



Institute of Economic Research Working Papers

No. 116/2015

**THE IMPACT OF INTEGRATION IN THE EUROPEAN
UNION ON THE DEVELOPMENT OF FOOD PRODUCTS
TRADE OF THE REPUBLIC OF MOLDOVA**

Silvia ZAHARCO

The paper submitted to

**VIIIth INTERNATIONAL CONFERENCE ON APPLIED
ECONOMICS
CONTEMPORARY ISSUES IN ECONOMY
under the title
MARKET OR GOVERNMENT?**

Institute of Economic Research and Polish Economic Society Branch
in Toruń

18-19 June 18-19, 2015, Toruń, Poland

Toruń, Poland 2015

© Copyright: Creative Commons Attribution 3.0 License

Silvia ZAHARCO

The State Agrarian University of Moldova, 44 Mircesti Str., 2049, Chişinău, The Republic of Moldova,

Phone: +373.22.432.387, Email: silviazaharco@mail.ru

THE IMPACT OF INTEGRATION IN THE EUROPEAN UNION ON THE DEVELOPMENT OF FOOD PRODUCTS TRADE OF THE REPUBLIC OF MOLDOVA

JEL Classification: *F15, Q17.*

Keywords: *trade; integration; agri-food sector; cooperation agreement; export; import.*

Abstract. *This paper presents a study of the development of foreign trade in agricultural products of the Republic of Moldova under the impact of EU integration. The agricultural sector has been and continues to be, traditionally, the main branch of the national economy. The average share of agriculture generates to 12% of GDP; in this sector almost half of the working population works. Thus, the development of the agricultural sector directly affects the living standards of the people employed in agriculture. However, the development of agriculture depends largely on agricultural production possibilities of sale on foreign markets, it depends on foreign trade.*

Introduction

The establishment of the Zone of Deep and Comprehensive Free Trade (DCFT) between Moldova and the European Community allows the access to the community market for most Moldovan food products. DCFT, as part of the European Association Agreement, involves increasing economic benefits for the Republic of Moldova. The EU gave to the Republic of Moldova a transitional period of up to 10 years to adapt national standards to the Community's standards. The sensitive Moldovan food products on the Community market are: corn, wheat, barley, white sugar, wine, meat and meat products, dairy products, egg production, certain fruit and vegetables. The food sectors that can easily adapt to the EU requirements are: horticulture (apples, pears), the wine sector (grapes and grape spirits), cereals, meat products, poultry and eggs. Much of the food products cannot be sold on the EU market (especially animal products except honey), because in most cases they do not meet the EU sanitary and phytosanitary standards, and domestic producers have difficulties in adapting them.

In this context, the aim of this article is to examine the impact of the EU integration on the development of trade in agricultural products of the Republic of Moldova, considering the fact that the need for the reorientation of the foreign trade of the Republic of Moldova from CIS to the EU is undeniable.

Methodology of the research

In order to characterize the evolution of agricultural products trade of the Republic of Moldova there were taken into account the data collected from The National Bureau of Statistics. The analysis period of the study comprised the years 2009-2014.

To analyze the process of trading with food products there was used the statistical method, by providing data on the level of marketing of agricultural products; the economic method was applied to research the issues related to food products marketing on foreign markets and the ways to boost external trade flows with domestic food products.

Paragraph

The economy of any country, regardless of its level of development and size, has connection with the outside world through the mechanism of foreign trade exchanges. Exports and imports have an impact on the exchange rate, interest rate, volume of aggregate demand, domestic prices, i.e. on the overall macroeconomic equilibrium. In this context, the country's ability to secure economic independence can be judged by its achievements in foreign trade section. For the Republic of Moldova, which is an agricultural country, agricultural products trade is a significant impediment on the national economy.

In the European Union, trade is the second sector of the economic activity, representing the main component of the system of measuring the level of economic development. The emergence of the single internal market of the European Union led to a more efficient allocation of production factors and to the strengthening of the investment climate. These phenomena have led to a substantial improvement of the economic performances in the Commonwealth area (Patriche et al., 2006, p. 345).

Trade relations Moldova - EU. At the base of RM-EU trade relations is the Generalized System of Preferences (GSP) given to the Republic of Moldova in 1999. According to this system, the exports to the EU had partial or total exemption of customs tariffs. Its basic condition has been the compliance with the EU rules concerning the principle of exports origin. The basic elements of the GSP are the following: the unilateral character of

the offered concessions; their relatively short duration; limited access to the markets of the importing countries (the range of goods to which the concessions were offered and tariff reduction margin); the instability of the offered concessions (the possibility of their withdrawal). For the Republic of Moldova the major problem is that GSP practically doesn't open access to the most protected markets, such as agricultural market. In 2000, Moldova received additional preferences for sensitive products.

Since 2006, Moldova has had benefits from a new Generalized System of Preferences (GSP +), which includes additional preferences for 2006-2015, granted to the developing countries and those in transition. This fact allowed to attract more foreign direct investments.

From the 1st of September 2014 there entered into force the Association Agreement between the Republic of Moldova and the EU and the Agreement of the Establishment of the Zone of Deep and Comprehensive Free Trade between the Republic of Moldova and the European Union. In 2014, the European Parliament adopted amendments to Regulation ATP (autonomous trade preferences) for the Republic of Moldova by introducing three new tariff quotas for duty-free fresh apples (40 000 tons), fresh table grapes (10 000 tons) and fresh plums (10 000 tons), in addition to the quotas proposed under the Agreement of Deep and Comprehensive Free Trade. The tariff quotas shall be retroactive starting with August 1, 2014 (considering the peak season of the three products) and by the end of 2015, when PCA regime expires. Signing the Agreement of Deep and Comprehensive Free Trade will generate benefits for agriculture and agri-food sector of the Republic of Moldova, such as: increasing the attractiveness of Moldovan agricultural products on the EU market, agricultural modernization and the improvement of working conditions, increasing the investment attractiveness of the agri-food sector, new market opportunities in the EU.

Conducting trade relations between Moldova and the EU, however, is affected by the barriers related to standards, customs procedures, trade regulation, patenting imports, limited access to the market, price fluctuations, etc.

Moldovan agri-food sector is crucial in trade relations with the EU. In order to export goods to European markets and to ensure food safety in the national food sector changes are required in the following domains: certifying the origin of goods, compliance with competition rules, and the control of compliance with sanitary and phytosanitary standards. Up to now, European norms and standards have been largely adopted. However, their implementation is a long and costly process, especially for animal production. At the same time, the adjustment to European standards means high costs for small producers.

Moldovan food products face a low competitiveness on the EU market. The identification of the most competitive and the least competitive Moldovan products is very important in trade relations between the Republic of Moldova and the EU. Thus, less competitive food products require a longer period of adaptation to European standards.

In comparison with the competitors in the EU and the neighboring countries that are in a more advanced stage of accession to the European single market, Moldovan farmers are disadvantaged in terms of the status and dynamic of the factors that determine competitiveness. Among them there are: the poor state of inputs (except land resources quality), low economic potential of the economic agents in the food industry, the unfavorable competitive environment, weak links with the processing industries, etc. However, the local prices are much lower than international ones, which lead to lower profitability of agriculture. As a result of market imperfections and inefficiencies there occur important profit transfers from farmers towards other trade network subjects. These distortions reduce agricultural incomes, conditioning an insufficiency of working capital and lack of new investments, which in their turn cause reduced productivity and poor quality products – uncompetitive on export markets (Perju et al., 2010, p. 33).

The Independent Analytical Center "Expert-Grup" from Moldova identified competitive and uncompetitive products under the "revealed comparative advantage index". This index is the ratio of the weight of a certain product in the structure of Moldovan exports and the share of this product in total EU exports structure. If this index is greater than 1, our country has the advantage over the EU and vice versa, if the index is less than 1, Moldova has the disadvantage over the EU (Lupușor, 2012, pp. 50-52).

The category of competitive goods includes the products for which Moldova has managed to get a more efficient specialization. Trade liberalization of these products can bring important benefits for exporters, in particular, and for the economy in general. The situation is different for the products that are not competitive on the Community market. Their manufacturers are affected by the influx of cheaper and more qualitative goods from the EU, particularly the producers from certain sensitive sectors, such as alcoholic beverages, tobacco and sugar (Table 1).

Table 1. The competitiveness of Moldovan agricultural products on the EU market

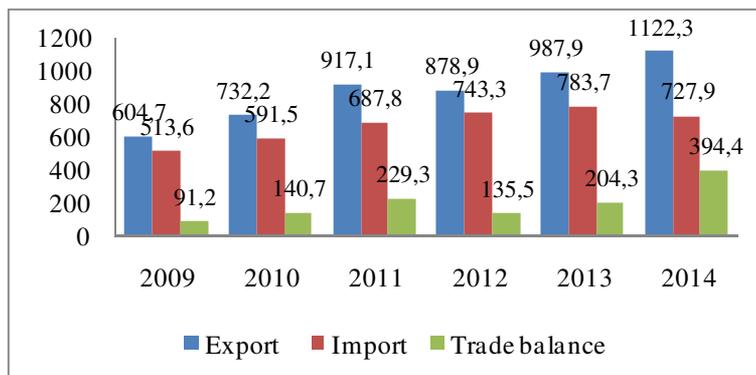
Competitive food products	Uncompetitive food products
Seed and sunflower seed oil	Concentrated or sweetened milk
Fresh and dry walnuts	Butter and other fats and oils derived from milk
Fresh and dry fruits	Cocoa food
Fresh and dry grapes	Confectionery (including white chocolate)
Juices	Bread and pastry
Corn seeds	Fresh plants
Seeds and rapeseed oil	Tobacco cigarettes
Molasses	Bottled water
Hides and skins of cattle and horses	

Source: Lupuşor (2012, p. 51).

From the table we can see that relatively competitive food products on the Community market have a lower degree of processing compared to the less competitive products. In most cases, the exported products are used as raw material in other EU countries. This shows the underinvestment, which does not allow technological modernization of the sector, which makes the firms export raw materials rather than process them on the place and then export the finished products.

Since 2006 the main market for Moldovan exporters has been the EU market due to the reorientation of the local trade from the CIS to the UE and due to granting GSP + and ATP to our country by the EU. In 2012, the share of exports to the EU from total Moldovan exports diminished due to the reduced competitiveness of Moldovan producers on the Community market and due to non-compliance with high quality standards of the EU. The exports of agricultural products for the first time exceeded the value of one billion dollars constituting 1.12 billion USD in 2014; it is an increase by 5.4% compared with 2013. Imports decreased by 9.7% (from to 805.82 mil. USD in 2013 to 727.93 mil. USD in 2014). The trade balance of foreign trade is positive and has a value of 394.37 mil. USD, which represents an increase by 52.5% (Figure 1).

Figure 1. The evolution of foreign trade with agricultural products of the Republic of Moldova, mil. USD

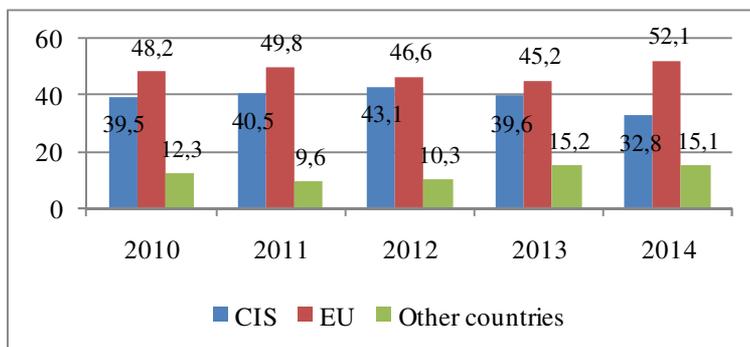


Source: National Bureau of Statistics (information do not include export-import operations of the enterprises and organizations from Transnistria)

The export of more product categories have increased, particularly plant products which have increased by 38%, animal products - by 65.7% and processed products – by 54%. However, the export of alcoholic beverages decreased by 32.6%.

This increase caused an increase in the share of the EU countries by 7 percentage points in the structure of exports by geographical areas and, respectively, a decrease in the share of CIS countries as a result of the restrictions imposed by the Russian Federation on Moldovan products. It is important that Moldova's major trading partners such as Ukraine, Russia and other CIS countries have similar standards that are used by Moldova and the compliance certificates are mutually recognized. Thus, the sudden reorientation of Moldova to the EU market can have a negative impact on foreign trade of the country. The main partners in the development of trade in agricultural products between Moldova and the EU are: Romania, Poland, Italy, Germany, France, Spain, Bulgaria and the Netherlands. In 2014, more than half of the value of exports was directed to the EU countries. A high dynamics was recorded in the deliveries to Romania, Italy, Germany and Great Britain, which have absorbed about $\frac{3}{4}$ of the products value exported to the EU. There also increased the exports of agricultural products, particularly cereals, nuts, wine etc. in other countries such as Indonesia, China and Switzerland (Figure 2).

Figure 2. The structure of the exports of agricultural products by groups of partners, %



Source: National Bureau of Statistics (information do not include export-import operations of the enterprises and organizations from Transnistria)

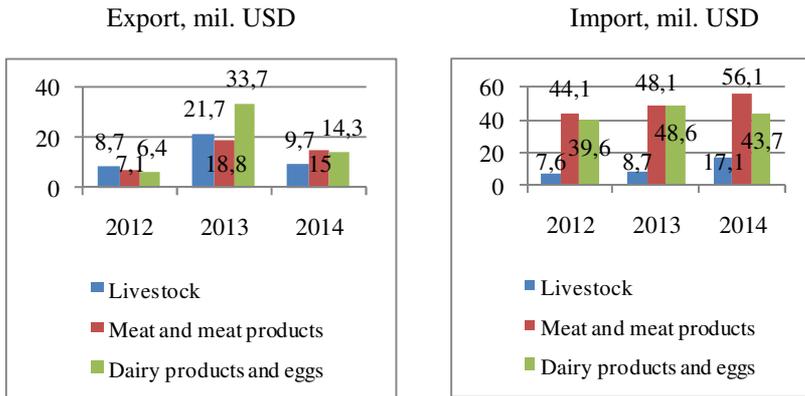
The largest trade deficit with the EU is recorded in animal products. The agricultural sector is dominated by crop production (60-70% of total agricultural production). The livestock sector plays a smaller role, with a low level of competitiveness. The development of the livestock sector is facing internal resource constraints (limited fodder) and harsh pressures caused by cheaper animal imports. Providing native forage is limited due to the limited availability of good quality pasture. On the other hand, the relatively high cost of local production, low productivity and poor animal breeds make animal products from the Republic of Moldova disadvantaged if compared to cheaper subsidized meat and dairy products from the UE markets and many other countries' markets. As a result, the Republic of Moldova becomes increasingly dependent on imported animal products.

In the last 10 years, the imports of live animals, meat and other animal products have increased approximately by 4.2 times, according to the National Bureau of Statistics. The exports have also increased, but less, only by 3.6 times. The consumption of animal products is increasingly covered by the products of foreign origin, particularly the consumption of fresh milk and dairy products. The imports of these products have increased considerably compared to the exports. If in 2002 dairy products were exported in greater volume than imported (32%), then from the next year the ratio has reversed, so that in 2014 the imports exceed the exports by three times.

During the same period, the number of cattle in the Republic of Moldova halved. Bovine livestock, including cattle, reduced from 410 thousand heads in 2012 to 195,000 heads in 2014, or by 52%, decrease rate

averaging about 4% annually. The livestock sector is not as attractive for Moldovan farmers as it was 12 years ago. Businesses profitability in this area cannot compete with imported products or with the products made from imported raw materials; and cattle growing both for meat and milk becomes more difficult. The reduction of the livestock sector can be explained by the increase of the imports of animal products (Figure 3).

Figure 3. The evolution of foreign trade in animal products, mil. USD



Source: National Bureau of Statistics (information do not include export-import operations of the enterprises and organizations from Transnistria)

The structural changes of agri-food exports show that cereals and cereal products as well as oilseeds have registered an increasing share. The exports of these products, however, occurred at a unit value lower than in previous years, which reduced the volume of foreign currency earnings. At the same time the exports of wine, grape juice, fruit and vegetables have reduced. A decisive role in this case had the embargo imposed by the Russian Federation.

The imports of agricultural products have recorded negative annual growth. This reduction in imports was caused by such negative factors as decrease of the real incomes of the population, which led to reduced consumption of products; the depreciation of the national currency, followed by higher prices for imported goods etc. The decrease in imports was caused partly by the supplies reduction from the CIS, including the Russian Federation (1.6%) and Ukraine (1.7%). Similarly, the imports from Turkey have reduced (1.7%). However, the imports from Romania have increased by 19.3%, from Germany by 10.3%, from Italy by 7.1% and by 12.9% from Poland. Favorable climatic conditions have generated a high bid of domestic agricultural products, which decreased food imports of

individual products. The value of agricultural products in 2014 decreased by 5% compared to the previous year, affecting imports fall by 0.7%. The reduction of agricultural products imports associated with increased domestic production is a positive indicator that shows the increasing competitiveness of the country's agri-food sector (Table 2).

Table 2. The structure and evolution of exports/imports by product groups

Product	Nominal value, mil. USD	Structure, %		Annual growth rythm, %	
	2014	2013	2014	2013	2014
Export					
Total products	1737,7	100	100	12,4	-0,2
Food products	761,1	38,4	43,8	14,3	14,0
Fruits and vegetables	168,2	10,1	9,7	-2,3	-4,1
Cereals and cereal products	155,5	5,4	8,9	177,2	64,3
Beverages	132,3	10,9	7,6	33,7	-30,3
Oilseeds and fruits	118,1	6,1	6,8	49,8	12,0
Vegetal fats and oil	55,8	1,0	3,2	-72,1	217,3
Sugar	51,5	1,4	3,0	25,5	104,3
Import					
Total products	3865,8	100	100	6,3	-2,6
Food products	516,6	13,7	13,4	7,5	-5,0
Fruits and vegetables	89,7	2,4	2,3	4,1	-6,6
Cereals and cereal products	56,5	1,5	1,5	-3,3	-8,1
Beverages	41,8	1,5	1,1	24,4	-27,8

Source: Stratan et al. (2014, pp. 64-68).

Domestic agricultural producers face various problems such as the sale of the harvested production; poor development of the services for the collection, storage, transport of agricultural products for food industry and for marketing; low level of competitiveness of domestic agricultural products; lack of product diversity, which contributes to the failure of local production as against the imported products. As a result, the turnover of domestic producers remains unchanged, which explains their financial constraints and leads to the underinvestment in the sector. This is caused by various problems, such as high cost of bank loans, lack of feasible

alternatives for financing capital investments, major administrative barriers that often hinder business development.

On the Community market local manufacturers meet tough competition in the marketing of some agricultural products, and namely spirits, fresh apples, processed vegetables, barley and unmanufactured tobacco, fruit jams and jellies. The main European competitors for Moldovan exporters are those from Romania, Bulgaria, Slovakia and France; and outside the EU they are mostly the exporters from Ukraine, Turkey and China. Therefore, to remain on the market Moldovan companies must keep up with its competitors from the Community market in terms of the modernization of technological processes, the increase of operational efficiency and the improvement of marketing and promotional strategies.

Conclusions

Trade relations Moldova – the EU bring significant benefits conditioned by production improvement: rising standards of quality and food safety, stimulating foreign and domestic investments, increasing export earnings, etc. However, these relationships determine a number of risks, such as the reduction of agricultural production, the increase of production costs, lower prices for some food products, as well as the reduction of workforce in the food sector.

RM's agricultural marketing infrastructure is weak, which leads to the constraints of the modernization and development of the food sector, of the competitiveness of Moldovan products. Thus, in order to modernize the food sector, it is necessary to conclude contracts between the processing enterprises and the producers of raw material to provide specified product volumes.

Moldovan exports to the EU markets are limited not only because of the difficulties faced by the exporters concerning quality and food safety, but also because of the lack of their competitiveness.

An important direction in agro-alimentary trade would be growing and promoting organic products. This is a real opportunity for the Republic of Moldova to penetrate into foreign markets, where there is a growing demand for organic products.

In order to minimize the risks and maximize the benefits of trade relations between the Republic of Moldova and the EU, the national authorities need to make considerable efforts to improve the business environment, to adjust quality infrastructure and to intensify reforms in the food sector.

References

1. Law on state regulation of foreign trade activity no. 1031 - XIV of 8 June 2000 // Official Gazette of RM 2000. no. 119-120. art. 838.
2. Lupușor, A. (2012). The analysis of the competitiveness of Moldovan products in the context of trade liberalization with the European Union. *Journal of Governance and Democracy*. 2(10).
3. Perju, I., Chivriga, V., Fala, A. (2010). The impact of future free trade agreement between Moldova and the European Union on the agri-food sector in the Republic of Moldova. Retrieved from <http://www.soros.md/files/publications/documents/IMPACTUL%20VIITOR.%20ACORD%20DE%20LIBER%20SCHIMB%20INTRE%20RM%20SI%20UE%20ASUPRA%20SECT%20AGROALIM.pdf> (11.01.2015).
4. Patriche, D., Patrichi, G., Chițu, I. B. (2006). *Rural trade. The prospects of integration in the European Union's distribution flows*. Bucharest: Economic Publishment.
5. Stratan, A., Lucașenco, E., Cara, O. et al. (2014). The tendencies in the economy of the Republic of Moldova. Retrieved from [http://file:///C:/Users/ASUS/Downloads/Iefs.md_met_15_ro_site%20\(1\).pdf](http://file:///C:/Users/ASUS/Downloads/Iefs.md_met_15_ro_site%20(1).pdf) (21.02.2015).