

WITH REGARD TO MOLDOVA'S INTEGRATION OPTIONS: QUO VADIS AGRI-FOOD TRADE?

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Abstract

During the period 2010-2013 the Republic of Moldova launched a number of initiatives for the development of its trade policy in order to ensure a more facilitating legal framework for the implementation of economic and trade relations with key external partners. An agreement on the creation of a free trade area in the CIS was signed in this period. Similarly, the Republic of Moldova started negotiating the Association Agreement with the European Union, which was initiated in November last year and is part of the Deep and Comprehensive Free Trade Agreement (DCFTA). This article aims to assess the main effects of signing the Association Agreement for Moldovan agricultural sector while examining its reaction if Moldova would choose integration into Russian Federation, Belarus and Kazakhstan Customs Union.

Keywords: free trade agreement, export, import, agri-food trade, customs union.

JEL classification: F13, F15, Q17

1. Introduction

In the recent years the agricultural sector of the Republic of Moldova has become a real concern for public authorities responsible for policy development and sector monitoring as well as for entrepreneurs and population engaged in this sector. The negotiation, initialing and preparation for signing the Association Agreement have increased the concerns for this sector, particularly for the way in which it will meet the challenges of symmetric liberalization of foreign trade with European Union countries and Turkey. The significance of these measures is more important than trade relations facilitation because it aims at speeding up structural reforms and overcoming the transition stage of the national economy. At the same time, the Association Agreement is also important for the national economy as much responsibility is required on behalf of national authorities and the entire civil society for its proper implementation. Along with the intensification of the liberalization process many sectors of the economy will face a number of challenges to increase competitiveness and ensure resistance to foreign competition. One of the most threatened sectors, considered of special importance in the negotiations is agriculture, which continues to play an important role in the national economy.

2. Problem awareness stage

Given the subject of analysis of this study, it is important to understand the distinction between the Free Trade Agreement (FTA) and the Customs Union (CU).

The Free Trade Agreement is a preferential trade agreement representing one of the early forms of economic integration. It may involve two or more partners who are committed to eliminate tariff and mostly, non-tariff barriers in mutual trade whilst retaining its autonomy in the development of customs tariffs in the relations with third countries/non-members (WTO Glossary), as well as promoting other trade policy issues including participation in other forms of integration [3].

The Customs Union implies a higher level of integration compared to FTA. Besides the maximal elimination of tariff and non-tariff barriers to trade, participants to the agreement that usually are geographically adjacent countries shall adopt a common customs tariff reaching a consensus on the degree of protection of all sectors. Therefore, the negotiation and implementation of a CU involves increased efforts in terms of time, financial resources and political concessions. By adhering to CU, a state loses a large part of its autonomy to develop its trade policy [2].

3. Material and method

The objective of this study is to assess the main effects of signing the Association Agreement on the Moldovan agricultural sector while examining its reaction if the Republic of Moldova would have opted for integration into the Russian Federation, Belarus and Kazakhstan Customs Union. During the investigations the following study methods were used: a) statistical method, involving researching a larger number of observations and analysis of economic indicators growth rate; b) theoretical synthesis, formulation of judgments. The information was gathered from the following sources: World Bank, World Trade Organization UNCTAD, WITS and the National Bureau of Statistics of the Republic of Moldova.

4. Results and discussions

Compared to other countries in the region, the contribution of agricultural sector to GDP growth is significant. According to the National Bureau of Statistics, in 2011 the share of agricultural sector (added value) in GDP exceeded the level of 12%, foods and beverages industry constituted about 4.5 % of GDP and more than a quarter of the added value created by the industry. The value added in industry was lower than in the agricultural sector, about 11.4% of GDP.

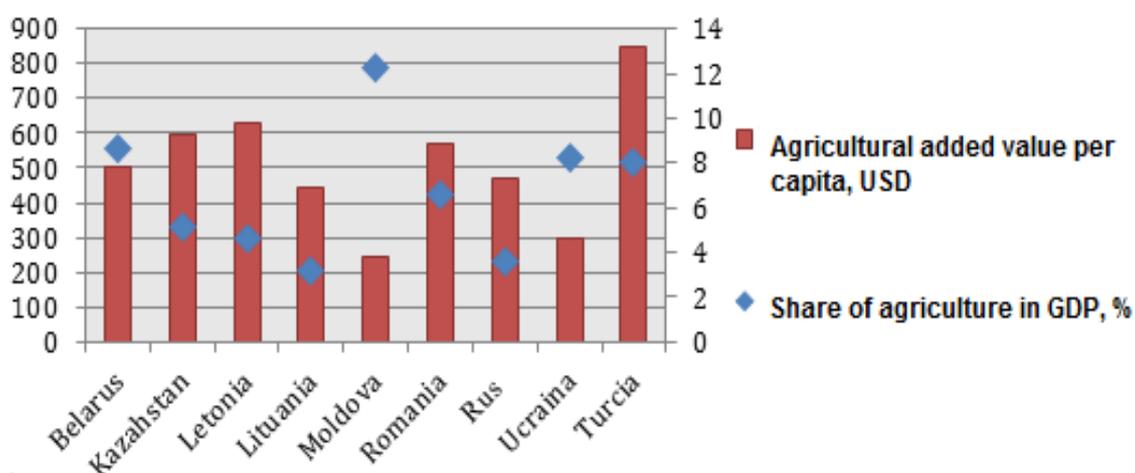


Figure 1: Share of agriculture in GDP and added value created in the sector per capita, 2011
Source: UNCTAD data.

The contribution of agriculture to GDP growth in the Republic of Moldova is significant, although it has been decreasing in recent years. Similarly, as also indicated by data in Figure 1, despite the high share in GDP compared to Central and Eastern European countries, the added value created in the sector reported per capita in the Republic of Moldova is much lower.

Given the still high share of agriculture in GDP, in the Republic of Moldova a moderate but positive correlation between the growth of added value in agriculture and GDP growth can be observed (Figure 2). In 2007-2012, the correlation coefficient between these two variables was 0.57.

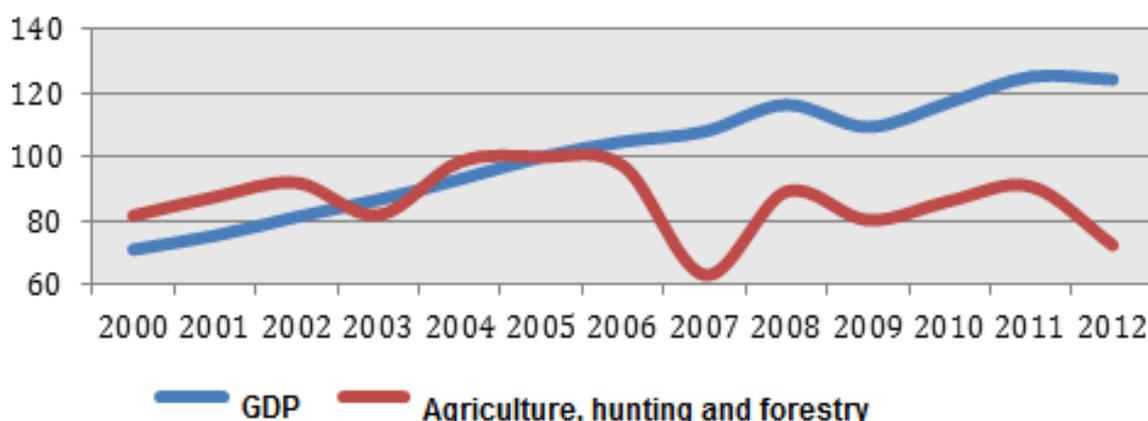


Figure 2: Evolution of added value in agriculture sector, 2005=100%

Source: According to the National Bureau of Statistics of the Republic of Moldova.

In order to assess the competitiveness of agri-food exports to Western market and Customs Union trading partners in the Eastern area, the index on concentration and diversity of products exported from the point of view of the number of product categories exported in a disaggregated way at the level of 4 digits according to the Harmonized System Classifier (HS) on both markets, including Turkey (Table 1), was calculated.

In 2012, 78.4% of total exports of agri-food products, corresponding to 688.9 million USD were exported to the Customs Union, European Union and Turkey. Separately, 37.9% of exports of this product category were delivered to the Customs Union market, 38.6% to the EU and 1.8% to Turkey.

Table 1: Number of products exported according to HS disaggregated at 4 digit level (2012)

	Customs Union	Belarus	Kazakhstan	Russia	Turkey	EU 27	Worldwide
Total number of products exported	121	121	121	121	121	121	121
Number of positions to the respective destination	71	37	36	62	15	76	121

Source: Author's calculations according to WITS data.

First of all, it should be mentioned that the value of exports is distributed more or less equally between East and West. At the same time, in the Customs Union consisting of three member countries approximately 71% of the agri-food products are going to the Russian Federation, and with regard to European Union, in 2012, half of the exports were delivered to three main markets - Romania, Italy and Poland.

Table 2 shows the results of calculating trade specialization index performed based on HS classifier disaggregated at 4 digit level using Bella Balassa's formula. The index is calculated by dividing a country's sectors share to total trade, on the one hand, and the share of world exports in the corresponding sectors in the worldwide total exports, on the other hand (International Trade Center).

According to RCA index, the number of tariff headings for which the country has a revealed comparative advantage in worldwide trade is very limited - 17 out of 121 categories exported by the Republic of Moldova and 196 by the countries worldwide in 2012. At the same time, these are products for which Moldovan exporters have a comparative advantage over all analyzed partners.

Table 2: Products in the trade of which the Republic of Moldova has a revealed positive comparative advantage worldwide and in relation to the partners from the Customs Union, European Union and Turkey (2012)

	Worldwide	Customs Union	Belarus	Kazakhstan	Russian Federation	EU 27	Turkey
1206	13.0	165.8	1747.0	212.9	148.2	82.7	50.7
2307	5.6	+	+	+	+	45.3	201.1
0802	5.2	1180.4	2197.6	1130.3	1142.9	129.0	5.7
1512	4.6	14.5	385.7	85.8	11.8	68.9	13.6
0809	3.6	2094.6	147.7	39983.2	215273.2	28.9	8.4
2204	2.7	10101.5	1826.8	145838.1	13185.6	15.8	1081.6
0808	2.7	291.2	20.8	23170.4	9602.9	24.8	60.0
0205	1.7	766.9	+	+	606.9	14.1	+
2001	1.7	78.2	7.2	1817.6	253.4	16.6	1.6
2208	1.4	75.7	37.5	1834.5	70.2	8.4	161.5
2009	1.4	210.5	222.1	1219.1	183.0	12.6	11.3
2206	1.3	435.2	55.2	+	762.1	9.4	814.1
2306	1.3	7.5	22.7	11.7	6.6	16.1	214.3
1703	1.1	7.7	10.6	18.9	6.8	20.0	2818.2
0806	1.1	1020.5	135.5	496.6	4232.9	16.6	1.5
2105	1.0	30.1	9.9	582.9	30.5	5.4	9.4
2005	1.0	71.2	30.4	1074.9	68.1	7.4	5.5

Source: Author's calculations according to WITS data.

Note: Those positions for which the comparative advantage of the Republic of Moldova compared to partners referred items mainly from the lack of exports of these countries as per respective tariff headings were marked with “+”.

Summarizing the main performance of agri-food products exports to these three destinations several general trends can be outlined.

The Customs Union is the traditional market available for the sale of more than a third of Moldovan exports of agri-food products and reduced imports from this destination allows to maintain a positive trade balance which value exceeded 200 million USD in 2010-2012. However, bilateral trade with these countries experienced a noticeable slowdown in recent years; the average annual growth in 2006-2012 placing it well below the overall average. Similarly, high geographic concentration determines a high volatility of exports to the Customs Union.

Currently, foreign trade between the Republic of Moldova and the European Union takes place within an asymmetric preferential trade regime, meaning “0” tariff for agri-food products exported to these destinations, with some exceptions:

- Products of animal origins, cereals, white sugar and grape wine are allowed to be exported within the established tariff quotas;
- Fruits and vegetables exempted of VAT payment at import. At the same time, many of these products are subject to a minimal price of entry at import [4].

Several previous studies indicate that even in these conditions local exporters cannot fully benefit from the existing preferential regime. The biggest constraint in this regard is their low capacity to adjust to European quality standards. Although there are many years since the Republic of Moldova started upgrading its quality infrastructure this process is still costly and time consuming.

Including the above reason, the agri-food industry has been given a special role in negotiating the agreement, regarding import both in the Republic of Moldova and in the EU.

Although competitive pressure is expected to bring benefits to local consumers, this might also influence their income levels given a high level of population employment in agriculture. Removal of any protection tools for this sector without increasing its immunity could cause higher unemployment and relatively low qualifications as well as reduced training of workers could create problems in their re-orientation toward other sectors.

As an alternative to creating a DCFTA with the European Union we considered appropriate the assessment of the effects that could be generated by the accession of the Republic of Moldova to Russia, Kazakhstan and Belarus Customs Union. Even now this issue is one that causes many discussions.

Unlike commercial relations with Western partners, the preferential trade regime with the member countries of the Customs Union is symmetrical, implying free access to mutual markets. In this context, according to the existing empirical evidence it is unlikely that the adherence of the Republic of Moldova to this structure could create new trade flows in the mutual trade - a term defined in the literature as trade creation effect.

About 38% of agri-food products, traded outside the Republic of Moldova, are exported to the Customs Union market [6]. This is an exclusive market for the sale of several plant and meat products. And joining the Customs Union involving immediate abolition of controls at the internal borders could contribute to the facilitation of trade for these product categories. Similarly, elimination of export duties of the member countries for various fuels, especially for the Russian natural gas, could reduce costs for farmers.

However, if the Republic of Moldova accedes to the Customs Union certain costs resulting from this process should be taken into account.

1. First of all, considering that joining the Customs Union would mean a common customs tariff and trade regime, CU membership is incompatible with DCFTA, which the Republic of Moldova intends to sign with the European Union. Similarly, it could most likely have the effect of non-renewal of autonomous trade preferences granted by CU markets, which would significantly affect exports of agricultural products on the Western market. In this way, if currently, with certain exceptions, within the autonomous trade preferences the exports of agri-food products enjoy free access to the EU market then the cancelation of trade preferences would mean imposing on Moldovan products entering the EU market an average tariff of about 13.2 %.

2. Exports of agri-food products to CU reflect a high degree of geographical concentration, thus increasing the volatility of exports and sector activity to various external shocks. And as shown by

2006 experience, such shocks can sometimes have fatal consequences on some sub-sectors of agriculture and food industry.

3. Reduction of productivity in the sector, as a result of increased customs tariffs for industrial products, including capital imported from third countries so necessary for the technical endowment of the sector.

5. Conclusions

The dilemma between East and West for the Republic of Moldova is a topic that has seen many debates in recent years. Currently, the Republic of Moldova is on the eve of signing a Deep and Comprehensive Free Trade Agreement with the European Union that will put on an equal footing two important economic partners, being able to exploit the opportunities offered by the preferential trade arrangements and close cooperation with both.

At the same time, we have addressed this issue in the context of agri-food sector development prospects, considering it as still an important one, or neglecting it could have adverse effects on the sector if potential risks are not acknowledged.

Agriculture is one of the sectors that still provide a major contribution to the growth of the national economy. At the same time, in recent years, its evolution indicates a relatively high volatility, which also caused large oscillations in economic growth rates.

For this reason, but also due to the importance of this sector to ensure development of rural areas and country's food security, agricultural development must have a special place in the economic policy of the state.

Regeneration of the sector and increase of its competitiveness abroad requires some radical measures that would produce changes in its structure. Signing the Association Agreement with the EU could serve as an instrument to stimulate this process, but the DCFTA establishment will present some challenges for the sector, which should be properly addressed, for not turning them into risks.

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