Grup calculations based on NBS data

We present below the data on the imports of products mentioned by President Igor Dodon in his analysis, along with imports from other groups of countries (CIS and other countries). Also, in order to avoid an incomplete interpretation (with overgrowth) both relative and absolute terms were used.

Thus, imports of poultry eggs increased 2.1 times in quantitative terms in January-November 2015 y-o-y (from 9.4 million pieces to 19.6 million pieces), and in January-November 2016 they dropped by 22% y-o-y (from 19.6 million pieces to 15.3 million pieces) (Chart 5). In addition, we draw attention to the fact that these imports included exclusively fertilised eggs for hatching, and these developments were triggered by the revitalisation of the poultry sector.

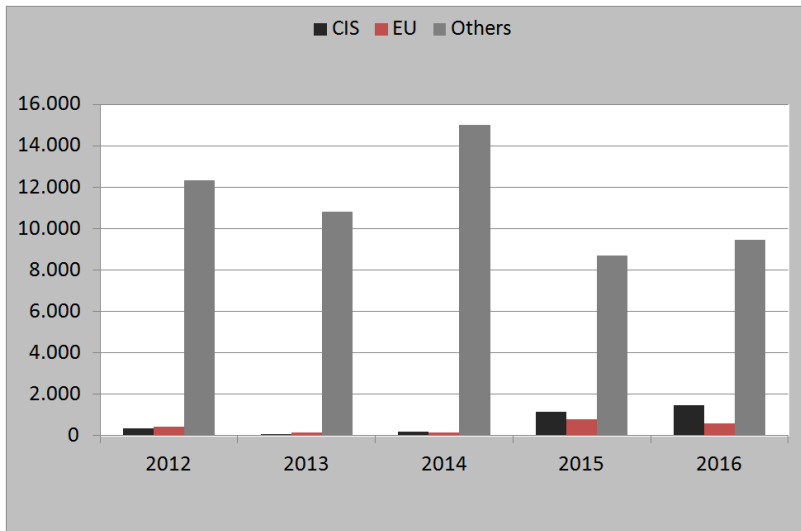
Chart 5. Republic of Moldova's Imports of Poultry Eggs during January-November, million pieces



Source: Expert-Grup calculations based on NBS data

Imports of tomatoes from the EU increased 4.8 times during January-November 2015 y-o-y (from 165 tons to 796 tons), followed by a decrease by 27% in January-November 2016 y-o-y (from 796 tons to 585 tons) (Chart 6). In addition, the share of these imports was only 5.1% in 2016 (7.5% in 2015) of the total imports of tomatoes (while the share of imports from CIS countries - 12.7%, other countries - 82.2%).

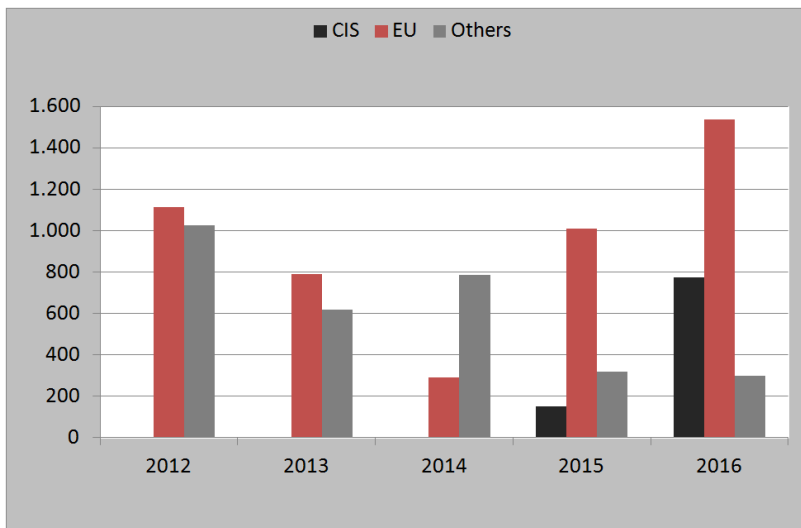
Chart 6. Republic of Moldova's Imports of Tomatoes during January-November, tons



Source: Expert-Grup calculations based on NBS data

The imports of apples from EU increased 3.5 times in quantitative terms during January-November 2015 y-o-y (from 292 tons to 1011 tons), and 1.5 times during January-November 2016 y-o-y (from 1011 tons to 1536 tons) (Chart 7). In addition, the imports of apples from the CIS during the same period increased 150 times during January-November 2015 y-o-y (from 1 ton to 150 tons), and 5.1 times during January-November 2016 y-o-y (from 150 tons to 773 tons). Even though we can talk about spectacular increases in relative terms (both for the EU and CIS), their value amounted to about USD 0.8 million during January-November 2016 (USD 0.5 million during the same period of 2015).

Chart 7. Republic of Moldova's Imports of Apples during January-November, tons

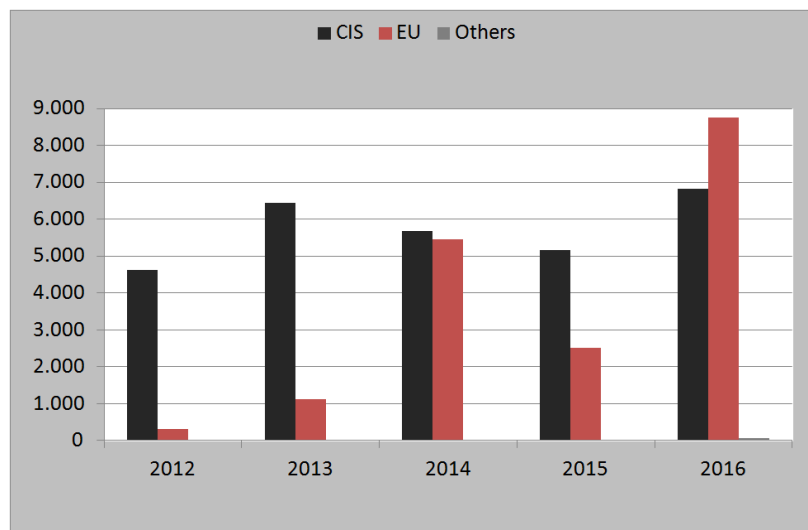


Source: Expert-Grup calculations based on NBS data

The imports of milk and sour cream from EU decreased by 54% in quantitative terms during January-November 2015 y-o-y (from 5450 tons to 2505 tons), followed by a 3.5-fold increase during January-November 2016 y-o-y (from 2505 tons to 8744 tons) (Chart 8). Note that the upward trend was due exclusively to the import of bulk milk, performed by a local company specialised in processing milk and producing dairy

products. Thus, this company has expanded its production facilities in Romania to meet the needs of raw material, given the constant reduction of the herd of cattle in our country¹.

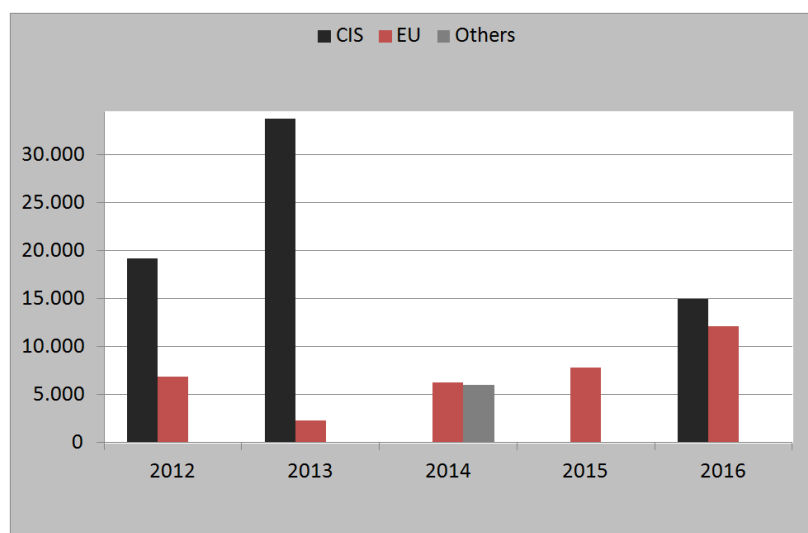
Chart 8. Republic of Moldova's Imports of Milk and Sour Cream during January-November, tons



Source: Expert-Grup calculations based on NBS data

The imports of sugar increased by 24% during January-November 2015 y-o-y (from 6291 tons to 7811 tons), followed by a 55-fold increase during January-November 2016 y-o-y (from 7811 tons to 12119 tons) (Chart 9). In addition, the sugar import from CIS countries recorded a much higher growth (if to speculate, we could admit that in 2016 it increased 1000 times!!!).

Chart 9. Republic of Moldova's Imports of Sugar during January-November, tons



Source: Expert-Grup calculations based on NBS data

As noticed above, to form an opinion based on the evolution of trade flows, the consideration of all existing aspects is imminent (comparison of imports from all sources both in relative and absolute terms, and for longer periods of time) in order to avoid misinterpretation.

¹According to NBS data the herd of cattle as of 1 January: 2010-161 thousand, 2011-154 thousand, 2012-144 thousand, 2013-134 thousand, 2014-131 thousand, 2015-130 thousand, 2016-128 thousand.

“Thus, signing the Association Agreement with EU did not improve the export position of Moldova on the EU markets. For Moldova, the EU markets opening has been accompanied by a catastrophic deterioration of the conditions of Moldovan exports to the Russian market.”

After EU and the Republic of Moldova signed the Association Agreement, in July 2014 the Russian Federation started to introduce restrictions on delivery of Moldovan products (fruit, canned vegetables, wine), because its economic and commercial interests were not taken into consideration following the necessary consultations. As a result, from July 2014 till August 2016 the export of Moldovan goods to the Russian market decreased by USD 325 million.

Exports to the Russian Federation

	September December 2014	-2015	8 months 2016
Exports			
% compared to the corresponding previous period	-42.6	-43.2	-6.3
+/-, million USD.	-132.1	-183.1	-9.7

Source: National Bureau of Statistics of RM⁴

According to the “good practices”, any decision on the country’s trade policy (including the negotiation of international agreements) relates directly and exclusively to its economic interests. Therefore, it is still unclear which would be the “*necessary consultations*” and why the “*economic and commercial interests*” of the Russian Federation should be taken into consideration (by analogy the “interests” of other trading partners could be invoked, as well). But, beyond the accuracy and rationale used by the Russian Federation to impose restrictions, we will try to analyse the “*catastrophic*” evolution of exports to this destination.

As soon as the Russian Federation imposed the trade restrictions (still unjustified in economic terms) to Moldovan products, apparently they dropped by 43% (or by USD 183 million less than in 2015 y-o-y). However, this figure in absolute terms does not reflect the real situation, given that most of the Moldovan exports to the Russian market are actually re-exports.

Especially, these are goods that represent the so-called classical re-export² and were exported fully to the Russian Federation, using the Republic of Moldova as a bridge for the final transactions for some objectives/reasons (geographical or cultural proximity). Thus, in 2015 they reached a value of USD 139 million, representing about 58% of total exports to the Russian Federation. Thus, the “*catastrophic*” decrease in absolute terms of exports to the Russian Federation was due mainly to the dramatic reduction of re-exports (Chart 10).

²Classical re-exports of goods are the exports of foreign goods, that previously were imported in the country and did not suffer any essential changes or change of the country of origin. National Bureau of Statistics

Chart 10. Export of Domestic Goods and Re-export to the Russian Federation during 2011-2015, million USD



Source: Expert-Grup calculations based on UN Comtrade data

To understand better this phenomenon, we will try below to quantify the actual performances of the country in terms of export to the Russian market, to have a clearer vision using statistical data on trade flows to this destination.

The disaggregation by main groups of goods exported to the Russian Federation, simultaneously with the disaggregation of exports (by re-exports and exports of domestic goods) indicates a negative phenomenon characteristic for the quasitotality of goods exported to the Russian Federation, such as the predominance of classical re-exports in export transactions (for a better understanding compare the data on exports for 2013 and 2015, Charts 11 and 12, respectively).

Chart 11. Structure of the Main Groups of Goods Exported to the Russian Federation (Export of Domestic Goods vs Re-export), 2013, million USD



Source: Expert-Grup calculations based on UN Comtrade data

Chart 12. Structure of the Main Groups of Goods Exported to the Russian Federation (Export of Domestic Goods vs Re-export), 2015, million USD



Source: Expert-Grup calculations based on UN Comtrade data

Considering the aforementioned, and if the transactions that do not involve any contribution of the real economic sector and thus, do not impact their value added are excluded, it appears that de facto goods worth USD 98 million (i.e. by 82 million less than in the previous year) were exported to the Russian Federation in 2015 (which is significantly less than the figure stated in the analysis - USD 183 million). In these conditions, the Russian Federation would hold about 5.3% of the total export (compared to 12.3% if taking into account the re-exports). Even in these conditions, the Russian Federation market should not be neglected. On the contrary, the good trade relations must be consolidated in the spirit of parity and fairness, based on the existing international commitments.

Before Drawing Conclusions...

“What should be done in this situation? Soon we will make public a comprehensive program of socio-economic development of the country. It is necessary to initiate a range of changes in all sectors and embark on the development path.”

Any analysis and interpretation of statistical data should be performed exclusively on the basis of unbiased economic reasoning, and before *“initiating a range of changes and embarking on the development path”*, they need to be reconciled to the country’s objective of sustainable development.