

DCFTA in the Transnistrian Region: Mission Possible?

Policy Brief

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Disclaimer

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Content

List of charts	2
List of tables.....	3
Abbreviations	3
Introduction.....	4
Executive Summary	5
I. Five Key Peculiarities of the Transnistrian Economy	7
1. Although the region depends on the EU market for exports, it is much more reliant on imports from Russia	7
2. The region's economy is not self-sufficient.....	10
3. The region's economy depends more on domestic rather than on foreign demand	10
4. The region's budget is very exposed to foreign trade liberalisation.....	11
5. The region is running out of international reserves.....	11
Implications for the AA/DCFTA Implementation in the Transnistrian Region.....	12
II. Recommended Approach to the Implementation of AA/DCFTA in the Transnistrian Region.....	13
How to ensure a constructive dialogue given the EU-skeptical attitude in the region?	13
How to downsize the immediate costs of trade liberalization?.....	13
How to mitigate the uncertainty about medium and long-term opportunities of AA/DCFTA?.....	14
III. Conclusions	15
Annex A.....	16
Annex B.....	17

List of charts

Chart 1. Region's exports, million USD	7
Chart 2. Region's exports, 2005	8
Chart 3. Region's exports, 2014	8
Chart 4. Region's exports, by key products, 2014.....	8
Chart 5. Region's imports, 2005.....	9
Chart 6. Region's imports, 2014.....	9
Chart 7. Region's imports, by key products, 2014	9
Chart 8. How the region is financing its current account deficit, 2014	10
Chart 9. Structure of Transnistrian region's GDP, 2014.....	11
Chart 10. Structure of Transnistrian employment, 2014	11

List of tables

Table 1. Balance of payments, Transnistrian region, USD million	16
Table 2. Budgetary revenues of the Transnistrian region, 2014	17
Table 3. Budgetary revenues of the Transnistrian region, 2014	17

Abbreviations

AA	Association Agreement
ATP	Autonomous Trade Preferences
COSME	Program of Competitiveness of Enterprises and Small and Medium-sized Enterprises
DCFTA	Deep and Comprehensive Free Trade Area
ENPARD	European Neighbourhood Programme for Agriculture and Rural Development
EU	European Union
GDP	Gross Domestic Product
VAT	Value Added Tax

Introduction

The year 2015 could be a crucial one for the Transnistrian economy. This is the year when the Autonomous Trade Preferences (ATP) granted by the EU to the Republic of Moldova (including to the Transnistrian region) expire, being replaced by the Deep and Comprehensive Free Trade Area (DCFTA) with EU. Whereas, ATP allowed for asymmetric trade arrangements (Moldova, including the Transnistrian region, was allowed to keep a certain level of tariff protection against imports from EU), DCFTA requires symmetry. It means that starting from 2016, the Transnistrian region should begin gradually abolishing its import tariffs with EU, as well as implementing other key provisions of the Association Agreement (AA). Otherwise, EU could cancel the trade preferences and apply higher import tariffs (Most-Favoured Nation tariffs) to goods originated from the Transnistrian region. It could severely hit the Transnistrian exporters and undermine the already shaky economic and social conditions in the region.

So far, both parties did not reach an understanding about a clear mechanism of DCFTA implementation in the Transnistrian region. On the one hand, the political leadership from Tiraspol is vehemently opposing the implementation of AA/DCFTA with EU (due to a number of reasons, from poor understanding about AA/DCFTA, to strong economic and political dependence on Russia). On the other hand, EU uses “all-or-nothing” rhetoric, asking that AA/DCFTA is fully implemented on the entire territory of Moldova (including Transnistrian region), whereas Chisinau authorities have little leverage in the dialogue with Tiraspol authorities.

Under these circumstances, the risks to the Transnistrian economy are imminent. EU is a key market for the region’s exporters, accounting for about one third of total exports. Moreover, the Transnistrian region did benefit enormously from the asymmetric trade preferences granted by EU to Moldova starting from 2006: the region’s exports to EU doubled (from USD 114.9 million in 2005 to USD 258.9 million in 2014) and the share of exports to EU in total exports increased from 20% in 2005 to 38% in 2014 (in January-July, 2015 it slightly shrank to 34%). No doubt, losing the preferential access to the EU market will significantly challenge the competitiveness of Transnistrian exports. In fact, they are already facing hard times given the depreciation of the national currencies of the key trading partners against the “Transnistrian rouble”, tough economic conditions in the region and the security crisis in Ukraine. All in all, refusal to implement AA/DCFTA could push the Transnistrian region into economic self-isolation, deepening the economic and social crisis it is currently facing (it could lead to a permanent 5% decline in the region’s GDP¹).

In order to avoid the worsening of the economic and social situation in the region, and ensure an efficient implementation of DCFTA on the entire territory of Moldova, we need a new and realistic approach to Chisinau-Tiraspol dialogue. The purpose of this policy-brief is to define the analytical background and key elements of this new approach, based on an evidence-based reality-check of the Transnistrian economy that would help better understand the real incentives driving the region’s political and economic elites. This document is composed of two parts: the first one describes the key peculiarities of the Transnistrian economy that should be taken into account in persuading it to implement the AA/DCFTA; and the second part provides key recommendations about the effective implementation of the DCFTA in the region.

¹ Adopting and implementing the EU quality standards, increasing the efficiency of rules of origin verification by the Moldovan custom’s authorities of the goods produced in the region, reforming the competition framework and state aid, closer collaboration with the Chisinau authorities, etc.

² “The Impact of the EU-Moldova DCFTA on the Transnistrian Economy: Quantitative Assessment under Three Scenarios”, Berlin Economics and Expert-Grup, 2013

Executive Summary

The implementation of the AA/DCFTA in the Transnistrian region is crucial at least for two reasons: (i) *political* - it could serve as a strong precondition for converging the economies from both sides of Nistru and reintegration of the country; and (ii) *economic* - it offers additional opportunities to export, attract FDI and set the economy on a sustainable path, which are vital elements for the Transnistrian region with dwindling economy and skyrocketing budgetary and current account deficits. According to some estimations, the implementation of AA/DCFTA will bring net benefits to the Transnistrian region, permanently boosting its economy by about 3-4%³.

The Transnistrian region could lose the AA/DCFTA opportunities at the beginning of 2016, when the current Autonomous Trade Preferences granted by EU will expire, being replaced by MFN import tariffs. Thus, if the region will not implement at least the minimum requirements of the AA/DCFTA, it could lose the preferential access to the EU market, cause a permanent 5% decline in its GDP. As the time passes, this scenario becomes more and more realistic, because so far the authorities did not agree on a clear mechanism about AA/DCFTA implementation in the Transnistrian region.

The approach in persuading the Transnistrian authorities to implement AA/DCFTA should be based on five key peculiarities of the region's economy. These peculiarities allow for better understanding the incentives that drive the reluctance of the region's authorities to implement AA/DCFTA and, therefore, should be taken into account by Chisinau and Brussels authorities:

1. Although, the region depends on the EU Market for exports, it is much more reliant on imports from Russia;
2. The region's economy is not self-sufficient - the huge current account deficit is financed, directly and indirectly, from Russia;
3. The region's economy depends more on domestic demand, fueled primarily by "Russian money", rather than on EU-driven foreign demand;
4. The region's budget is very exposed to foreign trade liberalisation, causing immediate budgetary costs as a result of removing customs' tariffs.
5. The region is running out of international reserves, the "rubble" being backed heavily by "Russian money".

These five key peculiarities of the Transnistrian economy reiterate the well-known fact: Russia has a strong leverage in the Transnistrian region, whereas the leverage of Chisinau and Brussels is relatively weak. It has obvious consequences on the behaviour of region's decision-makers, as well as the preferences of the most of its population, which transposes into a strong EU scepticism in the region. These feelings are fuelled by the fact that the Transnistrian economy is constructed in the way that AA/DCFTA could generate large immediate costs (e.g. decline in budget revenues, competitiveness shock), whereas the main benefits are expected for the long run and remain uncertain.

Hence, AA/DCFTA implementation in the region could be "mission possible" if and only if answers to three crucial questions will be found: (i) How to ensure a constructive dialogue given EU-skeptical attitude in the region? (ii) How to downsize the immediate costs of trade liberalization? (iii) How to mitigate the uncertainty about medium and long-term opportunities of AA/DCFTA for the region? The approach towards AA/DCFTA implementation in the region should be based on the answers to these three questions.

³ Ibid

How to ensure a constructive dialogue given the EU-skeptical attitude in the region? The dialogue between Chisinau and Tiraspol should be completely freed of “sensitive terminology” (e.g. AA/DCFTA, EU, European integration or trade liberalization etc.). At the same time, it is necessary to concentrate on a clear roadmap about the implementation of the most basic technical requirements that, on the one hand, should make the firms from the left-bank of Nistru eligible for the preferential access to EU, and on the other hand should not be perceived as part of the DCFTA commitments.

How to downsize the immediate costs of trade liberalization? Although, the AA/DCFTA implies a gradual removal of imports duties of Moldova, with transition periods ranging from 3 to 10 years for the most sensitive products, for the Transnistrian firms the liberalization schedules should be extended even further. The reason lies in the fact that the region’s economy is much more exposed to trade liberalization compared to the rest of the country (due to much higher import duties and their significant share in the region’s budget). Hence, it is necessary to allow longer transition periods for the most sensitive sectors of the region’s economy (textiles, footwear, leather, live animals and products of animal origin). Obviously, this liberalization slowdown should not generate moral hazards for the Transnistrian policy-makers, being conditioned by closer cooperation between Tiraspol and Chisinau authorities on issues related to verification of rules of origin, customs clearance for goods entering and coming out of the region, and implementation of EU quality standards. Moreover, the Transnistrian authorities should implement a structural fiscal reform in the region, that would be supported by the key development partners of Moldova and would consist of two important elements: (i) implementation of a transparent and simple VAT system; and (ii) improvement in the compatibility between fiscal systems on both banks of Nistru and aligning them to international standards.

How to mitigate the uncertainty about medium and long-term opportunities of AA/DCFTA? It is necessary to concentrate mainly on tangible and immediate benefits and opportunities of the association agenda. Some of them could be the Program of Competitiveness of Enterprises and Small and Medium-sized Enterprises 2014-2020 (COSME), Enterprise Europe Network, Erasmus for young entrepreneurs and the financing agreement in agriculture and rural development – ENPARD. Additionally, a platform could be created, comprising non-political policymakers and SME representatives from both sides of Nistru to discuss feasible mechanisms of extending EU programs in the Transnistrian region and increasing the level of information and awareness about these programs in the region.

In conclusion, the implementation of the AA/DCFTA in the Transnistrian region is conditional on the mutual compromise between Chisinau/Brussels and the region’s authorities. We believe this is the most realistic approach that takes into account the special statute of the region, as well as the peculiarities of the Transnistrian economy. The reality is that the Russian influence in the region is too strong for the “all-or-nothing” rhetoric regarding the AA/DCFTA implementation in the region. Failure to accommodate to this reality could turn into further economic and political isolation of the region, with major economic and social repercussions for the local firms and population, for whom the government of the Republic of Moldova is responsible, both from the constitutional and moral points of views.

I. Five Key Peculiarities of the Transnistrian Economy

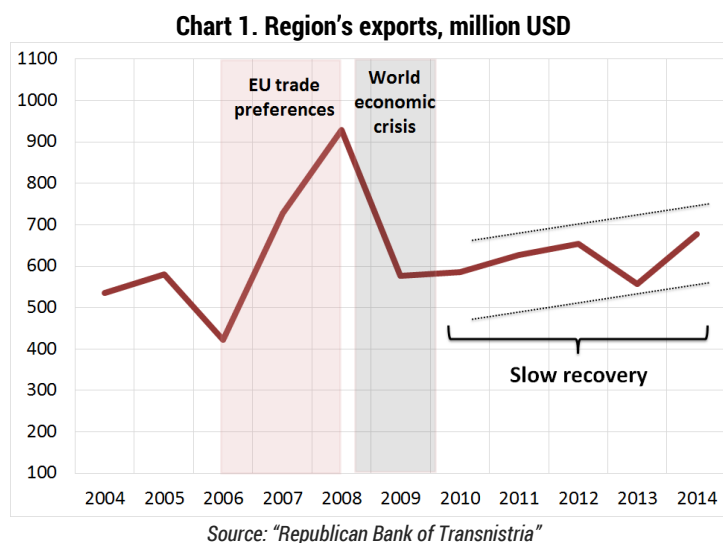
This section describes the key peculiarities of the Transnistrian economy, that fuel the reluctance of region's authorities to implement the AA/DCFTA. These peculiarities should be taken into account in defining the approach to AA/DCFTA implementation in the Transnistrian region.

1. Although the region depends on the EU market for exports, it is much more reliant on imports from Russia

So far, Chisinau and Brussels authorities were over-evaluating the same argument: EU is a key trading partner for Transnistria and, therefore, the region will have to implement, sooner or later, the AA/DCFTA. This is right and wrong at the same time.

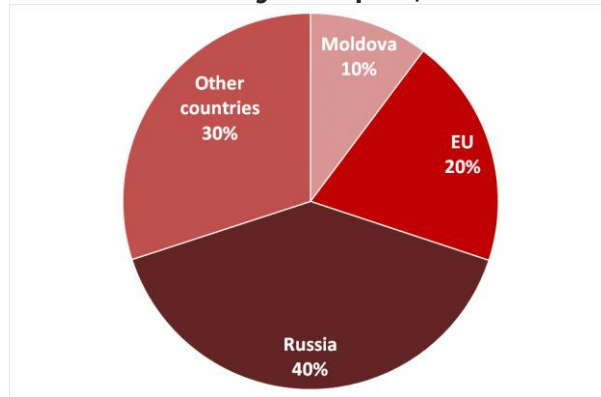
First side of the coin: EU is a key export market for the Transnistrian region

EU is a crucial export market for the Transnistrian exporters. As shown by Chart 1, Transnistrian region benefited from the asymmetric trade liberalisation of EU granted to the Republic of Moldova since 2006 within various preferential trade regimes (GSP, GSP plus and ATP). Thus, from 2005 (before the start of trade liberalisation) until 2008 (before the economic crisis), total exports of the Transnistrian region posted an impressive 60% growth. It was followed by a 38% slump in 2009 determined by the economic crisis and a slow period of recovery during 2010-2014. All in all, despite this volatile evolution, total exports of the Transnistrian region grew during 2005-2014 by 17% (from USD 578 million to USD 678 million), while the exports to EU doubled (from USD 115 million to USD 259 million).



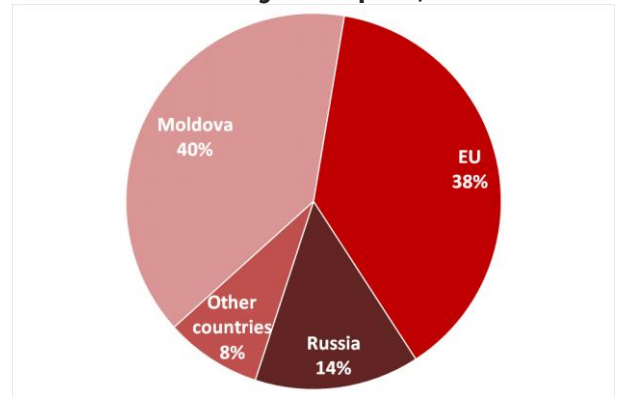
The growth in the region's exports during 2005-2014 was mostly determined by the exports to EU. During this period of time, the share of EU in total region's exports almost doubled: from 20% in 2005 to 38% in 2014 (after the first 7 months of 2015 this share slightly shrank to 34%). Additionally, the share of Russia in total exports shrank from 40% in 2005 to only 14% in 2014 (after the first 7 months of 2015 it shrank further becoming almost insignificant - 8%).

Chart 2. Region's exports, 2005



Source: "Republican Bank of Transnistria"

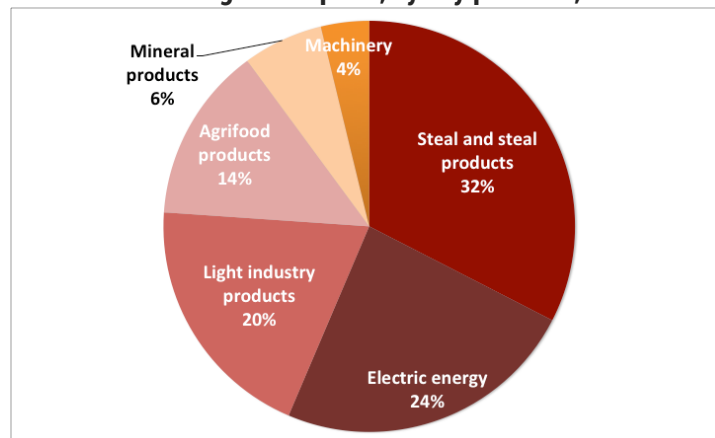
Chart 3. Region's exports, 2014



Source: "Republican Bank of Transnistria"

The exports are mostly driven by steel and steel products, which account for about one third of total exports, are ensured almost entirely by one single factory (Moldovan Steel Factory – MMZ), and are mainly oriented on the EU market (66% in 2014). The second largest exports are electrical energy, that account for about one quarter of all exports (though, de jure these are not exports because 100% of all electric energy produced in the Transnistrian region is sold on the right-bank of Nistru). Light industry form another important export category (20% of total exports), being mainly represented by textiles and footwear sold primarily on the EU market. Agrifood exports account for 14% of total exports, being sold on the right-bank of Nistru, as well as Ukraine and Romania. Mineral products and machinery form insignificant shares of region's exports, being mainly sold on the right-bank of Nistru and Russia.

Chart 4. Region's exports, by key products, 2014



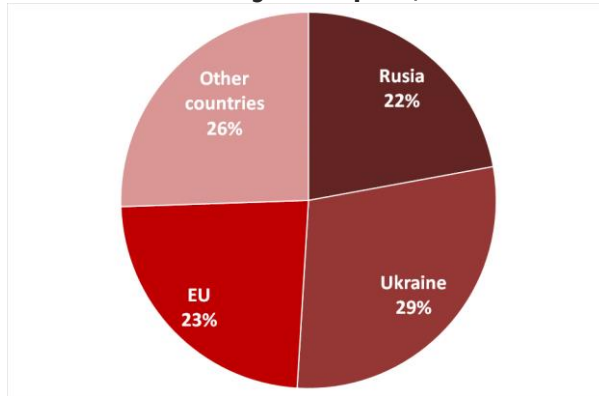
Source: "Republican Bank of Transnistria"

Thus, from the exports' point of view, further trade liberalization with EU will be beneficial for the Transnistrian region. According to some estimations, it could further boost region's exports by about 10%, investments – by 3-5% and GDP by 3-4%. However, do these benefits, which are mostly long-term, overcome the short-term economic and social costs of AA/DCFTA implementation? Thus, in pursuing the Transnistrian authorities to implement the AA/DCFTA, it is necessary to take into account the other side of the coin: region's huge dependence on imports, which are mainly coming from Russia.

Second side of the coin: Russia is the main source for imports of the Transnistrian region

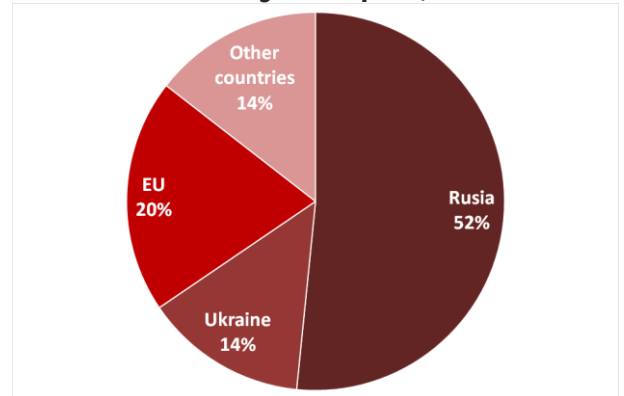
Whereas EU is a key export market, Russia is, by far, the most important source of imports for the Transnistrian region. In 2014, about 52% of region's imports were coming from Russia, which increased its importance compared to 2005, when it accounted only 22%. At the same time, the share of EU in region's imports shrank from 23% in 2005 to 20% in 2014 (Chart 4 and Chart 5).

Chart 5. Region's imports, 2005



Source: "Republican Bank of Transnistria"

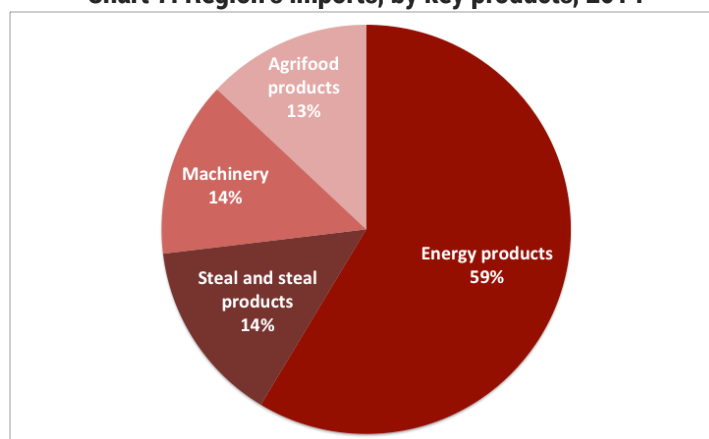
Chart 6. Region's imports, 2014



Source: "Republican Bank of Transnistria"

Imports are much more important for the Transnistrian region than exports. Whereas exports formed, in 2014, 64% of the region's GDP, imports' share is 2.3 times higher (146% of GDP). The most important imported item is energy, which represent about 44% of total imports, most of which is coming from Russia. Moreover, it is a well-know fact that Transnistrian authorities do not pay for the gas imports from Russia, which account for about USD 400-430 million annually⁵, contributing to growing external debt of the Republic of Moldova. This is the most important subsidy Russia is providing to the region, which on the one hand keeps the industrial sector competitive on the foreign markets, and on the other hand, is a major source of revenue for the region's budget (the authorities charge the firms and households for gas consumption). Moreover, this fuels the region's production of electrical energy, which represent about USD 170 million in annual sales to the right-bank of Nistru and is an important source of profits for the local political elites.

Chart 7. Region's imports, by key products, 2014



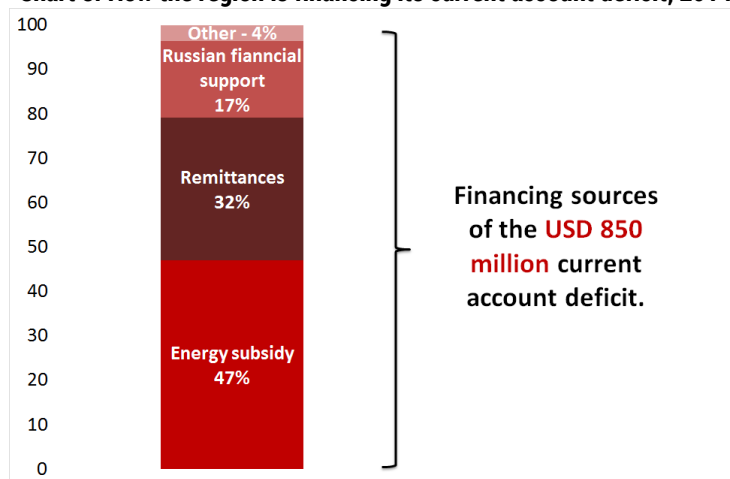
Source: "Republican Bank of Transnistria"

⁵ The region uses for its own consumption about 1.2-1.3 billion of cubic meters of natural gas, which multiplied by the price paid by the Republic of Moldova of ~USD 330 per 1 thousand of cubic meters, represents about USD 400-430 million.

2. The region's economy is not self-sufficient

Each year, the region runs an enormous current account deficit, pointing on the weak competitiveness and unsustainable economic growth model. In 2014, the region registered a current account deficit of USD 850 million, being at a cosmic level of 93% of GDP (usually, a current account deficit of more than 10% of GDP is dangerous for the macro-financial stability). It means that the region is consuming much more than is earning, putting huge pressures on the stability of the "Transnistrian ruble" and the indebtedness of the region (Annex A).

Chart 8. How the region is financing its current account deficit, 2014



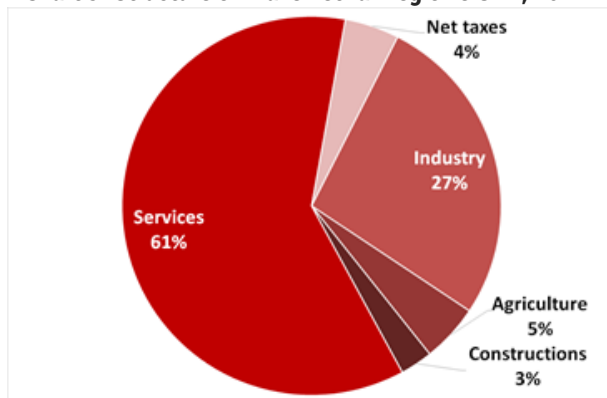
Source: Own calculations based on "Republican Bank of Transnistria" data

This huge current account deficit is the most important leverage Russia has in the Transnistrian region. The key financing sources of region's current account deficit are closely related to Russia. The largest share of the current account deficit is financed through the annual "energy subsidy" of nearly USD 400-430 million – imported natural gas for which the Transnistrian authorities do not pay, being accumulated as external debt of the Republic of Moldova. Another important financing source are the remittances, which in 2014 accounted for about USD 270 million or 25% of region's GDP and which come, at large extend (75-80%) from Russia. Additionally, Russia is transferring each year nearly USD 150 million as humanitarian assistance and building social infrastructure (project "Eurasian Integration), which are also contributing to financing the current account deficit.

3. The region's economy depends more on domestic rather than on foreign demand

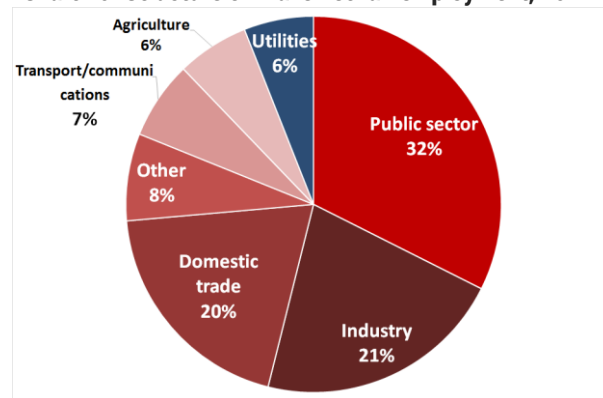
Transnistrian economy is driven mostly by services, which depend primarily on Russian-aided domestic demand. In 2014, about 61% of region's GDP was formed in the services sector, which is depend almost entirely on the domestic demand mainly aided by Russia. At the same time, the share of the industrial sector in the region's economy, which is mainly reliant on the EU demand, is respectable, but much lower than the services sector - 27% of region's GDP (Chart 7).

Chart 9. Structure of Transnistrian region's GDP, 2014



Source: "Republican Bank of Transnistria"

Chart 10. Structure of Transnistrian employment, 2014



Source: "Ministry of Economic Development" of the Transnistrian region

The structure of employment reiterates the fact that the region's economy is mainly dependent on the domestic demand. The share of sectors related to exporting activity in total employment (industry and transport/communication) represented, in 2014, only 28%, whereas the public sector and the domestic trade (mainly oriented to the domestic demand) account for over half of total employment (Chart 8). This fact fortifies the leverage of Russia, because the domestic trade is mainly fuelled by remittances and Russian direct and indirect financial support to the region.

4. The region's budget is very exposed to foreign trade liberalisation

About one quarter of region's budget is formed of import duties. This is explained by a relatively protectionist tariff policy implemented by the region's authorities: whereas the average of import duties for all goods on the right bank of Nistru is 4.6%, on the left-bank it is estimated at about 6.35%. It allowed, on the one hand, to compensate the forgone tax revenues from not implementing the VAT system, and on the other hand to preserve the competitiveness of domestic products on the region's internal market. Hence, it made the Transnistria very exposed to trade liberalization and continuously undermine the region's budget stability (Annex B).

Trade liberalization with EU implies direct immediate costs to the region's budget. Withdrawal of import custom duties for imports from EU could cost the region's budget about USD 30-35 million or 12-13% of its annual budgetary revenues. These are very sizable costs, given the shaky public finances system and a huge and continuously raising budgetary deficit: 12% of GDP in 2014.

While being vulnerable to trade liberalization, the region's budget is highly reliant on Russian direct and indirect aid. The direct budgetary support provided by Russia to the Transnistrian authorities, in 2014, was about USD 27 million, which is nearly 10% of the region's budget. However, the most sizable contribution to the public finances of the region comes from the sales of natural gas on the domestic market (about USD 400-430 million) provided for free by Russia and sold to local firms and households, the revenues being redistributed mainly for social purposes.

5. The region is running out of international reserves

The international reserves held by the "Republican Bank of Transnistria" account for about 1 month of imports, which is four times less than the minimum required level. Nevertheless, the exchange rate of the

• "Профсоюзные вести", no. 36(1184) from 12.09.2015

“Transnistrian ruble” was kept fixed at 11.1 against USD for the last couple of years (despite the fact that the national currencies of all its trade partners depreciated against USD). While causing huge losses to the region’s exporters, it helped to preserve a relatively stable inflationary environment. Obviously, it was achieved after massive selling of foreign currency on the domestic foreign exchange market, which was possible again with the strong financial support from Russia.

Implications for the AA/DCFTA Implementation in the Transnistrian Region

The dialogue about the AA/DCFTA implementation in the Transnistrian region will fail if EU and Chisinau authorities will neglect these five peculiarities of the region’s economy. It boils down to the strong leverage of Russia in the region, due to the massive dependence of the region’s economy and budget on the Russian direct and indirect support. It makes the Transnistrian decision-makers to pursue the Russian-led Eurasian integration vector and transpose at the local level the difficult relations between Brussels and Moscow.

Moreover, besides the geopolitical interferences, there are many other objective factors fueling region’s reluctance about implementation of AA/DCFTA. These are mainly related to the immediate costs of trade liberalization with EU (drop in public revenues, competitiveness shock for domestic producers, need to invest in the implementation of EU standards, etc.), compared to long-term and, hence, uncertain opportunities of AA/DCFTA implementation. The uncertainty about AA/DCFTA opportunities is also fueled by the lack of trust between Chisinau/Brussels and Tiraspol authorities, as well as by the poor understanding among region’s authorities, firms and population about AA implications.

Given the high immediate costs and uncertainty about future opportunities related to AA/DCFTA implementation, the Transnistrian authorities have the natural incentive to preserve the status quo: maintaining unconditional EU trade preferences for the region’s firms, while keeping the protectionist tariff policy. Hence, in order to facilitate the effective implementation of AA/DCFTA in the region it is necessary, on the one hand, to minimize the immediate costs of trade liberalization with EU and, on the other hand, to maximize the opportunities and eliminate the uncertainty about medium and long-term perspectives related to AA/DCFTA impact.

II. Recommended Approach to the Implementation of AA/DCFTA in the Transnistrian Region

Based on the key peculiarities of the Transnistrian economy described above, this section proposes the key components of the approach towards AA/DCFTA implementation in the Transnistrian region. It underlines the fact that AA/DCFTA implementation in the region is a “mission possible” if and only if we find answers to three crucial questions: (i) How to ensure a constructive dialogue given EU-skeptical attitude in the region? (ii) How to downsize the immediate costs of trade liberalization? (iii) How to mitigate the uncertainty about medium and long-term opportunities of AA/DCFTA?

How to ensure a constructive dialogue given the EU-skeptical attitude in the region?

The dialogue between Chisinau and Tiraspol should be completely freed of “sensitive terminology”.

Sometimes, the most difficult problems have the most simple and straightforward solutions. Given the high political, ideological and economic affiliation of the region’s authorities to the Russian sphere of influence, it is necessary to simply refrain from any “sensitive terminology” (e.g. AA/DCFTA, EU, European integration or liberalization etc.) in the discussions with the Transnistrian authorities.

At the same time, it is necessary to concentrate on a clear roadmap about the implementation of the most basic technical requirements that, on the one hand, would make the firms from the left-bank of Nistru to benefit of preferential access to EU, and on the other hand would not be perceived as part of the DCFTA commitments. It should be mainly focused on the technical collaboration between Chisinau and Tiraspol authorities on matters related to issuing certificates of origin, customs clearance procedures, sanitary and phytosanitary standards, competition policy, public procurement and fiscal policy. These are among the key preconditions to be implemented in order to be able to benefit from preferential access to the EU market. This roadmap could be elaborated jointly by the technical experts from both banks of Nistru, should contain clear deadlines and clear division of responsibilities between both parties.

How to downsize the immediate costs of trade liberalization?

It is necessary to amend the schedules of tariff-removals stipulated by the AA/DCFTA, by allowing longer transition periods for the most sensitive sectors of the Transnistrian region. Refraining from “all-or-nothing” rhetoric and adjusting the AA/DCFTA to the peculiarities of the Transnistrian economy could be a major step towards decreasing the EU-skepticism of region’s authorities. Given the fact that the “import tariffs” applied by the Transnistrian authorities are much higher than those applied on the right bank of Nistru, as well as the tight budgetary constraints amid economic recession, the pace of tariff liberalization should be slowed down for the most important imported goods from EU (textiles, footwear, leather, machinery and equipment, live animals and products of animal origin).

Obviously, this liberalization slowdown should not generate moral hazards for the Transnistrian policy-makers. Thus, the terms and stages of tariff liberalization should be clearly stipulated, while the amendment of the AA should be conditional on the cooperation of the Tiraspol authorities with Chisinau authorities on issues related to verification of rules of origin, customs clearance for goods entering and coming out of the region, EU quality standards, competition policy, public procurement and fiscal policy.

Implement a structural fiscal reform in the Transnistrian region. One of the direct causes of the high exposure of the region’s budget to trade liberalization is its high reliance on direct taxes: about half of budgetary revenues are coming from turnover tax applied to firm and personal income tax, while other 30%

are coming from custom duties and other taxes related to foreign trade. At the same time, the region does not apply the Value Added Tax, which on the one hand represents a huge forgone revenue for the region's budget (~USD 35-40 million annually⁷ – enough to cover the fiscal shock of trade liberalization); on the other hand undermines the competitiveness of exporters who cannot claim VAT refund, unlike their peers from the region's key trading partners. Therefore, the region should start a comprehensive fiscal reform, which could be based on two key elements:

- i. **Implementation of a transparent and simple VAT system.** In order to avoid a negative social shock, for the first five years, the goods that represent important shares in the consumer baskets of the poorest layers of the population (e.g. cereals, milk, bread, utilities) should remain VAT-free. Nevertheless, the region's authorities should have the vision to create, in a reasonable amount of time, a universal VAT system. Obviously, it should go in line with ensuring a simple mechanism for fiscal reporting, VAT refund and overall tax administration process.
- ii. **Ensuring the compatibility between fiscal systems on both banks of Nistru and aligning them to international standards.** This is related to the implementation of International Financial Reporting Standards, easing the process of VAT refund and customs clearance procedures, introducing ICT tools and one-stop shops, improving the transparency and predictability of the fiscal policy etc.

Moldova's development partners should support the fiscal reform on the left-bank of Nistru. The European Union, World Bank, European Bank for Reconstruction and Development and other key development partners should consider providing technical and financial assistance to designing and implementing the fiscal reform in the region. As noted previously, this cooperation should remain at the technical level.

How to mitigate the uncertainty about medium and long-term opportunities of AA/DCFTA?

Switch the focus from EU values to EU "valuables". In order to sell easier the AA/DCFTA to the Transnistrian authorities, population and firms, it is necessary to concentrate mainly on tangible and immediate benefits and opportunities associated with it. Particularly, it is related to establishing a functional and transparent mechanism that would allow the SMEs from the Transnistrian region, just like any SME from the rest of the country, to benefit from the Program of Competitiveness of Enterprises and Small and Medium-sized Enterprises 2014-2020 (COSME), Enterprise Europe Network, Erasmus for young entrepreneurs and the financing agreement in agriculture and rural development – ENPARD. Additionally, it is necessary to increase the level of understanding and awareness about the opportunities of these programs about the SMEs, farmers and general population from the region.

Create a platform comprising non-political policymakers and SME representatives from both sides of Nistru to discuss mechanisms of extending EU programs in the Transnistrian region. This platform should focus on removing or easing the technical and bureaucratic constraints that currently impede local firms and individuals to take a larger advantage of opportunities offered by EU programs. The platform should also contribute to increasing the level of information and awareness about these programs in the region among policy makers, SMEs and general population.

⁷ In case of 20% VAT.

III. Conclusions

In conclusion, the implementation of the AA/DCFTA in the Transnistrian region is conditional on the mutual compromise between Chisinau/Brussels and the region's authorities. We believe this is the most realistic approach that takes into account the special statute of the region, as well as the peculiarities of the Transnistrian economy. The reality is that the Russian influence in the region is too strong for the "all-or-nothing" rhetoric regarding the AA/DCFTA implementation in the region. Failure to accommodate to this reality could turn into further economic and political isolation of the region, with major economic and social repercussions for the local firms and population, for whom the government of the Republic of Moldova is responsible, both from the constitutional and moral points of views.

The mutually beneficial compromise for AA/DCFTA implementation in the region should be composed of the following key responsibilities that should be undertaken immediately by both parties:

Chisinau/Brussels authorities:

- Winding down the "all-or-nothing" rhetoric and accepting a gradual implementation of the AA/DCFTA in the Transnistrian region;
- Slowing down the pace of tariff liberalization for the most important imported goods from EU (textiles, footwear, leather, live animals and products of animal origin).
- Offering technical and financial assistance for designing and implementing harmonization reforms in the Transnistrian region in the following priority sectors: issuing certificates of origin, customs clearance procedures, sanitary and phytosanitary standards, competition policy, public procurement and fiscal policy;
- Refraining from sensitive terminology (e.g. AA/DCFTA, EU, European integration or liberalization etc.) in the discussions with the region's authorities;
- Supporting the extension of EU programs in the region, specifically for: Program of Competitiveness of Enterprises and Small and Medium-sized Enterprises 2014-2020 (COSME), Enterprise Europe Network, Erasmus for young entrepreneurs and the financing agreement in agriculture and rural development – ENPARD.

Tiraspol authorities:

- Take active part in the technical collaboration with Chisinau authorities on matters related to issuing certificates of origin, customs clearance procedures, sanitary and phytosanitary standards, competition policy, public procurement and fiscal policy.
- Implement a fiscal reform that would be based on two key pillars: (i) implementation of a transparent and simple VAT system; and (ii) ensuring the compatibility between fiscal systems on both banks of Nistru and aligning them to international standards.
- Adjust the customs clearance procedures, sanitary and phytosanitary standards, competition policy, public procurement and fiscal policy to EU norms and standards.
- Start the gradual removal of import tariffs, based on the updated schedules agreed with Chisinau and Brussels authorities.
- Support the informational and awareness-raising campaigns in the region about the opportunities to take part of the EU programs: Program of Competitiveness of Enterprises and Small and Medium-sized Enterprises 2014-2020 (COSME), Enterprise Europe Network, Erasmus for young entrepreneurs and the financing agreement in agriculture and rural development – ENPARD.

Annex A

Table 1. Balance of payments, Transnistrian region, USD million

	2012	2013	2014
I. Current account	-953	-878,5	-849,7
Goods and services	-1 172,60	-1 118,40	-1 043,30
A. Goods	-1 132,30	-1 092,10	-963,9
<i>export</i>	<i>653,30</i>	<i>556,40</i>	<i>677,70</i>
<i>import</i>	<i>1 785,60</i>	<i>1 648,60</i>	<i>1 641,60</i>
B. Services	-40,3	-26,3	-79,4
<i>export</i>	<i>55,6</i>	<i>68,3</i>	<i>65,6</i>
<i>import</i>	<i>95,9</i>	<i>94,6</i>	<i>145</i>
C. Primary incomes	-33,3	-24,6	6,6
<i>received</i>	<i>28,8</i>	<i>32,6</i>	<i>58,1</i>
<i>paid</i>	<i>62,1</i>	<i>57,2</i>	<i>51,5</i>
D. Secondary incomes	252,9	264,5	187
<i>received</i>	<i>294</i>	<i>312,4</i>	<i>277,4</i>
<i>paid</i>	<i>41,1</i>	<i>47,9</i>	<i>90,4</i>
II. Capital account	0	0	0
III. Financial account	-767,4	-767,2	-960,3
Direct investments	-13,4	-61,2	-96,8
<i>net purchases of financial assets</i>	<i>0,1</i>	<i>0,3</i>	<i>0,7</i>
<i>net financial liabilities</i>	<i>13,6</i>	<i>61,5</i>	<i>97,6</i>
Portfolio investments	7,4	1	-0,6
<i>net purchases of financial assets</i>	<i>7,4</i>	<i>1</i>	<i>-0,6</i>
<i>net financial liabilities</i>	<i>0</i>	<i>0</i>	<i>0</i>
Other investments	-838,6	-673,2	-851,7
<i>net purchases of financial assets</i>	<i>10</i>	<i>-0,4</i>	<i>-73,3</i>
<i>net financial liabilities</i>	<i>848,6</i>	<i>672,8</i>	<i>778,3</i>
Reserve assets	77,2	-33,8	-11,2
IV. Net errors and omissions	185,7	111,4	-110,7

Source: "Republican Bank of Transnistria"

Annex B

Table 2. Budgetary revenues of the Transnistrian region, 2014

	Millions of "Transnistrian rubbles"	Share in total, %
Revenues	2 919,50	100
1. Fiscal revenues	2 316,00	79,3
firms' turnover tax	748,2	25,6
income tax	441,3	15,1
custom duties	696,1	23,8
2. Non-fiscal revenues	65	2,2
3. Revenues of special funds	326	11,2
4. Revenues from entrepreneurial and other activities	212,4	7,3

Source: Own calculations based on "Republican Bank of Transnistria" data

Table 3. Budgetary revenues of the Transnistrian region, 2014

	Millions of "Transnistrian rubbles"	Share in total, %
Expenditures	3 844,40	100
1. Ensuring the functioning of the institutions	232,7	6,1
2. Law enforcement and security	402,4	10,5
3. Human capital	1 971,90	51,3
4. Support to selected "state enterprises"	85	2,2
5. Financial support to local budgets	155,5	4
6. Targeted programs	17,8	0,5

Source: Own calculations based on "Republican Bank of Transnistria" data