

Trade relations of the Republic of Moldova with the Russian Federation: from dependence to export reorientation

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Abstract: This article analyses the evolution of bilateral trade relations, registered over the last 20 years, between the Republic of Moldova and the Russian Federation, revealing the existing impediments to their optimal development. Trade relations between these two countries entered the uncertainty zone in the last decade. They are significantly affected by the political tensions between the Republic of Moldova and the Russian Federation, which generated the application by the Russian Federation of embargoes, prohibitions and import taxes on Moldovan products. The high share of Moldovan exports oriented to a single market destination - the Russian Federation, revealed the Moldova's commercial dependence on it until 2014, when exports have been reoriented to the EU following the signing of the Association Agreement. However, taking into account the dependence of the Moldovan economy on the Russian Federation's mineral resources and the Russian market size, which cannot be neglected, Moldova must strive to normalize economic relations with this country.

Key-Words: trade relations, Republic of Moldova, Russian Federation, economic crisis, embargo, Association Agreement with the EU

JEL codes: F18, F21, F51

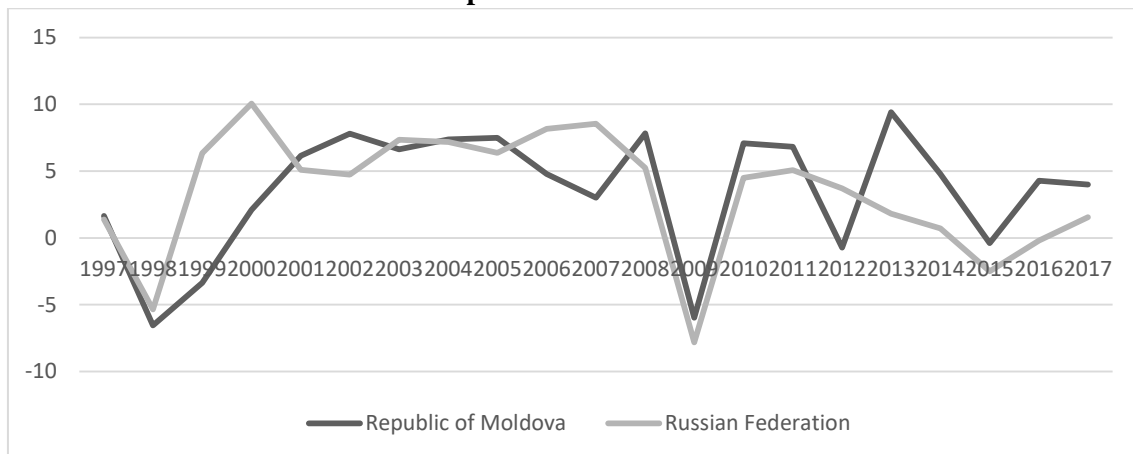
1 Introduction

The economic cooperation between the Republic of Moldova and the Russian Federation, as independent states, after the dissolution of the USSR, has been initiated when the Protocol on the extension of the Commonwealth of Independent States (CIS) has been signed, on December 21, 1991. Subsequently, several agreements that established economic and trade relations between the two countries, such as the Intergovernmental Agreement on commercial and economic cooperation of 1993, the Agreement on avoidance of double taxation and prevention of tax evasion of 1996, the 1998 Industrial Cooperation Agreement and the 1998 Mutual Investment Promotion and Protection Agreement were signed. In 2008 the governments of both states have developed the Economic Cooperation Program between the Republic of Moldova and the Russian Federation for the period 2009-2020, which established the directions for the development of mutually beneficial economic relations and bilateral trade of goods. In 2011, the Agreement on Participation of the Republic of Moldova in the Free Trade Area of the CIS (Free Trade Area) was signed, replacing the existing bilateral and multilateral free trade agreements between the signatory countries of this agreement and eliminating tariff barriers to foreign trade. In 2014, the Republic of Moldova made the decision to sign the Association Agreement and the Deep and Comprehensive Free Trade Area (DCFTA) with the EU, which does not contradict its participation in the CIS Free Trade Area.

Although almost three decades have passed since the collapse of the USSR and the adoption of the Declaration of Independence of the Republic of Moldova, the common historical past of the Republic of

Moldova and the Russian Federation continues to influence the development of bilateral trade relations. The historical belonging of the Republic of Moldova to a centralized economic system managed by Moscow determined the country's commercial orientation especially to the Russian Federation. Over a period of almost two decades, the volume of Moldovan exports was driven by exports to the Russian market, being determined by the geographical proximity and the significant size of the Russian Federation's market. In these circumstances, any negative evolution of the economic situation of the Russian Federation has affected the economic situation of the Republic of Moldova. The Republic of Moldova's GDP growth rate has evolved almost similar to that of the Russian Federation (Figure 1).

Figure 1: Evolution of GDP growth rate in the Republic of Moldova and the Russian Federation for the period 1997-2017

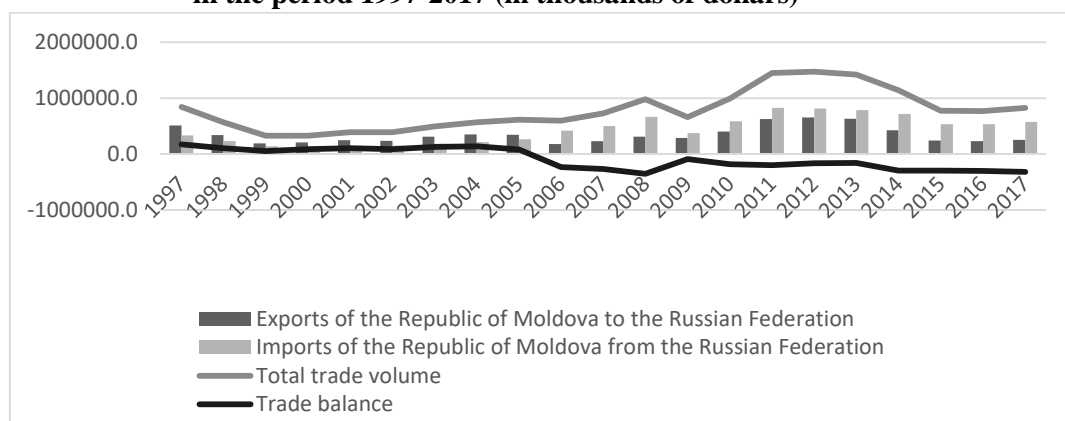


Source: Representation of the authors based on data from the International Monetary Fund (IMF, 2018).

The evolution of trade between the Republic of Moldova and the Russian Federation has experienced significant fluctuations over the past 20 years, from a minimum value of 30 million dollars in 1999 to a maximum of 1472 million dollars in 2012. Between 1998-1999, as a result of the financial crisis from Russia, which significantly undermined consumption, bilateral trade fell by 32% and 42% in 1998 and 1999 respectively. In 2009 the bilateral trade contracted again (by 33%), when the economy of the Russian Federation slipped into another recession (Figure 2).

In the period 2014-2016, the Russian economy faced a new economic crisis caused, on the one hand, by the imposition of economic sanctions by international community as a result of the annexation of the Crimea, while, on another hand, by the collapse of the world crude oil price in the second half of 2014. These events caused a decline in economic growth, depreciation of the Russian ruble, destabilization of the financial system, and a severe disinvestment process in the Russian Federation in 2014 (IMF, 2015). In this case, the bilateral trade with the Republic of Moldova was also affected, decreasing for the three consecutive years (Figure 2).

Figure 2: Evolution of the bilateral trade between the Republic of Moldova and the Russian Federation in the period 1997-2017 (in thousands of dollars)



Note: ¹The data of the National Bureau of Statistics of the Republic of Moldova do not include information about the Transnistrian region.

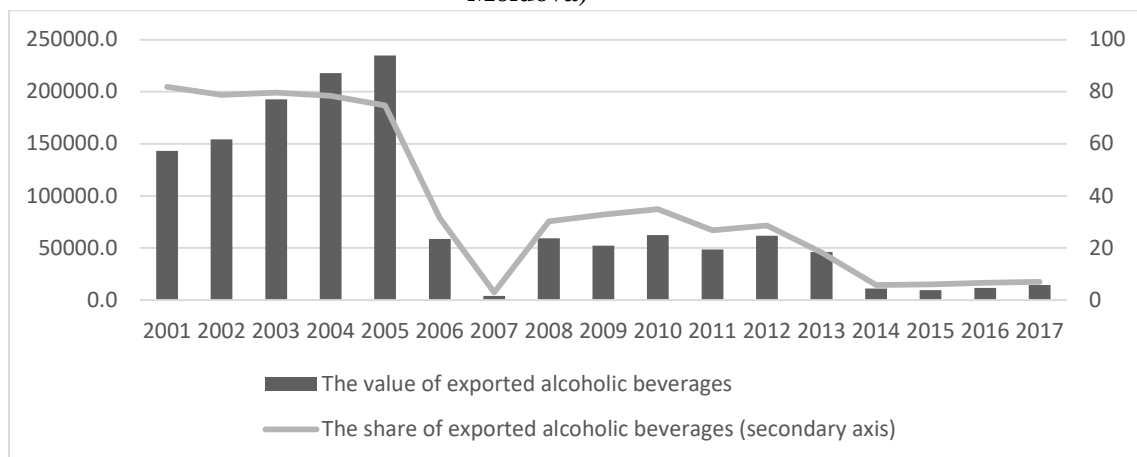
Source: Representation based on the authors' calculations and data of the National Bureau of Statistics of the Republic of Moldova (2018)

2 Impact of trade embargos on Moldovan exports

Bilateral trade between the Republic of Moldova and the Russian Federation has been affected in the past two decades not only by the crises that the economy of the Russian Federation has suffered, but also by the embargoes imposed by Russian authorities on Moldovan imports and by the application of some opaque game rules in the conduct of commercial relations.

The most significant embargo, which triggered a nearly 50% contraction of Moldova's total exports to the Russian Federation, causing a negative trade balance, was the one applied in 2006 to imports of Moldovan wines, due to the Federal Service for Consumer and Welfare Protection "Rospotrebnadzor" motivation that these would be of poor quality and harmful for consumption. However, according to some experts, the embargo was a response to the delay in signing by the Moldovan government of the bilateral agreement with the Russian Federation, necessary to the Russian Federation to join the World Trade Organization¹. This embargo has caused a sharp decline in the value of Moldovan alcoholic beverages exports to the Russian Federation, with the role of the Russian market shrinking from 74% in 2005 to just 2.9% as total weight in 2007 (Figure 3). Subsequently, after the lifting of the embargo, exports of alcoholic beverages targeted to the Russian Federation no longer reached the values similar to the 2001-2005 period, mainly due to the reorientation of these exports to other markets.

Figure 3: Evolution of exports of alcoholic beverages¹ to the Russian Federation in the period 2001-2017 (in thousands of dollars and in % of the total value of alcoholic beverages exported by the Republic of Moldova)



Note: ¹According to the Nomenclature for the classification of goods of the Republic of Moldova, alcoholic beverages do not exist as a separate group. Therefore, the data presented in the Figure refers to the value of exports for the group of goods "Alcoholic, non-alcoholic and vinegar beverages".

Source: Representation based on the authors' calculations and data of the National Bureau of Statistics of the Republic of Moldova (2018)

In September 2013, another embargo on imports of all Moldovan wine products was introduced, and the low quality of these products was again raised. The embargo has triggered a contraction in Moldovan exports to the Russian Federation for three consecutive years, by 33%, 43% and 3% in 2014, 2015 and 2016 respectively. The consequences of these two embargoes were felt at the level of the whole viticulture sector of the Republic of Moldova. More than 80 wineries in the country have been bankrupted, the area of vineyards has decreased by almost 40%, seriously affecting the production chain (AllMoldova, 2017). The wine industry is

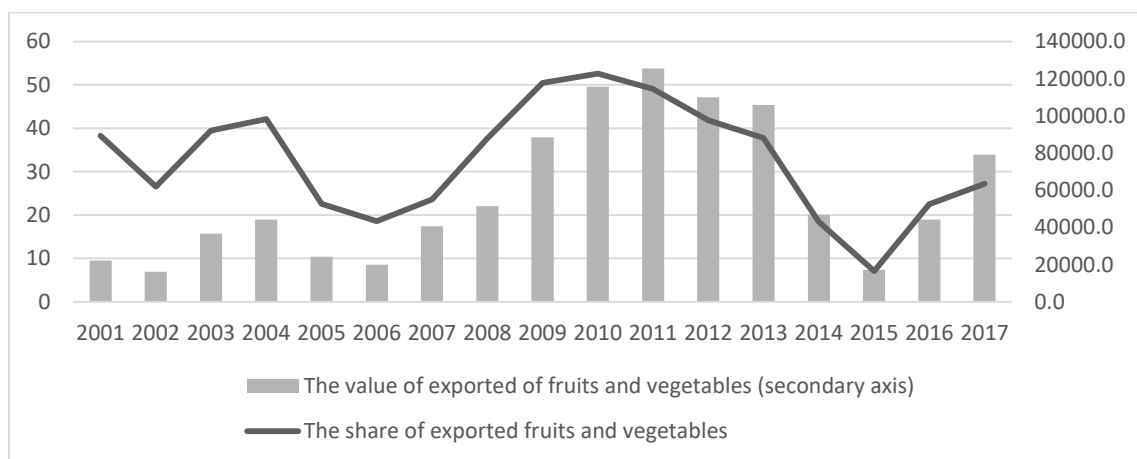
¹ Source: <https://echo.msk.ru/programs/beseda/47486/>

very important for the Republic of Moldova, the revenues generated by it providing about 10-15% of the national annual budget, and the incomes from the export of wine products represent up to 20% of the export revenues in favourable years (Ministry of Agriculture and Food Industry of the Republic of Moldova, 2013).

These embargoes have diminished the role of the Russian Federation as the main destination for the Republic of Moldova's wine exports, the share of exports of alcoholic beverages to this country in total exports of this group declining from 81% in 2001 to only 6,9% in 2017 (Figure 3). Exporters of wine products have shifted to other markets such as the EU, but also to countries such as China, Belarus and Ukraine.

In 2014, the Russian Federal Agency for Veterinary and Phytosanitary Surveillance "Rosselkhoznadzor" imposed a new embargo on the Republic of Moldova, this time on the import of processed meat, fruits and canned fruits and vegetables, invoking the violation of the phytosanitary requirements. Moreover, in the same year, the Russian Federation approved the imposition of import duties on 19 categories of the most exported Moldovan products, including wine, meat, vegetables, fruits and cereals (Government of the Russian Federation, 2014). This measure has been applied despite the fact that since 2011 the Republic of Moldova has signed the Agreement on Participation in the Free Trade Area of the CIS, according to which the Moldovan products exported to the Russian Federation were exempted from customs duties. The amount of import duties applied to Moldovan products was similar to that for countries not participating in this free trade area. As a consequence, the share of exports of fruits and vegetables oriented to the Russian Federation decreased from 37% in 2013 to 7% in 2015 (Figure 4).

Figure 4: Evolution of fruit and vegetables exports¹ in the Russian Federation in the period 2001-2017 (in thousands of dollars and in % of the total value of fruits and vegetables exported by the Republic of Moldova)



Note: The data presented in the Figure refer to the value of exports for the following groups in the Nomenclature for the classification of goods: "Vegetables, fruits or other parts of plants" and "Edible fruits and nuts; citrus peaches and melons".

Source: Representation based on authors' calculations and data of the National Bureau of Statistics of the Republic of Moldova (2018).

According to the National Bank of Moldova (2014), sanctions were imposed by the Russian authorities to protect the Russian market from European products that could reach Moldova through the Association Agreement signing with the EU. The issue of wine exports to the Russian Federation would have rather a political than a technical reason, the imposition of embargoes being used as a tool for promoting the political interests of the Russian Federation in the Republic of Moldova (Expert-Grup, 2010). The political character of the embargoes imposed by the Russian Federation was also confirmed by the Russian Deputy Prime Minister D. Rogozin in 2014 on the eve of signing the Association Agreement with the EU, arguing that Moldova's pro-European orientation decision was taken illegitimately without a referendum, and that the embargoes imposed are a reaction of the Russian Federation to such decisions (Kommersant, 2014). In addition, the awards won by Moldovan wines at international renowned exhibitions such as Decanter, Mondus Vini and International Wine

Challenge prove the opposite of the statements regarding the low quality of Moldovan winemaking (Acsa, 2017).

The rescue solution for the wine sector of the Republic of Moldova was represented by the entry into force of the Generalized System of Preferences (GSP) granted by the EU in 2006, immediately after the establishment of the Russian embargo, preference for doubling the quotas for the export of wine on the European market. In 2007, this system expanded (GSP plus), followed by the application of the Autonomous Trade Preferences in 2008. There were also several projects supported by international organizations, through which it was possible to increase the competitiveness of Moldovan products and to reorient their exports to other markets. Thus, in order to solve the structural vulnerabilities of the Moldovan wine industry and to increase the exports of wine products to other markets, in 2010, the Government of the Republic of Moldova and the European Investment Bank (EIB) restructured the Viticulture Sector Restructuring Program². In 2013, the National Vine and Wine Office was created through the public-private partnership with the support of USAID Moldova. Moreover, the Government of the Republic of Moldova ordered the establishment of the Vine and Wine Fund to financially support the development measures of the wine sector, formed by co-financing by the state and the private sector. With the help of this institution and the support of the Swedish Government and USAID, the unique brand Wines of Moldova was created and promoted. In addition, the European Union has taken the decision to double the export quotas for Moldovan fruits and has proposed the provisional application of the Free Trade Agreement with the EU. In the same year, the EU decided to fully open the Moldovan wine market, thus boosting wine exports from the Republic of Moldova, and thus ending the cycle of dependence of the wine industry on the East.

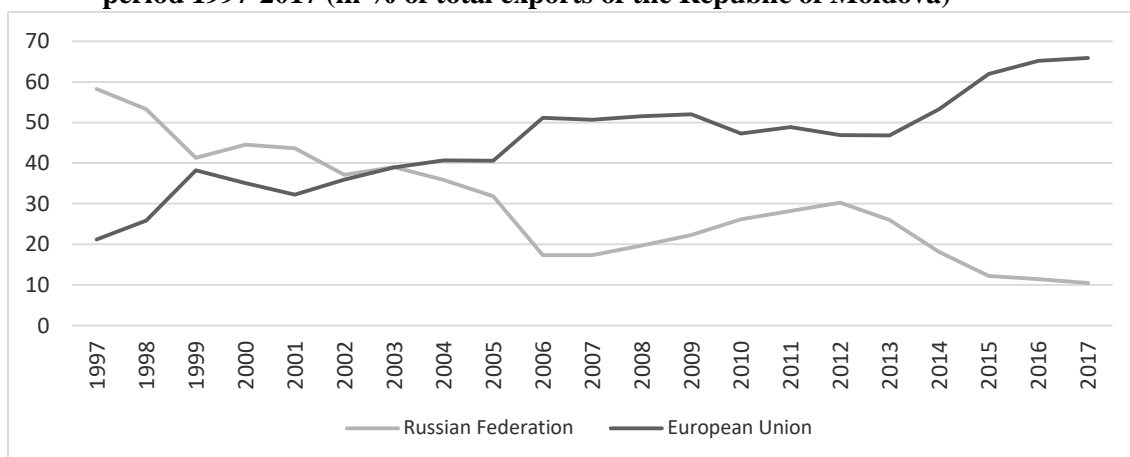
In order to increase the competitiveness of the agricultural sector and to diversify the markets, a series of projects were launched in 2014 with the support of external donors: The Livada Moldova Project, financed by a credit to the Government of the Republic of Moldova by the EIB; The Rural Inclusive Economic and Climate Resilience Program, funded by the International Fund for Agricultural Development, the Global Environment Fund and the International Development Agency of Denmark; The Competitive Agriculture Project, funded by the World Bank and the Global Environment Facility.

3 Diminishing the Republic of Moldova's commercial dependence on the Russian Federation

Considering the Russian embargoes and the actions of the Republic of Moldova to shift exports to European markets, the role of the Russian Federation as the main destination for Moldova's exports has gradually diminished. As a consequence of repeatedly imposed restrictions by the Russian Federation on the import of Moldovan products and the signing of the Association Agreement with the EU, the Moldovan exporters have gradually shifted to EU countries, the share of exports to this market increasing twice compared to 1997, from 21% to 65% in 2017. The share of exports the Russian Federation in total exports fell from almost 60% in 1997 to only 10% (Figure 5). The place of the Russian Federation was taken over in 2014 by Romania, which is currently the main trading partner of the Republic of Moldova.

² Under the Financing Agreement signed on November 23, 2010, the EIB grants the Republic of Moldova a loan of 75 million EUR to implement the Program. The objectives of the Program are: restructuring of the wine sector and related industries (production of packaging, labels, plugs, etc.); improving the quality and consistency of wine produced in Moldova from vineyard quality to final packaging and delivery of products; the diversification of the country's markets by ensuring the authenticity of the produced wine production. (Source: Ministry of Agriculture, Regional Development and Environment of the Republic of Moldova, 2018, <http://www.madrm.gov.md/en/content/rapoarte>)

Figure 5: Evolution of exports of the Republic of Moldova to the Russian Federation and the EU in the period 1997-2017 (in % of total exports of the Republic of Moldova)



Source: Authors' representation based on data from the National Bureau of Statistics of the Republic of Moldova (2018)

A comprehensive picture of the diminishing role of the Russian Federation as a market for the Republic of Moldova and of the decreasing economic dependence on the exports oriented towards this country is revealed by the share of Moldovan exports oriented to the Russian Federation in Moldovan GDP. Data show a decrease in this share from 17% in 2001 to just 2.6% of GDP in 2017 (Figure 6).

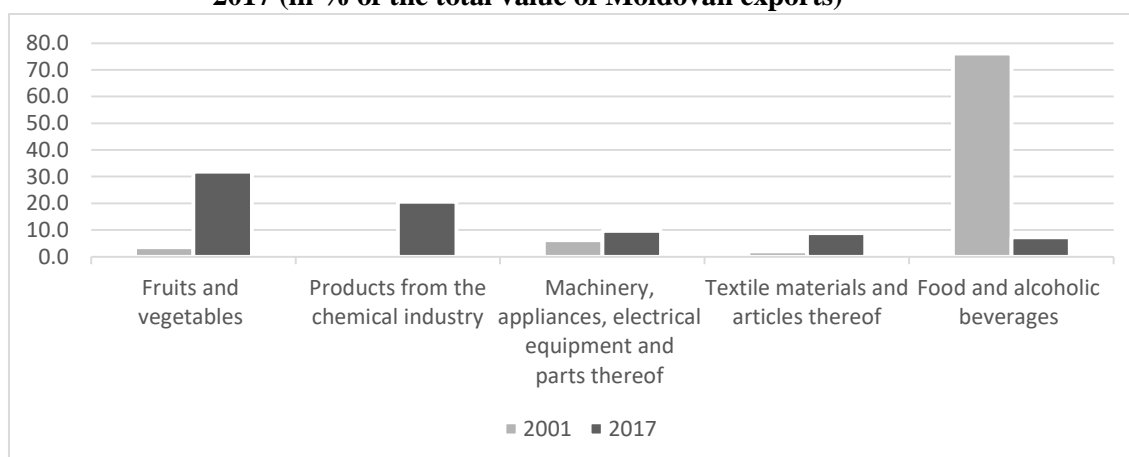
Figure 6: The share of Moldovan exports to the Russian Federation in 2001-2017 (in % of GDP)



Source: Authors' calculation based on data from the National Bureau of Statistics of the Republic of Moldova (2018)

The export structure of Moldovan products oriented to the Russian market has also changed, revealing that the basic exported products are now: fruits and vegetables (31%), products from the chemical industry (20%), machinery, appliances, electrical equipment and parts thereof (9%), textile materials and articles thereof (8.7%) and food and alcoholic beverages (7.3%) (Figure 7).

Figure 7: Products exported by the Republic of Moldova to the Russian Federation in 2001 and 2017 (in % of the total value of Moldovan exports)

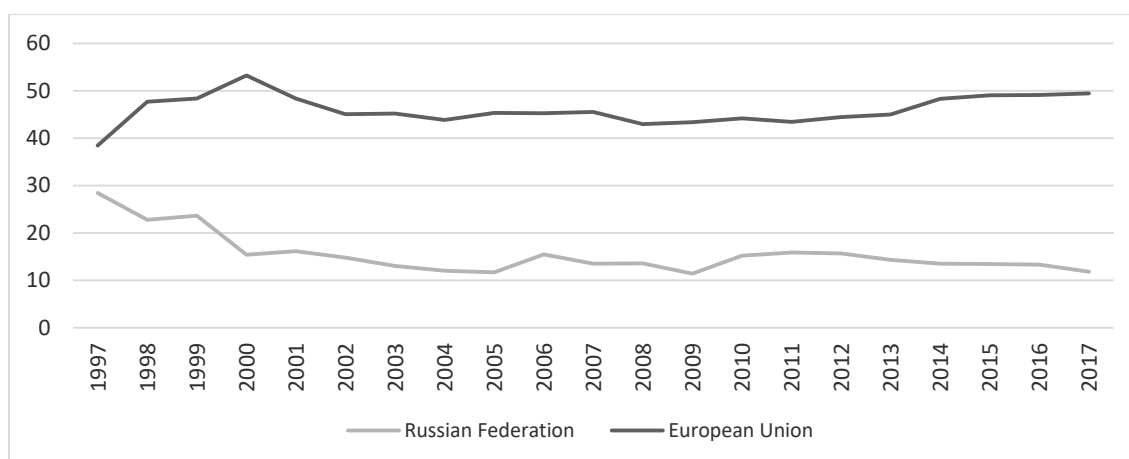


Source: Authors' calculation based on data from the National Bureau of Statistics of the Republic of Moldova (2018)

It can be noticed that the share of exports of food and alcoholic beverages in the total value of exports dropped significantly compared to 2001, thus, from the group with the largest share of 79%, it reached the fifth place, with a weight of only 7.3%. This decrease was largely determined by the embargoes imposed by the Russian Federation to Moldova since 2006 and by the reorientation of exports of this product category to the EU following the signing of the Association Agreement.

The share of imports from the Russian Federation into total imports of the Republic of Moldova decreased from 28% in 1997 to 12% in 2017, imports from the EU exceeding those from the Russian Federation over the entire period (Figure 8).

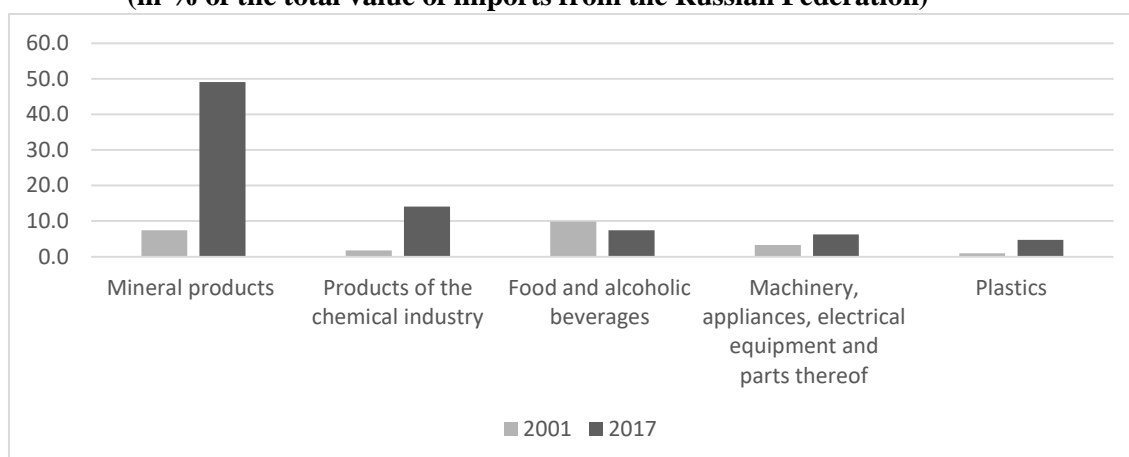
Figure 8: Evolution of Moldovan imports from the Russian Federation and the EU in the period 1997-2017 (in % of total exports of the Republic of Moldova)



Source: Authors' representation based on data from the National Bureau of Statistics of the Republic of Moldova (2018)

The structure of the products imported from the Russian Federation shows a high degree of dependence on mineral products (49%) (Figure 9). This dependence is suggested by the increasing path of minerals compared to 2001 values.

Figure 9: Products imported by the Republic of Moldova from the Russian Federation in 2001 and 2017 (in % of the total value of imports from the Russian Federation)



Source: Authors' calculation based on data from the National Bureau of Statistics of the Republic of Moldova (2018)

For the Russian Federation, the Republic of Moldova is not a vital economic and trade partner, but rather has a political role. The role of the Republic of Moldova as a market for exporters of the Russian Federation is insignificant, amounting to 0.18% of the total value of Russian exports, placing 49th in the list of countries of destination of the exports of the Russian Federation (Ru-Stat, 2018). Russian imports are almost similar in value, accounting for only 0.12% of the total value of Russian imports from the Republic of Moldova, ranked 63th in the list of partners exporting to the Russian Federation.

4 Conclusion

The analysis revealed that the trade relations between the Republic of Moldova and the Russian Federation entered the uncertainty zone in the last decade, being significantly affected by two factors: episodes of worsening of the economic situation of the Russian Federation which caused the contraction of the external demand but also political tensions between the Republic of Moldova and the Russian Federation, which generated the application by the Russian Federation of prohibitions and taxes on the import of a series of Moldovan products. The situation worsened even more especially following the signing by the Republic of Moldova of the Association Agreement and the creation of DCFTA with the EU, with bilateral trade entering on a downward slope since 2014.

The embargoes imposed by the Russian Federation since 2006, especially on Moldovan wines and subsequently on other agri-food products in 2013 and 2014, followed by the application of customs duties to imports of 19 categories of products, severely undermined the volume of trade between these two states. The biggest impact on Moldovan exports targeted to the Russian Federation was imposed by the embargo from 2006, when the trade balance of the Republic of Moldova with this country has entered a negative level. Although the embargo was lifted, exports of alcohol-based beverages to the Russian Federation have not yet reached values similar to the period from 2001-2005. These embargoes have led to a shift in the main destination for Moldova's wine products exports, while exporters of these products have oriented to other markets such as the EU. Moreover, the role of the Russian Federation as the main destination for Moldova's exports has gradually diminished, from 60% in 1997 to only 10% in 2016.

The rescue collar for Moldovan exports constituted the granting of EU Autonomous Trade Preferences immediately after the establishment of the Russian embargo in 2006, the signing of the Association Agreement and the creation of the DCFTA with the EU and the efforts made by the Moldovan authorities with the support of external donors, diversification of the markets and increasing the competitiveness of Moldovan products.

However, considering the size of the Russian market the value of which cannot be neglected (with a population of 146.8 million inhabitants) and the existence of a domestic market with limited absorption

capacity in the Republic of Moldova, the Moldovan authorities have to make efforts for the normalization of trade relations through the dialogue with the Moscow authorities. The trade relations of the Republic of Moldova with the Euro-Asian Customs Union in this context must be a priority, aiming at preventing the possible impediments that could arise from Moldovan exports by the Russian Federation or the other members.

Also, a solution related to the normalization of bilateral trade relations would be to increase the constant quality of Moldovan products exported to the Russian market in order to avoid factors that could constitute reasons for other restrictions imposed on imports by the Russian Federation. These actions are especially welcome in the context of the transition of the Republic of Moldova from an inertial growth model based on the consumption to an economic model based on the rapid growth of exports and on their structural diversification as the most appropriate option which the Republic of Moldova must follow.

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